STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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CASE 13-G-0136 - Proceeding on :
Motion of the Commission as to the :
Rates, Charges, Rules and Regulations :
of National Fuel Gas Distribution :
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POSITION OF NATIONAL FUEL GAS DISTRIBUTION CORPORATION ON THE APPLICABILITY OF PUBLIC SERVICE LAW § 66(20) TO THIS PROCEEDING

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I. PRELIMINARY STATEMENT

On April 19, 2013, the Commission instituted the above-captioned proceeding concerning temporary rates for National Fuel Gas Distribution Corporation ("Distribution" or "the Company") through an Order Instituting Proceeding and to Show Cause ("OTSC"). In the OTSC the Commission also "tasked" the Administrative Law Judges "with examining the applicability and appropriateness of [Public Service Law] ("PSL") §66(20) as a potential remedy in addition to temporary rates." OTSC, p. 7. Briefly summarized, PSL §66(20) purports to authorize the Commission to direct a utility to refund "revenues . . . in excess of its authorized rate of return." Even though National Fuel's customer rates (a) were approved by the Commission in late 2007;[1] (b) have not increased since January 1, 2008 while all other utilities'

[1] Western New York news outlets, and therefore consumers, were led to believe that this proceeding was commenced because the Company "overcharged" its customers. Although the Commission describes PSL §66(20) as a "remedy," nowhere did the Commission say, itself, in any order or public statement, however, that the Company "overcharged" its customers or engaged in any wrongdoing whatsoever. That is because, as a matter of law, National Fuel *could not* have overcharged its customers if the Company charged its customers no more than the lawful rates approved by the Commission, which is exactly what the Company has done and will continue to do. *Porr v. NYNEX Corp.*, 230 A.D.2d 564 (2d Dep't 1997);

rates have increased; and (c) are the lowest in the state, the OTSC essentially threatens to reach backwards and disgorge National Fuel's earnings achieved during an undefined, prior period of time, for no reason other than because the Company was efficient. While the idea of disgorging utility earnings may hold superficial appeal for its proponents, in fact the practice would be contrary to Commission precedent and, more importantly, in derogation of sound, consumer-oriented rate making policy. This is because the statute was not enacted to punish utilities for earnings resulting from efficient management, but rather was intended to extract, for consumers' benefit, windfall earnings resulting from extremely cold weather. Today, the Commission has other, established means of preventing such windfall earnings. The result is that PSL §66(20) is, at best, a mere vestige, with no reasonable current purpose. Worse, application of PSL §66(20) to National Fuel's circumstances would send a terrible signal to utility employees and managers who work hard to achieve savings and efficiencies in utility operations, and to investors upon whom consumers must rely for adequate funding of safe, reliable and economic utility infrastructure.

II. PROCEDURAL BACKGROUND AND DISCLAIMER

On August 26, 2013, Administrative Law Judges ("ALJs") Kevin J. Casutto and David L. Prestemon issued a Ruling on Scope and Schedule ("Ruling"), containing the following procedures and schedule for consideration of the PSL §66(20) matter.

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app. den. 91 N.Y. 2d 807 (1998)("once the rates have been accepted as reasonable and applied uniformly by the regulatory commission, a shipper may not claim that he has been damaged if he has paid the filed rates").

It is ironic, in fact, that the only delivery rate increase that consumers experienced since 2008, and in fact the largest rate increase imposed on customers in decades, was an increase in New York State taxes collected through utility rates. Aside from that, National Fuel's rates have been flat and gas supply charges have decreased.

First, the Ruling found that the applicability of the statute to this case would be briefed by the parties, followed by a ruling from the ALJs. Second, if PSL §66(20) was found to be applicable, the ALJs would then determine whether, and if so how, it should be applied in this case and be made part of the litigation. Under the schedule agreed to by the parties, and adopted by the ALJs, on September 13, 2013 Distribution would file its brief addressing applicability of PSL §66(20) as a remedy in this proceeding; on October 4, 2013 the other parties would file responses to Distribution's brief and on October 16, 2013 Distribution would file its response to the briefs of the other parties. This brief is responsive to the schedule and directives adopted in the Ruling.

In this context, however, it should also be understood that, on May 17, 2013, Distribution brought an action for a declaratory judgment in Supreme Court, Erie County to have PSL §66(20) declared unconstitutional and unlawful on its face. As a consequence, in agreeing to the schedule presented to the ALJs and with respect to its participation in this phase of the case, Distribution placed the following disclaimer on the record:

> The Company does not believe that section 66(20) is a valid law, and as you know, we have a challenge against it pending in Supreme Court. At the same time, however, we recognize that we have two orders that direct the Company to submit to further rate proceedings, including 66(20). We will take action as is necessary to uphold the law with regard to those further proceedings. Accordingly, our agreement to participate in the 66(20) phase of this proceeding should not be construed as NFG's consent to the validity of such proceedings or an order, based on those proceedings, purporting to implement 66(20).

This disclaimer remains effective and applies to the Company's continued participation in these proceedings.

III. HISTORY OF PSL§66(20)

PSL §66(20) states:

> Notwithstanding any general or special law, rule or regulation, the commission

> shall have the power to provide for the refund of any revenues received by any gas or electric corporation which cause the corporation to have revenues in the aggregate in excess of its authorized rate of return for a period of twelve months. The commission may initiate a proceeding with respect to such a refund after the conclusion of any such twelve month period.

