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Tallahassee
November 16, 1992

VIA HAND DELIVERY

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

Re: In re: Joint Petition of Florida Power Corporation
and Sebring Utilities Commission for Approval of
Certain Matters in Connection with the Sale of
Assets by Sebring Utilities Commission to Florida
Power Corporation, Docket No. 920949-EU

Dear Mr. Tribble:

Enclosed for filing in the docket referenced above are the original and 15 copies of Sebring Utilities Commission's Prehearing Memorandum. Also enclosed is an additional copy for our records to be date stamped by you and returned to our office.

Thank you for your consideration in this matter.

Sincerely,

HOLLAND & KNIGHT


D. Bruce May

3 Enclosure
DBM/sms
cc: All parties of record
- Andy Jackson

TAL1-18137

JCW

DOCUMENT 1100 11/16/92
13478 11/16/92
FPC-RECORDS/REPORT

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Joint Petition of Florida) DOCKET NO. 920949-EU
Power Corporation and Sebring)
Utilities Commission for Approval) FILED: November 16, 1992
of Certain Matters in Connection)
with the Sale of Assets by Sebring)
Utilities Commission to Florida)
Power Corporation.)
_____)

PREHEARING MEMORANDUM OF SEBRING UTILITIES COMMISSION

Sebring Utilities Commission ("Sebring"), pursuant to the Case Assignment and Scheduling Record filed on September 22, 1992, hereby submits its Prehearing Memorandum to facilitate timely review of the issues identified in this proceeding. Sebring reserves the right to supplement and revise the matters contained in this Prehearing Memorandum.

BACKGROUND

Sebring, Florida Power Corporation ("FPC") and the City of Sebring have entered into an Agreement For Purchase And Sale of Electric System under which FPC will purchase Sebring's electric utility system assets. The purchase is conditioned on the parties obtaining Commission approval of certain aspects of the transaction. In order to satisfy those conditions of closing and consummate the transaction, the parties have requested Commission approval of (1) an amendment to the parties' territorial agreement; (2) the depreciated net book value of the assets being acquired by FPC totalling \$17,813,753.00; (3) any additional amount to be allocated for going concern value deemed to be a prudent investment; (4) the imposition of the Sebring Rider and procedures

for periodically revising the rider; (5) inclusion of the SR-1 rate schedules as part of FPC'S rate schedules; (6) the assignment by Sebring of the Glades territorial agreement; (7) the purchase of Sebring's Rate Base Assets as a prudent investment; and (8) FPC's recovery of certain costs related to a purchase power agreement.

Approval of each of these items is in the public interest because it will enable Sebring to retire its existing bond indebtedness, avail Sebring customers to lower electric rates, allow FPC to realize benefits of foregone construction and other efficiencies attained through consolidation of resources, and resolve once and for all a long-standing territorial conflict between the two utilities.

DISCUSSION

ISSUE 1 Does the proposed Sebring Rider unduly discriminate against Sebring customers?

POSITION

No, the proposed Sebring Rider does not unduly discriminate against Sebring customers. In accordance with the Joint Petition and Exhibit 1 appended thereto, the Sebring Rider is intended to recover, over an appropriate time period, the amount of the Purchase Price attributable to the bond indebtedness of Sebring. The prefiled direct testimony of Florida Power Corporation ("FPC") witnesses Sam Nixon and Henry Southwick demonstrates that there are legitimate cost based reasons that this amount be appropriately recovered from the Sebring customers rather than from the entire body of FPC ratepayers.

ISSUE 2

Is the method used to calculate the rate of the Sebring Rider, and any changes thereto, appropriate?

POSITION

Yes. As set forth more fully in the prefiled direct testimony of FPC witness Nixon, the method used to calculate the Sebring Rider, and any changes thereto, is based on tested ratemaking principles and consistent with the requirements of the Agreement For Purchase And Sale Of Electric System.

ISSUE 3

Is the forecast of customers and usage used to develop the rate of the Sebring Rider appropriate?

POSITION

Yes. As set forth in the prefiled direct testimony of FPC witness Nixon and the deposition testimony of FPC witness Henry Southwick, the forecast of customers and usage used to develop the rate of the Sebring Rider is founded on conservative estimates which have been affirmed by Sebring's actual energy sales in 1992.

ISSUE 4

Is the method used to identify customers who will be subject to the Sebring Rider appropriate?

