

State of Florida



Public Service Commission

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**DATE:** JUNE 27, 2003

**TO:** DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

**FROM:** DIVISION OF ECONOMIC REGULATION (SLEMKEWICZ, DEVLIN) JS  
OFFICE OF THE GENERAL COUNSEL (BRUBAKER) JSB

**RE:** DOCKET NO. 000824-EI - REVIEW OF FLORIDA POWER CORPORATION'S EARNINGS, INCLUDING EFFECTS OF PROPOSED ACQUISITION OF FLORIDA POWER CORPORATION BY CAROLINA POWER & LIGHT. Jdy

**AGENDA:** 07/09/03 - SPECIAL AGENDA - ORAL ARGUMENT DISCUSSED IN ISSUE A

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** STAFF'S RECOMMENDATION ON MOTION TO ENFORCE SETTLEMENT AGREEMENT - DEFERRED FROM THE MAY 20, 2003 AGENDA CONFERENCE

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\000824.RCM

CASE BACKGROUND

The Commission opened Docket No. 000824-EI on July 7, 2000, to review the earnings of Florida Power Corporation (FPC), now known as Progress Energy Florida, Inc. (PEFI), and the effects of the acquisition of FPC by Carolina Power & Light Company. The acquisition was consummated on November 30, 2000. By Order No. PSC-01-1348-PCO-EI, issued June 20, 2001, in Docket No. 000824-EI, the Commission directed FPC to file Minimum Filing Requirements (MFRs) to provide the Commission and all other interested parties the data necessary to begin an evaluation of FPC's level of earnings on a going-forward basis.

DOCUMENT NO. 000824-EI

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FPSC-COMMISSION CLERK

The hearing was scheduled to begin on March 20, 2002. On that date, however, the parties filed a Joint Motion To Postpone Scheduled Hearings to afford the parties the opportunity to finalize the terms of a settlement stipulation. The motion was granted by Order No. PSC-02-0411-PCO-EI, issued March 26, 2002. By Order No. PSC-02-0412-PCO-EI, issued March 26, 2002, the Commission suspended the hearing schedule.

On March 27, 2002, FPC filed a Joint Motion for Approval of Stipulation and Settlement and Further Postponement of Hearings and a Stipulation and Settlement. The Commission approved the stipulation and settlement agreement (Settlement) in Order No. PSC-02-0655-AS-EI, issued May 14, 2002. Among other things, the Settlement required PEFI to make refunds to customers if its revenues should exceed certain thresholds during the years 2002, 2003, 2004, or 2005. For the period ended December 31, 2002, PEFI calculated a refund amount of \$4,954,413, excluding interest.

On February 24, 2003, the Office of Public Counsel, Florida Industrial Power Users Group, Florida Retail Federation, Buddy Hansen/Sugarmill Woods Civic Association, and Publix Super Markets, Inc. (Movants) filed a Motion To Enforce Settlement Agreement (Motion). The Movants contend that PEFI's refund calculation made three adjustments which are inappropriate and not contemplated by the Settlement.

On March 7, 2003, PEFI filed both a response in Opposition to the Motion To Enforce Settlement Agreement (Response) and a Request for Oral Argument and, in the Alternative, for an Evidentiary Hearing. In an effort to facilitate a possible resolution of these issues, staff held a noticed meeting with the parties on March 27, 2003. The parties were unable to resolve their differences at the meeting.

By letter dated April 9, 2003, PEFI provided its initial Revenue Sharing Refund Report per Order No. PSC-02-0655-AS-EI, indicating that \$4,995,649 had been refunded to its customers as of March 28, 2003.

This Recommendation is the same as that which was filed for consideration at the May 20, 2003, Agenda Conference, except for the addition of Issue A, which addresses oral argument. Issue 1 of this recommendation addresses PEFI's request for oral argument or,

in the alternative, for an evidentiary hearing. Issue 2 addresses the Movants' Motion and PEFI's Response.

The Commission has jurisdiction over this matter pursuant to Sections 366.04, 366.05, and 366.06, Florida Statutes.

### DISCUSSION OF ISSUES

ISSUE A: Should oral argument be permitted?

