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RECORDS AND REPORTING

November 15, 2000

**BY HAND DELIVERY**

Ms. Blanca S. Bayo, Director  
Division of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

Re: Tampa Electric Earnings, Docket No 950379-EI

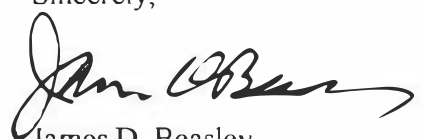
Dear Ms. Bayo:

Enclosed for filing in the above docket are the original and fifteen (15) copies of the Company Positions on the Treatment of Tax Deficiency Interest Incurred in 1999 filed on behalf of Tampa Electric Company.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning the same to this writer.

Thank you for your assistance in connection with this matter.

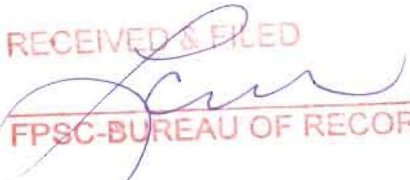
Sincerely,

  
James D. Beasley

JDB/bjd  
Enclosures

cc: All Parties of Record (w/encls )

*ECR*  
*Slomkowski*  
*RG0 - 1*  
*Legal - 1*  
*Com - 6*  
*Sec. - 1*

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

|   |   |                          |
|---|---|--------------------------|
| In re: Determination of regulated earnings of   | ) |                          |
| Tampa Electric Company pursuant to stipulations | ) | DOCKET NO. 950379-EI     |
| for calendar years 1995 through 1999            | ) | FILED: November 15, 2000 |
| _____   | ) |                          |

**COMPANY POSITIONS ON THE TREATMENT OF TAX DEFICIENCY INTEREST INCURRED IN 1999**

Tampa Electric files its attachment of Statement of Supplemental Position as requested by Staff on November 9, 2000.

**Background**

At the October 17, 2000 Florida Public Service Commission ("FPSC" or "Commission") Agenda Conference, Tampa Electric Company's ("Tampa Electric" or "company") 1999 earnings were addressed by the Commission for determining an amount to be refunded to customers beginning in 2001. The decision was to be based upon the Commission Staff's determination that the appropriate refund was \$6.1 million, including interest through December 2000.

At this Agenda Conference, the Office of Public Counsel ("OPC") asserted that one charge at Tampa Electric in 1999 should not be counted as an expense. OPC wants to calculate retail earnings in 1999 as if the interest expense was not incurred because the cost was listed as a FPSC adjustment on the company's net operating income schedule in the surveillance report, which does not include a section for this type of interest. OPC referenced a sentence in the Stipulations that states "the calculations of the actual ROE for each calendar year will be on an "FPSC Adjusted Basis" using the appropriate adjustments approved in Tampa Electric's full

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revenue requirements proceeding.” OPC interprets this statement in the Stipulations to mean that Tampa Electric’s cost for tax deficiency interest, whether or not it was a prudent expenditure, cannot be included as an “above-the-line” cost in the surveillance report because it was not an expense or adjustment approved in the last rate case.

### **Company Position**

Tampa Electric contends that the guiding principle of the Stipulations is whether the item of expense or investment at issue is reasonable and prudent. While the Stipulations provide for specific treatment of certain specific items, the Stipulations were not intended to provide an exclusive laundry list of which items to include or exclude in the ROE calculation. This is consistent with prior rulings of the Commission in interpreting the Stipulations and is consistent with OPC’s prior positions for other adjustments.

The sentence being referenced by OPC requires FPSC adjustments approved in the last rate case to be made, but it does not limit the allowable adjustments to only those adjustments approved in the last rate case. The very next important sentence in the Stipulations below the sentence referenced by OPC states that “all reasonable and prudent expenses and investment will be allowed in the computation and no annualization or proforma adjustments shall be made.” OPC cites the first sentence of the paragraph and concludes that only adjustments from the last rate case be used, and then ignores the rest of the paragraph stating that all reasonable and prudent expenses will be allowed. The Commission Staff has already recommended that the tax deficiency interest be considered a reasonable and prudent expense. What OPC suggests is that the Commission remove a reasonable and prudent expense from the surveillance report that was incurred on the company’s books and records in 1999.

OPC has already acknowledged in a prior Agenda Conference that the key principle in the Stipulations is whether an investment or expense is reasonable and prudent. OPC argued at the May 12, 1998 Agenda Conference addressing 1996 earnings (pg. 17 of transcripts) that an adjustment to the equity ratio was appropriate because the adjustment was reasonable and the Stipulations contemplate that all reasonable and prudent expenses and investments will be allowed. OPC supported an equity ratio adjustment even though the adjustment was not considered in the last rate case. Using that same logic previously advanced by OPC and accepted by this Commission, the tax deficiency interest is allowable if the Commission deems it a reasonable expense.

The reasonableness and proven benefit of the tax deficiency interest expense has been thoroughly investigated by the Commission Staff. As presented by the company to the Commission at the October 17, 2000 Agenda Conference, these expenses had to be recorded in 1999 to be in compliance with FAS 5.

