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Utah Department of Business Regulation, Division of Public Utilities, Committee of Consumer Services v. Public Service Commission of Utah, Brent H. Cameron, Chairman, David R. Irvine, Commissioner, James M. Byrne. Commissioner : Brief of Plaintiff, Division of Public Utilities

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IN THE SUPREME COURT OF UTAH

UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,	:	
Plaintiff,	:	
vs.	:	
PUBLIC SERVICE COMMISSION OF UTAH, BRENT H. CAMERON, Chairman, DAVID R. IRVINE, Commissioner, JAMES M. BYRNE. Commissioner,	:	Case No. 19361
Defendants.	:	Case No. 19362
COMMITTEE OF CONSUMER SERVICES,	:	
Plaintiff,	:	
vs.	:	
PUBLIC SERVICE COMMISSION OF UTAH, BRENT H. CAMERON, Chairman, DAVID R. IRVINE, Commissioner, JAMES M. BYRNE, Commissioner.	:	

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On Petition for Writ of Certiori
to the Utah Public Service Commission

Brief of Plaintiff, Division of Public Utilities

DAVID L. WILKINSON
Attorney General
STEPHEN G. SCHWENDIMAN, Chief
Assistant Attorney General
CRAIG R. RICH
Assistant Attorney General
Tax and Business Reg. Div.
Attorneys for Plaintiff
Dept. of Business Regulation,
Division of Public Utilities

MARK C. MOENCH
Assistant Attorney General
Attorney for Plaintiff
Committee of Consumer Ser.

THOMAS W. FORSGREN
Attorney for Intervenor-
Defendant
Utah Power and Light Co.
P. O. Box 899
Salt Lake City, Utah 84110

IN THE SUPREME COURT OF OF UTAH

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Plaintiff,	:	
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On Petition for Writ of Certiorari
to the Utah Public Service Commission

Brief of Plaintiff, Division of Public Utilities

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NATURE OF THE CASE

Plaintiff appeals from Orders of the Public Service Commission of Utah (PSC or Commission) issued in PSCU Case No. 82-035-14 in which Utah Power & Light Company (Utah Power or Company) was granted in effect a one-time increase in rates of $6,012,000 to be collected from Utah ratepayers during future period to partially make up for revenues received during the test year of PSCU Case No. 81-035-13 ending September, 1982 which were lower than revenues projected by the Company and included in rates.

DISPOSITION BEFORE THE PUBLIC SERVICE COMMISSION

Upon application by Utah Power, a majority of the Public Service Commission, by Order dated December 30, 1982, granted the Company's request to remove $6,012,000 from the Energy Balancing Account (EBA) of the Company, Account No. 191, which absent the Commission's Order, would have been returned to ratepayers in the form of an adjustment to the energy component of Utah Power's rates. The removal of $6,012,000 from the EBA offset Company expenses in 1982 with the result of increasing Company earnings for calendar year 1982 and requiring an increase in future rates to make up for the adjustment. On July 5, 1983,

after rehearing, a majority of the Commission affirmed its original decision. Pursuant to § 54-6-16, Utah Code Annotated 1953, plaintiff appeals directly to this Court.

RELIEF SOUGHT ON APPEAL

Plaintiff seeks a determination by the Court that the Orders of the Public Service Commission issued in Case No. 82-035-14 are void and unlawful as a matter of law and requests the Court to vacate said Orders with directions to the Public Service Commission to return to the balance of the EBA the amount removed by said Orders in order to allow those funds to be returned to ratepayers through the operation of the EBA procedure.

STATEMENT OF THE FACTS

On October 8, 1982, Utah Power filed an application with the Public Service Commission, Case No. 82-035-14, styled "In the Matter of the Application of Utah Power & Light Company to Implement the Company's Energy Balancing Account for the Period September, 1981, through September, 1982." The application requested the transfer of $6,012,000 from the then-existing balance in the Company's EBA to the Company.

Hearings were held on the application December 2, and 3, 1982. At the hearing, two witnesses testified on behalf of Utah Power. Dean L. Bryner testified as to the Company's view of purpose of the EBA pass-through procedure and the circumstances relating to the Company's request for a transfer of dollars from the EBA to the Company. He testified that during the general rate Case No. 81-035-13, which used a test-year period of 12 months ending September, 1982 for the purposes of projecting Utah jurisdictional revenues, expenses and investment as the basis of determining future rates, the Company's actual Utah jurisdictional sales were $40,000,000 less than projected by the Company and included by the Commission in the determination of rates. The reduction in jurisdictional sales created an unanticipated opportunity to make additional shortterm excess energy sales (termed by the Company surplus nontariff sales, which means sales from assets allocated to serve Utah jurisdictional customers that are made to non-jurisdictional customers or unexpected additional sales from surplus to jurisdictional customers) of $18,054,000.

Mr. Bryner argued that the current energy pass-through process, which offsets against energy expenses all nontariff sales revenues, created a "substantial windfall" to ratepayers at the expense of the Company. He argued that one-third of the additional revenue created by the loss of jurisdictional sales should not be credited against energy costs but should be used to

increase Company earnings. Mr. Bryner testified that this $6,012,000 adjustment should not affect Case No. 82-035-13, an application by the Company for a general increase in rates to customers using a test-year period of September, 1982 through September, 1983 (and being considered by the Public Service Commission concurrently with the request in this proceeding) since the revenue shortfall was experienced only in the test year related to Case No. 81-035-13 (Record 5-10). Orrin T. Colby, Jr. reiterated Mr. Bryner's testimony and verified his calculations. In addition, he testified with regard to the Company's financial condition for the 12 months ended August, 1982. He presented figures for earnings per share, dividend payout ratio and return on common equity for those periods on a total Company basis (including business operations in Wyoming, Idaho and wholesale operations regulated by the Federal Energy Regulatory Commission). Mr. Colby estimated Utah jurisdictional return on equity to be about 13.25% stating that it was below the return on equity authorized in Case No. 81-035-13 of 16.3%. He testified that the Company proposal would improve earnings per share and return on common equity for the calendar year 1982. (Record 47-57).

