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February 19, 1990

HAND DELIVERY

Mr. Steve C. Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301

Re: Corporate Income Tax Expense Adjustment; Midpoint
and Additional Changes; Docket No. 891278-PU

Dear Mr. Tribble:

ACK Enclosed for filing are fifteen copies of the Posthearing Statement of Tampa Electric Company in the above-styled docket.

AFA 3
APP Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning same to this writer.

CAF
CMI Thank you for your assistance in connection with this matter.

Sincerely,

Lee L. Willis

EAG

LEG 1

LIN 6

OMI

ROH LLW/bjm

SEC Enclosures

WAS

OTH

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

RECEIVED & FILED

IPB
BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

01597 FEB 19 1990

FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Amendment of Rule 25-14.003,)
F.A.C., Corporate Income Tax Expense)
Adjustment: Midpoint and Additional)
Changes)
_____)

DOCKET NO. 891278-PU
FILED: February 19, 1990

POSTHEARING STATEMENT
OF
TAMPA ELECTRIC COMPANY

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DOCUMENT NUMBER-DATE
01597 FEB 19 1990
FPSC-RECORDS/REPORTING

POSTHEARING STATEMENT

In accordance with Rule 25-22.056, F.A.C., Tampa Electric files this its Posthearing Statement:

Background

This docket was initiated by Order No. 22237 on November 29, 1989 to consider certain amendments to the Commission's Tax Savings Rule 25-14.003, F.A.C. This rule has been the subject of exhaustive review and criticism over the past three years since the enactment of the Tax Reform Act of 1986 which, among other things, lowered the federal corporate income tax rate.

While this rule, as currently written, in fact operated to the great benefit of Tampa Electric's ratepayers endless debate has ensued each time the Commission has applied the rule. This controversy led the Commission in late 1989 to remove water and sewer companies from the operation of the rule. The Commission initiated the instant rulemaking proceeding to consider several amendments to the rule and to consider whether the rule should be abolished altogether.

As provided in Order No. 22354 (12/29/89), Tampa Electric and Florida Power and Light Company ("FPL") prefiled testimony of Hugh Gower setting out these companies' objections to Staff's proposed amendments. These objections are summarized below.

**THE PROPOSED RULE VIOLATES THE NORMALIZATION REQUIREMENTS
OF THE FEDERAL INCOME TAX CODE**

This Commission has consistently recognized that in order to meet the requirements of IRS Section 46(f)(2) the cost of capital to be assigned to ITC must be at least equal to the overall weighted average cost of capital that would have been provided by common and preferred stockholders and long term creditors if the credit were unavailable. (See Gower, page 8) As recognized by the Commission in its prior orders (see page 55, Order No. 13537 issued in Docket No. 830465-EI), the use of a zero cost for ITC would place utilities and ratepayers in jeopardy of losing the benefits associated with ITC. In fact, the benefits associated with ITC are substantial amounting to hundreds of millions of dollars to Florida electric utility customers. Clearly, neither the risk of loss nor the ultimate loss of these benefits is in the interest of either ratepayers or investors (see Gower, page 10).

Mr. Gower's testimony also demonstrates that the normalization requirements of Section 46(f)(2) of the Internal Revenue Code applies not only to the regulatory treatment in full revenue requirements proceedings but also applies to the treatment in limited scope proceedings such as Rule 25-14.003. This is because of the obvious practical manner in which Rule 25-14.003 as proposed by Staff would work to undermine the provisions of the Internal Revenue Code. For example, the Commission could determine a company's revenue requirements, by giving ITC the weighted average cost of replacement capital as required by the Internal Revenue Code, and then in the very next year, through the operation of this rule, reestablish the company's revenue requirements and require a rate reduction by using a zero

cost for the ITC included in the capital structure. Any attempt to describe Staff's proposal as not involving ratemaking is obviously flawed where it is clear that the rule is intended to allow the Commission to make a change in rates based on changes in the tax rates of the Internal Revenue Code.

