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	:
Corporation for Gas Service.	:

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REPLY OF NATIONAL FUEL GAS DISTRIBUTION CORPORATION ON THE APPLICABILITY OF PUBLIC SERVICE LAW §66(20) TO THIS PROCEEDING

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October 16, 2013

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 13-G-0136 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service.	:

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GAS DISTRIBUTION CORPORATION
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I. INTRODUCTION

A. Overview

On August 26, 2013, Administrative Law Judges Kevin J. Casutto and David L. Prestemon issued a Ruling on Scope and Schedule addressing, among other things, the applicability of Public Service Law §66(20) to this proceeding. In accordance with that ruling, on September 13, 2013, National Fuel Gas Distribution Corporation ("National Fuel" or the "Company") filed a position statement ("Position Statement"). Responses to the Position Statement were filed by the Public Utility Law Project ("PULP") and the Department of Public Service ("Staff"). National Fuel hereby submits the instant Reply to the responses of PULP and Staff.

Both Staff and PULP go to great lengths to blur the distinction between the Commission's clear power to engage in prospective, temporary ratemaking under PSL §§72 and 114 and its highly questionable power to engage in retroactive ratemaking under PSL §66(20). This, perhaps, is understandable as a tactic but it fails to observe established legal and

constitutional protections.

Even if PSL §66(20) were not constitutionally infirm, its use as a "remedy" under these circumstances would violate sound rate making practices designed for the benefit of utility customers. It bears repeating: application of PSL §66(20) would be bad for customers. The question is whether the proponents of PSL §66(20) desire to subvert the long term interest of customers, reflected in well-established rate making principles, to a short-sighted, but politically expedient "fix" for a problem that does not exist.

As we have demonstrated in our filings to the Commission and in our presentations to the courts of this state, there is a vast difference between the Commission's well-established and properly thought out power to engage in temporary ratemaking and the blatantly unconstitutional and unfair legislative reaction to an isolated event that became PSL §66(20).[1]

We have also amply shown that the earnings experienced by National Fuel were not simply bestowed on it by some "act of the gods." Rather, those increased earnings resulted solely from the exceptionally difficult efforts of the Company's management and employees to lower the Company's costs. Those efforts, consequently, are *exactly* what the Commission has asked of its regulated utilities and merit both recognition and reward. Notwithstanding statements of Staff and PULP to the contrary, the productivity achieved by National Fuel is precisely consistent with the Commission's policy goals of providing incentives to productivity and efficiency and rewarding subsequent efficiency gains with higher earnings. These are goals that have been consistently enunciated for years, most recently in the Commission's own

[1] The legislative history amply demonstrates that PSL §66(20) arose solely because gas utilities refused to return profits from the unusually severe winter of 1977-78, after having suffering earnings shortfalls for years due to warmer than normal weather. The lack of symmetry in the statute is manifest. Fortunately, that shortcoming was addressed by a more enlightened Commission policy of weather normalization clauses that provided investors and consumers with equal protection.

Temporary Rates Order in this case.[2]

B. National Fuel Was Not "Overcharging" Customers

Repeating a fiction does not make it a fact and one oft-repeated fiction needs to be laid to rest – National Fuel was *not* overcharging its customers. The Company's rates were last set back in 2007. No other gas utility in the state has lower residential rates than National Fuel. With rate stability and lower gas commodity costs, National Fuel's customers are enjoying lower heating bills than they have seen in decades –both in real and relative terms. If a customer goes to a department store and sees two equally high quality coats, the customer could care less if the manufacturer of the coat costing $100 is earning more than the manufacturer of the equivalent coat costing $110. And certainly that customer does not feel in the least to be "overcharged" when she purchases the $100 coat.[3] National Fuel, like the more efficient coat manufacturer, was providing significant value to its customers at lower prices, along with excellent customer service and safety. If that is a "bad" thing, then something is seriously amiss with regulation in this state.

Equally important, National Fuel's 2007 rate case was a fully litigated case. Unlike negotiated rate plans resulting from settlements, the entire range of the Company's costs and plant expenditures were exhaustively investigated in that case and the Company was held to strict levels of cost control. In fact, as the Commission recognized, instead of the usual 1% productivity adjustment target traditionally imposed on utilities' labor costs to drive greater efficiency, National Fuel's rates incorporated a 6% productivity adjustment. Case 07-G-0141,

[2] Case 13-G-0136, *National Fuel Gas Distribution Corporation*, Order Setting Temporary Rates (issued June 14, 2013)("Temporary Rates Order").

[3] The Company is perfectly aware that, with cost of service regulation, the analogy is not completely on point, but to a customer, the result is the same. A utility providing a lower price for an equivalent level of service should be encouraged, not punished with threats of taking away the very earnings that resulted from its efficiency and lower prices.

