

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into) DOCKET NO. 950379-EI
earnings for 1995 and 1996 of) ORDER NO. PSC-97-0436-FOF-EI
Tampa Electric Company.) ISSUED: April 17, 1997
_____)

The following Commissioners participated in the disposition of this matter:

JULIA L. JOHNSON, Chairman
SUSAN F. CLARK
J. TERRY DEASON
JOE GARCIA
DIANE K. KIESLING

NOTICE OF PROPOSED AGENCY ACTION
ORDER DETERMINING 1995 EXCESS EARNINGS

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

CASE BACKGROUND

On March 1, 1995, Tampa Electric Company (TECO or Company) submitted its 1995 Forecasted Earnings Surveillance Report in compliance with Rule 25-6.1353, Florida Administrative Code. Per that report, TECO forecasted an achieved return on equity (ROE) of 14.28% which exceeded its then currently authorized ROE ceiling of 12.35%. Due to the high level of TECO's forecasted earnings, meetings were held to explore the possible disposition of the excess earnings. TECO, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG), and the Commission Staff participated in the meetings.

TECO subsequently proffered a proposal concerning the disposition of the excess revenues for 1995. The main provisions of the proposal were to: (1) establish a new ROE of 11.75% with a range of 10.75% to 12.75%, and (2) defer 50% of any revenues in excess of an 11.75% ROE up to a net 12.75% ROE; and (3) to defer all revenues in excess of a net 12.75% ROE. The Commission

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accepted this proposal in Order No. PSC-95-0580-FOF-EI, issued May 10, 1995. Potential excess earnings for 1996 and subsequent years have been addressed in other stipulations.

On February 15, 1996, TECO filed its Earnings Surveillance Report for December, 1995. The report indicated excess earnings of \$48,832,000. After audit, further investigation and analysis, we find that several adjustments are appropriate.

This Order reflects our determination of the appropriate amount of excess revenues to be deferred for 1995. Specifically, the Order addresses TECO's investment in a 25% interest in a transmission line and the associated acquisition adjustment, the treatment of deferred revenues in the capital structure, and the Company's equity ratio.

I. TECO's investment in a 25% share of the Orlando Utility Commission's (OUC) Lake Agnes-Cane Island 230 KV line

History of Existing Facilities

Since the early 1980's, the Orlando Utilities Commission (OUC) has owned and operated a 230 kV transmission line connecting OUC's service territory with McIntosh Unit 3, located in Polk County and jointly owned by OUC and the City of Lakeland. In 1994 and 1995, the Cane Island plant, located in northwestern Osceola county and jointly owned by the Florida Municipal Power Agency (FMPA) and the Kissimmee Utility Authority (KUA), was placed into service and connected to the Taft-McIntosh line via a tap. During this time, TECO constructed the Lake Agnes substation on the Taft-McIntosh line.

Description of TECO's Investment

TECO purchased a 25% share in the portion of the existing 230 kV line between the Lake Agnes substation and the Cane Island tap. After considering the information furnished by TECO, we find that no portion of the investment in this transmission line should be allocated to the retail jurisdiction.

It appears that TECO purchased 25% of the line primarily to ensure the ability to make wholesale sales to entities such as the Reedy Creek Improvement District (RCID). TECO currently has a power sales agreement with RCID which expires in the year 2017.

Through this agreement, TECO sells firm capacity in amounts varying from 10 to 40 MW throughout the contract period. Although mention is made of benefits to the retail load, TECO's Program Scope Approval (PSA) states, in part:

Purchase of the OUC 230 kV circuit between the Lake Agnes Switching Station and the Cane Island tap will provide Tampa Electric with 111 MVA of transmission capacity into Central Florida, providing Tampa Electric with direct interconnect capacity with the City of Kissimmee and the Florida Municipal Power Agency (FMPA). This will facilitate interchange purchase and sales opportunities without wheeling costs and constraints. The project also provides to TEAK opportunities for more wholesales into the fast growing Central Florida at very low incremental costs. (Program Scope Approval, page 3)

TECO also asserts that the transmission line purchase will alleviate potential transmission system reliability concerns. The PSA notes that the reliability of the connection with Florida Power Corporation's Lake Buena Vista Substation was of such concern to RCID that other potential wholesale suppliers bidding on the RCID load were requested to provide remedies for the potential overload of RCID circuits on this route. Based on this statement, we conclude that the availability of the purchased transmission capacity was a significant deciding factor in TECO's winning bid.

