IN THE SUPREME COURT OF FLORIDA

GULF POWER COMPANY

Appellant,

vs.

FLORIDA PUBLIC SERVICE COMMISSION

Appellee.

Appeal from an order of the Florida Public Service Commission

Case No. 77,153

# INITIAL BRIEF OF APPELLANT GULF POWER COMPANY

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## PRELIMINARY STATEMENT

In this brief, appellant Gulf Power Company will be referred to as "Gulf Power," or the "Company." Appellee Florida Public Service Commission will be referred to as "the PSC" or "the Commission."

References to the record on appeal will be indicated as "(R. __)." References to the transcript of the hearings will be indicated as "(Tr. __)." References to transcripts of Pensacola and Panama City Service Hearings will be indicated as "(Pensacola Serv. Tr. ___)" and "(Panama City Serv. Tr. ___)." Commission Order No. 23573, dated October 3, 1990, as modified by the Order on Reconsideration, Order No. 13894 ("R. Order"), dated December 17, 1990, will be referred to as "the Order," and a copy of both of those orders is set forth in the Appendix (Volume I) to this brief at Tab 1. Volume II of the Appendix contains copies of orders not published in West reporters. All references to the Appendix are designated as "(App. Tab __)."

All emphasis is supplied unless otherwise noted.

## STATEMENT OF THE CASE AND FACTS

On December 15, 1989, Gulf Power filed rate schedules with the Florida Public Service Commission which, if approved by the Commission, would have allowed the Company to earn an additional $26.3 million in revenues, based on a requested return on equity of 13.00%. (R. 25, 27). Docket No. 891345-EI was formally opened by the Commission for the purpose of considering Gulf Power's petition for a rate increase. In Order No. 22681 issued March 13, 1990, the Commission suspended the filed rate schedules pending formal hearings. (R. 1285, 1297-98). An interim rate increase of $5,751,000 was awarded in that order. (R. 1298). Based upon market conditions that developed after Gulf Power's petition was filed, Gulf Power subsequently increased its requested rate of return on equity from 13.00% to 13.50%. (Tr. 3208).

The year 1990 was approved by the Commission as an appropriate "test year" (R. 4-5) and the PSC projected data as to Gulf Power's operations and expenses for that discrete time period in order to set Gulf Power's future rates. As the Commission later explained in its final order, the test year "provides a set period of utility operations that may be analyzed so the Commission can set reasonable rates for the period the rates will be in effect." (Order at 7, App. Tab 1). The Commission found that a 1990 test year, if appropriately developed and adjusted, would "reasonably represent expected future operations." (Id.).

Prehearing statements were filed by all parties. In its prehearing statement, the Staff of the Florida Public Service Commission ("Commission Staff" or "Staff") identified an issue for the Commission's consideration which came to be designated "Issue 38" in the final Prehearing Order (Order No. 23025), entered by the Commission on June 4, 1990. Issue 38 was stated as follows in that order:

> 38. Should the newly authorized return on common equity be reduced if it is determined that Gulf Power has been mismanaged?

In that same order, Issue 37 was stated as follows:

> 37. What is the appropriate cost of common equity capital for Gulf Power?

(R. 1606).

The parties took various positions on Issue 38, which arose out of certain improper corporate activities, such as illegal political contributions and employee theft of Company property.1/ (Tr. 2980-94). These activities centered around then Gulf Power senior vice president Jacob Horton, and all occurred during the period from the early 1980's through 1988. (R. 2392-2400; Tr. 3003-04, 3018-19, 3022, 3031). Staff and the Office of Public Counsel urged that these activities constituted mismanagement on the part of Gulf Power, and they recommended 50 and 200 basis point reductions, respectively, to the rate of return on equity

1/ Gulf Power's citations to the Commission's findings with regard to the alleged improper conduct are for purposes of this appeal only and are in no way intended to constitute an admission by Gulf Power of mismanagement.

otherwise recommended as fair and reasonable under Issue 37. (R. 1606, 2382, 2392, 2400). Gulf Power took the position that no such penalty was proper. (R. 1606).

Hearings were held June 1-22, 1990, at which time the Company presented evidence and testimony in support of its petition for a rate increase. Gulf Power's President, Douglas L. McCrary, and then-Chief Auditor, George A. Fell, testified and were cross examined extensively on Issue 38. (Tr. 20-282, 4155-4206 [McCrary], 4506-4154 [Fell]). On that issue, Gulf Power also presented the testimony of Mark Bell, a partner in Arthur Anderson & Co., retained as the independent auditor for Gulf Power Co. (Tr. 683-729, 3759-74). These witnesses, along with Gulf Power's Vice-President/Finance, Arlan E. Scarbrough, testified concerning the corrective measures Gulf Power had already taken in order to prevent the occurrence of any such illegal or unethical activities by employees or vendors of the Company. (Tr. 513-22).

Staff presented the testimony of Roberta Bass in support of Staff's recommended 50 basis point reduction in return on equity as a mismanagement penalty. Although Ms. Bass urged the imposition of such a penalty, she candidly acknowledged that the complained of activities had no effect whatsoever on Gulf Power's rates or services:

> Q. To your knowledge, have any of the overt acts contained in the plea agreement caused the lights to go out or impacted the reliability of Gulf's service?
>
> A. <u>No. I don't believe it's impacted its reliability.</u>

Q. Have you made any determination or any assessment of the impact of the overt acts on the rates that are to be set in this rate case? Whether there's been any impact at all?

A. No. I don't believe any of these amounts impact the current rate case. These are all historical amounts.

(R. 3035-36, App. Tab 2).

No other testimony was presented on this issue. In particular, there was no evidence suggesting that those activities had any impact upon Gulf Power's rates or service during the test year. In fact, the uncontradicted evidence affirmatively established that no costs associated with those activities or with the investigations of those activities were included in the test year data; thus, any such costs would be borne by Gulf Power's stockholders rather than the ratepayers. (Tr. 305-306; Tr. 695-47).

On the other hand, considerable evidence was presented establishing Gulf Power's low rates and high service reliability during the test year. (Tr. 974-77; Exhibits 3, 4, 15, 16, 183, 606). Without contradiction, the evidence showed that Gulf Power's retail rates were among the lowest in the state, southeast, and nation -- and would be even with the full rate relief requested. (Exhibit 4, Page 1; Exhibit 16, Page 2). The evidence also showed that, even with the full amount of rate relief requested, Gulf Power's residential retail rates will actually be lower than in December of 1984, the time of the granting of Gulf Power's last rate increase, and even as long ago as 1982. (Exhibits 3, 4).

