

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080317-EI

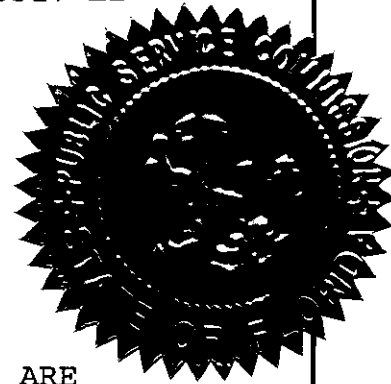
In the Matter of:

PETITION FOR RATE INCREASE BY TAMPA
ELECTRIC COMPANY.

VOLUME 9

Pages 1264 through 1397

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PROCEEDINGS: HEARING

BEFORE: CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Wednesday, January 28, 2009

TIME: Commenced at 9:09 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, RPR, CRR
Official FPSC Reporter
(850) 413-6734

APPEARANCES: (As heretofore noted.)

DOCUMENT NUMBER-DATE

FLORIDA PUBLIC SERVICE COMMISSION 00713 JAN 29 8

FPSC-COMMISSION CLERK

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P R O C E E D I N G S

(Transcript continues in sequence from Volume 8.)

CHAIRMAN CARTER: We'll call this hearing to order.

First of all, every witness that's going to testify that's in here today, would you please stand so we can get you all sworn in as a group, and that way we won't have to do that one by one. All witnesses, would you please stand and raise your right hand.

(Witnesses collectively sworn.)

Thank you. You may be seated.

Okay. Staff, are there any preliminary matters?

MR. YOUNG: No, sir. I think we can start with Mr. Harris.

CHAIRMAN CARTER: Okay. Call your next witness.

MR. WAHLEN: Tampa Electric Company calls Steven P. Harris.

STEPHEN P. HARRIS

was called as a witness on behalf of Tampa Electric Company and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. WAHLEN:

Q Would you please state your name, occupation, business address and employer?

A My name is Steven P. Harris. I'm a Vice President with ABS Consulting, an affiliated company of EQECAT, Inc.,

1 both of which are subsidiaries of ABS Group of Companies. My
2 business address is 475 14th Street, Oakland, California.

3 Q And did you prepare and cause to be filed in this
4 proceeding --

5 CHAIRMAN CARTER: Hang on a second. Could you get
6 closer to your mike or --

7 THE WITNESS: Absolutely. Is that better?

8 CHAIRMAN CARTER: And kind of start over because we
9 were having trouble hearing here at the bench.

10 THE WITNESS: Sure.

11 MR. WAHLEN: You want to start with the introduction
12 again?

13 CHAIRMAN CARTER: Yes.

14 MR. WAHLEN: Okay.

15 BY MR. WAHLEN:

16 Q Would you please state your name, occupation,
17 business address and employer?

18 A My name is Steven P. Harris. I'm a Vice President
19 with ABS Consulting, an affiliated company of EQECAT, both of
20 which are subsidiaries of the ABS Group of Companies. My
21 business address is 475 14th Street, Oakland, California.

22 Q Mr. Harris, did you prepare and cause to be filed in
23 this proceeding on August 11th, 2008, prepared direct testimony
24 consisting of 18 pages?

25 A Yes, I did.

1 Q And do you have any changes or corrections to your
2 prepared direct testimony?

3 A No, I do not.

4 Q If I were to ask you the questions contained in your
5 prepared direct testimony today, would your answers be the
6 same?

7 A Yes, they would.

8 MR. WAHLEN: Mr. Chairman, Tampa Electric moves the
9 prepared direct testimony of Mr. Harris into the record as
10 though read.

11 CHAIRMAN CARTER: The prefiled testimony of the
12 witness will be entered into the record as though read.

13 BY MR. WAHLEN:

14 Q Mr. Harris, attached to your direct testimony did you
15 include a composite exhibit premarked as Exhibit SPH-1 in
16 hearing Exhibit 27 consisting of one document?

17 A Yes, I did.

18 Q Do you have any corrections to your exhibit?

19 A No, I do not.

20 Q Mr. Harris, did you prepare and cause to be prefiled
21 in this proceeding on December 17th, 2008, prepared rebuttal
22 testimony consisting of eight pages?

23 A Yes, I did.

24 Q Do you have any changes or corrections to your
25 prepared rebuttal testimony?

1 A No, I do not.

2 Q If I were to ask you the questions contained in your
3 prepared rebuttal testimony today, would your answers be the
4 same?

5 A Yes, they would.

6 Q Tampa Electric Company requests that the prepared
7 rebuttal testimony of Mr. Harris be inserted into the record as
8 though read.

9 CHAIRMAN CARTER: The prefiled testimony of the
10 witness will be inserted into the record as though read.

11 BY MR. WAHLEN:

12 Q And just to be clear, Mr. Harris, there was no
13 exhibit to your rebuttal testimony; is that correct?

14 A That's correct.

15

16

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**2 **PREPARED DIRECT TESTIMONY**3 **OF**4 **STEVEN P. HARRIS**5 **ON BEHALF OF TAMPA ELECTRIC COMPANY**6
7 **Q.** Please state your name and business address.8
9 **A.** My name is Steven P. Harris. My business address is ABSG
10 Consulting, Inc. ("ABS Consulting"), 475 14th Street,
11 Oakland, California 94612.12
13 **Q.** Who is your employer and what is your position?14
15 **A.** I am a Vice President with ABS Consulting, an affiliated
16 company of EQECAT, Inc. both of which are subsidiaries of
17 the ABS Group of Companies, Inc. Together these two
18 companies are leading global providers of catastrophic
19 risk management services, including software and
20 consulting, to major insurers, re-insurers, corporations,
21 governments and other financial institutions. In
22 addition, these companies develop and license
23 catastrophic underwriting, pricing, risk management and
24 risk transfer models that are used extensively in the
25 insurance industry. The companies provide the financial,

1 insurance and brokerage communities with a science and
2 technology-based source of independent quantitative risk
3 information.

4
5 **Q.** Please describe your educational background and business
6 experience.

7
8 **A.** I received Bachelors and Masters Degrees in engineering
9 from the University of California at Berkeley. I am a
10 licensed civil engineer in the State of California. Over
11 the past 25 years, I have conducted and supervised
12 independent risk and financial studies for public
13 utilities, insurance companies and other entities both
14 regulated and unregulated. My areas of expertise include
15 natural hazard risk analysis, operational risk analysis,
16 risk profiling and financial analysis, insurance loss
17 analysis, loss prevention and control, business
18 continuity planning and risk transfer.

19
20 A significant portion of my consulting experience has
21 involved the performance of multi-hazard risk studies,
22 including earthquake, ice storm and windstorm perils, for
23 electric, water and telephone utility companies, as well
24 as insurance companies.

25

1 I have performed or supervised windstorm (tropical storm
2 or hurricane) loss and solvency analyses for utilities
3 including Tampa Electric Company ("Tampa Electric" or
4 "company"), Florida Power & Light, Progress Energy
5 Florida, Gulf Power Company and others. Additionally, I
6 have performed loss analyses for earthquake hazard for
7 utilities including the Los Angeles Department of Water
8 and Power, the California-Oregon Transmission Project,
9 Big Rivers Electric and Anchorage Municipal Light and
10 Power.

11
12 For energy companies that have assets in a wide array of
13 geographic locations, I have performed or supervised
14 multi-peril analyses for all natural hazards, including
15 earthquakes, windstorms and ice storms.

16
17 **Q.** Are you sponsoring an exhibit in this case?

18
19 **A.** Yes. I am sponsoring Exhibit No. ____ (SPH-1), entitled
20 "Exhibit of Steven P. Harris on Behalf of Tampa Electric
21 Company", was prepared under my direction and
22 supervision. It consists of one document, "Transmission
23 and Distribution Assets - Storm Loss and Reserve
24 Performance Analysis".
25

1 Q. What is the purpose of your direct testimony?

2

3 A. My direct testimony presents the results of ABS
4 Consulting's independent analyses of risk of uninsured
5 losses to Tampa Electric's transmission and distribution
6 assets and insurance retentions from hurricanes and
7 tropical storms. These studies include Storm Loss
8 Analysis and Reserve Performance Analysis.

9

10 Q. Please briefly describe the studies performed for Tampa
11 Electric.

12

13 A. ABS Consulting performed two analyses relative to the
14 reserve: The Storm Loss Analysis ("Loss Analysis"), and
15 The Reserve Performance Analysis ("Performance
16 Analysis"). The Loss Analysis is a probabilistic
17 windstorm analysis that uses proprietary software to
18 develop an estimate of the expected annual amount of
19 uninsured windstorm losses to which Tampa Electric is
20 exposed. The Reserve Performance Analysis is a dynamic
21 financial simulation analysis that evaluates the
22 performance of the reserve in terms of the expected
23 balance of the reserve and the likelihood of positive
24 reserve balances over a five-year period, given the
25 potential uninsured losses determined from the Loss

1 Analysis, at various annual accrual levels.

2

3 **Q.** Please summarize the results of your analyses.

4

5 **A.** The Loss Analysis was performed to estimate the level of
6 annual damage that Tampa Electric is exposed to from
7 hurricanes and tropical storms. The Reserve Performance
8 Analysis was performed to test three levels of possible
9 annual accrual to the reserve. This analysis tests the
10 performance of the reserve against the potential storm
11 losses determined from the storm Loss Analyses. The
12 accrual levels tested are the company's current \$4
13 million per year accrual as well as two other higher
14 levels of \$15 million and \$20 million. The study
15 estimated the total expected average annual uninsured
16 cost to Tampa Electric from all storms to be \$17.8
17 million.

18

19 The Reserve Performance Analysis demonstrated that an
20 accrual level of \$4 million would result in an expected
21 reserve deficit of \$52.4 million and a probability of
22 negative reserve balances of 55.4 percent within the
23 five-year simulation time horizon. The Reserve
24 Performance Analysis demonstrated that an accrual level
25 of \$15 million would result in an expected reserve

1 balance of \$0.3 million and a probability of negative
2 reserve balances of 32.9 percent within the five-year
3 simulation time horizon. The Reserve Performance
4 Analysis demonstrated that an accrual level of \$20
5 million would result in an expected reserve balance of
6 \$28 million and a probability of negative reserve
7 balances of 26.1 percent within the five-year simulation
8 time horizon.

9
10 **LOSS ANALYSIS**

11 **Q.** Please summarize the Loss Analysis.

12
13 **A.** The Loss Analysis determined the expected annual
14 magnitude of windstorm losses to Tampa Electric's
15 transmission and distribution ("T&D") system. Windstorm
16 losses include costs associated with service restoration
17 and repair of Tampa Electric's T&D system as a result of
18 hurricanes and tropical storms. Also included are
19 estimates of the costs of windstorm insurance deductibles
20 attributable to non-T&D assets.

21
22 **Q.** Please describe the computer software used to perform the
23 Loss Analysis.

24
25 **A.** USWINDTM is a probabilistic model designed to estimate

1 damage and losses due to the occurrence of storms.
2 EQECAT's proprietary computer software USWIND™ is one of
3 only four models evaluated and determined acceptable by
4 the Florida Commission on Hurricane Loss Projection
5 Methodology for projecting hurricane loss costs.

6
7 Probabilistic annual damage and loss is computed using
8 the results of over 100,000 random variable storms.
9 Annual damage and loss estimates are developed for each
10 individual site and aggregated to overall portfolio
11 damage and loss amounts. USWIND™ climatological models
12 are based on the National Oceanic and Atmospheric
13 Administration's ("NOAA") National Weather Service
14 Technical Reports.

15
16 **Q.** Does USWIND™ take into account storm frequency and
17 severity?

18
19 **A.** Yes. The analysis is based on storm frequency and
20 severity distributions developed from the entire 105-year
21 historical record. USWIND™ also allows the estimation of
22 frequency of storms in the current period of heightened
23 hurricane activity.

24
25 **Q.** Please describe the current period of heightened

1 hurricane activity.

2

3 **A.** Hurricanes are known to occur in multi-year cycles. The
4 recent decades of the 1970s through the mid-1990s had
5 significantly lower activity than the 105-year long-term
6 average. Other decades have had periods of higher
7 activity. NOAA has expressed its belief that we entered
8 a period of increased hurricane formation around 1995.

9

10 There is the emerging consensus that changes in the El
11 Niño/Southern Oscillation and North Atlantic Oscillation
12 variables indicate we have entered a more active period
13 for hurricane formation like the 1920s and 1940s.
14 Therefore, Tampa Electric may expect to experience higher
15 damage to its T&D assets over the next several years than
16 would be predicted by the long-term hurricane hazard.

17

18 The Loss Analysis is based on hurricane frequency and
19 severity distributions that are reflective of the
20 relatively more active periods of the 1920s and 1940s.
21 The length of these active periods is thought to be about
22 25 to 40 years or more, and the recent period of higher
23 activity is believed to have begun only about a decade
24 ago.

25

1 The hurricane hazard cases analyzed therefore represent
2 frequencies associated with the current period that may
3 be associated with a higher frequency of hurricane
4 formation. If the view held by NOAA other meteorological
5 experts is correct, we may expect to see larger numbers
6 of hurricanes form and larger numbers of landfalls in the
7 coming decades than we have in the pre-1995 period.

8
9 **Q.** Do the storm frequency assumptions include the
10 possibility of having multiple hurricane landfalls within
11 Florida in any given year?

12
13 **A.** Yes. USWINDTM does include the possibility of having
14 multiple hurricane landfalls within Florida in any given
15 year, including the impact of such landfalls on aggregate
16 losses, consistent with the 2004 hurricane season.

17
18 **Q.** Did the Loss Analysis take into account the frequency of
19 storms during the 2004 and 2005 storm seasons?

20
21 **A.** The current analysis takes into account the hurricane
22 history up to and including the 2004 storm season. While
23 the frequency and severity of the 2005 storm season was
24 not incorporated into the EQECAT model used for the Tampa
25 Electric analysis, this impact is expected to be small

1 since there were no hurricane landfalls near Tampa in
2 2005.

3
4 **Q.** What impact did the 2004 experience have on the results
5 of the analysis?

6
7 **A.** Adding the 2004 season increased the long-term hurricane
8 hazard in the Tampa area by about 60 percent over the
9 prior modeled hazard.

10
11 **Q.** What were the results of the Loss Analysis?

12
13 **A.** The total expected annual uninsured cost to Tampa
14 Electric's system from all storms is estimated to be
15 \$17.8 million.

16
17 **Q.** What does this expected annual loss estimate represent?

18
19 **A.** The expected annual loss estimate represents the average
20 annual cost associated with damage to T&D assets,
21 insurance deductibles for damage to other assets such as
22 generating plants and substations, and service
23 restoration activities resulting from windstorms over a
24 long period of time.

25

1 Q. Is the Loss Analysis performed for Tampa Electric the
2 same analysis performed for insurance companies to price
3 an insurance premium?
4

5 A. Yes. The natural hazards loss modeling and analysis
6 would be similar for an insurance company, electric
7 utility or other entity. The expected annual loss is
8 also known as the "pure premium", which when insurance is
9 available is the insurance premium level needed to pay
10 just the expected losses. Although insurance companies
11 would add their expenses and profit margin to the pure
12 premium to develop the premium charged to customers,
13 those costs are not reflected in ABS Consulting's
14 analyses results.
15

16 **RESERVE PERFORMANCE ANALYSIS**

17 Q. Please summarize the Reserve Performance Analysis.
18

19 A. ABS Consulting performed a dynamic financial simulation
20 analysis of the impact of the estimated windstorm losses
21 on the reserve for specified levels of annual funding.
22 The starting assumption for the Reserve Performance
23 Analysis was a reserve balance of \$21.6 million. This
24 Performance Analysis performed 10,000 simulations of
25 windstorm losses within the Tampa Electric service

1 territory, each covering a five-year period, to determine
2 the effect of the charges for loss on the reserve.

3
4 The analysis technique used relies on repeated sampling
5 to model multiple storm seasons and simulates variable
6 storm losses consistent with the results of the Loss
7 Analysis. Because storm seasons and losses are highly
8 variable, 10,000 five-year simulations are performed to
9 estimate the performance of the reserve with various
10 accrual levels and ensure an adequate number of samples
11 of rare storm events. Monte Carlo simulations were used
12 to generate damage samples for the analysis.

13
14 The simulations were used to generate loss samples
15 consistent with the expected \$17.8 million annual loss
16 from the Loss Analysis results. The analysis provides
17 the expected balance of the reserve in each year of the
18 simulation accounting for the annual accrual and losses
19 using a financial model.

20
21 **Q.** How are the results of the Loss Analysis used in the
22 Reserve Performance Analysis?

23
24 **A.** Both the likelihoods and amounts of uninsured annual
25 losses determined in the Loss Analysis are used to

1 simulate losses in each of the five years in the
2 Performance Analysis in order to determine the likelihood
3 of the reserve having positive balances.

4
5 **Q.** Please describe the assumptions that were included in the
6 Reserve Performance Analysis.

