# BEFORE THE

# FLORIDA PUBLIC SERVICE COMMISSION

# DOCKET NO. 080317-EI

IN RE: TAMPA ELECTRIC COMPANY'S
PETITION FOR AN INCREASE IN BASE RATES
AND MISCELLANEOUS SERVICE CHARGES

TECO.
TAMPA ELECTRIC

## REBUTTAL TESTIMONY

## OF

## JEFFREY S. CHONISTER

TECO

TAMPA ELECTRIC

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080317-EI

IN RE: TAMPA ELECTRIC COMPANY'S

PETITION FOR AN INCREASE IN BASE RATES

AND MISCELLANEOUS SERVICE CHARGES

REBUTTAL TESTIMONY

OF

JEFFREY S. CHRONISTER

## TABLE OF CONTENTS

## REBUTTAL TESTIMONY

## OF

## JEFFREY S. CHRONISTER

BEFORE THE PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

JEFFREY S. CHRONISTER

**Q.** Please state your name, business address, occupation and employer.

**A.** My name is Jeffrey S. Chronister. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company ("Tampa Electric" or "company") as Assistant Controller.

**Q.** Are you the same Jeffrey S. Chronister who filed direct testimony in this proceeding?

**A.** Yes, I am.

**Q.** What is the purpose of your rebuttal testimony?

**A.** The purpose of my rebuttal testimony is to address serious errors and improper conclusions reached in the prepared direct testimonies of Messrs. Hugh Larkin and Helmuth Schultz, testifying on behalf of the Office of Public Counsel ("OPC"), Mr. Jeffry Pollock, testifying on behalf of the Florida Industrial Power Users Group, Mr. Stephen Stewart, testifying on behalf of AARP, and Mr. Kevin O'Donnell, testifying on behalf of the Florida Retail Federation.

**Q.** Please summarize the key concerns and disagreements you have regarding the substance of the testimonies of Messrs. Larkin, Schultz, Pollock, Stewart and O'Donnell.

**A.** My key concerns and disagreements relate to the following rate base, operating expenses and other topics:

- Annualization of Combustion Turbines and Rail Facilities
- Plant In Service Projections
- Customer Information System Upgrades
- Plant Held for Future Use
- Construction Work in Progress
- Working Capital Adjustments
- Storm Damage Accrual
- Bad Debt Expense
- Dredging Expense
- Payroll and Incentive Compensation
- Directors and Officers' Liability Insurance Expense
- Rate Case Expense

- Office Supplies and Expense
- Fuel Under-recovery
- Transmission Base Rate Adjustment

**ANNUALIZATION OF COMBUSTION TURBINES AND RAIL FACILITIES**

**Q.** Mr. Larkin argues that the company's requested annualization of the five combustion turbines ("CTs") and Big Bend Station rail facilities that will be placed in service in 2009 is a violation of the basic ratemaking principle of matching costs with benefits and that "the cost of the new plant would be put in rates without accounting for the new customer growth that would otherwise support those costs." Do you agree with his arguments?

**A.** No. The company's proposed annualization adjustments are proper and should be accepted by the Commission. Tampa Electric's proposal does not violate the matching principle and the new plant is not being put in rates without accounting for new customer growth. As Tampa Electric witness Mark Hornick describes in his rebuttal testimony, the five CTs and the rail facilities are being placed in service to address issues other than customer growth and increased sales. The five CTs are primarily needed to ensure the reliability of the system, not to increase the sales of electricity. These peaking units will serve the demand of customers at peak periods of time. The energy sales revenue from these machines will be relatively small and has been included in the test year projections for energy revenue. The CTs are also being installed for improved reliability since some of the CTs will be engineered to provide black start and quick start capability.

The Big Bend Station rail facilities are needed to cost effectively and reliably transport solid fuel by rail as described in Tampa Electric witness Joann Wehle's rebuttal testimony. The reduction in fuel costs would have very little, if any, impact on the sales of energy. The facilities are not being constructed to enhance electric sales; they are being constructed to help ensure the lowest delivered cost for coal and petroleum coke. Such benefits will be reflected through the fuel and purchased power adjustment clause.

**Q.** Mr. Larkin claims there are cost savings associated with the CTs that are not reflected in the annualization of the units. Is this correct?

**A.** No. As Mr. Hornick describes in his rebuttal testimony, the benefits he referred to in his direct testimony come to customers by way of fuel savings, which are not the subject of this proceeding. These savings are made possible by enabling the company to more efficiently operate its overall generating system by keeping large units running. There are no O&M savings to capture in 2009 projections as Mr. Larkin suggests.

**Q.** Is it possible to precisely match significant revenue producing plant in service with corresponding revenues as suggested by Mr. Larkin?

**A.** No. Mr. Larkin's approach ignores the "lumpiness" of making large electric utility investments. There can never be an exact match between new investment and corresponding revenues.

**Q.** Mr. Larkin states, "The end result in setting rates should be an appropriate matching of the period used for forecasting generally coinciding with the period in which rates would become effective, there would be a matching of investment and operating revenues and expenses." Do you agree with his statement?

**A.** Yes I do. Tampa Electric annualized the CTs and rail facility for this exact reason. These substantial investments are known and measurable. Failure to recognize these investments in their entirety by prorating them over the forecasted test year would result in a mismatch on a go-forward basis and would deprive the company of an opportunity to earn a fair rate of return on property that will be used and useful during the period when the proposed rates will be in effect. All of the benefits of these investments, including enhanced reliability and decreased fuel costs, will likewise be available to customers during the period proposed rates will be in effect. The company's recommended adjustments to annualize the five CTs and rail facility appropriately account for the investment in rate base.

**Q.** Has the Commission previously approved the annualization of assets being placed in service during a projected test year?

**A.** Yes. In Docket Nos. 830470-EI and 910890-EI, the Commission accepted adjustments Progress Energy (formerly Florida Power Corporation) made to its projected test years to annualize the impacts of new units being placed into service. Also, in the most recent base rate proceeding for Florida Public Utilities Company in Docket

No. 070300-EI, the Commission determined that it was appropriate to include the full 13-month average amount of a new asset and associated accumulated depreciation and depreciation expense in the test year for ratemaking purposes because it was representative of the future. Similarly, it is appropriate to annualize the CTs and rail facility in 2009.