The Commission voted on August 14, 1990 to authorize a 12.55% return on equity, resulting in a rate increase of $14,131,000. (R. 2400K-2400L). However, the Commission then voted to impose a "penalty" on Gulf Power on the grounds that improper activities of the Company during the years from the early 1980's through 1988 constituted "mismanagement." (Id.; Order at 6-7, 28). The Commission accepted the Staff's recommendation of a 50 basis point reduction for a two year period, thereby lowering Gulf Power's allowable return on equity to 12.05% and resulting in a penalty of $2,293,000 per year for two years. (Id.)

A formal order to this effect was issued on October 3, 1990. (R. 2401-2483). In that order, the Commission acknowledged that the revenue requirements of a public utility are determined by its rate base, net operating income and fair rate of return, all as derived from a test year of operations. (Order at 7). The Commission also set forth the principles governing the establishment of the "fair rate of return" that Gulf Power should be given an opportunity to earn on its investment in rate base. The Commission's order stated that the fair rate of return "should be established so as to maintain the Company's financial integrity and to enable it to acquire needed capital at a reasonable cost." (Order at 19).

In order to reach a "fair" overall rate of return, the Commission established an "allowable rate of return on common equity capital," and stated that, based on the evidence in the record, "we find that a reasonable allowed rate of return on common equity capital for Gulf is 12.55%." (Order at 19-20). This rate, the Commission specifically found, "will allow Gulf the opportunity to raise capital on fair and reasonable terms and to maintain its financial integrity." (Id. at 20). The Commission concluded that this rate was not only "well-supported by the evidence presented," but "represents the best estimate of the Company's cost of equity." (Id.). The Commission further stated, "[W]e believe the appropriate ROE for Gulf Power Company to be 12.55%." (Id. at 29).

Notwithstanding those findings, the Commission then withheld that rate relief for a two-year period. The Commission declared that it took that action as a "penalty" for the past misconduct of Gulf Power employees. (Order at 7).

Specifically, the Commission found that certain "corrupt practices" had taken place at Gulf Power "from the early 1980's through 1988," including theft of Company property, use of Company employees on Company time to perform services for management personnel, executives' accepting appliances without payment, and political contributions made by third parties and illegally charged back to Gulf Power.[2] (Id. at 22). The Commission concluded that Gulf Power management "knew or should have known" of the illegal or unethical conduct and that this constituted "mismanagement." (Id. at 22-23). The Commission also noted that

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2/ Although the Commission's order also criticized certain practices of Gulf Power as violative of the Commission's policy of fuel neutrality, the Commission expressly stated that it imposed no penalty based on those practices. (Order at 46-47).

Gulf Power had paid a $500,000 fine in connection with a federal grand jury investigation concerning the illegal political contributions. (Order at 24).

There was no finding of any "mismanagement" or "corrupt practices" whatsoever in the test year of 1990. In fact, the evidence showed, without contradiction, that these practices had ceased by that time, and the Commission explicitly found that Gulf Power had "turned the corner" in dealing with this "illegal/unethical behavior." (Order at 29).

As noted above, there was no evidence in this proceeding, and the Commission did not find, that any of the activities the Commission deemed "mismanagement," all of which occurred in the past, had any demonstrable, quantifiable impact on the Company's rates, facilities, or service, either during the time they occurred or thereafter in 1990, the test year. Indeed, this very question is the subject of a pending special investigation (Docket No. 890832-EU), commenced by the Commission to determine what effect, if any, those activities had on the ratepayers, and whether any costs should be disallowed as a result of them. (See Order Granting in Part Citizens' Motion to Spin-Off Investigation of Irregularities at Gulf Power Company, No. 21459, Docket No. 890832-EI, June 28, 1989). Gulf Power has expressly agreed to make appropriate refunds in that proceeding if the Commission determines there was any such impact.

In _this_ proceeding, however, the Commission made no finding that the alleged misconduct had any effect whatever on the Company's service or charges to its customers. The Commission found only that this "hurt the company's relationship with its customers, as was made clear from the testimony customers gave at the service hearings." (Order at 29). Although it is true that there was some testimony by Gulf Power customers criticizing the Company for the past illegal activities of its employees, their testimony was nevertheless unequivocal with respect to the adequacy of Gulf Power's _service_ to its customers. Thus, while customers testifying at the hearings made clear their disapproval of these illegal activities, the _only_ complaints about Gulf Power's service concerned such matters as interruptions of service, and were wholly unrelated to the activities alleged by the Commission to constitute "mismanagement."

To justify the reduction of what it had explicitly found to be the "appropriate" rate of return, the Commission stated that "[a]nalysis of the cost of equity is a subjective process" and declared that it could "take management efficiency into account in setting rates." (Order at 29). As the Commission put it:

> It is axiomatic that the involvement of managerial personnel in criminal activities lessened the efficiency of management in providing efficient service.

(_Id_. at 29). On this basis, the Commission reduced the "appropriate" rate of return by 50 basis points for a two year period and, as a result, Gulf Power will _not_ be allowed to recover that "appropriate" return on equity for those two years.

The Commission explicitly characterized this reduction as a "penalty" imposed "as a message to management" that the type of misconduct found to have occurred would not be tolerated. (Order at 7, 29). The Commission took this action despite the fact that there was absolutely no evidence of any improper conduct during 1990 the test year that had been expressly accepted and used by the Commission in setting Gulf Power's future rates, and despite the Commission's finding that Gulf Power had "turned the corner" in dealing with the prior "mismanagement." Gulf Power now appeals from that ruling of the Commission.

## ISSUE PRESENTED FOR REVIEW

Whether the Commission erred as a matter of law by reducing Gulf Power Company's return on equity as a "penalty," particularly where it was uncontroverted that the corporate misconduct occurred wholly in the past and there was no finding that it had any demonstrable effect on rates or service to customers.

