

FLORIDA PUBLIC SERVICE COMMISSION
Capital Circle Office Center • 2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

M E M O R A N D U M

DECEMBER 20, 1995

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (SLEMKEWICZ,
MAUREY, STALLCUP) *DM*
DIVISION OF ELECTRIC AND GAS (BASS) *RUE*
DIVISION OF LEGAL SERVICES (ELIAS) *AAC* *pm* *JS* *198* *JAJ*

RE: DOCKET NO. 950379-EI - TAMPA ELECTRIC COMPANY -
INVESTIGATION INTO EARNINGS FOR 1995 AND 1996 OF TAMPA
ELECTRIC COMPANY

AGENDA: 01/03/96 - REGULAR AGENDA - DECISION PRIOR TO HEARING -
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\950379.RCM
ATTACHMENT NOT AVAILABLE

CASE BACKGROUND

On March 1, 1995, Tampa Electric Company (TECO) submitted its 1995 Forecasted Earnings Surveillance Report in compliance with Rule 25-6.1353, Florida Administrative Code. Per the report, TECO forecasted an achieved return on equity (ROE) of 14.28% for 1995. This exceeded the top of TECO's then currently authorized ROE range (10.35% to 12.35%, with an 11.35% midpoint). Subsequently, additional data was requested and received for 1996 that indicated a projected ROE of 13.81%, which was later adjusted downwards to 13.07%.

Due to concerns over the high level of TECO's forecasted earnings, a meeting was scheduled on March 22, 1995, to explore alternatives regarding the possible disposition of the excess earnings. TECO, the Office of the Public Counsel, FIPUG and the Staff participated in the discussions at the meeting. As a result of this and subsequent meetings, a proposal was proffered concerning the disposition of the excess revenues for 1995 only. Per Order No. PSC-95-0580-FOF-EI, the Commission accepted Tampa Electric Company's proposal to: (1) establish a new return on equity of 11.75% with a range of 10.75% to 12.75%, effective January 1, 1995; (2) irrevocably defer a revenue amount of \$15

DOCUMENT NUMBER-DATE

12835 DEC 20 1995

FPSC-RECORDS/REPORTING

DOCKET NO.950379-EI
DECEMBER 20, 1995

million for 1995; (3) defer 50% of any revenues in excess of an 11.75% ROE up to a net 12.75% ROE and to defer all revenues in excess of a net 12.75% ROE; (4) defer any deferred revenues until 1997 and accrue interest at the commercial paper rate; and (5) end the oil backout clause, effective January 1, 1996.

As of October 31, 1995, TECO has deferred \$39.1 million of excess revenues for 1995. It is anticipated that the final amount of deferred revenues will approach \$45 million for 1995. However, the issue of any potential excess earnings for 1996 was left unresolved in TECO's proposal. It is Staff's understanding that TECO and the Office of the Public Counsel (OPC) have been holding discussions in an attempt to reach a possible stipulation to resolve the issue of future overearnings. On December 19, 1995, Staff was invited to observe a meeting between TECO and OPC regarding the resolution of the issue of potential future overearnings. It appears that a stipulation between those two parties will not be forthcoming soon. This recommendation addresses the need for the Commission to obtain jurisdiction over any potential overearnings during 1996.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission order Tampa Electric Company to hold 1996 earnings in excess of the maximum of the range of its authorized rate of return on equity (12.75%) under bond or corporate undertaking subject to refund?

RECOMMENDATION: Yes. The best information available to staff, including TECO's own projections, indicates substantial overearnings are projected for 1996. The Commission should exercise its general ratemaking authority to prospectively order revenues held subject to refund. The application of the interim statute in this case is inappropriate, as it would likely overstate the amount necessary to protect the interests of the ratepayers. The Commission should order TECO to hold 1996 earnings in excess of the maximum of the range of its authorized rate of return on equity (ROE) of 12.75%, under bond or corporate undertaking subject to refund. [ELIAS, SLEMKEWICZ, STALLCUP]

STAFF ANALYSIS: Tampa Electric Company (TECO) has informed staff that it has projected substantial overearnings for 1996. This docket addresses the core issue of whether the Commission should exercise its general ratemaking authority to attach jurisdiction over utility overearnings on a prospective, i.e., going forward, basis.

