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# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

**DATE:** May 7, 2009

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Slemkewicz, Maurey, Draper)  
Office of the General Counsel (Fleming, Klancke, ~~Saylor~~, Young)

*JS* *EAD* *ALM*  
*JSB* *TJ*

**RE:** Docket No. 090079-EI – Petition for increase in rates by Progress Energy Florida, Inc.

**AGENDA:** 05/19/09 – Regular Agenda – Decision on Interim Rates – Participation is at the discretion of the Commission

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Skop

**CRITICAL DATES:** 05/19/09 (60-Day Suspension Date)

**SPECIAL INSTRUCTIONS:** Place before Docket No. 090144-EI

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\090079.RCM.DOC

### Case Background

This proceeding commenced on March 20, 2009, with the filing of a petition for a permanent rate increase by Progress Energy Florida, Inc. (PEF or Company). The Company is engaged in business as a public utility providing electric service as defined in Section 366.02, Florida Statutes (F.S.), and is subject to the jurisdiction of the Commission. PEF's service area comprises approximately 20,000 square miles in 35 of Florida's counties. PEF serves more than 1.6 million retail customers.

PEF requested an increase in its retail rates and charges to generate \$499,997,000 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 9.21 percent or a 12.54 percent return on equity (range 11.54 percent to 13.54

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percent). The Company based its request on a projected test year ending December 31, 2010. PEF stated that this test year is the appropriate period to be utilized because it represents the conditions to be faced by the Company, and is representative of the customer base, investment requirements, and overall cost of service to be realized for the period when the new rates will be in effect.

PEF has also requested an interim rate increase in its retail rates and charges to generate \$13,078,000 in additional gross annual revenues. This increase would allow the Company to earn an overall rate of return of 7.84 percent or a 10.00 percent return on equity. The Company based its interim request on a historical test year ended December 31, 2008.

In PEF's most recent base rate proceeding in Docket No. 050078-EI,<sup>1</sup> the Commission approved a stipulation and settlement agreement (Stipulation). The Stipulation provides that retail base rates will not increase during the term of the Stipulation except for the recovery of the revenue requirements associated with certain power plants that go into service during the term of the agreement. Essentially, the Stipulation terminates on December 31, 2009.

On April 3, 2009, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG), the Attorney General's Office, The Florida Retail Federation (FRF), and PCS Phosphate (collectively, Intervenor) filed a joint consolidated response, opposing PEF's request for interim rate relief, petition related to accounting treatment for pension and storm hardening expenses and petition for limited proceeding to include the Bartow Repowering Project in base rates. On April 8, 2009, the parties and staff met to discuss the Intervenor's joint consolidated response. At the meeting, staff noted that while a response to a response is not normally contemplated by the Commission's rules, it might be helpful for PEF to file some additional clarifying comments regarding the Intervenor's response. The Intervenor did not object to staff's request at that time, nor have they filed an objection to PEF's response. PEF filed a response to the joint intervenors consolidated response on April 15, 2009.

This recommendation addresses the interim rate increase request and the suspension of the requested permanent rate increase. The Commission must take action to suspend the permanent rates and act on the interim request within 60 days of the filing, which is on or before May 19, 2009. The Commission has jurisdiction over this request for a rate increase and interim rate increase under Sections 366.06 and 366.071, F.S.

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<sup>1</sup> Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

**Discussion of Issues**

**Issue 1:** Should the \$499,997,000 million permanent base rate increase and its associated tariff revisions requested by Progress Energy Florida, Inc. be suspended pending a final decision in this docket?

**Recommendation:** Yes. The \$499,997,000 permanent base rate increase and its associated tariff revisions requested by Progress Energy Florida, Inc. should be suspended pending a final decision in this docket. (Slemkewicz)

**Staff Analysis:** PEF filed its petition, testimony, and MFRs on March 20, 2009. The Company has requested a total permanent base rate increase of \$499,997,000 based on a projected test year ending December 31, 2010.

Historically, the Commission has suspended the requested permanent rate schedules in order to adequately and thoroughly examine the basis for the new rates. The suspension of the rate increase is authorized by Section 366.06(3), F.S., which provides:

Pending a final order by the commission in any rate proceeding under this section, the commission may withhold consent to the operation of all or any portion of the new rate schedules, delivering to the utility requesting such increase, within 60 days, a reason or written statement of good cause for withholding its consent.

Staff recommends that the Commission suspend the requested permanent rate schedules to allow staff and any intervenors sufficient time to adequately investigate whether the request for permanent rate relief is appropriate.