7
8 **A.** All computations were performed with an initial reserve
9 balance of \$21.6 million and all results are shown in
10 constant 2007 dollars. The analysis also assumed future
11 growth of the customer base and system assets and
12 inflationary cost increases for new T&D assets of 4.5
13 percent annually.

14
15 **Q.** Please summarize the results of the Reserve Performance
16 Analysis.

17
18 **A.** Reserve performance can be viewed in terms of the
19 expected or mean balance of the reserve and the
20 likelihood of positive reserve balances occurring within
21 the five-year period. Based on the simulated loss
22 distributions, there is some likelihood of negative
23 reserve balances for each of the annual accrual levels
24 analyzed. Higher accrual levels will result in a lower
25 probability of negative reserve balances, and will have a

1 higher probability of a positive reserve balance at the
2 end of the five-year simulation period. If the annual
3 accrual levels are smaller, there is a greater chance of
4 negative reserve balances, especially in the early years.
5

6 **TAMPA ELECTRIC'S RECOMMENDED ACCRUAL**

7 **Q.** Did you make a recommendation for Tampa Electric's annual
8 level of accrual?
9

10 **A.** No. My role was not to recommend an annual level of
11 accrual. It was to present probabilities to Tampa
12 Electric regarding reserve performance based on various
13 levels of annual accrual. There are large uncertainties
14 associated with the hurricane hazard and the specific
15 storm outcomes have large variances. There could be
16 hurricane seasons with no loss at all and hurricane
17 seasons with hundreds of millions of dollars in losses.
18 The Performance Analysis presents information about the
19 likelihood of the adequacy of funding that can be used to
20 make decisions about the reserve. I do believe that
21 given Tampa Electric's objectives, a \$20 million annual
22 accrual is appropriate.
23

24 **Q.** What factors are contributing to the significant increase
25 in Tampa Electric's proposed reserve accrual of \$20

1 million compared to the existing \$4 million accrual?

2

3 **A.** It is my understanding that the current \$4 million
4 accrual was authorized based on an analysis performed in
5 1994. Since that time, there have been significant
6 changes in Tampa Electric's T&D exposures. The
7 replacement value of T&D assets estimated by Tampa
8 Electric to be \$1.1 billion at that time is now estimated
9 to be \$3.4 billion. The Loss Analysis performed also
10 reflects the current view of the increased frequency of
11 hurricane formation resulting in a higher likelihood of
12 losses. Potential un-recovered losses to Tampa Electric
13 in the current analyses also include tropical storms
14 damage and property deductibles.

15

16 **Q.** Is Tampa Electric's recommendation of a \$120 million
17 target level for the reserve adequate?

18

19 **A.** Yes. Based on the current value of Tampa Electric's T&D
20 assets, a reserve balance of \$120 million would be
21 adequate to cover uninsured losses during most, but not
22 all, storm seasons. There is a 2.6 percent chance every
23 year that storm loss could exceed \$120 million.

24

25 **Q.** Did you analyze a range of annual accrual levels in your

1 evaluation?

2

3 **A.** Yes. My evaluation included analyses of the reserve
4 performance at the current annual accrual level of \$4
5 million, and at the annual accrual levels of \$15 million
6 and \$20 million.

7

8 **Q.** What is the likelihood of company's reserve having an
9 inadequate balance at the current annual accrual level of
10 \$4 million?

11

12 **A.** At the current annual accrual level of \$4 million, the
13 likelihood of the reserve having negative balances within
14 the five-year period is 55.4 percent, and it is estimated
15 that the reserve would have a deficit of \$52.4 million at
16 the end of five years.

17

18 **Q.** What did your evaluation show with respect to a \$20
19 million accrual?

20

21 **A.** At an annual accrual level of \$20 million, the likelihood
22 of the reserve having negative balances within the five-
23 year period is 26.1 percent, and the expected balance of
24 the reserve at the end of five years would be
25 approximately \$28 million.

1 Q. Would a \$20 million accrual cover all potential storm
2 loss outcomes?

3
4 A. No. The expected or mean balance of \$28 million has a 50
5 percent chance of being exceeded. The analysis also
6 provides estimates of the fifth percentile and ninety-
7 fifth percentile reserve balances. At the fifth
8 percentile reserve balance, only five percent of the
9 simulated outcomes have smaller values. Similarly, for
10 the ninety-fifth percentile reserve balance, only five
11 percent of simulated outcomes have values, which would be
12 greater than that value. The fifth percentile represents
13 an extremely adverse five years of storm experience where
14 the losses would far exceed the reserve levels.
15 Conversely, the ninety-fifth percentile line would
16 represent an extremely favorable five years of storm
17 experience where only five percent of simulated reserve
18 outcomes would be greater than the estimated balance or
19 five years of very small or no storm damage.

20
21 Q. What is your conclusion with respect to the \$20 million
22 annual level of accrual selected by Tampa Electric?

23
24 A. My analysis indicates that, with an expected annual loss
25 of \$17.8 million and an annual accrual of \$20 million,

1 the balance of the reserve at the end of five years is
2 expected to be \$28 million. This represents a slight
3 increase in reserve from the initial balance of \$21.6
4 million. There is about a one in four chance that storm
5 losses would create a deficit in the reserve within the
6 five-year period. Additionally, only with an extremely
7 favorable five-year storm experience would the reserve
8 balance reach or exceed the \$120 million target. Tampa
9 Electric's recommendation appears reasonable and
10 appropriate.

11
12 **Q.** Does this conclude your direct testimony?

13
14 **A.** Yes.
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16
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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**2 **REBUTTAL TESTIMONY**3 **OF**4 **STEVEN P. HARRIS**5 **ON BEHALF OF TAMPA ELECTRIC COMPANY**

6
7 **Q.** Please state your name, business address, occupation and
8 employer.

9
10 **A.** My name is Steven P. Harris. My business address is
11 ABSG Consulting, Inc. ("ABS Consulting"), 475 14th
12 Street, Oakland, California 94612. I am a Vice
13 President with ABS Consulting, an affiliated company of
14 EQECAT, Inc. both of which are subsidiaries of the ABS
15 Group of Companies, Inc.

16
17 **Q.** Did you previously submit direct testimony in this
18 proceeding?

19
20 **A.** Yes.

21
22 **Q.** What is the purpose of your rebuttal testimony?

23
24 **A.** The purpose of my rebuttal testimony is to address
25 errors and inaccuracies in portions of the testimony

1 submitted by Hugh Larkin on behalf of the Citizens of
2 the State of Florida and by Stephen Stewart on behalf of
3 AARP pertaining to Tampa Electric's recommended
4 adjustment to its annual storm damage accrual amount.

5
6 **Q.** Do you agree with both Messrs. Larkin and Stewart who
7 suggest that Tampa Electric's annual storm damage
8 accrual of \$4 million does not need to be increased
9 substantially, if at all, because the accrual was
10 sufficient to cover actual storm damages incurred
11 through the 2004 hurricane season?

12
13 **A.** No. The reason that Tampa Electric's annual accrual of
14 \$4 million appears to have been sufficient since its
15 inception and through the hurricanes of 2004 is because
16 of Tampa Electric's very favorable storm history. Even
17 in the 2004 season, no hurricanes made direct landfall
18 in Tampa Electric's service territory. Judging the
19 annual accrual on the basis of a single season and
20 excluding the consideration of other possible damage
21 events, both large and infrequent or small and frequent,
22 is neither meaningful nor appropriate.

23
24 Messrs. Larkin's and Stewart's suggestions would require
25 Tampa Electric's management and the Commission to

1 speculate that Tampa Electric's recent good luck over a
2 brief, selective storm period considered by them will
3 continue. However, such speculation would ignore the
4 fact that over the 105-year Florida hurricane history,
5 there have been many more hurricane landfalls and
6 damaging events than in the last 25 years. In addition,
7 there is a growing body of evidence suggesting that the
8 North Atlantic Oscillation ("NAO") and the El Niño or
9 Southern Oscillation ("ENSO") are important climate
10 variables in modulating hurricane return periods. If
11 you accept this growing body of evidence that changes in
12 the ENSO and NAO variables indicate we have entered a
13 more active period for hurricane formation, such as the
14 1920s and 1940s, you should conclude that Tampa Electric
15 may expect to experience higher than the long term
16 average damage to its transmission and distribution
17 ("T&D") system over the next several years.

18
19 While the 2004 hurricane season was unusual because
20 three hurricanes affected Tampa Electric, none of the
21 hurricanes made landfall in Tampa Electric's service
22 territory. In fact, all three of these storms had wind
23 speeds in Tampa Electric's service territory that were
24 near or below the threshold of hurricane strength. If
25 any of these storms had either made landfall in or

1 tracked directly through Tampa Electric's territory, the
2 storm losses would have been significantly greater. For
3 example, Hurricane Charley made landfall near Punta
4 Gorda, Florida, close to milepost 1280 as shown in
5 Figure 4-1 of Document No.1 of Exhibit No.____ (SPH-1) of
6 my direct testimony, which is about 50 miles south of
7 Tampa Electric's service territory. It tracked North-
8 East through Orlando. The National Oceanic and
9 Atmospheric Administration reported peak gust wind
10 speeds in Tampa of 30 mph, Lakeland of 58 mph, and Plant
11 City of 62 mph, all well below the threshold of Category
12 1 hurricane wind sustained speeds of 74 mph. Had
13 Hurricane Charley made landfall closer to the mouth of
14 Tampa Bay, the damage to Tampa Electric's T&D system
15 could have been in the hundreds of millions of dollars.
16 Reliance on this fortuitous outcome of the 2004 and
17 earlier seasons for Tampa Electric and the Tampa Bay
18 area does not provide a reliable basis for estimating
19 hurricane losses.

20
21 **Q.** What approach would you consider preferable to that
22 suggested by Messrs. Larkin and Stewart to estimate
23 Tampa Electric's hurricane T&D loss exposure?

24
25 **A.** Messrs. Larkin's and Stewart's approach, which relies on

1 a short hurricane loss history, was replaced in the
2 insurance industry decades ago with the use of
3 catastrophe simulation modeling. Any reliable estimate
4 of the expected annual windstorm damage to which Tampa
5 Electric is exposed (expected annual damage) must
6 include the most complete and full damage distribution
7 that can be determined both from actual experience and
8 from simulated possible damage. In developing expected
9 annual damage estimates, the most reliable methodology
10 is to utilize the longest, most complete historical
11 record available. Since Florida's recorded hurricane
12 history is just over 105 years old, insurers rely on
13 simulation modeling to extend this "known" history into
14 thousands of simulated years for the purpose of
15 estimating likely damage. Computer modeling is the
16 current standard of care and method utilized by
17 insurance and re-insurance companies to estimate
18 hurricane loss exposures for underwriting and
19 aggregation of their business. The ABS Consulting model
20 is based on the 105 years of known hurricane history,
21 the science of meteorology, and computer models to
22 simulate thousands of storm seasons, including the
23 effects of the current period of higher frequency of
24 hurricane formation. The ABS Consulting model utilizes
25 the same methods and standard of care in estimating the

1 annual losses that an insurer would use, if affordable
2 insurance for this peril was available.

3
4 **Q.** Do you agree with the statement by Mr. Stewart, that ABS
5 Consulting's storm loss analysis is "biased" by the
6 inclusion of the 2004 storm season data since it
7 "increased the long-term hurricane hazard in the Tampa
8 area by about 60 percent over the prior modeled hazard"?

9
10 **A.** No. The Florida Commission on Hurricane Loss Projection
11 Methodology ("FCHLPM"), is an independent panel of
12 experts that evaluates computer models and actuarial
13 methodologies for projecting hurricane losses. The
14 FCHLPM goes to great lengths to ensure that all models
15 used in the State of Florida for insurance rating
16 purposes appropriately capture the full range of the
17 hurricane hazard and are not biased. This includes the
18 annual incorporation of each preceding season's
19 hurricane history and submission of models to the FCHLPM
20 for review. The ABS Consulting/EQECAT's USWIND™ model
21 used to calculate Tampa Electric's expected annual
22 damage has appropriately included the 2004 hurricane
23 season data. This model has been evaluated and
24 determined acceptable by the FCHLPM for projecting
25 hurricane loss costs. The inclusion of the 2004 season

1 hurricane data therefore is appropriate for use by the
2 Commission.

3
4 **Q.** Do you agree with Mr. Larkin who suggests that a \$16
5 million increase in the annual storm reserve accrual
6 would result in Tampa Electric collecting huge amounts
7 of reserves prior to the occurrence of a storm?

8
9 **A.** No. As shown in Document No. 1, Table 5-5(a) of Exhibit
10 No. __ (SPH-1) of my direct testimony, the Reserve
11 Performance Analysis I performed considered a \$20
12 million annual accrual amount and concluded that the
13 likely reserve balance at the end of five years would be
14 approximately \$28 million. Figure 5-3 in Document No. 1
15 of Exhibit No. __ (SPH-1) of my direct testimony
16 estimates there is a five percent probability (95th
17 percentile result) that the reserve balance could exceed
18 \$121 million at the end of the five years. This would be
19 a very fortuitous five years of storm seasons and the
20 five percent probability represents an unlikely outcome.
21 My analysis estimates that with an annual accrual of \$20
22 million, there is about a one in four chance of the
23 reserve having a negative balance within the next five
24 years. Said differently, while a \$16 million increase
25 in the storm reserve accrual is an improvement over the

1 company's current accrual amount, it is very unlikely
2 that even it would result in the accumulation of a large
3 reserve balance over the next five years. On the other
4 hand, Mr. Larkin's recommendation that the annual
5 accrual should remain at \$4 million would likely have a
6 one in two or 50 - 50 chance of a negative balance over
7 the next five years as shown in Figure 5-1.

8
9 If the objective of the reserve is to provide funding
10 for some, but not all of Tampa Electric's most frequent
11 hurricane T&D losses, the one in two probability of
12 inadequate funds over the next five years associated
13 with the \$4 million level of funding recommended by
14 Messrs. Larkin and Stewart could be viewed as too high a
15 likelihood to reliably moderate rate volatility.

16
17 **Q.** Does this conclude your rebuttal testimony?

18
19 **A.** Yes.

1 BY MR. WAHLEN:

2 Q Thank you. Would you please summarize your direct
3 and rebuttal testimony?

4 A Yes, I will. Thank you.

5 Good morning, Commissioners. My testimony presents
6 the results of a study performed by ABS Consulting relative to
7 Tampa Electric's storm reserve. ABS Consulting is an
8 independent risk management consultant and provides
9 catastrophic loss modeling to utilities, insurers and
10 government agencies. The storm loss analysis estimates how
11 large and how often possible hurricanes and tropical storm
12 losses will be. Hurricanes and tropical storm losses are low
13 frequency, high severity events and actuarial analyses is not
14 possible due to their infrequent nature but potentially extreme
15 damage.

16 The loss analysis is performed using a proprietary
17 computer storm model, and this model simulates thousands of
18 possible storm losses using known science to estimate the
19 expected annual damage to Tampa Electric's transmission and
20 distribution assets. The model is one of only four models that
21 has been evaluated and determined acceptable by the Florida --

22 CHAIRMAN CARTER: Pull the mike a little closer,
23 please.

24 THE WITNESS: I'm sorry?

25 CHAIRMAN CARTER: You're fading in and out.

1 THE WITNESS: I'll try to sit closer.

2 CHAIRMAN CARTER: There you go. Thank you.

3 THE WITNESS: The storm model is one of only four
4 models that has been evaluated and determined acceptable by the
5 Florida Commission on Hurricane Loss Projection Methodology.
6 The Commission annually reviews all models used in the state
7 for insurance rating purposes to ensure that they're
8 appropriate and not biased.

9 Insurers rely on simulation modeling for the purpose
10 of estimating likely damage. Computer modeling is the most
11 reliable basis for estimating hurricane loss and is the current
12 standard of care and method utilized by insurers to estimate
13 hurricane losses for underwriting and aggregation of their
14 business.

15 The ABS loss analysis estimated the total expected
16 annual damage to Tampa Electric's system from all windstorms to
17 be \$17.8 million. This expected annual uninsured cost
18 represents only the purest cost of storm damage. Insurers
19 would add significant charges for overhead and profit to this
20 purest cost if insurance were available. This expected annual
21 uninsured cost is significantly higher than Tampa Electric's
22 currently authorized \$4 million accrual. The \$4 million
23 accrual may appear to have been sufficient since its inception
24 in 1994 and through the hurricanes of 2004 because of Tampa
25 Electric's very favorable storm history. Even in the 2004

1 season no hurricanes made direct landfall in Tampa Electric's
2 service territory. In fact, three of the 2004 season storms
3 had wind speeds in the service territory that were near or
4 below hurricane threshold. Damage to Tampa Electric's
5 transmission and distribution system from a direct hurricane
6 landfall like Hurricane Charley would be in the hundreds of
7 millions of dollars. Reliance on the fortuitous outcome of the
8 2004 hurricane season and earlier seasons for the Tampa
9 Electric system and for the Tampa Bay area is not a reliable
10 basis for estimating hurricane loss.

