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March 2, 1987

Mr. Harvey G. Hubbs
Secretary
Missouri Public Service Commission
P. O. Box 360
Jefferson City, Missouri 65102

Re: Case No. AO-87-48

Dear Mr. Hubbs:

Enclosed please find an original and fourteen copies of Southwestern Bell Telephone Company's Reply Comments to Procedural Proposals. Also enclosed is our Second Response to Order Establishing Docket to be filed with the Commission in the case referenced above.

Please stamp "filed" on the extra copy and return to me in the enclosed self-addressed, stamped envelope.

Thank you for bringing this filing to the attention of the Commission.

Very truly yours,

Michael A. Meyer

Michael A. Meyer

Enclosures

cc: All parties of record

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the investigation of the revenue effects upon Missouri utilities of the Tax Reform Act of 1986.	))))	Case No. AO-87-48

SOUTHWESTERN BELL'S REPLY COMMENTS TO PROCEDURAL PROPOSALS

The Commission's Order in this docket dated January 30, 1987 solicited "responses to Staff's alternate proposals with respect to the filing of interim tariffs" which would take effect on July 1, 1987. Staff has suggested that the Commission could "require all companies within its jurisdiction to file a tariff or schedule, superseding all other filed tariffs and schedules, which would indicate that all tariffed rates and charges in effect as of July 1, 1987 are interim and subject to refund." The proposal is unlawful and must be rejected.

The Commission Has No Authority To Order That Permanent Rates Be Made Interim Subject To Refund

The Staff has noted that the available complaint procedures under Chapter 386 are time consuming, and could not be completed concurrent with the reduction in revenue requirements associated with the Tax Reform Act. Without citation to any authorities, Staff proposes that the Commission declare that it will engage in retroactive ratemaking as of July 1, 1987 and thereafter undertake to award money damages for excessive earnings. This suggestion violates basic principles of constitutional and regulatory law.

The comments previously submitted by the Office of Public Counsel contain an excellent analysis of the Commission's implied authority under Missouri law to approve rate increases which are interim and subject to refund. Southwestern Bell will not repeat that analysis here. The Company concurs with Public Counsel's major conclusions that such interim rates are ancillary to the "file and suspend" procedure under Missouri law rather than to complaint cases, and that the authority for such interim rates is limited to requests for rate relief under emergency circumstances.

Southwestern Bell further contends, however, that Staff's proposal does not merely lack express authority under Missouri law but is explicitly forbidden. Staff is concerned that, in particular cases, prospective relief will not be timely. This concern does nothing to excuse the Staff's attempt to ignore the Commission's inability to award retroactive relief in the form of money damages.

Missouri courts have been especially zealous to prevent the exercise of judicial functions by administrative agencies in order to preserve the constitutional principle of separation of powers. A statute purportedly granting an administrative agency the power to issue declaratory judgments was thus held unconstitutional. State Tax Commission v. Administrative Hearing Commission, 641 S.W.2d 69 (Mo. en banc 1982). The same principles apply to the Missouri Public Service Commission. Lightfoot v. City of Springfield, 236 S.W.2d 348 (1951); State ex rel. Kansas City Terminal Railway v. Public Service Commission, 272 S.W. 957 (1925); State ex rel. Missouri Southern Railroad v. Public Service Commission, 168 S.W.1156 (Mo. en banc 1914).

By the same token, the Commission has no authority to order any reparation or refund from a public utility:

> The pecuniary relief so prayed by complainants calls for the exercise of a judicial function, by the entry of a judgment or order for the recovery of money, which function is exclusively exercisable only by the judicial branch or department of our state government. The Public Service Commission is an administrative body only, and not a court, and hence the commission has no power to exercise or perform a judicial function, or to promulgate an order requiring a pecuniary reparation or refund.

State ex rel. Laundry, Inc. v. Public Service Commission, 34 S.W.2d 37, 46 (Mo. 1931). See also, Wilshire Construction Company v. Union Electric Company, 463 S.W.2d 903 (Mo. 1971); Straube v. Bowling Green Gas Co., 227 S.W.2d 666 (Mo. 1950).