**PLANT IN SERVICE PROJECTIONS**

**Q.** Is Mr. Larkin's proposal to reduce Plant In Service for the projected test year 2009 by $53,958,000 justified?

**A.** No. Mr. Larkin bases his proposal on an analysis that is simplistic, flawed, and unsubstantiated. Mr. Larkin first incorrectly assumes that differences between projected and actual plant in service balances for the months January through September of 2008 are relevant to the projected test year. He states, "The 13-month average for plant in service balance for the test year ended December 31, 2009, starts out with the same balance for December resulting from the projections for the prior year ended December 31, 2008. Any inaccuracies in 2008 are carried forward into the 2009 test year because the December 31, 2008, balance becomes the first month in the 13-month future test year average, and the same projection methodology is used." Simply stating his assumption does not prove it.

In fact, Mr. Larkin's own exhibit does not support his statement. In Exhibit No.___HL-1, Schedule B-3, page 1 of 1, line 9, the September 2008 projected Plant In Service of $5,472,308,000 is only $625,000 higher than the actual Plant In Service of $5,471,683,000 on September 30, 2008, a difference of only one one-hundredth of one percent. Even if his assumption is correct, which the company disputes, Mr. Larkin's own exhibit shows that an adjustment for a carry forward to 2009 would produce a reduction of only $625,000, not $53,958,000. In any event, no adjustment is warranted. The company's 2009 projected Plant In Service is appropriate.

**Q.** Are there other flaws in Mr. Larkin's methodology?

**A.** Yes. His methodology has a basic flaw in that he incorrectly assumes that variances from budget in a particular prior month or year automatically carry forward to all future periods. Many capital projects catch up from delays and some projects can ultimately cost more than projected. It is incorrect to assume that temporary variances are permanent differences or are indicative of the future. The 2009 projections are appropriate and Mr. Larkin presents no factual evidence that Tampa Electric's projected capital expenditures will not be incurred as projected.

Another major flaw in Mr. Larkin's proposal is his simplistic comparison of differences between projected and actual Total System Plant In Service. His proposal ignores that a part of the Total System Plant In Service is adjusted out of jurisdictional rate base for Plant In Service that has a return provided for through the Environmental Cost Recovery Clause ("ECRC") and the Conservation Cost Recovery Clause. This analysis should only be performed using jurisdictional balances that are recovered through base rates.

For example, the company had an ECRC project, the Big Bend Unit 3 selective catalytic reduction equipment installation, expected to go in service in May 2008 for $76,780,773. This ECRC project actually went in service in July 2008 for $78,635,423. The ECRC timing variance has a significantly large impact for the May and June balance differential amounts but not to the test year rate base used to calculate base rates.

Mr. Larkin's calculation for the percentage difference over actual on Exhibit HL-1, Schedule B-3 is incorrect. He inappropriately calculates the difference amount divided by the actual balance. The appropriate calculation should be the difference amount divided by the projected balance. After comparing the two versions of the calculation, Mr. Larkin's adjustment is overstated.

If Mr. Larkin's approach is used, which the company disputes, the ECRC asset removal alone applied to his methodology results in actual balances and revised calculations that are $16 million lower, not the $54 million proposed by Mr. Larkin.

**Q.** Is Mr. Larkin's proposal to reduce the accumulated reserve and depreciation expense for the projected test year 2009 by $8.5 million justified?

**A.** No. Mr. Larkin should not have performed this calculation modeled after the proposed Plant In Service balance adjustment and this calculation contains the same errors as described above with respect to ECRC removal and difference percentages. His proposed changes to Plant In Service balances multiplied by the 3.5 percent composite rate of depreciation yields the effective accumulated reserve and depreciation expense adjustments. Based on the corrections to his proposed Plant In Service adjustment discussed above, this adjustment should be ($35,671,000) x 3.5% = ($1,248,485) in depreciation expense reductions and a corresponding accumulated reserve offset in the amount of $1,248,485. However, as with his adjustment to Plant In Service, this "fall out" adjustment is completely inappropriate and depends on his inappropriate adjustment to Plant in Service discussed above. Moreover, if any adjustment were made using Mr. Larkin's faulty logic, it would be inaccurately calculated.

**CUSTOMER INFORMATION SYSTEM UPGRADES**

**Q.** Do your agree with Mr. Larkin's assertion that the Customer Information System ("CIS") upgrade includes costs that would be incurred in the normal course of business in any year base rates or fuel rate changes are made and does not justify a separate adjustment?

**A.** No. The CIS modifications are necessary to reflect proposed changes in the company's base rate filing. Many of the customer rate schedules will be designed differently as a result of this proceeding and the CIS and its sub-systems must be programmed in advance to ensure accurate billings upon Commission approval of the company's proposed rate design in April 2009. The modifications include, but are not limited to: inverted energy rates for residential customers, demand rate changes, new service charges, new lighting schedules, and changes to interruptible customer rate schedules. These rate design changes are substantial.

The company began making the modifications to CIS in the second quarter of 2008 and expects to complete the modifications in early 2009. To make these changes, the project needed to be properly scoped, resources secured, requirements identified and outlined, changes programmed and tested, and Customer Service Professionals and other company team members trained. The changes are extensive and the company has estimated it will require about 40,000 hours of resources. Because the modifications are dependent on Commission approval in April 2009, the company could not have completed the changes prior to the projected test year.

The CIS modifications are not the types of changes that are typically made in the normal course of business as Mr. Larkin implies. The cost has not been included in base projections and normal budgets of the past.

**Q.** Do you agree with Mr. Larkin's proposal to disallow $2,445,000 of rate base and reduce amortization expense $558,000?

**A.** No. The cost of this very significant modification to CIS functionality is solely due to changes proposed in this proceeding and is appropriately recovered as a cost of service. Alternatively, if this cost was not considered as a rate base adjustment, Plant In Service should be increased by $2,445,000 and depreciation expense should be increased by $558,000 since these modifications are properly charged as a capital project. Either approach has the same end result for revenue requirements.