The Division of Public Utilities (Division or Plaintiff) presented testimony through Dr. George Compton, that based on current financial conditions and investors' expectations, the requested infusion of dollars with the result of

improving the Company's financial condition was not necessary. In addition, Dr. Compton objected to the proposal of the Company because 1) it was retroactive in nature and 2) if the Commission wished to reduce risk, borne by shareholders of the Company, that jurisdictional revenues received will be less than and approved by the Commission that the Commission must also look at the other side of the coin; that is, reduce the risk borne by ratepayers that jurisdictional revenues received by the Company will be higher than those approved by the Commission. Dr. Compton suggested the consideration by the Commission of prospective modification of the energy pass-through procedure to consider both issues. (Record 101-126).

At the conclusion of the presentation of evidence, the Division of Public Utilities verbally moved the Commission to dismiss the application. The Division argued that 1) the Company's request was being improperly considered as an energy cost pass-through pursuant to § 54-7-12(3)(d), Utah Code Ann. 1981 Amend.); 2) the request was in contravention of the rule prohibiting retroactive ratemaking; and, 3) because the request was not an energy cost pass-through such a rate increase could not be granted without a determination that rates were just and reasonable based on evidence with regard to basic ratemaking components and that such evidence was not presented. The Commission failed to rule on the Division's Motion.

On December 30, 1982, the Commission issued its Order granting the application of Utah Power. The Commission, in its findings, recited the evidence presented by Utah Power including earnings per share, dividend payout ratio, and return on equity for the 12 months ended August, 1982, found that the Company had been authorized a return in equity by the Public Service Commission in Case No. 81-035-13 of 16.3% and concluded that "the adjustment proposed by the Company was just and reasonable and should be allowed". However, the Commission also concluded that any future adjustments of this kind must be prospective in nature.

The Order was silent as to the evidence presented by the plaintiff that current financial conditions and market expectations did not require the infusion of earnings requested by the Company. The Order was also silent as to the legal arguments raised in the plaintiff's Motion to Dismiss. Commissioner Bryne dissented, objecting to the retroactive nature of the Company's request stating "this Commission should not engage in retroactively assisting the Company when earnings are low or in retroactively punishing the Company when earnings are high". The Order of the Public Service Commission is attached hereto as Appendix 1.

Because the Order was issued in the closing days of 1982, the transfer of dollars was made by Utah Power with the

effect that the Company's financial condition was improved for calendar year 1982.

On January 19, 1983, within the time provided by law, plaintiff filed with the Commission its Petition for a Rehearing and Reconsideration pursuant to the requirements of § 54-7-15, Utah Code Annotated (1981 amendment). The Committee of Consumer Services also filed with the Commission a Motion for Rehearing and Reconsideration. By Order dated April 20, 1983, the Commission granted the Motion for Rehearing of the Division and the Committee. Hearing was held the 24th and 25th days of May, 1983. At the hearing, further testimony as presented by Mr. Bryner, which further explained the Company's views as to the purpose and function of the EBA. Mr. Colby also testified as to the financial effect on the Company should the Commission's Order be reversed on rehearing.

By Order dated July 5, 1983, the Commission reaffirmed its original decision in the proceeding. The majority of the Commission concluded that 1) the adjustment to the EBA approved by the Commission in this proceeding was "consistent" with other adjustments previously and currently made and did not alter the Commission-approved rate, 2) the "adjustment" was within the authority of the Commission, 3) it was consistent with the Commission's intent that the EBA "eliminate inequitable results or windfall benefits to either the Company or its ratepayers"

and, 4) the "adjustment" was not retroactive ratemaking. Commissioner Byrne again dissented. The Order on Rehearing is attached hereto as Appendix 2. Thereafter, on August 3, 1983, plaintiff petitioned this Court for Writ of Certiorari pursuant to the requirements of § 54-7-16, Utah Code Annotated 1953. Concurrent with the filing of the Petition for Certiorari, plaintiff requested of this Court a stay or suspension of the Public Service Commission's decision pending the outcome of this appeal. After oral argument by Plaintiff and intervenor Utah Power, the plaintiff's Motion was denied, by a Minute Entry dated August 15, 1983.

ARGUMENT

INTRODUCTION

In order to understand the nature of this appeal and the effect of the Public Service Commission decision in the proceeding before the Court, an understanding of the Public Utility regulatory process in the state of Utah is essential. Plaintiff intends, therefore, to as simply and briefly as possible describe the means available to the Public Service Commission to adjust utility rates within the authority delegated to the Public Service Commission by the Legislature as set forth in Title 54 Utah Code Ann.

After Munn v. Illinois , 94 U.S. 113, 24 L.Ed. 77 (1877), where the United States Supreme Court upheld an Illinois statute fixing maximum rates for the storage of grain by public warehousemen saying that such regulation was "for the public good", there had been a search for general standards in setting of fair rates for regulated industries. Smyth v. Ames , 169 U.S. 466 18 S.Ct. 418, 42 L.Ed. 819 (1898), was an early attempt to develop such standards. There, the Court held that the basis for all calculations as to reasonableness of rates must be the "fair value" of the property used in serving the public. This was later called the "rate base".