In previous instances where there has been some question of the effect of the treatment of investment tax credits, this Commission has declined to adopt such proposals for fear that it would jeopardize the utility's ability to use these valuable tax credits. Where the Commission, nevertheless, felt the proposal had some merit it has required the various utilities to submit revenue ruling requests to the Internal Revenue Service to settle the point. Following a discussion of this issue during the hearings held on January 29, Staff proposed a new paragraph 8 to the rule which would provide for an Internal Revenue ruling request. Tampa Electric Company first urges that the Commission abandon the requirement in the rule that zero cost ITC be used. However, if the Commission insists on including such a provision in the rule, it is imperative that Staff's language proposed for a new paragraph 8 be included within the rule. During the hearing, Staff agreed to revise the date in the proposed paragraph 8 so that a ruling request would be required a reasonable time after the adoption of the rule.

STAFF'S PROPOSAL TO UTILIZE THE MOST RECENT
COMMISSION - APPROVED RATE OF RETURN ON COMMON EQUITY

AND THE CALCULATION OF THE WEIGHTED COST OF CAPITAL IS INAPPROPRIATE

It is obviously difficult to take sufficient evidence to appropriately set common equity returns within the confines of a limited scope proceeding. Such a procedure would require the Commission to decide an issue which is uniquely complex, interrelated and affected by many other variables, and risk the result which may not be appropriate and fair. (See Gower, page 13) As stated by the Florida Supreme Court in United Telephone Company v. Mann, 403 So.2d 962 (Fla. 1981):

Since changes in the cost of equity are not easily calculable, they are not proper subjects for interim hearing.

This is because the consideration of comprehensive evidence on return on equity "would have been tantamount to holding a comprehensive rate-making proceeding." The confusion of the return on equity issue into the operation of the rule significantly adds to the complexity of the rule. The purpose of the rule should be limited to provide an efficient means of correcting for an economic impact caused by changes in income tax rates between general rate cases. By requiring the Commission to address numerous complex issues within the context of the operation of the rule, the Commission will create even more controversy and acrimony under the revised rule than has been experienced under the present rule.

**STAFF'S EXCLUSION OF NONRECURRING ELEMENTS FROM THE EARNINGS
CALCULATION IS IMPROPER AND INCONSISTENT WITH THE INTENT OF THE RULE**

Staff's recommendation to only consider recurring elements in the rule's earning calculation ignores a fundamental difference between a general rate case which is designed to establish future rates based on total revenue requirements and a limited scope proceeding. The Tax Savings Rule was designed to approve a refund or to collect a shortfall of actual prior periods base rates attributable to one specific element of the cost of service - income taxes. In general rate cases where rates are set for the future, this Commission frequently adopts adjustments so that the total revenue requirements will be representative of actual operating conditions expected to exist when the new rates will be in effect in the future. In contrast, adjustments for nonrecurring items are not consistent with the intent of a limited scope proceeding. (See Gower, page 15)

Moreover, any attempt to exclude nonrecurring cost of service items is not administratively efficient. By introducing this issue into the proceeding, endless debate will occur whether specific costs are, in fact, recurring or nonrecurring. It will be argued that a given expense which never before occurred and is expected never to again occur will be replaced with another "unique" expense. This Commission has considerable difficulty with such issues when considering the context of full general rate cases and this difficulty will be not be lessened in a limited scope proceeding.

Moreover, this rule should be designed to address the actual increase or decreases in income tax expenses based upon the actual earnings of the utility calculated in a manner consistent with Commission policies and

procedures. Arguments regarding nonrecurring items are not reflected on the actual earnings of a prior period. Even in rate and full revenue requirement cases, all nonrecurring items are not excluded from the ratemaking formula. For example, the Commission routinely considers gains on sale of property which may be nonrecurring but are nevertheless amortized over some period of time rather than totally ignored. It is generally recognized that every year, some level of nonannual expense occurs which repeats itself in the aggregate, if not specifically. As long as these items are prudent, they are part of the necessary cost of doing business. (See Gower, page 18) Finally, and perhaps more importantly, if nonrecurring expenses (however defined) are always excluded from the ratemaking formula, utilities would never earn their authorized return. (See Gower, page 16)

