

1989

MCI Telecommunications Corp. v. Public Service Commission of Utah; Brian T. Stewart, James M. Byrne, Steven F. Mecham : Petition for Rehearing

Utah Supreme Court

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U.S. DISTRICT COURT
D. K. 4

IN THE

BRIEF

DOCKET NO. 890251 **IN THE SUPREME COURT OF THE STATE OF UTAH**

MCI TELECOMMUNICATION CORP.
Petitioner,

vs.

PUBLIC SERVICE COMMISSION OF
UTAH; BRIAN T. STEWART,
CHAIRMAN, JAMES M. BYRNE,
COMMISSIONER, STEVEN F. MECHAM,
COMMISSIONER,
Respondents.

Consolidated Case
Nos. 890251
and 890252

TEL-AMERICA OF SALT LAKE CITY,
INC.,
Petitioner,

vs.

PUBLIC SERVICE COMMISSION OF
UTAH; BRIAN T. STEWART,
CHAIRMAN, JAMES M. BYRNE,
COMMISSIONER, STEVEN F. MECHAM,
COMMISSIONER,
Respondents.

**PETITION FOR REHEARING
OF U S WEST COMMUNICATIONS, INC.
(FORMERLY THE MOUNTAIN STATES TELEPHONE
AND TELEGRAPH COMPANY)**

FILED
MAY 26 1992

**ON PETITION FOR REVIEW FROM THE
PUBLIC SERVICE COMMISSION OF UTAH**

CLERK SUPREME COURT
UTAH

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LIST OF PARTIES

The principal parties to the proceeding below included the Division of Public Utilities, Committee of Consumer Services, The Mountain States Telephone and Telegraph Company, Tel-America of Salt Lake City, Inc., and MCI Telecommunication Corp.

The Request for Agency Action was signed by petitioners and the following individuals, organizations, and companies who are, pursuant to the requirements of Utah Code Ann. § 54-7-9, consumers of telephone service:

Senator Frances Farley	Georgia Peterson	PST Vans, Inc
Senator Jack Bangerter	Joe Duke-Rosati	Ann L. Lazerus
Senator Omar Bunnell	Barbara Toomer	Amfac Electrical Supply
Senator Wilford Black	Bill Walsh	Monica E. Gornik
Senator Darrell Renstrom	Jerry Dyer	G T Sales
Representative Kim Burningham	Bruce Lybbert	Louis C. Kunde
Representative Stan Smedley	Harold Paulos	Amtel Corporation
Committee of Consumer Services	Robert Benson	Lawrence S. Fowers
Salt Lake Citizens' Congress	Sherry L. Hansen	Access Long Distance
Utah Telephone Answering Services Association	Donald W. Mortenson	Ronald Haggin
Evan Twede Advertising	Michael L. Meyers	David Irvine
M & G Uintah Freightway	Patricia J. Bonny	David Haggin
Ken-Son, Inc.	Chad Bauer	Mark Barandermeyer
Coryell Answering Service	James Hal Chaney	Pat Coryell
	Ron Turpin	

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Pursuant to Rule 35, Utah Rules of Appellate Procedure, U S WEST Communications, Inc. (hereinafter “U S WEST”) petitions for rehearing. In this Petition, U S WEST describes with particularity the points of law and fact that the Court overlooked or misapprehended in its opinion dated May 12, 1992 (hereinafter “the Opinion”—Appendix A). This Petition is presented in good faith and not for the purpose of delay.

I. THE COURT’S HOLDING IS INCONSISTENT WITH THE EXCEPTIONS ADOPTED BY THE COURT AND WITH THE REMEDY SOUGHT BY THE PARTIES.

In the Opinion, the Court adopted an exception to the rule against retroactive ratemaking relating to “unforeseeable and extraordinary increases or decreases in expense.” (Opinion at 9) The theory underlying this exception is that “justice and equity require that adjustments be made for unforeseen windfalls and disasters not caused by the utility.” *Id.* Thus, “[t]o achieve fairness, the exception allows the recoupment of such expenses. . . .” *Id.*, emphasis added. The exception, therefore, allows recovery of the amount of the unforeseen and extraordinary increase or decrease in expense.

The Court also made it clear that a rate of return is not an absolute limit on profits:

The rate of return is neither a guarantee of nor a limit on profits. A utility should be rewarded for becoming more efficient through its own efforts. If the authorized rate of return were an absolute ceiling on profits, that objective would be subverted.

Id. at 16, emphasis added.

Yet, despite these principles, the Court held:

[I]f on remand the Tax Reform Act of 1986 is found to have resulted in an unforeseeable and extraordinary decrease in expenses or if U. S. West is

found to have engaged in misconduct, we hold that U. S. West's earnings, to the extent they exceeded its authorized rate of return established in the 1985 general rate case, should be refunded to U. S. West ratepayers.

Id. at 16, emphasis added. Read literally, the holding would mandate that, if the unforeseen and extraordinary exception applies in a particular year, all earnings above the authorized return must be refunded, even if the extraordinary and unforeseen decrease in expense accounts for only a portion of the excess earnings. Thus, if a utility earned \$10 million more than the authorized return in a particular year, but only \$2 million was attributable to the extraordinary expense decrease, the Court's holding would seemingly require that the entire \$10 million be refunded. Such a holding is patently unfair, is inconsistent with the Court's articulation of the exception and the objective of promoting efficiency, and its application will amount to a penalty rather than recoupment of earnings attributable to the extraordinary expense.

The holding also goes far beyond what was requested by the parties. In oral argument before the Commission, Mr. Dryer, counsel for MCI, was asked to describe what Petitioners were requesting. He gave the following response:

Well, if the Commission were to adopt the argument that this is not retroactive ratemaking but it's in the nature of reparations, then I believe the Commission could order a refund of the entire amount due to whatever factor that exceeded 14.2 percent which was the authorized rate of return. If, however, the Commission concludes that there is an exception to the doctrine of retroactive ratemaking for unforeseen events, then I think the amount would be restricted solely to the unforeseen event which was the passage of the 1986 Tax Reform Act.

(R. 942, emphasis added) He later indicated that, if the unforeseen and extraordinary exception were adopted, the amount at risk "would be narrowly

limited to those truly unforeseen events.”¹ (R. 943)

Finally, as noted in our Brief, the rule against retroactive ratemaking is constitutionally based. See Respondents’ Brief at 28-29; *accord* South Central Bell Telephone Co. v. Louisiana Public Serv. Comm’n, 594 So. 2d 357 (La. 1992); Kansas Gas & Elec. Co. v. State Corp. Comm’n, 794 P.2d 1165, 1170 (Kan. App. 1990). By sanctioning the refund of earnings unrelated to the exception, the Court’s action would violate both the rule against retroactive ratemaking and U S WEST’s constitutional rights.

Similarly, in a situation where “utility misconduct” exists, to the extent the Court’s holding would require the refund of amounts above the authorized rate of return unrelated to the misconduct, the Court’s holding would be unfair, would be inconsistent with the theory underlying the adoption of the exception, and would violate U S WEST’s constitutional rights.

U S WEST, therefore, requests that the Court rehear this issue and clarify

¹ Counsel for Tel-America participated later in the oral argument and did not disagree with Mr. Dryer’s statement. (R. 949 *et seq.*) Mr. Dryer also made it clear that refunds which would reduce earnings below 14.2% would be inappropriate and that earnings above 14.2% attributable to efficiencies and other matters within the control of the utility should be retained by the Company:

The bottom line is 14.2 percent. That would be the trigger point to analyze the amount in excess, but it would be our position that if the excess is attributable to efficiencies or other actions over which the utility had control, then the benefit would inhere to the utility.

(R. 974). In Combe v. Warren’s Family Drive-Inns, 680 P.2d 733, 736 (Utah 1984), this Court stated:

In law or in equity, a judgment must be responsive to the issues framed by the pleadings, and a trial court has no authority to render a decision on issues not presented for determination. Any findings rendered outside the issues are a nullity.