In substance, Staff's proposal merely invites the Commission to engage in "retroactive ratemaking," even though the Commission has previously been reversed for this practice. Its authority "cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses." State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 59 (Mo. en banc 1979). The prospective nature of the Commission's rate setting function has long been a feature of Missouri law:

> Although the Public Service Commission has exclusive jurisdiction to establish interest rates to be charged from and after the time of their promulgation, it does not have authority to hear an action by a public utility customer for an accounting for past overcharges in excess of rates established by it for the purpose of recovering such excess from the public utility. The Commission is not a court and cannot enter a money judgment from one party against another.

May Department Stores Company v. Union Electric Light and Power Company, 107 S.W.2d 41, 57-58 (Mo. 1937) (emphasis added).

Even if the Commission had authority to order refunds, the Staff's proposal is still defective. It incorrectly assumes that a utility's earnings are "excessive" merely because the utility has exceeded some approved rate of return. In Lightfoot v. City of Springfield, 236 S.W.2d 348 (Mo. 1951), it was held that a utility was entitled to funds collected pursuant to its authorized tariffs, notwithstanding the fact that the Federal Power Commission had later reduced wholesale prices for natural gas and thereby increased the utility's profits. The court acknowledged that rates of return will necessarily fluctuate:

> The Public Service Commission has no power to declare or enforce any principle of law or equity. The ultimate return to the utility as a result of the rate fixed and subsequently charged and collected will necessarily vary from time to time.

236 S.W.2d at 352. The court noted that the Commission sets rates prospectively, and that reduced operating costs can only be passed through to customers on a prospective basis:

> The Commission (or other regulatory authority) in the exercise of its rate-making powers may modify or change the rate to consumers, the Commission having in mind such reduced operation costs and other ever-changing operation costs and the ever-changing rate base to be considered in fixing rates. In this matter the Commission may in some measure pass on to ultimate consumers the benefit of the utility's reduced operating costs. The Commission fixes rates prospectively and not retroactively.

236 S.W.2d at 353 (emphasis added). Accordingly, the utility was able to retain the funds collected under its approved tariffs:

> We have said that when the established rate of a utility has been followed, the amount so collected becomes the property of the utility, of which it cannot be deprived by either legislative or court action without violating the due process provisions of the state and federal constitutions.

236 S.W.2d at 354.

In a similar case, the Missouri Supreme Court rejected the contentions of consumers that a utility had been unjustly enriched because of its excessive returns. The holding was based on the fact that the Commission does not authorize rates of return, but only approves fixed rates:

> What constitutes a fair return is only the basis for the rate fixed. . . . The rate must be just and reasonable. The ultimate return to respondent as a result of the rates so fixed and subsequently charged and collected will necessarily vary from time to time. . . . No maximum or minimum return was determined when the rate was

Commission's Order of January 28, 1987 indicates its willingness to incorporate this mechanism into the case if the legislation is timely enacted.

Southwestern Bell urges the Commission not to place undue reliance on these bills. The "all relevant factors" requirement is not merely a matter of statutory construction, but also invokes substantive constitutional rights. If enacted in their present form, H.B. 431 and S.B. 257 will be constitutionally dead on arrival. The Commission's search for lawful procedural alternatives should not be curtailed in reliance on a legislative initiative which represents an attempt to confiscate private property.

It has long been established that a utility's investors are constitutionally entitled to a reasonable return on their investment:

> The question in the case is whether the rates prescribed in the commission's order are confiscatory and therefore beyond legislative power. Rates which are not sufficient to yield a reasonable return on the value of the property used, at the time it is being used to render the service, are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. This is so well settled by numerous decisions of this court that citation of the cases is scarcely necessary.

Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690 (1923). See also Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944).

Necessarily, determination of a fair rate of return involves the consideration of all factors relating to the operation of the utility. As a matter of due process, a Commission cannot escape the task of considering these factors. The Supreme Court has indicated the standard of review which applies to judicial consideration of such a Commission proceeding:

> The court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risk they have assumed, and yet provide appropriate protection to the relevant public interest, both existing and foreseeable. The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Re Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968) (emphasis added). These Supreme Court cases provide the framework for judicial analysis of Commission decisions in Missouri today. State ex rel. Associated Natural Gas Company v. Public Service Commission, 706 S.W.2d 870, 873 (Mo. App. 1985).

