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

REPLY 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." The Office of Public Counsel, representing appellees the Citizens of the State of Florida, will be referred to as "Public Counsel."

References to the record on appeal will be indicated as "(R. __)." References to the transcript of the hearings will be indicated as "(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." References to the Answer Brief of The Florida Public Service Commission will be designated "(C. Br. ___)" and references to the Answer Brief of Appellees, Citizens of the State of Florida, will be designated "(PC Br. ___)." All emphasis in quoted material is supplied unless otherwise indicated.

ARGUMENT

In its initial brief, Gulf Power showed that the PSC erred as a matter of law in imposing "a 50 basis point penalty" on Gulf Power's allowed return on equity in order to reduce its gross annual revenue for two years as a penalty for mismanagement. (Order 7). The PSC did not find that the misconduct had any effect on Gulf Power's rates or electric service -- an issue that is the subject of an independent PSC investigation that is currently pending -- nor did it find that the misconduct either continued in the test year or was expected to continue in the future. The PSC nevertheless reduced Gulf Power's allowed return on equity below the amount it expressly found to be "appropriate," declaring that this was intended to be a "message" that such misconduct would not be tolerated. This penalty violates Florida's constitutional prohibition against administrative penalties as well as fundamental principles of ratemaking.

In response, the PSC mischaracterizes Gulf Power's argument, fails to address the controlling authorities cited by Gulf Power, and relies on inapposite authorities or authorities that actually support, rather than undermine, the merits of Gulf Power's position. And, notwithstanding its own express characterization of its action as a "penalty" and its stated purpose of "sending a message" to the management of Florida's utilities, the Commission disingenuously argues that its action was not really a penalty because it did not purport to act under the only statutory power it has to impose penalties, which it concedes to be inapplicable

in this case. But that, of course, begs the question -- which is whether the PSC's action was in fact, as stated in its Order, a penalty and, since not expressly authorized under the "penalty" statute, illegal under Florida's Constitution.

The PSC further asserts that it has implied power to take "management efficiency" into account in setting a utility's return on equity, and that Gulf Power has no right to challenge the ordered reduction as long as the "end result" falls within a range of reasonableness. Significantly, however, the PSC fails to cite any authority granting it the power to impose such a penalty for past management misconduct which is not found to have impacted rates or service, much less to have had any impact in the test year adopted by the PSC in setting the future rates. Nor does it attempt to show why the Carter, Deltona, Askew, and Gulf Power decisions of this Court -- discussed at length in Gulf Power's initial brief -- are not controlling on that issue. As those decisions make clear, the PSC lacks any such power, and it therefore cannot justify this penalty by asserting the propriety of the "end result."

Finally, the PSC wholly misrepresents Gulf Power's argument, characterizing it as a claim that the Commission is "powerless" to deal with utility mismanagement. Gulf Power does not suggest any such thing; Gulf Power fully acknowledges the PSC's authority to act upon utility mismanagement, but only within the boundaries set by the Florida Constitution and Chapter 366 and only upon competent substantial evidence that the mismanagement affects the

rates or service of the utility -- which are the matters the PSC is statutorily empowered to regulate and are, as well, the very measure of "management efficiency" previously established by the PSC.[1/] This Court should fulfill its proper role by ensuring that the PSC stays within those boundaries.

A. The Reduction in Return on Equity Constitutes An Improper Administrative Penalty.

Gulf Power has shown that, under Florida law, administrative agencies such as the PSC may not impose penalties in the absence of statutory authority for doing so, which authority must be express and may not be implied from a general grant of power to the agency. In response, the Commission and Public Counsel argue that Gulf Power has simply "labelled" what the PSC did a penalty and that the use of that term in the PSC's Order was merely "inartful." (C. Br. 15-16; PC Br. 8). This is patently not the case.

Although the word "penalty" is only used once in the Order, it appears in the "Summary of Decision," where the Commission describes what it has done and why it has done so. The Commission states, "[w]e have set the rate of return on common equity at

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1/ Contrary to Public Counsel's argument, Gulf Power is not being inconsistent in opposing this penalty while agreeing to make a refund if deemed appropriate in the separate proceeding. (PC Br. 11, 13). Gulf Power obviously recognizes the PSC's authority to disallow imprudent utility expenses, Gulf Power Co. v. Florida Pub. Serv. Comm'n, 453 So.2d 799 (Fla. 1984), and that proceeding addresses that issue. Gulf Power simply asserts that the PSC does not have blanket authority to impose penalties for all corporate misconduct.