11 Our other analysis is a five-year perspective dynamic
12 financial simulation of the reserve's performance. This
13 analysis models reserve inflows from accruals along with
14 periodic withdrawals to pay for storm losses. The likelihood
15 and amounts of uninsured annual losses come from the loss
16 analysis and are used to simulate thousands of five-year
17 historical periods.

18 This provides estimates of the performance of the
19 reserve and the likelihood of the reserve balance being
20 negative for annual accruals of the reserve of \$4 million,
21 \$15 million and \$20 million. The reserve performance analysis
22 demonstrated that the current \$4 million accrual level,
23 assuming a starting reserve balance of \$21.6 million and no
24 recoveries of any negative reserve balances, would result in an
25 expected deficit balance of a negative \$52.4 million at the end

1 of the five-year simulation and have a 50/50 chance that storm
2 losses would create a deficit in the reserve over the five-year
3 period.

4 The reserve performance analysis with the same
5 assumptions also demonstrated that the \$20 million accrual
6 level selected by Tampa Electric would result in an expected
7 reserve balance of a positive \$27.9 million at the end of five
8 years and have only a one in four chance that the storm losses
9 would create a deficit in the reserve.

10 Our analysis also estimates the best case outcome for
11 the requested \$20 million accrual. There is only a 5 percent
12 chance that the reserve balance could reach \$121 million at the
13 end of five years. This would represent a very fortuitous five
14 years of storm seasons and represents a very unlikely outcome
15 of the reserve accumulating a large balance. This concludes my
16 summary.

17 MR. WAHLEN: Mr. Harris is available for
18 cross-examination.

19 CHAIRMAN CARTER: Ms. Christensen. Good morning.

20 MS. CHRISTENSEN: Good morning. I have no questions
21 for this witness.

22 CHAIRMAN CARTER: Ms. Bradley, good morning.

23 MS. BRADLEY: Good morning, Mr. Chairman.

24 CROSS EXAMINATION

25 BY MS. BRADLEY:

1 Q Sir, in your testimony you talked about you had done
2 risk analysis on hurricanes, tornadoes, ice storms, floods,
3 that type of thing.

4 A That's correct.

5 Q How do those compare as far as damage and cost to --
6 damage caused by hurricanes? Are they considered insignificant
7 when compared to hurricanes?

8 A These are all significant perils. The risk that any
9 particular peril presents is composed of several components.
10 One is the assets at risk themselves. The larger the asset
11 base that you have at risk, the larger potential you have for
12 loss. The second component is the hazard itself. Hurricane
13 hazards tend to be relatively frequent in comparison to other
14 perils like earthquakes, but are less frequent than perils like
15 ice storms, which are threats to midwest utilities, for
16 example, or northeast utilities.

17 Another component to the loss equation is the
18 vulnerability of the assets that are at risk. And in the case
19 of transmission distribution lines, the highest vulnerability
20 really is the fact that the lines are aerial and they're
21 exposed to both wind and debris fields. So they have
22 relatively high vulnerability compared to other kinds of assets
23 like residence or commercial structures.

24 So it's a very complex phenomena and we use
25 simulation models to model both the asset geo-locations, the

1 hazard itself based on meteorologic science, the vulnerability
2 based on loss experience, and all of this is put together in
3 simulation models that model many thousands of hurricane
4 seasons to actually estimate the results.

5 Q So the ice storms that we're seeing currently up in
6 the northern part of the country is fairly common and fairly
7 significant?

8 A They are more frequent than hurricanes and they do
9 produce a lot of damage and with a higher frequency than the,
10 than hurricanes would. Yes.

11 MS. BRADLEY: No further questions. Thank you.

12 CHAIRMAN CARTER: Thank you.

13 Ms. Kaufman, good morning.

14 MS. KAUFMAN: Good morning, Mr. Chairman. I have no
15 questions.

16 CHAIRMAN CARTER: Thank you.

17 Mr. Wright, good morning to you.

18 MR. WRIGHT: Good morning to you, Mr. Chairman.

19 Thank you very much. I do have a few questions for this
20 witness.

21 CHAIRMAN CARTER: You're recognized.

22 CROSS EXAMINATION

23 BY MR. WRIGHT:

24 Q Good morning, Mr. Harris.

25 A Good morning.

1 Q I'll start with a few brief questions regarding your
2 rebuttal testimony. On Page 8 of your testimony you make some
3 remarks about the consumer side witnesses being inappropriate
4 to reliably moderate rate volatility. Do you remember that
5 testimony?

6 A Yes, I do recall that.

7 Q Okay. Now you're not the company's rate witness, are
8 you?

9 A No, I'm not.

10 Q And you're not the company's cost allocation witness?

11 A That's correct.

12 Q Have you ever testified on rate design?

13 A No, I have not.

14 Q So what's the point of this testimony?

15 A The point of this testimony is to demonstrate that
16 this does have an effect on rate volatility. If the storm
17 reserve is inadequate to cover the storm losses, then other
18 options are required by the utility, either surcharges or
19 securitization or some other form of revenue generation which
20 will affect volatility of rates.

21 Q Are you familiar with the storm restoration surcharge
22 experience of the other Florida utilities, Florida Power &
23 Light, Progress and Gulf Power?

24 A Peripherally, yes.

25 Q Okay. As far as you know, is that satisfactory to

1 recover the companies', those respective companies', plural,
2 storm restoration costs?

3 A I don't know whether they consider it satisfactory or
4 not. I know they did recover some of their costs.

5 Q Has Tampa Electric Company experienced rate
6 volatility due to storm restoration costs since 1994?

7 A I couldn't speak to that.

8 Q When did Tampa Electric set up a storm reserve?

9 A I couldn't speak to that either. My, my
10 understanding is that it was set up after Hurricane Andrew, but
11 I don't know that for a fact.

12 Q Do you know whether the storm reserve of Tampa
13 Electric Company has ever gone negative since its inception?

14 A I do not know that for a fact.

15 Q I just have a clarification question. You used a
16 phrase that I did not understand in your direct testimony at
17 Page 15. You used the phrase "potential unrecovered losses to
18 Tampa Electric." That's at Line 12 on Page 15 of your direct
19 testimony. What does that mean, the phrase "potential
20 unrecovered losses to Tampa Electric," as you used the term in
21 your testimony?

22 A My use of that phrase is, represents damage to
23 transmission distribution assets from hurricanes, from tropical
24 storms and from deductibles on property insurance which are not
25 recovered through the insurance process.

1 Q So would I be correct to understand that response as
2 indicating that the word, use of the word "unrecovered" simply
3 means not recovered from insurance?

4 A That's correct.

5 Q Thank you. This is perhaps a clarification of a
6 question I asked earlier, but do you know whether the Florida
7 Public Service Commission has ensured that Florida utilities
8 that were, that have been adversely affected by storms have
9 recovered their reasonable and prudent storm restoration costs
10 in a timely manner?

11 A I do not know that. I'm, I'm not an expert in that
12 area.

13 Q Yesterday I distributed an exhibit that has been
14 admitted into the record, a report done for the Edison Electric
15 Institute regarding utility restoration cost recovery. Did
16 you, did you happen to see that during the --

17 A No, I did not see that yesterday. I know of the
18 report but I've not seen it recently.

19 Q Had you looked at it in the past?

20 A I did look at it after it was published. I think
21 that was sometime in early 2005.

22 MR. WRIGHT: Permission to approach, Madam Chair?

23 COMMISSIONER EDGAR: Yes.

24 MR. WRIGHT: Madam Chairman, I've just handed the
25 witness a copy of what has been admitted as Exhibit 108, and

1 I've particularly opened it to Page 12, which shows a table,
2 Figure 11. We talked about it briefly yesterday with
3 Mr. Carlson.

4 BY MR. WRIGHT:

5 Q Mr. Harris, looking at that table, you'll agree that
6 the other utilities in Florida, FPL, Progress and Gulf Power,
7 all experienced storm restoration costs significantly greater
8 than Tampa Electric in the 2004 storm season?

9 A That's what this figure would indicate. Yes.

10 Q Okay. And if you read the paragraph below that, it
11 indicates that the Florida Public Service Commission signaled
12 that it was willing to work with the utilities to make sure
13 they'd recovered their costs. Do you --

14 A I see where it says that. Yes.

15 Q And are you familiar with the actions that the
16 Florida Public Service Commission took in that regard?

17 A No. I'm not really an expert in Florida Commission
18 doings related to storm cost recovery.

19 Q Thank you. At Page 5 of your direct testimony and
20 then also in your, in your summary you talk about the
21 probability of Tampa Electric experiencing a negative storm
22 reserve balance over a five-year simulation time horizon. The
23 actual number in your testimony is 55.4 percent and you
24 described it in your summary as a 50/50 chance; correct?

25 A That's correct.

1 Q Does this mean, does this have any meaning for us
2 with respect to the probability of a negative balance in any
3 year?

4 A No, it doesn't. That is the probability that the
5 reserve will have a negative balance at some point over the
6 five-year period. The probability of that negative balance is
7 highest in the initial year because the balance is \$20 million,
8 \$21 million, \$22 million. Each year there's an additional
9 accrual, so the balance has an opportunity to grow. And as the
10 balance grows, the probability of having a negative balance due
11 to storm losses declines. So the risk in the first year is
12 lower, slightly lower than it is in subsequent years.

13 Q If I may, I think you just misspoke. I think you
14 meant to say the risk is higher in the first year.

15 A I'm sorry. Did I --

16 Q Okay.

17 A Yeah. The risk is higher in the early years rather
18 than the later years.

19 Q Thank you. On Page 8 of your direct testimony you
20 make a couple of statements regarding the increased hurricane
21 activity that we apparently are experiencing, and you say
22 first, "NOAA has expressed its belief," and that's the National
23 Oceanic and Atmospheric Association; correct?

24 A That's correct.

25 Q "NOAA has expressed its belief that we entered a

1 period of increased hurricane formation around 1995." And then
2 you go on further down the page and you say that the recent
3 period of higher activity is believed to have begun only about
4 a decade ago.

5 Just for clarification, are we talking about the same
6 period and a decade is approximately equal to 14 years or are
7 there two different --

8 A No. That is referring to the same period. And the
9 statement that "approximately a decade" is referring to -- the
10 actual date of the onset of this period is not a fixed and
11 indisputable period. I mean, some people would claim that this
12 period began in 1992 with Hurricane Andrew. There are other
13 studies of surface sea temperatures that indicate it's around
14 1995. So it's been a decade, a decade and a half that we've
15 been in this period that scientists and meteorologists
16 generally concede is a warm sea period.

17 Q And that -- as at least a statistical scientist
18 specializing in this area, would you agree with what you just
19 characterized a general scientific opinion that, that this
20 level of higher activity began somewhere maybe between 1995 and
21 2000?

22 A Well, I would, I would say that it began around 1995.
23 I mean, that is the established position in the scientific
24 literature that I would accept. But I'm not an expert, I'm not
25 a meteorologist.

1 Q Thank you. On Page 14 of your testimony you refer to
2 large uncertainties and large variances in the prediction of
3 hurricane events and damages. Is that a fair characterization
4 of your testimony?

5 A That's correct.

6 Q Okay. If you were to apply your simulation model to
7 any five-year period beginning in 1995, wouldn't it have
8 predicted similarly a 50/50 chance that the storm reserve would
9 have gone negative in any of those five-year periods?

10 A I'm sorry. Could you ask that question one more
11 time? I'm not sure I understood it.

12 Q If you were to, if you were to have applied, if you
13 were to apply your simulation model to a different five-year
14 period -- i.e., you applied it to 2009 to 2013 I believe;
15 correct?

16 A The simulation model is, is not period dependent.
17 It's, it's actually a simulation of 10,000 different five-year
18 periods. So we've actually generated 10,000 five-year paths
19 through a hurricane history, randomly sampling losses in each
20 of those years from the loss analysis. So there are actually
21 10,000 five-year periods that are used statistically to
22 determine the means and the statistical bounds of the reserve
23 balance.

24 Q And if I understand your testimony then, your
25 testimony to the Commission is that there is a greater than one

1 in two chance that over the next five years Tampa Electric's
2 storm reserve will go negative. Is that your testimony?

3 A That is the testimony.

4 Q Okay.

5 A That there is a 50/50, approximately a 50/50 chance
6 that in one of those five years the reserve would go negative.

7 Q And my question for you is if you were to apply the
8 same simulation model to, let's say, the period 1999 to 2004 or
9 1997 to 2001, any given five-year period, wouldn't it show
10 approximately the same results?

11 A It's not annual dependent. It isn't time dependent.
12 We're not taking 1999 to, or I should say we're not taking 2008
13 through 2013 as a simulation period. It's five random years,
14 each having the same frequency and likelihood of hurricane
15 losses.

16 Q Well, is it a fair interpretation of your testimony
17 then that the, that the probability of it going negative in any
18 five-year period is roughly one in two?

19 A That's, that's correct.

20 Q Okay. You were here yesterday evening, were you not?

21 A Yes, I was. No, I was not here this morning,
22 yesterday morning. I was here yesterday afternoon.

23 Q I apologize. I mumbled. I meant to say you were
24 here yesterday evening when Mr. Carlson testified, were you
25 not?

1 A That's correct. I was.

2 Q Okay. Did you hear him testify that since its
3 inception that Tampa Electric's storm reserve has never gone
4 negative?

5 A Yes, I did hear that testimony.

6 Q Back to Page 14 of your direct testimony, after you
7 referred to the large uncertainties and large variances, you go
8 on to say that the company's proposed \$20 million a year
9 accrual is appropriate. And my question for you is why should
10 Tampa Electric Company's customers give up another \$16 million
11 of their money every year starting in May of this year
12 especially in this economy when the company has never
13 experienced a negative storm reserve balance since it first
14 implemented its storm reserve 15 years ago?

15 A Well, I would say that that's a policy question that
16 I'm not really an appropriate witness to answer.

17 MR. WRIGHT: Thank you very much. No more questions.

18 CHAIRMAN CARTER: Thank you, Mr. Wright.

19 Good morning, Mr. Twomey.

20 MR. TWOMEY: Good morning, Mr. Chairman,
21 Commissioners.

22 CROSS EXAMINATION

23 BY MR. TWOMEY:

24 Q Good morning, Mr. Harris.

25 A Good morning.

1 Q The last answer you gave Mr. Wright was you said that
2 there was a question of whether the customers should be
3 required to give up \$16 million in terms of revenue
4 requirements to meet the company's requested storm damage
5 accrual and amounts was a policy question; right?

6 A Yes. Well, it was, it was a multipart question that
7 he asked. Part of the answer to his question is it is
8 appropriate because the expected annual damage of \$17.8 million
9 is close to \$20 million. It is a cost of doing business, and
10 over a long period of time Tampa is expected to see those kinds
11 of losses.

12 I believe the second part of his question was related
13 to whether customers should pay for that in this current
14 climate, this current economic difficulties that we're seeing,
15 and that really is a policy question.

16 Q Right. Now Mr. Wright started out asking you in part
17 what your familiarity was with, with prior Florida cases
18 dealing with storm damage. And the fact of the matter is, is
19 that you were more intimately and specifically familiar, pardon
20 me, with the number of storm damages in this case because
21 you've filed testimony in a number of previous cases; correct?

22 A That is correct.

23 Q How many, Mr. Harris?

24 A Testimony in Florida, I believe, is, has been filed
25 for both Florida Power & Light and for Progress Energy.

1 Q And in the case of Florida Power & Light, how many
2 cases did you testify in?

3 A I believe it was one rate case. I believe there may
4 have been some other filings related to storm cost recovery as
5 well.

6 Q Was it a rate case or a storm damage cost recovery
7 case?

8 A Well, there's definitely a storm damage cost recovery
9 case and I believe there was a filing in a rate case that was
10 in an earlier period.

11 Q Their, their last rate case that I recall was in
12 1985. Did you testify in that case?

13 A 1985. Then it was not a rate case. I misspoke.

14 Q Okay. Now on the Florida Power & Light case, the, do
15 you recall what the company was requesting in terms of its
16 annual storm damage accrual and its Storm Damage Reserves
17 target?

18 A My recollection was that the authorized FPL accrual
19 was about \$20 million and they were requesting something near
20 double that. That's my recollection. And I don't have the
21 facts to speak to that with me.

22 Q You don't? Now the, isn't it -- did you ever, did
23 you follow what the Commission's vote was on that, on that
24 matter?

25 A No. I, I'm not familiar with those facts.

1 Q You're not aware that, that the, this Commission in
2 that Florida Power & Light case substantially reduced both the
3 company's requested annual accrual as well as the target
4 reserve?

5 A I would accept that as a fact, but I don't know the
6 particulars of the final ruling.

7 Q So -- and since you don't know and if that was the
8 case, if they reduced the, the accrual and storm damage target,
9 you haven't chosen to criticize them in your testimony here.