The action staff recommends is preliminary in nature. If staff's recommendation is adopted, the Commission still has a duty to conduct a fair hearing, after actual 1996 results are known, to determine the amount and appropriate disposition of TECO's overearnings. United Telephone Co. of Florida v Beard, 611 So 2d 1240 (Fla 1993). Staff's recommendation at this time is only that TECO, based on its own data, be required to hold earnings in excess of the maximum of its ROE range under bond or corporate undertaking subject to refund. The questions of whether a refund will be ordered, and the amount of the refund, should be addressed later, after a hearing.

The Florida Legislature has declared the Commission's regulation of public utilities to be in the public interest, and has deemed Chapter 366, Florida Statutes, to be an exercise of the police power of the state for the protection of the public welfare with all provisions of Chapter 366 to be liberally construed for the accomplishment of that purpose. See Section 366.01, Florida Statutes.

Section 366.07, Florida Statutes, provides that:

Whenever the commission, after public hearing either **upon its own motion** or upon complaint, shall find the rates,

rentals, charges or classifications, or any of them, proposed, demanded, observed, charged or collected by any public utility for any service, or in connection therewith, or the rules, regulations, measurements, practices or contracts, or any of them, relating thereto, are unjust, unreasonable, insufficient, excessive, or unjustly discriminatory or preferential, or in anywise in violation of law, or any service is inadequate or cannot be obtained, the commission shall determine and by order fix the fair and reasonable rates, rentals, charges or classifications, and reasonable rules, regulations, measurements, practices, contracts or service, to be imposed, observed, furnished or followed in the future. (emphasis added)

The Commission's inherent authority to prevent detriment to ratepayers resulting from unjust or unreasonable earnings has been well recognized by the courts. In United Telephone Co. of Florida v Beard, supra, the Supreme Court of Florida stated:

We agree with the Commission that the unusual factual circumstances of this case, namely the length of time since the company's last full rate proceeding and the drop in interest rates, would have resulted in "unjust, unreasonable, [and] unjustly discriminatory" earnings for United, to the detriment of its ratepayers. §364.14(1), Fla. Stat. (1989).

Section 364.14, Florida Statutes, relied on by the Court in United Telephone Co. of Florida v Beard, is the telecommunications equivalent to Section 366.07, Florida Statutes. Section 366.07 confers to the Commission the same broad grant of authority over electric and gas utility rates that Section 364.14 confers over telecommunications rates. Both statutes contain language allowing the Commission to protect ratepayers from unjust and unreasonable excessive rates.

The case of Southern Bell v Bevis, supra, referred to in the passage quoted above, predates both the file and suspend statute (enacted in 1974) and the interim statute (enacted in 1980). In that case, the Court rejected the Commission's argument that it could not set rates without a comprehensive review, stating that nothing precluded the Commission from subjecting the increase to a refund provision. The Court found that a range of alternatives suitable to the particular circumstances of the case was available to the Commission, including the imposition of a reasonable refund provision to protect both the company and its customers.

In United Telephone v Mann, 403 So 2d 962 (Fla. 1981), the Court upheld the Commission's order subjecting earnings to refund

down to the authorized rate of return, pursuant to Section 364.14, Florida Statutes (the telecommunications equivalent to Section 366.07, Florida Statutes). The Court stated that the Commission could order moneys held subject to refund, "upon finding that a company is earning revenues in excess of its maximum allowable rate of return." 407 So 2d at 966. The Court relied on the Commission's general ratemaking authority, outside of the file and suspend and interim statutes, to capture revenues subject to refund. The Court found a broad range of alternatives (including capturing money subject to refund), that did not necessarily flow from the file and suspend and interim statutes, to be inherent in the Commission's general rate setting authority set forth in Section 364.14, Florida Statutes.