POSITION

Yes. As set forth in the prefiled direct testimony of FPC witness Nixon, the method used to identify customers subject to the Sebring Rider is straight forward and readily administered. The Sebring Rider will apply for the entire Transition Period to (1) all retail electric customer locations receiving electric service through a Sebring meter at the time of closing; and (2) after closing all retail meters at new locations within Sebring's territorial boundaries previously approved by the Commission. The

Sebring Airport would continue to be served by FPC and thus would not be subject to the rider. [Nixon; page 14, lines 10-18.]

ISSUE 5 **Is the proposed 15 year period to collect the Sebring Rider appropriate?**

POSITION

Yes, as set forth in the prefiled direct and deposition testimony of FPC witness Nixon, the proposed 15 year period to collect the Sebring Rider is appropriate.

ISSUE 6 **Is the proposed regulatory treatment of the Sebring Rider financing appropriate?**

POSITION

Yes. The prefiled direct testimony of FPC witness Nixon demonstrates that the proposed regulatory treatment of the Sebring Rider financing is appropriate. [Nixon; pages 7-10.]

ISSUE 7 **Should the Commission approve the SR-1 Rate Schedule as a part of FPC's rate schedule?**

POSITION

Yes. As set forth more fully in the prefiled testimony of FPC witness Nixon, the Sebring Rider is appropriately calculated and not unduly discriminatory. The SR-1 Rate Schedule therefore should be approved so that it can be timely implemented consistent with the terms of the Purchase and Sale Agreement.

ISSUE 8 **Should the Commission approve the Sebring Rider and retain jurisdiction over the Rider in accordance with the terms of the Joint Petition?**

POSITION

Yes, for the reasons expressed by FPC witness Nixon in his prefiled testimony, the Commission should approve the Sebring Rider and retain jurisdiction over the Rider so that it can be reviewed

and appropriately adjusted no less frequently than every four years. [Nixon; page 12, lines 16-21; page 13, lines 2-17.]

ISSUE 9 **Is the cost study performed by RMI to value Sebring's distribution system, transmission system and other tangible assets reasonable and appropriate?**

POSITION

Yes, the cost study performed by RMI to value Sebring's tangible assets is reasonable, appropriate and performed in accordance with valuation methods recognized by this Commission and commonly employed by utility system appraisers throughout the country.

When Sebring determined in May, 1991, to sell the remaining assets of the utility system, a review of its books and records indicated that Sebring was not in compliance with the FERC Uniform System of Accounts, and that Sebring's records were insufficient to establish the true net book value of the utility's tangible assets. [Rumolo, page 3, lines 17-20; Holloway, page 5, lines 4-13.]

Sebring thus authorized an expert in utility system valuation--RMI-- to assess the true value of the utility system. [Rumolo, page 1, lines 10-25; page 2, lines 1-20; page 3 , lines 8-14.] At the outset, RMI tested the value of the utility system as then stated in Sebring's records by various approaches including a review 53 work order files selected at random from those records. This test confirmed that Sebring's stated book value was not an accurate reflection of the true net book value of the utility's assets. Indeed, RMI determined that the asset value reflected in Sebring's books was seriously understated: for the 53 work order

files analyzed, the booked cost was approximately 37% lower than it should have been. [Rumolo, page 3, lines 17-25.]

Because Sebring lacked sufficient records prior to 1982, it was not possible for RMI to determine whether the sample of 53 work order files was representative of the Sebring system as a whole. Thus, RMI could not rely on the sample to project the value for the entire system. In RMI's expert opinion the most appropriate method to assess the true value of Sebring's tangible assets was to perform a full valuation study. [Rumolo, page 4, lines 5-8.]

RMI employed a fundamentally accepted methodology to value the Sebring system . First, RMI participated in a physical inventory of all the facilities, taking precautions along the way to insure the accuracy of the field inventory. [Rumolo, page 4, lines 10-18 and page 5, lines 8-19.] Second, RMI prepared detailed estimates of the costs to reproduce those inventoried facilities and, using the Handy-Whitman index, adjusted those reproduction costs to reflect the original cost of construction. [Rumolo, page 5 , lines 23-25 and page 6 , lines 1-4.] This methodology is commonly accepted by experts in the utility valuation area and has been recognized by this Commission as a valid means to establish original utility costs where, as here, original plant cost documentation is insufficient. See, e.g., In re: Application of Webster Mobile Home and Travel Park for a Staff Assisted Rate Case in Sumter County, 88 F.P.S.C. 12:408, 410-411 (1988); In re: Application of Marion Utilities, Inc. for Certificate to Provide Water Service in Marion County, Florida, 83

F.P.S.C. 1:280 (1983); In re: Application of Southern Utilities, Inc., Docket No. 73535-W, Order No. 6525 (1975).

