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JACK SHREVE
PUBLIC COUNSEL

**STATE OF FLORIDA**
OFFICE OF THE PUBLIC COUNSEL

c/o The Florida Legislature
111 West Madison St.
Room 812
Tallahassee, Florida 32399-1400
850-488-9330


January 14, 1999

Ms. Blanca S. Bayó, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0870

RE: Docket No. 950379-EI

Dear Ms. Bayó:

Enclosed is an original and fifteen copies of the Brief of the Office of Public Counsel for filing in the above referenced file.

Also enclosed is a 3.5 inch diskette containing the Brief of the Office of Public Counsel in WordPerfect for Windows 6.1. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

John Roger Howe
Deputy Public Counsel

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**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

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| In re: Investigation into earnings for 1995 and 1996 of Tampa Electric Company. | Docket No. 950379-EI<br>Filed: January 14, 1999 |

**BRIEF OF THE OFFICE OF PUBLIC COUNSEL**

The Citizens of the State of Florida, through the Office of Public Counsel, submit this Brief.

PRELIMINARY STATEMENT

This case is more complicated than it needs to be. It would seem from the plain language of the order accepting Tampa Electric's proposal to defer revenues and accrue interest for 1995 that a fairly straightforward measure of excess earnings would have done the trick. Earnings above a 12.75% return on equity (ROE) would have been identified, expanded to revenues, and increased for interest to give the total amount of deferred revenues plus interest for that year.

Similarly, from the plain language of the First Stipulation (the one approved in Order No. PSC-96-0670-S-EI), after accounting for the $15 million to be refunded, earnings above 11.75% for 1996 would be split 60%/40%, expanded to revenues, and increased for interest to give the total amount of revenues plus interest for 1996. Adding the two years together (after allowing for another year's interest on the 1995 total and giving consideration to refunds from 1995) would give the total in the deferred revenue pot going forward into 1997 and 1998 to either prop up the company's earnings or to be refunded to customers.

Things got complicated, however, in the calculation of 1995's results. (Pursuant to the Second Stipulation in Docket 960409-EI, the Office of Public Counsel and FIPUG were required to stay out of the process.) Deferred revenues for 1995 were affected by the inclusion of the 13-month average of deferred revenues actually booked by the company, even though the entries were unrelated to

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either the amount the company thought was appropriate or the amount ultimately approved by the Commission..[1] The 13-month average of accrued interest on the improper total, although not considered in the 1995 calculations, resurfaced to affect 1996 results. The interest associated with the deferred revenue amount actually approved by the Commission for 1995 has apparently never been quantified

All this means the starting point for evaluating 1996 earnings pursuant to the First Stipulation was somewhat muddled, to say the least. Add to this the Commission's insistence upon following the 1995 "precedent," even though the parties had chosen not to incorporate any such precedent in their

[1]See Attachment B to Order No. 97-0436, the order establishing $50,517,000 as the appropriate amount of deferred revenues for 1995. The "STAFF SPECIFIC" adjustment to the "DEFERRED REVENUE" line shows an amount of $20,868,462, which is the 13-month average of the $50,800,000 of deferred revenues for 1995 shown on page 2 of 2 of Exhibit 4. The $454,353 13-month average of interest on the $20,868,462 was apparently allowed to remain spread over all sources of capital to earn at the weighted average cost of capital. For what it's worth, the 13-month average of $50,517,000 (assuming equal amounts each month as explicitly required by Order No. 95-0580: "[A]ny revenue deferred until 1997 will be treated as if it was earned evenly throughout 1995, or one-twelfth per month.") would have been $25,258,500. The 13-month average of the $50,800,000 or the $48,832,000 on the same basis would have been $25,400,000 or $24,416,000, respectively. Any of these larger 13-month average amounts, if included in the capital structure at zero-cost, would have reduced the "beginning sharing point" below the 8.14% shown in Attachment B.

