M E M O R A N D U M

November 19, 1990

TO : DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF LEGAL SERVICES (PALECKI; VANDIVER) R/MP
DIVISION OF ELECTRIC AND GAS (SLEMKEWICZ) JS
DIVISION OF AUDIT AND FINANCE (SAIAK) JDS

RE : DOCKET NO. 891345-EI - APPLICATION OF GULF POWER COMPANY FOR A RATE INCREASE

AGENDA: DECEMBER 4, 1990 - CONTROVERSIAL - PARTIES MAY NOT PARTICIPATE

PANEL: WILSON, BEARD, GUNTER, EASLEY

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

BACKGROUND

On October 3, 1990, the Commission issued Order No. 23573, regarding Gulf Power Company's (Gulf or Company) petition for an increase in its rates and charges. On October 18, 1990, Gulf filed the following motions:

1) Motion for Reconsideration of Decision Requiring Partial Refund of Interim Rates;

2) Request to be Heard in Oral Argument or at Agenda Conference on Motion for Reconsideration;

3) Motion to Sever as to Issue 111, or in the alternative, Request for Expedited Consideration of Motion for Reconsideration; and (Issue 111 relates to the refund of interim rates)

4) Motion for Stay as to Issue 38. (Issue 38 relates to the reduction to the return on equity)

On October 25, 1990, the Office of Public Counsel (OPC) filed the following documents:

1) Public Counsel's Response to Motion for Stay;

2) Public Counsel's Response to Motion for Reconsideration; and

3) Public Counsel's Cross-Motion for Reconsideration.

The Federal Executive Agencies (FEA) also filed a very brief Cross-Motion for Reconsideration in support of the OPC Motion. Gulf responded to the OPC and FEA Cross-Motions on November 1, 1990.

In Order No. 23707, issued October 31, 1990, Commissioner Beard, as Prehearing Officer, denied the oral argument request and the request to be heard at Agenda Conference on these issues. As to the Motion to Sever or in the Alternative, Request for Expedited Consideration of Motion for Reconsideration, because OPC has filed a Cross-Motion for Reconsideration of the reduction in return on equity issue, the Commission should not grant the Motion to Sever. Staff has expedited this recommendation and therefore believes the motion to be moot.

This sequence of events leaves the following matters for Commission decision:

1) Gulf's Motion for Reconsideration and OPC response thereto;

2) Gulf's Motion for Stay and OPC response thereto;

3) OPC's and FEA's Cross-Motions for Reconsideration and Gulf's response thereto; and

4) A factual error in Order No. 23573.

These four matters are discussed under the four issues discussed below.

DISCUSSION OF ISSUES

ISSUE 1: What action should the Commission take on Gulf's Motion for Reconsideration?
RECOMMENDATION: Gulf's Motion should be granted.
DISCUSSION: The purpose of a motion for reconsideration is to point out some matter of law or fact which the Commission failed to consider or overlooked in its prior decision. Diamond Cab Co. of Miami v. King, 146 So.2d 889 (Fla. 1962); Pingree v. Quaintance, 394 So.2d 161 (Fla. 1st DCA 1981).

The Motion for Reconsideration seeks Commission reconsideration of refund of a portion of the interim increase. Gulf argues that the refund is inconsistent with the purpose of the interim statute which is to prevent regulatory lag. Gulf offers an exhibit showing that with or without the interim refund, Gulf's

earnings would be below what the Commission found to be fair and reasonable on a permanent basis.

OPC argues that the Commission should not reconsider its decision to order a refund of a portion of the interim rates. OPC first argues that Gulf has received preferential treatment because the Commission used 12.55% (as opposed to 12.05% after the reduction for mismanagement) to test the interim award. This argument will be addressed under Issue 4. OPC next argues that the statute contemplates a rate-of-return test, not the total revenue comparison Gulf advocates. OPC argues that case law on the subject forbids using the hearings in the full case to retroactively justify the interim award. OPC finally points out that the decision is consistent with Docket No. 881056-EI, Florida Public Utilities (Fernandina Beach Division).