See Cornia v. Cornia, 546 P.2d 890, 893 (Utah 1976) (“[L]iberality in procedure . . . does not authorize granting of relief on issues neither raised nor tried.”)

its holding so that only those earnings above the authorized rate of return attributable to the events giving rise to an exception to the rule against retroactive rate making are subject to refund.

II. THE COURT'S RULING ON THE ISSUE OF PETITIONERS' FAILURE TO RAISE UTILITY MISCONDUCT IN THEIR PETITIONS FOR REHEARING IS BASED ON A SERIOUS MISAPPREHENSION OF FACT.

Utah Code Ann. Section 54-7-15(2)(b) explicitly states that no party can raise on appeal any ground not set forth in its petition for rehearing. In Utah Associated Municipal Power Systems v. Public Serv. Comm'n, 789 P.2d 298, 300 (Utah 1990), this Court expressly reaffirmed the principle that “an issue is not preserved for consideration on appeal unless it has been specifically raised in a petition for rehearing before the PSC.”² (Emphasis added)

In this case, neither Tel-America nor MCI raised the claim that the Commission erred in failing to hold a factual hearing on utility misconduct in its petition for rehearing. (R. 685-95) Yet, in their briefs, they raised the issue of utility misconduct and argued that the Commission erred in not holding such a hearing. (MCI Brief at 44-45, Tel-America Brief at 22)

In ruling that MCI and Tel-America had satisfied Section 54-7-15(2)(b), the Court overlooked two important facts in the record that completely undercut the Court's conclusion. First, the Court quoted a portion of the Commission's November 1, 1988 order for the proposition that the Commission only wanted the parties to address the threshold legal question rather than specific facts relating to their claim for relief. (Opinion at 13) This conclusion overlooks another

² In Utah Dep't of Business Regulation v. Public Serv. Comm'n, 602 P.2d 696, 699 (Utah 1979), this Court held that compliance with Section 54-7-15 is “a jurisdictional prerequisite to the grant of judicial review by this Court.”

statement from the November 1, 1988 Commission order. After setting the filing date for the briefs of parties supporting the Request for Agency Action, the Commission defined the parameters of their briefs this way:

Those parties making the Request for Agency Action and any intervenors who support the Request shall file legal memoranda in support of the relief sought in the Request. (R. 3, emphasis added)

Thus, contrary to the Court's conclusion that the Commission asked the parties to only address the broad jurisdictional issues, the Commission specifically requested that they support their specific requests for relief. Second, the Court compounded this error by stating that the parties, in their briefs filed below, "focused on the legal issue whether the Commission had authority to grant any relief in light of the EBA case and not on the facts that might support any particular theory justifying relief." (Opinion at 13, emphasis added) The Court's conclusion that the briefs did not focus on facts that would support the misconduct theory is simply not supported by the record. In fact, MCI's Brief before the Commission contained a detailed factual recitation (R. 378-88) that served as the basis for the argument that "there is evidence to indicate that the Company has been less than forthcoming in providing sufficient information . . ." (R. 399) and to claim that "Mountain Bell actively frustrated the regulatory process" and "failed to advise the Commission that its earnings had exceeded its authorized rate of return." (R. 415) MCI made specific assertions of misconduct in its Brief in support of its specific claim that U S WEST should be estopped from relying on the rule against retroactive ratemaking.³ In response, U S WEST presented a

³ In fact, the heading of the final section of MCI's Brief states: "Mountain Bell Should be Estopped from Raising the Rule Against Retroactive Ratemaking." (R. 415)

detailed factual discussion and a specific response to the allegations of misconduct. (R. 469-85)

Having specifically raised the issue before the Commission and having failed to raise it in their petitions for rehearing, the issue was not preserved by MCI and Tel-America as required by Section 54-7-15. Because the Court's decision was based on a serious misapprehension of fact, U S WEST respectfully requests the Court to rehear this issue and rule, consistent with the explicit requirements of Section 54-7-15, that the misconduct issue was not preserved. Because this issue was not preserved, the Court should reconsider its decision which appears to have been heavily influenced by unsubstantiated allegations of misconduct.

III. THE COURT CONCLUDED THAT THE PROCEDURES FOLLOWED BY THE COMMISSION IN APPROVING REVENUE REDUCTIONS IN 1987 AND 1988 WERE IRREGULAR. THIS CONCLUSION IS BASED ON MISAPPREHENSIONS OF BOTH LAW AND FACT.

The Opinion states that the procedures followed by the Commission in approving the December 1987 tariff reduction and the 1988 stipulation were "irregular, if not illegal." (Opinion at 10) The Court also stated that "the fixing of utility rates by private negotiation with no findings of fact raises serious questions about the legality and integrity of the procedures the Commission employed." *Id.* at 11. There are two problems with this conclusion. First, the orders approving both decreases are final and were not appealed by any party. Second, the Court's criticism of the procedural basis for the 1987 and 1988 rate reductions is unfounded, both factually and legally.

With regard to the 1987 reduction, the Court characterized it as a "stipulation" between U S WEST and the Division. *Id.* at 4. While the Division

supported the reduction, such a characterization is incorrect since there was no stipulation between U S WEST and the Division. Procedurally, the reduction resulted from the filing by U S WEST of revised tariffs for five services⁴ that had the overall effect of lowering annual revenues by \$9.02 million. (Appendix B). No party opposed the tariff reduction.⁵ Since the tariffs involved only rate reductions, the statute governing the filing was Section 54-7-12(4)(a):

Notwithstanding any other provisions of this title, any schedule, classification, practice, or rule filed with the commission that does not result in any rate increase shall take effect:

(i) 30 days after the date of filing; or

(ii) within any lesser time the commission may grant, subject to its authority after a hearing to suspend, alter, or modify that schedule, classification, practice, or rule.

Utah Code Ann. § 54-7-12(4)(a) (1987),⁶ emphasis added. Section 54-7-12(4)(a) does not require a hearing to approve the kind of filing made by U S WEST. If the Commission is not required to take any action before a utility-proposed rate decrease takes effect, obviously there is no need for it to make findings regarding the decrease.

The October 1988 rate reduction in Docket No. 88-049-07 was much more than a private negotiation between two parties. In fact, it was a detailed stipulation

⁴ The five services were residential basic exchange service, residential installation charges, long distance service, OUTWATS, and switched access service (which is the service purchased by MCI and Tel-America).

⁵ Both MCI and Tel-America were fully aware that U S WEST was proposing these tariff reductions – including a 35% reduction to U S WEST's rates to them – and did not oppose them. (See Appendix 12 to Respondents' Brief, at 2-3).

⁶ Section 54-7-12(4)(a) has been amended slightly since 1987; however, the changes to it are not substantive in nature.

entered into by nine of the ten parties to the proceeding, including U S WEST, the Division, Tel-America, and MCI.⁷ (R. 916-27) While the Committee of Consumer Services did not sign the Stipulation, it affirmatively stated that it did not object to it.⁸ This Stipulation and the Commission's Order did not end the rate case. Rather, they placed two rate decreases into effect pending full hearings in the matter, thus allowing significant rate decreases to become effective in the absence of a fully litigated proceeding.⁹ Had the parties not entered into the Stipulation, those reductions would have been significantly delayed. Thus, from the perspective of ratepayers, it is inappropriate to criticize the Commission's procedures, particularly when considered in light of Utah Code Ann. § 54-7-1, which states in part:

(1) Informal resolution, by agreement of the parties, of matters before the commission is encouraged.

⁷ The other signatories were Contel, a large independent local exchange carrier, the Exchange Carriers of Utah, an association representing all independent local exchange carriers in Utah, the Utah Telecommunications Management Association, a trade group representing larger users, and AT&T and U S Sprint, large interexchange carriers.

