AUSLEY & MCMULLEN
ATTORNEYS AND COUNSELORS AT LAW

227 SOUTH CALHOUN STREET
P.O. BOX 391 (ZIP 32302)
TALLAHASSEE, FLORIDA 32301
(904) 224-9115 FAX (904) 222-7560

RECEIVED-FPSC
98 SEP 28 PM 4:02
RECORDS AND REPORTING

September 28, 1998

HAND DELIVERED

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, FL 32399-0850

Re: Investigation into Earnings for 1995 and 1996 of Tampa Electric Company; FPSC Docket No. 950379-EI

Dear Ms. Bayo:

Enclosed for filing in the above docket, on behalf of Tampa Electric Company, are the original and fifteen (15) copies of Direct Testimony of Delaine M. Bacon.

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

Thank you for your assistance in connection with this matter.

RECEIVED & FILED
FPSC-BUREAU OF RECORDS

Sincerely,

James D. Beasley

ACK
AFA
APP
CAF
CMU
CTR
EAG 2
LEG 1
LIN 5+org
OPC
RCH
SEC 1
WAS
OTH

JDB/pp
Enclosures

cc: All Parties of Record (w/enc.)

DOCUMENT NUMBER-DATE
10671 SEP 28 98
FPSC-RECORDS/REPORTING

TAMPA ELECTRIC COMPANY
DOCKET NO. 950379-EI
SUBMITTED FOR FILING 09/28/98

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DELAINE M. BACON

Q. Please state your name, business address and position with Tampa Electric Company.

A. My name is Delaine M. Bacon. My business address is 702 North Franklin Street, Tampa, Florida, 33602. I joined Tampa Electric Company ("Tampa Electric" or "company") in October 1984 and have held various positions within the Regulatory Affairs department. Currently, I am the Director of Utility Financial Analysis - Regulatory Affairs for TECO Energy, Tampa Electric Company's parent. I am responsible for financial-related regulatory issues before the Florida Public Service Commission ("Commission") for Tampa Electric, as well as developing the company's long-term financial forecasts.

Q. Please state your educational background and qualifications.

A. I have a Bachelor of Science in Accounting from St. Leo College and a Masters of Business Administration from the University of Tampa. I am a Certified Public Accountant and a member of the Florida Institute of Certified Public Accountants.

Q. What is the subject of your direct testimony?

A. I address the Commission's orders which determined the interest rate to be applied to deferred revenues in Tampa Electric's regulatory capital structure for 1996, and relevant Commission precedent for this treatment. I also address the appropriate regulatory accounting separation in 1996 for Tampa Electric's City of Lakeland ("Lakeland") and Florida Municipal Power Agency ("FMPA") wholesale sales contracts.

Interest on Deferred Revenues

Q. Please identify the Commission orders that are applicable to this proceeding.

A. In the Stipulation Agreements between the Office of Public Counsel ("OPC"), the Florida Industrial Power Users Group ("FIPUG") and Tampa Electric, the parties agreed to an interest rate equal to the 30-day commercial paper rate on the balance of revenues deferred from 1995 and 1996. In the company's 1995 earnings review (Order No. PSC-97-0436-FOF-EI), the Commission included the deferred revenue balance as a specific item in the company's regulatory capital structure, concluding that these deferred revenues were a source of funds for Tampa Electric.

Because the parties had stipulated that the deferred revenues balance should accrue interest at the 30-day commercial paper rate, the Commission also made a decision in Order No. PSC-97-0436-FOF-EI to apply a 30-day commercial paper rate to this source of funds in the capital structure. The Commission explained in its decision that this treatment was consistent with prior Commission decisions.

In Tampa Electric's 1996 earnings review (Order No. PSC-98-0802-FOF-EI), the Commission again determined that the 30-day commercial paper rate should be applied to the deferred revenues specifically identified in the capital structure. In June of this year, the OPC and FIPUG protested the Commission's decision contending that a zero cost rate should be applied to the deferred revenues in the capital structure.

Q. Please provide the background and purpose of the deferred revenues.

A. Tampa Electric made substantial reductions in its level of operating expenses beginning in 1994 in order to offset the anticipated increase in revenue requirements associated with the company's Polk Power Station ("Polk"), which was to be placed into service in late 1996. In 1995 and 1996, the Commission approved a regulatory accounting treatment in which Tampa Electric would defer earnings in excess of its allowed return on equity in 1995 and 1996 to be included as a part of Tampa Electric's earnings in 1997 and 1998 to offset the additional revenue requirements of Polk.

This regulatory accounting treatment was agreed upon in settlements between the OPC, the FIPUG and Tampa Electric. Rather than have Tampa Electric refund overearnings and file a petition for a rate increase at the same time, the parties agreed that rate stability for customers was important, and they agreed to a regulatory treatment(the Stipulations) that would defer revenues into years where the return on equity would be adversely affected by the new unit.