Building on Smyth , Justice Brandeis in his now universally followed concurring opinion in Missouri ex rel Southwestern Bell Telephone Company v. P.S.C. , 262 U.S. 276, 43 S.Ct. 544, 67 L.Ed. 981 (1923), articulated the standard for "just and reasonable" rates:

> To decide whether a proposed rate is confiscatory, the tribunal must determine both what sum would be earned under it, and whether that sum would be a fair return. The decision involves ordinarily the making of four subsidiaries one:
> 1) What the gross earnings from operating a utility under the rate in controversy would be (a prediction).
> 2) What the operating expenses and charges while so operating would be (a prediction).
> 3) The rate base, that is what the amount is on which a return should be earned. (Under Smyth v. Ames an opinion, largely.)
> 4) What rate of return should be deemed fair. (An opinion, largely.)

262 U.S. at 291.

Subsequently, numerous cases have attempted to better define the basic requirements mentioned by Brandeis. See, for example, F.P.C. v. Hope Natural Gas Company , 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944), discussing proper rate base determination and Bluefield Water Works, and Improvement Company v. P.S.C. , 262 U.S. 679, 43 S.Ct. 675 and 67 L.Ed. 476 (1923) discussing "fair rate of return".

Over the years, a well-defined standard for the determination of "just and reasonable" rates has solidified. This standard is applicable in the state of Utah (§ 54-3-1 Utah Code Ann. 1977 Amend.), and the procedure developed to assist in the determination of "just and reasonable" rates is also used in the State of Utah. This procedure was described by this Court in Utah Department of Business Regulation Division of Public Utilities v. Public Service Commission , 614 P.2d 1242 (1980), citing City of Los Angeles v. Public Utilities Commission , 497 P.2d 785, 797 (1972):

> In City of Los Angeles v. Public Utilities Commission , the Court pointed out that the basic approach in ratemaking is to take a test year and determine the revenues, expenses, in investment for the test year period. Test year results are adjusted to allow for reasonably-anticipated changes in revenues, expenses, or other conditions in order that the test period results of operations will be as nearly representative of future conditions as possible. The Commission may adjust all figures, revenue, expense, and investment for anticipated

> changes, but it may not adjust one side or part of the equation without adjusting the other . . .
>
> In determining a just and reasonable rate, the gross revenue should be of a sum to cover two distinct components, the operating expense and the return on invested capital. The return (the profit) is calculated solely on the rate base (the capital contributed by the investors); a utility is not entitled to earn an additional profit on its expenses but only to recover those costs on a dollar-for-dollar basis. In a general rate proceeding, the Commission determines for a test period the expenses, the rate base, and the rate of return to be allowed. Based on those figures, the Commission determines the revenue requirements, then fixes a rate to produce sufficient income to meet the revenue requirements.

This formula is used only to determine rates prospectively in effect. Section 54-4-4(1) Utah Code Ann. (1953) gives the Public Service Commission authority to "determine just, reasonable or sufficient rates, . . . to be thereafter observed and in force".

In implementing this prohibition against retroactive ratemaking, the Commission looks to the future, using a future test year pursuant to § 54-4-4(3) (Utah Code Ann. 1975 Amend.), on the premise that, particularly in inflationary times, the future test period more accurately reflects conditions faced by the Company during the time the rates would be in effect. The Commission ignores occurrences prior to the test year whatever they may have been.

In order to arrive at rates which are just and reasonable using the rate-making procedure described, it is essential that all elements of revenue derived from utility assets, as well as expenses incurred in providing utility service be considered. However, because rates are always set prospectively, there exists the possiblity that actual revenues, expenses and investment may be different than expected. There exists a risk for both ratepayers and the utility. The Company takes the risk that earnings will be less than intended by the Public Service Commission (until an adjustment can be made) and ratepayers take the risk that Company earnings may be better than authorized (until an adjustment can be made). This risk relationship helps promote cost effective and productive operations of utilties since any productivity gains directly affect earnings, and has been generally accepted in utility regulation. (A more complete discussion of this principle follows in Point III herein.)

During the time of the energy crisis of the early '70s, it became apparent that existing regulatory practices were not adequate to deal with volatile, unpredictable expenses such as fuel costs. Because fuel costs are typically a substantial portion of a utility's expense, rapid unforseen increases in such costs had devastating effects on utility earnings. Legislators responded by implementing statutory methods of allowing rapid

adjustments in rates to pass these increased costs along to customers. These methods, often known generically as "fuel adjustment clauses", took many different forms but were typically limited to a dollar-to-dollar pass-through of fuel costs incurred by the utility.

In Utah, H.B. 227 was introduced in the Legislature in 1975, which resulted in an amendment to § 54-7-12(1) Utah Code Ann. (1953). Prior to the amendment, subsection (1) provided:

> No public utility shall raise any rate . . . under any circumstances whatever, except upon a showing before the commission and a finding by the commission that such increase is justified.

After 1975, subsection (1) read:

> No public utility shall raise any rate, fare, toll, rental, or charge or so alter any classification, contract, practice, rule or regulation as to result in an increase in any rate, fare, toll, rental or charge under any circumstances whatsoever except in the case of fuel cost increases to the utility by an independent contractor or other independent source of supply and then only upon a showing before the commission and a finding by the commission that such increase is justified.

Prior to 1975, the only procedure set forth in the statutes for obtaining a rate increase was that in 54-7-12(2), Utah Code Ann. (1953), designed to accommodate a general rate case proceeding. After 1975, with the amendment of § 54-7-12(1), the opportunity existed for a more responsive action by the

Commission related to utility fuel costs from an independent source of supply.