RMI's valuation process produced the original costs for the materials, labor, and vehicle components of Sebring's distribution system. [Rumolo, page 6, lines 15-25 and page 7, lines 1-7.] The process also produced the original costs of Sebring's transmission lines, substations and general plant. [Rumolo, page 7, lines 16-25 and page 8, lines 1-17.] To calculate net book value, the resulting statements of original costs were reduced by accumulated depreciation using those depreciation schedules identified by expert engineering judgments of RMI and recommended by the Rural Electrification Administration (REA)¹. [Rumolo, page 9, lines 9-22.] RMI also took into account the value of Construction Work In Progress by examining the detailed printout from Sebring's accounting system for each construction work order and making appropriate adjustments for overheads and vehicle charges. [Rumolo, page 8, lines 20-25.]

Without taking into account current assets, unbilled revenue and adjustments for Contributions In Aid of Construction (CIAC), the RMI valuation study concluded that the net book value of the tangible property, plant and equipment assets being acquired by FPC is \$15,429,039.00 as of September 30, 1991. [Rumolo, page 10, lines 1-6; Holloway, page 5, lines 17-21.] The testimony of Sebring's Director of Finance and Chief Financial Officer, as well

¹ Sebring's distribution construction standards are the same as REA construction standards. In fact, the Sebring standards manual is a reproduction of the REA standards manual.

as Sebring's independent auditor, further demonstrates that when current assets and accrued unbilled revenues are accounted for and CIAC adjustments are made, the net book value of the tangible assets being acquired by FPC is \$17,813,753.00 as of September 30, 1991. [Holloway, page 6, lines 12-23; Williams, page 2, lines 18-22, page 3, lines 3-7, page 4, lines 5-6; Exhibit 1, page 230; Rumolo, page 10, lines 6-10.]

Sebring's independent auditor has testified that the utility's efforts to ascertain net book value of its electric system was consistent with actions taken by other municipal electric utilities to implement continuing property records systems and comply with the Federal Energy Regulatory Commission's Uniform System of Accounts. [Williams, page 4, lines 10-21.] In fact, under RMI's valuation, Sebring's net book value on a per customer basis is consistent with per customer values of other utilities in Florida and across the nation. [Rumolo, page 10, lines 10-14.] The reasonableness of RMI's valuation was further confirmed by FPC witness Southwick who testified that " \$17.8 million is the correct allocation of the Purchase Price to the tangible assets because it represents the net book value of these assets...." [Southwick, page 18, lines 5-7.]

Based on the forgoing, RMI's valuation study is consistent with industry practice, reasonable and appropriate.

ISSUE 10 **Is the proposed regulatory treatment of the Sebring system acquisition financing appropriate?**

POSITION

Yes, as set forth in the prefiled testimony of FPC witness Nixon the proposed regulatory treatment of the Sebring system acquisition financing is appropriate.

ISSUE 11 **Is the methodology used to arrive at the valuation of Sebring's rate base assets appropriate?**

POSITION

Yes. As detailed in response to Issue 9 above, the methodology relied on by RMI to value Sebring's tangible assets was conducted in accordance with standard industry practice and has been recognized by the Commission as appropriate for establishing the original costs of a utility system.

ISSUE 12 **Should the Commission approve the depreciated net book value of Sebring's Electric System Assets, as of September 30, 1991, in the amount of \$17,813,753.00?**

POSITION

Yes, the Commission should approve the depreciated net book value of those assets being acquired by FPC (Rate Base Assets), as of September 30, 1991, in the amount of \$17,813,753.00. For the reasons set forth in Sebring's Positions on Issues 9 and 11, the methodology used to arrive at the depreciated net book value of the Rate Base Assets is appropriate, and the value is reasonable. Furthermore, the 1991 Sebring financial statement which reflects the depreciated net book value of the assets being acquired by FPC has been audited by an independent certified public accountant. [Williams, page 2, lines 18-22 and page 3, lines 1-25.]