The calculation of the $50,517,000 is also suspect on other grounds. Not the least of these is that the Commission, after concluding that the company's actual accrual of $50,800,000 was inadequate, incongruously decided the total deferral for 1995 should be even less. In Attachment A to Order No. 97-0436, the $1,685,063 of additional deferred revenue is based upon the differential between Tampa Electric's "reported achieved rate of return" of 8.58% and the Commission's 8.61%. (Can achieved rates of return derived from different rate bases be meaningfully subtracted from each other and the difference multiplied by one of the rate bases?) The company's 8.58% achieved rate of return was derived from the actual, booked deferral of $50,800,000. [Exhibit 3, the 1995 surveillance report, Attachment 1] Consistency would appear, therefore, to have required that the $1,685,063 adjustment be added to the $50,800,000 (not to the $48,832,000 as shown on Attachment A), for a total deferral of $52,485,063 plus interest for 1995. The 13-month average of this amount would have been $26,242,532, resulting in an even lower beginning sharing point.

stipulation, and the Commission's Order No. PSC-98-0802-FOF-EI, the proposed agency action order setting the deferred revenue amount for 1996, was no less confusing.

Having said all this, the parties who protested the proposed agency action accepted everything about the Commission's calculation of deferred revenues for 1996, except one. Both the Office of Public Counsel and FIPUG protested the use of the 30-day commercial paper rate as the cost rate assigned to the 13-month average of deferred revenues plus interest in the capital structure. The use of such a cost rate requires the customers to pay their own interest and results in less revenue being deferred than if there had been no provision for interest at all.

Tampa Electric, predictably, responded that Public Counsel and FIPUG were wrong, and if they were right, the Commission's interest synchronization adjustment must then be modified. Thus, the only issues in dispute in this proceeding pursuant to Section 120.80(13)(b), Florida Statutes (1997), are whether a zero cost should be assigned to the $77,670,075 of deferred revenues in the capital structure and, if so, should an appropriate adjustment be made to the interest reconciliation. Public Counsel agrees that assignment of a zero cost requires that the Commission's interest synchronization adjustment should be altered. As a result, the amount of deferred revenue for 1996 should be increased from the $22,094,593 in Order No. 98-0802 to $24,596,416 plus interest.

<u>ISSUE 1</u>: What is the appropriate cost rate to apply to deferred revenues in the capital structure?

<u>OPC</u>: *Deferred revenues plus interest should be assigned a zero cost rate. To do otherwise would cause less revenues to be deferred than if no interest were required. Order No. 95-0580, which governed 1995's deferred revenues, is not applicable to 1996, which is governed by the First Stipulation.*

## DISCUSSION

There really can be no question whether Tampa Electric must accrue interest at the 30-day commercial paper rate. The First Stipulation explicitly requires it. Paragraph 9 states that "[t]he revenues held subject to refund and the deferred revenues provided for herein shall accrue interest at the thirty day commercial paper rate." The only issue presented in this proceeding is whether, given this requirement for accrual at an interest rate, it would be appropriate to assign a zero cost in the capital structure for purposes of quantifying deferred revenues for 1996.

Tampa Electric takes the position that, since it must pay interest and there are no explicit terms in the First Stipulation requiring its stockholders to absorb this expense, logic and regulatory policy dictate that the cost be recognized in the capital structure as the Commission did in its proposed agency action order. Public Counsel and FIPUG, on the other hand, argue that, although the company is obligated to pay interest, use of a zero cost in the capital structure is required for pragmatic reasons. Use of a zero cost is the only way to achieve an equitable result: it gives customers the benefit of their bargain, i.e., deferred revenue plus interest instead of deferred revenues less than if no interest were allowed.