This section of the PSL was added as Chapter 394 of the Laws of 1978 and became effective on June 19, 1978.

The legislative history of PSL §66(20) reveals that it was enacted for a very specific purpose. The memorandum by Assemblyman Hoyt, a primary sponsor of the legislation, in support of Chapter 394 of the Laws of 1978 states succinctly:

> The Public Service Commission, as a result of the unusually harsh winter of 1977 and a prolonged labor dispute held hearings to determine if the National Fuel Gas Company had earned "excess profits." In the course of those hearings, it came to the sponsors [sic] attention that, even if excess profits had been earned, the Public Service Commission would be without the legal authority to order a refund.
>
> Under current practice, the Public Service Commission determines an appropriate rate of return for a utility and then sets permitted rates. The Public Service Commission does not have the power to order a refund if an unanticipated event makes their assumptions faulty and a utility is able to earn an "excess profit." In the next rate case, the Public Service Commission can adjust its assumptions. This adjustment will, however, only apply to future rates. In addition, the Public Service Commission could not reasonably anticipate another unusually harsh winter and thus could not set rates accordingly.
>
> Thus, if there are "excess profits" caused by high fuel sales which resulted from an unusually harsh winter, the Public Service Commission would be powerless to order refunds.
>
> This bill is designed to remedy this situation.
>
> * * *

To the best of Distribution's knowledge, PSL §66(20) has been invoked by the Commission only once since its enactment.[2] That case was instituted against The Brooklyn

[2] There was at least one other instance where a Section 66(20) complaint was actually assigned a case number but did not progress because a settlement was reached. In 1984 the Consumer Protection Board brought a petition "for the initiation of a proceeding to determine the magnitude of excess earnings, to

Union Gas Company in response to a Consumer Protection Board ("CPB") complaint in 1981 claiming that the company was "overearning." Then-Secretary Madison rejected the CPB's complaint initially because the period used was unrepresentative. Eventually, however, the Commission did issue an order directing Brooklyn Union to show cause why the entire claimed $2,772,000 of revenue that was in excess over a 14% return on equity should not be refunded to ratepayers under the authority of the law. Case 28395, *The Brooklyn Union Gas Company,* Order to Show Cause, December 28, 1982.

The Commission ultimately decided not to order a refund, finding:

> As for the revenue attributable to the colder-than-normal weather, we recognize that the statute authorizes us to direct refunds under these circumstances. But it does not require us to do so, and, in view of the comparatively small amount at issue and all other circumstances presented, we are unconvinced, as a matter of policy, that we should exercise our discretion to direct refunds here. At the same time, however, we do not intend to suggest that "excess" earnings arising from weather variations will never be subject to refund under our application of the statute.

Case 28395, *The Brooklyn Union Gas Company*, Order Closing Proceeding, 24 NYSPC 415, 1984 N.Y. PUC LEXIS 292 (January 16, 1984). The Commission thereupon ordered the proceedings closed.

The Commission also declined to proceed under Section 66(20) in the 2006 O&R rate case, finding:

> We reject the proposal for relief of the Town of Ramapo. Initially, we note that Ramapo's proposal to proceed under PSL §66(20) and to refund all earnings

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refund this sum to ratepayers and to reduce Consolidated Edison's current equity ratio." *See* Case 28847 Order Approving Agreement And Closing Proceeding, 1984 N.Y. PUC LEXIS 144; 24 NY PSC 4331 (August 23, 1984). Because the matter resulted in a settlement, the Commission approved the agreement and closed the proceeding without addressing the Section 66(20) matter.

> above an allowed return since June 30, 2006 has been made for the first time on brief. That statute was not referenced in CPB's complaint nor in our Order to Show Cause initiating this proceeding, and it was not the subject of testimony or hearings in this case. We did not choose to proceed under that section of the Public Service Law but instead instituted this proceeding pursuant to PSL §§ 66(5), 72, and 114 to examine the Company's rates prospectively.

Case 06-E-1433, *Orange and Rockland Utilities, Inc.*, Order Setting Permanent Rates, Reconciling Overpayments During Temporary Rate Period, And Establishing Disposition Of Property Tax Refunds, p. 34 (October 18, 2007).

Consequently, in the 35 years since its passage, the Commission has *never* used PSL §66(20) to order a utility to disgorge revenue in excess of the rate of return authorized in the utility's last rate order. Given the purpose and effect of PSL §66(20), we believe that this was no regulatory oversight.

IV. PSL §66(20) IS NOT APPLICABLE TO THE SITUATION AT HAND

A. The Situation that PSL §66(20) Was Designed to Remedy No Longer Exists

The fact that PSL §66(20) has never been used by the Commission in the 35 plus years since its enactment is no accident. Conceived as a remedial statute for one particular purpose that will be discussed *infra*, the language of the law, itself, is vague and imprecise, mandating recourse to a legislative history that refutes its use here.

Although PSL §66(20) is thought of as a remedy for "excess earnings," the law actually says nothing about earnings. Earnings are normally conceived to be measured by a company's rate of return on equity ("ROE"). The language used in PSL §66(20), however, permits the Commission to order the "refund of any revenues received by any gas or electric corporation which cause the corporation to have revenues in the aggregate in excess of its authorized rate of return…." A utility's "rate of return," however, is not its ROE but is, rather, composed of the cost of its equity, short and long-term debt and customer deposits. Given that the rate of return changes over time from that set in the utility's rate case (due to debt cost rate changes as well as equity costs), the authorized rate of return is likely to be a completely meaningless number for purposes of estimating a utility's real earnings.   Furthermore, PSL §66(20) has a vague temporal reach.   It speaks of a "refund after the conclusion of any such twelve month period" but fails utterly to define such period.