## SUMMARY OF ARGUMENT

Chapter 366, Florida Statutes, constitutes a carefully tailored statutory scheme governing the PSC's regulation of utilities and, in particular, the Commission's powers in setting rates for the utilities. Under that statutory scheme, penalties may be imposed by the PSC for a utility's refusal to comply with, or its willful violation of, a Commission order or a provision of Chapter 366. The PSC is constitutionally prohibited from imposing a penalty for conduct other than as statutorily authorized. Since the penalty imposed here was not based upon any purported violation of or refusal to comply with PSC orders or Chapter 366, the Commission acted beyond its constitutional authority. The penalty must be reversed for that reason alone.

Further, the imposition of this penalty also violated the Commission's statutory rate-making powers in two fundamental ways. First, rate-making is a prospective matter in all aspects. Since the PSC sets rates for the future, historical matters which have no continuing validity cannot, as a matter of law, be taken into account. Here, however, although the Commission expressly found the "appropriate" future return on equity for Gulf Power to be 12.55% based on the test year evidence, it then refused to grant that return for a two year period as a "penalty" for certain improper activities of the Company which took place wholly in the past, not in the test year. But those historic matters could not, as a matter of law, be relied upon by the PSC to reduce the Company's future rates.

Second, although the PSC is statutorily allowed in setting future rates to take into account the efficiency, sufficiency and adequacy of the "facilities provided and the services rendered," Chapter 366 does not authorize consideration of "management efficiency" apart from its impact on utility rates or service. Yet, that is exactly what the Commission did here. The Commission made no finding that Gulf Power's service or facilities were inadequate. In particular, it made no finding and did not point to any evidence of any effect whatsoever that these activities had on the Company's service, facilities, or rates in the test year. In fact, it is engaged at this very time in a separate investigation to determine whether these activities in the past had any adverse impact on Gulf Power's service or rates that would require a refund to the ratepayers. The Commission cannot lawfully penalize the Company in this proceeding for a purported adverse impact on service or facilities that has not even been found to exist!

No one, including Gulf Power, suggests that illegal or unethical corporate conduct should be tolerated. The fact is, as the Commission freely acknowledged, Gulf Power had already corrected the past improprieties and instituted measures to prevent any occurrence of such conduct in the future. But the Public Service Commission is not a watch-dog of all improper corporate conduct of a public utility. Instead, it has been granted specific powers and duties by the Florida Legislature towards the end of assuring reasonable rates and adequate service by the utilities it regulates.

Consistent with that statutory scheme, the PSC has instituted a proceeding to investigate whether the activities in question here adversely impacted upon Gulf Power's service or rates to its customers in the past. The Company has expressly agreed that it will make whatever refunds are found by the Commission to be required by any past adverse effect upon Gulf Power's rates or service. <u>That</u> is the appropriate remedy here -- <u>not</u> a massive, undifferentiated penalty imposed on the Company's future rates for past improprieties.

The Commission's imposition of that penalty should be reversed, without prejudice to the Commission's right to require any refund, if found appropriate based on competent, substantial evidence in its parallel investigation, and the Commission should be directed to allow Gulf Power the rate relief it found to be "appropriate" under the evidence adduced in this proceeding.

## ARGUMENT

### The Commission Erred As A Matter of Law By Imposing The Penalty Against Gulf Power.

Finding that Gulf Power was guilty of "mismanagement" in connection with the improper conduct described in its order, the Commission ordered a 50-basis point reduction in the Company's return on equity for a two-year period. (Order at 29). The Commission did not take that punitive action based upon any finding that the misconduct adversely affected Gulf Power's facilities or service to its customers or otherwise impacted the test year selected by the Commission in order to set the Company's future rates. Rather, it was admittedly a "penalty" imposed in order to send a "message" that such conduct was improper and would not be condoned by the Commission. (Order at 7, 29).

The inescapable fact remains, however, that this "penalty" is not authorized by the Florida Statutes and it accordingly must be reversed as exceeding the constitutional powers of the Commission. Furthermore, this penalty must also be reversed because it directly contravenes settled requirements of rate-making established by the Florida Legislature and this Court.

#### A. The Reduction In Return On Equity Constitutes An Improper Administrative Penalty In Violation Of the Florida Constitution.

Article I, Section 18 of the Florida Constitution specifically provides that:

> No administrative agency shall impose a sentence of imprisonment, nor shall it impose any other penalty except as provided by law.

This constitutional proscription has been consistently enforced by Florida courts to bar attempts by administrative agencies to impose penalties without explicit statutory authority to do so.[3/] See, e.g., Willner v. Dep't of Professional Regulation, 563 So.2d 805, 806 (Fla. 1st DCA 1990); PAC for Equality v. Dep't of State, 542 So.2d 459, 460 (Fla. 2d DCA 1989); Broward County v. Plantation Imports, Inc., 419 So.2d 1145, 1148 (Fla. 4th DCA 1982); McFarlin v. State, Dep't of Business Regulation, 405 So.2d 255, 256 (Fla. 3d DCA), dismissed, 411 So.2d 383 (Fla. 1981).

Thus, the power to impose penalties cannot be implied from a general grant of authority to perform acts necessary to carry out the agency's statutory purposes. Continental Constr. Co. v. Bd. of Trustees, 464 So.2d 204, 207 (Fla. 1st DCA 1985), review denied, 472 So.2d 1180 (Fla. 1985); see also Willner, 563 So.2d at 806-807; Holmberg v. Dep't of Natural Resources, 503 So.2d 944 (Fla. 1st DCA 1977). Rather, there must be an explicit grant of the power to impose administrative penalties.

Chapter 366 constitutes the general grant of authority to the PSC to regulate utilities. There is no express statutory authority for the Public Service Commission to impose a penalty for the type of corporate conduct found here to constitute "mismanagement." To the contrary, the Commission's only statutory power to impose penalties is carefully delineated in Florida

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[3/] Quite apart from Florida's constitutional prohibition, the United States Supreme Court has held that a party subject to administrative regulation by an agency "is not to be subjected to a penalty unless the words of the statute plainly impose it." Commissioner v. Acker, 361 U.S. 87, 91, 80 S. Ct. 144, 147 (1959).

Statutes Section 366.095, and that limited power does not apply under the circumstances presented here. That statute, entitled "Penalties," provides only as follows:

> The commission shall have the power to impose upon any entity subject to its jurisdiction under this chapter that is found to have refused to comply with or to have willfully violated any lawful rule or order of the commission or any provision of this chapter a penalty for each offense of not more than $5,000, which penalty shall be fixed, imposed, and collected by the commission.