12.55%. The reduced increase in gross annual revenues for two years . . . reflects a 50 basis point penalty on return on equity imposed for mismanagement." (Order 7).

Even apart from that explicit acknowledgment that this reduction was imposed as a penalty, the Order, read as a whole, confirms this truth.[2] Thus, although a 12.55% return was specifically found to be "appropriate" and is the return the Company will be allowed upon expiration of the penalty, the PSC barred Gulf Power from collecting revenues calculated to provide the opportunity to earn that return for two years as a "message" to management. (Order 29). The PSC has plainly imposed a penalty, regardless of what it is called.

The PSC also claims that it did not impose a "penalty" because its action was not an "extraction of money by the state for the violation of a statute, rule, or order." (C. Br. 16). The PSC cites no authority for this narrow definition of "penalty," and Florida decisions make it plain that the PSC's refusal to allow "appropriate" rate relief for two years constitutes a penalty encompassed by the Constitutional proscription. As noted in Broward County v. La Rosa, 484 So.2d 1374, 1376 (Fla. 4th DCA 1986), aff'd, 505 So.2d 422 (Fla. 1987), a penalty "involves the idea of punishment, and its character is not changed by the mode in which it is inflicted, whether by civil action or criminal prosecution."

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[2] References to this mismanagement "penalty" were also made throughout the proceedings, and in the very answer brief in which the PSC denies having imposed such a penalty. (See Appendix Tabs 1-2; C. Br. 10, 17, 23.)

The PSC undeniably intended to punish the Company for past misconduct, not to make restitution to the customers for any past "injury" from that misconduct. Indeed, there was no causal relationship whatsoever between any alleged injury from the misconduct and the multimillion dollar sanction imposed.[3/] That is precisely what makes it a penalty. Lollie v. General American Tank Storage Terminals, 34 So.2d 306, 307 (Fla. 1948); Broward County v. La Rosa, 484 So.2d at 1377 ; Hyman v. State, Dep't of Business Regulation, 431 So.2d 603, 605 (Fla. 3d DCA 1983); U.S. v. Halper, 490 U.S. 435, 109 S. Ct. 1892, 1902 (1989).

There can, in sum, be no real question but that the Commission did exactly what it acknowledged it was doing: it imposed a "penalty" for past misconduct. Certainly, the Commission did not, as it repeatedly states, "set [Gulf Power's return] in a range of 11.75 to 13.5 per cent" (C. Br. 9), and then simply take "management inefficiency" into account in setting Gulf Power's future return on equity at the lower end of that range.[4/] Quite to the contrary, the Commission expressly found that 12.55% was the "reasonable" rate of return for Gulf Power (Order 20),

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3/ As noted, the Commission is now engaged in a separate investigation to determine whether this alleged mismanagement had any actual impact upon the ratepayers. If so, Gulf Power has agreed to make a refund to its ratepayers. This reduction was imposed to send a "message" to the management of Florida's public utilities. (Order 29). "Sending a message" is classic language used in arguing for punitive damages, which by their nature are aimed at punishment rather than restitution. See, e.g., Erie Ins. Co. v. Bushy, 394 So.2d 228, 229 (Fla. 3d DCA 1981).

4/ The Commission merely recited expert testimony that supported positions between 11.75% and 13.5% (Order 20), but the PSC itself "set the rate of return . . . at 12.55%." (Order 7).

representing the "best estimate" of the Company's cost of equity. (Order 20). A rate of return of "12.55%," the PSC found, would allow the Company "to raise capital on fair and reasonable terms and to maintain its financial integrity."[5/] (Order 20). Then, in an entirely separate section from the section of its Order in which the PSC set that rate of return, the Commission lowered that "appropriate" return, for a two year period, as a penalty for past misconduct. (Order 29).

Public Counsel only makes Gulf Power's point by emphasizing that setting an appropriate rate of return is a matter of economic judgment. (PC Br. 6, 19). Here, the Commission exercised its economic judgment when it set Gulf Power's future rate of return at 12.55%. The subsequent reduction in that "appropriate" return on equity was not the exercise of Commission expertise and economic judgment but rather, a penalty imposed after its exercise of such judgment. (Order 7).