⁸ In the October 13, 1988 Order approving the Stipulation, the Commission noted that "[t]he Stipulation was entered by all parties to this proceeding, with the exception of the Committee of Consumer Services which stated that it had no objection to the Stipulation." (R. 912; emphasis added) Neither that order nor the final order in Docket No. 88-049-07 was appealed by the Committee or any other party.

⁹ It is inappropriate to negatively contrast the terms of the August 1988 stipulation to the October 1988 stipulation. While the August stipulation would have reduced rates by an additional \$5 million, it would also have completely resolved all revenue issues in the case and put in place an incentive regulation plan, under which no further rate reductions would have been made until 1992. On the other hand, the October stipulation put in place rate reductions without resolving the rate case. Indeed, the rate case continued, with additional revenue reductions of \$22 million in 1989. It should also be remembered that the October 13 rate reduction took place only four months after the Division initiated the proceeding. In fully litigated proceedings prior to the amendment to section 54-7-12(3) to allow interim rate reductions, rate decreases would not normally be effective until much longer periods of time had elapsed since the filing.

(2) The commission may approve any agreement after considering the interests of the public and other affected persons.

(3)(a) At any time before or during a hearing or proceeding before the commission, the parties, between themselves or with the commission or a commissioner, may engage in settlement conferences and negotiations.

(b) The commission may adopt any settlement proposal of the parties and may enter an order based upon the proposal.

The Commission's approval of the Stipulation, which had no opposition, was in full compliance with Section 54-7-1 and with prior precedent. In Utah Dept. of Admin. Services v. Public Serv. Comm'n, 658 P.2d 601, 613 (Utah 1983) [Wexpro II], this Court strongly supported the policy of encouraging settlements of controversies before regulatory agencies "since it avoids the delay and the public and private expense of litigation."

The Court's Opinion creates a "Catch 22" for the entire rate process before the Commission. On the one hand, the Court was highly critical that the 1987 and 1988 reductions were not based on detailed findings, which would have required detailed testimony and extensive hearings. On the other hand, the Court was even more critical of the Commission for not acting more expeditiously in reducing U S WEST's earnings. The two criticisms are inconsistent. Comprehensive hearings, detailed findings, full discovery and all the other attributes of due process require a great deal of time. Rapid action, on the other hand, requires parties to compromise their positions. In this case, the Commission's approval of the rate reductions provided benefits to ratepayers far faster than would have otherwise been achieved. To have required the Commission to fully develop the record in order to enter detailed findings would have delayed and utterly frustrated that effort. Because the

Court's ruling appears to mandate such an approach, U S WEST respectfully submits that it will cause profoundly negative impacts to the regulatory process.

An issue related to the Court's criticism of the Commission's procedures is the inference that the Commission acted far differently than other regulatory commissions in dealing with the Tax Reform Act of 1986. In its Opinion, the Court stated that "[b]y August 1987, utility regulators in forty-three states and the District of Columbia had taken some action to reduce utility rates in response to the Act." (Opinion at 3) The clear implication of the Court's statement is that by August 1987 rates had been reduced in forty-four regulatory jurisdictions in response to the Tax Reform Act. A further implication is that the Utah Commission, which was not one of the jurisdictions listed, was derelict in its duties. The source for the Court's statement was a Public Utilities Fortnightly article provided by MCI. (R. 111-18) That article and its detailed footnotes make it clear that in many of the jurisdictions reported, no rate reductions had taken place and that such changes would be considered in the context of the normal rate-making process.¹⁰ That is no different from the Utah Commission's handling of the matter. Furthermore, in many of the states, the rate reductions occurred only with regard to those utilities that were currently in general rate proceedings. Few of the rate reductions related to telephone companies, and those that did primarily involved companies in the midst of rate proceedings. The Utah Commission's actions were consistent with those of

¹⁰ Arizona, for example, was listed as one of the forty-four jurisdictions. The footnote associated with Arizona states, in part: "No substantive action yet taken. The effect of TRA86 will be dealt with in the context of the general rate case proceedings of the state's larger investor-owned utilities." (R. 115, note 4)

many other jurisdictions.¹¹

A major premise of the Court's decision is that the Commission's procedures were improper and inadequate. Since that premise is not correct, U S WEST requests that the Court reconsider its decision. In addition, U S WEST requests that the Court explicitly clarify its decision by reaffirming its Wexpro II position encouraging the informal resolution of matters before the Commission.

IV. THE COURT'S UNRESTRICTED ADOPTION OF THE EXTRAORDINARY AND UNFORESEEABLE EXPENSE AND UTILITY MISCONDUCT EXCEPTIONS TO THE RULE AGAINST RETROACTIVE RATE MAKING VIOLATES U S WEST'S CONSTITUTIONAL RIGHTS AND CREATES A CLOUD ON U S WEST'S ABILITY TO FINANCE.

U S WEST has received and reported earnings in 1987 and 1988 based upon final Commission rate orders that were not appealed by any party. U S WEST argued that it could not be deprived of those earnings without violating the due process provisions of the state and federal constitutions (Respondents' Brief at 28-29), but acknowledged in oral argument that a showing that U S WEST had defrauded the Commission could operate as an exception to this constitutional prohibition. The Opinion does not address this constitutional argument.

Because it is unconstitutional and a violation of statute to order a utility to refund revenues collected pursuant to a final rate order (Respondents' Brief at 23-31), any exception must be strictly drawn. While it is conceivable that an "act of God," such as a severe storm, which occurs and is concluded before there is any reasonable possibility for prospective rate relief, might constitute an appropriate

¹¹ The Public Utility Fortnightly article makes no effort to analyze or describe the difference in state laws in each jurisdiction. The law in a particular state can have a dramatic effect on the remedies available to a regulatory agency in dealing with situations like the Tax Reform Act.

exception, an event like the Tax Reform Act which altered tax rates prospectively on a continuing basis is not an appropriate exception.

Likewise, the Opinion's adoption of a "misconduct" exception to the rule against retroactive ratemaking is overly broad. U S WEST has conceded throughout this case that revenues collected pursuant to a final order would be subject to refund to the extent that they were based upon fraudulent misrepresentations or omissions by the utility. The three cases cited in the Opinion all involved allegations of fraudulent conduct. The "utility misconduct" exception adopted by the Court does not define "misconduct" or require a finding of intent on the part of the utility, and is, therefore, so vague as to violate the due process rights of a utility. In addition, it cuts only one way. If a party seeking lower rates than supported by the utility is successful in achieving its aims through fraudulent misrepresentation or omission, the rates ought to be subject to surcharge.

The Court's failure to precisely and narrowly define its exceptions to the rule against retroactive rate making seriously impairs the constitutional protection of the rule.

Furthermore, if the rule against retroactive rate making is to have as many potential loopholes as these overly broad and vague standards would suggest, it is hard to imagine a situation in which anyone can rely upon the finality of a rate order. As pointed out in our brief (Respondents' Brief 29-31), it is in the interests of the utility, its customers and its investors to have finality in rate orders. The lack of finality created by the opinion is particularly problematic for utility investors. As noted in Indiana Tel. Corp. v. Public Serv. Comm'n, 171 N.E.2d 111, 124 (Ind. App. 1960) and State ex rel. Standard Oil of Calif. v. Dep't of Public Works, 53 P.2d 318,

319 (Wash. 1936), a public utility's ability to attract capital or make investments is seriously undermined if final rate orders are subject to adjustment after-the-fact.

For the foregoing reasons, U S WEST requests that the Court reconsider its adoption of the two exceptions to the rule against retroactive rate making. If the Court concludes that the exceptions should be adopted, U S WEST respectfully requests that the Court define the exceptions more precisely and narrowly to limit the potential for their misapplication. U S WEST requests the opportunity to brief this issue further.