The Commission did not purport to act under this statutory provision, and it made no finding that Gulf Power "refused to comply with . . . or willfully violated any lawful rule or order of the commission or any provision of this chapter," as required for imposition of a penalty under Section 366.095. The Commission simply found that Gulf Power's management knew or should have known of the misconduct and that this constituted corporate "mismanagement." (Order at 22-28). But, the statute does not authorize the Commission to withhold otherwise justified rate relief as a penalty for such conduct, and this Court's decisions make it clear that the imposition of such a penalty in the absence of specific statutory authority exceeds the Commission's jurisdiction.

In Florida Tel. Corp. v. Carter, 70 So.2d 508 (Fla. 1954), this Court held that the Railroad and Public Utilities Commission (the predecessor to the Public Service Commission) had no authority under the then existing statute to deny a utility's requested rate increase as a penalty for inadequate service. Framing the issue in language directly applicable to this case, the Court stated:

> The primary question with which we are now concerned is whether or not the Commission, in the same proceeding in which it found the increase in rates to be just under applicable provisions of the Florida Statutes, may deny such increase by imposing a penalty for inadequate services . . . ?

Id. at 509. The Court then answered this question in the negative, holding that:

> The respondent-Commission had no authority to deny an increase in rates which it found to be just, by the means of inflicting a penalty because of poor or inadequate service, and exceeded its jurisdiction when it inflicted such penalty in a rate-making proceeding.

Id. at 510. In short, the Carter Court looked to the statutory language and, finding no specific provision authorizing a rate penalty for inadequate service, held that the Commission's action exceeded its jurisdiction.

The absence of Commission jurisdiction to impose the penalty at issue here is further confirmed by this Court's decision in Deltona Corp. v. Mayo, 342 So.2d 510 (Fla. 1977), which presented circumstances very similar to those presented here. In that case, this Court quashed a Commission order that denied Deltona Utilities a rate increase for the services of its water and sewer system, based on land sales practices alleged to be fraudulent. The Court declared that "[i]f Deltona has engaged in an unfair business practice or committed fraud, . . . it may be a concern of other state agencies or the basis for private law suits . . . but it is not a matter of statutory concern to the Public Service Commission." Id. at 512.

Noting the oft-cited maxim that "the Commission has only those powers granted by statute expressly or by necessary implication," the Court emphasized that the Florida Statutes governing water and sewer rates "do not empower the Commission to set rates so as to right any wrong which it perceives regardless of its relationship to water and sewer service." Id. at 512 n.4. Accordingly, the Court directed the Commission to grant the utility "such rate relief as is appropriate on the basis of the record. . . ." Id. at 512.

These controlling precedents establish beyond peradventure that the Commission cannot assess a penalty against a utility unless it has been given express statutory authority to do so. The circumstances under which the Commission can impose penalties are spelled out with clarity in section 366.095, and the settled principle of "expressio unius" makes it clear that the Commission is not empowered to impose penalties except under those specified circumstances. Dobbs v. Sea Isle Hotel, 56 So.2d 341, 342 (Fla. 1952) (express mention of one thing in statute means the exclusion of another); see also P.W. Ventures, Inc. v. Nichols, 533 So.2d 281, 283 (Fla. 1988) (applying expressio unius principle to construction of Chapter 366).[4/] Indeed, it would be ludicrous to

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[4/] This is also consistent with the basic precept that statutes authorizing the imposition of penalties must be strictly construed as exclusive in favor of those against whom a penalty is sought to (footnote continued) suggest that the Legislature, after having expressly authorized maximum penalties of $5,000 for willful violations of Commission orders and rules, impliedly authorized multi-million dollar "penalties" for "mismanagement."

A recent Texas decision construing a very similar statute made precisely that point. In Pub. Util. Comm'n v. Houston Lighting and Power Co., 715 S.W.2d 98 (Ct. App. Tex.), aff'd in relevant part, rev'd in part on other grounds, 748 S.W.2d 439 (Tex. 1987), appeal dismissed, 109 S. Ct. 36 (1988), just as here, the Texas commission reduced the approved return on equity as a "mismanagement penalty." The Texas court reversed, holding that the statutory scheme governing public utility regulation in Texas did not authorize imposition of such a penalty. The court pointed out that the statute contained a specific section, entitled "Penalties," which expressly authorized the imposition of fines ranging from $1,000 to $5,000 for a utility's violation of statutes, commission rules, regulations, or orders, and declared that "it would be unreasonable to conclude that PURA also impliedly authorizes the Commission to levy a multi-million dollar rate penalty." Id. at 103.

The circumstances identified by the Florida Legislature as grounds for a penalty by the PSC do not include such things as illegal political contributions, which were the "criminal activities" found by the Commission to constitute "mismanagement"

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(footnote continued from previous page)
be imposed. See, e.g., Gardinier v. Florida Dep't of Pollution Control, 300 So.2d 75, 78 (Fla. 1st DCA 1974); Holmberg v. Dep't of Natural Resources, 503 So.2d 944, 947 (Fla. 1st DCA 1977).

(Order at 28-29); rather, such conduct is the appropriate subject of scrutiny by other state and federal agencies,5/ not the PSC. Nor has the Legislature authorized the imposition of a penalty for corporate misconduct which is wholly unrelated to the utility's service or facilities. Consequently, the Commission exceeded its jurisdiction by imposing such a penalty here.

It is critical to recognize that the Commission's rate reduction here was admittedly a "penalty" and not a rate reduction based upon an existing deficiency in Gulf Power's service or facilities. In fact, the Commission expressly characterized its action as a "penalty." (Order at 7). Thus, the case stands in sharp contrast to Gulf Power Co. v. Florida Pub. Serv. Comm'n, 453 So.2d 799 (Fla. 1984), where the Commission excluded from the Company's rate base certain excess generating capacity that was not currently serving customers. This Court upheld the Commission's downward adjustment in the allowable rate increase precisely because that adjustment was not a "penalty" but rather was based upon a deficiency in the Company's existing facilities that adversely impacted its customers. Id. at 806. For that

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5/ As reflected in the statement of facts, this conduct was in fact the subject of a federal criminal proceeding and Gulf Power has fully paid the $500,000 fine imposed there for that illegal activity. (Order at 24). The Securities Exchange Commission has also obtained, from the United States District Court for the Northern District of Florida, a judgment enjoining Gulf Power from making political contributions. See S.E.C. v. Gulf Power Co., Civil Action No. 90-30286, Final Judgment of Permanent Injunction (N.D. Fla. Sept. 26, 1990). The Court may take judicial notice of these matters of public record. Florida Accountants' Ass'n v. Dandelake, 98 So.2d 323, 327 (Fla. 1957); Shriver v. Tucker, 42 So.2d 707, 709 (Fla. 1949).

reason, it was "within the delegated authority of the PSC."6/ Id. Here, of course, the Commission made no bones about imposing a penalty for past -- and now corrected -- practices, and that is not "within the delegated authority of the PSC."