National Fuel Gas Distribution Corp., Order Establishing Rates for Gas Service, December 21, 2007, pp. 8-9. This means that the productivity goal set for National Fuel was *six times higher* than normally set for other utilities. Despite this, the Company's diligent efforts to control and cut expenses surmounted even that high hurdle. The Commission has said many times that efficient utilities should experience higher earnings. The Company's performance fully merited those earnings.

Finally, as a matter of law, the Company was not overcharging its customers. The Commission is well-aware that utilities are permitted to charge only their filed and approved rates and, if National Fuel had attempted to charge any other rate, it would have been subject to severe sanctions under the Public Service Law. Furthermore, the courts of this state have made it clear that when a utility charges its filed and approved rates, there is no "overcharge" that can be claimed. *Porr v. NYNEX Corp.,* 230 A.D.2d 564 (2d Dep't 1997); *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"). Quite simply, the claim that customers were somehow "overcharged" is both legally insupportable and insulting to the many employees of National Fuel who have labored ceaselessly and successfully to provide customers with the most efficient utility service possible.[4]

II. THE COMMISSION HAS ALL THE POWER IT NEEDS TO ADDRESS SO-CALLED "EXCESS EARNINGS" THROUGH ITS WELL-ESTABLISHED POWER TO SET TEMPORARY RATES

[4] It is also worth noting that had the Commission determined that National Fuel was, in fact, charging higher rates than warranted, the Commission had the means of setting new rates when it established temporary rates in the Temporary Rates Order. Instead, the Commission merely declared the Company's *existing rates* to be "temporary" and subject to refund, a meaningless distinction to customers who actually pay bills on a monthly basis. The Commission's decision to hold existing rates steady, when those rates could have been changed, is rather convincing evidence that the Company was not (and is not) "overcharging" its customers.

Both Staff and PULP appear to believe it is perfectly fine to go back years in the past to deprive a utility of earnings that were recorded, booked and distributed to investors. In addition to the chaos that this would sow, we show *infra* that it is manifestly unworkable and patently unconstitutional. Moreover, it is completely unnecessary. The Commission has all the power it needs to address "overearnings" through its clearly lawful and long established power to set temporary rates.

In our Position Statement we observed that PSL §66(20) is a retroactive statute and the Court of Appeals has noted "a singular distrust of retroactive statutes." *James Sq. Assoc. LP v. Mullen*, 21 N.Y. 3d 233 (2013). Although PULP and Staff claim, without any citation, that the Commission is free to go back over any period of years to order disgorgement of revenue above the authorized ROE (*see e.g.,* PULP at 17-18), the statute does not grant the Commission this power. It says only that the Commission may order the refund of revenue "in excess of its authorized rate of return for a period of twelve months...after the conclusion of any such twelve month period." We previously noted in our Position Statement (p. 19) that, because 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...." *Bonanno v. Town Bd. of Babylon*, 148 A.D.2d 532, 533 (2d Dep't 1989); *see also Luedeke v. Board of Police Comm'rs*, 87 A.D.2d 669 (3d Dep't 1982). We further demonstrated that waiting any longer than several months after the conclusion of a 12 month period would not be reasonable.[5]

In fact, there is no need for the Commission ever to resort to the dubious powers granted by PSL§66(20). In the event that a utility is achieving earnings at levels which the Commission finds to be unacceptable, it need only invoke its well-established power to set lower, temporary

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[5] Under PULP's and Staff's open-ended definition, nothing would stop the Commission from seeking refunds beyond the date of the last rate order, indeed, in this odd statutory construction, nothing would prevent disgorgement of revenue back to the passage of Section 66(20) in 1978.

rates under PSL §§72 and 114. Utilities, National Fuel included, routinely report their earnings levels to the Commission. Moreover, Department of Public Service auditors routinely monitor the large utilities and are aware of their earnings, virtually on a real time basis. At any point that the Commission believes that such earnings have reached an unacceptably high level and are likely to stay at that level for a time, it has only to commence an investigation under PSL §72 and set a lower rate at a more acceptable earnings level.[6]

Contrary to Staff's and PULP's contentions, the Commission is not hamstrung in the least by such a process and there is no need ever to resort to PSL§66(20). Whether a utility's rates are set via a one year, fully litigated proceeding or through a joint proposal and ensuing rate plan, the Commission is almost immediately aware if a utility's earnings are likely to cross an "overearnings" threshold meriting a temporary rate proceeding. If that threshold is not crossed, some levels of earnings in excess of the return on equity last determined are fully consistent with the Commission's oft-expressed view that efficient utilities do and should experience such earnings. *See, e.g.,* Case 13-G-0136, *National Fuel Gas Distribution Corp.*, Order Setting Temporary Rates, p. 8 (June 14, 2013); 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.