V. THE COURT'S CONCLUSION THAT ALL CUSTOMERS SHOULD BENEFIT FROM ANY REMEDY IS ERRONEOUS.

The Opinion concludes that "[a]ny refund of excess earnings that might be appropriate . . . must not be solely for the named petitioners; all of U.S. West's ratepayers are entitled to the benefit of any remedy the Commission finds to be appropriate." (Opinion at 16) The only support in the Opinion for this striking result is the reference that "MCI's and Tel-America's petitions for rehearing stated that they were filed for and on behalf of all petitioners and all customers of U. S. West." *Id.* at 14. Although the Court's observation about the petitions for rehearing is correct (R. 684, 694), the mere assertion by Tel-America and MCI, who are interexchange carriers and competitors of U S WEST, that they were acting in a representative capacity on behalf of all ratepayers, does not grant them that status.

To act in a representative capacity, a person must either have statutory authority to do so or must have complied with Rule 23 of the Utah Rules of Civil

Procedure.¹² Rule 23 prescribes the procedures that must be followed if a party wishes to act in a representative capacity. See Workman v. Nagle Construction, 802 P.2d 749, 753 (Utah 1990). Neither Tel-America nor MCI ever purported to comply with these requirements. Rule 23 applies to Commission proceedings. Utah Admin. Code R750-100-1.G.

The conclusion of the Opinion that all U S WEST ratepayers are entitled to the benefit of any remedy was not briefed or argued by the parties and is based upon a misapprehension of both law and fact. U S WEST respectfully requests that the Court grant rehearing to correct this error.


CONCLUSION

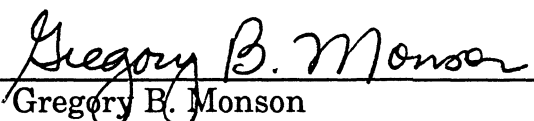
The Opinion effects far-reaching changes in the regulation of public utilities in this state based upon a serious misapprehension of both law and fact. Without the benefit of appeal or briefing of the issues involved in a series of rate reduction orders of the Public Service Commission, the Court concluded that U S WEST achieved excessive earnings as a result of the Commission's failure to respond to the Tax Reform Act of 1986 and fashioned a remedy consistent with that erroneous conclusion. It is respectfully submitted that the Court erred in considering issues not properly before it and in modifying principles of law which have served the state well for many years. U S WEST respectfully requests that

¹² Here, the only parties statutorily authorized to act in a representative capacity are the Committee, the Division, and the Commission. Utah Code Ann. §§ 54-4-1 et seq., 54-4a-1(1)(b) & 54-10-4(3). Although the Committee joined in the Request for Agency Action, it did not file a memorandum or present argument below and it did not join in the appeal of the Commission's order. The Division, which is charged with representing the general public interest, did appear and opposed the Request below and on appeal. The Commission's order was the subject of this appeal, and the Commission appeared in defense of its order.

the Court rehear the case and correct these errors.

Dated this 26th day of May 1992.


Ted D. Smith


Gregory B. Monson
Attorneys for U S WEST
Communications, Inc.

CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, postage prepaid, pursuant to Rule 26, Utah Rules of Appellate Procedure, four true and correct copies of the foregoing Petition for Rehearing of U S WEST Communications, Inc. (formerly The Mountain States Telephone and Telegraph Company) to the following on this 26th day of May, 1992.

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A handwritten signature in cursive script, appearing to read "David L. Stott", is written over a horizontal line.

APPENDICES

- A. Opinion of May 12, 1992
- B. Order of December 10, 1987. Docket No. 87-049-T35

APPENDIX A
OPINION OF MAY 12, 1992

This opinion is subject to revision before
publication in the Pacific Reporter.

IN THE SUPREME COURT OF THE STATE OF UTAH

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MCI Telecommunications Corp., No. 890251
 Petitioner,

v.

Public Service Commission of
Utah; Brian T. Stewart,
Chairman, James M. Byrne,
Commissioner,
 Respondents.

Tel-America of Salt Lake City, No. 890252
Inc., F I L E D
 Petitioner, May 12, 1992

v.

Public Service Commission of
Utah; Brent H. Cameron,
Commissioner; James M. Byrne,
Commissioner; Brian T. Stewart,
Chairman,

 Respondents.

Geoffrey J. Butler, Clerk

Original Proceeding in this Court

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 of Public Utilities

STEWART, Justice:

In 1985, the Public Service Commission (Commission) granted Mountain States Telephone and Telegraph Co., now U.S. West Corp. (U.S. West),¹ a \$22 million general rate increase and established 14.2% as its authorized rate of return on equity. In granting the increase, the Commission assumed that U.S. West would pay a federal corporate income tax of 46%, the then-existing rate.

On October 22, 1986, Congress enacted the Tax Reform Act of 1986 (Act), which provided a two-step reduction in the federal corporate income tax rate, from 46% to 40% effective June 1987, and then to 34% effective January 1988. This amounted to a total reduction of approximately 26%.

In December 1986, the Commission requested that the major utilities in the state provide it with information showing the anticipated effect of the reduced income tax rates on their earnings. The president of U.S. West responded that although the initial impact on cash flow would be negative, "the tax law is a critical factor in averting rate requests." He further stated, "Considering all of the data, I feel very good about the possibility of rate stability for our customers over the next few years. The benefits of the 1986 Tax Reform Act will go to ratepayers since they work to offset intrastate increases in our continuously changing industry." In January 1987, the Commission requested that the Utah Division of Public Utilities (Division) review the responses of the companies. The Division recommended that the Commission not order U.S. West to reduce its rates. The Commission then directed the Division to undertake a formal investigation of U.S. West's rate of return.

The Committee of Consumer Services (Committee) was created by the Legislature to serve as "advocate . . . of positions most advantageous to a majority of residential consumers." Utah Code Ann. § 54-10-4(3) (1990). On June 1, 1987, the Committee filed a motion with the Commission asking it to declare the rates of all public utilities subject to the Commission's jurisdiction interim rates or, alternatively, to require them to establish refund reserve accounts from which excess earnings could be refunded to ratepayers. The Commission denied the motion on June 30, 1987, referring in part to the Division's report that U.S. West's rate of return for 1986 and 1987 would be less than 13% and 12% respectively, less than its authorized rate of 14.2%. The Division represented that the net effect of the Act on U.S. West's earnings would be an increase of \$1.2 million in 1987 and \$0.5

1. Mountain Bell became U.S. West Corp. in 1988. We will use the name "U.S. West" throughout this opinion for ease of reference.

million in 1988. The Division also reported that it was monitoring U.S. West's earnings on a monthly basis and would alert the Commission to any significant changes.

By August 1987, utility regulators in forty-three states and the District of Columbia had taken some action to reduce utility rates in response to the Act.

On August 11, 1987, the Committee requested that U.S. West disclose its earnings. U.S. West objected on the ground that the Division was already monitoring its earnings. The Committee then moved to compel U.S. West to respond to the request for data. The Commission ruled in November 1987 that the motion to compel would be held in abeyance pending completion of the Division's investigation, but that in the meantime the Division should give the Committee the financial information it had obtained from U.S. West.

On September 1, 1987, the Division filed a second report with the Commission indicating that U.S. West's rate of return remained below its 14.2% authorized rate of return. Again, the Division recommended that the Commission take no action.

The Division's conclusions appear to have been seriously in error. U.S. West's actual rate return had exceeded its authorized rate of return in six of the first eight months of 1987, even though the first phase of the federal tax reduction was not effective until June 1987. Data furnished by U.S. West to MCI Telecommunications Corporation in September 1988 in response to interrogatories provided the following monthly breakdown for U.S. West's return on equity for its Utah intrastate operations:

<u>Month</u>	<u>1987</u>	<u>1988</u>
January	12.02%	17.23%
February	15.14%	15.62%
March	3.52%	22.04%
April	15.00%	16.23%
May	16.62%	12.29%
June	17.86%	16.02%
July	16.24%	
August	25.31%	
September	20.76%	
October	17.24%	
November	19.89%	
December	24.48%	

As is evident from these figures, U.S. West's rate of return increased dramatically after the first phase of the tax reduction became effective. For the last six months of 1987, U.S. West's average monthly rate of return on equity was over 20%.