**THE PROPOSED REPORT FORM INAPPROPRIATELY
ELEVATES THE STATUS OF THE O&M BENCHMARK**

The Staff's proposed report form which retains a requirement to provide a calculation of the O&M benchmark is inappropriate. The Tax Savings Rule should be designed to approve a refund or collect a shortfall of an actual prior period based rates attributable to a single element of cost of service - income taxes. The purpose of the calculation of earnings under the rule is on actual prior earnings adjusted only for specific cost elements recovered through a separate recovery clause or for expenses previously excluded from consideration as a matter of Commission policy. The Commission has consistently applied the O&M benchmark as an analytical tool. Nothing more, nothing less. It is the point of beginning of

analysis. The inclusion of the O&M benchmark analysis and every filing of the rule create an enormous unnecessary reporting burden which would frustrate the administrative efficiency of the rule. Infusion of the O&M issues within the operation of the rule injects further controversy and endless debate. Concern over utilities earnings level of operation expense level should be addressed through continuing surveillance and, if necessary, show cause proceedings.

**THE RATE DESIGN REQUIREMENTS IN PARAGRAPH 5(f)
OF THE RULE WILL ADD FURTHER CONTROVERSY TO THE RULE**

Under the current rule, each customer's share of the refund or collection is determined on a kilowatt hour basis. The proposed rule would create cost of service study issues within this already overburdened, so-called limited-scope, procedure. As was pointed out during the hearing on this matter, cost of service and rate design issues are highly controversial and require the testimony of numerous experts and considerable hearing time to resolve. The rule should not be amended to allow these extremely complex issues to be included in tax savings rule cases.

PROPOSED RULE IMPROVEMENTS

During the hearing, Mr. Gower discussed several conceptual improvements to the rule which are generally stated as follows:

1. The rule should operate essentially in the same manner regardless of whether tax changes are up or down.

2. The rule should be amended so that rate increases or decreases would be implemented coincident with the date income tax increases or decreases are effective, rather than after the year in which the rate change occurs.

3. The rule should be changed so that the previously determined revenue effect of tax increases or decreases being passed on to ratepayers is included in the utility's base rates after a period of time.

The exact changes and language which would implement these general provisions are attached as Exhibit 1 hereto.

COMMENTS ON COMMISSIONER GUNTER'S PROPOSAL

During the January 29, 1990 hearing, Commissioner Gunter requested comment on a proposal that the rule be amended to provide that when tax rate changes occur in the future, a calculation would be made using the data in the record of the company's last rate case but substituting the new tax rate for the tax rate used in that case to derive a revenue requirement difference. The company's rates would then be immediately adjusted to take that difference into effect.

While this may have some appeal at first blush, there are some substantial difficulties with this approach which will lead to unfair results. In the first instance, a substantial amount of time may have passed since the company's last rate case; for example, Centel's last rate case was in 1976. Tampa Electric's last rate case was based on a 1984 test year. Secondly, the billing determinants used in a prior proceeding can significantly distort the amount of the rate increase or decrease.

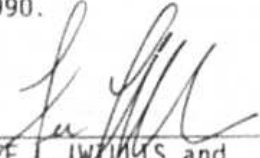
If, for example, a tax rate increase is enacted and the prior case data indicates a difference in tax expense of \$1 million, the prior case billing determinants will exaggerate the amount of the rate increase as applied to the current customer base. This means that a \$1 million rate increase applied to 1984 billing determinants will produce more than \$1 million in 1990.

In summary, there are several factors which could operate to distort the results under this proposal.

CONCLUSION

The amendments proposed by Staff in this proceeding will operate to the substantial detriment of both the company and its ratepayers. As a matter of priority, the Commission should either: adopt the changes in the rule which are set out in Exhibit 1 hereto; or leave the rule as is in its present form. In the alternative, the rule should be repealed. The least attractive option before the Commission would be to adopt the amendments to the rule as proposed by Staff. The changes proposed by Staff would greatly complicate an already overburdened limited-scope proceeding. The complexities added are so severe that the rule would be essentially unworkable. Staff's primary recommendation to the Commission in the past has been to repeal the rule rather than to amend it in the manner as proposed in this proceeding.

