

FLORIDA PUBLIC SERVICE COMMISSION  
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MEMORANDUM

April 30, 1998

APR 30 1998

FPSC - Records/Reporting

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

FROM: DIVISION OF AUDITING & FINANCIAL ANALYSIS (L. ROMIG, MERTA, LESTER, DRAPER) PL *SM* *DM* *JS*  
DIVISION OF ELECTRIC & GAS (MAKIN, MILLS) *ORFB*  
DIVISION OF LEGAL SERVICES (C. KEATING) *WCE* *RUE*

RE: DOCKET NO. 980434-GU - PETITION BY TAMPA ELECTRIC COMPANY D/B/A PEOPLES GAS SYSTEM FOR APPROVAL OF A METHODOLOGY FOR ACCOUNTING FOR ENVIRONMENTAL EXPENSE ACCRUAL AND RESERVE ACCOUNT AND DISPOSITION OF WEST FLORIDA DIVISION'S ENVIRONMENTAL RESERVE ACCOUNT

AGENDA: 05/12/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\AFA\WP\980434.RCM

CASE BACKGROUND

By Order No. PSC-92-0924-FOF-GU, issued September 3, 1992, the Commission authorized Peoples Gas System ("Peoples" or "the Company") to amortize \$1,248,000 in environmental costs annually based on a 5-year amortization period beginning November 1, 1990. On December 10, 1993, the Commission issued Order No. PSC-93-1773-FOF-GU, which required Peoples to fully amortize \$2,496,000 in environmental clean-up costs by September 30, 1994.

Since September 30, 1994, the Company has been deferring all environmental costs instead of expensing them. The Commission, by Order No. PSC-98-0329-FOF-GU, issued February 24, 1998, ordered Peoples to write-off, against 1996 over earnings, the deferred environmental costs as of December 31, 1996. The Commission also ordered the Company to expense all environmental costs as incurred effective January 1, 1997, until the Company formally requests and receives Commission authority to account for these costs using reserve or other treatment.

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On June 30, 1997, West Florida Natural Gas ("West Florida" or "WFNG") was merged into Peoples Gas System. Prior to the merger, the Commission authorized West Florida to accrue \$198,312 annually for environmental costs. By Order No. PSC-94-0452-FOF-GU, issued April 14, 1994, the Commission ordered that either at June 30, 1997, during West Florida's next rate case, or at the discretion of the Commission, any accruals in excess of actual expenses would be reviewed and subject to refund with interest, or other disposition, independent of West Florida's earnings. Also, the same order required WFNG to apply \$515,622 of 1993 overearnings towards the environmental clean-up costs. As of June 30, 1997, West Florida had accrued \$475,306 in excess of actual costs. By December 31, 1997, this balance reached \$546,464. The balance at March 31, 1998, further increased to \$595,052.

As a result of Order No. PSC-98-0329-FOF-GU, Peoples filed a petition on March 25, 1998 requesting approval of a methodology for accounting for environmental expense accrual and reserve accounting and disposition of West Florida Division's environmental reserve account.

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve Peoples' request to implement reserve accounting treatment for environmental costs?

RECOMMENDATION: Yes. The Commission should approve Peoples' request to implement reserve accounting for environmental costs. (L. ROMIG, MERTA)

STAFF ANALYSIS: Peoples is requesting approval to use reserve accounting for environmental costs as provided for in the Uniform System of Accounts for Natural Gas Utilities. As stated in its petition, the purpose for using reserve accounting is to "...mitigate the earnings impact from fluctuations which occur in environmental costs....". In response to a data request from Staff, Peoples provided historical environmental costs for Peoples and West Florida which show such cost fluctuations. From 1985 to 1997, Peoples' environmental costs ranged from a low of negative \$766,231 to a high of \$2,478,538. From 1993 to 1997, West Florida's environmental costs ranged from a low of \$7,662 to a high of \$69,786.

Because of the wide fluctuations in these costs, and in an attempt to levelize expenses and mitigate the earnings impact, Staff recommends that the Company's request for reserve accounting be approved.