The exception to general rate case treatment was narrowly defined by the Legislature. While the Legislature wished the regulatory process to be flexible enough to be responsive to volatile and unpredictable costs, there was the expression of concern about the misuse of the amendment by utilities attempting to raise company profits and concern that the amendment would result in the reduction of incentives to be efficient and cost-effective in operations. Therefore, the Legislature limited the so-called "pass-through statute" to a pass-through of fuel cost increases from independent sources of supply with a finding by the Commission that the increase is "justified". Tapes of House of Representatives Floor Debate, H.B. 227, Feb. 12, 14, 1975.

The pass-through statute was amended in 1976 and again in 1981 in order to better define expenses which qualified for pass-through treatment and to streamline the pass-through procedure. § 54-7-12(3)(d), Utah Code Ann. (1981 Amend.) now reads:

> If a public utility files a proposed rate increase based on an increase cost to the utility for fuel or energy purchased or obtained from independent contractors, other independent suppliers, or any supplier whose prices are regulated by a governmental agency, the commission shall issue a tentative order with respect to such proposed increase within ten days after the proposal is filed unless it issues a final order with respect to such rate increases in

> 20 days after the proposal was filed. A public hearing shall be held by the commission within 30 days after issuance of such tentative order to determine if the proposed rate increase is just and reasonable.

In a pass-through proceeding only evidence related to energy costs is considered and a Commission finding that a rate increase is just and reasonable only relates to the energy cost component of the rates collected from customers, since only energy costs are considered.

The vehicle developed for the purpose of implementing the Legislature's intent with regard to the pass through of energy related costs for both gas and electric utilities has been the Energy Balancing Account. The Energy Balancing Account (EBA) was instituted by the Commission for Utah Power & Light in Case Nos. 78-035-21 and 79-035-03 in a general rate Order issued July 20, 1979, and the pertinent portions of which are attached hereto as Appendix 3.

In the context of Utah Power not only fuel costs, (coal) were unpredictable but also the cost of purchased energy and non-tariff revenues. It was because these energy related costs and revenues could not be adequately projected in general rate cases that the EBA was instituted. The Commission found:

> The commission notes that Utah Power is in a unique position to acquire and use or sell inexpensive hydropower from the northwest as well as sell at a profit power generated with its own surplus capacity to oil-burning electric utilities in the southwest. Because of fluctuations and the avail-

> bility of hydropower, however, there can be wide variations in the revenue available from the sales of such power and the amount of fuel costs saved when such power is used to offset internal generation.
>
> Because of these wide variations, the appropriate treatment of expense and revenue attributable to purchase power sales for resale and fuel costs is of considerable concern to the commission. During the course of these proceedings, the division presented testimony on appropriate amounts to be allowed for purchase power and sales for resale which differ significantly from figures proposed by the company. Given that these items have not been susceptible to accurate estimation, we conclude that the division's figures are as much a guess as Utah Power's. Therefore, we have declined to adjust the revenue requirement found herein by the amounts proposed by the division as well as those adjustments proposed by Utah Power as they relate to sales for resale and energy costs.
>
> The commission concludes that it would be reasonable and in the public interest for Utah Power to establish an energy-balancing account which is designed to track the actual annual costs and revenues attributable to these items making estimates thereof unnecessary in future cases.

Order page 14, paragraphs 31-33.

The EBA is an account which is intended to keep track of over or under collections in net energy costs. If in previous periods the energy component of rates to customers has been insufficient to cover all net energy costs, there will be a balance in the EBA in favor of Utah Power which indicates that they have not recovered all of their energy costs. Conversely,

if the energy component of the rate actually overcollects net energy costs, there will be a balance in favor of ratepayers which must be returned to ratepayers in the future in the form of a reduced energy cost component of rates.

Utah Power's rates to customers are made up of a non-energy component-items considered in a general rate case, and an energy component-items related to net energy costs. The energy component is adjusted in energy balancing account pass-through proceedings.

In determining the appropriate energy component, the Commission will approve projections as to energy expenses for a future period, which costs include projections as to the cost and amount of coal to be used in Utah Power generating facilities and the cost of purchased power projected to be used by the Company. Offset against these costs are projections of non-tariff revenues. The third element is the current balance in the EBA, whether in favor of ratepayers or in favor of the Company.

An energy component of the rate is calculated which will, during the future period measured, recover for the Company actual net energy-related costs and also bring the EBA balance to zero. For example, if in past periods the Company has over collected in rates for its net energy expenses, there would be a balance in favor of ratepayers in the EBA. For a future period, the Company would calculate the amount necessary to be collected

in rates from customers for future net energy costs and calculate an energy component of rates necessary to recover those costs. That rate is then reduced to offset the EBA balance in ratepayers' favor over time. If the calculated energy component of the rate which would collect energy costs and "zero out" the balancing account is different than the energy component currently included in rates, the Commission, by Order in a pass-through proceeding, will modify the energy component. The result is that over the long term Utah Power will collect only actual energy-related expenses.

In summary, the energy cost pass-through procedure removes from the utility company a very important risk - the undercollection of net energy related expenses. It also removes an opportunity for over-recovery of net energy costs. However, the energy cost pass-through procedure does not insulate the Company from risks of reduced earnings related to misprojections of other components of the ratemaking process.

The pass-through proceeding, which considers the elements of the energy component of rates, may or may not result in a change in the energy component of the rate since even wide fluctuations of the expense or revenue elements may be offset by changes in other elements. However, modifications of the elements which make up the energy component of the rate will ultimately have an impact on the energy component of the rate and on revenue collected from ratepayers.