In December 1987, the Division and U.S. West privately negotiated a \$9 million reduction in future rates to be effective January 1, 1988. The Commission approved the stipulation without a hearing or findings of fact to justify the amount of reduction and without disclosing what U.S. West's earnings had been in 1987, what they would likely be in 1988, or by how much they exceeded the authorized rate of return.

Subsequent events disclosed that the \$9 million reduction was inadequate to reduce U.S. West's earnings to its authorized rate of return. U.S. West's high rate of earnings continued for the first six months of 1988. During that period, its average monthly earnings were in excess of a 16% rate of return, even with the January 1987 rate reduction. Thus, U.S. West's earnings significantly exceeded its authorized rate of return for each of the twelve months following the effective date of the first phase of the tax reductions under the Act.

On January 28, 1988, the Committee requested that U.S. West produce the financial data on which the \$9 million rate reduction was negotiated. This request was made after the second phase of the tax reduction became effective. U.S. West responded that it considered the investigation closed and refused to disclose the data. The Committee then hired an independent consulting firm to review both the settlement and U.S. West's earnings. In May 1988, the firm issued a report asserting that the \$9 million stipulated rate reduction was "clearly inadequate."

In July 1988, the Commission initiated a general rate case, docket No. 88-049-07, to investigate the reasonableness of U.S. West's rates and earnings. Again the Commission denied the Committee's request to declare U.S. West's rates interim rates. Instead, the Commission ruled that if U.S. West's earnings were in excess of its authorized rate of return, they would be subject to a rebuttable presumption that they were unjust and unreasonable and subject to refund. In August 1988, the Division, the Committee, and U.S. West stipulated to a further rate reduction of \$31 million, a \$20 million reduction to be effective September 1, 1988, and an \$11 million reduction to be effective January 1, 1989.

On September 22, 1988, the Commission, with no findings of fact, rejected the stipulated reduction and ordered an interim rate reduction of only \$27 million, \$16 million of which would be effective August 1, 1988, and \$11 million of which would be effective January 1, 1989.

Then, in October 1988, the Commission, at U.S. West's request, vacated its September 22 order reducing rates by \$27 million--again with no findings of fact--and instead approved a stipulation for a permanent reduction of

\$26 million, \$16 million to be effective September 22, 1988, and \$10 million to be effective January 1, 1989. The Commission, also at U.S. West's request, vacated its August 2 order declaring that earnings in excess of U.S. West's authorized rate of return were presumptively unjust and unreasonable and subject to refund. In addition, the parties agreed that there would be no further demands for interim rate decreases pending the conclusion of the general rate case, and the Commission approved the agreement, again without findings.

Finally, one year later, in October 1989, after formal hearings and extensive findings of fact and conclusions of law, the Commission entered still another rate reduction order of almost \$22 million to be effective November 15, 1989.

Thus, over a period of approximately two years, the Commission entered three orders reducing U.S. West's rates in a four-step process by a total of \$57 million. The reductions were apparently due, at least in part, to the fact that the Tax Reform Act had decreased U.S. West's federal tax liability, thereby increasing its earnings to a level significantly in excess of its authorized rate of return.

While the Commission was considering the stipulation on which the October 1988 rate reduction was based, David Irvine, a U.S. West ratepayer and former PSC Commissioner, filed a request for agency action, asking the Commission to (1) investigate U.S. West's rate of return for the years 1987 and 1988, and (2) order U.S. West to refund to the ratepayers all earnings exceeding the 14.2% authorized rate of return. The Commission subsequently granted MCI Telecommunications Corp. (MCI), Tel-America of Salt Lake City, Inc. (Tel-America), and other interested parties, including a number of members of the Utah Legislature, leave to join in the request.

The Commission severed the request for agency action from the general rate case and assigned the request for agency action docket No. 88-049-18. The Commission denied the relief sought by the request. Although the Commission found that U.S. West's earnings had exceeded its authorized rate of return for the period in question, it did not state by how much. It did state, however, that the Tax Reform Act was a cause of the overearnings. The Commission ruled that it had no authority to order a refund because a refund would constitute retroactive rate making in violation of Utah Code Ann. § 54-4-4(1) and Utah Department of Business Regulation v. Public Service Commission, 720 P.2d 420 (Utah 1986).

I. STANDARD OF REVIEW

The Utah Administrative Procedures Act (UAPA), Utah Code Ann. §§ 63-46b-1 to -22 (1989), establishes the appropriate standards of review. UAPA applies to all agency

adjudicative proceedings commenced on or after January 1, 1988. Id. § 63-46b-22(1).

The primary issues to be resolved are whether the Commission erred in (1) ruling that there is no applicable exception to the rule against retroactive rate making for unforeseeable and extraordinary events, and (2) ruling that there was no basis for a factual inquiry into whether U.S. West engaged in misconduct by presenting misleading information on actual and projected earnings or by improperly avoiding disclosure of its earnings. Both issues are questions of law, subject to de novo review. Utah Code Ann. § 63-46b-16(4)(d); Mountain States Tel. & Tel. Co. v. Public Service Comm'n, 754 P.2d 928, 930 (Utah 1988).

II. EXCEPTIONS TO THE PROHIBITION AGAINST RETROACTIVE RATE MAKING

As a general proposition, a utility's recoupment of costs that were greater than projected or revenues that were less than projected from future rates constitutes retroactive rate making. The leading case in this jurisdiction prohibiting retroactive rate making is Utah Department of Business Regulation v. Public Service Commission, 720 P.2d 420 (Utah 1986) [hereinafter EBA]. Utah Power & Light Co. had established an energy balancing account (eba account), an accounting device created to facilitate interim rate increases to compensate for rapidly escalating fuel costs. Utah Power transferred greater than expected revenues that had accrued in the eba account to general revenues. The purpose of the transfer was to benefit the stockholders. If left in the eba account, the increased revenues would have benefited the ratepayers. Utah Power argued that the transfer was an accounting adjustment, not retroactive rate making, that the ratepayers would reap a windfall if the unexpected revenues remained in the eba account, and that, even with the transfer, Utah Power's shareholders would receive a lower return on equity (13.25%) than the authorized rate (16.3%).

The Court held that Utah Power could not transfer the unanticipated increased revenues out of the eba account to benefit the stockholders. The Court stated that in a general rate proceeding utility rates are fixed on the basis of projected costs and revenues for a future "test" year. Although the Legislature had specifically authorized interim rate increases to adjust for rapidly increasing fuel costs in a bob-tailed rate proceeding, the Court held that the utility could not recoup lost earnings caused by costs greater than projected or by revenues less than projected in the prior rate case. The Court reasoned that "neither the pass-through legislation nor the Commission's general grant of regulatory authority permits a utility to have retroactive revenue adjustments in order to guarantee shareholders the rate of return initially anticipated." EBA, 720 P.2d at 423.

The Court explained that the prohibition against retroactive rate making is designed to provide utilities with an incentive to operate efficiently. For that reason, utilities are not allowed to recoup unanticipated costs or unrealized revenues.

This process places both the utility and the consumers at risk that the rate-making procedures have not accurately predicted costs and revenues. If the utility underestimates its costs or overestimates revenues, the utility makes less money. By the same token, if a utility's revenues exceed expectations or if costs are below predictions, the utility keeps the excess. Overestimates and underestimates are then taken into account at the next general rate proceeding in an attempt to arrive at a just and reasonable future rate.

EBA, 720 P.2d at 420-21 (citations omitted). Therefore, "[t]he bar on retroactive rate making makes no exception for missteps in the rate-making process," even though the projections of expenses and revenues for the test year will necessarily vary from actual experience. Id. at 424.