DATED this 19th day of February, 1990.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Posthearing Comments has been furnished by U. S. Mail this 19th day of February, 1990 to the following:

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25-14.003 CORPORATE INCOME TAX EXPENSE ADJUSTMENTS

1. Definitions. For the purpose of this Rule, the following definitions shall apply:

- (a) "Tax Savings." The difference between the actual jurisdictional tax expenses for a utility or regulated company calculated under the previously effective corporate income tax rates and those calculated under newly effective, reduced corporate income tax rates.
- (b) "Tax Deficiency." The difference between the actual jurisdictional tax expenses for a utility or regulated company calculated under newly effective, higher corporate income tax rates and those calculated under the previously effective corporate income tax rates.
- (c) "Associated Revenues." Those revenues resulting from the application of a utility's or regulated company's revenue expansion factor to a tax savings or tax deficiency. The tax rate to be used in calculating the revenue expansion factor shall reflect the newly effective tax rate.
- (d) "Previously Effective." Refers to the corporate income tax rate used in a utility's or regulated company's last rate case or earnings review ~~or show cause~~ proceeding, or rate adjustment approved by the Commission to reflect a previous tax rate change ~~used in the last tax expense adjustment by the Commission~~, whichever occurred most recently.

- (e) "Tax Rate." The statutory tax rates, both federal and state, applicable to utility or regulated company income, including any surcharges, minimum taxes, and other adjustments to the basic percentage tax rates.
- (f) "Midpoint." The midpoint of the weighted average cost of capital calculated using the average capital structure for the period of time covered by the tax rate change report, as described in paragraph 4. below, and using as cost rates the midpoint of the return on equity approved by the Commission in the utility's last rate case, the current embedded cost of fixed rate capital, the actual cost of variable cost debt, and the required cost of other sources of capital which were utilized in the utility's last rate case ~~range of return approved by the Commission in the utility's last rate case, adjusted for the cost of any debt issued subsequent to the rate case, and prior to the commencement of a tax savings refund or tax deficiency collection.~~

2. Tax Savings Rate Adjustments ~~Refunds~~. In accordance with subsection (5) of this rule ~~and using a calendar year as the basis of the calculation.~~

- (a) When, during the reporting period described in paragraph 4 below, a utility or regulated company is earning a rate of return which is at or above the midpoint of its authorized range computed in accordance with subsection (1)(f) and without consideration of a tax rate reduction, the utility or regulated company shall apply for a rate adjustment to reflect ~~refund~~ all associated revenues as described in paragraph 5(c).

(b) When, during the reporting period described in paragraph 4 below, a utility or regulated company is earning a rate of return which is below the midpoint of its authorized range computed in accordance with subsection (1)(f) and without consideration of a tax rate reduction, the utility or regulated company shall apply for a rate adjustment to reflect ~~refund~~ only those associated revenues which cause the utility or regulated company to earn in excess of its ~~that~~ midpoint, as described in paragraph 5(c).

3. Tax Deficiency Rate Adjustment Collections. In accordance with subsection (5) of this rule ~~and using a calendar year as the basis of the calculation~~

(a) When, during the reporting period described in 4 below, a utility or regulated company is earning a rate of return which is at or below the midpoint of its authorized range computed in accordance with subsection (1)(f) and without consideration of a tax rate increase, the utility or regulated company shall apply for a rate adjustment to reflect ~~collect~~ all associated revenues, as described in paragraph 5(c).

(b) When, during the reporting period described in 4 below, a utility or regulated company is earning a rate of return which is above the midpoint of its authorized range computed in accordance with subsection (1)(f) and without consideration of a tax rate increase, the utility or regulated company shall apply for a rate adjustment to reflect ~~collect~~ only those associated revenues which cause the utility or regulated company to earn below its ~~that~~ midpoint, as described in paragraph 5(c).

4. Reporting Requirements. Prior to the effective date of ~~On or before~~
~~March 1 of every year following~~ a tax rate change, each utility or
regulated company shall furnish a final report on the form prescribed by
the Commission, Form PSC/AFA 1(), which is incorporated into this rule by
reference. Form PSA/AFA 1(), entitled "Rule 25-14.003 Corporate Income
Tax Expense Adjustments," was effective () and may be obtained from
the Commission's Division of Auditing and Financial Analysis. A utility or
regulated company is not precluded from providing tax adjustment
information in addition to that prescribed by Form PSC/AFA 1() ~~in the form~~
~~prescribed by the Commission.~~ The report shall cover the most recent
reasonably available 12-month period, as approved by the Commission, prior
to the effective date of a tax rate change and reflect a pro forma
adjustment for the tax rate change as well as specific adjustments to
reflect current commission policy ~~only the prior calendar year during which~~
~~the tax rate change was effective.~~

5. Procedure.

(a) ~~Refunds or collections~~ A rate adjustment shall be calculated based on
the reporting period described in paragraph 4 above adjusted to reflect
the tax rate change ~~from the effective date of any tax rate change~~
~~through the end of the calendar year. If the tax rate change is in~~
~~effect for only part of a tax year, the refund or collection~~ The rate
adjustment shall be calculated in accordance with the utility's or
regulated company's customary accounting treatment as authorized by the
federal or state taxing authority for tax rate changes which occur
during a tax year.