The Commission should accordingly be compelled, as in Carter and Deltona, to grant Gulf Power "such rate relief as is appropriate on the basis of the record. . . ." Deltona, 342 So.2d at 512. The rate relief that is "appropriate" for Gulf Power is that which is established by the Commission's own order in this case: based on the evidence before it, the Commission expressly found that the "appropriate" return on equity for Gulf Power is 12.55%. (Order at 29). Under Florida law, the Commission could not withhold a significant portion of that rate relief to Gulf Power for two years as a "penalty" for prior corporate misconduct.

B. The Reduction In Return On Equity Also Violates Fundamental Principles Of Rate-making.

Quite apart from the constitutional prohibition against an administrative penalty such as this, the Commission's action also violated its statutory rate-making powers. First, it impermissibly set future rates based on past matters that were not a part of the test year utilized by the Commission and would have no future validity. Second, even if the Commission had imposed the penalty for improper practices during the test year, "management efficiency" is a proper rate-making tool only to the

6/ Furthermore, the action was not taken because of matters wholly in the past, as is the case here, and thus did not violate the rate-making principles discussed in the next section of this brief. See pages 22-25, infra.

extent that it affects the utility's facilities or service and this penalty was not based on any claim of a deficiency in service or facilities.

Accordingly, there was no basis under Florida law to reduce the rate of return which had been explicitly found by the Commission to be the "appropriate" rate of return which "will allow Gulf the opportunity to raise capital on fair and reasonable terms and to maintain its financial integrity." (Order at 20). Rather, the appropriate procedure is the one the Commission has actually undertaken in its separate docket: an investigation to determine if improper activities of the Company in prior years adversely affected the ratepayers and thus require a refund to them.

1. The Reduction Violates the Test Year Concept.

It is settled that utility rate-making is prospective only: rates are fixed for the future rather than for the past. This crucial limitation on the Commission's power to fix rates is set forth in Chapter 366, Florida Statutes.

Section 366.06(2) provides that if the Commission finds that the rates charged by a utility are unreasonable or inadequate, the Commission may set a new rate to be charged in the future:

> [T]he commission shall order and hold a public hearing . . . and shall thereafter determine just and reasonable rates to be thereafter charged for such service . . . .

Similarly, section 366.07 provides:

> Whenever the commission . . . shall find the rates . . . collected by any public utility for any service . . . unjust, unreasonable [or] insufficient . . . the commission shall

> determine and by order fix the fair and reasonable rates . . . to be imposed, observed, furnished or followed <u>in the future</u>.

Courts interpreting similarly worded statutes have uniformly held that rates may only be set prospectively. <u>Pub. Util. Comm'n v. United Fuel Gas Co.</u>, 317 U.S. 456, 464, 63 S. Ct. 369, 374 (1943) ("There is no basis in the statute for concluding that the Commission's order can be retroactive . . .; on the contrary, the explicit language of the statute precludes such a construction.").

Furthermore, it is settled that this rate-making principle may not be ignored in order to remedy past defects <u>or</u> past excessive profits. The United States Supreme Court emphasized this very point in <u>Los Angeles Gas & Elec. Corp. v. R.R. Comm'n.</u>, 289 U.S. 287, 313, 53 S. Ct. 637, 647 (1943):

> Deficits in the past do not afford a legal basis for invalidating rates, otherwise compensatory, any more that past profits can be used to sustain confiscatory rates for the future.

In short, the rule that rates are set prospectively is applied in a completely equal manner, and it precludes setting rates to account for <u>past</u> matters which will have no future effect, <u>regardless</u> of whether those matters would increase or decrease future rates.

The rule in Florida is the same. As this Court emphasized in <u>Gulf Power Co. v. Bevis</u>, 289 So.2d 401, 404 (Fla. 1974):

> Rates are fixed for the future rather than for the past . . . [T]he process is one of making a rule for the future.

This Court quoted with approval from an order of the Commission which set forth the proper procedure for determining the utility's future revenue requirements based on a test year:

> The judicial decisions on the subject of the appropriate test year in a utility rate case uniformly adhere to the rule that the test period should be based on the utility's most recent actual experience <u>with such adjustments as will make the test period reflect typical conditions in the immediate future</u>.

<u>Id</u>. (emphasis the Court's). Because the goal of examining operations during the test year and making adjustments to it is to "fairly represent the <u>future period</u> for which the rates are being fixed," <u>the Commission may not consider factors which will have no continuing effect</u>:

> Inapplicable factors must be removed from test year considerations . . . . <u>[F]acts which have no future validity must be discarded</u>.

<u>Id</u>. at 405.7/

Instead of following these settled rate-making principles here, the Commission set rates for future years which were reduced as a penalty for conduct which occurred wholly in the past, without any finding that those problems had any effect on operations during the test year, without any finding that those problems would have any "future validity," and in the face of an explicit finding that Gulf Power had already "turned the corner" in solving those problems. As Chairman Wilson candidly acknowledged at the Agenda Conference on various reconsideration

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7/ The Commission has repeatedly acknowledged the validity of these principles. <u>See</u>, <u>e.g.</u>, Re Tampa Electric Co., 39 P.U.R. 4th 553, 557 (Fla. Pub. Serv. Comm'n. 1980).

motions, the Commission took this action as "a prospective penalty for past mismanagement." (R. 2605-C). By doing so, the Commission has totally ignored the very purpose of the rate-making test year, which is to set the appropriate rate of return for the future on the basis of the applicable test year factors and <u>to discard facts "which have no future validity</u>." <u>Gulf Power Co.</u>, 289 So.2d at 405.