RECOMMENDATION: Yes. Each side should be permitted twenty minutes to present oral argument with respect to the Motion to Enforce Settlement Agreement and Progress Energy's Response in Opposition thereto. (BRUBAKER)

STAFF ANALYSIS: Staff believes that oral argument would aid the Commission in comprehending and evaluating the issues before it, due to the importance and complexity of this matter. Further, staff notes that since no hearing has been held with respect to these issues, parties and interested persons may participate at the Special Agenda Conference at the Commission's discretion. Staff recommends that each side be permitted twenty minutes to present oral argument.

**ISSUE 1:** Should Progress Energy Florida, Inc.'s Request for Oral Argument and, in the Alternative, for an Evidentiary Hearing, be granted?

**RECOMMENDATION:** Progress Energy Florida Inc.'s request for oral argument should be granted. Progress Energy Florida, Inc.'s request for an evidentiary hearing should be denied. (BRUBAKER)

**STAFF ANALYSIS:** In its request, PEFI contends that oral argument will be essential to the Commission's resolution of this matter, and that after oral argument, the Commission will be in a position to rule in PEFI's favor on the current state of the record. If however, the Commission believes that it does not have a sufficient record to rule on the merits in PEFI's favor, PEFI requests that the Commission schedule an evidentiary hearing to resolve the dispute. No party filed a response either in opposition to or in support of PEFI's request.

Staff believes that oral argument would aid the Commission in comprehending and evaluating the issues before it, due to the importance and complexity of this matter. Further, staff notes that since no hearing has been held with respect to these issues, parties and interested persons may participate at the Agenda Conference at the Commission's discretion. Accordingly, for purposes of this recommendation, staff recommends that oral argument should be granted.

Staff recommends that the Commission deny PEFI's alternative request that the Commission schedule an evidentiary hearing in this matter. A proceeding pursuant to Section 120.57, Florida Statutes, is designed to address matters involving disputed issues of material fact. PEFI's concerns present matters which require a legal, rather than factual, determination. Staff does not believe that additional evidence is necessary in order for the Commission to fully and fairly resolve the matter before it. As such, this matter has been noticed as a matter of final agency action, to which the appropriate recourse is to seek further relief from a court of competent jurisdiction. Staff therefore recommends that PEFI's alternative request to set this matter for an administrative hearing should be denied.

**ISSUE 2:** What considerations should the Commission take into account in deciding whether to approve the Motion for Enforcement of Settlement Agreement?

**RECOMMENDATION:** The Commission should take into account the matters listed below in the Staff Analysis in the evaluation of the positions of the Movants and PEFI. Also, the Commission should consider a compromise position that is based on Commission ratemaking practices. (SLEMKEWICZ, BRUBAKER, DEVLIN)

**STAFF ANALYSIS:** This issue involves a dispute between the parties regarding one component of a very comprehensive stipulation, the refund for 2002. Staff was not privy to the discussions leading to the wording of the stipulation. Therefore, staff is unable to provide an opinion regarding the intent and understanding of the various parties when they agreed to the provisions and amounts contained in the Settlement. Staff is further unaware of the basis for the revenue sharing mechanism. This recommendation involves three alternatives with each having a different basis:

**Option 1:** Grant the Movants' Motion to Enforce Settlement Agreement and require an additional refund of \$18,079,591, plus interest. This option is based on the strict reading of the stipulation and is consistent with the Movants' position.

**Option 2:** Deny the Movants' Motion to Enforce Settlement Agreement and require no further refund. This option is based on the premise that the revenue threshold and determination of 2002 operating revenue were predicated on the utility's 2002 operating budget. This is consistent with PEFI's position.

**Option 3:** Deny the Movants' Motion to Enforce Settlement Agreement and approve an alternative calculation that would require an additional refund of \$6,388,000, plus interest. This option is based on using past Commission practice in the determination of 2002 operating revenues.

In its Response, PEFI calculated a refund amount of \$4,954,413, excluding interest, based on its understanding of the intent of the provisions of the Settlement and its interpretation of those provisions. The Movants calculated a refund amount of \$23,034,004, excluding interest, based on their understanding of the intent and interpretation of those same provisions. The difference in the two amounts stems from three adjustments PEFI

made in its refund calculation, which the Movants contend are inappropriate and not contemplated by the Settlement.