The PSC contends that it did not impose a "penalty" because it did not act under Section 366.095, the only statute authorizing the PSC to impose penalties. (C. Br. 15-17; PC Br. 8, 10, 13). That concession is fatal, however, because the PSC is constitutionally prohibited from imposing any penalty other than

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5/ As reflected in the Commission's own summary of its decision, it "set" Gulf Power's return on equity at "12.55%". (Order 7). Thus, contrary to the Commission's arguments, Gulf Power is not claiming that its shareholders are entitled to more rate relief than the Commission found to be appropriate. (C. Br. 23). Rather, Gulf Power simply asserts that it should be granted rates commensurate with the rate of return on equity the PSC specifically found to be "appropriate," without the illegal penalty then assessed by the PSC.

as expressly provided by law. The PSC obviously cannot impose an unauthorized penalty by the simple tactic of making it a penalty on rates. The substance of the PSC's action is determinative, not its procedural dress.

Ignoring the authorities holding that the power to penalize may not be inferred from the general grant of powers in Chapter 366, the PSC argues that its regulatory powers are an exercise of police power that "carries with it the authority to exercise discretion in determining what measures are necessary to protect the public interest." (C. Br. 17; PC Br. 7). But, Section 366.01 does not state, as the PSC suggests, that it has been given general "police power" to regulate every aspect of utilities "in the public interest." Chapter 366 instead grants specific jurisdiction to the PSC "to regulate and supervise each public utility with respect to its rates and service. . . ." § 366.04, Fla. Stat. (1989).

The point is, the Commission is not the "police" with respect to all activities of public utilities and it does not have "any general authority" to regulate them. City of Cape Coral v. GAC Util., Inc., 281 So.2d 493, 495-96 (Fla. 1973). This was precisely the basis for this Court's decisions in Carter and Deltona, decisions that the Commission does not even try to address.[6] As the Court squarely held in Deltona, the PSC is not

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6/ Public Counsel attempts to avoid Deltona by distinguishing between Deltona Corporation, which allegedly made false representations in selling land, and Deltona Utilities. But that was not the Court's holding, which was that the Commission cannot use its rate setting authority to punish conduct that is not its

(footnote continued)

empowered to "set water and sewer rates to right any wrong which it perceives regardless of its relationship to water and sewer service."

Ignoring those directly relevant decisions, the Commission cites State v. Atlantic Coast Line R. Co., 47 So. 769 (Fla. 1908) and Deltona Corp. v. Florida Pub. Serv. Comm'n, 220 So.2d 905, 907 (Fla. 1969), to justify this penalty under the PSC's implied "police power." (C. Br. 17). In fact, those cases dealt with entirely different issues, and neither held that PSC has the implied power to impose penalties. Thus, although the PSC clearly has certain implied powers, Florida case law is settled that the Constitutional proscription against administrative penalties cannot be avoided by implication from a general grant of power.

B. The Penalty On Return On Equity Also Violates Fundamental Principles of Rate Making.

Gulf Power's initial brief showed that, when using a test year to set rates, facts that have no future validity must be discarded. Gulf Power Co. v. Bevis, 289 So.2d 401, 405 (Fla. 1974). The PSC concedes that no "mismanagement" was found in the test year (C. Br 18), but makes three flawed arguments as to why the Court should ignore this undeniable fact.

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concern under the statute. 342 So.2d at 512 & n.4.

Public Counsel further argues that Carter is superseded by statutory amendments granting the Commission authority to consider adequacy of service in setting rates. (PC Br. 14-16). That misses the point of Gulf Power's argument. Carter holds that the Commission can only reduce utility rates based upon matters within its express regulatory powers; just as adequacy of service was not such a matter at the time of Carter, here utility mismanagement that does not affect rates or adequacy of service is not within those powers today.

The PSC first claims that the absence of such a finding is not surprising since the test year was "projected." (C. Br. 18). Ignored is the fact that Gulf Power's projected 1990 budget, the test year, was based on 9 months actual and 3 months projected data from 1989. In addition, by the time of the actual hearings, historical data from the Company's actual experience during all of 1989 and 5 months of 1990 itself was available for the PSC's review. Nevertheless, there was no evidence, much less any finding of any existing misconduct, or any effects from the prior misconduct, in either 1989 or 1990.