Where a statute is ambiguous, as is PSL §66(20), recourse to the legislative history is in order. *Roberts v Tishman Speyer Props., L.P.,* 13 N.Y.3d 270, 286 (2009)("When construing a statute, we seek to discern and give effect to the Legislature's intent and the starting point for accomplishing this is the statute's language. If the language is ambiguous, we may examine the statute's legislative history.")(*citations omitted*). *People ex rel. Makin v. Wilkins*, 22 A.D.2d 497, 498 (4th Dep't 1965)("Therefore, the history of the measure during its enactment, that is, during the period from its introduction in the legislature to its enactment, has generally been the first extrinsic aid to which courts have turned in attempting to construe an ambiguous act. Thus, communications sent to the Governor relating to a bill passed by the Legislature and before him for action 'are not conclusive but they are aids in seeking legislative intent.'")(*citations omitted*).

In this case, the legislative history of PSL §66(20) demonstrates conclusively that it was enacted specifically to address a unique situation that arose when the dramatically increased sales revenue due to the unseasonably cold winter of 1977-78 led to unusually higher earnings for Distribution and other gas companies. It bears repeating Assemblyman Hoyt's rationale in support of the bill that led to PSL §66(20):

> Thus, if there are "excess profits" caused by high fuel sales which resulted from an unusually harsh winter, the Public Service Commission would be powerless to order refunds. This bill is designed to remedy this situation.

"This situation," where an unusually cold winter would bestow an earnings "windfall" upon a gas utility in New York, no longer exists.

In 1988, the Commission adopted a weather normalization clause ("WNC") for Distribution on a trial basis for one year. In doing so the Commission recognized that:

> The weather normalization clause would not operate to maintain a particular earnings target; rather, it would simply stabilize revenues (and customer bills) by moderating the influence of weather. [Distribution] will be permitted to implement such a clause on a trial basis, provided that it is modified in an acceptable fashion to "normalize" bills within a heating season (and thus stabilize customers' expenditures and company revenues) rather than during the following year.

Case 29679, *National Fuel Gas Distribution Corp.* Opinion No. 88-19; 28 NY PSC 1061 (July 18, 1988). One year later, the Commission adopted the WNC for Distribution on a permanent basis. Case 88-G-180, *National Fuel Gas Distribution Corp.*, Opinion No. 89-22; 29 NY PSC 1021 (July 19, 1989). The WNC continues in operation for Distribution today.[3]

In addition to the removal of weather anomalies from ratemaking, the Commission has also more recently removed revenue fluctuations due to significant variations from sales due to increased or decreased usage per customer through a revenue decoupling mechanism ("RDM"). Case 07-G-0141, *National Fuel Gas Distribution Corp.*, Order Establishing Rates for Gas Service (December 21, 2007)("2007 Rate Order"). Here, too, the chance that a utility could receive windfall earnings from unusually high usage has been significantly curtailed.

In the next section we will explain why the application of PSL §66(20) in this case is antithetical to the Commission's expressed policy of providing incentives to efficient, productive utilities. Here, however, we have shown that the primary reason for the passage of PSL §66(20)

[3] Merely because the "harm" that was the impetus for the passage of PSL §66(20) has been ameliorated by the adoption of the WNC does not vitiate the unconstitutionality of the law. At the time of its passage, a gas company could suffer weather related losses for nine of ten years in a decade and still be subject to a refund for the one year in which it exceeded its rate of return. This imbalance is not only fundamentally unfair but denies the utility equal protection under the law in violation of the federal and state constitutions. The Commission's 1978 memorandum to the Legislature conceded that utilities were not earning their allowed rates of return.

– i.e., weather-related earnings "windfalls" - has been addressed and eliminated. No longer is Distribution, or any other gas utility in the state, able to reap windfall profits merely by reason of the caprice of unusually cold weather or usage spikes delivering unanticipated revenue increases that are completely unrelated to any efficiency gains or other actions by the utility.

Given that the "evil" addressed in Assemblyman Hoyt's bill was "windfall profits" due to unanticipated cold weather, that situation no longer exists. Moreover, given that a utility's "rate of return" does not really measure profits, the "power" that the Legislature gave the Commission actually missed the mark at which it was really aiming. If the Legislature had intended to address earnings, it properly should have referred to the ROE. PSL §66(20), however, does not grant the Commission power to order a refund of earnings in excess of the ROE.

B. *In the Case, the Application of PSL §66(20) to Require the Refund of Earnings Would be Directly Contrary to the Commission's Explicit Policy Goals*

Once the chance occurrences of weather or usage producing higher than expected rates of return have been eliminated, as they have been in Distribution's case, a utility's ability to earn a rate of return higher than that set as the cost of equity for the rate year rests almost entirely on its ability to eke out productivity and efficiency gains over and above those examined in the rate case process or anticipated explicitly. In the normal rate case process, a utility's cost levels are extensively monitored for reasonability. So any additional efficiencies that a utility manages to achieve are over and above those activity levels that have already been monitored for efficiency.[4]

Furthermore, as in the case of most American businesses, the costs of obtaining goods, labor and taxes have risen for Distribution. At the same time, because its share of the heating market is almost 100%, Distribution has not been able to avail itself of the oil-to-gas conversion market that its downstate utility brethren have been able to tap for additional revenue. Yet,

[4] In addition, Distribution has also been subjected over the years to management audits that test the efficiency of the organization. Distribution's most recent audit is nearing its conclusion.

unlike other major utilities in the state, Distribution has not asked the Commission for a general rate increase in over six years nor has it had a rate increase since January 1, 2008 - more than five and one-half years ago. *See* 2007 Rate Order.