**PLANT HELD FOR FUTURE USE**

**Q.** Do you agree with Mr. Larkin's assertion that "it is obvious that the Company did not project monthly additions and uses during either the projected prior year ending December 31, 2008 or the projected test year ended December 31, 2009" and that if the company "had projected monthly, the PHFU balance would not have remained the same for each month except for December of each of the years."?

**A.** No. The company did project the monthly expenditures for land acquisition requirements - in Account 107, Construction Work In Progress. The annual budgeted expenditures are forecasted to close from Account 107 to Account 105, Property Held for Future Use, in December for 2008 and 2009. Land acquisitions, like construction, take a period of time as work in progress until the purchase is finalized at closing. The balances noted by Mr. Larkin are simply the result of reflecting a normal Account 107 to Account 105 transfer process.

**Q.** Is Mr. Larkin's proposal to decrease the investment in Plant Held for Future Use by $2,328,354 justified?

**A.** No. The adjustments related to Plant Held for Future Use would be offset by a corresponding increase in Electric Plant In Service resulting in no change to total system rate base since both Property Held for Future Use and Electric Plant In Service are components of rate base. The transfer of costs from Property Held for Future Use to Electric Plant In Service is simply a balance sheet transfer or reclassification with no impact to total system rate base. Mr. Larkin's proposal to reduce

Property Held for Future Use incorrectly reflects only the credit side of the two-sided journal entry.

**CONSTRUCTION WORK IN PROGRESS**

**Q.** Do you agree with Mr. Larkin's proposed increase in jurisdictional Construction Work In Progress of $2,608,000?

**A.** No. Despite this proposal being an increase to jurisdiction rate base, I would echo the same objections discussed related to Plant In Service. Mr. Larkin repeats his errors related to variance extrapolation, lack of ECRC removal and incorrect calculations.

**WORKING CAPITAL ADJUSTMENTS**

**Q.** Mr. Larkin proposes a working capital jurisdictional adjustment of $10,959,000 for Account 143 - Other Accounts Receivable because he alleges the company has not shown that these accounts are related to utility service. Is this an appropriate adjustment?

**A.** No. All of the balances contained in Account 143, except for the previously identified Commission adjustment for job orders, reflect activities related to utility service for jurisdictional customers. They include receivables for off-system sales, pole attachment revenue, rent revenue from fiber optic, by-product sales, and residual revenues. All revenues for these balances are properly reflected in net operating income.

**Q.** Mr. Larkin is proposing a working capital jurisdictional adjustment of $6,309,000 for Account 146 - Accounts Receivable from Associated Companies contending that the utility should be required to show that the entire balance is a necessary working capital requirement for ratepayers to bear and is directly related to provisions of utility services. Is this an appropriate adjustment?

**A.** No it is not. The balance includes $5,919,000 for services Tampa Electric provides to its utility affiliate, Peoples Gas System ("Peoples Gas") and is directly related to the provision of utility services. The company provides information technology support, facility management services, and payroll and accounts payable services. The associated revenues and expenses are appropriately included in test year projections. Therefore, it is appropriate for these transactions to remain in working capital. Correspondingly, Peoples Gas' balance for intercompany payables is appropriately included in working capital as well. The remaining jurisdictional balance of $390,000 is for non-utility intercompany receivables

**Q.** Is Mr. Larkin's proposed working capital adjustment to reduce fuel stock appropriate?

**A.** No. Mr. Larkin makes an arbitrary 10 percent reduction to fuel inventory citing recent market price changes. In her rebuttal testimony, Tampa Electric witness Joann Wehle demonstrates that market price changes have not affected fuel inventory amounts largely because much of the fuel inventory is coal, the prices for which have remained relatively stable. Consequently, such an adjustment is not warranted.

**Q.** Are Mr. Larkin's proposed working capital adjustments associated with other parts of his testimony appropriate?

**A.** No. Mr. Larkin has proposed inappropriate working capital adjustments associated with storm damage accrual, dredging amortization, and rate case expense. I will discuss these adjustments in the operating expense section of my rebuttal testimony.

**STORM DAMAGE ACCRUAL**

**Q.** Do you agree with Mr. Larkin's statement "that the current level of $4 million of storm damage accrual is adequate given the Company's past history and the current guarantee by the Commission that costs incurred over the storm damage accrual would be reimbursed to the Company through future surcharges on ratepayers"?

**A.** No. The company's past history does not support his claim of adequacy. The storm damage reserve balance in 2004 was more than the charges ultimately posted against it only as the result of a stipulation with OPC and other interested parties. If the current Commission rule had been applied to the 2004 storm costs incurred by Tampa Electric, the reserve would have been millions of dollars below the costs properly chargeable to it. Also, there is no surcharge "guarantee" provided by the Commission as suggested by Mr. Larkin.

**Q.** Please describe the impact of the 2004 storm costs on the company's storm damage reserve.

**A.** As indicated in Order No. PSC-05-0675-PAA-EI issued June 20, 2005, Tampa Electric had accumulated $42.3 million in its property damage reserve prior to the 2004 storms. Initially, total storm damage costs of $74.6 million were charged to the reserve. To avoid a surcharge to account for costs and to restore the storm reserve balance, the company negotiated a creative settlement with OPC and other interested parties. By proposing to remove $38.9 million from the storm reserve and capitalize asset additions and removal costs, the storm reserve was restored with a positive balance. If the company had followed the accounting subsequently prescribed by Commission Rule 25-6.0143 after the settlement was approved, then only the normal capital costs of $14.1 million would have been capitalized; the storm reserve would have been deficient by $18.2 million.

**Q.** But Mr. Larkin states, "While I do agree that the value of the Company's transmission and distribution system has increased since 1994, it is clear that the reserve was adequate in the year 2004 to cover the higher value of assets damaged by the storms which struck in that year." Do you agree?