ISSUE 13 **What are the tax consequences associated with Florida Power Corporation's acquisition of the Sebring system?**

POSITION

Sebring takes no position on this issue. Only FPC is in a position to respond as to the tax consequences it may incur by acquiring the Sebring system.

ISSUE 14 **Should the Commission approve at this time the prudence of the proposed acquisition of Sebring's Electric System Assets for recovery from Florida Power Corporation's general body of ratepayers?**

POSITION

Yes, the Commission should approve at this time the prudence of the proposed acquisition for recovery from FPC's general body of ratepayers. As shown in Sebring's Positions on Issues 9 and 11 above, the \$17,813,753.00 value placed on the Rate Base Assets being acquired by FPC is reasonable and appropriate. Moreover, the direct prefiled testimony of FPC witnesses Southwick and Dagostino demonstrates that there are direct and identifiable benefits associated with FPC's purchase of the Sebring's tangible assets that flow to FPC's general body of ratepayers. Therefore it is prudent for FPC to acquire those tangible assets at the \$17,813,753 net book value for recovery from that utility's general body of ratepayers. [Southwick, page 18, lines 5-8.]

ISSUE 15 **Should the Commission approve at this time the prudence of any proposed "going concern" value of the Sebring system for recovery from Florida Power Corporation's general body of ratepayers and in what amount?**

POSITION

Yes. The Commission should not only approve the prudence of the depreciated net book value of the tangible assets being acquired by FPC (\$17,813,753), it should approve the prudence of

an additional \$4,850,000.00 representing the intangible asset of "going concern" that FPC will acquire from its purchase of Sebring's ongoing operations. "Going concern" is the value of an established and mature business compared to a business that is not established and, when purchased by a regulated electric utility may be included in that utility's rate base. Section 366.06(1), Florida Statutes. The testimony in this proceeding demonstrates that the "going concern" value FPC derives from Sebring's on-going utility system should be included in FPC's rate base as a positive acquisition adjustment [Warren, page 12, line 17 -25, page 13, lines 1- 16].

Sebring recognizes that the Commission's practice is to allow the purchasing utility to rate base only the depreciated net book value of the acquired utility's system, except in extraordinary cases. In re: Investigation into Acquisition Adjustment Policy, Order No. 23376, 90 F.P.S.C. 8:306 (August 21, 1990). However, on several occasions the Commission has approved positive acquisition adjustments when the utility has demonstrated extraordinary circumstances and has proven that the acquisition will provide benefits to the existing customers of the acquired company. For example, the Commission approved an acquisition adjustment for Peoples Gas Systems, Inc. of \$2,351,756.00 when it demonstrated that its purchase of the assets of Southern Gas Company would provide the following potential benefits to the customers of Southern Gas: increased quality of service; lowered operating costs; increased ability to attract capital for improvements; a

lower overall cost of capital; and more professional and experienced managerial, financial, technical and operational resources. In re: Application of Peoples Gas Systems, Inc. for a rate increase, Order No. 23858, 90 F.P.S.C. 12:187, 190-192 (December 11, 1990). Positive acquisition adjustments were allowed for similar reasons in In re: Application for transfer of Certificate Nos. 475-W and 411-S from St. Johns North Utility Corp. to Jacksonville Suburban Utilities Corp. and for a limited proceeding to adjust rates, Order No. 23111, 90 F.P.S.C. 6:386, 390-392 (June 25, 1990) and In re: Application of General Waterworks Corporation for approval of transfer of Certificates Nos. 194-W and 140-S and utility facilities from Lucina Utilities Co. in Duval County to Jacksonville Suburban Utilities Corporation, 86 F.P.S.C. 8:250 (August 25, 1986). FPC witnesses Peter Dagostino, Henry Southwick and Samuel Nixon demonstrate in their direct testimony that benefits justifying a positive acquisition adjustment will flow to Sebring's existing customers through this transaction [Dagostino, page 26, line 11 through page 29, line 2; Southwick, page 4, line 18 through page 14, line 17; Nixon, page 22, line 1 through page 24, line 19]. FPC witness Henry Southwick testified in his deposition that a purchase by FPC of the Rate Base Assets at a price including \$4.85 million for "going concern" value would be prudent considering the benefits accruing from the purchase of the Sebring electric system.