In the face of no growth and rising cost pressures, Distribution has avoided filing rate increases through cost containment efforts and prudent management. If the Company had not taken these efforts, its ROE would have been approximately 7.77%, far below a reasonable ROE (Tr. 69) and the Commission would now be considering the Company's request for a significant rate *increase*.

Instead, the Company achieved this rate stability even while investment in pipeline safety and system modernization continued apace and the Company provided excellent service and safety to its customers. No other utility in this state has achieved a similar record of performance since 2008. Coupled with low natural gas commodity prices, Distribution's efforts have helped to offset inflation and tax increases, helping homes and businesses to keep more of their incomes for other purposes. The net effect of the Company's cost reduction efforts not only provided rate stability[5] and excellent service to customers, but also bolstered earnings for investors.

The legislative history of PSL §66(20) confirms that all utility earnings are not created equal. The Commission's policies and rate orders *promote* earnings increases that result from efficiencies and productivity. Lest there be any doubt as to the singular achievement of the Company's efficiency and cost cutting efforts, it must be kept in mind that it has been common over the last few decades for the Commission to impute a target, one percent additional productivity gain on top of the already, extensively audited costs. In Distribution's 2007 Rate Order, however, the Commission declined to impute the one percent productivity adjustment that

[5] Of course, rate stability in times of inflation – even the moderate inflation of recent years – means that the Company's distribution rates have actually fallen in real terms. Except for, as described above, a sizable tax increase.

had become a standard adjustment because the workforce reduction that was imputed to the Company in that case equated to *a six percent productivity adjustment*:

> The administrative law judge did not apply the standard 1% productivity adjustment to NFG because he accepted Staff's proposed employee count which reduces the Company's workforce by 54 positions….In this instance, where a workforce reduction equivalent to a 6% productivity adjustment has been taken, the Company believes the judge correctly recommended that the standard productivity adjustment be omitted.

2007 Rate Order, *supra* at 8-9. In other words, the Company was held to a productivity adjustment that was six times larger than that normally imputed to a utility in a rate case. What this means is that, unless Distribution actually achieved productivity six times greater than that usually imputed to a utility in its rate case, the Company would not even have been capable of earning the 9.1% ROE found reasonable in Case 07-G-0141.

As was explained in the preceding section, PSL § 66(20) was enacted to prevent windfall profits. Arguably this makes sense because unlike earnings that flow from efficiency gains and other efforts of utility employees, higher earnings that arise from extremely cold weather (at the time that PSL §66(20) was enacted) yielded no current or future consumer benefits. Thus, in this regard, PSL §66(20) was not enacted to deprive efficient utilities of the fruits of their productivity efforts. The Commission's former general counsel recognized this, in his memorandum to the Governor's counsel in 1978 when he observed that: "[i]t should be recognized, of course, that there is some incentive to efficient operation by a utility if it can achieve and retain a higher return than authorized."

More recently, that recognition has grown into a full throated and long-standing policy of permitting utilities to retain any earnings that result from their successful productivity efforts. In fact, for more than two decades, the Commission has explicitly recognized the simple economic verity that well-managed companies should and do exceed their allowed returns:

> Rates are set to give a utility a reasonable opportunity to earn a fair return. What it actually earns depends on its performance. If the company fails, for instance, to control costs or to achieve foreseen productivity gains, it will fall short of earning the stipulated fair return. If, on the other hand, the utility does well at controlling costs, and beats the assumed productivity gain rate without sacrificing service, it can earn more than the allowed return while benefitting consumers as well.

Case 28425, *New York Telephone Company*, Opinion and Order Concerning Pending Revenue Requirement, Opinion No. 92-26, 1992 N.Y. PUC LEXIS 60 (September 9, 1992) p. 49.

Indeed, in this very case, the Commission again reaffirmed that policy and stated:

> Of course, if shareholders never benefited from cost reduction efforts, there would be very little incentive for utility managers to aggressively pursue efficiency gains. That is not how our system of regulation works, however. Between rate settings, utilities charge their authorized rates and are free to retain the revenues collected regardless of the actual cost of service they incur. This phenomenon is referred to as "regulatory lag" because there is normally a gap in time between the occurrence of changes in a utility's cost of service and the recognition of those changes in rates. This gap, or lag, provides an important incentive for utilities to reduce costs while the benefit of those cost reductions can be retained.