**A.** No. Again, the reserve was not adequate in 2004. The company avoided a negative reserve balance and a customer surcharge only through a stipulation that allowed costs normally charged to the reserve to be charged to capital. Tampa Electric's request to change the target reserve from $55 million to $120 million is, in fact, partly predicated on the growth in the value of the company's transmission and distribution ("T&D") system. In 1994, the system had a gross investment value of $1.045 billion and a net book value of $730 million; the amounts projected for 2009 are $2.375 billion and $1.488 billion, representing increases of $1.330 billion and $758 million, respectively. The requested accrual increase, as well as the requested target itself, is very reasonable given the increased system value and the projected hurricane cycles identified by Tampa Electric witness Stephen Harris. The good fortune of past storm seasons is not a reasonable basis on which to ignore real probabilities for future storm costs.

**Q.** Do you agree with Mr. Larkin's statement, "The Commission should continue with that [$4 million] level of storm accrual and when, and if, a storm occurs which is in excess of the reserve the Commission should then deal with that through a surcharge on rates."?

**A.** No. Tampa Electric serves an area that is vulnerable to tropical and hurricane force storms. By approving a reserve and annual accrual in 1994, the Commission has recognized the appropriateness of recovering the expected costs of storm damage on a levelized basis similar to paying an insurance premium. That fundamental policy remains as sound today as it was when first adopted by the Commission.

Mr. Larkin's proposed approach is actually contrary to the interests of the customers he is representing, because it substantially increases the likelihood that they will be faced with a storm damage surcharge sometime in the future at a time when the effects of a storm on other parts of their lives may make paying a surcharge undesirable. The Commission and Tampa Electric's longstanding approach has supported the use of a provision for storm damage that levelizes the cost over time and mitigates the need for "one-time" impacts to customers. While surcharges were granted to other utilities after the impacts from the 2004 storm season, the associated proceedings in no way "guaranteed" recovery as Messrs. Larkin and Stewart imply. In fact, OPC and other intervenors vehemently opposed the proposed surcharges and argued that accounting for storm damage expense is a base rate item.

Mr. Larkin's position relies on surcharges as the preferred method to provide cost recovery, apparently based on an unrealistic assumption that they will never be necessary or, if necessary, will be someone else's problem. The recommended reliance on surcharges poses numerous problems for the Commission, its Staff, the company, and, most importantly, customers. The impact of surcharges, on top of the impact of a catastrophic storm, far exceeds the impact of a reasonable allowance in rates.

**Q.** Do you agree with Mr. Stewart's statement that "the Securitization legislation guarantees the recovery of all reasonable and prudent expenses for storm damage."?

**A.** First of all, neither surcharges nor securitization "guarantee" cost recovery. Like with any type of cost recovery, there are differing opinions on the appropriate mechanism for recovery and I would not expect recovery of storm costs to be any different. This is evidenced by the duration of the Commission's hearings and rulemaking workshops associated with 2004 statewide hurricane activity.

While in theory securitization is an option available to utilities and may be an effective recovery mechanism, there are fixed and administrative costs associated with this financing alternative that undermine the cost-effectiveness of securitization for a company the size of Tampa Electric. Tampa Electric witness Gordon Gillette describes this in more detail in his rebuttal testimony.

**Q.** Do you agree with Mr. Stewart's concerns regarding the Commission's ability to review storm damage costs?

**A.** No. Mr. Stewart states, "A large storm damage reserve will allow a utility to charge larger storm-related losses against the reserve without having to prove the expenses were reasonable and prudent." This is inaccurate. In fact, the Commission rule states: "All costs charged to Account 228.1 are subject to review for prudence and reasonableness by the Commission." Thus, Mr. Stewart is incorrect in his position that a lower reserve level increases "the likelihood for closer scrutiny." The Commission maintains the ability to scrutinize any storm charge as it sees fit. This is supported by this statement from the Commission's rule: "The records supporting the entries to this [storm reserve] account shall be so kept that the utility can furnish full information as to each storm event included in this account." The Commission's monitoring capabilities are further enhanced by this statement from the rule: "The utility shall notify the Director of the Commission's Division of Economic Regulation in writing for each incident expected to exceed $10 million." Clearly, the size of each utility's reserve is not relevant to the Commission's ability to examine storm costs charged to it.

**Q.** Do you have other concerns regarding Mr. Stewart's testimony regarding the Commission's ability to review storm charges?

**A.** Yes. Mr. Stewart states, "Forcing a hearing for all but the most minimal storm damage occurrences guarantees a more thorough review and the reduced likelihood that inappropriate expenditures will be charged to the reserve." This is precisely the type of inefficient use of Commission and company resources that the Commission was trying to avoid by establishing the storm cost rule, with thresholds and defined allowable charges that it approved in 2007.

**Q.** Is Mr. Larkin's portrayal of an unfunded storm damage reserve appropriate?

**A.** Not entirely. He states that since Tampa Electric has an unfunded storm reserve this means that the company will not have the funds on hand when needed. He is correct that with an unfunded reserve, the funds are not set aside in a dedicated fund. However, he is not correct in stating that funds will not be available. Tampa Electric's credit lines are more than sufficient to provide immediate access to cash equal to the proposed $120 million reserve. In effect, the cash received from customers over time associated with the storm accrual reduces the amount Tampa Electric would otherwise need to borrow in the normal course of business, and thus frees up credit capacity. It is also important to note that because an unfunded reserve does not result in a rate base increase, it has a lower revenue requirement than a funded reserve.

**Q.** Are Messrs. Larkin and Stewart's positions beneficial to customers?

**A.** No. There are several advantages to customers to have a reasonable storm reserve: costs are spread over a longer period of time, overall costs are lower in the long term, and rate shock is mitigated or avoided when a storm does hit. Tampa Electric's proposed annual accrual and target for storm damage costs are appropriate and no adjustment is warranted.

**BAD DEBT EXPENSE**

**Q.** Do you agree with Mr. Larkin's assertion that for 2008 and 2009, "the company also included as sales subject to bad debt write-off account 447 - Sales for Resale, Account 456 - Unbilled Revenues and Accounts - 407.3 and 407.4 - Deferred Clause Revenues"?