10 A No, I haven't spoken to it at all.

11 MR. TWOMEY: Thank you. That's all.

12 CHAIRMAN CARTER: Thank you, Mr. Twomey.

13 Commissioners, I'm going to go to staff, unless there
14 are questions from the bench.

15 Staff, you're recognized.

16 MR. YOUNG: No questions.

17 CHAIRMAN CARTER: Okay. Anything from the bench?

18 Commissioner Skop, you're recognized, sir.

19 COMMISSIONER SKOP: Thank you, Mr. Chair.

20 And yesterday, again, we went pretty long, so my
21 thoughts were confused. But what I was trying to articulate to
22 the prior witness, and then I have a quick question, was that
23 the, in an unfunded reserve it represents just free cash flow
24 coming in to the extent that it's an accounting entry.

25 But to the witness, on Page 5 of your testimony

1 following to the top of Page 6 you discuss the sensitivity
2 analysis that was performed between the \$20 million scenario
3 and the \$15 million scenario. And subject to check, would you
4 agree that, that for the \$15 million accrual level versus the
5 20, it would only represent an increased probability risk of a
6 negative reserve of only, of 7.8 percent additional risk over
7 the \$20 million scenario?

8 THE WITNESS: Yes. I think that sounds correct.

9 COMMISSIONER SKOP: Okay. And has any calculation
10 been performed on what, you know, the difference in the rate
11 impact would be in terms of --

12 THE WITNESS: Not, not by ourselves. No.

13 COMMISSIONER SKOP: Okay. And subject to check,
14 would you generally agree that that might be, you know, maybe a
15 dollar a month in terms of that difference?

16 THE WITNESS: I really wouldn't, wouldn't be able to
17 comment on that.

18 COMMISSIONER SKOP: All right. Thank you.

19 CHAIRMAN CARTER: Commissioner Argenziano.

20 COMMISSIONER ARGENZIANO: Yes. Thank you.

21 Mr. Harris, I'm not sure you're the person to answer
22 this. You could probably answer it in part, and, if not, just
23 please tell me. You're being compensated a total of \$202,000
24 for your services?

25 THE WITNESS: I don't know that as a fact, and it

1 doesn't sound correct.

2 COMMISSIONER ARGENZIANO: It doesn't sound correct?

3 THE WITNESS: I, I don't know the number.

4 COMMISSIONER ARGENZIANO: Okay. Then you probably
5 don't know what I'm looking at. There's been a payment of
6 \$32,000 for what is titled as other. You're not sure of that
7 either then.

8 THE WITNESS: No.

9 COMMISSIONER ARGENZIANO: I guess I need to ask
10 Mr. Chronister. Mr. Chronister is the gentleman up next. I
11 guess I'll save it for him. Thank you.

12 CHAIRMAN CARTER: Okay. You think that would be more
13 appropriate for Mr. Chronister?

14 MR. WAHLEN: Yes, sir.

15 CHAIRMAN CARTER: Okay. Good. Good.

16 All right. Commissioners, anything further from the
17 bench?

18 Okay. Exhibits.

19 MR. WAHLEN: Tampa Electric moves Exhibit 27 into the
20 record.

21 CHAIRMAN CARTER: Any objections? Without objection,
22 show it done.

23 (Exhibit 27 marked for identification and admitted
24 into the record.)

25 MR. WAHLEN: May this witness be excused?

1 CHAIRMAN CARTER: And there was no --

2 MR. WAHLEN: No rebuttal exhibits.

3 CHAIRMAN CARTER: -- no rebuttal witness exhibits or
4 anything like that?

5 MR. WAHLEN: That's correct.

6 CHAIRMAN CARTER: Okay. You may be excused. Thank
7 you.

8 THE WITNESS: Thank you.

9 CHAIRMAN CARTER: Before we call our next witness,
10 Commissioners, let me kind of think out loud a little earlier
11 than I did yesterday. So for planning purposes so -- I know
12 that we all have other things that we've got to get done, is
13 that for lunch we'll break from 11:30 to 12:45, and after lunch
14 we come back and then I'll have better thoughts for a dinner
15 break. But those, those are so far, so I know that you've
16 got -- so for planning purposes both for the bench, 11:30 to
17 12:45.

18 Commissioner Skop.

19 COMMISSIONER SKOP: Mr. Chair, if we break at 6:00,
20 is Commissioner Argenziano bringing us an Italian dinner? No?

21 COMMISSIONER ARGENZIANO: No.

22 (Laughter.)

23 COMMISSIONER SKOP: I'm going to go hungry again.

24 CHAIRMAN CARTER: She's not the domestic type.

25 COMMISSIONER ARGENZIANO: I beg to differ. I could

1 be if I wanted to.

2 (Laughter.)

3 CHAIRMAN CARTER: If you wanted. Yeah. It's by
4 choice.

5 COMMISSIONER ARGENZIANO: I'd rather somebody bring
6 me the dinner.

7 COMMISSIONER SKOP: Well, cavatini from Pizza Hut is
8 not my idea of good Italian cooking, but anyway.

9 COMMISSIONER ARGENZIANO: You're right about that.

10 CHAIRMAN CARTER: Well, you know, being from South
11 Georgia --

12 COMMISSIONER ARGENZIANO: (Microphone off.)

13 CHAIRMAN CARTER: Yeah. Being from South Georgia, I
14 wouldn't know cannellini from pennellini (phonetic). So it,
15 you know, it all tastes the same to me. All I know is noodles
16 and cheese.

17 COMMISSIONER ARGENZIANO: Noodles?

18 CHAIRMAN CARTER: It's not noodles? See. Let's move
19 before I get in trouble here.

20 Call your next witness quick.

21 MR. HART: Tampa Electric Company calls Alan D.
22 Felsenthal.

23 ALAN D. FELSENTHAL

24 was called as a witness on behalf of Tampa Electric Company
25 and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

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BY MR. HART:

Q Would you please state your name and business address.

A Yes. My name is Alan Felsenthal. My business address is 550 West Van Buren, Chicago, Illinois. I work for Huron Consulting Group.

Q Did you prepare and cause to be filed in this proceeding prepared direct testimony consisting of 36 pages?

A Yes, I did.

Q Are there any changes or corrections to your prepared direct testimony?

A No, there is not.

Q If I were to ask you the questions contained in your direct testimony today, would your answers be the same?

A Yes.

MR. HART: Mr. Chairman, we'd request that Mr. Felsenthal's direct testimony be inserted into the record as though read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

BY MR. HART:

Q Mr. Felsenthal, attached to your direct testimony did you include a composite exhibit premarked as Exhibit ADF-1 and hearing Exhibit Number 28 consisting of two documents?

1 A Yes, I did.

2 MR. HART: Mr. Chairman, we would ask that
3 Mr. Felsenthal's composite exhibit premarked as hearing Exhibit
4 Number 28 be identified.

5 CHAIRMAN CARTER: Identified for the record.

6 (Exhibit 28 marked for identification.)

7 BY MR. HART:

8 Q Mr. Felsenthal, did you prepare and caused to be
9 filed in this proceeding prepared rebuttal testimony consisting
10 of 30 pages?

11 A Yes, I did.

12 Q Are there any changes or corrections to your prepared
13 rebuttal testimony?

14 A Yes, I have one. It's on Page 15, Line 8, where I am
15 quoting from a private letter ruling. There is a sentence
16 omitted that I need to include. That sentence is -- oh, it
17 goes right after the word "portion." And the additional
18 wording is, "If such composite annual percentage rate were
19 revised for purposes of computing depreciation expense
20 beginning with a particular accounting period, the computation
21 of rateable portion must also be revised beginning with such
22 period."

23 Q With that correction, if I were to ask you the
24 questions contained in your rebuttal testimony, would your
25 answers be the same?

1 A Yes, they would.

2 MR. HART: Mr. Chairman, we would request that the
3 rebuttal testimony of Mr. Felsenthal be inserted into the
4 record as though read.

5 CHAIRMAN CARTER: The prefiled testimony of the
6 witness will be inserted into the record as though read.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

ON BEHALF OF TAMPA ELECTRIC COMPANY

1
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4
5
6
7 **Q.** Please state your name, business address, occupation and
8 employer.

9
10 **A.** My name is Alan D. Felsenthal. My business address is
11 550 West Van Buren Street, Chicago, Illinois 60607. I
12 am employed by Huron Consulting Group ("Huron").

13
14 **Q.** Please provide a brief outline of your educational
15 background and business experience.

16
17 **A.** Upon graduating from the University of Illinois in 1971,
18 I was hired by Arthur Andersen & Co. ("Arthur Andersen"
19 or "the Firm"), where I was an auditor, focusing on
20 audits of financial statements of rate regulated
21 entities. I supervised audits, from which the Firm
22 issued audit reports on financial statements that were
23 filed with the Securities and Exchange Commission,
24 Federal Communications Commission, Federal Energy
25 Regulatory Commission ("FERC") and various state

1 commissions.

2

3 Arthur Andersen also consulted in a significant number
4 of utility rate cases, and I helped develop testimony
5 for myself and others on a variety of issues including
6 Construction Work in Progress in rate base, phase-in
7 plans, projected test years, lead-lag studies, cost
8 allocation and income tax normalization. I joined
9 PricewaterhouseCoopers ("PwC") in 2002 and continued
10 performing audits and rate work for regulated entities.
11 The testimony was filed in Arizona, Illinois, Indiana,
12 Florida, Michigan, Minnesota, New Mexico, Texas, Nevada
13 and Wisconsin.

14

15 I have testified before the Florida Public Service
16 Commission ("FPSC" or "Commission"), the Arizona
17 Corporation Commission and the Illinois Commerce
18 Commission.

19

20 **Q.** Have you dealt with the unique accounting, tax and
21 financial reporting issues encountered by rate regulated
22 enterprises?

23

24 **A.** Yes. Throughout my career, I have focused on utility
25 accounting, income tax and regulatory issues, primarily

1 as a result of auditing regulated enterprises. The
2 unique accounting standards applicable to rate regulated
3 entities are embodied in Financial Accounting Standards
4 Board Statement of Financial Standards ("FAS") 71, FAS
5 90, FAS 92, FAS 101, FAS 109 and various Emerging Issues
6 Task Force issues. These standards must be understood
7 so that auditors can determine if the standards have
8 been applied appropriately. These standards were issued
9 during my career and I have consulted with utilities as
10 to how they should be applied. At both Arthur Andersen
11 and PwC, I worked with the technical industry accounting
12 and auditing leadership to communicate and consult on
13 utility accounting and audit and income tax matters.

14
15 **Q.** What are your current responsibilities?

16
17 **A.** I am a managing director at Huron. Huron provides a
18 variety of accounting, tax and consulting services to
19 various industry sectors. My focus is on the regulated
20 industry sector, primarily electric and gas utilities.

21
22 **Q.** Have you provided training on the application of
23 Generally Accepted Accounting Principles ("GAAP") to
24 rate regulated enterprises?

25

1 **A.** Yes. At Arthur Andersen, PwC and Huron, I have
2 developed and presented utility accounting seminars
3 focusing on the unique aspects of the regulatory process
4 and the resulting accounting consequences of the process
5 on the application of GAAP. One of the seminars I have
6 presented focuses on the unique accounting and
7 ratemaking impacts applicable to income tax accounting
8 for rate regulated enterprises, including the specific
9 requirements of the Internal Revenue Code ("IRC")
10 applicable to public utilities.

11
12 I have presented seminars on an open registration basis
13 as well as delivered training on an in-house basis.
14 Seminar participants have included utility company and
15 regulatory commission staff accountants, utility rate
16 departments and internal auditors, tax accountants and
17 others. I also conducted these seminars on an in-house
18 basis for the FERC and several state commissions and
19 have presented at various Edison Electric Institute and
20 American Gas Association ratemaking and accounting
21 seminars. Personnel from various state regulatory
22 commissions have attended the open registration
23 sessions.

24
25 **TESTIMONY PURPOSE**

1 Q. What is the purpose of your direct testimony?

2

3 A. My direct testimony will address several aspects of the
4 income tax calculations submitted by Tampa Electric
5 Company ("Tampa Electric" or "company") in this
6 proceeding.

7

8 I will testify on the computation of income tax expense,
9 accumulated deferred income taxes ("ADIT") and
10 unamortized investment tax credit ("ITC") set forth in
11 the company's Minimum Filing Requirement ("MFR")
12 schedules. My testimony will address whether such
13 computations for 2007 are in conformity with GAAP, the
14 Uniform System of Accounts and the requirements of the
15 IRC and Income Tax Regulations.

16

17 I will also testify on the calculation of income tax
18 expense, ADIT and unamortized ITC included in the MFRs
19 for the projected year 2009, the test year for this
20 proceeding. My testimony on the 2009 projected
21 information will explain that the projected income tax
22 expense, ADIT and unamortized ITC have been determined
23 using a methodology consistent with the actual 2007
24 income tax calculations, the projected test year cost of
25 service and the specific IRC and Income Tax Regulations

1 covering projected test years.

2

3 **Q.** What principles guide your direct testimony?

4

5 **A.** My direct testimony is guided by the recognition that in
6 the ordinary operation of a public utility such as Tampa
7 Electric, both the accrual of revenue based on delivery
8 of electric service and the accrual of expenses generate
9 income tax consequences. To the extent that those
10 revenues and expenses are included in the cost of
11 service of the utility, so should the related income tax
12 expense. To do otherwise would deny Tampa Electric the
13 opportunity to recover a necessary cost of providing
14 service. The amount of income tax expense should be
15 consistent with the requirements of GAAP and the IRC.

16

17 **Q.** Have you prepared an exhibit to support your testimony?

18

19 **A.** Yes, I am sponsoring Exhibit No. ____ (ADF-1), entitled
20 "Exhibit of Alan D. Felsenthal, on Behalf of Tampa
21 Electric Company", was prepared under my direction and
22 supervision. This Exhibit consists of:

23

Document No. 1 List Of Minimum Filing Requirement

24

Schedules Sponsored Or Co-Sponsored

25

By Alan D. Felsenthal

Document No. 2 Calculation Of IRC Required Deferred
Income Tax Adjustment

ACCOUNTING FOR INCOME TAXES

Q. Can you please describe the computation of income tax expense?

A. Yes. FAS 109, Accounting for Income Taxes, provides guidance on accounting for income taxes and has been adopted by the FPSC for regulatory purposes in Rule 25-14.013, Florida Administrative Code. There are several components to the calculation. The first component is "current" income tax expense, representing the estimated amount of current year income taxes payable based on current year taxable income. Taxable income for the year is determined in accordance with the IRC. The IRC contains procedures for determining if and when an item is "taxable" or "deductible." The IRC rules for determining what is taxable or deductible may differ from what is reportable as "revenue" or "expense" under GAAP. For instance, certain expenses recorded on the financial statements under GAAP in one year may be deductible on the tax return in a different period. There are also instances where the amounts shown as deductions on the tax return in one year are not

1 reflected on the financial statements until a later
2 year. Differences between the book treatment and the
3 tax return treatment of revenues and expenses result in
4 different balances of book and tax assets and
5 liabilities on the respective book and tax balance
6 sheets. These differences are referred to as temporary
7 differences.

8
9 **Q.** Can you provide an example of a book/tax temporary
10 difference?

11
12 **A.** Yes. When a company acquires a fixed asset, that asset
13 is depreciated for book purposes over its estimated
14 useful life in a systematic and rational manner. Most
15 utilities use the straight-line depreciation method to
16 determine book depreciation expense. For income tax
17 purposes, that same asset may be depreciated for
18 determining taxable income on the income tax return
19 using an accelerated method permitted under the IRC.
20 When the annual depreciation charge for book and income
21 tax purposes is compared each year, there will likely be
22 differences between annual book and tax depreciation.
23 However, given the same capitalized asset cost, total
24 depreciation will be the same over the life of the
25 asset.

1 Another example of a temporary book/tax difference is
2 the accrual recorded on the books for other post-
3 employment benefit costs, which is not deductible for
4 income tax return purposes until it is settled. In this
5 example, the book accrual/expense occurs in advance of
6 the tax deduction.

7
8 A third example is contributions in aid of construction,
9 which are generally considered taxable when received for
10 income tax purposes. However, for book purposes they
11 are recorded as a reduction of property, plant and
12 equipment.

13
14 **Q.** How are differences between the book treatment and
15 income tax treatment of these types of transactions
16 accounted for under FAS 109?

17
18 **A.** In addition to the calculation of current tax expense,
19 FAS 109 requires a calculation of the tax expense on
20 temporary differences. The income tax component
21 resulting from applying the income tax rate to temporary
22 differences at each balance sheet date is known as ADIT.
23 Deferred tax expense reflects the period to period
24 change in ADIT. Because the financial statements
25 reflect accrual accounting, the income tax expense

1 calculation must reflect the liability for income taxes
2 payable in the future as a result of transactions
3 recorded in the current financial statements. Thus,
4 income tax expense under GAAP includes both a currently
5 payable component as well as a deferred income tax
6 component. In the regulated environment, the process of
7 recording deferred income taxes on temporary differences
8 is often referred to as "comprehensive interperiod
9 income tax allocation" or "normalization".

10
11 **Q.** Does the ADIT balance represent an obligation for future
12 income taxes at the balance sheet date?

