

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into) DOCKET NO. 930987-EI
Currently Authorized Return on) ORDER NO. PSC-94-0337-FOF-EI
Equity of TAMPA ELECTRIC COMPANY) ISSUED: March 25, 1994
_____)

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
SUSAN F. CLARK
JULIA L. JOHNSON
DIANE K. KIESLING
LUIS J. LAUREDO

APPEARANCES:

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and

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On Behalf of Tampa Electric Company

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On behalf of the Citizens of the State of Florida.

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On behalf of the Commission Staff.

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On behalf of the Commissioners.

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FPSC-RECORDS/REPORTING

**ORDER RESETTING AUTHORIZED RETURN ON EQUITY
AND APPROVING STORM DAMAGE RESERVE**

I. CASE BACKGROUND

Commission Staff (Staff) met with Tampa Electric Company (TECO or Company) on September 27, 1993 to discuss its currently authorized return on equity (ROE). The Office of Public Counsel (OPC) was represented at the meeting. At the meeting, Staff suggested that TECO's currently authorized ROE could possibly be reduced, given the current market conditions. Since the time the Commission approved the currently authorized ROE of 12.0% for TECO in Order No. PSC-93-0165-FOF-EI (Order No. 93-0165), capital costs have declined and Staff suggested that TECO's authorized ROE should be reduced to reflect the decline.

TECO filed a formal proposal on October 7, 1993 to reduce its ROE to 11.35% and implement a storm damage reserve of \$4 million a year for the next four years, both effective January 1, 1994. The Commission accepted TECO's proposal at the October 19, 1993 agenda conference and issued Proposed Agency Action (PAA) Order No. PSC-93-1570-FOF-EI (Order No. 93-1570) on October 27, 1993.

On November 12, 1993, OPC timely filed a petition to officially protest the Commission's action in Order No. 93-1570. In a separate petition filed on the same date, OPC filed a motion to hold an expedited hearing to set a new ROE for TECO, rescind TECO's 1994 rate increase and order a rate reduction, or, in the alternative, if a hearing cannot be held before January 1, 1994, order the 1994 rate increase to be held subject to refund pending the outcome of the hearing.

At the December 7, 1993 agenda conference the Commission voted to deny OPC's motion and scheduled this hearing for January 21, 1994. We also established on that date a schedule for the filing of testimony and exhibits to be considered at the hearing. OPC timely filed a Motion for Reconsideration of the Order (PSC-93-1840-FOF-EI) memorializing the Commission's action. Our ruling on that Motion is included in this Order.

The hearing was held on January 21, 1994 and February 3, 1994. At the hearing, Tampa Electric Company offered the testimony and exhibits of five witnesses: Girard F. Anderson, Charles A. Benore, Samuel C. Hadaway, Alan D. Oak and Elizabeth Townes. OPC offered the testimony of David C. Parcell, Kimberly H. Dismukes and Steven A. Stewart.

Basic Positions of the Parties:

In its Prehearing Statement, TECO alleges that:

"... review of a company's authorized return on equity is a very serious matter. It is a matter of primary concern to Tampa Electric, its Customers and investors. This Commission should take care to preserve the fairness and symmetry of its procedures. The continuity and consistency of regulation is essential. The decision the Commission makes in this docket will have a real time, real dollar effect on Tampa Electric's ability to serve its Customers.

This Commission recently determined Tampa Electric's allowed return on equity to be 12% within a zone of reasonableness of 11% to 13%. The last order in that proceeding was issued in May 1993, only a few months ago. That determination was made in a fully litigated case.

All of the evidence presented in this current proceeding shows that Tampa Electric's fair and reasonable return on equity, both actual and projected, remains within the zone of reasonableness of its currently authorized return.

....The proposed annual storm damage accrual of \$4 million replaces commercial insurance which is no longer available due to recent hurricane experience, most notably those from Hurricane Andrew, on the insurance industry. The use of accrual accounting for this necessary expense has the effect of levelizing the impact on rates of our Customers as opposed to recognizing a very large expense at the time of a particular storm event. Tampa Electric is not requesting additional rate relief for this expense but plans to absorb this cost until its next rate proceeding.

.... Tampa Electric urges this Commission to enter its order approving the proposed storm damage reserve, confirming its last allowed return on equity, finding that none of its revenues should be held subject to refund and closing this docket.