**A.** No, he is incorrect. The revenues used to calculate uncollectible expense did not include Account 447 - Sales for Resale, Account 456 - Unbilled Revenues, and Accounts 407.3 and 407.4 - Deferred Clause Revenues. The company properly used Accounts 440 through 446 - Retail Revenues Billed and Account 451 - Miscellaneous Service to calculate uncollectible expenses.

**Q.** How did Mr. Larkin reach this incorrect conclusion?

**A.** It appears that Mr. Larkin is pointing out a discrepancy that only exists on MFR C-11 and that MFR does not impact the projection of bad debt expense contained in the 2009 test year. The only impact that MFR C-11 has is on the Bad Debt Factor that is used for calculating the ultimate revenue requirement.

**Q.** If the discrepancy on MFR C-11 were corrected, what would be the impact to the company's revenue requirement?

**A.** The correction, which would change the factor by less than one one-hundredth of one percent, would cause the revenue requirement to increase by $7,000. The company is not proposing to make this adjustment due to its lack of materiality.

**Q.** Do you agree with Mr. Larkin's recommendation to decrease uncollectible expenses by $2,409,000?

**A.** No. This is not an appropriate adjustment due to several factors. First, the proposed adjustment ignores reality. The present economic downturn is not a theoretical concept. More customers are, in fact, not paying their bills. As a result, the actual bad debt write-offs are increasing rapidly despite the company's numerous efforts to manage the increase. Second, Mr. Larkin bases his position simply on the observation that the projected 2009 bad debt expense is higher than it has been in previous years. He is correct it is higher than in the past and for good reason.

**Q.** Please elaborate.

**A.** Bad debt expense first peaked in 2007. It peaked again in 2008, and is expected to be at its highest level ever in 2009. However, Mr. Larkin's contention that a peaking expense should be disallowed unilaterally is not appropriate. He ignores a broader view that all expenses are either increasing or decreasing. Blindly cutting an increasing expense in isolation, without considering whether other expenses should be increased if they are well below previous high points, is one-sided and unfair.

**Q.** Do you have examples where the company is recommending a lower expense for 2009 than recent years?

**A.** Yes. In 2001, FAS 112 expense peaked at $8.6 million, but the company is only proposing a 2009 expense of $5.4 million. Although FAS 106 expense peaked in 2003 at $15.1 million, the company is only proposing a 2009 expense of $13.1 million. Finally, although injuries and damages expenses peaked in 2004 at $10.2 million, the company is only proposing 2009 expenses of $7.2 million.

**Q.** How does this relate to Mr. Larkin's bad debt adjustment?

**A.** The ultimate adjustment that Mr. Larkin proposes for bad debt simply causes the 2009 amount to revert back to a number based on historical averages. If 2009 expenses should be adjusted to match historical averages, then, in order to be fair, Mr. Larkin needs to make similar adjustments for expenses like FAS 106 and 112 and injuries and damages expenses. This targeted isolated approach is obviously unfair and imbalanced and should not be the basis for an adjustment to revenue requirements. Bad debt expense, as well as the other expenses I have discussed, should not be adjusted. The expenses in question are based on reasonable and prudent cost projections based on the facts and circumstances that are expected to exist in the 2009 test year.

**DREDGING EXPENSE**

**Q.** Mr. Larkin states that based on the company's past sharing arrangements with other entities for dredging the Big Bend Station channel, "at most only half the requested dredging cost should have been included in the request or $665,000 (jurisdictional expense $1,330,000/2 = $665,000). Additionally, he claims that this amount "should be amortized over five years and only $133,000 included in the test year." Are these calculations accurate?

**A.** No. Mr. Larkin's calculations contain two errors.

First, the 50/50 sharing assumption is not based on fact. Mr. Hornick states in his rebuttal testimony that there are currently two users of the channel and many, but not all, of the costs are expected to be shared. However, only the company's portion of dredging costs is reflected in its 2009 projections. Therefore, dividing the expense in half is not appropriate.

Additionally, the $1,330,000 Mr. Larkin uses to make his adjustment is an amount that is already the result of a five-year amortization. Mr. Larkin erroneously performs a second five-year amortization, thus producing a 25-year amortization. By combining the division and the double amortization, Mr. Larkin's suggested test year amount of $133,000 is 1/50$^{th}$ of the projected dredging cost.

**Q.** Mr. Larkin states, "I have removed from the rate base the Company's deferred dredging cost balance of $2,657,000 (jurisdictional) and I have also removed from operating expenses the remaining amount which the Company did not remove of $1,330,000." Is this appropriate?

**A.** No. Although there is historical variation in the timing and amount for dredging expense, it is certain that dredging must be done and that costs will be incurred in

2009 that should support five years of shipping requirements. As Mr. Hornick describes in his rebuttal testimony, the dredging costs are both prudent and necessary. Accepting Mr. Larkin's recommendation would effectively deny recovery for 100 percent of these costs.

**PAYROLL AND INCENTIVE COMPENSATION**

**Q.** Mr. Schultz expresses concern with the company's requested payroll because "the overtime dollars included in the filing have not been identified or tracked by the company." Is this a valid concern?

**A.** No. Overtime dollars are most certainly tracked by the company in its actual accounting records. Tampa Electric's general ledger, along with its internal control systems, contains time data and payroll transactions with a well-documented audit trail. The same level of detail is not generated for budget purposes because it is not necessary to perform a simulated time entry process. This approach is not the result of an "unsophisticated" budget system as Mr. Schultz suggests, but rather it is the result of a practical and efficient budget process. Overtime is properly estimated and included in projected expense based on the expertise and experience of the departments creating their budgets.

Contrary to Mr. Schultz's assertion, the company can and does "measure performance" by comparing both actual overtime and total payroll to budgeted amounts.

**Q.** Is Mr. Schultz correct that "100% of incentive compensation is expensed" and therefore, a portion of it should be adjusted from revenue requirements?