The adjustments made by PEFI to its actual revenues for calculation of its 2002 refund are as follows:

- Increased actual revenues by \$35 million to account for the refund of interim revenues as required by Order No. PSC-02-0655-AS-EI.
- Reduced actual revenues by \$9.3 million, related to the Service Fee/Lighting rate increase.
- Reduced 2002 actual revenues by \$41.6 million to account for the rate reduction not being in effect for the entire year.

(For informational purposes, the three adjustments are addressed in greater detail below under the section, "Areas of Contention.")

The Movants contend that PEFI entered into an agreement that set forth specific calculations determining the amount it would refund for 2002. Now that the year 2002 is over, PEFI cannot change those calculations to suit its tastes, and cannot rely on matters lying outside of the written agreement in order to change its obligations. The Movants contend that the Commission must issue an order enforcing the settlement agreement so that PEFI's customers will get the refund to which they are entitled.

In its Response, PEFI states that:

Traditionally, the Commission has used an authorized Return on Equity ("ROE") to limit earnings levels. When the utility earns above the top of the range, the Commission or OPC might initiate a rate review to reduce the utility's rates. In their Settlement Agreement in this case, however, the parties agreed to a revenue sharing plan in lieu of a traditional limit on ROE as a means to limit earnings levels. Under this revenue sharing plan, when Progress Energy receives more revenues than projected, the excess revenues are shared on a 1/3 - 2/3 basis between shareholders and customers.

The key to the plan is that expected - i.e., projected - base rate revenues must be compared on an apples-to-

apples basis with actual base rate revenues for the periods in which revenue sharing is in effect in order to identify excess revenues that should be shared.

(Response at page 2) PEFI states that the dispute about how to treat the transition year, 2002, arises from the fact that the revenue sharing plan commences part way through that year, on May 1, 2002. PEFI contends that the fact that the revenue sharing plan commences part way through the year necessitates some adjustments; however, "the basic premise of the plan remains unchanged: the object is still to identify whether there are any excess revenues over those projected." (Response at page 2) PEFI believes that when the Settlement and Order PSC-02-0655-AS-EI are applied "in a sensible manner, consistent with both the language and explicit intent of those documents, it becomes clear that a refund of excess revenues in the amount \$4,998,489 is called for in the year 2002."

#### **Areas of Contention**

Interim Refund - During its review of the Settlement, staff noticed that the provision regarding the \$35 million interim refund was silent regarding the apportionment of the interim refund between the amount attributable to 2001 and the amount attributable to 2002. In its recommendation, staff pointed out the need for clarification of this point and proposed that only \$10,370,000 of the interim refund was related to 2002. At the April 23, 2002, Agenda Conference, all of the parties, including PEFI and the Movants, agreed with the staff's calculation which was subsequently approved by the Commission.

The \$35 million interim refund was made during the May 2002 through December 2002 period, thereby reducing 2002's actual revenues by \$35 million. While both PEFI and the Movants agree that an adjustment to increase revenues is necessary, each has proposed a different amount. PEFI has increased revenues by the entire \$35 million while the Movants have increased revenues by the net amount of \$24,630,000 (\$35,000,000 - \$10,370,000). Because of the Commission's express ruling as to this issue, it is staff's opinion that the appropriate adjustment is \$24,630,000 based on the Commission's approval of staff's clarification of the Settlement. This adjustment only affects the revenue sharing refund calculation for 2002.

Staff would also note that PEFI has stated that an adjustment of \$24,630,000 would be appropriate if it reduced its "rate reduction not in effect" adjustment from \$41,625,000 to \$31,255,000. (Response at page 10, footnote 2)

Lighting/Service Fee Increases - The second area of contention involves the treatment of the approximately \$14 million annual revenue increase related to the increases in lighting and service fees. PEFI has made an adjustment to reduce its revenues by \$9,338,000 to remove the portion of the increased lighting and service fee revenues that it collected between May 1, 2002, and December 31, 2002. PEFI claims that the increased lighting and service fee revenues should not be included as "base rate revenues" that are subject to the revenue sharing mechanism. As noted on Pages 5 and 6 of the Company's Response, the term "base rate revenues" is not defined in the Settlement. On Page 4 of its Motion, the Movants disagree with this adjustment and state that "No such adjustment is allowed by the agreement". Although the Settlement contains various explicit provisions, there is no provision for excluding any revenues from base rate revenues in determining the amount of revenues that are subject to the sharing mechanism.