Also, the location of the line is not directly tied into TECO's retail territory, so any retail service benefits would be indirect at best. Although the analysis provided by the Company shows a base revenue savings to retail customers, the RCID sale is a separated sale. All revenue from separated sales goes to stockholders, not retail ratepayers. The projected increase in broker revenues is negligible and the projected benefit of cheaper off-system power will likely benefit only non-firm customers. There is little danger that TECO will have insufficient capacity to serve its firm load because of the recent addition of the new Polk Unit. Likewise, the avoided wheeling costs cited as a savings which are in the PSA assume TECO will have the need to purchase power, which is unlikely.

Ownership of limited transmission capacity in an environmentally sensitive area will undoubtedly benefit TECO in a competitive market, but appears to provide little near term benefits to retail ratepayers. The reliability arguments advanced by TECO further support the position that the primary purpose of the transmission line is to provide reliable service to a wholesale customer (RCID). Documents provided by the Company reiterate the

need to provide RCID with reliable power and the way in which the purchased transmission will fill that need.

The argument can be made that increasing overall system reliability benefits retail ratepayers as well as wholesale customers. The question at hand is who should bear the cost of that increased reliability. If the wholesale load causes the need for increased transmission capacity for reliability, then costs should be assigned to the wholesale jurisdiction. The fact that some incidental benefits may accrue to retail ratepayers does not justify imposing the cost of the line on them.

The utility has failed to demonstrate the benefits to retail ratepayers that would justify the allocation of any portion of the transmission line to the retail jurisdiction. Based on the information available at this time, we find that the entire investment shall be assigned to the wholesale jurisdiction. This reduces the retail rate base by \$1,599,806 and increases the retail net operating income by \$37,643.

This does not preclude the utility from seeking, at some future time, recovery of its investment in the retail jurisdiction, upon a showing that it is a reasonable and prudent investment to provide retail service. If it chooses to do so, it must comply with the requirements of 25-6.014(1), Florida Administrative Code. Because we have not included any of the investment in the retail jurisdiction, no action with respect to the associated acquisition adjustment is necessary.

II. Treatment of deferred revenue subject to the earnings sharing agreement in TECO's capital structure

In its December 1995 earnings surveillance report, TECO included the amount of revenue deferred subject to the earnings sharing agreement (agreement) approved in Order No. PSC-95-0580-FOF-EI in its capital structure on a pro rata basis across all sources of capital. Under this treatment, the Company will earn its overall cost of capital on the balance of deferred revenue. For 1995, the Company reported a rate of return of 8.58%. The Company contends this treatment is appropriate because a similar treatment was not challenged in the tax savings dockets (Docket Nos. 880356-EI, 890325-EI, and 900153-EI).

We do not agree with TECO's proposed treatment. A review of the Orders in the tax savings dockets indicate this issue was not raised or affirmatively decided in those dockets. If TECO's proposed treatment were allowed, the Company would earn a return in

excess of its actual costs on the balance of deferred revenues during the period this amount is held by the Company. Based on its filing, for 1995 TECO would be allowed to earn 8.58% on the balance of deferred revenues. However, in the event a refund is ordered, it would only be required to refund the specified amount plus interest calculated at the thirty day commercial paper rate. For 1995, the average cost rate for thirty day commercial paper was 5.97%. Under TECO's proposal, the Company would keep the difference. For 1995, this treatment would allow TECO to reduce revenues subject to deferral under the agreement by \$1,532,083.

We believe the deferred revenue should be included in the capital structure as a separate line item. The cost rate should be the thirty day commercial paper rate as specified in Rule 25-6.109, F.A.C. This is the interest rate TECO would use to calculate the interest on the balance of deferred revenue under the terms of the agreement in the event a refund is ordered.

This treatment is consistent with the treatment in a number of other Commission decisions. In Order No. 22367 involving Quincy Telephone (Docket Nos. 890292-TL and 891237-TL), deferred revenues from 1987, 1988, 1989, and the first six months of 1990 were included in the capital structure and allowed to accrue interest at the thirty day commercial paper rate. In Order No. PSC-94-0172-FOF-TL involving Southern Bell (Docket No. 920260-TL), the accrued refund for Florida ratepayers was included in the capital structure as a specific adjustment to short-term debt and allowed to accrue interest at the thirty day commercial paper rate. Finally, in Order No. PSC-97-0135-FOF-EI involving Florida Public Utilities Company (Docket No. 961542-EI), deferred revenues associated with over earnings were included in the capital structure as a specific adjustment to short-term debt and allowed to accrue interest at the thirty day commercial paper rate.

Consistent with these Commission decisions, we find that the deferred revenue accrued subject to the agreement shall be included in the capital structure as a separate line item, with interest accrued at the thirty day commercial paper rate. The cost rate should be the thirty day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code. For 1995, the average cost rate for thirty day commercial paper was 5.97%.