Tampa Electric's position is grounded on an invalid assumption. The company assumes deferred revenues are just another source of funds with a cost rate. As such, since all other capital sources, such as long-term debt or customer deposits, are included in the capital structure at their appropriate cost rate, deferred revenues must be treated the same. Traditional sources of capital, however, will eventually be returned to their source; bond holders will eventually receive their principal and interest, and customers will receive their deposits plus interest. Neither the source of capital nor the interest on it could ever be booked as revenues.

Deferred revenues and the interest accrued on them, however, may either be returned to customers or become revenues of the company in later years. This reality was noted by Tampa Electric's witness, Ms. Bacon, who testified that "if we do not reach those [ROE] thresholds, the interest will be reversed as earnings of the Company, offsetting the cost of service that otherwise would have been passed on to customers." [T. 96-97][2] Since deferred revenues plus interest will either be refunds to the customers or revenues of the company, they bear no resemblance to traditional sources of capital.

The stipulation provision requiring the accrual of interest could only have arisen in one of two ways, either of which would require the company's stockholders to absorb the cost. For example, both sides may have wanted to maximize the sum of deferred revenues plus interest while still assuring adequate earnings in 1996. From the customers perspective, this would maximize the amount of refunds plus interest they might eventually receive if the funds were not necessary to prop up earnings in 1997 and beyond. Interest could only reasonably have been perceived as covering the time value of their money until it was actually refunded. From the company's perspective, it would maximize the amount of deferred revenues plus interest the company would have available to assure adequate earnings in those same years after the Polk unit came on line in late 1996. Because of the rate freeze incorporated in the stipulation, the company would have no other resource to tap if

[2]This was also confirmed in Tampa Electric's attorney, Mr. Hart's, cross-examination of FIPUG's witness, Mr. Pollock: "Q-It's true, is it not, that the interest that we're talking about here, the accrued interest on deferred revenues, will be paid to the customers in the form of refunds or will be used to offset legitimate cost of service expenses of the company in the future; isn't that correct? A - Yes." [T.173] Ms. Bacon had previously stated, in her prefiled direct testimony, that deferred revenues plus accrued interest were "subject to prior claim by the company." [T. 27] She also said "the Stipulations set forth in detail the circumstances under which the accumulated balance of deferred revenues, including interest, would be retained by the Company or refunded to customers." [T. 234]

earnings declined. The sum of deferred revenues plus interest is only maximized, however, if it is included in the capital structure at zero cost.

The only other reasonable (and more likely) interpretation of the stipulation would be that the customers' representatives, Public Counsel and FIPUG, insisted on interest. They always do. Even after the company refunded \$25 million plus interest back to its customers, there would still be the possibility that the company might overearn in the future. Insisting on additional refunds with interest would just guard against that eventuality. The 60/40 sharing arrangement encouraged the company to earn above 11.75% and make additional refunds possible. Whether stated explicitly or not, the parties' intent had to be that the company would absorb any interest expense. Public Counsel and FIPUG would never have insisted upon interest if it put customers in a worse position than if no interest were contemplated.

The company's interpretation is also inconsistent with other aspects of the stipulation. For example, the stipulation required Tampa Electric to refund \$25 million plus interest to its customers, \$10 million from revenues deferred from 1995 and \$15 million from 1996.[3] The source of the interest was not identified explicitly in the stipulation, but the parties understood that the stockholders would fund the interest, and the refunds were actually made on that basis.

Tampa Electric has the burden of proof in this proceeding, and it would serve the Commission well to evaluate the quality of the rebuttal to the testimony of Public Counsel's and FIPUG's

[3]Paragraph 1 of the stipulation provides that "[t]he refund will be composed of \$15 million derived from Tampa Electric's 1996 revenues and \$10 million from derived from those Tampa Electric revenues deferred in accordance with Order No. PSC-95-0580-FOF-EI ("Order 95-0580") issued May 10, 1995." Note that the \$15 million comes from 1996 "revenues" whereas the \$10 million comes from 1995 "deferred" revenues. The earnings for 1996 above an 11.75% ROE, however, were to be computed after accounting for the \$15 million pursuant to paragraph 4.