Given that the Commission and the Staff are well-aware, on virtually a real time basis, what a utility's past and future earnings are likely to be, it would not be responsible for either to

[6] Staff, perhaps unwittingly, confirms National Fuel's view that the temporary rate power provides the Commission with all the power it requires to address overearnings. In our Position Statement, we pointed out that, more than a decade ago, NYSEG was earning a rate of return on equity of over 40% and yet the Commission did not invoke PSL §66(20), In retort, Staff says: "When NYSEG filed with the Commission a proposed Electric Price Protection Plan to modify and extend the terms of the still active but soon-to-expire rate plan, the Commission took action almost immediately to establish temporary rates on learning that NYSEG was receiving excess profits" *citing* Case 01-E-0359, *New York State Electric & Gas Corporation*, Order On Temporary Rates, (issued January 10, 2002). Staff confirms, therefore, that temporary rates are the appropriate response to so-called "overearnings" – even at levels that approach four times the ROE currently being awarded.

remain silent and permit that situation to continue if the level or likely persistence of such earnings produces an intention ultimately to resort to a dubious remedy such as PSL§66(20). To do so would be unfair to the utility, its consumers and investors.

III. STAFF AND PULP CAVALIERLY IGNORE THE SERIOUS PROBLEMS INHERENT IN ANY EARNINGS REVIEW UNDER PSL§66(20).

Section 66(20) is an ill-considered law that suffers from serious shortcomings, not the least of which is its vagueness in referring to "revenues… in excess of its authorized rate of return…." The Company has pointed out that:

> 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.

Position Statement at 7.

PULP contends that:

> The plain language of the statute gives the Commission "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*." PSL § 66(20)(*emphasis added*). This clearly gives the Commission discretionary power to order refunds if the utility return on equity exceeded the return allowed when rates were last calibrated.

PULP at 3. PULP goes on to contend that "National Fuel's strained effort to twist the plain statutory language requiring refund of earnings above the authorized return into a confusing reference to a 'meaningless number' should be rejected." *Id.* PULP even goes so far as to argue that "[t]he ordinary or natural meaning of the 'authorized rate of return' language in the statute, as is reflected by the Commission's discussion and use of the terms in the OTSC, is the same as the ROE and the "allowed rate of return." PULP at 4. PULP misunderstands the statute and even some well-established principles of utility regulation.

The statute provides that 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.

The statute, therefore, clearly refers to an "authorized rate of return." It does not refer to a ROE. Although PULP accuses National Fuel of trying to provide an "alternative definition" of the term "rate of return," it is the Legislature, not National Fuel, which chose that term and not "rate of return on equity." And it is PULP, and not National Fuel, that is contending for words that are not in PSL §66(20).

As a long-time participant in utility cases, even PULP should understand that there is a fundamental difference between a rate of return and a rate of return *on equity*. The distinction between the two is no mere matter of semantics. As much as PULP might want the two concepts to be interchangeable, they are not. "Where the statutory language is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used…." *Patrolmen's Benevolent Assoc. v. New York*, 41 N.Y.2d 205, 208 (1976). The failure of the Legislature to include a matter within a particular statute is an indication that its exclusion was intended as a matter of legislative design and any other construction of the statute would amount to judicial legislation. *Pajak v. Pajak*, 56 N.Y.2d 394, 397 (1982). "[N]ew language cannot be imported into a statute to give it a meaning not otherwise found therein. Moreover, a court cannot amend a statute by inserting words that are not there, nor will a court read into a statute a provision which the Legislature did not see fit to enact." *Chemical Specialties Mfrs. Ass'n v. Jorling*, 85 N.Y.2d 382, 394 (1995). "A court cannot by implication supply in a statute a provision which it is reasonable to suppose the Legislature intended intentionally to omit"

because "the failure of the Legislature to include a matter within the scope of an act may be construed as an indication that its exclusion was intended. In other words, we cannot read into the statute that which was specifically omitted by the Legislature." *Commonwealth of the N. Mariana Is. v Canadian Imperial Bank of Commerce*, 21 N.Y.3d 55, 62 (2013).

A utility's rate of return is composed of the return on debt and on equity. The statute, which is clearly in derogation of constitutional property rights, says only that a refund may be required if a utility exceeds its "rate of return." As much as PULP might want the two concepts to be interchangeable, they are not. If the law is inadequate, the Commission does not have the ability to rewrite it. *Saratoga County Chamber of Commerce v. Pataki*, 100 N.Y.2d 801, 818 (2003).

Staff counsels an even more problematic approach – one that is permitted nowhere in the statute and which is anathema to reasoned ratemaking. Staff contends (at 10) that:

> PSL §66(20) is a traditional ratemaking exercise that determines the Company's costs including a fair rate of return on the Company's investment in order to establish the amount of revenues required to recover the cost of service.