The unfairness -- and, indeed, arbitrariness -- of the Commission's action is manifest. It is undeniable that utilities like Gulf Power may not go outside the test year and point to times in the past when the rates did not allow them to earn the allowed return. <u>See</u> <u>Los Angeles Gas & Elec. Corp.</u>, 289 U.S. at 313. Since Gulf Power may not, consistent with prospective rate-making principles and the test-year concept, go back to the past in order to set future rates that would make the Company whole, the Commission likewise may not reach back to selected activities in the past, which have <u>no continuing</u> effect (if they ever had any) on the Company's service or facilities, in setting rates for the future. Rather, the rate-making principles must be applied evenly, in precisely the same manner, whether that helps the utility or hurts it.

2. The Reduction Is Not Justified On Grounds <u>Of "Management Efficiency."</u>

The Commission violated rate-making principles in a second, equally fundamental way. Quite apart from the fact that this was an unauthorized "penalty" for <u>past</u> corporate misconduct, the Commission impermissibly reduced the rates Gulf Power would have otherwise been allowed to charge based on "management inefficiency" which was not found to have impacted the Company's facilities or service. The Florida Statutes make it clear, however, that the only "management efficiency" which the Commission is to consider in setting future rates is management efficiency which affects the facilities and the services of the utility.

Florida Statute Section 366.041(1) expressly provides that, in fixing future rates for public utilities, the Commission is authorized to consider:

> the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered; the cost of providing such service and the value of such service to the public; the ability of the utility to improve such service and facilities; and energy conservation and the efficient use of alternative energy resources; . . . .

In addition to these express criteria enumerated in section 366.041(1), all of which relate directly to the cost or adequacy of the utility's service and facilities, subsection (2) of that statute further confirms that the Commission's rate-making powers are to be employed to assure "adequate service":

> The power and authority herein conferred upon the commission shall not cancel or amend any existing punitive powers of the commission but shall be supplementary thereto and shall be construed liberally to further the legislative intent that adequate service be rendered by public utilities in the state . . . .

Consistent with the plain language of the statute, this Court has explicitly recognized that the Commission is to exercise its rate-making powers for the purpose of improving service to the customer. The Court's decision in Askew v. Bevis, 283 So.2d 337 (Fla. 1973), speaks directly to this point.

In Askew, this Court affirmed the Commission's conditional two-year rate increase to a utility that was providing inadequate service. In construing Section 366.041, as modified by the Legislature following the Carter decision, the Court concluded that "in our view the statute mandates the Commission to grant rate increases to insure a reasonable rate of return, but additionally provides the Commission with a means of insuring that all such increases will achieve the desirable goal of more efficient service and adequate facilities." Id. at 340. The Court cited with approval from the Commission's order, noting that "[w]e are impressed with the Commission's evaluation of the goals sought to be obtained by the Legislature pursuant to the subject statute, to-wit":

> Our power to withhold rate relief in appropriate instances, where the quality of service justifies such action, is a powerful tool that is bringing about a steady and substantial improvement in public utility services, as is evident in this particular case. The purpose of the law is to achieve good service and its reasonable use will accomplish that purpose.

Id. at 340.

In sum, any "mismanagement" that adversely affects the utility's service and facilities can be considered in setting rates, in order to improve service in the future. But that is not what the Commission based this penalty upon, nor could it have lawfully done so since there was absolutely no evidence of any deficiency in Gulf Power's existing service to its customers or in its existing facilities as a result of the improper activities. In fact, the Staff's own witness who testified concerning its recommendation that this penalty be imposed frankly conceded that those activities had not impacted the quality or cost of Gulf Power's service:

> Q. To your knowledge, have any of the overt acts contained in the plea agreement caused the lights to go out or impacted the reliability of Gulf's service?
>
> A. No. I don't believe it's impacted its reliability.
>
> Q. Have you made any determination or any assessment of the impact of the overt acts on the rates that are to be set in this rate case? Whether there's been any impact at all?
>
> A. No. I don't believe any of these amounts impact the current rate case. These are all historical amounts.

(Tr. 3035-3036)

Thus, in imposing this penalty, the Commission was not able to point to any evidence of an adverse effect on Gulf Power's service or facilities. Instead, it simply asserted, in its order, that "[i]t is axiomatic that the involvement of managerial personnel in criminal activities lessened the efficiency of management in providing electric service." (R. 2399; Order at 29). "Axiomatic," however, means "self-evident," and it is not at all self-evident that those particular activities necessarily lessened Gulf Power's "management efficiency." In fact, Gulf Power's rates are among the lowest in the nation and its service to its customers is admittedly exemplary, which certainly does not make management inefficiency "axiomatic" here.

The point is, this Court requires orders of the Commission -- including orders finding utility "mismanagement" -- to be supported by substantial and competent evidence, not merely declarations concerning what the Commission believes to be "axiomatic." Florida Power Corp. v. Cresse, 413 So.2d 1187, 1189 (Fla. 1982); see also Florida Power Corp. v. Pub. Serv. Comm'n, 424 So.2d 745 (1982); Florida Power Corp. v. Pub. Serv. Comm'n, 456 So.2d 451 (Fla. 1984). As this Court explained in Florida Bridge Co. v. Bevis, 363 So.2d 799, 802 (Fla. 1978), where it reversed the Commission's order disallowing certain utility costs as "a departure from the essential requirements of law," the Commission is required to produce "competent evidence" to justify its action.

This record is devoid of any such evidence and the Commission points to none in its order. Manifestly, the Commission's intuitive belief that management efficiency was lessened by "the involvement of management personnel in criminal activities" cannot serve as a substitute for the "substantial" and "competent" evidence that must be presented to support any Commission finding that those criminal activities did in fact adversely impact Gulf Power's service to its customers.

Indeed, given the actual nature of those criminal activities -- illegal political contributions in the '80's -- it is perfectly evident that, although improper, they nevertheless had nothing to do with the service rendered and facilities provided to Gulf Power's customers. Certainly, they did not have any impact on Gulf Power's operating expenses in the 1990 test year, or on the Company's ability to provide "sufficient, adequate, and efficient" electric service to its customers in the future. § 366.03 Fla. Stat. (1989). Quite to the contrary, as Staff witness Kathryn Dyal Brown testified, the most current information available during the test year demonstrated that Gulf had the fewest service complaints of all major Florida investor-owned electric utilities for the first five months of 1990. (Tr. 2044-2045; Exhibit 606).