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ISSUE 2: Should the Commission approve Peoples' request for a base annual environmental cost accrual of \$640,000 with an effective date of January 1, 1998?

RECOMMENDATION: Yes, the Commission should approve the Company's request to accrue a base amount of \$640,000 to a reserve account with an effective date of January 1, 1998. (L. ROMIG, MERTA)

STAFF ANALYSIS: The Company requests that it be allowed to accrue a base amount of \$640,000 to a reserve account for environmental costs. The Company bases this amount on the historical environmental clean-up costs incurred at the Peoples Gas and West Florida Divisions. The Company requests an effective date of January 1, 1998. In addition, the Company requests that it be given authority to establish an expensing mechanism to adjust the base expense accrual based on adjusted reserve balances. This request is addressed separately in Issue 3.

As stated in Issue 1, Peoples' environmental costs vary widely from year-to-year and could impact earnings from year-to-year. Based on a review of the historical environmental costs and the amount of ongoing work to be performed at the affected sites, Staff believes that the requested accrual of \$640,000 is reasonable and would levelize expenses. In addition, the approval of \$640,000 less the requested discontinuance of the West Florida accrual of \$198,312, discussed in Issue 4, would result in a net increase to expense of \$441,411. This increase would not have a significant impact on the Company's earnings. After increasing expenses by \$441,411 for 1997, the Company's earned Return on Equity would decrease from 10.88% to 10.68%, within an authorized range of 10.25%-12.25%. Based on the Company's budget, the ROE for 1998 would decrease from 11.72% to 11.52%.

Based on the above, Staff recommends that the requested \$640,000 base accrual be approved. Staff recommends that this accrual become effective January 1, 1998, because the Company is on a calendar year fiscal year.

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**ISSUE 3:** Should the Commission approve Peoples' request for authority to establish an expensing mechanism to adjust the base expense accrual based on expected reserve balances?

**RECOMMENDATION:** No. The Company's request to establish an expensing mechanism to adjust the base expense accrual based on expected reserve balances should not be approved. (L. ROMIG, MERTA)

**STAFF ANALYSIS:** The Company stated, in a data request from Staff, that the requested accrual was based on historical costs since future costs cannot be predicted. Further, on pages 4 and 5 of its petition, Peoples stated:

"(1) The requested expense is \$640,000 annually, based on combined historical annual environmental costs at Peoples Gas System (including its West Florida Divisions). Peoples also requests authority to adjust the expense based on the Company's budgeted surveillance report if the expected reserve balance reaches certain levels after applying the normal \$640,000 expense amount in a given year. The following adjusted annual expense amounts would apply under the circumstances listed below:

<u>Forecasted Reserve Balance</u>	<u>Adjusted Annual Expense</u>
Asset more than \$2 million	\$1,280,000
Asset more than \$1 million (but less than \$2 million)	\$ 960,000
Asset less than \$1 million	\$ 640,000
Liability less than \$1 million	\$ 640,000
Liability more than \$1 million (but less than \$2 million)	\$ 320,000
Liability more than \$2 million	\$ -0-

(2) Peoples submits that the \$640,000 annual expense amount, adjusted as set forth above, would avoid repeated petitions to the Commission for adjustment of the annual expense amount, while ensuring that the balance in the reserve is limited over time. The amount of the expense would be established at the beginning of each year and the computation thereof would be included in the Company's forecasted earnings surveillance report filing with the Commission."

By Rule 25-7.014, Florida Administrative Code (F.A.C.), the Commission adopted the Uniform System of Accounts for Natural Gas Utilities. Further, Rule 25-6.0143, F.A.C., concerns accumulated provision accounts for electric utilities, including the account

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for Accumulated Provision for Property Insurance which is similar in nature to the corresponding account for gas utilities contained in the Uniform System of Accounts for Natural Gas Utilities. The rule provides, in pertinent part, that "charges shall be made to accumulated provision accounts regardless of the balance in those accounts." In other words, the Commission has recognized that there is the possibility that costs incurred may exceed the accumulated accruals. While this requirement is not per se applicable to natural gas utilities, it is instructive and, Staff believes, appropriate in this instance.