In addition to the agreement to defer revenues into 1997 and 1998 to offset Polk revenue requirements, the company agreed to refund or return $50 million to customers over the October 1996 to December 1998 time period. This equates to over half of the revenues deferred from 1995 and 1996, and is equivalent to a 2.5 percent reduction in the average residential base rate over a 27-month period. The company also agreed to freeze base rates through 1999, absorb $12 million of new annual base rate revenue requirements previously recovered through the Oil Backout Clause, share equity returns on a 60/40 basis with customers even as the company earned within its allowed return on equity range, and potentially refund additional earnings to customers in 1999 and 2000.

Q. Please summarize the Commission's decision in Order No. PSC-97-0436-FOF-EI related to the treatment of deferred revenues in the capital structure and the Commission's stated reasons in that decision.

A. In the 1995 earnings surveillance report, deferred revenues were included in the capital structure on a pro-rata basis across all sources of capital, consistent with the treatment in the company's tax savings docket. As explained earlier, the Commission made a decision in Order No. PSC-97-0436-FOF-EI to treat deferred revenues in the capital structure as a separate item, and applied a cost rate at the 30-day commercial paper rate as specified in Rule 25-6.109, F.A.C.

The transcript of the March 18, 1997 agenda conference for the 1995 earnings review, which resulted in Order No. PSC-97-0436-FOF-EI, shows that the following factors were considered when the Commission made its decision: it was patently fair to include the same rate in the capital structure as utilized for refund purposes; the Commission's rule called for a commercial paper rate to be applied for refund purposes, and therefore the commercial paper rate was the cost of capital and should be utilized in the capital structure; the Stipulation was silent on the proper treatment, and therefore the Commission was free to utilize what it concluded was appropriate accounting; and, the Commission should not apply one cost for capital structure purposes and another cost for refund purposes.

Q. What precedent did the Commission reference in Order No. PSC-97-0436-FOF-EI in making its decision to include deferred revenues in the capital structure at the 30-day commercial paper rate?

A. Page 5 of Order No. PSC-97-0436-FOF-EI states that the Commission's method for applying interest to the deferred revenues is consistent with prior cases involving Quincy Telephone, Order No. 22367 (Docket No. 890292 & 891237), Southern Bell, Order No. 94-0172-FOF-TL (Docket No. 920260) and Florida Public Utilities Company - Fernandina (FPUC - Fernandina), Order No. 97-0135-FOF-EI (Docket No. 961542-EI).

Q. Please provide more detail of these orders referenced by the Commission.

A. In the Quincy Telephone docket, the Commission ordered the company to set aside surplus revenues from 1987, 1988, 1989 and the first six months of 1990. This revenue of $504,000 was to accrue interest at the 30-day commercial paper rate and then be returned to the company beginning January 1, 1991. The annual credit was $200,000 until the full amount was exhausted. The Commission stated in its Order No. 97-0436-FOF-EI that these deferred revenues "were included in the capital structure and allowed to accrue interest at the thirty-day commercial paper rate." This scenario is comparable to Tampa Electric's deferred revenue agreement.

In the Southern Bell case (Docket No. 920260), revenues from 1994, 1995 and 1996 were deferred for eventual refund to customers. These deferred revenues were included in the capital structure as a specific adjustment to short-term debt and allowed to accrue interest at the 30-day commercial paper rate. This case, likewise, is relevant precedent to Tampa Electric's case.

FPUC - Fernandina earned above its allowed return on equity in 1995. The Commission made a decision in Order No. 97-0135-FOF-EI to defer these overearnings into 1996 to be booked to FPUC - Fernandina's storm damage reserve. For its 1995 surveillance report, the overearnings were specifically included as short-term debt in the capital structure with an effective interest rate of 5.97 percent. The short-term or 30-day commercial paper rate was correspondingly used in calculating the interest to be added to the 1995 excess earnings. This capital structure treatment is identical to what the Commission ordered in Tampa Electric's 1995 and 1996 earnings reviews.

Q. Please explain the effect of using a zero cost in the capital structure for deferred revenues as proposed by OPC and FIPUG.

A. Using a zero cost rate for deferred revenues in the capital structure goes against financial and regulatory theory and against Commission precedent. It has the effect of treating the interest expense being accrued by the company as though it is not a legitimate cost of providing service and, therefore, leaves the cost to be absorbed by the utility's shareholders "below the line." The company would not be afforded an opportunity to achieve the return on equity disclosed in its surveillance report because the interest expense being incurred would effectively be disallowed.

Since the company is obligated to accrue this interest pursuant to Commission order, it is clearly reasonable to include it in the determination of regulatory earnings. It should not be treated in a manner that, in effect, represents a disallowance of an expense ordered by the Commission.

Q. The protest from the FIPUG states that the Stipulations called for interest to come from "below the line," not "above the line." Did the Stipulations discuss or state that interest on the deferred revenues was to come from "below the line?"