In Citizens v Public Service Commission, 425 So 2d 534 (Fla., 1982), the Court indicated that it did not intend a narrow reading of United Telephone v. Mann, supra. The court stated that it has consistently recognized the broad legislative grant of authority conferred upon the Commission and the considerable license the Commission enjoys as a result of that delegation. Citizens v Public Service Commission, reaffirmed the sentiment expressed in the 1973 Southern Bell v Bevis case: the Commission has a broad range of discretion, which remains unimpaired with the passage of the interim and file and suspend statutes, to protect against unreasonable rates, even to the point of conditioning revenues on the outcome of future hearings. Where a utility itself has projected substantial overearnings, the Commission definitely has the inherent authority to protect ratepayers by requiring the utility to hold earnings in excess of the maximum of its ROE range, under bond or corporate undertaking subject to refund.

Attaching jurisdiction over a portion of current rates believed to be excessive will not harm the utility. In addition, this action should not have a detrimental effect on the Company's financial integrity since only revenues in excess of the maximum allowable ROE would be held subject to refund. A hearing will provide ample opportunity to challenge both the factual and legal basis for any revenues held subject to refund. No one is harmed if the Commission should later determine that it must remove the refund condition without ordering any refunds. The utility is not harmed if it has a full opportunity to present its case and is put on notice that its revenues are not unconditional.

Section 366.071(5), Florida Statutes (the interim statute) provides in part:

5)(a) In setting interim rates or setting revenues subject to refund, the commission shall determine the revenue deficiency or excess by calculating the difference between the achieved rate of return of a

public utility and its required rate of return applied to an average investment rate base or an end-of-period investment rate base.

(b) For purposes of this subsection:

"Achieved rate of return" means the rate of return earned by the public utility for the most recent 12-month period. The achieved rate of return shall be calculated by applying appropriate adjustments consistent with those which were used in the most recent individual rate proceeding of the public utility and annualizing any rate changes occurring during such period.

In the instant case, application of the formula mandated by Section 366.071, Florida Statutes, fails to consider certain known events which will impact TECO's 1996 earnings. The first item is the \$21.3 million in severance pay that TECO expensed in November and December, 1994. The effects of this non-recurring expense are still included in the latest available 1995 actual data that Staff has received from TECO, namely the October 1995 Earnings Surveillance Report. This adjustment would reduce TECO's expenses and increase its achieved ROE. The other major item is the elimination of the Oil Backout Cost Recovery Clause, effective January 1, 1996. Since this change does not occur until 1996, it is not included in the October, 1995 data. However, it is a known change affecting 1996 and should be considered. This adjustment would increase TECO's expenses by approximately a \$12.5 million revenue requirement.

Preferably, staff would like to rely on TECO's own projections for 1996 to evaluate its earnings. Staff reviewed the financial forecasts submitted by the Company in response to a data request. This forecasted financial information was developed by the Company in early 1995 and projected a 1996 ROE of 13.07%. After evaluating this projection and other information, staff believes that TECO's projected 1996 ROE is not reliable. This conclusion is based on three factors. First, for each of the last three years for which both actual and forecasted financial information is available, the Company has under-forecasted ROE by an average of 89 basis points per year (after adjusting for the non-recurring restructuring charge of \$21.3 million in 1994). Second, as of October 1995, the Company's surveillance report shows that actual year-to-date ROE is 15.91% (after adjusting for the effects of the \$21.3 million restructuring charge and \$39 million in deferred revenues) compared to projected ROE of 14.28%. This 163 basis point differential represents approximately \$21.1 million in revenues. Of this amount, staff estimates that approximately one-third is attributable to weather, leaving two-thirds to non-weather related factors. This indicates that TECO's historical pattern of under-