At the April 23, 2002, Agenda Conference, several Commissioners asked numerous clarifying questions to obtain a better understanding of the meaning and intent of various provisions in the Settlement. As previously discussed, staff also expressed its concerns about the apportionment of the \$35 million interim refund in its recommendation and offered a proposed treatment for clarification. There was ample opportunity at the Agenda Conference for the parties to offer their own clarifications if the provisions of the Settlement, as plainly written, did not reflect their intent and understanding. This adjustment, if made, could also affect the calculation of any revenue sharing refund for each subsequent year during the term of the Settlement.

Rate Reduction Impact - PEFI had made another adjustment to reduce revenues by \$41,625,000 for the January 1, 2002, to April 30, 2002, period prior to the actual implementation of the \$125 million rate reduction. The Movants contend that the Settlement "sets forth a very specific calculation for 2002," and that PEFI "cannot simply add an additional adjustment of \$41,625,000 when the agreement does not allow this adjustment." (Motion at page 4)



Paragraph 6 of the Settlement clearly states how the refund, if any, is to be calculated for 2002. It provides for a \$1,296 million sharing threshold at which sharing is to begin. It also clearly states that, for 2002 only, the amount to be refunded "...will be limited to 67.1% (May 1 through December 31) of the 2/3 customer share". (Response at page 16, Exhibit A) The purpose of the 67.1% limitation is to recognize that the \$125 million rate reduction was not effective until May 1, 2002. Neither Paragraph 6 nor any other paragraph of the Settlement provides for any adjustments to the base rate revenues subject to the sharing mechanism. This adjustment only affects the revenue sharing refund calculation for 2002.

**Option 1 (Movants' Position)**

The Movants urge application of the parole evidence rule, which simply put, holds that the terms of the contract speak for themselves; that absent an ambiguity in the contract terms, they may not be explained by extrinsic evidence or by reference to any other matter. Whereas PEFI contends, e.g., that the "key" to the agreement is "that the projected base rate revenues must be compared on an apples-to-apples basis with actual base rate revenues for the periods in which revenue sharing is in effect," there is no mention of this "key" in the Settlement.

If the Commission believes that it is compelled to apply the law of contracts to the Settlement at issue, then it should grant the Movants' Motion. That is, the Commission may not consider an unstated "key" and it may not consider other matters not expressly set forth in the Settlement.

Had the intent of the agreement been as asserted by PEFI, language to that effect could have been incorporated in the Settlement. PEFI might also have requested clarification of such an understanding at the April 23, 2002, Agenda Conference. As discussed below, a staff clarification regarding the interim refund portion of the Settlement was raised at the Agenda Conference, agreed to by all parties to the Settlement, and thereafter incorporated as part of the Settlement through Order No. PSC-02-0655-AS-EI. PEFI's interpretation is contrary to the language of the Settlement, which provides a hard number - \$1,296 million - as the threshold from which any revenues to be shared are to be calculated.

Staff notes that in prior settlements with Gulf Power Company and Florida Power & Light Company (FPL) that involved revenue sharing mechanisms, no adjustments were made to the actual base rate revenues. Although FPL's current settlement is similar, but not identical, to PEFI's, no adjustments to base rate revenues were requested by FPL, nor were any allowed. Because the making of adjustments to base rate revenues is a significant departure from the provisions of previous settlements, the Movants contend that any such proposed adjustments should have been specifically addressed in the provisions of the Settlement itself.

Under this Option, the Commission should grant the Motion to Enforce the Settlement Agreement, and find that the Movants' calculation of a \$23,034,004 refund, plus interest, is the appropriate amount to be refunded under the revenue sharing mechanism for 2002. In such instance, PEFI should be required to refund an additional \$18,079,591 (\$23,034,004 - \$4,954,413), plus interest, beginning with the first billing cycle for September 2003.

**Option 2 (PEFI Position)**

PEFI maintains that it agreed to a revenue sharing threshold based, in part, on its calendar year (CY) 2002 budget. It is true that the agreed upon threshold of \$1.296 billion equals PEFI's original budget of \$1.421 billion less the full effect of the \$125 million base rate reduction. According to PEFI, the rate increases (street lighting and service) and interim refund were not part of its budget and therefore, the related effects should be removed so CY 2002 revenues are on a comparable basis to the \$1.296 billion threshold considering full effect of the rate reduction. Since the \$1.296 billion threshold is an unusual number, there is logic to PEFI's stated derivation of that number.