witnesses. The best Ms. Bacon could do in response to Mr. Larkin's simplified "$1,200" example was to say customers under the Commission's approach would not get less than if no interest was required in the First Stipulation, they'd get the same. [T. 246] She also said customers could "potentially" get more than if no interest were accrued. [T. 247]

But look at the hypotheticals in the schedules appended to her rebuttal testimony in Exhibit 8. If no interest had been required in the First Stipulation, deferred revenues would have been $225, as shown in her Schedule B. Under the company's approach, as shown in Schedule A, deferred revenues would only have been $211. This is exactly Public Counsel's point. The Commission's use of a cost rate in the capital structure in Order No. 98-0802 resulted in less deferred revenues than if the First Stipulation had not provided for any interest at all. Ms. Bacon must add $14 of interest to the $211 to get to the same $225 resulting from no interest. It is completely implausible, however, be believe the parties to the First Stipulation intended all along that the customers could be no better off by explicitly requiring the accrual of interest than if they had ignored the matter altogether.

Ms. Bacon's Schedule C shows that Public Counsel's method would result in deferred revenues calculated without regard to interest and then increased by interest. What's wrong with that? It is completely consistent with any reasonable reading of the First Stipulation. The customers bargained for a deferred revenue amount at least equal to what they would get if no interest were required and then insisted on interest also to cover the time value of the excess rates they were providing to the company. The fact that the company would show lower earnings for financial reporting purposes when compared to its regulatory return is completely irrelevant. The First Stipulation was only concerned with Tampa Electric's return on equity on an "FPSC adjusted basis." The Commission's jurisdiction extends no further.

STAFF'S DEFERRED REVENUE BALANCE ISSUE

Staff has apparently taken the position that, if Public Counsel and FIPUG should prevail in their argument that deferred revenues plus interest should be assigned a zero cost, then the 13-month average in the capital structure is overstated and must also be reduced. This purportedly innocuous "fallout" issue would lessen the amount of revenues deferred into future periods for potential refund to Tampa Electric's customers. It would also reduce the amount of deferred revenues plus interest available for the company to prop up earnings in later years. Staff is wrong for factual, procedural, and legal reasons.

Factually, the staff is incorrect because the First Stipulation, in paragraph 9, explicitly requires that deferred revenues accrue interest at the thirty-day commercial rate pursuant to Rule 25-6.109, Florida Administrative Code. The company, therefore, has no alternative but to accrue interest. The issue presented here is only whether it is appropriate to assign a zero cost for computational purposes to avoid an illogical result in which less revenues are deferred than if the stipulation had not provided for any interest at all.

Moreover, the staff's adjustment, if followed to its logical conclusion, should reach the same result advocated by Public Counsel. Public Counsel would assign a zero cost to the entire $77 million of deferred revenues in Tampa Electric's 1996 capital structure. Assigning a zero cost in the capital structure is, of course, the same as deducting the $77 million from Tampa Electric's rate base for purposes of calculating the required rate of return. Staff would reduce the deferred revenue to approximately $74 million and assign a zero cost on this smaller amount. However, since the starting point for this adjustment is a rate base which equals the capital structure, reducing the capital structure by $3 million requires that the rate base be reduced by the same amount. Reducing rate base by $3 million and assigning a zero cost to the $74 million is the same as assigning a zero cost to the entire $77 million. Staff is, therefore, factually mistaken that assigning a zero cost to deferred revenues requires a reduction in the 13-month average balance.

Another way to evaluate whether the $77,670,075 must be assigned a zero cost is to consider whether, in the absence of any deferred revenue plan or stipulation, the company's failure to collect revenues resulting from such a calculation would still allow it to earn an 11.75% ROE in 1996. In fact, after all appropriate adjustments are made to restate the income statement, rate base and capital structure as if $55,994,026 of gross excess revenue had never been collected results in an earned ROE of 11.75%.[4] This means the $55,994,026 accurately measures the gross amount of excess revenues for 1996 contributing to earnings above an 11.75% ROE. Subtracting the $15,000,000 of refunds attributable to 1996, then taking 60%, gives the $24,596,416 plus interest which should be deferred for 1996 pursuant to the First Stipulation.