The point is, the PSC could take "management inefficiency" (in the proper sense) into account only to the extent there was evidence that the inefficiency or its effects would be reasonably expected -- "projected" -- to continue in the future. Gulf Power, 289 So.2d at 405. But, as the PSC itself admits, that is not what it did. Instead, the PSC violated the very foundation of the test year concept by considering a purely historical matter, with no future validity, in this proceeding. Maule Industries, Inc. v. Mayo, 342 So.2d 63, 65 n.3, 68 (Fla. 1977) (inclusion of nonrecurring, extraordinary item unrepresentative of normal operations was "wholly inappropriate to the test year tool of rate-making."). This principle must be applied in an even-handed manner, whether it hurts or helps the utility in any particular case.

The Commission next claims that Gulf Power's argument is "contrived" because the issue of "mismanagement" would have been considered in the 1988 rate case if it had not been withdrawn by Gulf Power "in the face of the Federal Grand Jury Investigation." (C. Br. 18). What <u>might have been</u> considered in the 1988 case is <u>obviously</u> irrelevant here. By withdrawing that case, the Company gave up its right to any increase in rate relief at that time. The Commission cannot now avoid this test year's boundaries by claiming that certain factors might have been considered had an earlier proceeding been brought. Manifestly, that would destroy the very basis for test year rate-making.

The Commission finally argues that the test year concept "has nothing to do with establishing or measuring the attitudes, misconduct, and inefficiencies which the commission addressed in its order." (C. Br. 19). That is precisely Gulf Power's point. The Commission's own Order establishes that the fair rate of return, together with rate base and net operating income are to be derived <u>using a test year</u>. (Order 7). If the misconduct which was the basis for the Commission's penalty does not relate to the test year, it had no business being considered in this proceeding. Having adopted a 1990 test year for rate-making purposes, the PSC cannot then reach out to earlier years to select certain <u>isolated</u> matters that it will consider.

In short, the PSC cannot claim that its action was not a penalty but rather the proper exercise of its ratemaking powers, while ignoring fundamental ratemaking principles by relying on

out-of-period matters that were <u>not</u> found to be continuing or probative of future conditions. While the PSC disingenuously asserts that it sought to correct a problem existing "here and now," (C. Br. 19), there was <u>no such finding</u> in its Order nor was there any <u>evidence</u> that there was any on-going misconduct. To the contrary, the evidence was uncontroverted that the improper activities had already come to an end by 1989 and that Gulf Power had <u>already</u> taken corrective measures to prevent the recurrence of such problems, (Tr. 513-22), and the PSC explicitly found that Gulf Power had <u>already</u> "turned the corner" in this regard. (Order 29).

Significantly, this reduction in "appropriate" rate relief is ordered for a two year period, <u>regardless</u> of the measures taken by the Company to prevent any such misconduct in the future. Had the Commission truly been intending to provide "incentives" to correct an existing problem, it would not have set an arbitrary two-year penalty but would have instead required Gulf Power to take further corrective action, for subsequent review by the PSC. Indeed, in prior orders, the Commission has recognized that management inefficiencies impacting rates or service would only justify a lowered return "until the efficiency deficit has been removed."7/

7/ Even if the conduct cited in the Order could be found to relate to adequacy of service, reduction of rates on this basis would be improper until Gulf had been allowed time to correct the cause of any service complaints. § 366.041(1), Fla. Stat. (1989). This statutory provision is completely consistent with the principle that rate-making is a prospective enterprise, and confirms the impropriety of penalizing the Company without regard to the fact that the activities complained of had been brought to an end.

Re Florida Power Corp., 73 PUR 3d 295, 299 (Fla. Pub. Serv. Comm'n 1968). The imposition of this penalty for two years graphically demonstrates that it is not intended to encourage elimination of existing misconduct but rather to punish for past misconduct.

Despite the patent lack of any evidence that this past misconduct was continuing or that it had any effect on test year rates or service, the PSC and Public Counsel nevertheless rely on cases where, unlike here, the "mismanagement" at issue related directly to the utility's existing rates or service to the ratepayers. (C. Br. 11-15, 20-22; PC Br. 14-16). In fact, the two Florida orders cited by the PSC specifically establish that "management efficiency" is determined by the adequacy of the utility's service and rates. Re General Tel. Co., 44 PUR 3d 241 (Fla. Pub. Serv. Comm'n 1962); Re Florida Power Corp. 73 PUR 3d at 297-98.