13
14 **A.** Yes. The ADIT balance at any point in time represents
15 taxes that are expected to be paid in the future based
16 on transactions recorded in the financial statements
17 today. The purpose of deferred income tax accounting is
18 to reflect in the financial statements the tax effects
19 (both current and deferred) of assets, liabilities,
20 revenues and expenses recorded on the financial
21 statements.

22
23 ADIT balances are sometimes referred to as an "interest
24 free loan" from the U.S. Treasury. This was the result
25 intended by Congress when it changed the IRC to permit

1 the use of accelerated depreciation. Congress felt that
2 by being allowed to accelerate depreciation deductions
3 (and thereby reduce current income tax payments),
4 companies would lower the financing costs of their
5 investment in capital assets and thus would be incited
6 to incur such expenditures. For accounting purposes,
7 using up the tax basis of capital assets is both a cost
8 to be recognized in the financial statements when
9 claimed (deferred tax expense) and a liability for
10 future taxes due when the turnaround occurs and book
11 depreciation exceeds tax depreciation (ADIT).

12
13 **Q.** Are all book/tax differences "temporary differences"?

14
15 **A.** No. Certain items of revenue and expense are treated
16 differently for financial reporting purposes than for
17 income tax purposes. These are referred to as permanent
18 differences.

19
20 An example of a permanent difference is the cost of
21 meals and entertainment, which are reported as expenses
22 in the financial statements but, based on the IRC, are
23 not completely deductible in determining taxable income
24 on the income tax return.

25

1 Q. Is the distinction between permanent and temporary
2 differences important in the income tax calculation?

3
4 A. Yes. Deferred income taxes are not applicable to
5 permanent differences, because such differences will
6 never be included on income tax returns.

7

8 **RATEMAKING TREATMENT OF INCOME TAXES**

9 Q. Is deferred income tax accounting appropriate for
10 ratemaking purposes?

11

12 A. Yes. Income tax expense in a given year is the result
13 of that year's economic activity. In determining the
14 revenue requirement, it is important for regulatory
15 commissions to consider the recovery of all appropriate
16 costs of providing service, including the associated
17 income tax effects of the costs.

18

19 During the ratemaking process, the regulator considers
20 all items of revenues and expenses and makes a finding
21 as to whether the individual revenues and expenses
22 should be allowed in the determination of revenue
23 requirements. Once the regulator determines the
24 allowable costs excluding income taxes, the income tax
25 consequences, both current and deferred, can be

1 calculated. This is because income taxes have no
2 independent existence of their own. They result from an
3 independent determination of revenues and expenses. The
4 revenues and expenses are generally determined on an
5 accrual basis and the tax consequences of revenues and
6 expenses must be determined on that same accrual basis
7 (current and deferred income taxes).

8
9 As I discussed earlier, the accelerated depreciation
10 (the major component of deferred taxes for capital
11 intensive entities such as Tampa Electric) of assets was
12 meant to lower the cost of financing assets by providing
13 the company an interest free loan. The ADIT balance
14 (the interest free loan from the U.S. Treasury) is a
15 zero cost source of capital in the cost of capital
16 computation thereby giving the benefit of the reduced
17 financing costs to ratepayers.

18
19 **Q.** Is there another methodology used to compute income tax
20 expense for utilities?

21
22 **A.** Yes. Some regulatory commissions have utilized a "flow-
23 through" methodology. This methodology is not GAAP for
24 enterprises in general. Under flow-through, the tax
25 reducing effects of book/tax temporary differences are

1 flowed-through to ratepayers by only permitting the
2 utility to recover current income tax expense in the
3 cost of service. The deferred income tax expense is not
4 included as a recoverable test year expense. Under
5 flow-through, the "interest free loan" from the U.S.
6 Treasury is not retained by the company to pay the taxes
7 in the future when they become payable. Instead, these
8 interest free funds go to the ratepayers when the
9 temporary difference arises and are paid back by the
10 ratepayer when the taxes become payable.

11
12 Because temporary differences, by definition, will
13 reverse in the future, under a flow-through methodology
14 ratepayers receive the benefit of accelerated deductions
15 in the periods where current income tax expense is
16 reduced for such deductions but pay the higher current
17 income tax expense when the temporary difference
18 reverses. No deferred income tax expense is recorded.

19
20 Mechanically, a temporary difference that is flowed-
21 through has the same effect as a permanent difference in
22 that no deferred income tax expense is recorded on the
23 flow-through temporary difference. Utility companies
24 whose regulators have determined income tax expense
25 using the flow-through methodology are the only entities

1 that can use this approach for determining income tax
2 expense.

3
4 **Q.** Is flow-through an appropriate methodology?

5
6 **A.** No. The flow-through method has a number of flaws
7 including:

- 8 • The stimulus incentives of accelerated income tax
9 deductions are not available to the utility as such
10 benefits are given to ratepayers when the temporary
11 difference arises via a reduction in income tax
12 expense.
- 13 • There is a significant potential for
14 intergenerational inequity. Ratepayers who are
15 customers of the company when the flowed-through
16 temporary differences arise will receive the lower
17 income tax expense and may not be the same
18 ratepayers that will be responsible for the higher
19 income tax expense deemed necessary to pay the
20 higher income tax expense when the temporary
21 differences reverse.
- 22 • The FERC and others have demonstrated that in the
23 long-term, ratepayers are better off with
24 permitting recovery of deferred income tax expense.
25 This is mainly due to the increased risk associated

1 with the flow-through methodology, among which is
2 the need for additional rate cases to get back the
3 interest free loan that is in the hands of the
4 ratepayer to be able to pay the increased taxes
5 when the temporary difference reverses.
6

7 **Q.** Has the FERC taken a position on the appropriateness of
8 deferred income tax accounting?
9

10 **A.** Yes. The FERC concluded in Orders 144 and 144A that
11 deferred tax accounting was appropriate. The FERC has
12 required deferred tax accounting since the issuance of
13 those orders in the 1980's.
14

15 **Q.** Has the FPSC taken a position on the appropriateness of
16 deferred income tax accounting?
17

18 **A.** Yes. The FPSC has long acknowledged that normalization
19 is appropriate for revenues and expenses that are
20 recognized at different times for book and tax purposes.
21

22 **Q.** Does the IRC contain requirements addressing deferred
23 income tax accounting?
24

25 **A.** Yes. The IRC contains specific requirements that are

1 applicable to public utility property. These
2 requirements, in effect, mandate that in order for a
3 public utility to be eligible to claim accelerated
4 depreciation for income tax purposes, the regulator must
5 permit recovery of deferred income taxes on the
6 difference resulting from using accelerated depreciation
7 for income tax purposes and straight-line depreciation
8 for book purposes. In other words, the use of the flow-
9 through accounting method for the book/tax depreciation
10 difference would cause a "normalization violation".
11

12 The penalty for violating the normalization requirements
13 is the loss of the ability to claim accelerated
14 depreciation for income tax purposes on all assets as of
15 the violation date and on subsequent additions. It is a
16 severe penalty.
17

18 **Q.** Is there another component of the income tax
19 calculation?
20

21 **A.** Yes. In addition to current and deferred income taxes,
22 a third element of the tax computation is the ITC.
23

24 **Q.** Can you please summarize what the ITC is and how it is
25 treated for accounting/rate making purposes?

1 **A.** The ITC has gone in and out of existence over the years
2 and lowers income tax expense permanently if certain
3 qualifying investments are made. The intent of the ITC
4 is to reduce the net cost of acquiring depreciable
5 property, thereby providing taxpayers an incentive to
6 invest in qualifying assets. To make sure that its
7 objectives are met for investments in qualifying utility
8 property, the IRC prescribes methods of sharing the
9 benefit between the ratepayers and the shareholders.

10
11 The ITC is a direct reduction of income taxes payable in
12 a given year. Unlike accelerated depreciation and other
13 book/tax differences that will eventually reverse or
14 turn around, the ITC is similar to a grant or rebate.
15 The ITC provides an incentive to make capital
16 investments by granting a tax credit (a direct dollar
17 for dollar offset to current taxes payable) based on a
18 percentage applied to investment in tangible personal
19 property (most generation, transmission and distribution
20 assets).

21
22 The accounting rules for the ITC are contained in
23 Accounting Principles Board Opinions 2 and 4, Accounting
24 for the Investment Credit. Most utilities account for
25 the ITC by reducing current income taxes for the amount

1 of the ITC realized in a particular year, with an
2 offsetting "unamortized ITC". The unamortized amount is
3 then amortized to reduce income tax expense over the
4 life of the property, giving rise to the ITC. Under
5 this approach, the ITC is reflected in net income over
6 the productive life of the acquired property.

7
8 For ratemaking purposes, in 1972 utilities were required
9 to elect how they intended to share the ITC between
10 ratepayers and shareholders. Most utilities, including
11 Tampa Electric, elected to share the ITC by including
12 the annual amortization to income tax expense as an
13 above the line reduction which reduced income tax
14 expense benefiting ratepayers. The unamortized amounts
15 were not used to reduce rate base, benefiting
16 shareholders who were entitled to earn on property,
17 plant and equipment financed partially by the ITC
18 "grant" or "rebate".

19
20 The ITC was repealed as a result of the Tax Reform Act
21 of 1986. Tampa Electric had realized ITC on tax returns
22 prior to its repeal and the current filing reflects
23 unamortized ITC on property, plant and equipment it
24 realized prior to its repeal. The unamortized ITC is
25 being amortized over the lives of the property, plant

1 and equipment, giving rise to the ITC.

2
3 **HURON PROCEDURES AND INCOME TAX MFRs**

4 **Q.** What procedures did Huron perform with respect to the
5 company's income tax calculations?

6
7 **A.** The following procedures were performed by me or under
8 my direct supervision:

9 1. We read the company's portion of TECO Energy,
10 Inc.'s 2006 income tax return to identify the
11 differences between book and taxable income.
12 Schedule M of the tax return lists the book/tax
13 differences. We did not review the 2007 tax return
14 as it is currently being prepared and is not
15 expected to be finalized and filed until September
16 15, 2008.

17 2. We obtained the supporting documentation for
18 significant book/tax differences, noting that the
19 book/tax differences were treated appropriately in
20 the calculation of both current and deferred income
21 tax expense and the related current and deferred
22 balance sheet accounts for 2007 and the 2009 test
23 year.

24 3. We reviewed the calculation of projected 2009
25 income tax expense and the methodology used to

1 determine such amounts. During this process, we
2 focused on amounts treated as permanent
3 differences, as these items impact the total income
4 tax expense calculation.

5 4. We analyzed the roll-forward of ADIT from December
6 31, 2007 to December 31, 2009 based upon projected
7 2008 and 2009 activity.

8 5. We reviewed the documentation supporting the ITC
9 amortization.

10 6. We read the relevant sections of prior FPSC Orders
11 pertaining to income taxes.

12 7. We read the MFR schedules identified in Document
13 No. 1 of my exhibit.

14 8. We compared the projected 2009 ADIT amounts
15 included in the MFR income tax schedules to the IRC
16 requirements for how such amounts are to be
17 computed when a forecasted test period is used in a
18 rate proceeding.

19
20 **Q.** Have there been recent changes in Federal tax policy
21 that have been considered in this proceeding?

22
23 **A.** Yes. On February 13, 2008, the President of the United
24 States signed the Economic Stimulus Act of 2008 (the
25 "Act"). The Act allows an additional first-year

1 depreciation deduction equal to 50 percent of the
2 adjusted basis of qualified property for the 2008 and
3 2009 calendar years. This results in a larger book/tax
4 difference for accelerated depreciation used for income
5 tax depreciation versus straight-line depreciation used
6 for financial reporting. Tampa Electric has reflected
7 the impact of this provision in the 2009 MFRs.

8
9 **Q.** Are the income tax accounts reflected in the historical
10 2007 and forecasted 2009 MFRs computed appropriately?

11
12 **A.** Yes. Federal and state income tax expense has been
13 correctly computed in the income statement in accordance
14 with GAAP and the requirements of the FPSC. In
15 addition, the computed income tax expense for 2007 and
16 2009 conforms with the requirements of the IRC,
17 including the special provisions applicable to
18 utilities.

19
20 The ADIT balances included in the MFRs are appropriate
21 with one exception. The exception relates to an
22 overstatement of ADIT resulting from a required true-up
23 entry recorded on the books but erroneously omitted from
24 the MFRs. The adjustment to correct for this omission
25 is to reduce the ADIT balance by approximately \$8.4

1 million. The adjustment was identified after the MFRs
2 were completed and, had the MFRs correctly reflected the
3 ADIT balance, there would be no impact to Tampa
4 Electric's revenue requirement calculation.

5
6 Tampa Electric's income tax provision has been
7 determined using a comprehensive interperiod income tax
8 allocation. The company's tax computation is based on
9 the revenues and expenses associated with the provision
10 of its regulated utility service to its ratepayers. In
11 this manner, the tax expense included in the revenue
12 requirement calculation is the appropriate tax expense
13 reflecting the tax consequences of the costs and
14 revenues included in the establishment of the revenue
15 requirement.

16
17 In addition, Tampa Electric's unamortized ITC is being
18 amortized to tax expense over the book life of the
19 related property. The amortization is "no more rapidly
20 than ratably" in accordance with the IRC requirements.

21
22 **IRC REQUIREMENTS FOR PROJECTED TEST PERIODS**

23 **Q.** Has the company made any other material adjustments when
24 computing income tax expense and deferred taxes for the
25 2009 test year?

1 **A.** Yes. My testimony addresses one further adjustment that
2 has been made to comply with the normalization
3 requirements of the IRC when a projected or forecast
4 test period is used.

5
6 The ADIT balances on MFR Schedule D-1a, Cost of Capital,
7 are based on a 13-month average of projected balances.
8 However, the IRC requirements for projected test years
9 require a specific computation to determine the maximum
10 amount of ADIT to be treated as zero cost capital in the
11 cost of capital calculation. The specific computation
12 is shown on MFR Schedule D-1b, Cost of Capital-
13 Adjustments, and reduces the ADIT included on MFR
14 Schedule D-1a by \$1,894,000. It is also shown on
15 Document No. 2 of my exhibit. This adjustment is only
16 required for accumulated deferred income taxes recorded
17 in Account 282, net of the FAS 109 component, because
18 this account includes the deferred taxes governed by the
19 Internal Revenue Service ("IRS") normalization rules.

20
21 **Q.** Can you please describe the projected test year
22 requirements of the IRC?

23
24 **A.** Yes. The IRC rules are set forth in Treasury Regulation
25 Section 1.167(l)-1(h)(6) which address forecasted test

1 periods and the appropriate amount of ADIT used to
2 reduce rate base (or to be treated as zero cost capital
3 in the determination of cost of capital) for a forecast
4 test period. Specifically, these regulations require
5 that:

6 "for the purposes of determining the maximum
7 amount of the reserve to be excluded from the
8 rate base (or to be included as no-cost
9 capital) under subdivision (I) of this
10 subparagraph), if solely an historical period
11 is used to determine depreciation for Federal
12 income tax expense for ratemaking purposes,
13 then the amount of the reserve account for the
14 period is the amount of the reserve (determined
15 under subparagraph (2) of this paragraph) at
16 the end of the historical period. If solely a
17 future period is used for such determination,
18 the amount of the reserve at the beginning of
19 the period and a pro rata portion of the amount
20 of any projected increase to be credited or
21 decrease to be charged during a future period
22 (or the future portion of a part-historical and
23 part-future period) shall be determined by
24 multiplying any such increase or decrease by a
25 fraction, the numerator of which is the number

1 of days remaining in the period at the time
2 such increase or decrease is to be accrued, and
3 the denominator of which is the total number of
4 days in the period (or future portion)."

5
6 **Q.** Tampa Electric has used a 2009 forecast test year in
7 this proceeding. It expects new rates to be effective
8 in May 2009. Do these rules apply to this situation?

9
10 **A.** Yes. Tampa Electric's revenue requirements are based on
11 the 2009 13-month average balances of plant, accumulated
12 depreciation and other rate base items. The 13-month
13 average is developed based on the monthly rate base
14 balances from December 2008 through December 2009.
15 Similarly, the ADIT balances treated as a source of
16 cost-free capital in the capital structure are also
17 based on a 13-month average. Operating expenses,
18 including depreciation expense and federal income tax
19 expense, are based on the year ending December 31, 2009.
20 This timing situation, where rates go into effect before
21 the end of the test period is the situation wherein
22 these IRC rules are applicable.

23
24 **Q.** Can you cite specific IRC guidance or interpretations to
25 support your position?