PSL §66(20) does no such thing. Assuming arguendo that it is constitutional, which it is not, PSL §66(20) allows the Commission only to refund to consumers "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." This does *not* permit the Commission to engage in a "ratemaking exercise." It does *not* permit the Commission to determine a new, fair rate of return and it does *not* provide the Commission with any power to "establish the amount of revenues required to cover [that newly determined] cost of service."

The Commission has no general power to engage in retroactive ratemaking. *Mtr. of National Fuel Gas Distribution Corp. v. Public Serv. Comm'n.*, 97 A.D.2d 674, 675 (3d Dep't

1983), *app. den.* 61 N.Y.2d 607 (1984) (holding that "it is well settled that retroactive rate-making is not permissible"); *see also Mtr. of Niagara Mohawk Power Corp. v. Public Serv. Comm'n,* 54 A.D.2d 255 (3d Dep't 1976). Staff's contention (at 8) that "non-prospective ratemaking exercises are permissible where, as here, there is specific statutory authorization for them" is difficult to fathom, especially given the fact that the very case which Staff cites held that retroactive revision of prospective reimbursement rates was impermissible. *Wellsville Manor Nursing Home v. Axelrod***,** 142 A.D.2d 225, 227 (3d Dep't 1988)("Petitioner's claim that the retroactive revision of the reimbursement rates in this case violates the provisions of Public Health Law § 2807 (7) (a) establishing prospective Medicaid reimbursement rates is well taken."). This is especially true when the Commission has said many times that its ratemaking actions are rulemaking under SAPA, and SAPA §102(2)(a) speaks of the "prescription for the future of rates." Prospective ratemaking is, of course, exactly what the Commission did on December 21, 2007. Case 07-G-0141, *National Fuel Gas Distribution Corp.*, Order Establishing Rates for Gas Service (December 21, 2007).[7] Staff now advocates that it is perfectly fine retroactively to readjust those rates. It is not.

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[7] The United States Court of Appeals for the D.C. Circuit provided a useful test for whether a *post hoc* adjustment to rates was, or was not, retroactive ratemaking:

> Whether approval of the proposed surcharges would be retroactive ratemaking depends upon one's characterization of the superseded fuel adjustment clauses. If those clauses are viewed (as petitioners do) as cost of service tariffs with deferred billing, then the requested surcharges which merely assure that the utilities recover their fuel costs would not be retroactive rate increases. But if the superseded clauses are viewed (as the Commission does) as fixed rate tariffs which used past costs as a proxy for the actual current cost, then the proposed surcharges would indeed be retroactive rate increases.

Public Service Co. of New Hampshire v. Federal Energy Regulatory Comm'n, 600 F.2d 944, 950 (D.C. Cir. 1979). By that standard the rates set in 2007 were clearly fixed rate tariffs and any attempt to reset them retroactively would constitute impermissible retroactive ratemaking. The *PSNH* case also shows, dramatically, why PSL §66(20) is so wrong. Rates can be set for the future with no true up, which is the procedure followed by the Commission's 1977 Policy Statement. Alternatively, they can also be set provisionally and trued up at a later date. What cannot be done is for rates to be set for the future based on a forecast and then trued up only if earnings exceed the rate of return but not if they fall short. This is the fundamental equal protection problem that renders PSL §66(20) facially unconstitutional.

What Staff counsels, of course, is a huge leap from the powers granted in the statute and goes way beyond the power granted by the Legislature to refund, for a 12-month period, any revenues collected in excess of the authorized rate of return. Indeed, Staff's claim that the Commission can engage in a backward looking, temporally unbounded retroactive ratemaking exercise is nowhere countenanced by the law and goes far beyond the limited exercise envisioned by the Legislature in PSL §66(20).

In any event, as will be demonstrated in the following section, neither PSL §66(20) nor Staff's lavishly expanded view of the Commission's powers under that law, pass constitutional muster.

IV. ANY EFFORT TO USE PSL §66(20) BEYOND LIMITED PROCEDURAL AND TEMPORAL BOUNDARIES RUNS AFOUL OF BASIC DUE PROCESS PROTECTIONS

As noted, PSL § 66(20) provides that the Commission may order "a refund [of] revenues in the aggregate in excess of its authorized rate of return for a period of twelve months…after the conclusion of any such twelve month period." The rate year in Case 07-G-0141 was calendar year 2008 and the Company's cost of equity of 9.1% was set for that period and for no other. The time for the Commission to investigate whether National Fuel exceeded the 9.1% cost of equity set for 2008 was shortly after the expiration of that calendar year. PULP, however, now advocates that the Commission should "look-back… at least to 2010." PULP at 21. Staff appears to say that the Commission can use any past 12-month period. Staff Statement at 7. The Company disagrees. Using any period beside the calendar 2008 rate year from the 2007 rate case simply cannot be squared with constitutional due process protections.

