BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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| In re: Petition of Gulf Power Company for Refund of Tax Savings Revenues Pursuant to Rule 25-14.003, Florida Administrative Code. | ) ) ) ) ) | DOCKET NO. 880360-EI<br>ORDER NO. 20969-A<br>ISSUED: 4-5-89 |

The following Commissioners participated in the disposition of this matter:

KATIE NICHOLS, Chairman
THOMAS M. BEARD
GERALD L. GUNTER
JOHN T. HERNDON
MICHAEL McK. WILSON

APPEARANCES:

EDISON HOLLAND, Esquire, and JEFFREY STONE, Esquire, Beggs and Lane, P. O. Box 12950, Pensacola, FL 32576
On behalf of Gulf Power Company.

STEVE BURGESS, Esquire, Office of the Public Counsel, c/o Florida House of, Representatives, The Capitol, Tallahassee, FL 32399-1300
On behalf of the Citizens of the State of Florida.

MICHAEL B. TWOMEY, Esquire, Florida Public Service Commission, Division of Legal Services, 101 East Gaines Street, Tallahassee, Florida 32399-0863
On behalf of the Commission Staff.

PRENTICE PRUITT, Esquire, Florida Public Service Commission, Division of Appeals, 101 East Gaines Street, Tallahassee, Florida 32399-0862
Counsel to the Commissioners.

AMENDATORY ORDER

ORDER ON 1987 TAX SAVINGS REFUND

BY THE COMMISSION:

The Federal Tax Reform Act of 1986 reduced the maximum federal corporate income tax rate from 46% to 34%, effective July 1, 1987, resulting in an effective federal income tax rate for 1987 of 39.95%. While we determined that we would utilize our existing rule, Rule 25-14.003, Florida Administrative Code, (the Tax Savings Rule or rule) to address the change in tax rates, we recognized the inadequacy of the Rule using the "midpoint of the range of return approved by the Commission in the utility's last rate case" in the refund calculation and directed that the parties negotiate in an attempt to settle

upon a more current and, therefore, lower equity rate for purposes of the rule. As is reported in Order No. 17126, the parties were unable to reach agreement and we accepted Gulf Power Company's (Gulf's) unilateral offer to utilize a return on equity rate of 13.6% for purposes of the Tax Savings Rule for 1987.

On March 1, 1988, pursuant to the rule, Gulf filed its petition in which it proposed to refund to its customers $1,143,211 of 1987 tax savings. Pending a complete review of the calculations and underlying data supporting Gulf's refund amount, we, in Order No. 19185 , approved its refund proposal and the utility began making the refund in the form of billing credits in May, 1988.

The other parties to this docket, the Office of Public Counsel, and our Staff took the position that Gulf's refund should be larger and an evidentiary hearing on the matter was held on December 2, 1988. As a result of this hearing, we found that Gulf's tax savings refund was understated by $312,760, plus additional interest of $90,958 through December 31, 1988. Our adjustments are described below.

Revenue Effect of 1987 Jurisdictional Tax Savings

Gulf took the position that the revenue effect of its 1987 jurisdictional tax savings was $7,646,496, while Public Counsel argued that it was $8,776,062. Gulf's figure is the revenue effect of the change in actual tax expense, while Public Counsel's is based upon his assertion that all regulatory adjustments must be taken into consideration before the tax savings amount is determined. Having considered the arguments, we are persuaded that the revenue effect should be limited to the actual tax savings experienced by Gulf. In this case that amount is $7,646,496.

Effective Date of Interest

Rule 25-14.003(5)(e), Florida Administrative Code, provides that:

> 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. (Emphasis added).

Gulf took the extreme position that interest should not begin accruing until March 1, 1988, the date the tax savings report was due under the rule (other major utilities recognized that interest was due at least from January 1, 1988). Further, Gulf took the position that interest should be paid at the 30-day commercial paper rate as required by Rule 25-6.109, Florida Administrative Code.

Public Counsel witness Hugh Larkin testified that the accrued refund should be included as a reduction to working capital for 1987, which would effectively provide the ratepayers with an interest rate equivalent to the utility's overall cost of capital.

We agree with Staff witness Ann Causseaux that interest should begin being accrued on January 1, 1987, assuming one-twelfth of the 1987 tax savings was earned each month and with interest paid at the 30-day commercial paper rate as provided by Rule 25-6.109(4)(a), Florida Administrative Code.

Gulf's argument that interest should not begin accruing until March 1, 1988, is devoid of merit inasmuch as the full amount of the tax savings refund, excluding interest, was ascertainable as of the closing of the utility's books on December 31, 1987. Furthermore, recognizing that it was obvious that the tax savings of $1,143,211 million were not earned between December 31, 1987 and January 1, 1988, and that the time value of this amount of money is substantial, we find that interest should begin being accrued at January 1, 1987.

Absent evidence from the utility or another party that the tax savings was earned in specific months, we find that it is reasonable to assume that one-twelfth of the annual total tax savings were earned in each month of 1987. Lastly, we reaffirm our decision in Order No. 19185 that the 30-day commercial paper rate as required by Rule 25-6.109(4)(a), Florida Administrative Code, shall be used in calculating the interest owed. The 30-day commercial paper rate is commonly used to calculate interest in fuel cost recovery proceedings, refunds for interim rate awards and other proceedings before this Commission. It provides for an easily calculated rate upon which to peg interest and simplifies the tax savings refund process.