Case 13-G-0136, *National Fuel Gas Distribution Corp.*, Order Setting Temporary Rates, p. 8 (June 14, 2013). As the Commission notes, ratepayers benefit significantly from "regulatory lag" for the reason that if utilities were prohibited from "retaining the revenues collected regardless of the actual cost of service they incur," then there would be no incentive to reduce costs. The result would be endless rate *increases*, and no instances of the kind of rate stability that Distribution's customers have enjoyed since 2008.[6] This is why public policy favors regulatory lag: the utility's cost-savings achievements, when captured in a future rate case (or through rate case avoidance), produce lasting, beneficial customer savings. This differs markedly from the earnings "windfall" that section §66(20) was designed to address. A revenue "spike" resulting from cold weather, prior to the introduction of a WNC, would have produced

[6] Experience in New York suggests that rate increases are avoided due to regulatory lag in the absence of an "earnings sharing mechanism," which tends to promote periodic and recurring rate cases and higher rates.

no lasting benefit for customers in a future rate case because it would have had no beneficial effect on future revenues or expenses.

In the temporary rates phase of this case, Distribution demonstrated that, with one exception, every other gas company in this state was exceeding the rate of return on equity set in its previous rate order without any attempt by the Commission to order a disgorgement of the revenue associated with those higher ROEs. Consequently, it should be clear that the Commission has diligently followed the above described policy without deviation.

Here, there is no basis to deviate from that explicit policy. As explained above, without cutting and controlling costs, Distribution could not have exceeded the 9.1% rate of return set in the 2007 rate case. In the OTSC (at 4) the Commission expressly recognized the Company's efficiency efforts, stating: "We have, in the past, and will continue to commend National Fuel for cutting costs and increasing productivity." Moreover, the Commission also recognized that the Company achieved this efficiency without sacrificing safety or customer service standards:

> We also note that while National Fuel has been reducing its costs of providing service during this period it has achieved the service and safety performance standards that we established in the 2007 Rate Order. In the most recent Staff report provided to us concerning customer service performance of major energy utilities for 2011, National Fuel demonstrated better than average performance in most of the metrics used to measure customer service.

Id.

The Commission's long-standing policy has been to permit utilities to retain earnings earned above the return set in the last rate case as an incentive to greater efficiency. There is no basis for the Commission to turn its back on that policy which has been recognized to be in the best interest of the ratepayers who ultimately enjoy the benefit of that greater efficiency and the

Commission has not provided any reason for such a drastic about-face.[7] Again, questions of its legality notwithstanding, the legislative history of PSL §66(20) reveals no intention to deprive an efficient utility of the fruits of that efficiency between rate cases. This is especially true, where, here, the company that is in the cross-hairs of the PSL §66(20) target is, incomprehensibly, at the same time, the only company to have refrained from filing for a rate increase since 2007 *and* the company with the lowest residential gas rates in the state.

Neither would a refund, under PSL §66(20), of only *part* of the so-called "excess" revenues, in a misguided but presumably well-intentioned effort to retroactively establish a "reasonable" level of earnings in excess of the 2008 ROE, be either a solution or a plausible compromise. As more fully described below, the effect on regulatory lag would be the same, as would the effect on a utility's ability to determine, with any degree of certainty, its earnings for reporting purposes. Furthermore, given that the statute limits the Commission's power to a "refund of any revenues…in the aggregate in excess of its authorized rate of return for a period of twelve months" the statute appears to constrain any such attempt to be reasonable. Consequently, in all likelihood the Commission's search for that "reasonable" level of prior earnings would be an arbitrary exercise, given the ambiguity of the statute itself and the absence, following the rate year, of any "authorized rate of return" upon which rates could effectively be retroactively re-set.

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[7] The Court of Appeals has held that an agency's unexplained departure from its prior interpretation of the statute that it administers is, as a matter of law, arbitrary and capricious. *Matter of Richardson v Commissioner of N. Y. City Dept. of Social Servs.,* 88 N.Y. 2d 35 (1996). It is a fundamental principle of administrative law that the administrative agency justifies any departure from its prior practice. *Matter of Lafayette Stor. & Moving Corp.,* 77 N.Y. 2d 823 (1991). "Unless such an explanation is furnished, a reviewing court will be unable to determine whether the agency has changed its prior interpretation of the law for valid reasons, or has simply overlooked or ignored its prior decision . . . Absent such an explanation, failure to conform to agency precedent will, therefore, require reversal on the law as arbitrary." *Mtr. of Field Delivery Serv. v. Roberts,* 66 N.Y. 2d 516, 520 (1985).

C. *The Level of Earnings Retained By Distribution From the Fruits of Its Efficiency Efforts are not of the Magnitude that Require Refunds*

In endorsing the passage of PSL §66(20) in 1978, the Commission also recognized that the statute should be used, if at all, only in rare instances. Then-General Counsel Schiff wrote:

> Thus, if we do return to a period in which utilities are able to earn the allowed rate of return, it may be that the Commission would only exercise the new authority in cases where the allowed rate of return has been *exceeded by a significant margin*.

Clearly, that situation does not pertain here.

The evidence adduced in the case so far demonstrates that Staff believes that the Company will earn slightly over 11% on equity, while Distribution's witnesses Meinl and Truitt project the earnings in the twelve months ending on May 31, 2014 to be slightly over 9%. Given the Commission's failure to take any action when other utilities' earnings were greater than this, it should be clear that Distribution's level of earnings is nowhere near the level intended to trigger PSL §66(20).

Mr. Meinl's exhibits show, and it is undisputed, that every major gas utility in New York, except Niagara Mohawk, has exceeded the rate of return on equity set in its prior rate case. Orange and Rockland's gas operations earned 12.62% on equity for the 12 months ending on October 31, 2012. KEDNY's earnings before sharing for the 12 months ending on December 31, 2010 were 13.98% and 11.85% after sharing, and for the 12 months ending on December 31, 2011 were 14.10% and 11.85% after sharing. Despite those earnings levels, the Commission took no action to subject those utilities to a PSL§66(20) review.