The 9.1% cost of equity was set for the Company in an order issued in December 2007. Attempting to use that cost of equity for any period other than the rate year following its

determination is constitutionally infirm. Supreme Court precedents are crystal clear that "[t]he just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property *used at the time that it is being used for the public service.*" *Board of Public Utility Comm'rs v. New York Tel Co.*, 271 U.S. 23, 31 (1926)(emphasis added). In fact, the Supreme Court has directly held that "what would have been a proper rate of return for capital invested in gas plants and similar public utilities a few years ago furnishes no safe criterion for the present or for the future." *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679, 694 (1923); *citing Lincoln Gas & Electric Light Co. v. Lincoln*, 250 U.S. 256, 268 (1919). The Commission, however, did not specify a reasonable rate of return for National Fuel for any year but 2008 – not for 2009, or for 2010, or for 2011, or for 2012, for that matter. For the Commission to now try to confiscate revenue in any year after 2008 based on a stale, 9.1% cost of equity that was determined in 2007 would violate some of the bedrock principles upon which modern ratemaking rests.

This is amply demonstrated by considering that the cost of equity was determined by the Commission to be approximately 10.5% in 2009:

> As noted, the Joint Proposal reflects the parties' agreement on a cost of common equity of 10.70% including the 20 basis point stayout premium. The underlying 10.50% cost of equity was presented in Staff's testimony and was uncontested. Staff's analysis, taking an approach similar to our decisions in other recent cases, identified a gas and electric utility proxy group with a 10% cost of equity; then Staff derived its 10.50% estimate by adding 50 basis points to recognize additional risk on the theory that Corning's risk more closely resembles that of a BBB rated utility rather than the proxy group's.

Case 08-G-1137, *Corning Natural Gas Co.* Order to Show Cause Regarding Revenue Requirement and Rate Design and Further Suspending Rate Filing, July 17, 2009, 2009 N.Y. PUC LEXIS 88. This is no anomaly, because in April of that year, the Commission found that the gas and electric proxy group produced an ROE of 10.41%. Cases 08-E-0539; 08-M-0618,

Consolidated Edison Company of New York, Inc., Order Setting Electric Rates, April 24, 2009, 2009 N.Y. PUC LEXIS 507. Given that the cost of equity in 2009 was as high as 10.5 % for the gas and electric proxy group, forcing National Fuel to disgorge any earnings from that year above a 9.1% ROE would be confiscatory on its face. Nor may the Commission use the higher 10.5% ROE for disgorgement purposes because the statute only permits the Commission to order the disgorgement of revenue above the "authorized rate of return," which, in National Fuel's case, is a return composed of debt costs and an ROE of 9.1% that would have been patently deficient in 2009. Again, Section 66(20) does not permit the Commission to use any other return for disgorgement purposes than the "authorized rate of return." And, where that return is stale, as it is here, nowhere does PSL §66(20) permit the Commission to determine a new, constitutionally acceptable rate of return on equity for purpose of refunding so-called excess revenue. Consequently, for any year other than the 2008 Rate Year determined in Case 07-G-0141, the statute cannot be followed consistent with constitutional due process protections.[8] (And, if the Company's court challenge is correct, the statute would not be constitutional in any setting due to its facial unconstitutionality on equal protection grounds.)

Furthermore, if the Commission were to try to decide today what would be a proper ROE for a past period, it would clearly run afoul of the rule against retroactive ratemaking. *Mtr. of National Fuel Gas Distribution Corp. v. Public Serv. Comm'n., supra*; *Mtr. of Niagara Mohawk*

[8] A similar exercise can be applied to 2010, 2011 and 2012. For example, in the Central Hudson rate case decided in 2010, the Commission noted that "the cost of equity methodology presented in Staff's testimony (if updated to the time of the Joint Proposal) supports a 9.65% cost of equity." Cases 09-E-0588; 09-G-0589, *Central Hudson Gas & Electric Corp.*, Order Establishing Rate Plan, June 18, 2010, 2010 N.Y. PUC LEXIS 186. In 2011, the ROE was 9.2%. Case 10-E-0362, *Orange and Rockland Utilities, Inc.* Order Establishing Rates For Electric Service, June 17, 2011, 2011 N.Y. PUC LEXIS 275. And for 2012, a cost of equity of 9.4% to 9.6% was established for Orange and Rockland. Case 11-E-0408, *Orange and Rockland Utilities, Inc.*, Order Adopting Terms off Joint Proposal, With Modification, and Establishing Electric Rate Plan, June 15, 2012, 2012 N.Y. PUC LEXIS 245 Again, forcing refunds based on a 9.1% cost of equity would have been clearly confiscatory, yet Section 66(20) would permit the use of no other rate than the rate of return, or as PULP would have it, the ROE inherent in that rate of return.