Further justification, unique to this proceeding, is provided by Sebring witness Gerald Warren, who demonstrates in his direct

testimony that benefits will flow not only to Sebring's existing customers but to FPC customers as well. Mr. Warren demonstrates that \$4.85 million is a fair, reasonable and conservative value of the "going concern" benefits that FPC's general body of ratepayers will receive by purchasing the Sebring system as an ongoing, operating business. Mr. Warren's estimate was conservative because he included only those benefits of "going concern" value that are the most identifiable and the easiest to quantify in terms of dollar value, rather than including more speculative, less quantifiable elements [Warren, page 12, lines 6-11]. Included in these benefits are the value of Sebring's established customer base, the reproduction costs of Sebring's maps and records, the value of the training and experience of the Sebring personnel, the value of an avoided or deferred FPC substation, and the resolution of territorial and annexation disputes that will be accomplished by FPC's purchase of the Sebring assets [Warren, page 6, line 1 through page 11, line 12]. As stated by FPC witness Peter Dagostino, each of those benefits has a distinct and positive impact on Florida Power Corporation's general body of ratepayers. [Dagostino Deposition, page 9, line 18 through page 11, line 1]. Thus, the Commission should approve the \$4.85 million "going concern" value identified by Sebring witness Gerald Warren as a positive acquisition adjustment that benefits customers of both Sebring and FPC.

ISSUE 16

Should the Commission approve at this time the prudence of Florida Power Corporation's proposed

assumption of Sebring's purchased power contract with Tampa Electric Company?

POSITION

Yes, the Commission should approve at this time the prudence of FPC's proposed assumption of Sebring's purchased power contract with Tampa Electric Company ("TECO").

ISSUE 17 Should the Commission approve Florida Power Corporation's recovery of the fuel costs associated with the Tampa Electric Company purchased power contract through the fuel cost recovery clause from its general body of ratepayers with no special allocation of costs to Sebring's ratepayers?

POSITION

Yes, the Commission should approve FPC's recovery of the fuel costs associated with the TECO purchased power contract through the fuel cost recovery clause from its general body of ratepayers with no special allocation of costs to Sebring's ratepayers.

ISSUE 18 Should the Commission approve Florida Power Corporation's recovery of the capacity costs associated with the Tampa Electric Company purchased power contract through the capacity cost recovery clause from its general body of ratepayers with no special allocation of costs to Sebring's ratepayers?

POSITION

Yes, the Commission should approve FPC's recovery of the capacity costs associated with the TECO purchased power contract through the capacity cost recovery clause from its general body of ratepayers with no special allocation of costs to Sebring's ratepayers.

ISSUE 19 Should the Commission approve the proposed Amendment to the Territorial Agreement and Termination of Settlement Agreement?

POSITION

Yes, the Commission should approve the proposed Amendment to the Territorial Agreement and Termination of Settlement Agreement.

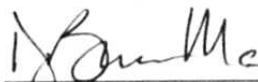
ISSUE 20

Should the Commission approve the assignment of the Glades Electric Cooperative Territorial Agreement to Florida Power Corporation?

POSITION

Yes, the Commission should approve the assignment of the Glades Electric Cooperative Territorial Agreement to Florida Power Corporation.

Respectfully submitted,



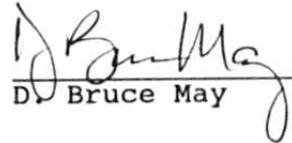
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Attorneys for Sebring
Utilities Commission

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished by U.S. Mail to James P. Fama, Florida Power Corporation, 3201 34th St., South, St. Petersburg, FL 33733; Martha Carter Brown, Public Service Commission, 101 E. Gaines St., Rm. 226, Tallahassee, FL 32399-0863; Don Darling, Co-Chariman, Citizens for Utility Rate Equity, 1520 10th Avenue, Sebring, FL 33872; Harold E. Seaman, Chairman, Action Group, 2145 Fiesta Way, Sebring, FL 33872; Russell D. Chapman, Manager, Regulatory Coordination and Business Planning, Tampa Electric Company, P.O. Box 111, Tampa, FL 33601; Lee L.

Willis, James D. Beasley, Ausley, McMullen, McGehee, Carothers & Proctor, P.O. Box 391, Tallahassee, FL 32302; and to Robert G. Pollard, Chairman, Concerned Citizens of Sebring, 810 N. Ridgewood Drive, Sebring, FL 33870 this 16th day of November, 1992.


D. Bruce May

TAL-17788