Furthermore, in the past, utilities have earned even higher rates of return on equity without being subjected to a PSL §66(20) review. In a 2002 case involving NYSEG there was evidence that: "NYSEG's year 2000 earnings were as high as 41%. Staff of the Department of Public Service (Staff) contend that through the end of the RRP, NYSEG's returns would be

23.6% in 2002 and 40.5% in 2003 and that NYSEG's electric rates *now generate $300 million/year in excess of costs, including a fair return on equity*." Case 01-E-0359, *New York State Electric & Gas Corporation*, Order On Temporary Rates, p. 2 (January 10, 2002) (*emphasis supplied*). Company witness Meinl also showed that the earnings in the 2006 O&R temporary rate case were similarly quite high, noting the-then CPB complained that O&R's earnings would be 16.17% in 2006 and would increase to 19.81%. Meinl, p. 15, *see* Case 06-E-1433, *Orange and Rockland Utilities, Inc.*, Order Making Temporary Rates Subject to Refund, (March 1, 2007).

The obvious point is that neither historically, nor currently, has the Commission subjected a utility to a PSL §66(20) review when its earnings were only modestly above the level of currently allowed rates of return, as Distribution's are here.

Nor should the Commission apply PSL §66(20) against Distribution in this case. This is not a case where a utility has become only marginally more efficient or has only improved on efficiencies from a previously low level. The record in this case is crystal clear that Distribution has the lowest residential gas rates in the State of New York. Obviously, if the "proof of the pudding is in the eating," the fact that Distribution's residential rates are so low is all the Commission needs to know with respect to the fruits of the Company's successful efficiency efforts.

Moreover, without these efficiency gains, Distribution would have been filing rate cases just like its utility brethren did. Instead, Distribution hasn't filed a rate case since 2007. This wasn't achieved by happenstance. Had the Company not achieved the efficiency gains that it did, its earnings would be far below the 9% threshold claimed by Staff and it would have had to seek rate relief. The fact that Distribution has the lowest residential rates in the State and that it has not filed for new rate increases since 2007 are tangible, significant benefits that have flowed to its customers directly from the productivity efforts.

Furthermore, the Commission has made far too much of the fact that Distribution was not operating under a rate plan with an earnings sharing mechanism such as that which its peers have adopted:

> Unlike many utilities currently operating under negotiated rate plans, NFGD does not have an earnings sharing mechanism in place that would credit at least a portion of excess earnings to ratepayers. Therefore, unless current rates are made temporary, ratepayers will have no recourse for recovery of any excess rates they may pay while this case moves forward. If Staff's estimate that the Company may be overearning at a rate of $10.3 million per year proves to be correct, the cost to ratepayers is likely to be millions of dollars before we are able to render a final decision in this case.

Case 13-G-0136, Temporary Rates Order, *supra* at 9. This statement suggests a distinction without a difference: utilities under earnings sharing mechanisms continue to earn in excess of their "authorized" rate of return. In some cases, they have earned *significantly* more than their "authorized" rates of return. If PSL §66(20) stands for the proposition that consumers are harmed by utility "excess revenues," then "excess revenues" retained by a utility under an earnings sharing mechanism are no less offensive under the statute.

More importantly, if the Commission "gives a pass" for "excess" revenues under an earnings sharing mechanism, then it cannot be ignored that Distribution filed a proposal on March 27, 2013 that would have, if adopted, permitted ratepayers to share equally in all earnings on equity above 9.96% and that would have begun on June 1, 2013. Therefore, ratepayers could have already been enjoying the fruits of Distribution's efficiency gains had the proposal been adopted, either as filed or as changed through negotiation.

For all of the above reasons, it should be clear that using PSL §66(20) for anything other than its intended purpose – disgorgement of "windfall profits" – is directly contrary to the

Commission's long-standing policy of permitting efficient utilities to retain those earnings that are due to efficiency gains until such time as rates are re-set in a subsequent rate case. Moreover, the application of PSL §66(20) to Distribution – and Distribution alone – is not only directly contrary to that long-standing policy, but it would treat Distribution differently from utilities with lesser productivity achievements without any rational basis for doing so and likely in derogation of Distribution's right to equal protection under the law.

D. Earnings May Not be Subject to an Open-Ended Refund Obligation

Finally, both the language and the legislative history of PSL §66(20) make it clear that the law was not intended to create an open-ended, continuing liability of a utility to be subject to refund claims.