Power Corp. v. Public Serv. Comm'n, supra. Even Staff concedes, as it must, that retroactive ratemaking is prohibited except for the limited situations where a statute allows it. Even if PSL §66(20) were held to be lawful, the limited grant of power in that law is manifestly insufficient to permit the Commission to engage in a wholesale restaging of the 2007 rate case, including a redetermination of the ROE. In all cases, then, the statute cannot stand for the expansive powers to which Staff and PULP attribute to it and would constitute a clear violation of due process were it to be so applied.

V. STAFF'S AND PULP'S CONTENTIONS THAT NATIONAL FUEL'S ARGUMENTS ARE CONTRARY TO COMMISSION POLICY SIMPLY DON'T HOLD WATER

Pointing to the Commission's relatively recent history of adopting Joint Proposals for rate plans containing Earnings Sharing Mechanisms ("ESMs"), Staff contends that:

> [National Fuel] then makes the unsupportable leap of logic that because such excess profits were thus achieved via the utility's own operational productivity and efficiency efforts, the utility is entitled to retain the entire amount of such gains. In making this argument, [National Fuel] claims not only that the foregoing is Commission policy, but that it is the only way to encourage utilities to make such cost cutting efforts. [National Fuel's] all or nothing proposition belies the Commission's actual policy and practice and therefore provides no support for its assertion that PSL §66(20) is inapplicable in this matter

Staff is wrong on multiple levels. First, the practice of allowing utilities to retain the benefit of productivity driven earnings increases between rate cases reflects a long-standing policy of the Commission that was affirmed in the Temporary Rates Order issued in this very case. If the result is that the utility achieves higher earnings than it would have earned in the absence of such efficiency efforts, that is hardly a surprise – it is the very purpose of regulatory lag. Thus the dispute is not over the fact that productive utilities are permitted higher earnings. They are.[9]

[9] In fact, not only are productive utilities permitted to keep the earnings above the authorized rate of return as an incentive for productive operation but the Commission has even awarded a higher than usual ROE as an explicit recognition of productivity and innovation. In Case 27014, *Rochester Telephone Corp.,* 17 NYPSC 448, 462

Second, the Company never claimed that permitting a utility to retain the entire amount of productivity gains "is the only way to encourage utilities to make such cost cutting effort," as Staff contends. National Fuel acknowledges that there are many ways for the Commission to encourage and reward productivity. The Company's point was that singling out the utility with the lowest rates in the state and the longest period of refraining from seeking higher rates for the imposition of both temporary rates *and* a PSL §66(20) inquiry doesn't appear to be an especially effective way to "reward" such productivity and efficiency. National Fuel further acknowledges, as discussed *supra* that the Commission is well within its rights and traditional powers to commence an investigation, even including setting temporary rates, when earnings exceed a certain level over an appropriate incentive level. Engaging in a retroactive earnings grab, however, is nothing other than a punitive exercise, because it does not reflect Commission policy. It is possible that the Commission's decision to impose PSL §66(20) on National Fuel, under these circumstances, is the first expression of a major shift in longstanding policy that has yet to be articulated. If that is indeed the case, then the Commission needs to explain that new policy in a future effort to impose PSL §66(20), because that explanation, which is required when an agency changes policy, is wholly absent here.

Staff then goes on to claim that ESMs have become the norm and "[w]ithout the existence of any earnings sharing mechanism, the Company's customers receive no benefit from the actual excess earnings taken in by [the Company]." Staff Statement at 9. Hyperbole is no substitute for reasoned debate. It should be obvious that, where a Company such as National Fuel, has provided its customers with almost six years of rate stability, has the lowest residential rates in the state and has exemplary customer service and safety, the charge that the Company's

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(1977), the Commission agreed with the ALJ that, although an ROE or 12.75% would be adequate, a 13.0% ROE was warranted due to Rochester's "commitment to efficiency and productivity." The 25 basis points award was viewed as a "modest premium" to reward that utility for its past actions.

customers have received "no benefit" rings hollow, indeed. Especially when, as Staff well knows, other utilities with the vaunted "earnings sharing mechanism" have sought *and received* multiple, sometimes successive rate increases over the same period. Utility rate increases are not a periodic *fait accompli*. When given the opportunity to earn, utilities can and do avoid rate increases. This was demonstrated by National Fuel, to the immense benefit of western New Yorkers, and has also been demonstrated by utilities in other jurisdictions where ESMs (and inordinately complex, highly prescriptive rate plans) are not the norm. Staff's "no benefit" claim also pretends that Staff is ignorant of the fact that National Fuel beat an effective 6% productivity adjustment, held rates steady and avoided a rate case for years while other utilities increased rates, sometimes more than once. Under the circumstances, the proper question might be why National Fuel without an ESM managed to produce better results for its customers than did other utilities with such a mechanism, perhaps prompting the regulator to at least ask if ESMs, a very recent ratemaking vogue, are indeed better for customers than the model of ratemaking that obtained for about 80 years or more prior to the advent of ESMs.

