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Blanca S. Bayo, Director
Florida Public Service Commission
Division of Records and Reporting
Gunter Building
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0870

Re: Docket No. 950379-EI

Dear Ms. Bayo:

Enclosed for filing and distribution are the original and fifteen copies of the Direct Testimony of Jeffry Pollock on behalf of the Florida Industrial Power Users Group in the above docket.

Please acknowledge receipt of the above on the extra copy enclosed herein and return it to me. Thank you for your assistance.

Sincerely,

Vicki Gordon Kaufman

Vicki Gordon Kaufman

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Before the
Florida Public Service Commission

In re: Investigation into Earnings for 1995 and 1996 of Tampa Electric Company	))))	Docket No. 950379-EI

Testimony of

Jeffry Pollock

On Behalf of

Florida Industrial Power Users Group

October 1998
Project 6945

BRUBAKER & ASSOCIATES, INC.

Before the
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Testimony of

Jeffry Pollock

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October 1998
Project 6945

BAI

BRUBAKER & ASSOCIATES, INC.

Before the
Florida Public Service Commission

In re: Investigation into Earnings for 1995 and 1996 of Tampa Electric Company — **Docket No. 950379-EI**

Direct Testimony of Jeffry Pollock

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A Jeffry Pollock, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri, 63141-2000.

Q **WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

A I am an energy advisor and a principal in the firm of Brubaker & Associates, Inc. (BAI).

Q **PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A I have a Bachelor of Science Degree in Electrical Engineering and a Masters in Business Administration from Washington University. Since graduation in 1975, I have been engaged in a variety of consulting assignments including energy and regulatory matters in both the United States and several Canadian provinces. I have participated in regulatory matters before this Commission since 1977. More details are provided in Appendix A to this testimony.

Q **ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?**

A I am appearing on behalf of the Florida Industrial Power Users Group (FIPUG). FIPUG members are customers of Tampa Electric Company (TECo). They purchase substantial quantities of electric power and energy under various firm and interruptible tariffs.

Q **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A I will explain the reasons why it would be inappropriate to impute interest on deferred revenues pursuant to the Stipulation Agreements between TECo, the Office of Public Counsel (OPC) and FIPUG for purposes of determining TECo's earned return on equity for regulatory surveillance purposes. I shall also respond to the testimony of Ms. Delaine M. Bacon, on behalf of TECo, which advocates imputing interest on deferred revenues and which addresses the FMPA/Lakeland cost separation issue.

Q **TO WHAT STIPULATION AGREEMENTS ARE YOU REFERRING?**

A I am referring to the orders approving Stipulation in Docket Nos. 950379-EI (Order No. PSC-96-0670-S-EI, issued May 20, 1996) and 960409-EI (Order No. PSC-96-1300-S-EI, issued October 24, 1996).

Q **PLEASE SUMMARIZE YOUR RECOMMENDATION.**

A It is inappropriate to impute an interest expense to the deferred revenues in determining TECo's earned return on common equity for regulatory surveillance reporting purposes. Deferred revenues are, by definition, revenues in excess of TECo's cost of service. TECo has no entitlement to these excess revenues, and the only reason that TECo is being permitted to retain these revenues is to provide rate stability. This was the bargain that the Stipulating Parties entered into in the 1995-1996 Stipulation Agreements. In effect, the deferred revenues represent customer advances against future increases in TECo's cost of service. These advances, thus, represent a source of "cost-free" capital that TECo can use for its own internal purposes. To impute interest on the deferred revenues, as TECo proposes, would have the perverse effect of forcing customers to pay TECo for the interest on <u>their</u> money that TECo is holding. Just as TECo is allowed to accrue interest on under-collections of fuel and purchased power costs, so too are the customers entitled to be compensated for their time value of money. This can only occur if the deferred revenues are included as cost-free capital in determining TECo's regulatory return on common equity.

<u>Interest Imputation On Deferred Revenues</u>

Q MS. BACON ARGUES THAT ASSIGNING AN INTEREST RATE TO THE DEFERRED REVENUES IS CONSISTENT WITH FINANCIAL AND REGULATORY THEORY. DO YOU AGREE?

A No. Deferred revenues are monies that TECo has already collected from its customers in excess of TECo's actual cost of providing service. Ordinarily, a utility that is earning in excess of its actual cost of service would be required to either reduce rates or refund the overcharges to its customers. However, the Stipulating Parties agreed to let TECo retain some of the excess revenues so that they can be used to offset projected increases in TECo's cost of service. Consequently, the deferred revenues may be appropriately characterized as a "prepayment" by customers to offset future increases in TECo's cost of service.

Consistent with financial and regulatory theory, any time that a customer is required to prepay an expense, those prepayments are treated as "cost-free capital" in determining that utility's revenue requirement.

Q DO YOU HAVE ANY EXAMPLES OF CIRCUMSTANCES WHERE CUSTOMERS HAVE PROVIDED COST-FREE CAPITAL TO THE UTILITY?