The Company provided, in response to Staff's data request, the environmental costs incurred by year from 1985 - 1997 for Peoples Gas and 1993 - 1997 for West Florida. The average annual cost was \$607,435 for Peoples and \$39,634 for West Florida, which yields an average total cost of \$647,069. This average total cost was apparently rounded down to \$640,000 by the Company. In the thirteen years of historical costs presented for Peoples Gas, the average annual cost exceeded actual costs in nine of those years. The average annual cost for West Florida exceeded the actual costs in two out of the five years presented. In addition, if the Company had accrued \$640,000 each year for the last thirteen years, the reserve would never have been over or under accrued by the \$2 million requested threshold. Further, the Company's methodology results in a yearly fluctuation in expenses. Based on the Company's response to Staff's data request, the expense would vary from \$320,000 to \$1,280,000. This would defeat one of the purposes of reserve accounting treatment which is to levelize expenses. It should also be noted that total expense for the thirteen years under the Company's plan would have been approximately \$600,000 higher than using the \$640,000 annual accrual for each year. Therefore, Staff believes that a fixed accrual based on historical experience, as shown above, would result in a reasonable reserve balance over time.

Staff recognizes that the Company's actual costs may exceed its reserve balance. If, over time, the reserve balance does not appear representative of costs actually incurred, the Company may file a petition for different treatment at that time. Because of the wide fluctuations in environmental costs and in an attempt to levelize expenses and mitigate the earnings impact, Staff recommends that the Company's request for an expensing mechanism be denied.

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ISSUE 4: Should the Commission approve Peoples' request to suspend the \$198,312 annual environmental cost accrual for West Florida, effective January 1, 1998?

RECOMMENDATION: Yes. The Commission should approve Peoples' request to suspend the \$198,312 annual environmental accrual for West Florida, effective January 1, 1998. (L. ROMIG, MERTA)

STAFF ANALYSIS: Peoples acquired WFNG by merger in June 1997. WFNG has an old manufactured gas plant in Ocala, Florida. WFNG currently uses reserve accounting for environmental costs and is accruing \$198,312 annually to the reserve.

Peoples requests that the \$198,312 accrual be suspended and replaced by a base accrual of \$640,000 for Peoples' and its West Florida division combined. In the future, all environmental costs associated with the Company's combined operations would be applied against the new environmental reserve accrual. Staff recommends that the Company's request be approved effective January 1, 1998.

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**ISSUE 5:** Should the Commission approve Peoples' request to dispose of West Florida's environmental clean-up reserve account for environmental costs by writing it off against a portion of the current balance of unamortized debt costs for issuance costs and prepayment premium?

**RECOMMENDATION:** No. The Commission should not approve Peoples' request to dispose of West Florida's reserve account for environmental costs by writing it off against a portion of the current balance of unamortized debt costs for issuance costs and prepayment premium. Instead the reserve balance of \$546,464 plus interest through July 31, 1998, of \$79,870, for a total of \$626,334, should be disposed of by making a refund to West Florida's customers.

The total refund amount divided by July 1998 actual therm sales would be refunded to customers in August 1998. Any dollars remaining after the refund, will be credited to fuel expense for the following month after the refund is made. Within 60 days of the refund, a complete report must be filed with the Division of Records and Reporting indicating the total amount of refund, total amount of interest, and total amount remaining, if any. (L. ROMIG, MERTA, MAKIN)

**STAFF ANALYSIS:** Based on discussions with the Company and review of documents, Staff believes that by the end of 1997, Peoples had incurred \$637,521 in costs associated with West Florida's debt of which \$270,641 related to unamortized debt issuance costs. The balance related to prepayment premiums of West Florida debt retired by Peoples at the time of the merger. The Company stated in its petition that the debt was retired because there was a net present value savings notwithstanding the prepayment premium.