Staff further charges that the Company's "Position Statement practically ignores the Commission's long standing policy of adopting earnings sharing mechanisms, and where [it] does acknowledge such clauses, it dismisses their importance." Staff Statement at 9. National Fuel did nothing of the sort. What the Company *did* say was that where another utility with an ESM, has earnings higher than National Fuel's – even after earnings are shared pursuant to the ESM – there is no reason to treat National Fuel differently from that other utility simply because it has an ESM and National Fuel does not. This seems self-evidently true but perhaps Staff missed its import. Furthermore, Staff also seems determined to ignore both the fact that the

Public Service Law nowhere discusses ESMs and the primary reason why ESMs exist in the first place, which was as a check on earnings resulting from "black box" settlements.

Although National Fuel concedes that multi-year rate plans with ESMs have both a common recent history and valid reasons for their existence, they are not the *sine qua non* for responsible ratemaking nor are they the only means of achieving incentives to productivity. Moreover, the Commission has proved itself more than capable of setting just and reasonable rates in fully litigated proceedings, both before the advent of multi-year rate plans and after, in litigated, one-year rate cases.

Certainly, the use of ESMs is not the only way to provide incentives for efficiency. Regulatory lag, in the context of a fully litigated rate case has historically provided an incentive to efficiency, as the Commission observed in the New York Telephone case cited in our Position Statement:

> 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, September 9, 1992, p. 49, 1992 N.Y. PUC LEXIS 60.

As a matter of fact, because multi-year rate plans entail forecasts over a longer period than the one-year, rate year prescribed in the 1977 Policy Statement on Test Years, the use of ESMs arose not as a prod to productivity but as a "check" on the accuracy of those longer, and less fully considered, forecasts. The Commission confirmed this recently in rejecting a multi-year rate plan without an ESM:

> ESMs protect customers should forecasts implicit in a rate plan prove materially inaccurate with respect to items such as expenses, revenues from customer classes not subject to an RDM, or rate year capital structure. If a company incurs a materially negative impact because of the forecast error, it has the option of applying for rate relief. (Indeed, under the terms of the Joint Proposal in this case, Corning could avoid the rate restrictions of the rate plan's second year and file a general rate application as early as October 2009.) In contrast, however, should the forecast error result in an achieved return on common equity (ROE) significantly higher than allowed in a rate plan, then the lack of an ESM leaves customers with no recourse for the duration of the plan unless the plan is terminated through procedures such as a show cause order.

Case 08-G-1137, *Corning Natural Gas Corporation*, Order to Show Cause Regarding Revenue Requirement and Rate Design and Further Suspending Rate Filing, July 17, 2009, 2009 N.Y. PUC LEXIS 881.

Staff's final salvo on the ESM/litigated rate case dichotomy for purposes of PSL §66(20), makes one wonder if Staff simply views the language of the law as an inconvenience or merely a "suggestion" to be applied according to regulatory whim:

> Thus, the existence of an earnings sharing mechanism, in and of itself, may be sufficient for the Commission to determine that rates producing high returns were just and reasonable when charged such that PSL §66(20) need not be invoked. Indeed, should the Commission decide to order a refund in this case, Staff would not be surprised if the Commission calculated such refund by using an earnings sharing formula, although it could use whatever method it felt best served the balance between customers and shareholders.

Staff Statement at 14. As noted previously, §66(20) provides no such latitude to the Commission. The Commission may not *re*determine a proper rate of return, it may not *re*determine expenses or other ratemaking indicia and it most certainly may not *re*determine to apply a sharing formula or "whatever [other] method it felt best served the balance between customers and shareholders if such determination is not authorized by statute." If there is a statute that provides that power, Staff has not identified it. Plainly, the law does not say, or even suggest, that such a non-statutory power can be imposed on a utility – let alone retroactively.

Apparently, the narrow constraints of PSL §66(20) present no obstacles to regulatory flights of fancy.

VI. PULP'S EXTRA RECORD PRESENTATION HOPELESSLY MISUNDERSTANDS THE COMMISSION'S PENSION AND OPEB POLICY

In their ruling of August 26, 2013, the ALJs directed the parties to address the applicability of PSL §66(20) to this case. Instead of complying with that ruling, roughly one-half of PULP's presentation amounts to a misguided evidentiary offering about accounting standards and National Fuel's Pension and OPEB expenses. This presentation must be disregarded. The place for such a presentation is in an evidentiary proceeding and not in a brief. *Wallman v. Wolfson*, 184 Misc. 520, 524 (Sup. Ct. N.Y. Co. 1945)("this is merely an assertion in a brief, and, of course, is not evidence."); *Public Service Comm'n v. Grand Cent. Cadillac Renting Corp.*, 183 Misc. 419, 423 (Sup. Ct. N.Y. Co. 1944) ("such statements are, of course, disregarded; statements in a brief are not evidence.") The Commission, itself, has recognized this fundamental tenet. Cases 95-C-0657; et al.; *Complaint of AT&T et al.*, PHASE 3 OPINION AND ORDER, Opinion No. 99-4, February 22, 1999, 1999 N.Y. PUC LEXIS 17 ("New York Telephone is correct. There is no reason why a recommended decision should not invite argument on issues it identifies, and we are capable of distinguishing between arguments properly made in brief and evidence that generally should be open to cross-examination before being relied on.").