It is well settled that legislative acts, such as the approval of public utility tariffs, are prospective only and may not be applied retroactively. *Arizona Grocery v. Atchison Topeka & Santa Fe Ry. Co.*, 284 U.S. 370 (1932); *Mtr. of National Fuel Gas Distribution Corp. v. Public Service Comm'n.*, 97 A.D.2d 674 (3d Dep't 1983); *app. den*. 61 N.Y.2d 607 (1984): *Mtr. of Niagara Mohawk Power Corp. v. Pub. Serv. Comm'n,* 54 A.D. 2d 255 (3d Dep't 1976). The Commission, moreover, does not have any general power to order a utility to make reparation or refunds to its customers. *Purcell v. New York Cent. R. R. Co.*, 268 NY 164, *cert. den.* 296 U.S. 545 (1935); *Mtr. of Niagara Mohawk Power Corp. supra*. Even if ultimately held to be constitutional, because PSL §66(20) is in derogation of the doctrine that ratemaking is prospective and the Commission has no general power to order a utility to make refunds to its customers, its terms must be strictly applied. *Rust v. Reyer*, 91 N.Y. 2d 355, 360 (1998)("a statute in derogation of the common law must be strictly construed"). Furthermore, PSL §66(20) is a retroactive statute and the Court of Appeals, quoting the dissent of Justice Breyer in *Eastern*

Enterprises v Apfel, 524 U.S. 498, 547 (1998), has noted that "for centuries our law has harbored a singular distrust of retroactive statutes." *James Sq. Assoc. LP v. Mullen***,** 21 N.Y. 3d 233 (2013).

PSL §66(20) states, in relevant part, that "[t]he [C]ommission may initiate a proceeding with respect to such a refund after the conclusion of any such twelve month period." This is not an open-ended invitation for the Commission to delve years into the past to identify and refund to customers any revenue related to earnings that might have exceeded some arbitrary level of earnings. Although there is no specific time period set forth in PSL§66(20) governing how long the Commission may wait to institute such a proceeding, "[a] reasonable time to act is presumed when there is no specific time given." *Bonanno v. Town Bd. of Babylon*, 148 A.D. 2d 532, 533 (2d Dep't 1989); *see also Luedeke v. Bd. of Police Comm'rs*, 87 A.D.2d 669 (3d Dep't 1982). Given that the statute is both of a class that is in derogation of the common law and has been "singularly distrust[ed]," the allowable time period for such review must be the most restrictive possible.

Waiting any longer than several months after the expiration of any 12 month period to commence a PSL §66(20) review is not reasonable for a number of reasons.

First, the Commission has an auditing Staff that is dedicated to each utility. That Staff is well-aware of the utility's financial information, virtually on a real-time basis. Consequently, it would be patently unreasonable for the Commission to wait more than a few months to initiate the PSL§66(20) review because the Commission is in possession of that utility's actual earnings at any given time.

Second, Distribution also directly reports its earnings to the Commission Staff at the conclusion of selected 12 month periods. Therefore, again it would be unreasonable for the

Commission to delay more than a few months of the close of a period to commence the PSL§66(20) review when Staff has been directly notified of the Company's earnings and the basis on which they are calculated.

One needs to look no further than the OTSC to understand that the Commission and its Staff were well aware of what the Company's past earnings were, as well as what its future earnings were likely to be. And, in the case of the OTSC, the Commission *did* take action directly to address those earnings by convening a temporary rate inquiry. Consequently, no 12-month period other than that directly addressed in the OTSC is properly in play and, even if PSL§66(20) were to survive a constitutional challenge, it would be completely inappropriate to address any period other than that raised within a reasonable time following the expiration of that 12-month period.

Third, and most important, no public company's earnings can be held open and subject to a review for an open-ended period. Timely, accurate financial reporting lies at the heart of the U.S. and world markets for securities. Such reports underlie the New York utilities' abilities to market their equities and raise money in the bond market. If a utility's earnings are to be subject to PSL§66(20) for some open, inchoate time, the ability of the utilities in this State to raise the money necessary for infrastructure investment will be seriously compromised. If investors can never rely on reported earnings because the Commission might launch an investigation of some alleged "excess earnings" for some bygone period, few such investors will be willing to place their hard earned funds in such a capricious environment.

Clearly, for the reasons expressed above, Section 66(20) has no application to Distribution's earnings. If, however, the ALJs disagree and decide that the statute should be applied, it must be obvious to all that the time period examined may not extend back beyond the most recently concluded 12-month earnings review. Any other inquiry would be patently unreasonable and contrary to the clear language of the law and good sense.[8]

In fact, in a state tax context the Court of Appeals has recently considered and rejected the use of retroactive tax statutes as an unconstitutional taking. The Court found:

> [T]he length of the period of retroactivity, also benefits plaintiffs… Regardless of whether the period of retroactivity is deemed to span 16 or 32 months, the length of retroactivity should be considered excessive and weighs against the State. While one year of retroactivity is not considered excessive according to Replan, the period of retroactivity was long enough in the present case so that plaintiffs gained a reasonable expectation that they would "secure repose" in the existing tax scheme (Replan, 70 NY2d at 456 [internal quotation marks omitted]). While the State points to various federal and state cases where tax laws with longer periods of retroactivity were upheld, many of the cases concerned curative measures by legislatures to correct errors, instances where logistical issues made retroactivity necessary (e.g. Welch v Henry, 305 U.S. 134, 144-149, 59 S. Ct. 121, 83 L. Ed. 87 [1938][retroactivity period of two years upheld where Wisconsin Legislature only met every two years and acted at its first opportunity]), or the lack of detrimental reliance by the taxpayers (e.g. Matter of Varrington Corp. v City of N.Y. Dept. of Fin., 85 NY2d 28, 33, 647 N.E.2d 746, 623 N.Y.S.2d 534 [1995][two-year period of retroactivity upheld where taxpayer did not detrimentally rely on the temporarily altered tax policy]). As none of these points is present here, the cases cited by the State are distinguishable.