1 **A.** Yes. There have been several private letter rulings
2 ("PLRs") issued in instances with fact patterns similar
3 to Tampa Electric's. The specific PLRs are PLR 9029040,
4 PLR 9202029, PLR 9224040 and PLR 9313008. Although
5 private letter rulings issued to specific taxpayers are
6 not to be cited as precedent, they reflect IRS thinking
7 on an issue and are consistently followed by the IRS.
8 PLR 9029040, which states:

9 "If rates go into effect before the end of the
10 test period, and the rate base reduction is not
11 prorated, the utility commission is denying a
12 current return for accelerated depreciation
13 benefits the utility is only projected to have.
14 This procedure is a form of flow-through, for
15 current rates are reduced to reflect the
16 capital cost savings of accelerated
17 depreciation deductions not yet claimed or
18 accrued by the utility. Yet projected data is
19 often necessary in determining rates, since
20 historical data by itself is rarely an accurate
21 indication of future utility operating results.
22 Thus, the regulations provide that as long as
23 the portion of the deferred tax reserve based
24 on truly projected (future estimated) data is
25 prorated according to the formula in section

1 1.167(1)-1(h)(6)(ii), a regulator may deduct
2 this reserve from rate base in determining a
3 utility's allowable return. In other words, a
4 utility regulator using projected data in
5 computing ratemaking tax expense and rate base
6 exclusion must account for the passage of time
7 if it is to avoid flow-through."

8
9 **Q.** Has the IRS defined "historical" versus "future" test
10 periods as it relates to the pro rata ADIT calculation?

11
12 **A.** Yes. In PLR 9202029, the IRS provided the following
13 guidance:

14 "Critical to the interpretation of section
15 1.167(1)-1(h)(6)(ii) of the regulation is the
16 meaning of the terms "historical" and "future"
17 in relation to the period for determining
18 depreciation for ratemaking tax expense (this
19 test period might not be consistent with the
20 taxpayer's test year; see, e.g. section
21 1.167(1)-1(h)(6)(iv) Example (2)). The meaning
22 of these terms does not depend on the type or
23 quality of the data used in the ratemaking
24 process--whether the data used is actual or
25 estimated--but on when the utility's rates

1 become effective. The historical period is
2 that portion of the test period before rates go
3 into effect, while the portion of the test
4 period after the effective date of the rate
5 order is the future period.

6
7 These date-based definitions of the terms
8 "historical" and "future" are consistent with
9 the purpose of normalization, which is to
10 preserve for regulated utilities the benefit of
11 accelerated depreciation as a source of cost-
12 free capital. This cost-free capital is made
13 available by prohibiting flow-through. But
14 whether or not flow-through can be accomplished
15 by means of a rate base exclusion depends
16 primarily on whether, at the time rates become
17 effective, the amounts originally projected to
18 accrue to the deferred tax reserve have
19 actually accrued."

20
21 In Tampa Electric's filing, the future portion of the
22 test period subject to the pro rata guidance is the
23 period from May 1, 2009 (the expected effective date of
24 the rate change) to December 31, 2009 (the end of the
25 projected test period).

1 Q. How did Tampa Electric address this requirement in
2 determining the proper level of accumulated deferred
3 taxes to be treated as cost-free capital in the forecast
4 test period ended December 31, 2009?

5
6 A. Tampa Electric first determined the monthly projected
7 balances for accumulated deferred income taxes for the
8 year 2009. The monthly changes to accumulated deferred
9 income taxes were based on the specific forecast of book
10 and tax depreciation throughout the 2009 projected test
11 period. These amounts were used to populate the 2009
12 MFRs related to monthly ADIT in accordance with the FPSC
13 rules. Month-end ADIT balances from December 2008
14 through December 2009 are shown on MFR Schedule B-3, and
15 a 13-month average is computed and summarized on MFR
16 Schedule D-1a.

17
18 As explained previously, the average ADIT balance
19 determined in this manner does not comply with the pro
20 rata Treasury Regulations. The Treasury Regulations
21 require that a pro rata calculation be used to determine
22 the maximum amount of ADIT to be treated as cost-free
23 capital in the cost of capital computation.

24
25 The monthly changes to ADIT were identified based on the

1 specific forecast of book and tax depreciation
2 throughout the 2009 projected test period. The January
3 to April 2009 changes to ADIT were not prorated because
4 they occur prior to the estimated May 2009 effective
5 date of the rate increase (the "historical" portion of
6 the test period as defined by the IRS). The projected
7 changes to ADIT after the effective date of the rate
8 increase are subject to the pro rata rules (the "future"
9 portion of the test period). Thus, the forecasted May
10 2009 increase in ADIT was prorated using a numerator of
11 215 days and a denominator of 245 days (the number of
12 days from the effective date of the rate change to the
13 end of the forecast test period). The projected ADIT
14 change in December 2009 was prorated using a numerator
15 of one day and a denominator of 245 days.

16
17 Next, a 13-month average of the prorated monthly change
18 in the ADIT balances for the test period was computed.
19 This amount was compared to the 13-month average non-
20 prorated 2009 monthly change in ADIT balances reflected
21 on MFR Schedule B-3 and MFR Schedule D-1a and an
22 adjustment of \$1,894,000 million was computed. This
23 adjustment is reflected on MFR Schedule D-1b and is
24 necessary to state the projected 2009 ADIT balance to be
25 treated as zero cost capital at the level required to

1 comply with the forecast test period requirements set
2 forth in Treasury Regulation Section 1.167(l)-1(h)(6).

3
4 **Q.** Once the ADIT for each month in the test period is
5 determined using the pro rata methodology, why is it
6 necessary to average the pro rata monthly ADIT balances?

7
8 **A.** When an average rate base is used, the pro rata monthly
9 ADIT balances must also be averaged to comply with the
10 consistency portion of the normalization requirements.
11 In PLR 9224040, the IRS was requested to rule on the
12 following issue:

13 "Where an average rate base is used and where
14 the test period is part historical and part
15 future under section 1.167(l)-1(h)(6)(ii) of
16 the regulations, whether the consistency rules
17 of section 168(i)(9)(B) of the Code require the
18 average rate base to be reduced by the average
19 of (i) the estimated deferred taxes at the
20 beginning of the test period and (ii) the
21 prorated estimated deferred taxes at the end of
22 the test period?"

23
24 The conclusion in that PLR is clear:

25 "2. Where an average rate base is used and

1 where the test period is part historical and
2 part future for purposes of section 1.167(1)-
3 1(h)(6)(ii) of the regulations, failure to
4 reduce the average rate base by the average of
5 (i) the estimated deferred taxes at the
6 beginning of the test period and (ii) the
7 estimated deferred taxes at the end of the test
8 period as prorated under section 1.167(1)-
9 1(h)(6)(ii), will violate the consistency rules
10 of section 168(i)(9)(B) of the Code.”
11

12 **Q.** What are the consequences if Tampa Electric does not
13 follow the pro rata rules of the IRS with respect to
14 forecast test period ADIT?
15

16 **A.** Based on the Treasury Regulations and the PLRs I
17 referenced, noncompliance with the Treasury Regulations
18 would result in a form of flow-through that violates the
19 normalization requirements of the IRC. As I explained
20 previously, the penalty for violating the normalization
21 requirements is the loss of the ability to claim
22 accelerated depreciation on public utility property.
23

24 **Q.** Why is this pro rata averaging adjustment only required
25 for the ADIT balances recorded in Account 282, net of

1 the related FAS 109 component?

2

3 **A.** The ADIT recorded in Account 282, net of the related FAS
4 109 component; represent the deferred taxes subject to
5 the IRS normalization rules. The remainder of the ADIT
6 balances (Accounts 190,281 and 283) included as zero
7 cost capital in the capital structure are not subject to
8 the same requirements.

9

10 **FIN 48**

11 **Q.** Were any new income tax standards considered?

12

13 **A.** Yes. In June 2006, the FASB issued FASB Interpretation
14 Number 48, Accounting for Uncertainty in Income Taxes -
15 an interpretation of FASB Statement No 109, Accounting
16 for Income Taxes (FIN 48). FIN 48 addresses the
17 determination of whether tax benefits claimed or
18 expected to be claimed on a tax return should be
19 recorded in the financial statements. Under FIN 48, a
20 company may recognize the tax benefit from an uncertain
21 tax position only if it is more likely than not that the
22 position will be sustained on examination by the taxing
23 authorities, based on the technical merit of the
24 position.

25

1 Q. Please describe how this affects Tampa Electric.

2

3 A. The company adopted the provisions of FIN 48 effective
4 January 1, 2007 with no impact. Tampa Electric does not
5 have any uncertain tax positions at December 31, 2007
6 and has not projected any such positions in the 2009
7 MFRs.

8

9 **SUMMARY**

10 Q. Please summarize your direct testimony.

11

12 A. Tampa Electric has presented income tax schedules in
13 accordance with the requirements of the Commission's
14 MFRs. The income tax MFRs have been prepared based on
15 comprehensive interperiod income tax allocation in
16 accordance with GAAP and this Commission's long standing
17 policies.

18

19 ITC amortization for the projected 2009 test period has
20 been calculated and presented appropriately in
21 accordance with GAAP and the requirements of the IRC.

22

23 The 2007 income tax MFRs present fairly the information
24 required to be set forth therein in accordance with GAAP
25 and the requirements for preparation of such schedules.

1 With the exception of the erroneously omitted \$8.4
2 million ADIT adjustment discussed earlier in my direct
3 testimony, the projected 2009 MFR income tax schedules
4 have been presented on a basis consistent with the
5 historical schedules and consistent with other projected
6 information for the test period. Further, the projected
7 2009 MFR income tax amounts have been properly stated in
8 accordance with GAAP and, with the adjustment included
9 on MFR Schedule D-1b, have been calculated in accordance
10 with the requirements of the IRC and Regulations
11 applicable to projected test periods.

12
13 **Q.** Mr. Felsenthal, does this conclude your direct
14 testimony?

15
16 **A.** Yes, it does.
17
18
19
20
21
22
23
24
25

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**2 **REBUTTAL TESTIMONY**3 **OF**4 **ALAN D. FELSENTHAL**5 **ON BEHALF OF TAMPA ELECTRIC COMPANY**

6
7 **Q.** Please state your name, business address, occupation and
8 employer.

9
10 **A.** My name is Alan D. Felsenthal. My business address is
11 550 West Van Buren Street, Chicago, Illinois 60607. I am
12 a Managing Director at Huron Consulting Group.

13
14 **Q.** Are you the same Alan D. Felsenthal who filed direct
15 testimony in this proceeding?

16
17 **A.** Yes, I am.

18
19 **Q.** What is the purpose of your rebuttal testimony?

20
21 **A.** The purpose of my rebuttal testimony is to address
22 certain income tax-related issues raised in the prepared
23 direct testimony of Mr. Helmuth Schultz and Mr. Hugh
24 Larkin, testifying on behalf of Office of Public Counsel
25 ("OPC").

1 Q. Please summarize the disagreements you have regarding the
2 substance of the income tax positions included in the
3 testimony of Messrs. Schultz and Larkin and describe the
4 purpose of your rebuttal testimony.

5
6 A. My disagreements are as follows:

- 7 • Messrs. Schultz and Larkin do not accept the revision
8 made by Tampa Electric related to the amortization of
9 Investment Tax Credit ("ITC"). This change to the
10 amortization amount is necessary for Tampa Electric to
11 comply with the normalization requirements of the
12 Internal Revenue Code ("IRC"). My rebuttal testimony
13 explains the nature of the revision and why it must be
14 made for Tampa Electric to avoid the adverse
15 consequences of violating the IRC requirements.
- 16
17 • Messrs. Schultz and Larkin object to the Accumulated
18 Deferred Income Tax ("ADIT") adjustment explained in
19 my direct testimony that is required to comply with
20 the normalization requirements of the IRC when a
21 forecast test period is used. My rebuttal testimony
22 will further explain why this adjustment is necessary
23 and the potential consequences to Tampa Electric if
24 the position of the OPC witnesses is accepted.

25

1 • In both cases, my testimony is based partially on
2 interpretations of the IRC included in Private Letter
3 Rulings ("PLR") and Messrs. Schultz and Larkin imply
4 that such interpretations should be given little, if
5 any, weight in this proceeding. In my rebuttal
6 testimony I explain why this Commission should
7 consider the interpretations included in those PLRs
8 when addressing the specific income tax issues in this
9 proceeding.

10
11 **AMORTIZATION OF INVESTMENT TAX CREDIT**

12 **Q.** What is the Investment Tax Credit or ITC?

13
14 **A.** As explained in my direct testimony, the ITC provides
15 taxpayers an incentive to make capital investments by
16 granting a tax credit (a direct dollar for dollar offset
17 to current taxes payable) to taxpayers calculated by
18 applying a percentage rate to investment in tangible
19 personal property including most generation, transmission
20 and distribution assets. The intent of the ITC is to
21 reduce the net cost of acquiring depreciable property,
22 thereby providing taxpayers an incentive to invest in
23 qualifying assets. To make sure that its objectives are
24 met for investments in qualifying utility property, the
25 IRC prescribes methods of sharing the benefit between the

1 ratepayers and the shareholders.

2

3 **Q.** What journal entries are required to account for the ITC?

4

5 **A.** The journal entries can best be illustrated with an
6 example. Assume that in 1985, a public utility spent \$100
7 million in acquiring tangible assets (generating
8 facilities) that qualified for the ITC. Also assume that
9 the ITC percentage or rate was eight percent in that
10 year. The entity would be entitled to an \$8 million ITC,
11 which is a direct reduction of the entity's tax expense.

12

13 Current Taxes Payable \$8 million

14 Current Tax Expense \$8 million

15

16 In effect, the net cost of the acquired capital asset
17 would be \$92 million (\$100 million incurred less an \$8
18 million reduction in income taxes).

19

20 The journal entries do not stop here. Rather than
21 reflecting the realized ITC in net income in the year
22 realized, most public utilities defer the ITC and
23 amortize the unamortized ITC over the life of the asset
24 that gave rise to the ITC in the first place.

25

1 The entry to defer the ITC in the year claimed is as
2 follows:

3		
4	Current Tax Expense	\$8 million
5	Unamortized ITC	\$8 million

6

7 Assuming the \$100 million tangible asset used in this
8 example has a 20-year life, the following entry would
9 result in each year 1 through 20:

10		
11	Unamortized ITC	\$400,000
12	Income Tax Expense	\$400,000

13

14 In this manner, each year's net income would include
15 depreciation expense of \$5 million (\$100 million divided
16 by 20) and ITC amortization of \$400,000, or a net of \$4.6
17 million. You would get this same result if the "net
18 cost" of the asset, \$92 million, were depreciated over 20
19 years.

20

21 **Q.** How is the ITC treated for ratemaking purposes?

22

23 **A.** For ratemaking purposes, in 1972 utilities were required
24 by the IRC to elect how they intended to share the ITC
25 between ratepayers and shareholders. Most utilities,

1 including Tampa Electric, elected to share the ITC by
2 including the annual amortization to income tax expense
3 as an "above the line" reduction, which reduced income
4 tax expense thereby benefiting ratepayers. The
5 unamortized amounts were not used to reduce rate base
6 thereby benefiting shareholders who were entitled to earn
7 on property, plant and equipment financed partially by
8 the ITC "grant" or "rebate".
9

10 Tampa Electric's current filing reflects the unamortized
11 ITC balance of property, plant, and equipment realized on
12 tax returns prior to the repeal of the ITC as a result of
13 the 1986 Tax Reform Act. The unamortized ITC is being
14 amortized over the lives of the property, plant, and
15 equipment giving rise to the ITC.
16

17 **Q.** Mr. Schultz states on pages 37 and 38 of his direct
18 testimony that he requires additional information with
19 respect to how the ITC amortization change "was reflected
20 in the filing". Can you please describe the ITC
21 amortization change and provide additional information?
22

23 **A.** Yes. Under the ITC election made by Tampa Electric, the
24 unamortized ITC is to be amortized over the book life of
25 the asset generating the ITC. While reviewing the income

1 tax MFRs, we noted that Tampa Electric was amortizing the
2 ITC using the composite depreciation rate of the assets
3 giving rise to the ITC. This rate included not only the
4 recovery of the asset over its estimated useful life but
5 also included factors for interim retirements and
6 negative salvage. However, the IRC requirements make it
7 clear that ITC amortization should be based solely on the
8 depreciable lives and should exclude interim retirement
9 and salvage value factors. Use of the combined
10 depreciation rate results in ITC being fully amortized
11 before the related asset is fully depreciated.

12
13 When Tampa Electric stripped these other factors out of
14 the computation, a revised rate based solely on the asset
15 lives was computed and used to calculate the annual
16 amortization in order to comply with the IRC requirements
17 for ITC amortization. The company made the appropriate
18 adjustment in its financial statements effective in the
19 second quarter of 2008. This change resulted in a
20 decrease in ITC amortization in 2008 and 2009, which can
21 be seen on Minimum Filing Requirements ("MFR") Schedule
22 B-23, Column 4, Rows 18 and 19. Because Tampa Electric
23 revised the ITC amortization in this manner, a pro forma
24 adjustment was not required. It is also important to
25 note that the book lives of certain generation assets

1 were extended in connection with the 2007 Tampa Electric
2 depreciation study, further contributing to the reduction
3 in ITC amortization.

4
5 **Q.** Can you please quantify the impact on the ITC
6 amortization recorded on the books by Tampa Electric and
7 included in the MFRs resulting from revising the
8 amortization rate to include only the depreciation life
9 component?