But what of the deferred revenues in the capital structure, without which Tampa Electric would have had to incur additional debt and equity obligations? This question presupposes that

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[4] Assigning a zero cost to deferred revenues in the capital structure on Attachment B of Order No. 98-0802 (including an adjustment to the interest synchronization amount on Attachments A and C) would result in gross excess revenues for 1996 on Attachment D of $55,994,026. If there had been no deferral plan or stipulation, would this amount accurately reflect revenues contributing to earnings above 11.75% for 1996?

Removing the $77,670,075 of deferred revenues for 1995 and 1996 from the capital structure would raise the allowed rate of return reported on Attachment B to 8.27% for 1996. If Tampa Electric never received the $55,994,026, its 1996 operating revenues would have been $565,491,997 ($621,486,023 - $55,994,026). Income tax expense would decrease by $19,963,812 (an increase of $1,635,884, attributable to the change in interest synchronization, and a decrease of $21,599,696, or 38.575% of $55,994,026). And net operating income would fall to $144,815,507 ($180,845,721 - $1,635,884 - $55,994,026 + $21,599,696). Rate base would, of course, also have been $77,670,075 less, or $1,171,817,414 ($1,829,487,489 - $77,670,075). Dividing the net operating income by the rate base gives an overall rate of return of 8.27%, which corresponds to an ROE of 11.75%.

Tampa Electric used the lower-cost funds provided by deferred revenues to fund operations necessary to earn an 11.75% ROE. In truth, the periodic accrual of deferred revenues increased both the rate base and the capital structure above what they would have been if Tampa Electric's revenues had only been adequate to earn 11.75%. The monthly accrual of interest on the deferred revenues increased rate base and capital structure that much more. As a result, the deferred revenues plus accrued interest in the capital structure were only funding that portion of rate base inflated by the accruals. Stated differently, since the deferred revenues in the capital structure were only supporting themselves (i.e., the increase in rate base they had caused), they were not available to reduce other capital components. The clear intent of the First Stipulation was to identify funds which would be available either to reverse as revenues or to be refunded to customers.

Procedurally, staff's insistence on identifying a "fallout" issue is unfair to the parties. Tampa Electric is the petitioning party in this docket and, as such, bears the burden of proof. In its prefiled direct testimony, the company raised all the factual arguments it thought necessary to sustain its burden. In response, intervenors filed testimony disputing the company's claims and asserting that a zero cost should be assigned to the entire balance of deferred revenues in the capital structure. Tampa Electric was free in its rebuttal testimony to argue the intervenors were wrong and that, even if they were right, the use of a zero cost for deferred revenues would require a reduction in the 13-month average balance in the capital structure. The company, however, chose not to advocate an alternative position. Procedurally, it is inappropriate for the staff to introduce issues which a party, for tactical reasons or otherwise, consciously chose to disregard -- especially when the interests of the utility and its customers are adequately represented.

Staff's identification of "fallout" issues is also legally suspect. Neither Public Counsel nor FIPUG challenged the dollar amount of deferred revenue plus interest in Tampa Electric's capital structure. The company did not raise it in rebuttal or elsewhere. As a matter of law, the 13-month average of deferred revenues plus interest in Tampa Electric's capital structure for purposes of calculating 1996 deferred revenues has been deemed stipulated pursuant to Section 120.80(13)(b), Florida Statutes (1997):

> Notwithstanding ss. 120.569 and 120.57, a hearing on an objection to proposed agency action of the Florida Public Service Commission may only address the issues in dispute. Issues in the proposed agency action which are not in dispute are deemed stipulated.