A second exception to general rate case procedure exists. That exception was described by this Court in Utah Department of Business Regulation, Division of Public Utilities v. P.S.C. 614 P.2d 1242 (1980) as an "offset" proceeding. An offset proceeding is intended to provide prompt rate adjustment for unusual changes in expenses other than energy costs. While the Court intended to allow for abbreviated proceedings related to items of expense outside of energy-related costs, the offset proceeding shares the same limititation as the pass-through energy cost statute, namely that it allows from the pass-through of a particular extraordinary expense, and is not a vehicle for the consideration of "just and reasonable" rates including a fair rate of return. No utility to date has filed an application for a rate increase based on the Court's delineation of a "offset" proceeding for extraordinary expenses other than energy costs.

Plaintiff asserts that the Public Services Commission decision at issue allows Utah Power to further modify the existing risk relationship between the Company and ratepayers, using the energy cost pass-through procedure to shift to the ratepayers risk associated with misprojection of elements of rates other than the energy related expenses and revenues. This action is an unwarranted and unlawful misuse of the energy cost pass-through procedure and has the effect of a future increase in

rates to insure company earnings for past periods, resulting in the Public Service Commission essentially guaranteeing the company a minimum level of earnings, and thereby removing incentives to be cost effective and efficient in utility operation, in violation of existing regulatory policy and law.

POINT I

COMMISSION'S ORDER IN THIS PROCEEDING RESULTED IN A ONE-TIME INCREASE IN RATES TO THE CUSTOMERS OF UTAH POWER OF $6,012,000

Section 54-7-12(1) Utah Code Ann. (1981 Amend.) defines rate increase as "any direct increase in a rate, fare, toll, rental or other charge of a public utility or any modification of a classification, contract, practice, rule or a regulation that increases a rate, fare, toll, rental or other charge of a public utility" . (Emphasis added.) The language of this section, which prefaces the procedures required in the consideration by the Commission of a rate increase, is obviously intended to be all-inclusive. Whether a rate increase occurs as the result of a direct modification of the Company's tariff on file with the Commission, or whether it results in a modification of any practice, rule, regulation, contract or classification which has the effect of increasing rates, the procedural requirements of the applicable portion of § 54-7-12 apply.

The result of the Commission's Order transferring $6,012,000 from the EBA to the Company for the purpose of increasing Company return in 1982 is that the Company has been granted a one-time rate increase of $6,012,000.

Any adjustment to any element of the Energy Balancing Account or other components of the pass-through procedure inevitably results in a modification of rates and revenue collected by the Company. The fact that there is uncertainty as to when the rate increase will occur does not detract from the certainty of the rate increase, itself.

Although the energy component of the rates charged to Utah ratepayers was not modified by the Commission's Order in this case, the rate increase nonetheless was granted. The energy component of the rate remains the same until the energy related expenses and revenues in total require a modification and that modification is adopted by the Commission. The simple effect of the Commission's Order in this proceeding is that by removing from the current balance of the EBA $6,012,000, which would have been returned to ratepayers in the future, rates during the future will be higher in order to allow the Company to retain the $6,012,000. This fact was conceded by Utah Power Witness Bryner:

> Question: The results of the $6,000,000 taken out of the balancing account, you testified previously, will result in the surcharge for energy costs being raised, is that correct? In order to collect in the future an additional $6,010,000?

Answer: Some time in the future that will occur.

Question: Do you know when in the future?

Answer: No, not until there has to be an increase.

Question: But at some point 6,000,000 additional dollars will have to be recovered from ratepayers because of that $6,000,000 adjustment, is that correct?

Answer: It--had it not been removed. yes.

Commissioner Byrne: It may be a reduction foregone rather than an increase required, no?

The Witness: That's correct.

Question: (By Mr. Rich) It is an additional $6,000,000 that must be recovered somehow whether in less of a reduction or increase?

Answer: A dollar is a dollar.

(Record 220-221.)

The $6,012,000 increase granted by the Public Service Commission is currently being collected from Utah ratepayers. In Case No. 83-035-04, by Order issued July 1, 1983 (after the Order issued in this case but prior to the Order on Rehearing issued July 5, 1983), the PSC reduced the energy component of Utah Power rates. This reduction was based on evidence presented that due to large amounts of cheap hydropower available in the Northwest, revenue expections from non-tariff rates and a reduction in cost of coal from company owned mines, that by October 1, 1983 the EBA

would have a balance in ratepayers' favor of $10,371,000. The Commission reduced the energy component of the rate by an amount which was intended to reduce the EBA balance to zero by October 31, 1983. If the Company request at issue in this proceeding had not been granted, the balance in the EBA in favor of ratepayers would have been $6,012,000 higher and the reduction in rates ordered by the Public Service Commission in order to meet the goal of "zeroing out" the EBA by October 31, 1983 would have been larger. The Public Service Commission Order in that proceeding is attached hereto as Appendix 4.

The defendant cannot claim that this Order does not constitute a rate increase. There is only one source for utility revenues; that is utility ratepayers. There is only one way of increasing revenues collected from ratepayers and that is through an increase in rates. The fact that this increase is indirect and the result of a complicated balancing account procedure makes it no less a rate increase wherein the appropriate statutory requirements apply.