A. Exception For Extraordinary and Unforeseeable Expenses or Revenues

MCI and Tel-America acknowledge the general rule against retroactive rate making, but argue that the instant case falls within an exception that applies when an unforeseeable event results in an extraordinary increase or decrease in expenses or revenues.

A number of courts have recognized the exception for unforeseeable and extraordinary increases in a utility's expenses. Increased expenses from natural disasters, such as extreme weather conditions, and other extraordinary events are the typical bases for the exception. See, e.g., Office of Consumer Advocate v. Iowa State Commerce Comm'n, 428 N.W.2d 302, 306-07 (Iowa 1988) (one-time assessment for permanent storage of nuclear waste under Nuclear Waste Act of 1982 was extraordinary, unforeseeable expense); Narragansett Elec. Co. v. Burke, 415 A.2d 177, 178-80 (R.I. 1980) (extraordinary ice storm); In re Green Mountain Power Corp., 519 A.2d 595, 597-99 (Vt. 1986) (unscheduled shutdown of nuclear plant extraordinary expense); Wisconsin's Environmental Decade, Inc. v. Public Serv. Comm'n, 298 N.W.2d 205, 212 (Wis. Ct. App. 1980) (severe ice storm); Re Kansas City Power & Light Co., 75 Pub. Util. Rep. 4th (PUR) 1, 38-41 (Mo. Pub. Serv. Comm. 1986) (severe ice storm); Re Kansas City Power & Light Co., 55 Pub. Util. Rep.

4th (PUR) 468, 480-81 (Mo. Pub. Serv. Comm. 1983) (power outage caused by interruption of water supply to boiler). In Green Mountain Power, the Vermont Supreme Court explained the rationale for the exception:

"If this treatment is not to be permitted, not only would there be a serious question as to whether the Company has been afforded a fair opportunity to earn a reasonable rate of return, it would also imply the need for an upward revision of the rate of return in all cases in the future. Such a revision, of course, would have to be based on a prediction of inherently unpredictable events--the occurrence of extraordinary plant shut-downs."

The Board's conclusion was correct. Once it is clear that a particular cost is "extraordinary" and that it does not result from company mismanagement, or imperfect forecasts, treatment of such costs through appropriate amortization in future rate determinations does not constitute a "true-up" of past calculations, because a truly extraordinary cost by definition would not be factored into the original rate.

Green Mountain Power, 519 A.2d at 597 (citations omitted) (emphasis in original) (quoting Order of Vermont Public Service Board); accord Burke, 415 A.2d at 178-79.

The exception has been applied not only to unforeseeable and extraordinary increases in expenses, but also to unforeseeable and extraordinary decreases in expenses. See, e.g., Re Narragansett Elec. Co., 57 Pub. Util. Rep. 4th (PUR) 549, 558 (R.I. Pub. Utils. Comm. 1984) (excess earnings due to "unanticipated economic recovery and unforeseeable weather"); see also Chesapeake and Potomac Tel. Co. v. Public Serv. Comm'n, 514 A.2d 1159, 1170 (D.C. 1986) (reimbursement of license contract payments previously paid to AT&T); Turpen v. Oklahoma Corp. Comm'n, 769 P.2d 1309, 1332 (Okla. 1988) (AT&T's reimbursement to subject utility was unexpected windfall).

The extraordinary and unforeseeable nature of the expenses recognized under the exception differentiates them from expenses inaccurately estimated because of a misstep in the rate-making process, such as the inability to predict precisely, or from mismanagement. An increase or decrease in expenses that is unforeseeable at the time of a rate-making proceeding cannot, by hypothesis, be taken into account in

fixing just and reasonable rates. Furthermore, because the increase or decrease must have an extraordinary effect on the utility's earnings, the increase or decrease will necessarily be outside the normal range of variance that occurs in projecting future expenses.

If a rate-making body were to attempt to make allowance for an unforeseeable and extraordinary increase or decrease in expenses in fixing rates, a task that by definition is impossible, the resulting rates would always be unjust and unreasonable, if not confiscatory or exploitive, as to either ratepayers or stockholders. To achieve fairness, the exception allows recoupment of such expenses either in future rates or in some other appropriate fashion.

The rule stated in the EBA case is a sound rate-making principle, but it only applies to "missteps in the rate-making process." It does not apply where justice and equity require that adjustments be made for unforeseen windfalls or disasters not caused by the utility. We emphasize that the exception for unforeseeable and extraordinary events cannot be invoked simply because a utility experiences expenses that are greater or revenues that are less than those projected in the general rate proceeding.

In the instant case, the Commission held that the rule against retroactive rate making barred any relief sought by the request for agency action and that no exception to the rule was applicable. The Commission did not specifically state, however, whether there was an exception for unforeseeable and extraordinary expenses. We now hold that the exception for unforeseeable and extraordinary increases or decreases in expenses is recognized in this state.

We also hold that the Commission's refusal to allow petitioners a factual hearing on whether the exception applies was error. The extent of the reduction of corporate income tax rates under the Act was clearly unforeseeable when the last general rate case was decided in 1985. Ordinarily, changes in tax laws are not a sufficient basis for invoking the exception to the general rule. Here, however, the federal corporate income tax rate was cut by more than one-fourth. As the United States Court of Appeals for the District of Columbia Circuit commented in connection with the Act, "The change in [Carolina Power & Light Company's] tax costs at issue here was caused by an act of Congress (one only marginally more foreseeable than an act of God)." Carolina Power & Light Co. v. FERC, 860 F.2d 1097, 1102 (D.C. Cir. 1988).

U.S. West, the Division, and the Commission argue that the Act was foreseeable and that "the Commission and the Division foresaw the potential impact of the [Act] and acted responsibly in attempting to deal with it." The Commission,

however, did not foresee the Tax Reform Act in the general rate case in 1985. In fact, that case assumed a federal tax rate of 46%.

Moreover, it appears that the Commission seriously misappraised the effect of the Act after it was enacted, as evidenced by the gross inadequacy of the 1987 rate reduction. There is even doubt that the Commission accurately foresaw the effect of the Act in 1988 when it agreed to a \$26 million rate reduction, and only a few months later, to another \$20 million reduction. Even if we agreed with the Commission that it foresaw the effect of the tax reduction and took action to remedy it in 1987, it is clear that the Commission did not understand the full effect of the Act with sufficient clarity to remedy U.S. West's overearnings. Whether that failure was a result of U.S. West's failure to disclose relevant financial data and projections promptly should be explored on remand.

Not only did the Commission fail to foresee the effect of the Act, but there is significant evidence, at least on this record, that the Act provided an extraordinary decrease in U.S. West's expenses and a corresponding extraordinary increase in earnings.

Furthermore, whether the Commission and the Division acted responsibly in attempting to deal with the effects of the Act, as the Commission asserted, is problematic. The Commission's procedural handling of U.S. West's excessive earnings in the 1987 and 1988 rate reductions was irregular, if not illegal. The only explanation given by the Commission for the 1987 and 1988 rate reductions is found in its order denying the amended request for agency action, where the Commission stated that U.S. West "earn[ed] in excess of its authorized rate of return in calendar years 1989 and 1988," and the only explanation the Commission has given for the overearnings is, "One of the reasons for the over-earning was the impact upon U.S. West of the Tax Reform Act of 1986." These explanations are clearly inadequate. The Commission has never indicated what U.S. West's actual earnings and rate of return were for the years in question, by how much its actual rate of return exceeded the authorized rate of return, what rate of return the 1987 and 1988 rate reductions were intended to produce, why the reductions were stretched out over three steps, whether the reductions were intended to reduce U.S. West's earnings to the level authorized in the December 1985 general rate case or to some other level, or whether the Commission allowed U.S. West to offset the decrease in taxes by increases in other expense items not associated with the Act.

