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March 27, 2001

Hon. Leon Jacobs, Chairman
Florida Public Service Commission
2400 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

In Re Docket 000824-EI,
Notice of intent to seek rate reduction

Dear Mr. Jacobs;

On July 7 last year the FPSC opened a docket to study the financial impact of the merger between Florida Power Corporation (FPC) and the North Carolina utility holding company, which now controls FPC. Press reports suggest that the merger of the two utilities will save up to \$180 million a year. Most of the savings come from a reduction in FPC's work force and operating expenses. There was some thought at the time that these savings would be shared with Florida's electric consumers, as has been done in other states. FPC seemed to be in favor of a reduction in base rates last July before the merger closed and even the early part of this year after the closing.

As time passed things changed. Jim McGee, FPC's attorney, reported to your Commission on March 1, of this year that informal discussions have been going on with Staff and interested parties regarding FPC's earnings. Your staff with knowledge of the discussion has withheld making recommendations to you. The docket was originally set for Commission action in November 2000. That deadline was postponed until March 13th 2001 and now as a result of Mr. McGee's letter the action date has been postponed until July 16th of this year, but that may be too late to help FPC's customers.

A major intervening factor has interrupted the negotiations. The Governor's 2020 Energy Commission filed its report on January 31st. The 2020 Commission performed admirably in the time frame allotted, but it didn't have the staff, appropriation or information to enable it to fully understand the facts that are available to the FPSC.

The 2020 report contains one potentially beneficial aspect for consumers. It favors removing a government protection investor owned utilities now enjoy by eliminating one of the barriers that keeps merchant plants out of the state. To obtain utility support the

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2020 Commission offered a payment of tribute from consumers to the state's entrenched power companies. Only the utilities and to a lesser degree your agency know the monetary value of this tribute, but it is apparent that the power monopoly is now supporting the proposal. Most of the consuming public doesn't know the consequences. Under the proposal utilities can remove their power plants from regulatory control, they are in the process of removing their transmission system from state regulation, FPC's operating expenses paid to affiliated companies will be removed to federal rather than state supervision and finally base rates will be frozen for three years. As you know the utilities have about 100 lobbyists in Tallahassee to help the proposal become law. In spite of comments to the contrary it is possible that the whole package could become law this year without a fair understanding of its import.

If the report becomes law, FPC will not have to share its merger savings with consumers. FPC has not invited the organization I represent to any discussion on rate reduction since January 11th of this year. I believe there is no intention to go forward until the legislative session ends. If this is the case and rates are frozen at their current levels it will be very unfortunate for consumers. You can't fault FPC for trying to maximize profits, but on behalf of consumers I must strongly object and request the Commission to open FPC's financial records so that legislators and other interested parties will have a fair understanding of the bargain that has been struck at consumer's expense. FPC is only one of the utilities that will benefit, but its circumstances are typical of the others.

We would have filed an official complaint seeking to reduce FPC's excess earnings before now, but we can't until July 1, 2001 under an agreement signed in June 1997. In that settlement FPC agreed to refund some FPSC approved fuel charges and to forbear from charging customers other costs relating to its 1997 nuclear plant outage in return for a promise from the Public Counsel and other parties to neither seek nor support a base rate reduction for four years. In the last three years FPC's base revenues have exceeded its target return on equity by over \$140 million. Each year the excess earnings have grown. The 2020 proposed legislation involuntarily extends the current rate freeze from four to seven years even though the excess earnings will continue to grow. The FPSC is not restricted by the agreement. In each of the last three years we had hoped that the FPSC would move to reduce base rates rather than allowing FPC to keep the money and rapidly write down the book value of its regulatory assets. We stood by in silence in compliance with our 1997 agreement. As you and the other Commissioners know, the rapid depreciation program makes earnings appear to be in line with the approved return when they are not.