POINT II

THE PUBLIC SERVICE COMMISSION IS WITHOUT AUTHORITY TO GRANT A UTILITY A RATE INCREASE WHICH INCREASES COMPANY RETURN THROUGH THE USE OF THE ENERGY COST PASS-THROUGH PROCEDURE

As discussed previously, the Energy Balancing Account is the vehicle used by the Commission to pass through to rate-

payers net energy costs of Utah Power pursuant to the authority delegated to the Commission in § 54-7-12(3)(d), Utah Code Ann. (1981 Amend.). The Commission's Order in this case (characterized by both Utah Power and the Commission as an energy cost pass-through) provides to Utah Power the opportunity, outside of the consideration of the justness and reasonableness of its rates, to be granted a rate increase which increases its earnings. This is entirely inconsistent with the language and intent of § 54-7-12(3)(d), Utah Code Ann. (1981 Amend.). As discussed previously, the Legislature in originally fashioning the opportunity for pass-through treatment for energy costs, was concerned about misuse by utilities of such pass-throughs with the effect of increasing Company earnings or reducing the incentive to provide cost-effective service. The Legislature designed limitations (as discussed at pages 13, 14, supra), as a means of preventing or minimizing these concerns.

The Legislature's concerns in 1975 appear to be well-founded. This Court has already had occasion to strike down an attempt by Mountain Fuel Supply Company to expand the pass-through provision to include pass-through of non-energy related expenses, i.e., wage increases. The Department of Business Regulation, Division of Public Utilities v. P.S.C. , 614 P.2d 1242 (Ut. 1980). Utah Power and Light's attempt to broaden the pass-through statute is much more far-reaching.

Utah Power has not attempted to pass through non-energy expenses to ratepayers. The Company's request is not a "pass-through" at all. The Company seeks no less than to increase future rates to make up for past "under-collections". The only tool available to that purpose is the energy cost pass-through statute, since in a general rate proceeding (such as Case No. 82-0500-13 where, based on test year ending September 1983, the Public Service Commission granted Utah Power a rate increase on an interim basis of $49,000,000 November 8, 1982) the Public Service Commission must ignore past occurrences. The Company, therefore, attempted to re-shape the energy cost pass-through procedure to accomplish this end.

The unambiguous language of § 54-7-12(3)(d), Utah Code Ann. (1981 Amend.), cited supra, together with the intent of the Legislture as described in the House of Representatives' floor debate and the determination of the Court in Department of Business Regulation v. Public Service Commission, compel the conclusion that the decision of the Public Service Commission in this proceeding is an unlawful misuse of the pass-through statute.

POINT III

THE COMMISSION ACTION IN THIS PROCEEDING VIOLATES THE RULE AGAINST RETROACTIVE RATEMAKING

The State of Utah has adopted by statute the rule

prohibiting retroactive ratemaking. Section 54-4-4(1) Utah Code Ann. (1981 Supp.) states in part:

> . . . the Commission shall determine the just, reasonable or sufficient rates, fares, tolls, rentals, charges, classifications, rules, regulations, practices or contracts to be thereafter observed and in force and shall fix the same by order as hereinafter provided. (Emphasis added.)!

This rule against retroactive ratemaking is based on one of the primary purposes of public utility regulation, i.e., encouraging, in the absence of competition, efficient and cost-effective operations resulting in reasonable utility rates. As stated by the Supreme Court of Rhode Island in Narragansett Electric Company v. Burke , 415 A.2d 177 (1980):

> The rule against retroactive ratemaking serves two basic functions. Initially, it protects the public by assuring that present customers will not be required to pay for past deficits for the company in their future payments. The Supreme Court of New Jersey has expressed this legitimate concern as follows:
>
> The present practice as set forth in these cases is fair to the public utility for it can act as speedily as it sees fit to move in the direction of inadequate rates and it is fair to the consumer in safeguarding him from surprise surcharges dating back over years that he had a right to assume were finished business for him and possibly over years when he was not even a consumer. New Jersey Power and Light Company v. State Department of Public Utilities, Board of Public Commissioners , 15 N.J. 82, 93, 104, A. 2d 1,7 (1954). See Western Oklahoma Gas and Fuel Company v. State , 113 Ok. 126, 239 P.588 (1925).

> The rule also prevents the company from employing future rates as a means of assuring the investments of its stockholders. Georgia Railway and Power Company v. Railroad Commission of Georgia , 278 F.242 (D.C. Geo. 1922). If the utility's income were guaranteed, the company would lose all incentive to operate in an efficient cost-effective manner, thereby leading to higher operating costs and eventual rate increases.

415. A.2d at 178, 179.

The general policy reasons for the rule against retroactive ratemaking were further elaborated by Justice Clark in his dissent from Southern California Edison Company v. Public Utilities Commission , 576 P.2d 945 (Cal. 1978):

> The rule against retroactive ratemaking places upon the utility the risk that in fixing the rate the commission erred in estimating expenses and revenues. If the estimated revenues were too high or the estimated costs too low, the utility will bear the loss and fail to recover the projected rate of return. On the other hand, if estimated revenues are lower than those that actually occurred or the estimated costs higher than actual costs, the utility will benefit. Because so many circumstances exist significantly effecting the expense and revenue, it is to be anticipated that estimated costs and revenues were rarely if ever equal actual ones and the utility will realize more or less than the predicted rate of return.
>
> Tne rule against retroactive ratemaking serves to encourage efficiency because the utility will strive to hold down costs so as to increase profits under the established rate. Permitting retroactive ratemaking would shift the risk of error in estimating costs and revenues from the utility to the consumer reducing the utility's incentive for efficiency.

576 P.2d at 958.

The Courts have routinely enforced the rule against retroactive ratemaking for the protection of utilities [see for example, Arizona Grocery Company v. Atchison, Topeka and Santa Fe Railway Company , 284 U.S. 370 (U.S. S.Ct. 1931)], as well as for utility ratepayers.

However, the rule against retroactive ratemaking has typically not been applied to fuel adjustment clauses. As discussed previously, the purpose of fuel adjustment clauses is to remove energy related costs from the typical ratemaking proceeding and fashion a more responsive and more accurate method of allowing the utility to recover such expenses. Often, such methods result in over or under-collection of energy related costs.