forecasting ROE has continued into the current year. Third, the underlying inflation assumption used to generate TECO's 1996 forecast is no longer appropriate. The Company used a 1996 inflation rate of 3.5% as an input to its O&M budget. This assumption was consistent with the prevailing view in early 1995 when the forecast was generated. However, latest inflationary expectations from DRI and Blue Chip Economic Indicators show that a more current assumption would be 2.9%. Other things constant, if actual inflation is lower than budgeted, then O&M expenses will be lower and ROE higher. Taken together, Staff believes that these three factors indicate a pattern of under-forecasting actual ROE by a substantial margin and that the Company's current 1996 forecasted ROE should not be relied upon.

As an alternative, the Commission could proceed under the interim statute. Staff has reviewed TECO's most recently filed Earnings Surveillance Report. Per TECO's October 1995 Earnings Surveillance Report, the achieved return on equity is 11.32% on an "FPSC Adjusted" basis. This return, however, must be adjusted for certain significant items if it is to be used as a basis for estimating TECO's 1996 earnings. These items are as follows:

- 1) Deferred 1995 revenues of \$39.1 million
- 2) 1994 severance pay of \$23.1 million
- 3) \$12.5 million effect of eliminating the Oil Backout Clause effective January 1, 1996

As shown on the Attachment, these adjustments result in an achieved ROE of 14.72%. This exceeds the authorized ROE ceiling of 12.75% by 197 basis points, or approximately \$25.7 million in terms of revenues.

Staff is cognizant and mindful of the Court's opinion in United Telephone Company of Florida v. Beard, supra. Staff believes the procedure outlined in staff's recommendation is consistent with the Court's opinion, affords Tampa Electric Company full due process rights, and protects the interests of the ratepayers.

Staff, therefore, recommends that the Commission order Tampa Electric Company to hold 1996 earnings in excess of the maximum of the range of its authorized rate of return on equity (12.75%) under bond or corporate undertaking subject to refund. If staff's recommendation is adopted by the Commission, a hearing should be conducted, after 1996 results are known, to determine the amount and appropriate disposition of TECO's overearnings.

DOCKET NO.950379-EI
DECEMBER 20, 1995

ISSUE 2: Should the Commission hold a limited proceeding hearing within 60 days to consider updating the authorized return on equity for Tampa Electric Company?

RECOMMENDATION: Yes, the Commission should hold a limited proceeding hearing within 60 days to consider updating the authorized return on equity for Tampa Electric Company. [MAUREY]

STAFF ANALYSIS: Tampa Electric Company's current authorized return on equity (ROE) is 11.75%, which the Commission approved in Order No. PSC-95-0580-FOF-EI issued on May 10, 1995. From April 1995 to November 1995, the monthly average yield on 30 year Treasury bonds has dropped 110 basis points, from 7.35% to 6.25%. The six month moving average of the yield on 30 year Treasury bonds has dropped 114 basis points over this period. In addition to the drop in rates on government bonds, the average monthly yield on Aa-rated public utility bonds has declined 95 basis points from 8.17% in April 1995 to 7.22% in November 1995. The six month moving average of the yield on Aa-rate public utility bonds has dropped 106 basis points over this period. Staff believes this decline in long-term interest rates indicates a corresponding decline in the cost of equity.

An analysis of the latest surveillance reports filed by the major Florida electric utilities indicates TECO has the greatest potential to overearn in 1996. In addition, TECO has the highest equity ratio (59.1%). A higher equity balance can absorb excess earnings. While the Commission retains jurisdiction over any excess earnings in 1995 as a result of the agreement approved by the Commission in Order No. PSC-95-0580-FOF-EI, no such arrangement is in place for 1996.