#### **Timing of the Tax Deficiency Interest Expense**

Several events with the IRS occurred in 1999 that caused the expenses to be probable and measurable. In early 1999, a settlement was reached for the 1986 to 1988 tax years. If the company had not settled its issues, the next step would have been a lengthy and expensive district court proceeding. Expert tax consultants advised the company to accept the compromise. Issues settled from this period were then also probable and measurable for subsequent tax periods.

Also in 1999, the company's petition for a refund of certain taxes from the 1989 to 1991 tax period was disallowed by the IRS. This caused the company to book costs related to issues from this period. Finally in 1999, the company received an IRS Revenue Agent's Report

("RAR") for the 1992 to 1994 tax period. This RAR report included all of the findings that were to be contested by the IRS.

Until 1999, Tampa Electric believed it had a high probability of prevailing on its contested tax positions, therefore the company did not have to book any interest costs. After the activities in 1999, it was clear to Tampa Electric and its auditors that under criteria set forth in FAS 5 (Accounting for Contingencies), the company was required to true-up actual and expected costs through 1999. Tampa Electric was obligated by Generally Accepted Accounting Principles to book its probable costs in 1999 since a contingent liability must be recorded when it becomes probable and cannot be delayed once it is probable.

In addition, as the Commission Staff states in their October 5, 2000 recommendation, "had the company recorded the interest expense in prior years when it was actually accruing, then the prior years' earnings and the prior years' refunds that have already been distributed would have been less." Therefore, the Staff recognized that if the events in 1999 with the IRS had occurred sooner, the refunds would have been similarly impacted by the interest expense. This recognition was important in the Staff's recommendation, however, the focus of the recommendation was on the positive outcome of the benefit analysis for the tax deficiency interest.

### **Benefit Analysis**

The Staff followed its precedent established in Docket No. 910890-EI for Florida Power Corporation and Docket No. 971310-GU for Peoples Gas System that if the benefits to customers from the deferred taxes associated with tax positions outweigh the cost of the interest associated with the same tax positions, then it is an allowable, above-the-line expense. The

decisions approving both the Florida Power Corporation and the Peoples Gas System charges were based upon the merits of the respective benefit analysis.

The company's benefit analysis clearly demonstrates why the tax deficiency interest is a reasonable and prudent cost. The company's tax positions with the IRS created deferred taxes that were included in the company's last rate case and lowered permanent rates to customers. The company's tax positions also lowered the cost of capital calculations used in determining the refunds from 1998 and 1999.

If not for the deferred taxes included in the last rate case, the company would have required a higher cost of capital and greater revenue requirements that would have impacted customers every year since 1994. OPC suggested in the meeting on November 9, 2000 with the Commission Staff and the company that these rate case benefits are not real benefits to customers. This position is unrealistic, however, because permanent base rates, which remain unchanged since 1994, would have been higher if not for Tampa Electric's tax positions that were included in the rate case test years. Even if permanent rates are removed from the benefit analysis, the nominal benefit to customers from the company's tax positions is \$6.8 million. The benefit is not less than \$6.8 million because if the higher rates from the original analysis are removed, less revenue is available during the Stipulation years to defer for eventual refunds.

The deferred taxes included in the rate case, along with deferred taxes created after the rate case, also impacted the calculations for the deferred revenue refund for 1998 and 1999. The benefit analysis presents a year-by-year impact to the deferred revenue calculations, which OPC has questioned because there were no actual refunds until 1998. This benefit analysis format was used, however, to allow for a thorough examination of the consequences on revenue deferrals in 1995 and 1996 and reversals in 1997 and 1998. The result, whether shown on an annual basis or

summed to a total in 1998, is the same. If there was less to defer or more to reverse to the company, then the final refund is less.

OPC agrees that Tampa Electric has been prudent to pursue tax deferrals, but reasons that prudence is irrelevant in this case. The tax deficiency interest, however, cannot be separated from the associated deferred taxes that have provided many more benefits than costs to customers. If the tax deficiency interest were excluded from retail earnings, then the related deferred taxes benefit should also be excluded from the deferred revenue calculations and permanent rates. This would be the only fair treatment if the tax deficiency interest were removed because the interest and the deferred taxes are interrelated. On a nominal basis, this means that permanent rates from 1995 through 1999 have been insufficient by \$14.3 million and the \$13 million deferred revenue refund from 1998 was \$5 million too high.

Tampa Electric does not advocate making any of these adjustments, but it shows how an exclusion of tax deficiency interest would be a partial adjustment that does not take into account deferred tax benefits. What Tampa Electric does support is above-the-line treatment of a cost that has been thoroughly examined and recommended for approval as a reasonable and prudent expense. Reasonableness and prudence are the key principles for an allowable cost, and any arguments as to whether the Stipulations allow for a cost have already been addressed by the Commission.