Furthermore, the Commission's assertion that the testimony of Gulf Power's customers at the service hearings showed that these activities "hurt the Company's relationship with its customers," (Order at 29), is entirely irrelevant. Chapter 366 does not allow rates to be set by the Commission based on some amorphous notion of how the utility's customers "feel" about the utility. Rather, rate-making must be based upon the adequacy of the utility's facilities and service to its customers. § 366.041 Fla. Stat. (1989). Since the testimony of Gulf Power's customers at the service hearings established no deficiency whatsoever in Gulf Power's service or facilities, it provided no basis for the Commission's mismanagement "penalty."

Out of a total of 34 customers who testified at those hearings, only six raised any sort of complaint concerning the Company's service and <u>none</u> of those service complaints had anything at all to do with the improprieties found by the Commission to be "mismanagement." Indeed, the typical complaint simply related to interruptions of service which required the customer to reset digital clocks, or concerns that the customer's bill was accurate as to kilowatt usage and charges. (Pensacola Serv. Tr. at 59-60, testimony of Austin M. Hudson; at 62-63, testimony of Don Welch; at 68-70, testimony of Russell Shields; at 114-118, testimony of Joseph E. Griffin; Panama City Serv. Tr. at 19-21, testimony of Ray Keahy; at 46-47, testimony of Larry Miller).

If anything, the customers who testified at those hearings corroborate the Company's position -- and the Staff's admission -- that the illegal activities, regrettable though they were, had no impact on the quality of service that the Company in fact provided to its customers. The witnesses at the service hearings who testified most vociferously concerning the allegations of improper conduct by Gulf Power employees were six customers who prefaced those complaints with compliments as to the quality of Gulf Power's <u>service</u>:

> I stated last year that I could not complain about Gulf Power's service; from my standpoint, it was excellent. I make the same

> statement this year, their service is excellent. I have no complaints on that regard.

(Pensacola Serv. Tr. at 22, testimony of Paul R. Goudy).

> . . . let me say this, repeat, that the service rendered by Gulf Power is usually excellent.

(Pensacola Serv. Tr. at 67, testimony of James Allen).

> Service is good by Gulf Power. I have no complaints there.

(Pensacola Serv. Tr. at 71, testimony of Charlotte Burda).

> I want to say I have had excellent service from Gulf Power.

(Pensacola Serv. Tr. at 103, testimony of Mary Wesley).

> I'm not arguing that Gulf Power doesn't provide good service . . . I appreciate the amenities provided by the power we have.

(Pensacola Serv. Tr. at 109, testimony of Shelby Owens).

> I have been doing business with Gulf Power for 40-something years. I've got no qualms with their service. No, sir, not a bit.

(Panama City Serv. Tr. at 26, testimony of W.C. Minshew).

By coupling their criticism of the improper conduct of certain employees of the Company with fulsome praise for Gulf Power's service, those customers made it clear that they recognized that the improper activities <u>did</u> <u>not</u> <u>adversely</u> <u>affect</u> their quality of service. In short, the record of the service hearings affirmatively establishes that those activities did not impact service or facilities and it does not provide any evidentiary support for considering those activities in setting future rates.

Moreover, the Commission's assumption that such involvement in criminal activities must have affected "management efficiency" is not a legally sufficient basis for imposing this penalty in any event. There is nothing in the Florida Statutes that empowers the Commission to withhold rate relief as a penalty for "management efficiency" under circumstances such as these. Indeed, one searches Chapter 366 in vain for any authorization for a "penalty" based on "management efficiency" that is unrelated to adequacy of the utility's service or facilities. The statutory provisions cited by the Commission (Order at 28) certainly do not grant any such authority. Rather, as even the most cursory review of those provisions establishes, they are patently irrelevant to the Commission's action, and the Commission is being disingenuous when it asserts that they are the basis upon which it withheld rate relief.

In truth and fact, the <u>actual</u> <u>rates</u> which were set by the Commission were <u>not</u> <u>themselves</u> based on "management inefficiency." Rather, the Commission set rates that it explicitly found to be "appropriate" and it expressly authorized Gulf Power to collect those rates in the future, thereby acknowledging that there was no existing "management inefficiency" which warranted lower rates. It then <u>withheld</u> part of that "appropriate" rate relief for a period of time as a plain and simple "penalty" for past improper corporate conduct. (Order at 7). Such a penalty is wholly unsupported by the Florida statutes authorizing the Commission to set utility rates.

Indeed, counsel for Gulf Power is aware of no decision in any other jurisdiction which has sustained a regulatory agency's power to impose a utility rate reduction as a penalty for past "mismanagement" without some demonstrable effect upon the utility's rates, service, or facilities. To the contrary, in reversing the Texas Commission's order lowering "a rate of return found by it to be reasonable as a penalty for mismanagement," the Texas Court of Appeal emphasized that the decisions in other jurisdictions only allowed the imposition of a rate penalty for "a utility's failure to provide adequate service to ratepayers over an extended period . . . ." Houston Lighting, 715 S.W.2d at 103. That is, of course, not at all the case here.

In its order denying Gulf Power's motion for reconsideration of the "penalty" issue, the Commission relied on several inapposite cases, each of which involved action by the regulatory agency based on specifically delineated deficiencies in the utility's existing rates, service, or facilities, or on the utility's failure to comply with Commission orders. (R. Order at 7). For example, in Re Otter Tail Power Co., 53 P.U.R. 4th 296 (N.D. Pub. Serv. Comm'n 1983) (App. Tab 3), the commission lowered the utility's return on equity because the company had failed to control its rates and as a result, customers had been forced to bear "inordinate rate increases." In Re Carolina Power & Light Co., 49 P.U.R. 4th 188 (N.C. Util. Comm'n 1921) (App. Tab 4), the commission based a reduction on ROE in the company's "poor nuclear plant performance" and the resulting unreasonably high electric rates. And, in Re Southern California Edison Co., 50 P.U.R. 4th 317 (Cal. Pub. Util. Comm'n 1982) (App. Tab 5), the California commission imposed a penalty for the utility's refusal to comply with specific commission directives that the utility offer full avoided cost payments to qualifying cogeneration facilities. Id. at 372-76.

The Commission's original order also cited a purported order of the New Hampshire Public Service Commission for the proposition that "[t]he method of addressing managerial efficiency which is most soundly rooted in proper regulatory principles and is most appropriate to the instant situation is a reduction in the allowed rate of return on common equity." (Order at 29). However, as the Commission subsequently acknowledged,8/ the quoted statement relied upon actually appeared in the dissent to the New Hampshire Commission's order. See Re Pub. Serv. Co., 57 P.U.R. 4th 563, 594 (N.H. Pub. Util. Comm'n 1984) (Aeschliman, Commissioner, dissenting).