A Yes. A close analogy is the treatment of accumulated deferred income tax expense (ADFIT). As the Commission is well aware, rates are set based on the assumption that the utility depreciates its plant on a straight-line basis in determining the amount of income tax expense for ratemaking purposes. The reality is that the utility is allowed to accelerate depreciation for tax reporting purposes. The effect of accelerated depreciation is to defer the actual payment of taxes associated with a particular asset until later in the life of that asset. By setting rates using straight-line depreciation, the calculated income tax expense is higher than the amount of income taxes actually paid in the early years of the life of an asset. Thus, customers are, in effect, prepaying the income tax expense associated with the asset.

Traditional regulatory practice recognizes these prepayments, such as ADFIT, as a source of cost-free capital supplied by customers. This cost-free capital is either treated as a deduction from rate base or, in the case of this Commission, zero cost capital in determining a utility's cost of providing service. Just as deferred taxes are used to pay future tax obligations, the deferred revenues can be used to offset or pay for future rate increases.

Q IS THE ANALOGY CHANGED BY THE FACT THAT TECO IS REQUIRED BY STIPULATION TO ACCRUE INTEREST ON THE DEFERRED REVENUES?

A No. First, it should be noted that the deferred revenues are monies that belong to TECo's customers. The Stipulating Parties agreed to allow TECo to hold these revenues to provide rate stability over a period when TECo's cost of service was changing. In other words, TECo is holding these funds for the customers' benefit, much like a banker holds funds provided by its depositors. In return, the depositors are entitled to receive interest on their deposits. They are not, however, required to pay for the interest earned on their deposits.

Under TECo's proposed regulatory treatment, although the customers would receive interest on the deferred revenues, the interest expense would increase the Company's cost of service. This, in turn, would accelerate the amortization of the deferred revenues and reduce the potential for future rate refunds. In effect, the customers receiving interest on the deferred revenues would then be paying more for their service than if interest had not been included as an expense. This scheme would be like robbing Peter to pay Paul except that, in this instance, Peter and Paul are the same.

Q **DOES TECO ACTUALLY INCUR ADDITIONAL FINANCING COSTS AS A RESULT OF THE OBLIGATION TO ACCUMULATE INTEREST ON THE DEFERRED REVENUES?**

A It is unlikely that TECo would have to obtain additional financing to cover its obligation to pay interest on the deferred revenues. Based on its earnings reports for the years 1996 and 1997, TECo has internally generated over 100% of its construction requirements. Thus, TECo has more than adequate cash flows to cover the interest obligation on the deferred revenues. Contrary to Ms. Bacon's assertion on Page 8 of her testimony, there can be no disallowance of an expense that never existed in the first place.

Q **COULD THE SAME ARGUMENT BE MADE TO ASSERT THAT CUSTOMER DEPOSITS REPRESENT COST-FREE CAPITAL?**

A No. First, customer deposits are a normal cost of doing business, whereas collecting revenues in excess of a utility's actual cost of providing service is not. Second, electric utilities are mandated by rule to pay a minimum interest on customer deposits of 6% per annum [Rule 25-6.097(4)]. This cost is properly included in the capital structure for regulatory monitoring purposes.

Q **MS. BACON ASSERTS THAT THE STIPULATION WAS SILENT ON THE PROPER TREATMENT OF DEFERRED REVENUES. DOES THIS SUPPORT TECO'S POSITION THAT INTEREST SHOULD BE IMPUTED?**

A No. The Stipulation clearly contemplated a refund. Logic and common sense suggests that at least two of the three Stipulating Parties — OPC and FIPUG — would not have agreed to any provision that would cause the customers to receive less than a full refund of excess revenues, including compensation for the time value of money.

As I previously stated, imputing a cost of short-term debt to the deferred revenues artificially inflates TECo's cost of service, which will ultimately reduce the earned return on common equity and the potential for future deferred revenues and/or refunds under the Stipulations. In effect, the customers are paying TECo for the interest on <u>their</u> money that TECo is holding. The customers would never have acquiesced to an accounting treatment that would have reduced the benefits that they bargained for under the Stipulations. Using the banking analogy, this would be tantamount to the banker paying a 6% interest on deposits in calendar year 1997 but reducing the interest rate on the very same deposits in 1998, in order to compensate for the interest paid on the 1997 deposits. It is difficult to imagine that anyone would consider such a result to be fair to the depositor. For the same reasons, imputing interest on deferred revenues would not be fair to TECo's customers, who are entitled to receive all of the benefits they bargained for under the terms of the Stipulations.

Q HASN'T THE COMMISSION ALREADY RULED THAT INTEREST SHOULD BE IMPUTED ON DEFERRED REVENUES FOR TECO?

A Ms. Bacon refers to the Order dealing with TECo's 1995 earnings (Order No. PSC-97-0436-FOF-EI issued April 17, 1997) as establishing a precedent for TECo. However, the interest imputation issue was never raised or contested by any of the active parties in the case. Further, neither OPC nor FIPUG were permitted to participate in the 1995 proceeding that led to the previously referenced order (Docket No. 960409-EI, Stipulation, Page 9, Paragraph 10). Since none of the parties were allowed to contest the issue, the outcome cannot legitimately be considered precedent-setting in this matter.