The Company also stated in its petition that "APB-26 of GAAP specifies that when an unregulated company extinguishes its debt the gain or loss is required to be adjusted for issuance costs and for unamortized premiums or discounts." Since Peoples has been amortizing the debt costs in conformity with the Uniform System of Accounts, a Regulatory Asset is generated because of the difference in accounting treatment.

In its petition, Peoples requests that the Commission dispose of the June 30, 1997, balance in the West Florida reserve account for environmental costs \$475,306 by writing it against the December 31, 1997 balance of unamortized debt costs \$637,521 related to West Florida. Peoples did not address the increase in the environmental reserve from July 1, 1997 to December 31, 1997, of approximately \$71,158 in its petition. Peoples states that this write-off will



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benefit both the ratepayers and the Company. Peoples contends that the ratepayers will benefit because they will not have to support a return on it as part of the rate base, and the Company will benefit by having a more competitive balance sheet. Finally, the proposal would dispose of the West Florida environmental clean-up reserve related to the environmental cost accruals.

In Staff's opinion, the impact on the balance sheet would be immaterial and there would actually be an increase to rate base by the amount of reduction to the liability account. Therefore, ratepayers would face higher rates in the event the Company had a rate proceeding under the Company's proposal. In addition, the Company's proposal would benefit current Peoples' customers who did not provide these funds, by reducing the amount of interest expense embedded in the capital structure.

West Florida's customers have provided funds for environmental clean-up costs that were not incurred. Therefore, those customers should be entitled to a refund of the current principal balance plus interest from the date these excess costs were accrued. If Peoples had not acquired WFNG, then Staff would most likely be recommending that a refund be made by WFNG. We do not believe the WFNG ratepayers should be denied a refund of amounts paid prior to the merger just because there was a merger. In addition, if Staff's recommendation in Issue 2 is approved, the \$200,000 annual environmental accrual which was applicable to WFNG will be decreased by \$160,000 to approximately \$40,000 annually. The \$160,000 will more than offset the annual amortization of the refinancing costs incurred by Peoples.

The Commission authorized West Florida to accrue \$198,312 annually for environmental costs. In Order No. PSC-94-0452-FOF-GU, the Commission ordered that either at June 30, 1997, during West Florida's next rate case, or at the discretion of the Commission, any accruals in excess of actual expenses would be reviewed and subject to refund with interest or other disposition, (independent of West Florida's earnings.) In addition, Order No. PSC-94-0452-FOF-GU applied \$515,622 of West Florida's 1993 over earnings to the environmental clean-up reserve and held it subject to refund. The remaining balance of 1993 over earnings, plus interest, was refunded to the customers. The Commission stated:

Because of the continued uncertainty of the potential liability associated with the clean-up, the Company requested that it be allowed to continue its annual accrual of \$198,312. As a concession for continuing the accrual, the Company proposed that it would refund any accruals in excess of actual expenses, plus interest. We

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believe that the Company's proposal is reasonable, since it will protect the Company against future liabilities and the customer in the event the Company does not incur anticipated expenses.

As of June 30, 1997, West Florida's environmental reserve balance was \$475,306. In response to Staff's data request Peoples stated that the balance in West Florida's reserve account had increased to \$546,464 at December 31, 1997, and had further increased to \$595,052 at March 31, 1998. Staff believes that the 1993 over earnings of \$515,622 which were applied to the reserve is the contributing factor to the \$546,464 reserve balance at December 31, 1997. Since these funds were not needed, Staff believes they should be refunded to WFNG customers as contemplated in the above Order.

Staff recommends that the Company's proposed disposition of the June 30, 1997 reserve balance of \$475,306 be denied. Instead the December 31, 1997 balance of \$546,464 be refunded, plus interest, to West Florida's customers on a cents per therm basis, based on actual therm sales for the month of July 1998. The total refund amount divided by July 1998 actual therm sales would be refunded to customers in August, 1998. Any dollars remaining after the refund, will be credited to fuel expense for the following month after the refund is made. Within 60 days of the refund, a complete report must be filed with the Division of Records and Reporting indicating the total amount of refund, total amount of interest, and total amount remaining, if any.