**A.** No. Incentive compensation is allocated to expense, capital and other activities based on the company's normal labor distribution. It appears that Mr. Schultz failed to consider that total expense reflects transactions posted to all expense accounts. It is true that incentive compensation is initially charged to as an expense but it is then allocated to capital and other accounts based on internal labor charges. Total expense reflects the net expense after allocations. Only about $7 million of the $11.6 million of projected incentive compensation is included in O&M for 2009. Mr. Schultz's recommended disallowance is not appropriate and it is not even calculated correctly.

**Q.** Mr. Pollock recommends 100 percent disallowance of officer and key employee short-term incentive plan expense because "those payments are contingent upon TECO

Energy achieving a specific level of net income." Is he correct and is his recommendation appropriate?

**A.** No. He is not correct and the recommendation is not appropriate. While officers' payout is contingent upon TECO Energy achieving certain financial results, key employee payout is not and the overall focus of all programs remains on Tampa Electric's operational and financial results. Incentive goals for officers, key employees and general employees are focused on performance that benefits Tampa Electric customers.

All incentive compensation is appropriate and, even if a portion were deemed inappropriate, it is not as Mr. Pollock suggests. Twenty percent of Tampa Electric officers' and 15 percent of key employees' short-term incentives are based on TECO Energy financial targets. For total projected incentive compensation, only five percent is attributable to officers' incentive compensation and 20 percent is for key employees with the remaining 75 percent being attributable to general employees' Success Sharing.

**Q.** Based on this, how would Mr. Pollock's disallowance recommendation change?

**A.** First, the amount to be adjusted would be based on total projected compensation of $11.6 million, not the 2007 amount of $12.9 million that Mr. Pollock erroneously uses. Second, only $7 million of the $11.6 million is in 2009 operating expenses as I noted above. Of the $7 million, only a portion is attributable to TECO Energy financial results. Since the payout for officers is contingent upon the parent company's financial results, up to 100 percent could be disallowed according to Mr. Pollock's approach. However, it is not a trigger for a key employee payout and only 15 percent of their incentive compensation is tied to TECO Energy results. Following Mr. Pollock's logic, only five percent (5% x 100% for officers) and three percent (20% x 15% for key employees) of total projected incentive compensation expense, or $560,000, would be subject to disallowance. While no disallowance is appropriate, it is certainly nowhere near the $6.45 million Mr. Pollock recommends.

**Q.** In her rebuttal testimony, Tampa Electric witness Dianne Merrill discusses the Success Sharing program and she notes that the financial goals, which make up 7 of the 12 percent (58 percent of the "at-risk" amount), are "self-funding." What does that mean?

**A.** "Self-funding" means that a payout for achieving financial goals only occurs when net income targets are exceeded, not met, to account for the actual expense associated with achieving the goals. The company does not budget for a potential payout and, accordingly, there is no amount related to Success Sharing financial goals included in its 2009 test year expenses.

**Q.** Does this explain the differences that Mr. Schultz raised that "in each of the years 2004-2007 the incentive payout exceeded the target even though there were goals that were not achieved."?

**A.** Yes, it appears so. In her rebuttal testimony, Ms. Merrill clarifies the actual annual payout percentages compared to potential maximum payout percentages. Mr. Schultz erroneously compares the "target", or budgeted, payout dollars to the actual incentive expenditures without recognizing that the company budgets for potential achievement of operational goals only. In other words, even though Success Sharing currently has a maximum payout potential of 12 percent, only the five percent tied to operational goals is budgeted. Again, the incentive expense included in the test year is reasonable and prudent.

**DIRECTORS AND OFFICERS LIABILITY INSURANCE**

**Q.** Do you agree with Mr. Schultz's assertion that the cost of directors and officers liability insurance ("D&O insurance") is inappropriate because the 2007 expense is higher than the 2003 expense?

**A.** No. The D&O insurance expense requested by the company is reasonable and prudent based on expected 2009 costs.

**Q.** Do you agree with Mr. Shultz's statement, "The increase began to occur after 2002 as a result of the claims against officers and directors."?

**A.** No. D&O insurance premiums fluctuate as a result of the same market forces that impact property, liability, workers' compensation, and other insurance policies. The D&O insurance market rapidly shifted from a very "soft" pricing environment in the late 1990's into a difficult or "hard" market in the early 2000's. The primary drivers for the significant change in market conditions included the very negative claim experience of D&O insurance underwriters resulting from the Dot-com stock market bubble, the negative influence of the 9/11 terrorist event on the entire insurance market, increasing and significant claim activity related to energy companies such as Enron and a general increase in attention and scrutiny surrounding corporate governance, including the passage of Sarbanes-Oxley legislation. A significant contraction in the availability and pricing for D&O coverage is directly attributed to these factors.

Since 2007, Tampa Electric's premiums have stabilized to a point that represents the current "market" pricing level for D&O insurance. The company anticipates that the sustainability of pricing at or near the 2009 budget forecast will be challenging in the future due to the negative insurance market influences that are expected given the current financial market distress.

**Q.** Do you agree with Mr. Schultz's position that D&O insurance should be treated differently than other insurance?

**A.** No. D&O insurance is a cost of doing business that is every bit as essential as traditional property and liability insurance. It is a necessary and prudent cost of providing electric service to customers and is appropriately included in the company's revenue requirement in this case.

**Q.** In Mr. Schultz's testimony he states, "In other proceedings where I have testified, companies have claimed that ratepayers benefit because the insurance is necessary to attract and retain competent directors and officers." Do you agree?

**A.** Yes. D&O insurance is clearly a necessary part of conducting business for any large corporation. In light of the growing risk exposures related to corporate governance, it would be impossible to attract and retain competent directors and officers without the protections afforded by a D&O insurance program. Corporate surveys indicate that virtually all public entities maintain D&O insurance, and the company is not aware of any investor-owned electric utilities that do not maintain D&O insurance.

**Q.** Do you agree with Mr. Schultz's assertion that D&O insurance provides no benefit to ratepayers?

**A.** No. To the contrary, D&O insurance enables the company to assemble an effective team of directors and officers to manage and oversee the conduct of the electric business. Furthermore, D&O insurance provides a significant source of balance sheet protection from losses due to lawsuits, thereby safeguarding the utility from financial stress and preserving capital for uses that ensure the efficient delivery of electric service to ratepayers.