PEFI argues that the Movants "are attempting to turn the revenue sharing feature of the Settlement Agreement on its head," by asking that PEFI be required to refund over \$18 million of revenues that it had always projected it would receive, as can be readily deduced from the forecasted information in PEFI's MFRs. In other words, the Movants argue that \$41.6 million in 2002 revenues that PEFI had always projected it would receive must be deemed excess revenues, subject to revenue sharing, because these revenues would have exceeded the forecast if the Commission had applied the agreed-upon 9.25% rate reduction (totaling \$125 million per year)

prior to May 1, 2002, the effective date of the rate reduction. PEFI argues that this results in a retroactive rate reduction for the first part of 2002, even though neither PEFI, the Commission, nor any of the parties ever stated or agreed that rates would be reduced prior to May 1, 2002.

PEFI contends that the Movants' argument contravenes the language and the intent of the Settlement and Order No. PSC-02-0655-AS-EI. PEFI also believes that the Commission took as a given that PEFI would have to make appropriate adjustments to "base rate revenues" in determining the appropriate level of revenue that will be subject to the revenue threshold and cap for 2002." In summary, PEFI believes that the revenue threshold and determination of 2002 operating revenue were predicated on the utility's 2002 operating budget.

Under this Option, no further refund would be made to PEFI's customers, and the Movants' Motion should be denied.

**Option 3 (Commission Ratemaking Model)**

Under PEFI's interpretation, revenue sharing would only take place if revenues exceeded budget. This is a very conservative interpretation of revenue sharing where ratepayers only benefit if revenues exceed budget which is, for the most part, outside the control of the company and dependent on the weather. It is uncertain whether the derivation of the revenue threshold or adjustments to CY 2002 revenue were discussed by the parties during negotiations. It is also uncertain whether the parties would have agreed to the Settlement if they had known that these adjustments would need to be made to CY 2002 revenues.

It appears that PEFI assumed these adjustments would be made, although there was no explicit mention in the stipulation. In evaluating the appropriateness of the adjustments, the Commission could look at its normal rate making treatment. Generally, the Commission "normalizes" a test period when determining earnings for rate setting. The Commission may find that the appropriate calculation of CY 2002 revenue for revenue sharing should be based on normalizing adjustments. This would make CY 2002 and subsequent revenue sharing years (CY 2003, CY 2004 and CY 2005) comparable. Since the parties are at odds over the appropriate determination of CY 2002, then the Commission may employ its normal rate making model.

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Two of the three proposed adjustments can be classified as normalizing adjustments. These are the annualization of the \$125 million rate reduction and removing the effects of the one-time \$35 million refund. To be consistent with the normalization philosophy, the annualization of the \$14.3 million worth of rate increases (street lighting and services) should also be made. This last adjustment is contrary to PEFI's position that the effects of the rate increases should be removed.

Under this Option, the Movants Motion should be denied. However, consistent with the discussion herein, PEFI should be required to refund an additional \$6,388,000 (\$11,342,000 - \$4,954,000) plus interest, beginning with the first billing cycle for September 2003.

### Conclusion

The following depicts the positions of the Movants (Option 1), PEFI (Option 2) and the alternative position (Option 3):

	(000) Option 1 <u>MOVANTS</u>	(000) Option 2 <u>PEFI</u>	(000) Option 3 <u>Alternative</u>
Actual CY 2002 revenue	\$1,322,836	\$1,323,004	\$1,323,004
Interim refund	24,630	35,000	35,000
Streetlight/service fee	0	(9,338)	4,962
Rate reduction	0	(41,625)	(41,625)
Adjusted revenues	1,347,466	1,307,070	1,321,341
Sharing threshold	(1,296,000)	(1,296,000)	(1,296,000)
Excess revenue	<u>\$51,466</u>	<u>\$11,070</u>	<u>\$25,341</u>
Refund amount excluding interest	<u>\$23,034</u>	<u>\$4,954</u>	<u>\$11,342</u>

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**ISSUE 3:** Should the docket be closed?

**RECOMMENDATION:** Yes, upon final disposition of this matter by the Commission, this docket should be closed. (BRUBAKER)

**STAFF ANALYSIS:** Upon final disposition of this matter by the Commission, this docket should be closed.