Reed T. Warnick (#3391)
Paul H. Proctor (#(#2657)
Assistant Attorneys General
Utah Committee of Consumer Services
Mark L. Shurtleff (#4666)
Attorney General
160 East 300 South
P.O. box 140857
Salt Lake City, Utah 84114-0857
(801) 366-0552

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Complaint of BEAVER COUNTY, *et al.* Complainants, vs. QWEST CORPORATION *fka* U S WEST COMMUNICATIONS, INC., fka MOUNTAIN STATES TELEPHONE & TELEGRAPH SERVICES, INC. Respondent.	Docket No. 01-049-75 **UTAH COMMITTEE OF CONSUMER SERVICES' RESPONSE TO QWEST'S MOTION FOR SUMMARY JUDGMENT**

The Utah Committee of Consumer Services (Committee), pursuant to Utah Administrative Code R746-100-1.C and R746-100-3.I.2, and Rule 56 of the Utah Rules of Civil Procedure, hereby responds to Qwest Corporation's (Qwest) Motion for Summary Judgment against Beaver County, *et al*. (Counties). The Committee also requests oral argument on this motion.

INTRODUCTION

This controversy over a refund from Qwest contesting its property tax assessments from 1988 to 1996, has been pending in one form or another since December 1998 when the Counties filed Docket No. 98-049-48, a request for a declaratory ruling. At the same time, the Counties filed on behalf of all Qwest ratepayers in Utah a court action claiming entitlement to the refund. Despite a series of legal proceedings, including an appeal to the Utah Supreme Court, disputes before the Public Service Commission (Commission), the September 2001 commencement of Docket No. 01-049-75, a July 2002 Amended Complaint and a Motion to Consolidate the two dockets, undecided dispositive motions, and Commission attempts to guide the parties to a resolution, the Counties' claim has progressed only a short distance from where it began.

In connection with the Counties' Motion to Amend its complaint and to consolidate the dockets, the Committee described the case as one reflecting "the ambiguity which might be expected in a cause of action brought by utility customers rather than by the utility or a state agency concerned with utility matters and versed in the

customs and practices of regulatory and administrative proceedings." The Committee continues to believe that the case deserves to be heard on its merits.

STATEMENT OF THE CASE AND THE ISSUE

In the years 1988 to 1996, Qwest's rates for telephone service included the property taxes Qwest determined it would pay in the rate effective period. As the annual assessment notices of taxable value were issued, Qwest challenged the assessments upon which the taxes were based. In March 1998, Qwest, the Counties, and the Utah State Tax Commission's Property Tax Division stipulated to a $68,628,402 reduction. As a result, Qwest received a property tax refund of $16,900,000, principal and interest.

From the ratepayers' perspective, in the years 1988 to 1996 Qwest charged and collected as part of their telephone bill, $16,900,000 in excess of the property taxes Qwest actually paid.

Qwest acknowledges that the second cause of action to the Amended Complaint "at least allows [the rate reparations] issue to now be directly addressed by the parties and ruled on by the Commission." *Qwest's Reply to Counties Motion to Amend and Consolidate,* August 9, 2002, Page 2. The Commission stated in its September 30, 2002 letter pertaining to a technical conference, "typical Commission proceedings affect all of a utility's service groups and customers."

The Committee contends that under Utah law Qwest must return the property tax refund to Utah ratepayers who paid it in the first place. Therefore, Qwest's motion for summary judgment must be denied.[1]

ARGUMENT

I. Under rate of return regulation in place during the years 1988 to 1996, ratepayers would have benefited from the decreased property tax assessments.

Utility rates established under Utah law must be just and reasonable, nondiscriminatory and non-preferential. Before 1997, telephone rates were determined by considering Qwest's historical income and cost data, and predictions of future costs and revenues the company will encounter during the rate effective period. Once determined by the rate of return method, rates will not be changed during the rate effective period due to actual costs and revenues being higher or lower than anticipated. *Utah Department of Business Regulation v. Public Service Commission*, 720 P.2d 420, 420 (Utah 1986). [2]

Under rate of return regulation between the years 1988 to 1996, Qwest's new rates were adjusted based upon the actual results that varied from the original estimates. To set future rates, "[o]verestimates and underestimates are then taken into account at the next

[1] Qwest correctly states the standard and burden of proof against which Qwest's Motion for Summary Judgment is to be tested.

[2] The rule against retroactive ratemaking provides that utilities may not "adjust their rates retroactively to compensate for unanticipated costs or unrealized revenues." *Utah Department of Business Regulation v. Public Service Commission*, 720 P.2d 420, 420 (Utah 1986). Likewise, the Commission may not retroactively adjust public utility rates to account for costs lower or revenues higher than those anticipated.

general rate proceeding in an attempt to arrive at a just and reasonable future rate." *Id.* at 421.