**Q.** Please comment on Mr. Schultz's final statement, "If the Commission can identify a benefit that ratepayers receive then I would recommend that the Company's request be limited to the 2003 expense."

**A.** This is totally inappropriate. Mr. Schultz has arbitrarily chosen a year, this time six years prior to the test year, that reflects an amount lower than the requested amount. Interestingly, he neglects to point out that the test year expense is actually lower than each of the previous four years' amounts. The requested amount of $1,700,908 is the lowest of the five-year period 2005 through 2009, including 2006 when the expense peaked at $2,115,321. The requested amount is reasonable and prudent, not because of its relationship to historical levels that happen to be favorable, but rather because it is a well-supported projection of the cost of this type of insurance based on the expected market conditions.

**RATE CASE EXPENSE**

**Q.** Mr. Schultz asserts that Tampa Electric's rate case expense is excessive. He argues that since the company is not small, it should not need consultants to assist in assembling a rate filing. Do you agree?

**A.** No. At this stage in the rate proceeding, I doubt the Commission Staff or any interested party would disagree that assembling such a filing requires resources that are incremental to day-to-day business operations. Much like the intervenors have hired resources to assist in preparing their case, Tampa Electric has hired consultants to assist in case preparation and to serve as expert witnesses. The company is staffed to handle ongoing, day-to-day responsibilities and the additional workload of the rate filings requires supplementing the existing team. To do otherwise would be costly to customers.

**Q.** Mr. Schultz is especially critical of the services Huron Consulting Services ("Huron") is providing. He argues that their contract is only for $468,000, yet the company has included $1.31 million in its rate case expense. Please explain.

**A.** Tampa Electric's contract with Huron includes numerous tasks to be performed including MFR review, tax analysis and support, testimony preparation, review of pro forma adjustments and revenue requirement components, and responding to discovery requests. In order to manage the consultant's time and scope of work, the company divided the tasks into groups and Huron is not authorized to proceed with certain tasks until specifically approved by Tampa Electric. The first grouping of tasks was for services estimated to cost $468,000. Since then, additional tasks have been authorized and the company's estimate of $1.31 million for Huron's services for the remainder of this proceeding remains appropriate.

**Q.** Both Mr. Schultz and Mr. O'Donnell argue that rate case costs for J.M. Cannell for $116,000 should be removed since the company has not entered into a contract for her services. Please comment on this.

**A.** Tampa Electric erroneously included rate case expenses for Ms. Cannell's services because it was not until intervenor testimony was filed on November 26 that it became clear her services were not needed.

**Q.** Mr. Pollock believes that "TECO should be required to provide actual rate case expenditures, with the actual expenditures being used to set the level of rate case expense to be recovered from customers." Is that practical?

**A.** No, it is not. As with all other costs of service, Tampa Electric has provided its best estimate for rate case expense based on the best available cost support. His recommendation is not reasonable.

**Q.** Messrs. Schultz and Pollock recommend that rate case expense should be amortized over five years rather than three. Do you agree?

**A.** No. While it is difficult to predict when Tampa Electric will file its next base rate case, I am relatively certain it will be sooner than five years. With the rapidly increasing costs associated with infrastructure investment and overall energy policies that suggest more investment, it is likely the company will need to file on a more frequent basis. Three years is an appropriate amortization period for rate case expense and no adjustment should be made.

**OFFICE SUPPLIES AND EXPENSE**

**Q.** Do you agree with Mr. Schultz's statement, "the Company failed to provide sufficient justification for the increase" in office supplies and expense?

**A.** No. The company provided a detailed breakdown of the $3.1 million increase in this expense in OPC's Sixth Set of Interrogatories No. 116. Along with other details, the company explained how there was a $216,000 increase in expense for security associated with its facilities, a $979,000 increase in information technology costs, a $461,000 increase in building maintenance expenses, and a $530,000 increase in training and development costs.

**Q.** Do you agree with Mr. Schultz's proposed $2.363 million reduction to expense because the test year amount is an "increase of 39% over the 2007" expense?

**A.** No. Again, it is inappropriate for Mr. Schultz to pick and choose certain expenses that may be higher than in a selected previous year and call for their reduction, while ignoring many other expenses that are lower than previous years. For example, he calls for a disallowance of Account 921 expenses because the 2009 amount is $11.2 million and the 2007 amount was $8.1 million. He fails to point out that pension expense is $6.8 million in 2009 but was $10.6 million in 2007. Following his logic, he should recommend an adjustment to increase expense by $3.8 million as a result of these facts.

**Q.** Is it still appropriate for the Commission to review the company's expenses in an isolated and detailed fashion?

**A.** Yes, of course. However, it should be done in a fair and balanced way. While some costs have increased, examination of individual expenses should also include recognition that the company has achieved reductions in costs over the years through efficiencies and other cost savings efforts. Although no single expense is justified or rejected based on the Commission's benchmark analysis, it is still helpful to put expense changes in the context of the company's entire cost profile. As I state in my direct testimony, total O&M expense for 2009 is $24 million below a benchmark based on 1991 actual O&M. The 2009 expense is also $33 million and $39 million below benchmarks based on the 1993 and 1994 O&M amounts, respectively.

**Q.** Are the company's proposed office supplies and expenses reasonable and prudent?

**A.** Yes. All of the projected costs included in Account 921 are necessary and appropriate for providing reliable electric service to customers in a safe, efficient manner. Therefore, Mr. Schultz's suggested disallowance is not appropriate.

**FUEL UNDER-RECOVERY**

**Q.** Mr. Larkin asserts that to reflect the rate base exclusion of fuel under-recoveries in the company's capital structure is a "gimmick." Do you agree?

**A.** No. Mr. Larkin appears to reach his conclusion simply because the adjustment results in an increase to the overall cost of capital. The company made this adjustment to more accurately reflect that the fuel under-recovery is primarily financed through deferred taxes and short-term debt. The company's proposal does so.