#### **Commission Standard When Addressing Specific Stipulation Period Costs**

At the October 17, 2000 Agenda Conference (pg. 7 of transcript) OPC stated that they want the Stipulation carried out in the way it was entered, within the four corners of the Stipulation. The Commission, while deliberating the recommended equity ratio adjustment for 1995 at the March 18, 1997 Agenda Conference, addressed the appropriate treatment of costs

under the Stipulations. On March 18, 1997, Tampa Electric had suggested that an adjustment to the equity ratio would not be appropriate because the adjustment was not made in the last rate case. The Commission Staff responded with the following position (pg. 23 of transcript),

*“It (the equity ratio) is not addressed in the four corners of the agreement, that’s true, but staff believes the Commission makes a final determination on what is reasonable and prudent in reviewing ROE calculations.”*

Therefore, when the company advocated that an adjustment to the equity ratio was not allowed because it was not made in the last rate case, the Commission Staff responded that reasonable and prudent adjustments could be made and included in the ROE computation.

The Commission also has already addressed the argument that because Section 29 tax credits and taxes related to the Polk Power Station are specifically mentioned in the Stipulations but other tax issues are not, it means that other tax issues cannot be considered. The Commission has firmly held that the Stipulations were not intended to provide a complete list of what is or is not to be included in the ROE calculations. The key is whether the investment or expense was reasonable and prudent. At the March 18, 1997 Agenda Conference, Staff attorney Bob Elias addressed a similar point by saying (pg. 24 of transcript),

*“It seems to me that if we are going to post hoc say that anything that is not addressed in the stipulation is waived or resolved in the company’s favor, we are going to have a lot tougher time recommending approval of stipulations to you that don’t have a laundry list and are needlessly inflexible with respect to some things that may change over time and may limit the company’s flexibility to react to changing financial conditions.”*

The Commission Staff recognized that it would have been irrational to include a list in the Stipulations of what would and would not be allowed in the deferred revenue calculations. In fact, Commissioner Deason made the following statement later at that same Agenda Conference (pg. 34 of transcript),



*“The fact that there was no equity cap mentioned specifically in the stipulation, that one would anticipate that it would be actual return – I mean, actual equity structure unless there was an affirmative showing that it was imprudent.”*

Including language in the Stipulation related to the Polk Power Station and Section 29 tax credits in no way precludes inclusion of other prudent expenses. The Stipulation simply clarified the treatment of those specific items. The correct interpretation of the agreement is that where it is silent on a cost or investment, that charge is allowed in the calculation if it is reasonable and prudent.

#### **Other Adjustments in the 1999 Earnings Calculation**

Many adjustments have been made during the deferred revenue years, including 1999, that were not approved in the last rate case but were included in earnings calculations to the benefit of customers. Examples are as follows:

- There was no equity ratio cap in the last rate case.
- There were no adjustments for the OUC transmission line in the last rate case.
- No Commission adjustments were made for environmental clause expenses.
- No adjustment was made in the last rate case to use the 13-month average balance for short-term debt rather than the average daily balance in the calculation of the short-term debt rate.
- Deferred revenues were not specifically identified in the capital structure in the last rate case.

None of these “post rate proceeding” adjustments have been challenged by OPC. In fact, OPC now states that any of these adjustments that have been related to the capital structure are permissible because the Stipulations intended to only exclude adjustments to net operating income and rate base. This assertion is plainly incorrect. The cost of capital is an integral part of the ROE computation, therefore OPC’s flawed interpretation of the Stipulation would have to include adjustments to the capital structure. If one were to believe OPC’s assertions, then all of the adjustments listed above must also be removed. Tampa Electric initially argued that some of these adjustments could not be made, however the Commission has ruled that the key consideration of any expense or investment at issue when calculating the deferred revenue refunds is whether the charge was reasonable and prudent.

### **Conclusion**

What Tampa Electric seeks is fair treatment on the principle that all reasonable and prudent expenses shall be included in the earnings calculation. Such treatment is consistent with prior decisions of this Commission that were supported by OPC.

It is also clearly practical that the Stipulations would not provide a complete laundry list of what costs can be included or excluded in determining regulated earnings. The Commission has full authority to judge the prudence of an expense and its inclusion in ROE calculations under the Stipulations.

Tampa Electric requests that the Commission reject OPC’s assertions to remove the tax deficiency interest from 1999. The company respectfully urges that the Commission approve its Staff’s recommendation for a \$6.1 million refund to customers.

DATED this 15th day of November 2000.

Respectfully submitted,



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ATTORNEYS FOR TAMPA ELECTRIC COMPANY

CERTIFICATE OF SERVICE

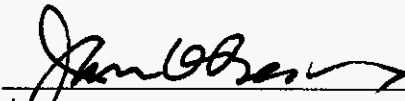
I HEREBY CERTIFY that a true copy of the foregoing, filed on behalf of Tampa Electric Company, has been furnished by U. S. Mail or hand delivery (\*) on this 15th day of November 2000 to the following:

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Attorney

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