Q MS. BACON ALSO CITES VARIOUS COMMISSION PRECEDENTS AS SUPPORTING THE IMPUTATION OF INTEREST ON THE DEFERRED REVENUES. DO THESE ORDERS SUPPORT TECO'S POSITION?

A No. Most of the cases cited by Ms. Bacon either are not the result of comprehensive settlements among the Stipulating Parties or are not on point. For example, the referenced Quincy Telephone (Order No. 22367) and FPUC-Fernandina (Order No. PSC-97-0135-FOF-EI) dockets were not settlements. To the best of my knowledge, the issue of interest imputation was never raised by any of the parties as a contested issue. The Southern Bell case referred to my Ms. Bacon (Order No. PSC-94-0172-FOF-TL) is also not on point. I am advised by counsel that Southern Bell agreed to reduce rates rather than defer revenues to offset future increases in cost of service.

Q **CAN YOU CITE ANY INSTANCES WHERE IMPUTING INTEREST ON DEFERRED REVENUES WOULD BE CONTRARY TO CURRENT COMMISSION PRACTICE?**

A Yes. Commission practice allows electric utilities to accrue interest on under- and over-collections of fuel and purchased power costs. Despite the fact that the utility is obligated to pay interest on over-collections or receive interest payments on under-collections, I am not aware of any instance where the Commission has permitted the utility to include this interest expense (or revenue) in the capital structure in determining the return on equity.

Thus, the fact that TECo is obligated under the Stipulations to pay interest on the deferred revenues does not create an entitlement to recover additional interest expense under this Commission's current practices.

Separation of the Lakeland and FMPA Sales in 1996

Q **WHAT IS FIPUG'S POSITION ON THE SEPARATION OF COSTS ASSOCIATED WITH THE FMPA/LAKELAND SALES DURING 1996?**

A In its testimony, TECo has conceded that the cost separation for 1996 should have included the entire month of December 1996, rather than only a partial month. The Company has agreed to make an adjustment to recognize this change in 1998, which should increase the deferred revenue balance. This resolves FIPUG's concern for 1996.

Q **SHOULD THE COMMISSION CONTINUE TO SCRUTINIZE THE SEPARATION OF THE FMPA AND LAKELAND CONTRACTS IN SUBSEQUENT REVIEWS?**

A Yes. It is vital that the customers be held harmless from TECo's decision to enter into below-cost contracts with wholesale customers. Therefore, the terms of the Commission's Order in Docket No. 970171-U-EI should be vigorously enforced to ensure that TECo's retail return on common equity is being calculated in the appropriate manner.

Q **DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

A Yes.

Appendix A

Qualifications of Jeffry Pollock

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A Jeffry Pollock. My business mailing address is P. O. Box 412000, St. Louis, Missouri 63141-2000.

Q **WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

A I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q **PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A I am a graduate of Washington University. I hold the degrees of Bachelor of Science in Electrical Engineering and Master of Business Administration. At various times prior to graduation, I worked for the McDonnell Douglas Corporation in the Corporate Planning Department; Sachs Electric Company; and L. K. Comstock & Company. While at McDonnell Douglas, I analyzed the direct operating cost of commercial aircraft.

Upon graduation, in June, 1975, I joined the firm of Drazen-Brubaker & Associates, Inc. Drazen Brubaker & Associates, Inc. (DBA) was incorporated in 1972 assuming the utility rate and economic consulting activities of Drazen Associates, Inc., active since 1937. Brubaker & Associates, Inc. (BAI) was formed in April, 1995. In the last five years, BAI and its predecessor firm has participated in more than 700 regulatory proceeding in forty states and Canada.

During my tenure at both DBA and BAI, I have prepared numerous financial and economic studies of investor-owned, cooperative and municipal utilities, including revenue requirements, cost of service studies, rate design, site evaluations and service contracts. Recent engagements have included advising clients on electric restructuring issues, developing responses to utility requests for proposals (RFPs), and managing RFPs for clients. I am also responsible for developing and presenting seminars on electricity issues.

I have worked on various projects in over twenty states and in two Canadian provinces, and have testified before the regulatory commissions of Alabama, Arizona, Colorado, Delaware, Florida, Georgia, Illinois, Iowa, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, Virginia and Washington. I have also appeared before the City of Austin Electric Utility Commission, the Board of Public Utilities of Kansas City, Kansas, the Bonneville Power Administration, Travis County (Texas) District Court, and the U.S. Federal District Court.

BAI provides consulting services in the economic, technical, accounting, and financial aspects of public utility rates and in the acquisition of utility and energy services through RFPs and negotiations, in both regulated and unregulated markets. Our clients include large industrial and institutional customers, some utilities and, on occasion, state regulatory agencies. We also prepare special studies and reports, forecasts, surveys and siting studies, and present seminars on utility-related issues.

In general, we are engaged in energy and regulatory consulting, economic analysis and contract negotiation.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing **Direct Testimony of Jeffry Pollock on Behalf of the Florida Industrial Power Users Group** has been furnished by hand delivery (*) or U.S. mail this **12th** day of **October, 1998**, to the following:

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