In its Prehearing Statement OPC argues:

In December, 1992, Tampa Electric Company was granted a 12% return on equity for 1994, apparently on the assumption that economic conditions would remain fairly constant through 1993 and 1994. Had the Commission foreseen the precipitous drop in interest rates during 1993, however, it would have authorized a return on equity of no more than 10.5% and realized that the company would also refinance its debt at lower rates. If the Commission had used a 10.5% equity return, it would have ordered a \$15 million reduction below 1993 revenue requirements (instead of a \$16 million increase) or a \$31 million reduction from current rate levels. Since interest coverage is above 3.75 times, there would have been no need for additional CWIP-eligible-for-AFUDC in rate base to meet a financial integrity target.

Rates should be reduced by at least \$31 million annually to reflect the declining cost of capital. Even at the 11.35% ROE proposed by the company and accepted by the Commission in Order No. 93-1570, rates should be reduced by \$3.5 million below 1993 levels and \$19.5 million below current levels.

Given our decision on OPC's Motion for Reconsideration, OPC amended its position at the hearing. OPC suggests that a one year credit equal to the 1994 rate increase be applied to customer bills is appropriate or, in the alternative to hold \$27 million subject to refund.

II. OPC'S MOTION FOR RECONSIDERATION

On January 11, 1994, OPC filed a Motion For Reconsideration of Order No. PSC-93-1840-FOF-EI. OPC asks the Commission to clarify that Order and "grant Public Counsel a hearing to consider reducing Tampa Electric Company's retail rates." In essence, OPC alleges that the action taken by the Commission in Order No. PSC-93-1840-FOF-EI is not responsive to the Petition on Proposed Agency Action filed in this docket.

In its response filed January 18, 1994 the company alleges that the Commission heard extensive argument prior to its vote to establish the issues to be litigated at this hearing. TECO further states "Public Counsel's Motion for Reconsideration misapprehends

the fundamental nature of a limited scope proceeding where the Commission specifically limits the proceeding to specified issues.

The appropriate legal standard for granting a motion for reconsideration is a showing that some matter of fact or law was overlooked by the Commission, which, if viewed correctly, would yield a different result.

The Petition at issue in this motion is somewhat different from most others, or a lot of others, because what is being "petitioned" is the Commission's Proposed Agency Action, which did not address a rate decrease. It simply made two determinations. One, that return on equity should be reduced and that a storm damage reserve was appropriate accounting accrual for Tampa Electric Company to make in 1994.

The Petition on Proposed Agency Action asked for a limited proceeding pursuant to Section 366.076, Florida Statutes. Section 366.076, Florida Statutes specifically gives the Commission authority to determine the issues to be considered at such a proceeding. It further gives the Commission explicit authority to grant or deny any request to expand the scope of the proceeding to include other matters.

By Order Number 1840, we expressly rejected Public Counsel's approach to merely presume a downwardly adjusted return on equity and adjust rates accordingly. The rationale that such an approach ignored other known changes in the Company's operation, which would have an impact on earnings, was explicitly expressed.

To include a consideration of a rate reduction in this proceeding is inconsistent with symmetry in the rate setting process. Clearly, if returns on equity were increasing, Public Counsel would expect, and we believe due process would require, a full exploration of all changes to the Company's operation in arriving at the fair, just and reasonable rates to be enacted. Such a comprehensive review is beyond the scope of this limited proceeding.

We have not made a substantive determination on the appropriateness of a rate decrease in this proceeding. That issue has not been litigated. Our actions in this docket should not be construed from precluding any party or person from raising that issue at anytime in the future, as that person or party believes is appropriate.

We therefore deny the motion for reconsideration as not pointing out any error of law or fact which, if viewed correctly, would yield a different result.

III.

AUTHORIZED RETURN ON EQUITY

In its Prehearing Statement TECO alleges "The Commission should affirm Tampa Electric's existing allowed return on equity of 12% within a zone of reasonableness of 11% - 13%."

In its Prehearing Statement OPC states:

Public Counsel recommends a range of 9.5% to 10.5% as a fair return on equity capital. In Tampa Electric's last rate case, the Commission set an ROE of 12%, which coincided with the upper end of the range recommended by Mr. Parcell. Changes in the financial markets since that time indicate that a fair return is now approximately 150 basis points lower, so the Commission should set a current ROE no higher than 10.5% to be consistent with its previous decision.

TECO presented the testimony and exhibits of two cost of equity experts: Charles A. Benore and Samuel C. Hadaway.