III. TECO's equity ratio for 1995

In the earnings sharing agreement (agreement) approved in Order No. PSC-95-0580-FOF-EI, as amended in Order Nos. PSC-96-0670-S-EI and PSC-96-1300-S-EI, for 1995 the Company is allowed to

retain 50% of the revenue above a return on equity (ROE) of 11.75% up to a net ROE of 12.75%. The remaining 50% of earnings between an ROE of 11.75% and a net ROE of 12.75%, as well as all revenues above a net ROE of 12.75%, are deferred to the future. For 1996, TECO defers 60% of net revenues that contribute to an ROE in excess of 11.75%. There is no ROE cap for earnings in 1996. For the years 1997 and 1998, TECO will defer 60% of net revenues that contribute to an ROE in excess of 11.75%, as well as all revenues above a net ROE of 12.75%. Under the terms of the agreement, TECO has the discretion to reverse and add to its 1997 and 1998 revenues all or any portion of the balance of previously deferred revenues. For 1999, TECO defers 60% of net revenues that contribute to an ROE in excess of 12.0%, as well as all revenues above a net ROE of 12.75%. If any deferred revenues remain after 1999, TECO will refund this amount plus interest accrued at the thirty day commercial paper rate.

Under the terms of the agreement, the sharing bands are established based on ROE. Since the amount of equity capital maintained by a company is integral in the determination of the ROE, a company can shield earnings from deferral by increasing its equity ratio. For example, in TECO's case the difference between sharing at an equity ratio of 55% and an equity ratio of 58.7% as filed by the Company at an ROE of 11.75%, is approximately \$5.3 million in revenue, all other things held constant. Through the flow of dividends and equity infusions between TECO and its parent, TECO Energy, the Company has complete control over the level of equity maintained at the utility level. By manipulating the level of equity maintained at the utility level, the Company could circumvent the sharing mechanism approved in the Commission's Order.

TECO contends that its equity ratio is necessary to support its "strong credit rating over time and ensure efficient access to capital." However, it is noted that other electric utilities in the country support the same or higher bond ratings at lower equity ratios.

The Company further stated that improved levels of financial flexibility would be necessary to counterbalance greater business risk. However, if the Company truly required this level of equity to offset the level of business risk faced by the regulated utility, it would stand to reason that the parent company would be capitalized at the same or higher level of equity to compensate for its relatively greater risk exposure. This is not the case. TECO has consistently employed greater equity capitalization at the regulated utility level than at the consolidated parent company level.

TECO represents approximately 75% of the assets of TECO Energy. Since these assets are capitalized at an equity ratio of approximately 58%, the remaining 25% of non-regulated assets must be capitalized at a significantly lower equity ratio to produce the approximate 46% equity ratio maintained by TECO Energy on a consolidated basis. Even after removing the non-recourse debt of TECO Power Services and making an adjustment for the unamortized portion of debt which financed the Company's ESOP, the level of equity at the utility level still exceeds the level of equity maintained at the consolidated level.

Unlike other expenses, the Company is in a position to control the amount of equity in its capital structure. We believe there is a reasonable maximum percentage of equity to be included in the capital structure. We note that TECO's equity ratio is at its highest level ever. However, equity ratios in the electric industry are increasing, reflecting the increased business risk. On balance, there is no showing that the Company's actual level of equity in 1995 is unreasonable. Therefore, we find that no adjustment to TECO's equity investment for 1995 is appropriate in calculating TECO's 1995 earnings.

IV. Total Amount of Excess Earnings to be Deferred for 1995

Per its December 1995 Earnings Surveillance Report, TECO reported that it had deferred \$50.8 million in revenues, which resulted in an earned ROE of 12.62% after the deferral. This amount, however, was adjusted by TECO to reflect a net earned ROE of 12.75% for 1995. The TECO adjusted amount of deferred revenues for 1995 is \$48.832 million. Based on the adjustments approved in this Order, an additional \$1,685,063 of revenues should be deferred. This results in a total revenue deferral of \$50,517,063 (\$48,832,000 + \$1,685,063), plus interest.

Therefore, we find that the total amount of excess earnings to be deferred for 1995 is \$50,517,063, plus interest. Spreadsheets detailing TECO's adjusted capital structure and the calculation of the amount of the excess earnings are included in this Order as Attachments B and A, respectively.

All issues in this Notice of Proposed Agency Action are severable. Any protest of this Order must specifically identify the issue or issues protested. The failure to protest an issue will waive any right to contest that issue.