Here there was no finding by the PSC of "poor service" or "high rates" -- the PSC's stated measures to test "management efficiency." Indeed, the uncontroverted evidence showed that Gulf Power fully satisfies the Commission's own previously set standard: the Company's rates are among the lowest in the nation, even with the full rate relief requested, and it provides excellent service to its customers, with a minimum of service complaints. Faced with this evidence, the PSC resorts to conclusory declarations that "there can be no doubt" and that it is "axiomatic" that there was an effect on efficiency.[8/] (C. Br.

8/ The Commission also relies on a purported quote of the Supreme (footnote continued)

20; Order 29). If so, one wonders why an independent proceeding is pending to make that very determination!

The PSC also asserts that this Court's decision in United Telephone Co. v. Mann, 413 So.2d 962 (Fla. 1981), allows the Commission to take "management efficiency" into account in setting rates regardless of its effect upon rates and service. (C. Br. 12). Mann does not so hold. The snippet of language the PSC seeks to take completely out of context is simply part of a brief, general description of the ratemaking process. Mann does not purport to recede from the Court's decisions explicitly holding that rates are to be set for the future, and that "facts which have no future validity must be discarded." Gulf Power, 289 So.2d at 405. Nor does Mann in any way hold that management misconduct that occurred well outside the test year being used in setting rates and that is wholly unrelated to service or rates of the utility can be the basis for a penalty such as this. Thus, Gulf Power's position is not at all inconsistent with Mann.[9]

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Court in State of Missouri ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n, 262 U.S. 276 (1923), to "prove" that "controversy" must lead to deleterious effects on efficiency. (C. Br. 21). But the reference there was to the "controversy" created by the regulatory body's rate-making procedures, not to "controversy" created by utility misconduct such as that complained of here. Further, the quoted language is not from the Supreme Court's opinion, but is instead from a concurring opinion.

9/ The Commission attempts to dismiss the decision 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), as inconsistent with decisions allowing adjustments for "management efficiency." But the Texas Court made the precise point urged by Gulf Power here based on Florida law -- such "adjustments" can
(footnote continued)

The Commission also relies heavily on <u>Gulf Power Co. v. Cresse</u>, 410 So.2d 492 (Fla. 1982), which upheld a 10 basis point "reward" in Gulf Power's 1980 rate case for the Company's energy conservation activities, urging that if it can reward, it necessarily must be able to punish. (C. Br. 12-13). That argument is without merit.

First, that precise rate-making device is authorized by statute, while a penalty other than as allowed by Section 366.095 is <u>expressly forbidden</u> by the Florida Constitution. Further, the "reward" in <u>Cresse</u> was to encourage management promotion of energy conservation, which reduces future needs for new, expensive generating capacity and hence results in lower rates. As such, the Commission's order was squarely within its power to consider management practices that affect existing and future rates and service. Here, in contrast, there is no incentive being offered to take any additional action to enhance the Company's service or lower its rates; indeed, the reduced rate relief will continue for two years <u>regardless</u> of what corrective measures the Company adopts.

The Commission finally maintains that, as long as the rate it set was not confiscatory, this Court is powerless to reverse it. (C. Br. 22-24). This argument is plainly contrary to Florida law. As this Court has repeatedly held, the "end result" doctrine does <u>not</u> justify Commission action that is arbitrary or unsupported by

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<u>only</u> be made upon a showing that the "management inefficiency" impacts existing rates or service.

substantial competent evidence, nor the use of methods that "go so far astray that they violate our statutes or run afoul of constitutional guarantees." Shevin v. Yarborough, 274 So.2d 505, 508 (Fla. 1973); General Telephone Co. of Florida v. Carter, 115 So.2d 554, 559 (Fla. 1959) ("[T]his Court will not give effect to the 'end-result' doctrine to justify improper or erroneous methods. . . ."). The Commission may not hide behind the "end-result" doctrine to justify its imposition of a penalty in this case.

CONCLUSION

The Commission's penalty against Gulf Power not only violated fundamental ratemaking concepts set forth in the statute, its own prior orders, and this Court's decisions, it also violated the Company's constitutional right to be free of unauthorized administrative penalties. For all the foregoing reasons, the Commission's penalty should be reversed.

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