**Issue 2:** Does the Stipulation approved by Order No. PSC-05-0945-S-EI, allow PEF to request an interim rate increase?

**Recommendation:** Yes. Staff believes that the Stipulation contemplates PEF's request for an interim rate increase and that such a request is not prohibited by the Stipulation. (Fleming, Klancke, Saylor, Young)

**Staff Analysis:**

Joint Intervenors' Consolidated Response

On April 3, 2009, the Intervenors filed a joint consolidated response opposing PEF's request for an interim rate increase. The Intervenors assert that the 2005 Stipulation precludes PEF from requesting interim rates during the period of the term of the stipulation. The Intervenors argue that the Stipulation and order approving the Stipulation does not contemplate an interim rate increase being granted and there is no express or implied language within the Stipulation that permits interim rates.

PEF's Response to Joint Intervenors' Consolidated Response<sup>2</sup>

On April 15, 2009, PEF filed its response to the Intervenors' consolidated response. PEF asserts that Section 366.071(1), F.S., provides that the Commission may authorize the collection of interim rates during the pendency of a petition for permanent rate increase. Moreover, the Stipulation between PEF and the Intervenors does not expressly prohibit PEF's request for an interim rate increase, unlike the 2002 Stipulation. PEF asserts that when the parties negotiated the Stipulation, they eliminated the interim rate increase prohibition, while retaining the interim rate decrease prohibition. In so doing, the parties expressed their intent not to preclude PEF from seeking an interim rate increase during the Stipulation period.

Analysis

*2005 Stipulation*

On September 1, 2005, the parties entered into the Stipulation. On September 28, 2005, in Order No. PSC-05-0945-S-EI, issued in Docket No. 050078-EI, the Commission approved the Stipulation. For ease of reference, the relevant portions of paragraphs 4, 7, and 14 of the 2005 Stipulation are quoted below:

4. No Party to this Agreement will request, support, or seek to impose a change in the application of any provision hereof . . . [and] neither seek nor support any reduction in PEF's base rates and charges, *including interim rate decreases*, that would take effect prior to the first billing cycle for January 2010 . . . unless such reduction is requested by PEF. PEF may not petition for an

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<sup>2</sup> The Commission's rules do not contemplate a response to a response; however, a response was requested at the April 8, 2009 informal meeting, which all parties attended. No objection has been filed to PEF's response.

increase in base rates and charges that would take effect prior to the first billing cycle for January 2010 . . . except as otherwise provided far in Sections 7 [Earning falling below 10 percent] and 10 [Storm Cost Recovery]<sup>3</sup> of this Agreement. . . .

...

7. If PEF's retail base rate earnings fall below a 10 [percent] return on equity as reported on a Commission adjusted or pro-forma basis on a PEF monthly earnings surveillance report during the term of the Agreement, PEF may petition the Commission to amend its base rates notwithstanding the provisions of Section 4, either as a general rate proceeding or as a limited proceeding under Section 366.076, F.S. The Parties to this Agreement are not precluded from participating in such a proceeding, and, in the event PEF petitions to initiate a limited proceeding under this Section, any Party may petition to initiate any proceeding otherwise permitted by Florida law. . . .

...

14. Effective on the Implementation Date, PEF will not have an authorized return on equity range for the purpose of addressing earnings levels, and the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels. However, for purposes other than reporting or assessing earnings, such as cost recovery clauses and Allowance for Funds Used During Construction ("AFUDC"), PEF will use 11.75 [percent] as its authorized return on equity percentage in such cost recovery clauses. . . .

(emphasis added).

Section 4 of the Stipulation provides that the Intervenors will not seek nor support any reduction in PEF's base rates and charges, including interim rate decreases, that would take effect prior to the first billing cycle for January 2010. Section 4 further provides that PEF may not petition for an increase in base rates that would take effect prior to the first billing cycle for January 2010. While Section 4 explicitly prohibits the Intervenors from seeking a rate decrease, including an interim rate decrease, Section 4 does not prohibit explicitly PEF from seeking an interim rate increase. Thus, staff believes that Section 4 does not limit PEF's ability to seek an interim rate increase in this proceeding.

Moreover, in 2002, PEF (then Florida Power Corporation) and the parties entered into a Stipulation.<sup>4</sup> In pertinent part, the 2002 Stipulation provides:

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<sup>3</sup> Section 10 of the Stipulation pertains to Storm Cost Recovery.

<sup>4</sup> Order No. PSC-02-0655-AS-EI, issued May 12, 2002, in Docket No. 000824-EI, In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light. Staff notes, that at the time of the 2002 Stipulation, PEF was known as the Florida Power Corporation, or FPC.

4. No Stipulating Party will request, support, or seek to impose a change in the application of any provision hereof. The Stipulating Parties other than FPC will neither seek nor support any additional reduction in FPC's base rates and charges, including interim rate decreases, that would take effect prior to December 31, 2005[,] unless such reduction is initiated by FPC. FPC will not petition for an increase in its base rates and charges, *including interim rate increases*, that would take effect prior to December 31, 2005.

(emphasis added.)