The Commission sought to explain its delayed response to U.S. West's overearnings by stating that the Division initially indicated that its analysis of U.S. West's financial data would reveal off-sets to the income tax reduction and it

suggested no need for Commission action. The Commission stated, "[T]he Division made a good faith effort to accurately and correctly analyze the information provided to it by the utility." That finding begs the question whether U.S. West promptly disclosed sufficiently specific and accurate financial information, a question the Commission has not addressed.

Moreover, the fixing of utility rates by private negotiation with no findings of fact raises serious questions about the legality and integrity of the procedures the Commission employed. The Commission serves a crucial role in protecting ratepayers from overreaching by entities with monopoly power that provide essential services. We have on many occasions emphasized that the Commission must make appropriate findings of fact to justify rate orders. In Utah Department of Business Regulation v. Public Service Commission, 614 P.2d 1242, 1245 (Utah 1980), we stated that the first prerequisite of a rate order is that it be preceded by a hearing and findings. We explained:

A state regulatory commission, whose powers have been invoked to fix a reasonable rate, is entitled to know and before it can act advisedly must be informed of all relevant facts. Otherwise, the hands of the regulatory body could be tied in such fashion it could not effectively determine whether a proposed rate was justified.

Id. at 1246. Although Department of Business Regulation dealt with an effort to increase rates, the same principle applies here, where the Commission acted to decrease rates. In that case, we emphasized the importance of adherence to proper procedures and specifically condemned procedures of the type employed here:

In summary, there is no provision in the Public Utilities Act which precludes the authority of the P.S.C. to conduct an abbreviated proceeding to adjust a utility rate or charge, but any rate so adjusted must be predicated upon a finding that such adjusted rate is just and reasonable. In turn, this finding must be supported by substantial evidence concerning every significant element in the rate making components (expense or investment) which is claimed by the applicant as the basis to justify a rate adjustment.

Id. at 1249-50.

Similarly, In Milne Truck Lines, Inc. v. Public Service Commission, 720 P.2d 1373, 1378 (Utah 1986), we stated that the Commission cannot discharge its statutory responsibilities without making findings on both ultimate and subordinate issues of fact. Once again, we emphasized that the Commission's regulation of public monopolies must strictly adhere to those procedures designed to give appropriate protection to the interests of ratepayers, investors, the utilities themselves, and where they exist, competitors. Id. Moreover, unless the Commission complies with those procedures, this Court cannot perform its assigned task of judicial review. Id.; Mountain States Legal Found. v. Utah Public Serv. Comm'n, 636 P.2d 1047, 1058 (Utah 1981).

Here, the Commission issued two orders that reduced U.S. West's rates by a total of \$35 million with no findings of fact on either subordinate or ultimate factual issues pertaining to the reasonableness of the reduction or to the reasonableness of the rates that went into effect after the reduction. Given the sequence of the Commission's orders and rate reductions, it seems highly likely that the first two reductions were not sufficient to offset the effect of the reduced income tax rate. In any event, it appears that by reducing the rates in a three-step manner the Commission allowed U.S. West to collect excessive rates and earnings, at least until all the reductions finally went into effect.

On remand, the Commission should make factual findings on all relevant issues. Its findings must, at a minimum, include (1) U.S. West's earnings and rate of return for the years 1986, 1987, 1988, and 1989 and the earnings and profits that would have been realized but for the stipulated rate reductions in 1987 and 1988; (2) the extent to which U.S. West's earnings exceeded the authorized rate of return in 1987, 1988, and 1989, both with and without the stipulated rate reductions; (3) the amount of the decrease in U.S. West's federal corporate income tax liabilities for the years 1987, 1988, and 1989 as a result of the decrease in the federal tax rates compared with what U.S. West's tax liabilities would have been under the federal corporate income tax rates in effect in December 1985; (4) the amount, if any, of increased expenses or decreased revenues that were offset against U.S. West's tax savings in negotiating the 1987 and 1988 rate reductions and whether they should have been allowed under the EBA case to "true up" past projections; and (5) whether U.S. West was cooperative, accurate, and forthright in the information provided and representations made to the Committee, the Division, and the Commission, including its initial representation by the president of U.S. West as to the expected effect of the Act.

B. Utility Misconduct as an Exception to
the Rule Against Retroactive Rate Making

Petitioners also argue that the rule against retroactive rate making does not bar a refund of earnings obtained as a result of utility misconduct and that the Commission acted arbitrarily and capriciously in not holding a hearing on whether U.S. West was guilty of misconduct in not providing timely, accurate, and specific information as to its actual or projected earnings for 1987 and 1988.

Before addressing the substantive issues, we address a procedural question. The Commission, the Division, and U.S. West argue that petitioners failed to raise in their petitions for rehearing the issue whether the Commission erred in failing to hold a factual hearing on the allegation that U.S. West engaged in misconduct. Under Utah Code Ann. § 54-7-15(2)(a) and (b), an issue must be presented to the Commission in a petition for rehearing to be raised on appeal.² See Hi-Country Homeowners Ass'n v. Public Serv. Comm'n, 779 P.2d 682, 683-84 (Utah 1989); Williams v. Public Serv. Comm'n, 754 P.2d 41, 46 (Utah 1988); Utah Dep't of Business Regulation v. Public Serv. Comm'n, 602 P.2d 696, 699 (Utah 1979).

In response to the petition for agency action, the Commission issued an order on November 1, 1988, which stated, "It is contemplated by the Commission that the parties will address in their legal memoranda the threshold issue of whether the Commission has the legal authority to grant the relief requested" Petitioners' memoranda accordingly focused on the legal issue whether the Commission had authority to grant any relief in light of the EBA case and not on the facts that might support any particular theory justifying relief. Neither side argued factual issues in that context. The Commission ruled, as a matter of law, that the rule against

2. Section 54-7-15 states in part:

- (1) Before seeking judicial review of the commission's action, any party . . . who is dissatisfied with an order of the commission shall meet the requirements of this section.
- (2) (a) After any order or decision has been made by the commission, any party to the action or proceeding . . . may apply for rehearing of any matters determined in the action or proceeding.
(b) No applicant may urge or rely on any ground not set forth in the application in an appeal to any court.

retroactive rate making governed and that there was no applicable exception to that rule. The Commission stated, "We would agree that certain exceptions to the rule are reasonable; for example, where it could be demonstrated that the utility had misrepresented important ratemaking information or otherwise misled regulators." The Commission concluded, however, that there was no factual basis for that exception, although the Commission had held no factual hearing on the issue and the parties were not allowed to focus specifically on the factual basis for the exception.

MCI's and Tel-America's petitions for rehearing stated that they were filed for and on behalf of all petitioners and all customers of U.S. West. They both asserted, inter alia, that the Commission erred in ruling that the rule against retroactive rate making barred any relief and that the Commission's order denying relief was arbitrary and, capricious. We conclude that petitioners adequately raised the issue of utility misconduct and that the issue is properly before this Court.

A utility that misleads or fails to disclose information pertinent to whether a rate-making proceeding should be initiated or to the proper resolution of such a proceeding cannot invoke the rule against retroactive rate making to avoid refunding rates improperly collected. The rule against retroactive rate making was not intended to permit a utility to subvert the integrity of rate-making proceedings. See Southwest Gas Corp. v. Public Serv. Comm'n, 474 P.2d 379, 383 (Nev. 1970). If a utility misleads the Commission or the Division by withholding relevant rate-making information, the rates fixed by the Commission cannot be based on reasonable projections of the utility's revenues and expenses. The rule against retroactive rate making was designed to ensure the integrity of the rate-making process, not to shelter a utility's improperly obtained revenues.

Moreover, the Commission has the inherent power to reopen a rate order if a utility engages in misconduct. In re Minnesota Pub. Util. Commission's Initiation of Summary Investigation, 417 N.W.2d 274, 280-82 (Minn. Ct. App. 1987); see also State ex rel. Corbin v. Arizona Corp. Comm'n, 693 P.2d 362 (Ariz. Ct. App. 1984).