This issue centers on the meaning of Section 366.071(4), Florida Statutes (1989). The pertinent language provides that "[a]ny refund ordered by the Commission shall be calculated to reduce the rate of return of the public utility during the pendency of the proceeding to the same level within the range of the newly authorized rate of return which is found fair and reasonable on a prospective basis . . ." (Emphasis supplied). The best analysis of proper application of this language which staff has located is contained in Order No. 12221, issued July 13, 1983. The relevant portion of that Order appears as Attachment I. As that discussion points out, the statute does not provide which data the new rate of return is to be applied.

There are three options as to which data to use:

1) The use of actual data for the period interim rates were in effect (here from March 10, 1990 through September 12, 1990 meter readings).

2) The use of data from the test year used in the full rate case (here the year ending December 31, 1990).

3) The use of the data from the test year used in granting interim rates (here the year ending September 30, 1989).

As Order No. 12221 points out, actual data is impractical to use because it has not been audited and adjustments would have to

be made consistent with the rate case, thus forcing another calculation. This method has never been used by the Commission and staff does not recommend its use here. Each of the last two approaches has been used by the Commission in the past.

In its original recommendation, staff used option 3, based on the decision in Docket No. 881056-EI (FPUC-Fernandina Beach). This recommendation was premised upon following the Commission's most recent precedent on the subject. The Commission employed Option 3 in Order No. 23573. Other Commission decisions have utilized option 2. Gulf Power cites seven of these decisions in its motion, including the Southern Bell case which appears as Attachment I.

Upon reflection, staff believes that Option 2 represents the best alternative on the facts of this case. This recommendation results in granting Gulf Power's motion for reconsideration on the interim issue, thus eliminating the refund of any interim rates. The policy reason for this recommendation is that the interim rates were in effect for the test year of the case. This information was obviously subject to intense scrutiny during the hearing. The Commission found that Gulf Power was entitled to a rate increase based on this information. If interim is truly to combat regulatory lag, the interim amount should act as a surrogate until the final rates are determined. Here the interim award was substantially less than the amount finally determined to be fair and reasonable. Because the period that interim rates were in effect and test year coincide, it makes sense to simply confirm the interim award rather than order a refund.

Staff does disagree with Gulf Power that option 3 is legally indefensible. The statute does not spell out on which data the new return on equity is to be applied. In the absence of legislative direction or Commission rules, and considering Commission precedent using both options, staff believes that it is within the Commission's discretion to use either option. On the facts of this case, we simply recommend that option 2 makes more sense to carry out the intent of the statute.

Staff also disagrees with OPC's analysis. OPC's argument elevates form over substance. OPC would have the Commission completely ignore the fact that interim rates were less than those found reasonable on a prospective basis. It makes little sense to further reduce an amount which was inadequate pursuant to the

evidence presented. The case law OPC cites to support its position was decided prior to passage of the interim statute, which expressly contemplates using evidence garnered in the full proceeding to test the interim award. Although staff believes that OPC's position is legally defensible as discussed above, we do not believe it to be the proper or best course of action.

ISSUE 2: What action should the Commission take on Gulf's Motion for Stay?
RECOMMENDATION: The Motion for Stay should be denied.
DISCUSSION: In the Motion for Stay as to Issue 38, Gulf asks the Commission to stay its decision to reduce Gulf Power Company's return on equity (ROE) by 50 basis points for mismanagement while Gulf appeals this decision to the Florida Supreme Court. In its motion, Gulf requests that it be allowed to implement the full amount of increased rates without the ROE reduction. The Company agrees to post an appropriate bond or corporate undertaking to refund appropriate amounts with interest in the event Gulf is unsuccessful on appeal. Gulf argues that in the absence of a stay, the reduction in ROE translates into lower earnings of $2,293,000 per year, causing irreparable harm to the Company in that the lost revenues are gone forever to the tune of $6,300 per day. Gulf also points to the lowered financial ratings to Gulf debt and security issuances, as well as the 12.8% ROE allowed in February for Florida Power and Light Company.