Based on the procedure approved above, the amount of refundable interest through December, 1988, is $103,568. Of this amount, $12,610 has already been refunded.

O&M Adjustments

The issue of the proper amount of operating and maintenance (O&M) expenses to be included in Gulf's 1987 tax savings is primarily a function of whether any adjustment should be made for a so-called "O&M benchmark," which would effectively hold Gulf's allowable O&M expenses to a growth rate which approximates increases in the number of Gulf's customers and inflation.

Gulf argues that the use of the benchmark is not appropriate for determining the refundable tax savings under Rule 25-14.003, Florida Administrative Code, and therefore, no benchmark adjustment to Gulf's O&M expenses should be made. Gulf considers the O&M benchmark to be an analytical tool to aid in the analysis of O&M expenses. Gulf cites Orders Nos. 13537 and 13948 which address the O&M benchmark as support for its opinion that expenses in excess of the benchmark are not per se unreasonable or imprudent but are subject to recovery by the utility if justified. Since there is no mechanism for justification of the excess amount in this proceeding, Gulf

argues that these expenses should be included in the calculation of Gulf's tax savings.

Public Counsel takes the position that the O&M benchmark calculation is, in effect, a cap or ceiling on Gulf's O&M expenses. Public Counsel says use of the benchmark was an essential part of Gulf's last rate case and submits that ignoring the benchmark and merely excluding O&M expenses "specifically identified" in Gulf's last rate case results in the utility's taxable income and the associated tax savings resulting from the reduction in the federal income tax rate being substantially understated. Furthermore, he says such an approach effectively permits Gulf to pass through cost increases above a level consistent with the Commission's determination in its last rate case and thereby reduce the refund otherwise due to ratepayers.

As stated in our previous orders, we reaffirm that the benchmark is an analytical tool used to "flag" certain rapidly increasing costs for closer scrutiny in the context of a proceeding where the utility has an opportunity to justify any amounts in excess of the benchmark. Although it is undisputed that Gulf's expenses do exceed the benchmark amount, there has been no representation by any party that those excess expenses are unreasonable or imprudent. For this reason, we find that no O&M adjustment should be made.

Advertising expense

Exhibit 302, a compilation of Gulf's advertisements, was introduced into evidence at the hearing. A review of the exhibit reveals that $78,591 ($80,374 system) is directly related to the utility's involvement in the United Way. While the company should be commended for its activities in this area, it is our policy to disallow advertising expenses of this nature. The remaining ads, totaling $10,416 ($10,652 system) are for promoting Pensacola as an All American City, the development of an "Avoid Rate Hike" campaign and a slide presentation to the Homebuilders Association of Northwest Florida. These ads are promotional and image-building in nature and we find that they should also be disallowed.

Out-of-period adjustments

Exhibits 301 and 304, the Staff's audit report and Gulf's response to that report, were introduced into evidence at hearing. These exhibits indicate that the total out-of-period adjustment for unit power sales to net operating income (NOI) is $123,927. Gulf contends that these amounts are immaterial and should not be used in the calculation of the tax refund. We find, however, that out-of-period adjustments, when identified, should be made and reduce jurisdictional NOI by $123,927.

Deferred tax adjustment

At December 31, 1986, Gulf recorded a tax loss of $8,356,022. The actual tax loss when the return was filed in September, 1987 was $21,954,484, considerably more than originally estimated. Gulf's witness testified that deferred taxes were increased and income taxes payable were reduced on

Gulf's balance sheet when the actual tax liability was recorded in 1987. Public Counsel argues that if the utility had been correct in its current income tax expense estimate, the deferred income tax balance would have been higher for the months January through September, 1987. This would have decreased the overall cost of capital by increasing the amount of zero-cost capital.

Estimated current income taxes are usually trued-up when the income tax return is filed. This is normal business procedure. Here the estimated balances were off significantly, a surprising fact since the estimated taxes were based on the old tax law. If this were a rate case where prospective rates were being set on a historic test period, we would make an adjustment to reflect the deferred income tax balances and accrued taxes would be adjusted to reflect the amount of current income tax expense included in the cost of service. However, this is not a rate case. The deferred tax adjustment and accrued tax adjustment should have no impact on the overall rate of return. Therefore, we find that the deferred income tax balance should not be adjusted.

Sales expense

Exhibit No. 301 indicates that our auditors reviewed $35,200 (3.19%) of the total sales expense of $1,103,454. Based on this sample, the auditors found several items which might be considered promotional in nature. As a result, the auditors determined that the maximum potential affect on operating expenses would be $1,103,454 if all of the sales expenses were disallowed.

Exhibit 303 contains the audit workpapers which support Gulf's sales expense. While a review of this exhibit reveals some expenses which may be of questionable value, the amounts are immaterial. In addition, the sample is too small to draw any supportable conclusion concerning the amount, if any, which could, or should, be disallowed. We find, therefore, that no adjustment should be made.

Based on the above, it is

ORDERED by the Florida Public Service Commission that Gulf Power Company shall refund an additional $312,760 plus additional $90,958 for a total of $1,455,971, plus accrued interest of $103,568, calculated as described in the body of this order, as a result of its excess tax savings in 1987, as defined by Rule 25-14.003, Florida Administrative Code.

By ORDER of the Florida Public Service Commission, this 5th day of APRIL, 1989.

STEVE TRIBBLE, 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 120.59(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 Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.