As Qwest describes in its Motion for Summary Judgment at page 38, once charges are determined by to be just and reasonable in a final rate order, later facts that render the previously charged rate unjust or unreasonable are to be addressed prospectively in a rate case. This is the statutorily sanctioned method grants Qwest rate stability, creates an incentive for efficient operations and allows ratepayers to benefit from Qwest's efforts to reduce costs such as property taxes – those savings are reflected in rates to be charged in the future.

The prohibition of retroactive ratemaking coupled with the obligation to adjust future rates for actual results, maintained the balance between Qwest and its ratepayers respecting the benefits of the reduced property tax assessments. However, the 1995 Public Telecommunications Law upset this balance.

II. The 1995 Public Telecommunications Law denied ratepayers the benefit of the reduced property tax obligation to which they were entitled under rate of return regulation.

The Counties' Amended Complaint pleads in the alternative that "justice and equity require appropriate adjustments in future rates to offset the extraordinary financial consequence of over $16 million in property tax refund." Amended Complaint ¶ 31. Addressing this claim, Qwest asked "the more fundamental question of whether the

Commission retains statutory authority under the 1995 Public Telecommunications Law, Utah Code Ann. § 54-8b-1 *et seq*., to engage in traditional, rate-of-return ratemaking. The answer to this question is clearly no." *Qwest's Reply To Committee On Motions To Amend and Consolidate,* August 23, 2002, Page 6.

Qwest concludes from Utah Code Ann. § 54-8b-3.3(1), that prices from the total service long-run incremental cost of providing the service are forward looking, based on a reasonable provider's estimated future incremental costs, and therefore "there is no room for a cost component based on any past alleged "double recovery" of tax assessments just as there is no room for a component for the under-recovery of costs that may have actually been higher."[3] *Id.*, Page 7

The 1997 implementation of price regulation in place of rate-of-return regulation, deprived ratepayers of a reduced future rate as restitution for having overpaid eight years of property taxes. Because ratepayers must realize in some form, the benefit of the tax savings or refund gained under rate of return regulation, this change of law justifies if not compels the Commission to deny Qwest's motion for summary judgment and devise a remedy for ratepayers.

[3] Under the 1995 Act, beginning in May 2000, the Commission was to adjust maximum prices for tariffed public telecommunications services to reflect such factors as "changes in tax rates applied to the incumbent telephone corporation" or "any other extraordinary events not reasonably foreseeable as of April 30, 1997". Utah Code Ann. §54-8b-2.4(5)(b)(iv) and (vi). However, given the definition of total service long-run incremental cost, Utah Code Ann. §54-8b-2(18), and the impact of House Bill 338 passed in 2000, the possibility that ratepayers could receive the tax refund benefit in future rates under price regulation was eliminated.

III. The Commission may respond to the change in law that renders Qwest's previously charged rate unjust or unreasonable by considering a one-time refund to ratepayers based upon the property tax refund that does not violate the prohibition of retroactive ratemaking.

The general rule against retroactive ratemaking is a sound ratemaking principle, but it only applies to " "missteps in the rate-making process." It does not apply where justice and equity require that adjustments be made for unforeseen windfalls or disasters not caused by the utility." *MCI Telecommunications Corp. v. Public Service Commission*, 840 P.2d 765, 771 (Utah 1992). "The rule against retroactive rate-making is not absolute and does not rest on a constitutional right of a utility to earnings in excess of what is just and reasonable any more than the rule gives ratepayers a constitutional right to service at rates that are less than just and reasonable." *Stewart v. Public Service Commission*, 885 P.2d 759, 779 (Utah 1994). "Because earnings or expenses caused by an unforeseeable event cannot be reasonably anticipated in the rate-making process, justice and equity may require appropriate adjustments in future rates to offset extraordinary financial consequences." *MCI*, 840 P.2d at 778.

MCI defined the unforeseeable and extraordinary increase or decrease in expenses or revenues as those that have an extraordinary effect on the utility's earnings. 840 P.2d at 771. In this case, the property tax refund has an extraordinary financial consequence because ratepayers have been foreclosed by statutory change from their benefit of the

ratemaking bargain - the $16,900,000 tax refund becomes an unexpected windfall that Qwest may not retain.

IV. The circumstances of Qwest's receipt of a property tax refund without a corresponding obligation to adjust future rates compel a one-time refund to ratepayers.

"To achieve fairness, the exception [to prohibited retroactive rate-making] allows recoupment of [unforeseeable and extraordinary increase or decrease in] expenses either in future rates or in some other appropriate fashion." *MCI*, 840 P.2d at 772. A decision by the State of New York Public Service Commission provides guidance to an appropriate remedy in this case.