Staff seems to be of the opinion that, if it characterizes an issue as one which is necessarily a "fallout" of another which has been protested, then this issue must also be addressed. But the Legislature must be presumed to have understood the scope of the Commission's, a legislative agency's, fact-finding processes. If the Legislature wanted the Commission to consider matters in dispute as well as those the Commission or its staff felt were "fallout" issues, it would have said so. Given the interrelationship of most ratemaking issues, virtually all are fallouts of each other. For example, as noted above, since the starting point is a capital structure equal in dollar amount to the rate base, the deferred revenue balance cannot be reduced without also adjusting the rate base in equal amount. Is rate base, therefore, a "fallout" placed in issue? Tampa Electric's attorney, Mr. Hart, apparently thinks not. [T. 223] Yet it would be patently unfair to take a step toward "getting the pot right" without completing the journey.

If the Commission is really interested in getting the pot right, it should follow the FPUC-Fernandina Beach methodology from Order No. PSC-97-0135-FOF-EI, issued on February 10, 1997.

The staff called a meeting on April 10, 1997, to discuss Tampa Electric's 1995 earnings. At that meeting, staff distributed copies of schedules from its recommendation in the Fernandina Beach docket, ostensibly to show Tampa Electric how to calculate deferred revenues. Deferred revenues for 1996 calculated in this way would be in excess of $29.5 million as shown on Exhibit 7.

<u>ISSUE 2</u>: What is the effect of assigning a zero cost rate to deferred revenues in the capital structure?

<u>OPC</u>: *It gives customers the benefit of the bargain reached in the First Stipulation. It allows for deferral of earnings above prescribed limits <u>plus</u> accrued interest. A cost rate, however, would allow less than if the customers were not entitled to any interest at all.*

<u>ISSUE 3</u>: What is the appropriate method to calculate the separation of the FMPA and City of Lakeland wholesale contracts from the retail jurisdiction for 1996?

<u>OPC</u>: *The company has agreed to make the appropriate adjustments to fully separate these sales for 1996.*

<u>ISSUE 4</u>: Has TECO properly calculated the amount of deferred revenues for 1996?

<u>OPC</u>: *No. Tampa Electric did not advocate its own calculation, but merely endorsed the Commission's PAA order, which was not substantiated at the hearing. Deferred revenues should be $24,596,416 plus interest.*

Respectfully submitted,

JACK SHREVE
Public Counsel

John Roger Howe
Deputy Public Counsel

Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street
Room 812
Tallahassee, Florida 32399-1400

(850) 488-9330

Attorneys for the Citizens
of the State of Florida

## CERTIFICATE OF SERVICE
## DOCKET NO. 950379-EI

I HEREBY certify that a copy of the foregoing BRIEF OF THE OFFICE OF PUBLIC COUNSEL has been served by *hand delivery or U.S. Mail to the following parties of record on this 14th day of January, 1999.

*Robert Elias, Esquire
*William Cochran Keating, IV, Esquire
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

John W. McWhirter, Jr., Esquire
McWhirter, Reeves, McGlothlin,
Davidson, Decker, Kaufman,
Arnold & Steen, P.A.
Post Office Box 3350
Tampa, Florida 33601

Lee L. Willis, Esquire
James D. Beasley, Esquire
Ausley & McMullen
227 South Calhoun Street
Post Office Box 391
Tallahassee, Florida 32302

Angela Llewellyn, Esquire
Regulatory and Business Strategy
Post Office Box 111
Tampa, Florida 33601-0111

Vicki Gordon Kaufman, Esquire
McWhirter, Reeves, McGlothlin,
Davidson, Decker, Kaufman,
Arnold & Steen, P.A.
117 South Gadsden Street
Tallahassee, Florida 32301

Harry W. Long, Jr., Esquire
TECO Energy, Inc.
Post Office Box 111
Tampa, Florida 33601-0111

John Roger Howe
Deputy Public Counsel