Mr. Benore utilizes six tests to determine the cost of equity for Tampa Electric Company. The two market equity risk premium models indicate a cost of equity between 11.2% and 12.4%. The three discounted cash flow (DCF) analyses he performs indicate a cost of equity between 9.4% and 13.1%. Finally, the comparable earnings model indicates a cost of equity of 12.8%. Based on the results of these tests and his judgment, Mr. Benore concludes "that Tampa Electric's cost of common stock is in the range of 11.9% to 12.4%" and he recommends a return of 12.2%.

Dr. Hadaway also performs DCF and risk premium analyses. His DCF analysis indicates an ROE range of 9.4% to 12.3%. His risk premium analyses indicate a cost of equity range of 11.7% to 12.7%. Based on these results and his review of market, industry, and company-specific factors, Dr. Hadaway concludes that a "fair cost of equity for Tampa Electric is in the range of 12.0% to 12.4%, with a midpoint of 12.2%."

David C. Parcell, testifying on behalf of the OPC, evaluates the changes in capital costs since Tampa Electric's last authorized ROE was set in December 1992. Based on his estimates of the decline in interest rates, decline in the Capital Asset Pricing Model (CAPM) cost rate, and the decline in the DCF cost rate, Mr. Parcell concludes that "the current market cost of equity is within a range of 9.5% to 10.5%."

In addition to considering changing TECO's authorized ROE, Public Counsel suggests that rates would be more current if we set them based on the new ROE. We think that adversely affects rate stability and the rate setting process. The evidence suggests that what TECO is likely to earn is not outside the range of reasonableness for this company. The purpose of establishing a range is to recognize revenue volatility and to encourage management efficiency through earning more by controlling their expenses. If we embark on a course of resetting rates on a yearly basis we will lose rate stability; we will increase the regulatory burden; and we will discourage management efficiency. We believe it would be counterproductive for the Commission, for the utilities and for the customers. We recognize the fact that TECO is embarking on a construction program. We are sensitive to what kind of signal what we do here may send to the market. We certainly don't want to drive up costs in the market at a time when TECO is going to need to go get either bonds or equity financing.

With respect to symmetry, if the cost of equity was increasing would we be willing, on that basis alone, to increase rates? We think not. The testimony shows that there are a lot of differences between what was included in the projected test year and what is happening currently. We believe the evidence adequately explains the differences. We are convinced that if we want to change the rates based on a new cost of capital, then we ought to look at the whole case again. That is beyond the scope of this type of proceeding.

Therefore, we find that the authorized return on equity for all regulatory purposes for Tampa Electric Company shall be 11.35 percent, plus or minus 100 basis points. We again decline to reset rates based on the revised ROE.

IV.

STORM DAMAGE RESERVE

In its Prehearing Statement, TECO alleges: "The appropriate amount that TECO should accrue for storm damage reserve is \$4 million annually for a period of two years or until the company's next full rate proceeding."

In its Prehearing Statement OPC suggests:

It is difficult to understand why this is even an issue. There is no petition pending before the Commission asking for a storm damage reserve. If there were, the petition would spell out the justification for a reserve in terms of actual historical experience or expected future expenditures. Florida Power Corporation, for example, alleged in its petition in Docket No. 930867-EI that "[b]ased upon our average storm damage experience over a 20-year period of \$.7 million, and the most recent 10-year period of \$1.4 million, FPC believes its proposed annual expense will be adequate." FPC's petition was supported by the prefiled testimony and supporting exhibits of Mr. John Scardino. In this case, there is no data to evaluate. Tampa Electric has simply made an unsubstantiated proposal to record \$4 million annually to a storm damage reserve. Public Counsel does not believe the company has made any attempt to actually quantify or justify the \$4 million figure or any other amount. (There is apparently no relationship between the storm damage accrual and the 11.35% equity return Tampa Electric proposed and the Commission accepted in Order No. 93-1570.) As such, the appropriate amount is zero.

In rebuttal testimony, OPC suggests that comparisons of the accrual amounts authorized for Florida Power and Light Company (Order No. 93-0918-FOF-EI issued in Docket No. 930405-EI) and Florida Power Corporation (Order No. 93-1522-FOF-EI issued in Docket No. 930867-EI) and the number of miles of transmission and distribution lines for each of the three utilities is a reasonable approach. This method would yield an annual accrual for TECO of approximately 1.3 million dollars.

Prior to October of 1993 TECO had \$15 million of transmission and distribution system storm damage insurance, subject to a deductible amount of \$3.5 million. As has been the experience of other investor owned utilities, this type of insurance is no longer available at a reasonable price, if available at all.

TECO has proposed establishing an annual accrual of four million dollars for two years to cover this contingency, with a full review of the appropriateness of the amount in the company's next rate case.