In response, OPC argues that Gulf just believes its rate increase should have been higher. OPC argues that as a matter of policy the utility should not be permitted to collect more than the Commission found appropriate on the record while the utility appeals. OPC questions whether the Commission would stay a management reward on appeal. OPC argues that Gulf fails to meet the standards of Rule 25-22.061(2), Florida Administrative Code, (which is discussed below), and that any irreparable harm, if it exists, is of the Company's own making. OPC also argues that Gulf's motion is internally inconsistent in that irreparable harm to customers is alleged if the stay is not granted, yet Gulf also alleges that customers are protected by the possibility of refund of any amounts stayed by the Commission.

The standard for evaluation of a request for stay is found in Rule 25-22.061, Florida Administrative Code. Subsection (2) of that Rule provides that the Commission may, among other things,

consider: a) whether the petitioner is likely to prevail on appeal; b) whether the petitioner demonstrates the likelihood of irreparable harm without the stay; and c) whether the delay will cause substantial harm or be contrary to the public interest.

Staff recommends that the Motion for Stay be denied. Gulf has made no showing whatsoever that it is likely to prevail on appeal. Staff does not believe Gulf is likely to prevail on the reduction to the ROE issue. The Commission set the ROE within the parameters of evidence stating that a fair return would range from 11.75% to 13.5%. Gulf does show that it suffers a reduction in earnings as a result of the Commission decision, but the same would be true in any rate case in which the Company does not obtain all the relief it requested. Staff does not believe it to sound policy to allow the Company to collect what it believes appropriate while the appeal is pending. This is particularly true considering the lack of allegations concerning prevailing on the merits of the appeal. The "harm" Gulf alleges is due solely to the activities of Gulf management. The last criteria, whether delay will cause substantial harm or be contrary to the public interest, is implicit in every vote the Commission takes. Staff believes the Commission's original decision is consistent with the public interest. See Order No. 23573 at page 29. Staff believes that the Commission could have legally set the ROE at 11.75%, the lowest point indicated by the evidence. Given this fact, Staff has a difficult time recommending that an ROE of 12.05% causes irreparable harm to the Company. Finally, Staff believes the ROE awarded to a different company at a different time on a different record does not automatically entitle Gulf to the same or a higher ROE on these facts.

ISSUE 3: What action should the Commission take on OPC's Cross-Motion for Reconsideration?
RECOMMENDATION: The Cross-Motion should be denied.
DISCUSSION: OPC's Cross-Motion for Reconsideration raises two principal issues: 1) The use of a 12.55% figure for the evaluation of the amount of interim revenues subject to refund; and 2) The amount of the reduction in the ROE for management imprudence. (Because the FEA motion raises the same points as the OPC motion, both motions will be discussed in the context of the OPC motion). In terms of the interim refund, OPC argues that the interim statute (Section 366.071, Florida Statutes) requires that refunds are to be calculated to reduce the rate of return to the

"same level within the range of the newly authorized rate of return which is found fair and reasonable on a prospective basis . . .". OPC argues that because Gulf's rates were initially set at 12.05% (after the reduction), this is the level that should be used to calculate any interim refund. OPC also argues that the fifty basis point reduction was not a large enough reduction given the magnitude and duration of Gulf Power mismanagement. OPC argues that 11.75% is the proper level for the ROE in this case.

In response, Gulf argues that the Commission specifically found 12.55% to be fair and reasonable on a prospective basis. The reduction to ROE was a step to reduce Gulf's earnings for a specific two year period, from September 13, 1990 to September 12, 1992. Gulf argues that OPC's position would move the reduction's effectiveness back to March 10, 1990, thus ending the reduction in March of 1992, to be consistent with the Commission's decision. As to increasing the reduction to ROE, Gulf states that OPC is merely rearguing its prior case and should be rejected under the Diamond Cab standard.