The determination of whether excess earnings exist is a function of the company's authorized ROE. In TECO's situation where there is a high probability of overearnings, it is imperative that the company's ROE is reflective of current capital market conditions. Staff believes that TECO's current authorized ROE is outdated. Therefore, Staff recommends that the Commission hold a limited proceeding hearing to set an authorized ROE for all regulatory purposes for TECO.

DOCKET NO.950379-EI
DECEMBER 20, 1995

ISSUE 3: Should this docket be closed?

RECOMMENDATION: No. This docket should remain open until Staff has reviewed Tampa Electric Company's historical earnings data for 1996, and the Commission has determined the amount and appropriate disposition of any overearnings. [ELIAS, SLEMKEWICZ]

STAFF ANALYSIS: Pursuant to United Telephone Co. of Florida v Beard, 611 So 2d 1240 (Fla 1993), the Commission should conduct a hearing, after 1996 results are known, to determine the amount and appropriate disposition of TECO's overearnings.

TAMPA ELECTRIC COMPANY
DOCKET NO. 950379-EI
OCTOBER 1995 EARNINGS SURVEILLANCE REPORT

DOCKET NO. 950379-EI
DATE: DECEMBER 20, 1995

| | FPSC Adjusted Basis | 1995 Deferred Revenue | 1994 Severance Pay | Oil Backout Clause Elimination | Total Adjustments | Adjusted Total |
|-------------------------------|---------------------------|-----------------------------|--------------------------|--------------------------------------|----------------------|-------------------|
| RATE BASE | | | | | | |
| Plant In Service | 2,563,977 | 0 | 0 | 140,305 | 140,305 | 2,704,282 |
| Accumulated Depreciation | (982,263) | 0 | 0 | (105,118) | (105,118) | (1,087,381) |
| Net Plant In Service | 1,581,714 | 0 | 0 | 35,187 | 35,187 | 1,616,901 |
| Property Held For Future Use | 54,084 | 0 | 0 | 0 | 0 | 54,084 |
| Construction Work In Progress | 46,112 | 0 | 0 | 0 | 0 | 46,112 |
| Net Utility Plant | 1,681,910 | 0 | 0 | 35,187 | 35,187 | 1,717,097 |
| Working Capital | 52,927 | 0 | 0 | (390) | (390) | 52,537 |
| Total Rate Base | 1,734,837 | 0 | 0 | 34,797 | 34,797 | 1,769,634 |
| INCOME STATEMENT | | | | | | |
| Operating Revenues | 566,591 | 39,056 | 0 | 0 | 39,056 | 605,647 |
| Operating Expenses: | | | | | | |
| O&M – Fuel & Interchange | 8,733 | 0 | 0 | 0 | 0 | 8,733 |
| O&M – Other | 226,712 | 0 | (21,300) | 3,597 | (17,703) | 209,009 |
| Depreciation & Amortization | 101,185 | 0 | 0 | 7,015 | 7,015 | 108,200 |
| Taxes Other Than Income | 39,744 | 0 | 0 | 0 | 0 | 39,744 |
| Income Taxes – Current | 70,962 | 14,697 | 8,015 | (1,354) | 21,358 | 92,320 |
| Deferred Income Taxes (Net) | (13,971) | 0 | 0 | (2,374) | (2,374) | (16,345) |
| Investment Tax Credit (Net) | (4,756) | 0 | 0 | (397) | (397) | (5,153) |
| Gain(Loss) On Disposition | (14) | 0 | 0 | 0 | 0 | (14) |
| Total Operating Expenses | 428,595 | 14,697 | (13,285) | 6,487 | 7,899 | 436,494 |
| Net Operating Income | 137,996 | 24,359 | 13,285 | (6,487) | 31,157 | 169,153 |
| Overall Rate Of Return | 7.95% | --- | --- | --- | 1.60% | 9.56% |
| Return On Equity | 11.33% | --- | --- | --- | 3.38% | 14.72% |
| Revenues Over 12.75% ROE | | | | | | 25,727 |