**Q.** Mr. Larkin states that the company's proposed treatment of fuel under-recovery is inappropriate and that it is not consistent with the Commission's treatment of fuel under-recoveries. Please explain the Commission's approach.

**A.** The Commission's treatment is to remove the under-recovery amount from working capital and, in order to reconcile capital structure to rate base, prorate the amount over all sources of capital. My understanding is that this approach is meant to "incent" companies to project fuel costs as accurately as possible and to avoid fuel under-recoveries. The "incentive" is that prorating under-recoveries over all sources of capital has a punitive impact.

**Q.** What about the adjustment is punitive?

**A.** Because the interest rate applied to the under-recovery in the fuel clause is based on commercial paper, it is much lower than the overall cost of capital. The effect of the difference in rates results in a disallowance ("below-the-line" adjustment) which has a punitive impact.

**Q.** Why is the company proposing a different adjustment?

**A.** When the Commission adopted its treatment, fuel was a much smaller and more predictable component of Tampa Electric's overall costs. Since then, fuel prices have been extremely volatile especially since natural gas has become a large percentage of the company's overall fuel expense. What was a modest impact is now significant. For example, under the Commission's historic treatment and using the company's 13-month average fuel under-recovery of $65 million, the amount effectively results in a "below-the-line" impact of approximately $7 million. While I have an appreciation for what the Commission is trying to incent, I am not sure how putting a permanent disallowance of the company's capital costs provides an incentive to avoid fuel under-recoveries.

**Q.** Please explain the company's proposed treatment for under-recovered fuel expense.

**A.** The company is proposing that its fuel under-recovery continue to be excluded from working capital, but its treatment in the capital structure should be changed. Since fuel under-recoveries result in a deferred tax timing related item, the company is recommending that this deferred tax amount be removed from the capital structure and short-term debt be adjusted. By not making this deferred tax adjustment, the Commission would be setting rates based on a deferred tax amount that will not exist once the under-recovery is recovered. However, by adjusting the short-term debt balance, it is more reflective of the most likely source of capital to finance the under-recovery.

**Q.** Is this proposed treatment consistent with the Commission's goal to "incent" companies to project fuel costs as accurately as possible and to avoid fuel under-recoveries?

**A.** Yes. The company is still motivated to avoid fuel under-recoveries primarily because it is still very likely that the cost of funding the under-recovery will be higher than the commercial paper rate earned in the fuel clause. While short-term debt is the most likely source, the company typically would not use short-term debt to fund the entire amount over the entire timeframe that the under-recovery exists. Since the company attempts to keep its credit lines free for hurricanes and other unexpected events, long-term debt issuances and equity infusions that were planned for future permanent financings are, in many cases, advanced to draw down short-term debt. This effectively funds the under-recovery with a higher cost of capital. Under this approach, the company is still incented to manage its fuel expenses to avoid an associated "below-the-line" adjustment.

**TRANSMISSION BASE RATE ADJUSTMENT**

**Q.** Is Mr. Larkin's characterization of the Transmission Base Rate Adjustment ("TBRA") as an "automatic adjustment clause" appropriate?

**A.** No. As I stated on page 44 of my direct testimony, the TBRA would be similar to the Generation Base Rate Adjustment clause approved by the Commission in Docket Nos. 050045-EI and 050078-EI. Recovery of costs would be based on prudent, required investments approved by the Commission, and would certainly not be "automatic". The company would expect a thorough review by the Commission as it does with all cost recovery clauses. There are no "automatic adjustment clauses" in Florida.

**Q.** Mr. Larkin points out differences between the TBRA and existing cost recovery clauses. Are there also similarities?

**A.** Yes. There are similarities to all of the clauses but especially with the ECRC. The Federal Energy Regulatory Commission, North American Electric Reliability Corporation and the Florida Reliability Coordinating Council's increased requirements associated with reliability and transmission planning are analogous to mandates similar to environmental compliance requirements. Just as it is difficult to manage required environmental investments, the company will not be able to entirely manage the need and timing of transmission investments to coincide with rate cases as suggested by Mr. Larkin. However, the Commission will maintain the capability to judge and monitor the prudence of expenditures associated with these large-scale transmission projects, just as it does with ECRC projects.

**Q.** What similarities are there with other cost recovery clauses?

**A.** There are also parallels with the Capacity Cost Recovery Clause. Mr. Larkin defends the Capacity Cost Recovery Clause because "capacity costs related to Purchased Power are difficult to predict and control on a long-term basis and cannot be accurately anticipated". Similarly, the new transmission requirements help ensure this same capacity can be delivered.

**Q.** Mr. Pollock argues that: "costs that are subject to recovery outside of a general rate case should be *material*, *volatile*, and *beyond the utility's control.*"

Do you agree with him?

**A.** Yes I do. Based upon the new requirements and the way costs will be allocated on a regional basis as described in Tampa Electric witness Regan Haines' direct and rebuttal testimony, transmission investment is likely to be *"material*, *volatile*, and *beyond the utility's control"*.

**Q.** Are Mr. Larkin's comments regarding customer benefits contradictory?

**A.** Yes. Mr. Larkin defends other clauses on the basis that they "provide benefit to ratepayers through the reduction of costs." However, the projects that will be eligible for cost recovery via the TBRA will lower costs by facilitating coordinated and cost-effective means of planning and constructing transmission for the entire peninsular Florida region. Moreover, these investments will result in improved reliability and lower fuel costs by enhancing dispatch for the entire region.

**SUMMARY OF REBUTTAL TESTIMONY**

**Q.** Please summarize your rebuttal testimony.

**A.** I have delineated the concerns and disagreements I have regarding the substance of the testimonies of witnesses Larkin, Schultz, Pollock, Stewart and O'Donnell. Their assertions contain a variety of points that are not accurate, not logical, not appropriate and/or not in agreement with the Commission's handling of various topics. I have presented facts and information that support the company's petition, the reasonableness and prudence of amounts and positions presented by Tampa Electric, and the appropriateness of the revenue requirement contained in its filing.

**Q.** Does this conclude your rebuttal testimony?

**A.** Yes, it does.