Staff recommends that OPC's Cross-Motion for Reconsideration be denied. The prospective ROE is 12.55%. This ROE was set indefinitely for the future. Interim refunds should not be tied to temporary reductions imposed on the company for mismanagement. The Commission also determined that the reduction be in effect for two years. Staff believes it to be reargument to expand the time frame or amount of the reduction. The Commission considered the proper amount of the reduction to be 50 basis points for two years on a 3-1 vote. OPC's argument to increase the reduction points out nothing the Commission failed to consider or overlooked and should be denied. The dissenting opinion would have placed the ROE at the level recommended by OPC, thus leading staff to conclude the majority considered and rejected this course of action. See Diamond Cab, supra.

ISSUE 4: Should the Commission, on its own motion, correct a citation error in Order No. 23573?
RECOMMENDATION: The Order should be modified as discussed below.
DISCUSSION: There is also a factual error in Order No. 23572 on Page 29. The quoted language is out of a dissenting opinion and should have been so identified. The Order on Reconsideration should reflect this. Thus, the sentence which reads "The New Hampshire Public Utilities has acted in conformity with this

principle:" should be struck and replaced with "This principle has been discussed as follows:"

The principle of adjusting the return on equity for management inefficiency has been employed by other state regulatory Commissions, however. See Re Otter Tail Power Co. (ND 1983) 53 PUR 4th 296, 309-10; Re Southern California Edison Co. (Cal. 1982) 50 PUR 4th 317, 374-76; Re Carolina Power & Light Company (NC 1982) 49 PUR 4th 188, 248, 250, 252.

XIII. CONFIRMATION OF INTERIM AWARD

As an alternative to its request for consent to the new rate schedules, Southern Bell requested interim rate relief pursuant to Sections 364.05 and 364.055, Florida Statutes. Three different levels of interim rate relief were requested. In Order NO. 11560, we found that some interim relief was appropriate pursuant to Section 364.055, Florida Statutes, and granted interim rates designed to generate additional annual revenues of $72,409,579.

As required by Section 364.055(4), Florida Statutes, we must now either confirm the interim or determine the amount of refund necessary. The test to apply to the interim rates is provided for in Section 364.055(4), Florida Statutes:

> (4) Any refund ordered by the Commission shall be calculated to reduce the telephone company's rate of return during the pendancy of the proceeding to the same level within the range of the newly authorized rate of return which is found fair and reasonable on a prospective basis, but the refund shall not be in excess of the amount of the revenues collected subject to refund and in accordance with paragraph (2)(b). In addition, the commission may require interest on the refund at a rate established by the commission.

This subsection provides a benchmark for determining whether a refund is due: the new rate of return set in the full case. What the statute does not provide is the data to be used in measuring what was earned during the pendancy of the proceeding.

There are three options available to the Commission:

1. The use of actual data from the period starting with the granting of interim rates on January 26, 1983, and ending on the date permanent rates are granted.

2. The use of data from the test year used in the full rate case (ending December 31, 1982).

3. The use of data from the test year used in in granting the interim rates (ending August 31, 1982).

The statute seems to imply the use of this actual data; however, we believe it is impractical for several reasons. A determination of the adjustments to be made to rate base, revenues and operating expenses would have to be done all over again after the full rate case. The Company would have to use the adjustments in the case, apply it to the actual data and measure over- or under-earnings subsequent to the final order. The actual data would not have been audited.

The use of data from the test period used to grant interim rates is also not the most satisfactory solution. Use of that test period would require evidence to be developed on whether it is representative of the time period the rates are in effect. The data from the full rate case period is probably more representative of the time the interim rates are in effect than the more distant interim test period. Much of the evidence on the interim test period will be duplicative of the evidence on the full case test period.

The use of data from the test period for the full rate case appears to be the most reasonable approach. This data will be thoroughly reviewed and audited as part of the full proceedings. However, not all adjustments made for the permanent rates will necessarily apply to the period interim rates are in effect.