In any event, PULP's discussion of Pension and OPEB expenses and deferrals founders upon the rocky shoals of its tenuous accounting knowledge and its incorrect grasp of the Commission's 1993 Policy Statement regarding those expenses (Case 91-M-0890, In the Matter of Policy Concerning the Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pensions, Statement of Policy and Order Concerning the

Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other than Pensions (issued September 7, 1993))("Policy Statement").

PULP's discussion of Pension and OPEB expense not only has nothing to do with PSL §66(20) but, rather, proceeds from the patently incorrect view that National Fuel somehow was remiss in hewing to a supposedly "unrealistic" belief that the long-term return on its Pension and OPEB plans would be 8.25%. E. g., PULP at 9. Of course, the return on the plans' assets was, as every American investor knows, adversely affected in the short-run by both the financial crisis of 2008 and the resultant action of the Federal Reserve in keeping interest rates at historically low rates. PULP charges that National Fuel's actuary should have adjusted the long-term return projection. PULP fails to understand that returns on plan assets change over time but the plan is intended to be a long-term arrangement. A short-term "snapshot" approach, such as advocated by PULP, could equally support a charge that the plan's return assumption was understated if market returns exceeded the 8.25% assumption – as they have for the last few years.

In addition to misunderstanding the long-term nature of the Pension and OPEB plans, PULP also misapprehends the Policy Statement and its goal, which the Commission clearly enunciated: "our Policy Statement regarding pensions and other post retirement benefits (OPEB) *allows for full recovery of pension and OPEB costs….*" Cases 12-E-0008; 09-E-0428, *Consolidated Edison Company of New York, Inc.*, Order Directing Use of Certain Credits to Offset $133.5 Million Surcharge, March 22, 2012, 2012 N.Y. PUC LEXIS 110 (emphasis added). Given the Commission's policy of permitting full recovery of pension and OPEB expense, if National Fuel had announced a change in assumptions as to the long-term return of the pension and OPEB plans – say halving it to 4% - the immediate result would have been a need to seek rates to recover the shortfall and the new, higher pension and OPEB expense or to

increase the deferral for future collection.

The remainder of PULP's presentation is wholly irrelevant, as it simply amounts to a complaint that the Policy Statement should have been changed to reflect PULP's odd view of how Pension and OPEB expense should be influenced by ASC 715-35-47, an accounting convention that has nothing to do with the Policy Statement. PULP at 11, fn. 8. National Fuel is, as are other utilities regulated by the Commission, governed by the Policy Statement. PULP, however, is seeking to have the Company governed by PULP's view of what the Policy Statement should contain, not what it *does* contain. This is made clear by PULP's statement that:

> The PSC Guidance does not appear to have been updated for the adoption of FAS 158, or its codification in ASC 715. Had the Guidance been updated for FAS 158 / ASC 715, the Company would have been required for ratemaking purposes to give consideration to the historic returns on its pension and OPEB plans as it annually reviewed it [*sic*] expected long term rate of return.

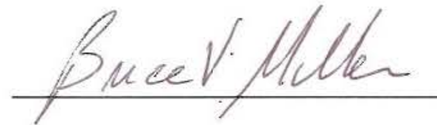
PULP at 11-12, fn. 9. National Fuel has clearly adhered to the Policy Statement. PULP's presentation, therefore, is irrelevant. If PULP wants a change to the Policy Statement, its remedy lies in a petition to the Commission, not an errant and unauthorized "backdoor" route through PSL §66(20).

VII. CONCLUSION

For the reasons expressed above, there is no basis to apply PSL §66(20) in this proceeding. As Staff's Statement acknowledges, the Commission's temporary ratemaking power has been used in the past to address situations where utilities were earning far more than National Fuel is earning here and the same remedy is equally available here. Indeed, where National Fuel's earnings have been in the same range of other utilities, the proper course is simply to conduct a prospective review of the justness and reasonableness of the Company's existing rates to determine if any adjustment is proper. PSL §66(20) has been on the books for over 35 years

and the Commission has never before ordered a refund under that law – even in cases where earnings were many times above the level the Company is earning here. To do so here would violate elementary principles of fairness and due process and would fly in the face of the Commission's own pronouncements about how ratepayers benefit from longstanding rate making practices that reward, and do not punish, efficient, productive utilities.

Respectfully submitted,



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Dated: October 16, 2013
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