In its *Order Addressing State Tax Refund*, Case 04-M-0612, Petition of Central Hudson Gas & Electric, December 20, 2004, the New York Commission addressed competing claims to a $6,500,000 tax refund resulting from Central Hudson's offsetting a $539,000,000 gain from the sale of a fossil fuel electric generation plant with a tax loss on the sale of an interest in a nuclear generation facility.[4] The New York Commission found that under the circumstances, except for the utility's direct expenses incurred to obtain the refund, ratepayers should receive the benefit and shareholders were not entitled to a portion of the refund.[5]

[4] The Committee believes this is an unpublished opinion and so has attached a copy to the electronic filing and to the paper copy. Citations are to the paper copy.

[5] The Committee believes that Qwest is entitled to recovery the expenses directly and reasonably incurred in obtaining the stipulated settlement of its case before the Utah State Tax Commission.

The New York Commission rejected the utility's claim that the refund was related to shareholder risk, not ratepayer payments. The New York Commission also rejected the utility's claim that shareholders should benefit from management's tax reduction efforts and achievement. The New York Commission found the utility's efforts to reduce the taxes were neither involved nor elaborate. The utility faced little risk in pursing the refund because; having paid the full taxes due, the company was not exposed to penalties, late fees or accumulated interest. "Indeed, much of the risk in this instance remained with ratepayers while the company pursued an advisory ruling after the close of the tax year." *Order*, Page 11. The New York Commission also found that the tax refund was not recurring and therefore not the permanent and continuing tax reduction that yields substantial, long-term benefits for ratepayers.

Likewise, in this case, because of the changed ratemaking mechanism, the property tax refund bestows no benefit to ratepayers and is a windfall for Qwest shareholders. On page 42 of the Motion for Summary Judgment, Qwest lists eight reasons why no exception to the rule against retroactive ratemaking applies. However, viewed in light of the fact that a change in law deprives ratepayers of the ratemaking bargain, these reasons favor the Commission's consideration of ratepayer interests, just as the New York Commission did.[6]

[6] Qwest's reason (8) is only partially correct. Rate of return regulation required that the reassessed tax values be considered in setting future rates.

The Committee contends that not only is Qwest not entitled to retain the windfall as a matter of law, and thus its motion should be denied, but also the Commission is expressly authorized by Utah Code §54-4-4 to establish, after hearing, new rates or charges necessary to remedy unjust and unreasonable rates.

CONCLUSION

The issue before the Commission is whether the ratepayers who paid Qwest's 1988 to 1996 Utah property taxes should be credited for the refund Qwest received when the assessed taxable values were reduced. Under the ratemaking and regulatory method that charged ratepayers for the taxes, it is agreed that the ratepayers would have received the on-going rate benefit when the reduced assessments were used to calculate future rates.

However, a change in law deprived the ratepayers of reduced future rates and allowed Qwest to retain a $16,900,000 windfall. It is therefore, necessary for the Commission to appropriately address the inequity and unfairness evident in Qwest's double recovery of property taxes in the years 1988 to 1996 – once in rates and again in

the $16,900,000 refund. Qwest's Motion for Summary Judgment should be denied and the parties should be allowed a hearing upon the merits.

RESPECTFULLY SUBMITTED this 31st day of March 2005.

/s/_____

Paul H. Proctor
Assistant Attorney General
Utah Committee of Consumer Services

CERTIFICATE OF SERVICE

I hereby certify that a true and complete copy of the foregoing **RESPONSE TO QWEST'S MOTION FOR SUMMARY JUDGMENT** was served on the following by electronic mail on March 31, 2005:

Bill Thomas Peters
David W. Scofield
PETERS SCOFIELD PRICE
111 East Broadway, Suite 340
Salt Lake City, UT 84111
btp@psplawyers.com
dws@psplawyers.com

Michael Ginsberg
Assistant Attorney General
Patricia E. Schmid
Assistant Attorney General
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84114
mginsberg@utah.gov
pschmid@utah.gov

Robert C. Brown
Qwest Services Corporation
1801 California, 10th Floor
Denver, CO 80202
(303) 383-6642
(303) 296-3132 (fax)
robert.brown@qwest.com

Gregory B. Monson (2294)
Ted D. Smith (3017)
David L. Elmont (9640)
Stoel Rives LLP
201 South Main Street, Suite 1100
Salt Lake City, Utah 84111
(801) 328-3131
(801) 578-6999 (fax)
gbmonson@stoel.com
tsmith@stoel.com
dlelmont@stoel.com