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Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that TECO's entire investment in the existing 230 kV line between the Lake Agnes substation and the Cane Island tap shall be allocated to the wholesale jurisdiction. It is further

ORDERED that the deferred revenue shall be included in the capital structure as a separate line item, with interest accrued at the thirty day commercial paper rate, as specified in Rule 25-6.109, Florida Administrative Code. For 1995, the average cost rate for thirty day commercial paper was 5.97%. It is further

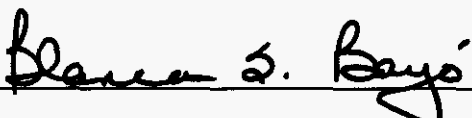
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ORDERED that this docket shall remain open pending the review of TECO's 1996 earnings and the determination of the appropriate amount of any additional deferred revenues related to 1996.

By ORDER of the Florida Public Service Commission, this 17th day of April, 1997.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), 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.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on May 8, 1997.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater 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 of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

**TAMPA ELECTRIC COMPANY
DOCKET NO. 950379-EI
REVIEW OF 1995 EARNINGS**

ATTACHMENT A

Adjusted Rate Base			\$1,725,082,509
Adjusted Achieved Rate of Return	8.61%		
Reported Achieved Rate of Return	8.58%		
Excess Rate of Return		0.03%	
Beginning Sharing Point Rate of Return:			
As Adjusted	8.14%		
As Filed	8.17%		
Excess Rate of Return		0.03%	
Total Excess Rate of Return		x	<u>0.06%</u>
Excess Net Operating Income			\$1,035,050
Revenue Expansion Factor		x	<u>1.62800</u>
Additional Deferred Revenues			\$1,685,063
Revenues Deferred by TECO		+	<u>48,832,000</u>
Total 1995 Deferred Revenues			<u><u>\$50,517,063</u></u>

ATTACHMENT B

DOCKET NO. 950379-EI
 TAMPA ELECTRIC COMPANY
 STAFF ADJUSTED EARNINGS SURVEILLANCE REPORT
 YEAR ENDING DECEMBER 31, 1995

AVERAGE
 TEST YEAR

	ADJUSTMENTS									
	RETAIL PER BOOKS	COMPANY SPECIFIC	COMPANY PRO RATA	COMPANY ADJUSTED	STAFF SPECIFIC	STAFF PRO RATA	STAFF ADJUSTED	WEIGHT	COST RATE	WEIGHTED COST
LONG TERM DEBT	\$589,862,991	(\$42,838,711)	(\$95,214,358)	\$451,809,922	(\$5,460,517)	(\$418,611)	\$445,930,794	25.85%	6.64%	1.72%
SHORT TERM DEBT	94,861,589	(17)	(16,511,486)	78,350,086	(946,929)	(\$72,593)	77,330,564	4.48%	6.01%	0.27%
PREFERRED STOCK	54,956,000	(852,735)	(9,417,146)	44,686,119	(540,071)	(\$41,403)	44,104,645	2.56%	6.49%	0.17%
CUSTOMER DEPOSITS	50,623,997	(25,000)	(8,807,198)	41,791,799	(505,090)	(\$38,721)	41,247,988	2.39%	5.73%	0.14%
COMMON EQUITY	995,852,169	(8,587,089)	(172,190,235)	817,074,845	(9,875,062)	(\$757,036)	806,442,747	46.75%	11.75%	5.49%
DEFERRED REVENUE	0	0		0	20,868,462		20,868,462	1.21%	5.97%	0.07%
DEFERRED TAXES	292,036,768	1,806,134	(51,145,926)	242,696,976	(2,933,205)	(\$224,864)	239,538,908	13.89%	0.00%	0.00%
FAS 109 DEFERRED TAXES	0	0	0	0	0	\$0	0	0.00%	0.00%	0.00%
TAX CREDITS - ZERO COST	126,907	0	(22,089)	104,818	(1,267)	(\$97)	103,454	0.01%	0.00%	0.00%
TAX CREDITS - WEIGHTED COS	60,755,179	(15,086)	(10,572,344)	50,167,749	(606,321)	(\$46,481)	49,514,946	2.87%	9.81%	0.28%
	<u>\$2,139,075,800</u>	<u>(\$48,512,504)</u>	<u>(\$363,880,781)</u>	<u>\$1,726,682,315</u>	<u>\$0</u>	<u>(\$1,599,806)</u>	<u>\$1,725,082,509</u>	<u>100.00%</u>		<u>8.14%</u>
			EQUITY RATIO	58.70%		EQUITY RATIO	57.82%			