James Sq. Assoc. LP v. Mullen, 21 N.Y. 3d 233 (2013). Here, where the Commission was well aware of Distribution's earnings and had an explicit policy permitting efficient utilities to retain such earnings, Distribution "gained a reasonable expectation that [its earnings] would 'secure repose'" and the confiscation of such earnings beyond the most recent 12-month period would be

[8] Distribution is well-aware of the Court of Appeals' admonition that "'[w]hile we have not absolutely precluded the possibility of estoppel against a governmental agency, our decisions have made clear that it is foreclosed in all but the rarest cases." *New York State Medical Transporters Ass'n v. Perales*, 77 N.Y. 2d 126, 130 (1990). At the same time, the doctrine is not inviolate and the Court of Appeals has found that "such exception as has been made to that rule is of "very limited application" and has been "addressed to an unusual factual situation." *Daleview Nursing Home v. Axelrod*, 62 N.Y. 2d 30, 33 (1984). The Company believes that the unique facts in this case certainly constitute the unusual factual circumstances anticipated by the Court of Appeals, given that the Commission was well-aware of Distribution's earnings in every 12-month period and yet took no action. Moreover, given that such inaction was due to the Commission's explicit policy of permitting efficient utilities to retain such earnings, Distribution was more than justified in believing that such earnings were not subject to any refund obligation.

an unconstitutional taking.

Finally, it needs to be said that the government should not engage in a game of "gotcha" and seek to extract millions of dollars of prior earnings, over a multi-year period, from a company that, by the Commission's own admission, has "done nothing wrong." Distribution's rates were established in an order issued by the Commission in 2007. The rates charged by Distribution pursuant to that order were held to be just and reasonable, and have been lawfully charged to customers, in compliance with the Company's tariff and in exchange for safe and reliable gas service, ever since then. In the same way that rates had been established in the overwhelming majority of rate cases decided by the Commission over its many years of setting rates, there was no earnings sharing mechanism or obligation imposed on the Company to file a future rate case.

The Company has kept its books and records open for inspection by the Commission and has regularly reported its earnings to the Commission's Staff, ever since then. More to the point, in reliance on the perfectly reasonable expectation that it would be permitted to retain revenues in excess of its cost of service as an incentive for efficiency and productivity, the Company embarked on a program of cost savings and efficiencies that successfully reduced overall operating expense. The result was that the Company avoided a rate case while every other utility in the state filed for, *and received*, rate increases. In other words, the Company's customers directly benefitted from Distribution's efforts, enjoying stable delivery rates for six years, while commodity prices fell.

It might, of course, be one thing if the Commission were to extract windfall profits from a utility for the very reason that they were a "windfall" – defined by Merriam-Webster's dictionary as "an unexpected, unearned, or sudden gain or advantage." While that might be the case with "unearned" profits delivered by unseasonably cold and unadjusted weather-related revenue, it is certainly *not* the case where the profits were delivered solely by efficiencies the utility achieved that were over and above the imputed efficiencies that were already six times higher than were normally imputed in a rate case (*i.e,* one percent standard productivity adjustment vs. six percent in Distribution's 2007 rate order).

Pulling the rug out from under the utility after the fact and confiscating the earnings resulting from these efficiencies would not only be punitive, it would simply be wrong. As the United States Supreme Court observed:

> Our Government should not by picayunish haggling over the scope of its promise, permit one of its arms to do that which, by any fair construction, the Government has given its word that no arm will do. It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their government. It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one-way street. To say to these appellants, 'The joke is on you. You shouldn't have trusted us,' is hardly worthy of our great government. Men naturally trust in their government, and ought to do so, and they ought not to suffer for it.

Heckler v. Community Health Servs., 467 U.S. 51, 61 (1984)(citations omitted). Here, where Distribution's effort was in response to a well-articulated and long-standing policy of the Commission to reward such efficient utilities for their productivity gains by permitting the utility to keep the fruits of its earnings above the nominal ROE identified in the current rate order, the Company was doing *exactly* what the Commission asked it to do. Under the circumstances, any attempt to deprive Distribution of those efficiency gains would be an unseemly violation of that long-standing regulatory bargain.

CONCLUSION

PSL§66(20) was enacted specifically to permit the Commission to address a situation where a utility had bestowed upon it windfall profits purely by happenstance and through no reason of its own superior performance. The law was intended only for such purposes and such review was to be swiftly applied following discovery of the "windfall."

That situation no longer obtains. Weather and usage related windfalls are a thing of the past, rendered obsolete by the use of WNCs and RDMs. Today, it is highly unlikely that a utility would exceed the rate of return found reasonable in its last rate case, unless that utility achieved productivity gains. For this reason, the disgorgement of revenue related to those efficiency earnings would be directly contrary to the long-standing, expressed policy of the Commission that utilities are entitled to retain such earnings as an incentive to greater efficiencies.

In this case, the record is irrefutable, and the Commission has recognized, that Distribution's earnings are the direct result of its efficiency efforts. These efforts also directly benefitted the Company's consumers, providing them with the lowest residential gas rates in the state, together with superior customer service and high levels of safety. Under the circumstances, there is no reason why PSL§66(20) should be applied in this proceeding, even in the unlikely case that it remains a lawful statute. The ALJs should, therefore, issue a report to the Commission finding that PSL§66(20) is inapplicable and contrary to Commission precedent, sound ratemaking principles and the best interests of the Company's customers and investors.

Respectfully submitted,

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