10
11 **A.** Yes. The following is the estimated annual impact:

- 12
- 13 • \$2,435,000 2007 historical ITC amortization
14 based on a depreciation rate
15 including life, interim retirements
16 and cost of removal factors
 - 17
 - 18 • \$368,000 2009 projected ITC amortization based
19 on a depreciation rate including life
20 only
 - 21
 - 22 • \$2,067,000 Annual reduction primarily related to
23 the revised ITC amortization rate
 - 24

25 The large reduction in the ITC amortization amount is due

1 to the combination of 1) removing cost of removal and
2 interim retirement impacts from the depreciation rate and
3 2) the lowering of the life component of the depreciation
4 rate to reflect significant life extensions on generation
5 plant resulting from the 2007 depreciation study. The
6 generating station that contributed to the majority of
7 the year end 2007 unamortized ITC balance was Big Bend
8 Unit 4. Based on the 2007 depreciation study, the life
9 of this asset was extended, thereby extending the period
10 of time over which to amortize ITC as well.

11
12 **Q.** Can you further distinguish between the composite
13 depreciation rate used to depreciate property, plant and
14 equipment and the depreciation life?

15
16 **A.** Yes. The depreciation life is generally one component of
17 the depreciation rate. The cost of an asset is
18 depreciated over its estimated useful life in a
19 systematic and rational manner (generally straight-line),
20 so at the end of its useful life, the plant asset has
21 been fully recovered through depreciation charges. In my
22 previous example, the cost of the asset, \$100 million, is
23 depreciated on a straight-line basis over an estimated
24 useful life of 20 years. A 20-year life converts to a
25 five percent annual depreciation rate ($1/20 = 5$ percent),

1 which when applied to the cost of the asset results in
2 annual depreciation expense of \$5 million.

3
4 When the asset is retired, there can be a salvage value,
5 a cost to remove or dismantle the fixed asset, or both.
6 When depreciation studies are performed, these additional
7 factors are considered in determining the annual
8 depreciation rate. The original cost of the fixed asset
9 is reduced by the estimated salvage value, and the net
10 original cost is used as the basis for depreciation. For
11 example, assume that the \$100 million property, plant,
12 and equipment have an estimated salvage value of \$6
13 million. The net cost to be recovered through annual
14 charges is now \$94 million or \$4.7 million per year. The
15 annual rate to apply to the \$100 million asset is now 4.7
16 percent.

17
18 Most utility property requires a cost to be incurred to
19 remove or dismantle the asset upon retirement. This cost
20 would also be considered in developing an annual
21 depreciation rate. Continuing with the example, assume
22 that it is estimated to cost \$16 million to remove the
23 asset upon retirement. In such a case, the "net negative
24 salvage" is \$10 million (\$6 million salvage less \$16
25 million to remove). The net cost to be recovered through

1 annual charges over the 20-year life is \$110 million,
2 \$5.5 million per year, converted to a depreciation rate
3 of 5.5 percent.

4
5 The 5.5 percent rate converts to a life of 18.18 (1
6 divided by 5.5 percent). Therefore, if the 5.5 percent
7 rate were applied to the unamortized ITC balance, that
8 balance would be fully amortized in 18.2 years, which is
9 faster than the asset's estimated useful life of 20
10 years.

11
12 In summary, the depreciation rates used by Tampa Electric
13 and most utilities include factors to recover the asset
14 over its estimated useful life as well as estimates of
15 salvage and removal costs anticipated upon retirement of
16 the asset. A five percent rate represents recovery of
17 the asset based only on its 20-year life. A 5.5 percent
18 rate represents recovery of the asset based on its life
19 as well as a factor representing the estimated cost to
20 remove the asset upon retirement. In order to comply
21 with the IRC rules, ITC amortization must be based upon
22 the five percent rate (corresponding to a 20-year life),
23 the book depreciation rate exclusive of cost of removal.
24 Use of the 5.5 percent would share ITC with ratepayers
25 more rapidly than the book life and would result in a

1 normalization violation.

2

3 **Q.** What are some other factors considered in the
4 determination of the depreciation rate?

5

6 **A.** When developing a depreciation rate, an entity may
7 include a factor for interim retirements to recognize
8 that some component parts of an asset will need to be
9 replaced prior to the retirement of the larger property
10 unit. A factor for interim retirements also has the
11 effect of increasing the depreciation rate.

12

13 **Q.** Why is it important to compute annual ITC amortization
14 using only the estimated useful lives included in the
15 depreciation computation and not the combined
16 depreciation rate?

17

18 **A.** The specific section in the IRC (Section 46 (f)(2))
19 refers to amortizing the ITC in a "ratable" manner and if
20 amortization is "more than a ratable portion", no ITC
21 will be permitted. In other words, if more than a
22 ratable portion of ITC is used to reduce income tax
23 expense, a violation of the IRC will occur and the
24 taxpayer will have to refund to the IRS any unamortized
25 ITC.

1 Under section 1.46-6(g)(2) of the IRC regulations,
2 ratable is to be determined by considering the time
3 actually used in computing depreciation expense for the
4 property giving rise to the ITC.

5
6 **Q.** Has the IRS published PLRs addressing this issue?

7
8 **A.** Yes. The IRS has issued a number of rulings on this
9 specific issue; that is, whether amortizing ITC using a
10 depreciation rate that includes interim retirements
11 and/or cost of removal is "more than a ratable portion"
12 and would cause a violation of the IRC requirements.

13
14 For instance, PLR 9023080, issued in the early 1990's
15 addressed the specific issue of whether a violation would
16 result if ITC were amortized using a depreciation rate
17 that included a factor for interim retirements. The
18 thrust of the PLR is that using a depreciation rate that
19 includes such a factor would result in the ITC being
20 fully amortized before the related asset is fully
21 depreciated, which is clearly a violation of the "more
22 than ratable" language in the IRC and regulations.

23
24 **Q.** The PLR you just cited is from the early 1990's. Has
25 there been more recent guidance?

1 **A.** Yes. In PLR 200802025, released January 11, 2008, a fact
2 pattern similar to that of Tampa Electric's was
3 addressed. In that release, the IRS concluded:

4
5 "Under section 1.46-6(g)(2) of the regulations,
6 "ratable" for purposes of former section 46(f)(2)
7 of the Code is determined by considering the
8 period of time actually used in computing the
9 taxpayer's regulated depreciation expense for the
10 property for which a credit is allowed.
11 Regulated depreciation expense is the
12 depreciation expense for the property used by a
13 regulatory body for purposes of establishing the
14 taxpayer's cost of service for ratemaking
15 purposes. Such period of time shall be expressed
16 in units of years (or shorter periods), units of
17 production, or machine hours and shall be
18 determined in accordance with the individual
19 useful life or composite (or other group asset)
20 account system actually used in computing the
21 taxpayer's regulated expense. A method of
22 reducing is ratable if the amount to reduce cost
23 of service is allocated ratably in proportion to
24 the number of such units. Thus, for example,
25 assume that the regulated depreciation expense is

1 computed under the straight line method by
 2 applying a composite annual percentage rate to
 3 original cost (as defined for purposes of
 4 computing depreciation expense). If cost of
 5 service is reduced annually by an amount computed
 6 by applying a composite annual percentage rate to
 7 the amount of the credit, cost of service is
 8 reduced by a ratable portion. A composite annual
 9 percentage rate is determined solely by reference
 10 to the period of time actually used by the
 11 taxpayer in computing its regulated depreciation
 12 expense without reduction for salvage or other
 13 items such as over and under accruals."

14 (Underlining added)

15
 16 Two more PLRs (200811004 and 200802026) were recently
 17 issued with a similar conclusion.

18
 19 Q. On page 6 of his direct testimony, Mr. Larkin suggests
 20 that the "proposed change" to the ITC amortization rates
 21 is "for a problem which does not exist". Do you agree
 22 with his assessment?

23
 24 A. No. As explained above, the ITC amortization is not a
 25 proposed change. Rather, it is an actual change that has

15

Insert following on Line 8 after the word "portion."
 If such composite annual percentage rate were revised for
 purposes of computing depreciation expense beginning with a particular
 accounting period the computation of rateable portion must also
 be revised beginning with such period.

1 already been made by the company and is necessary to
2 comply with the requirements of the IRC. The change in
3 the ITC amortization is reflected in the Tampa Electric
4 financial statements beginning with the second quarter of
5 2008.

6
7 **Q.** Because Tampa Electric had been amortizing ITC using the
8 depreciation rate rather than the depreciation life for a
9 number of years, is there a potential issue with the IRC
10 for this past practice?

11
12 **A.** No, not based on recent guidance contained in several
13 PLRs. Both PLRs 200802025 and 200802026 provide guidance
14 for regulated electric utilities that inadvertently
15 included a factor for cost of removal when developing the
16 ITC amortization rate and related ITC amortization. The
17 PLRs conclude that a normalization violation would
18 generally occur if the ITC amortization includes a factor
19 for cost or removal because, in such a circumstance, the
20 ITC amortization would be flowed to ratepayers more
21 rapidly than allowed by IRS rules. The IRS concluded that
22 (as is the case with Tampa Electric) because this
23 violation was through an oversight, was unintentional and
24 that the regulator was unaware that the ITC amortization
25 rate included an element for cost of removal (negative

1 net salvage) when reaching past regulatory decisions
2 regarding the utility, these situations did not result in
3 normalization violations. In PLR 200802025, the
4 following conclusion was reached:

5 "For the periods during which Taxpayer included
6 negative net salvage in its calculation of asset
7 life for ITC purposes, it appears that the
8 practical effect of that action was to flow the
9 ITC to ratepayers more rapidly than if calculated
10 without the negative net salvage. However, this
11 was not the intent of either the Taxpayer or
12 either Commission A or Commission B. In accord
13 with the Senate Reports quoted above,
14 disallowance or recapture of the ITC should be
15 imposed, if at all, only after a regulatory body
16 has required or insisted upon such treatment by a
17 utility. Because Commission A and Commission B at
18 all times required that Taxpayer comply with the
19 normalization tax rules and because the matter of
20 the ITC flow-through calculation was not
21 specifically addressed in the earlier orders by
22 either of the Commissions, no disallowance or
23 recapture is required in this case. Except as
24 specifically determined above, no opinion is
25 expressed or implied concerning the Federal

1 income tax consequences of the matters described
2 above. In particular, orders concerning this
3 matter finalized by either of the Commissions
4 after the date of this ruling are not necessarily
5 subject to the same analysis as those considered
6 above."

7
8 Now that Tampa Electric has discovered and adjusted its
9 books and rate request to incorporate the appropriate
10 amortization period for ITC and the issue has been raised
11 in the context of this rate proceeding, an inadvertent or
12 unintentional claim can no longer be raised.

13
14 **ACCUMULATED DEFERRED INCOME TAX ADJUSTMENT**

15 **Q.** In your direct testimony, you describe the IRC
16 requirement to pro rate the ADIT balance when a forecast
17 test period is used and propose an adjustment to the ADIT
18 balance to comply with the IRS requirement. The pro rata
19 ADIT computation is required for the period of the
20 projected or forecast test year that occurs after the
21 effective date of the rate order (referred to as the
22 "future portion of the forecast test period as opposed to
23 the "historic" portion of the forecast test period). In
24 Tampa Electric's case, a 2009 forecast test period is
25 used and new rates are expected to be effective in May

1 2009. Thus, the "future" portion of the forecast test
2 period is the period from May 2009 through December 2009
3 and the "historic" portion of the future test period is
4 January 1, 2009 through April 30, 2009. You cite
5 specific PLRs in support of this ADIT adjustment of
6 \$1,894,321.

7
8 On page 35 of his direct testimony Mr. Schultz states
9 that the PLRs that you rely on define historic and future
10 periods consistently for purposes of prorating ADIT, but
11 "the IRS could apply a different definition in a
12 subsequent letter ruling since each letter ruling only
13 applies to an individual company". Do you agree with
14 this statement?

15
16 **A.** Yes. However, as I indicate later in my rebuttal
17 testimony, the fact that the IRS has ruled consistently
18 on what is meant by "historic" and "future" portions of
19 forecast test periods in four PLRs makes it highly
20 probable that they will rule in a similar manner in the
21 future.

22
23 **Q.** Also on page 35 of his direct testimony, Mr. Schultz
24 says, "two of the three letter rulings that Mr.
25 Felsenthal has relied upon do not indicate the period

1 used so again facts are missing". Does the fact that the
2 specific dates are not included in the ruling affect your
3 conclusion?

4
5 **A.** No, not at all. Specific dates and time periods are
6 oftentimes redacted in published PLRs to help mask the
7 identity of the entity requesting the PLR. Whether the
8 specific time periods are redacted or not is not relevant
9 to the issue at hand. Each PLR referred to in my direct
10 testimony deals with whether the ADIT proration required
11 by the IRS rules should be performed or not. The key
12 determinant of the proration in each PLR is whether a
13 projected or forecast test period is used, and whether
14 the proposed rates go into effect before the end of the
15 projected test period (the "historic" or "future" portion
16 of the forecast test period).

17
18 **Q.** On pages 35 and 36 of his direct testimony, Mr. Schultz
19 indicates that the manner in which the average rate base
20 is computed may be a relevant consideration. He indicates
21 that a simple average of beginning of period and end of
22 period deferred income tax balances may have been used in
23 the rate proceedings and fact patterns referred to in
24 these PLRs as opposed to the 13-month weighted average
25 balance included in Tampa Electric's MFRs in this

1 proceeding. Assuming that Mr. Schultz is correct and
2 only a simple average was used in the rate proceedings
3 prompting the PLRs you have cited, do you agree that a
4 different finding would have occurred if a 13-month ADIT
5 averaging had been performed?
6

7 **A.** No. Each method serves to compute an average rate base.
8 One method uses two data points and the other method uses
9 thirteen data points. Based on the reasoning cited in
10 the PLRs, neither of the averaging techniques absolves
11 the company from performing the pro rata calculation when
12 a projected test period is used and the rates go into
13 effect before the end of the forecast test period.
14

15 **Q.** On page 36 of his direct testimony, Mr. Schultz presents
16 his view that the 13-month averaging technique is similar
17 to a pro rata calculation. He states, "A thirteen month
18 average reflects the deferred tax balance at the
19 beginning of a year and the pro rata portion of each
20 month added during the year. The regulations do specify
21 that the pro rata calculation is done based on days so
22 the determination that must be made is whether the
23 calculation based on days is materially different to
24 require a change in rate making across the country that
25 has utilized a pro-ration based on months." Can you

1 comment on this assertion?

2

3 **A.** Yes. The key conclusion in PLR 9202029 is that averaging
4 and prorating are different concepts. In situations
5 involving a forecast test period with rates effective
6 before the test period is completed, a normalization
7 violation would occur if the average ADIT balance is used
8 as zero cost capital and such balance exceeds the ADIT
9 balance determined using the specific pro rata formula.

10

11 In PLR 9202029, the staff of the commission of the
12 utility requesting the ruling suggested that averaging
13 was equivalent to prorating and required the utility to
14 seek the IRS guidance on the issue. The PLR summarizes
15 the commission staff's position as: "The Commission staff
16 responds that proration is the functional equivalent of
17 averaging...". In that PLR, the IRS rejected the staff
18 position by stating:

19

20 "The staff's position confuses function with
21 purpose. Proration is mathematically similar to
22 averaging, but the two techniques serve different
23 purposes. Proration is a crude way of discounting
24 the amount of deferred taxes (cost-free capital)
25 the utility expects to recognize sometime in the
future. Averaging, on the other hand, is simply

1 the Commission's chosen method of estimating the
2 test year rate base (it very well could have
3 projected an end-of-period rate base, for
4 example). Both ends are legitimate, but they
5 cannot be served by one means.

6
7 If an average test year rate base is used in
8 developing rates, all rate base components,
9 including the deferred tax reserve, must be
10 averaged. If the proration of deferred tax
11 accruals substitutes for taking the average of
12 the entire reserve, then the consistency
13 requirement of section 168(i)(9)(B) will be
14 violated (the projected deferred tax reserve will
15 not be consistent with the projected rate base).
16 Likewise, if a portion of the test year is a
17 future period, projected accruals to the deferred
18 tax reserve must be prorated. If averaging of the
19 entire reserve substitutes for this proration,
20 then the timing requirement of section 1.167(1)-
21 1(h)(6) will be violated (too much will be
22 excluded from rate base, thus denying the utility
23 a return on "capital" it is only projected to
24 have)." (Underlining added).