Courts have been unwilling to utilize the rule against retroactive ratemaking to allow utilities to be enriched when a fuel adjustment clause resulted in over-collections of energy related costs. For example, in Public Service Commission of Maryland v. Delmarva Power and Light Company of Maryland , 400 A.2d 1147 (Special Court of Appeals 1979), the Company's fuel rate adjustment clause had allowed the Company to collect in rates more than the cost of fuel. The Commission ordered a refund and the Company objected claiming, in part, that a refund would constitute retroactive ratemaking. The Court stated:

> All the parties to this case agree that retroactive ratemaking is impermissible but we think the controversy in this case is to be distinguished from the Commission's function in approving rates to be charged in a base rate hearing proceeding.
>
> As we have indicated. the theory of permitting the filing of FRA [fuel rate adjustment] clauses with the Public Service Commission is to permit a more rapid recognition and recovery of fluctuating fuel costs without the requirement of lengthy and complex hearings. As these FRA clauses contemplate complex formulas which must be tested against mathematical calculations from designated figures each month, we conclude that implicitly, the Commission must retain jurisdiction over such charges in order to assure that the charges made are fair and reasonable to the customer as well as to the company. . . . If as determined by the Commission Delmarva did miscalculate its fuel rate and as a result of the miscalculation did receive $400.000 in excess charges, then to suggest that the Commission had no power to order a refund as to these particular charges would make Section 27(a)(2) [which prohibits collection of compensation different from specified in tariffs on file with the Commission] completely unenforceable and nugatory. We do not mean by this conclusion to suggest even remotely that the Commission is empowered to engage in retroactive ratemaking but we distinguish between the ordinary ratemaking process and the necessarily ongoing process of verifying and adjusting fuel rate adjustment clauses so that they accurately reflect the increased and decreased costs (we hope) of the fuel necessary to operate a utility plant.

400 A.2d at 1153.

This exception from the rule against retroactive ratemaking for energy adjustment clauses is necessary in order t prevent a utility from misusing the energy adjustment clause. Like Utah Power in this case, some utilities have attempted to use energy adjustment clauses as a means of attempting to guarantee that they actually earn their authorized rate of return. In Southern California Edison Company v. Public Utilities Commission of California , 576 P.2d 945 (Cal. 1978), the California Commission instituted an automatic fuel adjustment clause in 1972 which allowed Edison to prepare a forecast of the quantity of fossil fuel it would need to purchase during a 12-month future period and calculate the cost of such fuel at current prices and adjust its rates based on these predictions. However. by the end of 1974, Edison had collected 408 Million Dollars for fuel expenses but had actually spent only $262.2 Million Dollars, leaving the Company holding 145.8 Million Dollars more than it needed to offset increased fuel costs. While Edison described the adjustment as a "miniature rate proceeding intended to generate whatever higher rates were deemed necessary to prevent 'decay' in the utility's overall rate of return on invested capital", 576 P.2d 948, the Commission disagreed and 1) instituted a monthly balancing account in order to balance future over or under-collections in fuel costs and, 2) ordered a refund of the 145 Million Dollar over-collection in

rates to customers over a three-year period. On appeal, the utility argued that the refund Order constituted retroactive ratemaking.

The California Supreme Court made a distinction between typical ratemaking proceedings and "narrowly restricted and semi-automatic functioning of an adjustment clause" which it referred to as "substantially ministerial". 576 P.2d 953. The Court concluded that because the operation of the adjustment clause was not "ratemaking", the rule against retroactive ratemaking did not apply.

In the case before this Court, Utah Power, like Southern California Edison, has attempted to use the energy balancing account pass-through procedure as a method of preventing "decay" in its overall rate of return. The Company presented testimony indicating that there was an foreseen drop in revenues during the year ending September, 1982 causing an overall earned rate of return less than authorized by the Public Service Commission. The Commission's decision, issued just prior to the end of 1982, allowed the Company a Six Million Dollar earning boost that increased the Company's total company return on equity for calendar year 1982 by almost one half of one per cent (Record 249). As previously discussed, approximately Six Million Dollars more revenue will be collected from Utah jurisdictional ratepayers in the future by operation of the EBA

procedure as a result of the Commission's decrease in this proceeding.

The Commission's decision in this proceeding in essence allows the exception to the rule against retroactive ratemaking for pass-through of energy costs to be expanded to such an extent that it "eats up" the general rule. Permitting utilities to use the energy balancing account pass-through mechanism as a means of improving past earnings by increasing future rates is in contravention of the policy reasons behind the rule against retroactive ratemaking . The risk that actual conditions will vary from predictions in the rate case would no longer (as has always been the case in the past) borne by the Company but now would be borne by utility ratepayers with the effect of guaranteeing a level of return for Utah Power and reducing the traditional regulation imposed incentive to provide cost effective and efficient operations.

POINT IV

COMMISSION'S ORDER IS ARBITRARY AND CAPRICIOUS BECAUSE THERE ARE NO FINDINGS OR CONCLUSIONS THAT THE INCREASE IN RATES IS JUST AND REASONABLE, AND THERE IS NO COMPETENT OR SUBSTANTIAL EVIDENCE TO SUPPORT SUCH A FINDING.

The Court states in Utah Department of Business Regulation v. Public Service Commission , 614 P.2d at 1245 that:

> The first prerequisite of a rate order is that it be preceded by a hearing and findings. At such a hearing, the Legislature intended that there be evidence introduced that could reasonably be calculated to resolve the issue presented for determination, which is this case is a rate increase. The findings required by statute (of a just and reasonable rate §54-7-12(2)) must be made in accordance with the evidence so presented. If there be no substantial evidence to support an essential finding, that finding cannot stand, and a rate order predicated upon it must fall.