The Commission stated that the Division's analysis of U.S. West's earnings was "complicated during the time period in question by changes in the U.S. West accounting system, delays in preparation of U.S. West's budget, swings in monthly earning reports, etc." That finding, however, does not address whether U.S. West acted forthrightly and made timely and accurate information available to the Division, the Commission, and the Committee so that each could accurately analyze U.S. West's actual and projected earnings. Significantly, the Commission's

finding does not explain why the rate of return figures finally provided by U.S. West pursuant to MCI's interrogatories evaded disclosure for so long. The Commission's explanation is simply inadequate under the circumstances. In this regard, it is significant that the \$9 million rate reduction negotiated by the Division and U.S. West and approved by the Commission was characterized by an independent consulting firm as "clearly inadequate." That characterization was substantiated, at least to some degree, by the subsequent \$26 million stipulated rate reduction a mere ten months later.

We conclude that given the facts appearing on the record and the allegations made by MCI and Tel-America to the Commission, the Commission's failure to hold a factual hearing on the issue of utility misconduct was arbitrary and capricious. See Utah Code Ann. § 63-46b-16(4)(iv) (1989).

III. REFUNDS AND REPARATIONS

U.S. West argues that petitioners have no remedy in the form of reparations under Utah Code Ann. § 54-7-20 because the availability of reparations is limited by § 54-4-4, which states that rates found to be just and reasonable under that section are to be "thereafter observed and in force."³

Section 54-4-4, however, does not preclude a remedy in this case. If the rates charged by U.S. West fall within an exception to the rule against retroactive rate making in this case, they are not just and reasonable.

Finally, petitioners argue that an authorized rate of return imposes an absolute legal ceiling on a utility's profits and that all profits in excess of that rate are refundable. As a general proposition, we disagree. An authorized rate of return is intended to be an estimate of the return on equity that investors would require before they would invest in the

3. U.S. West relies on American Salt Co. v. W.S. Hatch Co., 748 P.2d 1060 (Utah 1987), for the proposition that the Commission has no authority to grant reparations where a utility has charged rates that have been previously approved by the Commission. American Salt is inapposite. There, we held that the Commission was without authority to grant relief from a previously approved tariff rate because an application for a special commodity rate was not made prior to the hauling in question. Therefore, the Commission's order requiring American Salt to pay the tariff rate was not disturbed. The case stands for the proposition that in the motor common carrier context, the Commission may not grant relief from an approved tariff rate where an application for a special commodity rate is not made prior to the hauling. It does not stand for the general proposition U.S. West urges.

utility. The rate of return is neither a guarantee of nor a limit on profits. A utility should be rewarded for becoming more efficient through its own efforts. If the authorized rate of return were an absolute ceiling on profits, that objective would be subverted.

Nevertheless, if a utility earns profits in excess of its authorized rate of return because of an exception to the rule against retroactive rate making, the authorized rate is the best available measure of a fair return and earnings in excess of that rate are subject to refund. Accordingly, if on remand the Tax Reform Act of 1986 is found to have resulted in an unforeseeable and extraordinary decrease in expenses or if U.S. West is found to have engaged in misconduct, we hold that U.S. West's earnings, to the extent they exceeded its authorized rate of return established in the 1985 general rate case, should be refunded to U.S. West ratepayers. Any refund of excess earnings that might be appropriate, whether by way of reparations, refund, or credit against future rates, must not be solely for the named petitioners; all U.S. West's ratepayers are entitled to the benefit of any remedy the Commission finds to be appropriate.

Reversed and remanded.

WE CONCUR:

Gordon R. Hall, Chief Justice

Richard C. Howe, Associate
Chief Justice

Christine M. Durham, Justice

ZIMMERMAN, Justice: (Concurring)

I join the majority opinion, but write only to make explicit what I consider the underlying concern of the majority.

Today, we inform the Commission that the EBA decision does not preclude a retroactive adjustment of rates where they are either too high or too low as a result of an extraordinary and unforeseeable circumstance. The EBA case still prohibits retroactive rate making to address missteps in the rate-setting process or the normally occurring unexpected events that may lower or raise rates of return over time. Like the majority, I am unsure that even the tax changes' very large impact on the

utility's income warrants invocation of the "extraordinary and unforeseeable" exception to the ban on retroactive rate making. However, the Commission should at least consider the issue.

The profoundly troubling aspect of the matter before us is the inexplicable failure of the Division and the Commission to do their statutorily mandated jobs in the face of overwhelming evidence that the utility had made, and unless the Commission took remedial measures solely within its authority would continue to make, profits far beyond those anticipated at the time of the proceeding which set the current utility rates charged consumers. At almost every turn, the conduct of the Commission and the Division raises serious questions about whether the regulatory authorities--which state law charges with seeing that utility rates provide a fair but not exorbitant rate of return--were shirking the duty imposed upon them by law to check profiteering by the utility. I realize that these are harsh words, but from the record before us, it is difficult to reach any other conclusion.

Today's decision provides the Commission with a tool to deal with truly extraordinary and unforeseeable circumstances that impact the profits of a utility. Our decision also attempts to ensure that the Commission does the public's business in the open and that it explains in detail the rationale for its actions. However, nothing we can do can guarantee a vigorous and effective regulation of monopolistic utilities. That responsibility rests with the Commission.

APPENDIX B
ORDER OF DECEMBER 10, 1987
DOCKET NO. 87-049-T35

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

RECEIVED

In the Matter of the Applica-)
tion of MOUNTAIN STATES TELE-)
PHONE AND TELEGRAPH COMPANY)
for Authority to File Revised)
Tariffs Reducing Annual Re-)
venues by \$9.02 Million on)
less than 30 days Notice)

CASE NO. 87-049-T35

ORDER APPROVING ACCELERATED
EFFECTIVE DATE FOR REVISED
TARIFFS

By The Commission:

On December 7, 1987, Mountain States Telephone and Telegraph Company ("Mountain Bell") filed with the Commission revised tariffs reducing customer rates by \$9.02 million and requested that the Commission accelerate the implementation of such tariffs to December 22, 1987.

Mountain Bell represents that the reduction proposal follows from the informal earnings investigation ordered by this Commission and conducted by the Division of Public Utilities with the cooperation of Mountain Bell. The tariff rate revisions are based upon actual results of operation for 1987. Approximately 78% of the reductions go to residential customers.

It appearing that there is good cause to allow the proposed rate revisions to be implemented prior to the expiration of the 30-day statutory notice period at Section 54-3-3, Utah Code for the benefit of Mountain Bell's customers, the Commission will make the following order:

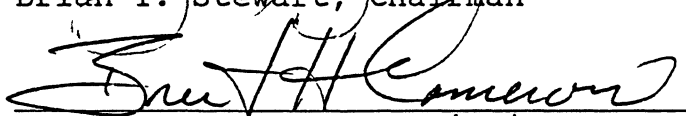
ORDER

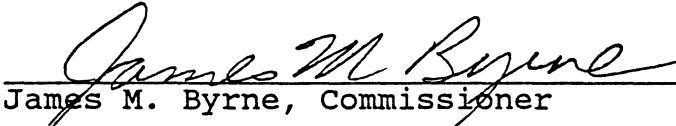
NOW, THEREFORE, IT IS HEREBY ORDERED, That the revised tariffs with the rate reductions detailed therein and filed by Mountain Bell in this matter be and are hereby made effective from

December 22, 1987. Any person desiring to protest such effective date shall file protest with the Commission prior to that date.

DATED in Salt Lake City, Utah this 10th day of December, 1987.


Brian T. Stewart, Chairman


Brent H. Cameron, Commissioner


James M. Byrne, Commissioner

Attest:


Stephen C. Hewlett, Commission Secretary