A. No. There is no discussion in the Stipulations calling for interest expense to be paid by shareholders. The reference to interest on deferred revenues in Paragraph 9 of Order No. PSC-96-0670-S-EI states:

> "The revenues held subject to refund and the deferred revenues provided for herein shall accrue interest at the 30-day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code."

The reference to interest on deferred revenues in Paragraph 6 of Order No. PSC-96-1300-S-EI states:

> "The revenues held subject to refund shall accrue interest calculated at the thirty-day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code."

These statements in no way indicate that the company's shareholders should pay for the interest to be applied to deferred revenues. There also was no indication by the parties during negotiations that these costs, that are required by the Stipulations, would be disallowed in the calculation of the company's returns on equity. Absent any language in the Stipulations to the contrary, the Commission should treat the interest on deferred revenues as a legitimate cost of providing service.

Q. In its protest of Order No. PSC-98-0802-FOF-EI, the OPC alleges that Tampa Electric's customers are harmed by the Commission's decision in Order No. PSC-98-0802-FOF-EI not to assign a zero cost to deferred revenues in Tampa Electric's capital structure for purposes of calculating the company's allowed rate of return for 1996. Please address this concern.

A. Customers are not harmed by this order because it does not treat them unfairly. In 1996, the company applied an interest rate to deferred revenues in the capital structure that corresponded to the rate being applied to the deferred revenue balance. The alternative proposed by the OPC and FIPUG to use a zero cost rate for deferred revenues in the capital structure could only be considered fair to customers and the company if interest was not being accrued on the deferred revenue balance.

In addition, as explained earlier, Commission precedent clearly establishes the principle that when the cost rate is applied consistently to the deferred revenue balance and to the deferred revenues in the capital structure, customers as well as the company are treated properly.

Q. Are there any situations similar to deferred revenue interest in which the expense is included in the calculation of earnings?

A. Yes. Interest accrued on customer deposits is similar to interest for deferred revenues. In both cases, the Commission has approved an accounting method for funds collected from customers in which the ultimate disposition of those funds is not certain.

In the case of customer deposits, amounts are collected as security on the customer's account and interest is accrued on these amounts. Later, the deposit plus accrued interest is returned to the customer or the company retains the amount plus any accrued and unpaid interest for application to unpaid bills.

The deferred revenues situation is similar. Interest is accrued on deferred revenues because such revenues are initially deemed to represent overearnings, with customers entitled to the benefit of interest on any such amounts. The deferred amounts plus the accrued interest are designed for return to customers in the form of refunds, subject to a prior claim by the company, as is the case of customer deposits. In the customer deposits case, the claim is based on a failure by the customer to pay for services, while in the deferred revenues case, the claim is based on the company's failure to achieve the return on equity previously determined by the Commission to be proper.

Q. Is the treatment of deferred revenues and customer deposits unusual?

A. No. It is consistent with the manner in which other sources of funds are treated in Tampa Electric and other utilities' capital structures for purposes of determining base rates.

Separation of the Lakeland and FMPA Sales in 1996

Q. Please describe the FPSC decision regarding the treatment of the FMPA and Lakeland contracts in Order No. PSC-97-1273-FOF-EI.

A. The Commission ordered Tampa Electric to separate capital and O&M costs associated with the wholesale sales made to FMPA and Lakeland in accordance with the procedure approved in the company's last rate case.

> "We find that the Stipulation approved pursuant to Order No. PSC-96-1300-S-EI requires TECO to separate capital, and operation and maintenance (O&M) costs associated with the FMPA and Lakeland wholesale sales.

Specifically, 5F of the order states, "The separation procedure to be used to separate capital and O&M which was approved in the Company's last rate case, Docket No. 920324-EI, shall continue to be used to separate any current and future wholesale sales from the retail jurisdiction."

Q. Please describe the separation methodology approved in the company's last rate case, Docket No. 920324-EI.

A. The approved method of separation in the company's last rate case was based upon the 12 coincident peak methodology. This methodology calls for a separation of costs to the wholesale jurisdiction that is based on the actual amount of resources used to serve the wholesale customer at the time of the company's monthly coincident peak.

Q. Please describe the calculation used by the company to comply with the FPSC order to separate FMPA and Lakeland in 1996.

A. The process used by the company to separate the FMPA and Lakeland contracts in 1996 is consistent with the methodology used by the company since the last rate case. In that process, separation factors are adjusted in its surveillance report based on any new wholesale sales being served from Tampa Electric's resources.

For the FMPA and Lakeland contracts, the separation factors were adjusted for the load served out of the resources used in the month of December 1996. Because the sale to FMPA did not begin until December 16, the separation for FMPA was adjusted only to reflect the time during the month the contract was in effect.

In retrospect, the company realizes that the proration of a month is not explicit in the 12 month coincident peak method and agrees to separate the full amount for December 1996. The company will make an accounting entry in 1998 to reflect this change which should increase the deferred revenue balance.

Q. Does this conclude your testimony?

A. Yes, it does.