The use of the historical test period used for the full case is compatible with the purpose of the interim award. Interim rates are intended to reduce regulatory lag. Had the Commission been able to review and decide the full case prior to January 26, 1983, a permanent award would have been made based on the test year ending December 1982. Since this is the case, it is reasonable to use the full rate case test year for purposes of evaluating the need to refund interim revenues.

The full rate case test year also provides the means to comply with the requirement of competent, substantial evidence for the interim award. Unless an adjustment made to test period data is not applicable to the interim period or some additional adjustment is necessary, the evidence is substantially the same.

We have, therefore, essentially used the data developed in the case based on the test period ending December 1982, to evaluate our interim award. We started with the revenue requirements found to be appropriate in the full case, which includes the newly authorized rate of return. However, there are some adjustments to be made to the revenue requirements determined to be appropriate to recognize operating conditions as they were experienced between January and July of this year.

The adjustments found to be appropriate involved:

a. Decreasing expenses by $35,830,834 to recognize of the fact that the depreciation represcription did not become effective until July 1, 1983.

b. Decreasing the amount allowed for attrition by $11,409,966. This adjustment recognizes that the allowance granted in the full case included six months attrition beyond that which would have been allowed had the case been decided in January of this year. The 12-month allowance is recognized because our interim award is an annual amount.

c. Increasing revenues required in the interim by $5,322,332, in recognition of the fact that during the interim period some expenses relative to franchise fees are recovered from the general body of ratepayers. In the full case award, franchise fee expenses and revenues were simply excluded because under Florida Administrative Code Rule 25-4.110, these expenses will be passed on directly to customers in franchised areas.

As a result of the above adjustments to the revenue requirements found appropriate in setting permanent rates, the amount found to be appropriate in the interim is $72,779,880. Since this is more than the amount awarded, no refund is necessary. The calculation is as follows:

Revenue Deficiency Per Full Case	$114,698,348
Less: Depreciation Represcription	35,830,834
Six Months of Attrition	1,409,966
Subtotal Without Required Revenues for Franchise Fees	$67,457,548
Additional Revenue Requirement for Franchise Fees	5,322,332
Adjusted Interim Requirement	$72,779,880

XIV. FINDINGS OF FACT

Based on the entire record herein, we hereby reaffirm all previous findings of fact set out in this Order and find in addition thereto:

1. That Southern Bell Telephone is a public utility subject to our jurisdiction under Chapter 364, Florida Statutes.

2. That the Company has supported, by competent, substantial evidence, its request for rate relief to the extent granted herein.

3. That the use of a partially projected test period has been shown to be reasonable and appropriate in this case.

4. That each of the adjustments to its rate base in the Rate Base portion of this Order are reasonable and proper, and that its adjusted rate base of $3,316,320,035 represents that property used and useful in serving the public and on which it is, by law, entitled to earn a fair rate of return.

5. That each of the adjustments to its operating income in the Net Operating Income portion of this Order are reasonable and proper, and that its adjusted net operating income of $304,744,185 represents the net operating income earned by the Company for the twelve months ending December 31, 1982.

6. That a fair rate of return lies within the range of 9.75% - 10.61%, with a focus on the midpoint, or 10.18%, and a corresponding return on common equity of 15.00%, and a zone of 14.00% - 16.00%.

7. That in lieu of certain proposed adjustments, an attrition allowance of $34,229,898 is appropriate, and an adjustment should be made to revenue to recognize this.

8. That the Company is entitled by law to adjust its rates and charges so as to produce additional annual gross revenues of $114,698,348 on a permanent basis in order to have the opportunity to earn its fair rate of return.

9. That the Company is providing adequate service as required by Chapter 364, Florida Statutes, and Florida Administrative Code Chapter 25-4, with the exception of the service deficiencies noted in the body of this Order.

10. That the rate schedules initially suspended herein have been shown to be just, reasonable and proper to the extent authorized by this Order by virtue of amplification and clarification of that data initially filed by the Company, as well as the filing of supplemental data by the Company.