Although we are restricted against seeking rate relief until July 1 of this year, I am not restricted against pointing out the circumstances as they appear in public records. Here are the circumstances as my industrial clients see them. Much of the basic information is secret until the Commission requires public disclosure, so my comments need to be weighed in the light of the secret information, which you may have, but the public does not. It may be that this information will be valuable to legislators considering

the 2020 report as it is translated into bill form. It may be your Commission will consider electing to exercise your authority under the provisions of §366.076 *Florida Statutes* in the next few weeks should it appear that 2020 enabling legislation is moving forward.

1. FPC's *after tax* return on equity was set at a maximum of 13% on October 10, 1992. The before tax return would be 21%. For the year ending December 2000, that return is reported to be about 15% (24% before income tax). Ironically the holding company structure allows the holding company to keep the money while avoiding much of the hidden income taxes included in base rates and customer's electric bills. If the FPSC selected for FPC the return FP&L accepted in 1999, it would reduce FPC's equity return 400 basis points and result in a base revenue and income tax reduction to FPC of approximately \$122 million. The cost of capital is less today than it was in 1999 when FP&L agreed with the Office of Public Counsel and others to reduce base rates.
2. If merger savings are not yet included in the December 2000 FPC surveillance report there is an additional \$120 to \$180 million to be shared. FPC's stockholders received their share of the merger benefits last November when Carolina Power & Light paid \$5.3 Billion for their stock.
3. If FPC spins off its transmission and generating assets the rate base will be reduced by more than two thirds justifying a corresponding base rate reduction before considering a proper return or the sharing of merger savings.

I believe a conservative estimate of FPC's current excess earnings before the spin off of generating and transmission assets is somewhere in the range of \$200 million a year. One year has already passed while discussions went nowhere.

What would a \$200 million base rate reduction mean to customers? Using FPC's 1999 annual report statistical data for residential consumption rather than the convenient but fictional proxy used in reports to the FPSC and the press the average residential consumer would receive a \$66.93 annual reduction in rates plus a reduction of \$ 11 in local taxes and fees that is added to this amount on the residential consumers' electric bills, but not shown on the "residential bill comparison" attached to FPC's fuel cost filings. The impact on the typical single family house as opposed to "average residential customer" is about twice as much. The impact on small business and industrial customers' bills will be far greater because they use more electricity and most of these customers pay sales tax on their bill in addition to the local taxes mentioned above.

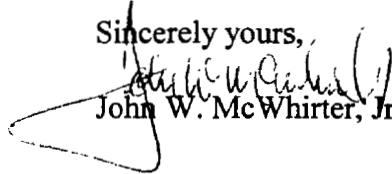
A base rate reduction, should FPC wish to voluntarily go forward with it, would ameliorate somewhat the dramatic increase in fuel and capacity charges all customers suffered in January. Earlier this month the FPSC agreed with FPC and voted to increase the fuel cost portion of customer's bills again in April of this year even though FPC's forecasted fuel costs didn't meet the criteria established by the FPSC for midcourse

correction. So base rate relief, the portion of the bill where profits are excessive, makes a lot of sense.

I understand the 2020 Commission would not oppose a proper base rate adjustment before the freeze. The consumer's interest would certainly be served by such an adjustment to avoid locking in windfall profits while guaranteed cost recovery clauses soar.

You are hereby officially notified that the Florida Industrial Power Users Group (FIPUG), will petition for a rate reduction as soon as contractual fetters are removed on July 1, 2001 unless we are foreclosed from doing so by law or action is taken before that date by your Commission or FPC to protect consumers. If the Commission enters a proposed agency action reducing the return on equity under the provisions of 366.076 *Florida Statutes* before July 1, you will not be restricted to the 13% return on equity implied in Mr. McGee's March 1, 2001 letter should you order an interim base rate reduction when the case is filed.

Sincerely yours,



John W. McWhirter, Jr.

Cc. Parties of record

Hon. Jeb Bush
Hon. Walter Revell
Hon. Walter G. Campbell
Hon. Jeff Miller
William Talbot, Exec Dir. FPSC