Because, as discussed previous herein, Utah Power's request in this proceeding was neither for an "offset" of unusual expenses or a pass-through of energy costs, the applicable standards of evidence and required findings related to such proceedings are not applicable. Therefore, the finding of a "just and reasonable rate" (of §54-7-12(2) Utah Code Ann. (1981 Amendment)) must be made and must be in accordance with the evidence presented. In this proceeding, the Commission's Order did not find that the rate increase granted was just and reasonable. Nor was there evidence upon which such a finding could have been based. Therefore, the Commission's Order must fail.

In the Commission's December 30th order, it concluded only that "the proposed adjustment of the company is just and reasonable and should be allowed". (Appendix 1, Order p. 4.) There was no finding or conclusion that the rates resulting from the Commission's Order were just and reasonable, nor could

there be. Utah Power and the Commission both considered this proceeding as if it were an energy-cost pass through proceeding and did not present or consider evidence necessary in the determination of just and reasonable rates. The evidence necessary for such a finding, described previously herein and discussed in Utah Department of Business Regulation v. Public Service Commission, requires the choosing of a future "test year", a projection of revenues, expenses, and "rate base" for that test year, and a determination of the appropriate return on investment during that period.

The evidence presented by Utah Power in support of its request did not meet this standard of evidence. No evidence was presented by Utah Power with regard to jurisdictional expenses or investment for any period of time. The company did present evidence that revenues for the twelve months ending August, 1982, were lower than projected by the company and included by the Commission in rates in Case no. 81-035-13. Record 7-8. No evidence was presented with regard to Utah jurisdictional revenues for any future period. Evidence relating to company actual return on equity was presented with regard to the twelve months ending August of 1982 for both total company and Utah jurisdiction. No evidence was presented by the company with regard to earnings current at the time of the hearing, or of projections of return for any future period or as to the appropriate level of return which would currently

be required. The only evidence relating to the current financial condition of the company was presented by Division witness Compton, who testified that the financial condition of the company and investor expectations as reflected by the stock price did not require an additional $6,012,000 in return. Record at 104, 105. This testimony, although uncontroverted, was ignored by the Commission.

In the Commission's Order, there were no findings as to rate base or expenses for any period. There was a finding that for the twelve months ending August, 1982, revenues were less than projected in Case No. 81-035-13. (Appendix 1, Order page 2).

The Commission also found that Utah jurisdictional return on equity for the twelve months ending August, 1982, was 13.25%, and that the company was allowed a return on equity of 16.3% in case No. 81-035-13. (Id., page 3) It was apparently in reliance on this fact that the company during 1982 had not earned a return on equity equal to that authorized in Case No. 81-035-13 that the Commission concluded the retro-active "adjustment" proposed by the company was was "just and reasonable". Such reliance on a prior determination of reasonable rate of return has been characterized by this Court as an "abuse of authority". In Utah State Board of Regents v. Utah Public Service Commission , 583 P.2d 609 (Utah. 1978), the issue was the appropriateness of using prior determinations in

calculating rate of return. The Court concluded that in the determination of just and reasonable rates, the Commission must make a determination as to the financial conditions then existing. The Court states:

> Such a course necessitates the taking of evidence after which the Commisison may well conclude that circumstances remain unchanged since the prior Order. However, to totally ignore the possibility of significant changes of circumstances or to assume there has been none, must be viewed as error. 583 P.2d at 611.

Because the Commission chose to rely on past determinations as to appropriate rate or return, and because there was not substantial evidence presented in which there could be a determination made as to the other basic rate making components for the Utah jurisdiction of Utah Power & Light, namely Utah jurisdiction revenues, expenses and rate base, there was no "evidence introduced that could reasonably be calculated to resolve the issue presented for determination, which is in this case a rate increase". Utah Department of Business Regulation v. Public Service Commission , 614 P.2d at 1245. In other words, there was not substantial evidence in the record upon which a finding that the rate increase granted in this case is just and reasonable.

Moreover, the Commission's conclusion that the "adjustment" proposed by the company is just and reasonable does not constitute a finding that rates are just and

reasonable. Because of the deficiencies of the evidence presented, reliance of prior determinations, and lack of a finding that the rate increase granted in the case was just and reasonable, the Commission's decision herein is arbitrary and capricious, and must be vacated by this Court.

CONCLUSION

For the foregoing reasons, the decision of the Public Service Commission in the case before the Court must be set aside and vacated, with directions to return $6,012,000 to the balance, in favor of ratepayers. of the EBA, thereby allowing that amount to return to the ratepayers.

The decision represents an attempt to re-shape regulatory law and policy, altering the role of regulation and the relationships between utilities and ratepayers. Such matters are the province, not of the Public Service Commission, but of the Legislature.

RESPECTFULLY submitted this 11th day of October, 1983.

CRAIG R. RICH
Assistant Attorney General
Attorney for Department of
Business Regulation
Division of Public Utilities

CERTIFICATE OF SERVICE

I hereby certify that two true and correct copies of the foregoing Brief of Plaintiff Department of Business Regulation, Division of Public Utilities were mailed or delivered this 12th day of October. 1983, to each of the following:

Public Service Commission of Utah
Heber M. Wells Building
Salt Lake City, Utah 84111

Thomas W. Forsgren
Attorney for Intervenor-Defendant
Utah Power and Light Co.
P.O. Box 899
Salt Lake City, Utah 84110

Mark C. Moench
Assistant Attorney General
Room 124 State Capitol Building
Salt Lake City, Utah 84114