Even more importantly, in making the quoted statement that a reduction in rate of return was the "most appropriate [remedy] to the instant situation," the dissenting commissioner had specifically pointed out that:

> In the present situation, where management inefficiency has not only adversely affected all present company operations, but has also clouded the utility's future ability to provide service at just and reasonable rates, the disallowance of an expense is an inadequate and inappropriate response.

8/ R. Order at 6-7.

Id. That dissent, then, actually confirms the very point made by Gulf Power in this case -- it is only utility mismanagement that is shown to adversely impact the utility's service or facilities which is a proper subject for Commission rate-making jurisdiction.

Not only is there an absence of support for imposition of such a penalty in the non-Florida authorities cited by the Commission, Florida law is contrary to the Commission's position as well. As this Court squarely held in Carter and Deltona, the Commission is not empowered to withhold rate relief except to the extent it has been expressly authorized by the Legislature to do so -- i.e., for inadequate service or facilities that would be expected to exist in the future.

Thus, this situation is wholly unlike Gulf Power v. Cresse, 410 So.2d 492, 494 (Fla. 1982), cited by Public Counsel in its papers opposing Gulf Power's request for a stay of the penalty imposed by the Commission. That decision, which was not relied upon by the Commission in imposing its penalty here, actually supports the Company's position that the penalty is contrary to law. In that case, this Court upheld a ten basis point return on equity "reward" granted by the Commission based on Gulf Power's energy conservation activities. As such, that "reward" was within the express statutory authority of the PSC. Section 366.041(1) was amended by Chapter 80-35, Laws of Florida, to specifically authorize consideration by the Commission of "energy conservation and the efficient use of alternative energy resources . . ." in setting rates. In sharp contrast, no such express statutory provisions address the matters at issue here or authorize a penalty for them. Quite to the contrary, the PSC is not empowered to impose a "penalty" except as specified in Section 366.095, and there has never been the slightest suggestion that these matters fell within that provision.

Moreover, even apart from the specific statutory authority for a "reward" such as was allowed in that case, by their very nature, energy conservation activities touch the very core of the Company's statutory duty to provide "sufficient, adequate and efficient" electric service. Thus, unlike the "mismanagement" activities complained of by the Commission in this case, conservation of energy resources has a direct effect on the utility's service and facilities, and, hence on the ratepayer. The fundamental difference between the energy conservation activities rewarded in Gulf Power v. Cresse and the corporate conduct penalized here makes Gulf Power's precise point -- the teachings of Carter and Deltona must be followed here because the Commission may not withhold rate relief except upon the basis of inadequate services or facilities of the utility which impact the ratepayer.

Furthermore, unlike those decisions, which directly addressed the question of whether the Commission can withhold rate relief as a penalty for particular types of misconduct, no such issue was presented in United Telephone Company of Florida v. Mann, 403 So.2d 962 (Fla. 1981), which is cited by the Commission as authorizing such a penalty. In that case, the Court was considering an entirely different question, namely, whether the Commission had statutory authority to hold interim rate decrease proceedings, and then to order a refund of interim revenues collected that were in excess of the authorized rate of return set after full rate-making proceedings. The one sentence that the Commission seized upon was merely a part of the Court's general description of the rate-making process and this Court did not either consider or hold that the Commission was empowered to deny otherwise justified rate relief due to past "management efficiency" that is unrelated to the utility's existing service or facilities.

Contrary to the proper purpose of Commission rate-making, the quality of Gulf Power's service and facilities was not the basis for withholding rate relief to Gulf Power in this proceeding. Rather, the "mismanagement" penalty was imposed because of corporate activities in the past, without any finding that those activities had any effect whatsoever on Gulf Power's facilities or service to its customers, much less its current service or facilities.

Nothing better illustrates the impermissibly penal nature of the Commission's action in this proceeding than its establishment of a special investigative docket, Docket No. 890832-EU, for the precise purpose of determining what, if any, impact the matters giving rise to this penalty may have actually had on Gulf Power's service and facilities.[9] This not only amounts to an admission

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9/ The Company specifically stipulated that, if the evidence (footnote continued) that no such determination has been made in _this_ proceeding, but shows that if the reduction in Gulf Power's return on equity is allowed to stand, Gulf Power will potentially pay _twice_ for the very same conduct.[10]

There can simply be no doubt that the proper procedure to be employed by the Commission is that in place in its independent investigative docket. The Commission has previously entered orders disallowing utility costs it found to have been incurred as a result of mismanagement, and its authority to do so has been directly upheld. _See_, _e.g._, _Florida Power Corp._, 424 So.2d at 746-47; _Richter v. Florida Power Corporation_, 366 So.2d 798 (Fla. 2d DCA 1979). Thus, any such order in the Commission's pending special investigation will fully protect the ratepayers, and the Commission should not be allowed to assess against the Company an additional rate penalty bearing no relationship to any impact on its service or facilities.

## CONCLUSION

The Florida Constitution, the Florida Statutes, and the teachings of this Court in _Carter_, _Deltona_, _Askew_ and _Gulf Power_ speak quite clearly. They lead to the inescapable conclusion that the penalty imposed here was not only improper but beyond the Commission's statutory and constitutional powers. Given the

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(footnote continued from previous page)
establishes that any of the past illegal activities adversely impacted the customers, an appropriate refund will be made, with interest. (R. 47, 4174).

[10] In addition, Gulf Power has already paid substantial penalties imposed by federal authorities. _See_ _supra_ n.5.

absence of any evidence whatsoever of an adverse impact upon Gulf Power's future service or facilities, the Commission could not, as a matter of law, reduce future rates to penalize and "send a message" to Gulf Power for past, non-continuing improprieties that did not impact the test year used by the Commission to set those rates in the first instance. Any past impact upon the customers must instead be remedied through the parallel proceeding already instituted by the Commission for that very purpose.

In sum, no "reduced return on equity" penalty is justified nor is it authorized by statute. The Commission's order should be reversed and the case remanded with instructions to the Commission to grant immediately the rate relief it found to be appropriate for Gulf Power -- a 12.55% return on equity.

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