- (b) A further change in the tax rate shall end one period of compliance and initiate a new period but shall not affect any rate adjustment ~~refund~~ ~~or collection~~ already in progress pursuant to this rule.
- (c) Together with the final report described in subsection 4. of this rule, each utility or regulated company shall file a petition containing a calculation of the rate adjustment required to reflect the tax rate change and the method for implementing the rate adjustment ~~refunding or collecting any tax savings or deficiency for the tax year of the report~~. The Commission will review and evaluate the petition and supporting data and either approve it, approve it with modifications, or deny it; an opportunity for a hearing on the Commission's decision will then be provided, if requested. Thereafter, the utility or regulated company shall implement the rate adjustment ~~either make the refund to or collect the deficiency from its existing customers~~ in accordance with paragraph (e) ~~and (f)~~ of this subsection.
- (d) Upon its own or other motion, the Commission may determine that a rate adjustment ~~refund or collection for a particular year~~ is impractical because its amount will not warrant the expense of making the rate adjustment ~~refund or collecting the deficiency~~. In such an event, no rate adjustment ~~refund or collection~~ will be made ~~for that year~~.
- (e) The rate adjustment will be effective upon the effective date of the tax rate change or on the first day of the month following the month in which the tax rate change occurs if the effective date is other than the first day of a month. ~~The utility may make any refund or~~

~~collection either as a lump sum payment or billing or in monthly installments not to exceed twelve (12) months. Such refunds or collections shall be made to or from current customers of the utility at the time that such refunds or collections are to be effected. In either event, the utility shall refund or collect the amount with interest accruing on any outstanding balance from the date of overcollection or underpayment. Interest shall be set by the Commission.~~

- (f) After the rate adjustment has been operational for 12 months, each utility shall file a petition to adjust its base rates by the amount of the rate adjustment. Thereafter, the rate adjustment shall be inoperative until the next income tax rate change. The Commission will review the petition and approve it, approve it with modifications, or deny it; an opportunity for a hearing on the Commission's decision will then be provided, if requested. An electric utility shall determine each customer's share of refund or collection on a kilowatt-hour basis. A telephone company shall determine each customer's share of refund or collection based on existing general residence and business-local rate relationships. Other utilities shall determine each customer's share of refund or collection based on consumption or any other reasonable basis specified in the utility's petition and approved by the Commission.

6. Effect of Rate Case or Earnings Review Show Cause Proceeding. A rate adjustment to reflect a tax rate change, ~~tax savings refund or tax deficiency collection~~ shall be consistent with this rule except that:

(a) ~~The issue of a~~ When a tax rate change occurs, its effects ~~tax savings refund or tax deficiency collection~~ shall be addressed ~~decided~~ in the course of rate cases and earnings review show cause proceedings that are pending when ~~a~~ the tax rate change becomes law. If a rate case or earnings review proceeding is begun in or that commence prior to the close of the tax year in which a tax rate change becomes effective, the effects of the tax rate change shall be addressed in such proceedings.

(b) ~~Nothing in this subsection shall be construed as limiting the operation of the tax expense adjustment process under this Rule either in completing a tax savings refund or tax deficiency collection for any tax years prior to the year in which a rate case or show cause proceeding is initiated. It shall also not prohibit a tax savings refund or tax deficiency collection for any tax year or portion thereof ending prior to the final order in a rate case or show cause proceeding.~~

7. The provisions of this rule shall not supersede any disposition of excess tax revenues or collections of tax deficiencies approved by the Commission prior to the effective date of this rule.

Specific Authority: 364.01, 366.05, 367.121, F.S.

Law Implemented: 364.01, 366.05, 367.121, F.S.

History: New 6/22/82, formerly 25-14.03, amended