> established. The contention and allegation that, if respondent is permitted to retain the said funds, it will result in respondent having charged and collected in excess of the "maximum return" cannot aid appellants, since the law of the state only provides for the fixing of rates and does not fix the maximum return thereunder.

Straube v. Bowling Green Gas Co., 227 S.W.2d 666, 671 (Mo. 1950) (emphasis added).

Thus, even if the Commission had authority to order refunds, it could not do so on the basis of a "maximum return" which the Commission has no authority to fix. So long as a utility only charges the rates approved by the Commission, it has a constitutionally protected property interest in its earnings until such time as its rates are changed pursuant to procedures established by law.

In recent years, utilities have been severely prejudiced by the fact that rates could not be adjusted fast enough to keep pace with changing conditions. Now Staff fears that the same problem of regulatory lag will retard its efforts to pass through the effects of tax reform. This problem scarcely justifies a procedure which is grossly unfair and unlawful. We note that Staff's one-sided proposal includes no mechanism by which utilities may retroactively recoup their "losses" from rates which result in earning less than an "authorized" rate of return.

As always, Southwestern Bell continues to support efforts to expedite regulatory proceedings and minimize the problems associated with regulatory lag. Such efforts, however, must be authorized by law and must comply with fundamental principles of fairness. Staff's proposal fails on both counts.

The Commission Must Consider All Relevant Factors

The Comments filed by both Staff and Public Counsel have agreed with Southwestern Bell's initial contention that the Commission must consider "all relevant factors" prior to issuing any order decreasing a utility's rates. In general, the issue has been treated as a matter of statutory interpretation. This has given rise to the misperception that the Commission could be relieved of its duty to consider all relevant factors if the statute were amended. Accordingly, this docket is overshadowed by pending legislation (H.B. 491 and S.B. 257) which purports to authorize the Commission to pass through to consumers the effects of tax reform without any consideration of other relevant factors. In the General Telephone complaint case, Case No. TC-87-57, the

Commission's Order of January 28, 1987 indicates its willingness to incorporate this mechanism into the case if the legislation is timely enacted.

Southwestern Bell urges the Commission not to place undue reliance on these bills. The "all relevant factors" requirement is not merely a matter of statutory construction, but also invokes substantive constitutional rights. If enacted in their present form, H.B. 491 and S.B. 257 will be constitutionally dead on arrival. The Commission's search for lawful procedural alternatives should not be curtailed in reliance on a legislative initiative which represents an attempt to confiscate private property.

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Missouri cases have also discussed the constitutional nature of the "all relevant factors" requirement:

> The reasonableness of rates charged by a public utility engaged in intrastate activities, such as the appellant water company, must be determined with due regard to the due process and equal protection clauses of both the federal and state constitutions in the statutes of the state in which the utility operates. . . "What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth."

State ex rel. Missouri Water Company v. Public Service Commission, 308 S.W.2d 704, 713-14 (Mo. 1957), quoting Smyth v. Ames, 169 U.S. 466, 546-47 (1898). On the basis of these constitutional principles, the court held:

> However difficult may be the ascertainment of relevant material factors in the establishment of just and reasonable rates, neither impulse nor expediency can be substituted for the requirement that such rates be "authorized by law" and "supported by competent and substantial evidence upon the whole record." Article V, §22, Constitution of Missouri, V.A.M.S.

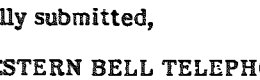
308 S.W.2d at 720.

More recently, a Missouri court has observed that "due process requires that administrative hearings be fair and consistent with rudimentary elements of fair play." State ex rel. Fischer v. Public Service Commission, 645 S.W.2d 44 (Mo. App. 1982). Accordingly, it was held that the Commission failed to satisfy the due process requirement by acting on the basis of a "limited hearing procedure" which failed to consider all relevant factors.

The legislature has no more power than the Commission to violate the constitutional rights of public utilities. As presently drafted, there is little likelihood that H.B. 491 and S.B. 257 will survive judicial scrutiny. The Commission should concentrate its search for procedural alternatives on those proposals which preserve the constitutional rights of the parties.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

By 

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was mailed, postage prepaid, this 2nd day of March, 1987, to all parties of record in this case.

Michael A. Meyer