While TECO has proposed this amount, the company freely admits this amount is not the result of any detailed actuarial analysis of the correct or best amount to accrue. It is simply a starting point and represents an estimate of the amount necessary to cover this potential liability.

On that limited basis, we find that TECO shall be permitted to accrue four million dollars of reserve for storm damage annually, beginning January 1, 1994. Should TECO incur storm damage expense in excess of the reserve, the company is authorized to utilize deferred accounting treatment for that balance. We will promptly consider any Petition for appropriate treatment of any unamortized balance. TECO shall, within six months of the date of this Order, file a study detailing:

- 1) the appropriate amount of the annual accrual;
- 2) the appropriate target reserve balance;
- 3) the best estimate of its exposure from storm related transmission and distribution system damage;
- 4) what types of expenses it intends to charge to the reserve;
- 5) its efforts to purchase insurance to cover this exposure; and
- 6) its evaluation of other alternatives to replace the self-insurance plan approved in this docket.

It is explicitly understood that any annual expenses less than 3.5 million dollars (the amount of the insurance deductible) will be paid from current resources and not from the reserve.

V. AMOUNT OF MONIES TO BE HELD SUBJECT TO REFUND

In its Prehearing Statement TECO alleges that "None of Tampa Electric's revenue should be held subject to refund."

In its Prehearing Statement OPC argues

The relevance of this issue is also difficult to understand. Public Counsel's request to hold the 1994 rate increase subject to refund pending the outcome of hearings was denied in Order No. 93-1840. Does the Commission now intend to hold a hearing solely to determine if rates should be held subject to refund pending some undisclosed future event? Public Counsel's Petition on Proposed Agency Action, at page 6, "request[ed] an expedited limited proceeding pursuant to Section 120.57(1) and Section 366.076(1), Florida Statutes (1991), to determine a fair return on equity for Tampa Electric Company and to establish new rates for 1994." (Emphasis added.) If the Commission decides that Tampa Electric's equity return should be set below 12%, rates should be adjusted accordingly. The utility's customers should not be required to pay rates designed to provide a 12% return on equity after a lower return has been found to be appropriate "for all regulatory purposes." Rates should be reduced commensurate with the magnitude of the change in the allowed return on equity. The rate reduction should not be affected by either a target interest coverage ratio or a related level of CWIP in rate base. Since a rate reduction is the appropriate action, it is unnecessary to condition any amount subject to refund.

OPC amended its position at the hearing to suggest that a one year credit equal to the 1994 rate increase be applied to customer bills would be appropriate or, in the alternative, to hold 27 million dollars subject to refund.

Based on the evidence presented in this docket, we find that no monies shall be held subject to refund. We believe that TECO is not likely to earn outside the range established in this proceeding this year.

Our decision does not preclude any party from petitioning the Commission at some future time, pursuant to the interim statute, to hold monies subject to refund.

VI.

DISSENTING VOTES

Commissioner Kiesling dissents from the Commission's vote on the authorized return on equity. Chairman Deason dissents from the Commission's vote on the authorized return on equity. Chairman Deason would set the authorized return on equity at a lower rate. Chairman Deason dissents from the Commission's vote on the appropriate amount of monies to be held subject to refund.

In consideration of the foregoing, it is

ORDERED by the Florida Public Service Commission that the findings set forth in the body of this Order are hereby approved. It is further

ORDERED that Tampa Electric Company is authorized to earn an 11.35% return on equity, plus or minus one hundred basis points, for all regulatory purposes. It is further

ORDERED TECO is authorized to accrue four million dollars of reserve for storm damages annually, beginning January 1, 1994. Any and all transmission and distribution system storm damage expense of up to 3.5 million dollars annually shall not be charged against the reserve balance. It is further

ORDERED that TECO shall file within six months of this Order a study, based on its estimate of the exposure, indicating the appropriate amount that should be contributed to the Storm and Property Insurance Reserve Fund annually and the appropriate total reserve amount. The company shall include in the study the types of costs it intends to charge to the reserve and detail the company's efforts in obtaining reasonably priced T&D insurance coverage or other alternatives to replace the self-insurance approach approved in this docket. It is further

ORDERED that no monies shall be held subject to refund. It is further

ORDERED that this docket shall remain open pending the review of the study on the appropriate storm damage reserve accrual.

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By ORDER of the Florida Public Service Commission, this 25th
day of March, 1994.

STEVE TRIBBLE, Director
Division of Records and Reporting

by: Kay Flynn
Chief, Bureau of Records

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Civil Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.