25

1 It is clear from the ruling that the IRS believes that
2 proration and averaging are different concepts serving
3 different purposes.
4

5 **Q.** On page 35 of his direct testimony, Mr. Schultz indicates
6 that "letter ruling 9029040 as stated earlier does not
7 identify the periods which is important because if that
8 ruling is based on an end of period rate base the facts
9 are definitely different from the facts presented in this
10 case." Do you agree that the facts in this PLR are
11 different than the facts presented in this case?
12

13 **A.** Yes. However, this PLR was referred to because it gives
14 guidance on when proration is necessary. This particular
15 PLR addressed a forecast test period with an end of
16 period rate base, with the effective date of the new
17 rates occurring after the end of the forecast test year.
18 Because in this PLR, the effective date of the new rates
19 was after the end of the test year, this PLR concluded
20 that no proration was necessary. It also gives guidance
21 consistent with the other three PLRs referenced.
22

23 **Q.** On page 34 of his direct testimony, Mr. Schultz states
24 "Mr. Felsenthal bases his position on the incorrect
25 assumption that the projected costs for 2009 are in

1 reality part historic and part projected." Do you agree
2 with his assertion?

3
4 **A.** No. I have applied the definitions of historic and
5 future consistent with the IRS guidance reflected in
6 these PLRs. PLR 9202029 states, "The historical period
7 is that portion of the test period before rates go into
8 effect, while the portion of the test period after the
9 effective date of the rate order is the future period."
10 Thus, the period from January 1, 2009 through April 30,
11 2009 is the historical portion of the projected year as
12 defined in the guidance of the IRS." The IRS has
13 remained consistent in their definitions throughout the
14 four PLRs referenced above and included in my direct
15 testimony.

16
17 **Q.** On page 37 of his direct testimony, Mr. Schultz states
18 that "If Mr. Felsenthal's position is adopted that would
19 mean the Company has been in violation of normalization
20 requirements at least since rates were set in February
21 1993." Do you agree?

22
23 **A.** No. Based on the PLRs I cite above related to ITC
24 amortization and the fact that the company's past actions
25 were inadvertent, the IRS would likely not find a

1 normalization violation back to 1993. Rather, they would
2 require the situation to be remedied going forward, which
3 is exactly what Tampa Electric has done.

4
5 **RELIANCE ON PRIVATE LETTER RULINGS**

6 **Q.** On page 35 of his direct testimony, Mr. Schultz states
7 that the PLRs you refer to in your direct testimony "do
8 not reveal all the important facts that must be known if
9 any credence should be placed on the ruling themselves."
10 Do you agree with this statement?

11
12 **A.** No. All pertinent facts of the letter request and related
13 IRS ruling are included in the PLR itself. Ample
14 background, relevance and rationale for the rulings are
15 included in the referenced PLRs. In addition, there is
16 an added requirement in the PLR process applicable to
17 utilities seeking interpretations of potential
18 normalization violations. The facts included in such
19 letter requests must be agreed to by the respective
20 regulatory commission and the taxpayer prior to
21 submitting the request to the IRS. The entire process
22 can be costly and time consuming.

23
24 **Q.** The OPC witnesses contend that PLRs are only applicable
25 to the taxpayer who requests the ruling and cannot be

1 used as precedent for others. Do you agree?

2

3 **A.** Yes, but certain other factors must be considered. PLRs
4 clearly show the thinking of the IRS with respect to
5 interpreting the IRC and the related regulations. In
6 addition, the IRS strives to achieve consistency in its
7 interpretations of the tax statute and regulations. On
8 the issue of the requirement to pro rate ADIT when a
9 forecast test period is used, the IRS has issued four
10 PLRs that build on each other and reach the same
11 consistent result. Similarly, on the issue of ITC
12 amortization, the IRS has ruled consistently in a number
13 of PLRs. Given the consistency of the PLRs, it is highly
14 probable that a similar request on a similar issue by
15 another taxpayer will likely result in a similar ruling.

16

17 All PLRs are published and made available to tax
18 professionals and the taxpaying public. The process of
19 publishing the rulings assists other taxpayers with
20 similar fact patterns, avoids the requirement to prepare
21 a ruling request and avoids the need for additional
22 effort by the IRS to respond to such requests when there
23 is a clear interpretation of the IRS position expressed
24 in the PLRs.

25

1 The fact that a PLR is binding only on the taxpayer
2 requesting it does not mean that the IRS does not use a
3 reasoned and consistent approach to support its decision.
4 Because the IRS is the administrative agency that
5 interprets the tax rules, published PLRs clearly reveal
6 the agency's interpretation of the tax rules. As such,
7 PLRs can be instructive to other taxpayers.

8
9 **Q.** On page 34 of his direct testimony, Mr. Schultz states,
10 "the Company has consistently accounted for deferred
11 income taxes and investment tax credits for years under
12 the method that Mr. Felsenthal now claims is incorrect,
13 despite repetitive audits where no errors were found by
14 the Internal Revenue Service (IRS)". Would you expect an
15 IRS audit to identify the ITC amortization and the
16 deferred tax pro rata adjustment?

17
18 **A.** No, it is not surprising that an IRS audit would not
19 identify these matters. The scope of an IRS audit varies
20 from company to company but generally focuses on current
21 revenue and current deductions included in the tax
22 return. The deferred tax pro rata adjustment is not an
23 actual adjustment to the ADIT balances. Rather, it is an
24 adjustment in rate filings to determine the appropriate
25 level of zero cost capital used to set rates.

1 Accordingly, there would be nothing in the books and
2 records of Tampa Electric with respect to this item.
3 Second, IRS audits related to the investment tax credit
4 would likely focus on the investment tax credit generated
5 or realized in the year such ITC directly reduces current
6 federal income tax payable. ITC amortization would not
7 be subject to audit by the IRS because such amortization
8 does not impact the current tax expense or the current
9 year return.

10
11 **SUMMARY OF REBUTTAL TESTIMONY**

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

13
14 **A.** Tampa Electric adjusted its ITC amortization rate from a
15 rate, which included factors for life, interim
16 retirements and cost of removal to a rate that only
17 includes a factor representing the estimated useful life
18 of the asset. The adjustment is necessary to comply with
19 IRC requirements stating that ITC amortization should be
20 over the life of the property giving rise to the ITC.
21 The ITC amortization included in the projected test year
22 (2009) MFRs reflects the appropriate amortization period.

23
24 The IRC, regulations and a number of PLRs contain
25 guidance on the maximum amount of ADIT that can be

1 treated as zero-cost capital in the return calculation
2 when a forecast test period is used. Including more than
3 the maximum level of ADIT as zero cost capital could
4 result in a violation of the IRC normalization rules,
5 with significant consequences. Tampa Electric has made an
6 adjustment in its filing to comply with these
7 requirements. While PLRs apply only to the taxpayer
8 requesting them, they express the interpretations and
9 reasoning of the IRS and are instructive to other
10 taxpayers. Four separate PLRs have been issued relating
11 to this issue and the IRS has reached consistent
12 conclusions in each one.

13

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

15

16 **A.** Yes, it does.

17

18

19

20

21

22

23

24

25

1 BY MR. HART:

2 Q Mr. Felsenthal, would you summarize your direct and
3 rebuttal testimony?

4 A Certainly.

5 Good morning, Commissioners. My testimony in this
6 proceeding addresses several aspects of the income tax
7 calculations submitted by Tampa Electric. Specifically my
8 testimony concludes that the 2007 income tax MFRs present
9 fairly the information set forth therein in accordance with
10 generally accepted accounting principles and the requirements
11 of the preparation of such schedules.

12 The projected 2009 MFR schedules, income tax
13 schedules have been presented on a basis consistent with
14 historical schedules and consistent with other projected
15 information for the test period. Further, the 2009 MFR income
16 tax amounts have been properly stated in accordance with
17 generally accepted accounting principles and with the
18 adjustment included on MFR Schedule D-01B have been calculated
19 in accordance with the requirements of the Internal Revenue
20 Code and the regulations applicable to public utilities where
21 projected test periods are used.

22 I also conclude that Tampa Electric's unamortized
23 investment tax credit is being amortized at tax expense over
24 the book of the life, book life of the related property. The
25 amortization is in accordance with generally accepted

1 accounting principles and is no more rapidly than ratably in
2 accordance with the requirements of the Internal Revenue Code.
3 This concludes my summary.

4 CHAIRMAN CARTER: Thank you. Go ahead.

5 MR. HART: Well, we would tender the witness for
6 cross-examination.

7 CHAIRMAN CARTER: Thank you.

8 Commissioner Argenziano.

9 COMMISSIONER ARGENZIANO: Yes. Thank you, Mr. Chair.

10 I just want to ask this up-front and I'm probably
11 going to be asking everybody. Are you being compensated
12 \$1,310,000?

13 THE WITNESS: The estimate for rate case expense,
14 which Mr. Chronister would know, I think is \$1.3 million. We
15 haven't -- through December I think the billings are around
16 \$600,000 through December. So the company would -- we worked
17 on at the front end an arrangement where we would be
18 compensated based on certain tasks that we performed. The
19 tasks would be agreed to on the front end and we would perform
20 them and get compensated.

21 COMMISSIONER ARGENZIANO: And are these tasks of such
22 expertise that you're one of few in the nation who can do that
23 or are they tasks pretty much what you would do I guess on
24 accounting issues such as this every year, a company like this?
25 Are they, are they so specialized?

1 THE WITNESS: Well, they are specialized because they
2 involve utility ratemaking and --

3 COMMISSIONER ARGENZIANO: Then are you one of a few
4 in the country who can do this? I'm just asking because I'm
5 trying to figure out, that's, that's a lot of money and I'm
6 trying to figure out what kind of services for that kind of
7 money. And I just thought maybe they're so specialized that
8 you're one of a few.

9 THE WITNESS: I would say they are specialized and we
10 are one of a few.

11 COMMISSIONER ARGENZIANO: Okay. I'll have to find
12 out how many --

13 THE WITNESS: I don't know how many a few is, but.

14 COMMISSIONER ARGENZIANO: Okay. Well, I would think
15 a minimal amount, but I'll, I'll look into that. And I'll ask
16 you, and if this is not, if you don't know the answer to this,
17 I'll ask Mr. Chronister. I notice that the other charge, which
18 I don't know what the definition of that is yet, is \$210,000 on
19 top of the \$1,310,000. And then traveling -- you're based in
20 Chicago; is that correct?

21 THE WITNESS: Yes, ma'am.

22 COMMISSIONER ARGENZIANO: How many times, an
23 estimate, I know you probably don't have the number in front of
24 you, would you travel back and forth to do this type of work?

25 THE WITNESS: Well, there are -- our team, which

1 is -- it's more than just me. Our team at one time had two --
2 probably six or seven people that were coming back on a weekly
3 basis, oh, I don't know, for a period of several months while
4 they were, while the MFRs were being, while we were working on
5 the MFRs before the filing was filed.

6 COMMISSIONER ARGENZIANO: Okay. But you don't know
7 what the \$210,000 was for?

8 THE WITNESS: I have no idea.

9 COMMISSIONER ARGENZIANO: I'll ask Mr. Chronister.
10 Thank you.

11 CHAIRMAN CARTER: Thank you.

12 Ms. Christensen.

13 MS. CHRISTENSEN: Good morning.

14 CROSS EXAMINATION

15 BY MS. CHRISTENSEN:

16 Q Good morning, Mr. Felsenthal. I just have a few
17 questions regarding your testimony.

18 Would you agree that according to the IRS its private
19 letter rulings are only applicable to the taxpayer who requests
20 the rulings and cannot be used as precedent for others?

21 A As I said in my rebuttal testimony, the answer to
22 that is yes. However, I think it's important to note that when
23 the IRS issues these private letter rulings, they -- the IRS is
24 the administrative agency that interprets the code and
25 regulations. So when they issue these, these letter rulings,

1 they need to be, have a reasoned approach, they need to be
2 consistent. They know these are going to be published and
3 potentially relied on by others, so I think they're
4 instruction, they can be instructional. But the answer to your
5 question is yes.

6 Q Okay. And Tampa Electric has not received a private
7 letter ruling from the IRS related to the changes that you're
8 proposing in your testimony; is that also correct?

9 A That is correct.

10 Q Okay. And would it also be correct that the IRS has
11 not found any errors despite its repetitive audits of Tampa
12 Electric?

13 A Could you rephrase that? Errors in -- I --

14 Q Errors in the audit. When they were conducting the
15 audits, they did not find any errors when they were conducting
16 the audits and more specifically of the type that you're
17 suggesting need to be changed.

18 A It's correct that they didn't. However, the purpose
19 of an IRS audit is typically on the, to examine the information
20 that's included in the current year's tax return, and neither
21 of these adjustments are tax return items.

22 MS. CHRISTENSEN: Okay. I have no further questions.

23 CHAIRMAN CARTER: Thank you.

24 Ms. Bradley.

25 MS. BRADLEY: No questions.

1 CHAIRMAN CARTER: Thank you.

2 Ms. Kaufman.

3 MS. KAUFMAN: No questions, Mr. Chairman.

4 CHAIRMAN CARTER: Mr. Wright.

5 MR. WRIGHT: Thank you, Mr. Chairman. I just have a
6 few questions following on questions asked by Commissioner
7 Argenziano.

8 CROSS EXAMINATION

9 BY MR. WRIGHT:

10 Q Mr. Felsenthal, what did you personally do besides
11 prepare your testimony in connection with this case?

12 A Among other things, I attended meetings, I reviewed
13 the MFRs, I worked with the company on responses to data
14 requests. I, I or Huron helped or discussed various positions
15 or ways to respond to data requests and rebuttal testimony. An
16 assortment of items.

17 Q I'm looking at your exhibits. You sponsored or
18 cosponsored a total of seven MFR schedules; correct? That's
19 your Exhibit ADF-1, which has another number for this hearing.
20 But you know what I'm talking about.

21 A Three, four, five. Yes.

22 Q You sponsored the income tax returns. Did you
23 actually prepare the company's income tax returns to the IRS?

24 A No, sir.

25 Q You're not the company's corporate accounting firm,

1 are you?

2 A No, sir.

3 MR. WRIGHT: Thank you. That's all the questions I
4 have, Mr. Chairman.

5 CHAIRMAN CARTER: Commissioner Argenziano.

6 COMMISSIONER ARGENZIANO: In your testimony it showed
7 that you conducted numerous seminars and trainings. Did you
8 also train any of TECO's staff at this period of time?

9 THE WITNESS: I'm not sure of that. I know that at
10 least several, a couple of their staff have attended what we
11 call the rate case seminar, which is a five-day seminar where
12 we go through a mock hearing. But over the years I've, like I
13 say, I've done training for years and years and years, so
14 potentially there have been TECO employees attending.

15 COMMISSIONER ARGENZIANO: I guess I meant within this
16 timeframe of --

17 THE WITNESS: Oh, no.

18 COMMISSIONER ARGENZIANO: Okay. Thank you.

19 CHAIRMAN CARTER: Mr. Twomey.

20 MR. TWOMEY: Yes, sir, Mr. Chairman. Just a couple.

21 CROSS EXAMINATION

22 BY MR. TWOMEY:

23 Q Good morning, sir.

24 A Good morning.

25 Q I'm Mike Twomey. I'm representing AARP in this case.

1 You have a written contract with, your firm has a
2 written contract with Tampa Electric Company for your services
3 in this case?

4 A Yes.

5 Q Okay. Are there any provisions of that contract that
6 would limit the recovery of your fees, the payment of your fees
7 contingent upon either the amount of revenue awarded by this
8 Commission as compared to what was requested or the recovery of
9 the full rate case expense?

10 A No, sir.

11 Q So if the Commission were to decide to disallow a
12 portion of the rate case expense, it wouldn't adversely impact
13 your firm?

14 A I hope not. No.

15 MR. TWOMEY: Thank you. That's all.

16 CHAIRMAN CARTER: Commissioners, I'm going to go to,
17 go to staff, unless there's a question from the bench at this
18 time.

19 Staff.

20 MR. YOUNG: Staff has no questions.

21 CHAIRMAN CARTER: Staff has no questions. Back to
22 the bench.

23 Okay. Redirect?

24 MR. HART: No redirect.

25 CHAIRMAN CARTER: Turn your mike on.

1 MR. HART: No redirect. Tampa Electric moves Exhibit
2 Number 28 into the record.

3 CHAIRMAN CARTER: Any objections? Without objection,
4 show it done.

5 (Exhibit 28 admitted into the record.)

6 Are there any exhibits from rebuttal?

7 MR. HART: No, Mr. Chairman, there's not.

8 CHAIRMAN CARTER: Okay. Good. Then this witness may
9 be excused.

10 MR. HART: Thank you.

11 CHAIRMAN CARTER: Thank you.

12 (Transcript continues in sequence with Volume 10.)

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1 STATE OF FLORIDA)
 :
2 COUNTY OF LEON)

CERTIFICATE OF REPORTER

3

4 I, LINDA BOLES, RPR, CRR, Official Commission
Reporter, do hereby certify that the foregoing proceeding was
5 heard at the time and place herein stated.

6 IT IS FURTHER CERTIFIED that I stenographically
reported the said proceedings; that the same has been
7 transcribed under my direct supervision; and that this
transcript constitutes a true transcription of my notes of said
8 proceedings.

9 I FURTHER CERTIFY that I am not a relative, employee,
attorney or counsel of any of the parties, nor am I a relative
10 or employee of any of the parties' attorneys or counsel
connected with the action, nor am I financially interested in
11 the action.

12 DATED THIS 29th day of January,
13 2009.

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Linda Boles
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