Clearly, the 2002 Stipulation expressly prohibited PEF from seeking an increase in base rates and charges, including interim rate increases. The 2005 Stipulation does not contain this express prohibition nor a similar proviso prohibiting PEF from requesting an interim rate increase during the term of the Stipulation. Staff believes that exclusion of this provision from the 2005 Stipulation is evidence that the parties intended to omit it in a proceeding such as this.<sup>5</sup> Moreover, by comparing the two Stipulations, it is clear that the parties intended to omit the proviso prohibiting PEF from requesting an interim rate increase from the 2005 Stipulation.<sup>6</sup> Therefore, staff believes that the Stipulation contemplates PEF's request for an interim rate increase and that such a request is not prohibited by the Stipulation.

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<sup>5</sup> See Azalea Park Utilities, Inc. v. Knox-Florida Development Corp., 127 So. 2d 121 (Fla. 2d DCA 1961) ("The absence of a provision from a contract is evidence of an intention to exclude it rather than of an intention to include it.")

<sup>6</sup> See Jacobs v. Petrino, 351 So. 2d 1036, 1039 (Fla. 4th DCA 1976) (quoting Gulf Cities Gas Corporation v. Tangelo Park Service Company, 253 So. 2d 744 (Fla. 4th DCA 1971) ("Where a contract is simply silent as to a particular matter, that is, its language neither expressly nor by reasonable implication indicates that the parties intended to contract with respect to the matter, the court should not, under the guise of construction, impose contractual rights and duties on the parties which they themselves omitted."))

**Issue 3:** Has PEF established a prima facie entitlement for interim relief pursuant to Section 366.071(1), F.S.?

**Recommendation:** Yes. Staff believes that the 10 percent threshold adopted by the parties in the Stipulation represents a level below which rates are no longer fair, just, and reasonable, thereby entitling PEF to petition the Commission to amend its base rates. PEF has presented prefiled testimony and documentation supporting that it is earning below the 10 percent threshold. Accordingly, staff recommends that PEF has established a prima facie entitlement for interim relief and is entitled to the proposed interim increase pursuant to Section 366.071, F.S., as discussed in Issue 4. (Fleming, Saylor)

**Staff Analysis:**

Joint Intervenors' Consolidated Response

The Intervenors are opposed to PEF's request for interim relief. The Intervenors contend that the revenue sharing agreement contained in the Stipulation specifically excluded the setting of an authorized ROE for PEF. The 10 percent figure in paragraph 7 of the Stipulation serves only as a "trigger", authorizing PEF to seek a change in its base rates when its achieved ROE falls below that level; thus, it is not a minimum authorized ROE. The Intervenors argue that according to Section 366.071, F.S., PEF must have a previously authorized ROE in order to receive interim rates. Because it has no minimum authorized ROE, the Intervenors contend that PEF cannot make a prima facie case for requesting an interim rate increase. Moreover, the Intervenors assert that the statute requires that the interim rates formula be followed exactly, and does not provide any exceptions. Therefore, the Intervenors contend that PEF's request for an interim rate increase should be denied.

PEF's Response to Joint Intervenors' Consolidated Response

PEF asserts that while the Stipulation specifically does not provide PEF an authorized ROE, the Stipulation provides that if PEF's earnings fall below 10 percent, then PEF may petition for a permanent rate increase. Furthermore, PEF asserts that while the Stipulation is silent on the minimum authorized ROE, the 10 percent threshold, triggering the right to petition for rate relief, should suffice as proxy for the minimum range of ROE.

PEF contends that Section 366.071(5)(b)(3), F.S., provides that the authorized ROE for purposes of interim rates may be established by voluntary stipulation approved by the Commission. As such, PEF argues that while the Stipulation does not establish a ROE, the Stipulation establishes 10 percent as the minimum required for requesting rate relief. Alternatively, PEF states that Section 366.071(5)(b)(3), F.S., provides that the authorized ROE for purposes of interim rates may be established by the utility's most recent rate case where the Commission set ROE, which for PEF was in 1992.<sup>7</sup> Based on the 1992 rate case, PEF asserts that the minimum authorized ROE would be 11 percent, and as such, PEF could have requested a

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<sup>7</sup> Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, In Re: Petition for a rate increase by Florida Power Corporation.

higher ROE. In this case, PEF is seeking 10 percent; thus, PEF contends that the Commission should grant interim rates in that amount.

### Analysis

#### *Interim Rate Statute*

Section 366.071(1), F.S., provides that the Commission may authorize the collection of interim rates until the effective date of the final order. Section 366.071(1), F.S., further provides that the Commission may authorize such interim rates when a public utility establishes a prima facie entitlement to interim relief. The provision of interim rates under the statute is intended to be an “expedited” process by which an utility obtains immediate financial relief during the pendency of a rate proceeding.<sup>8</sup> Additionally, authorized interim rates are subject to refund with interest, thereby protecting the customers from harm.

Section 366.071(1), F.S., states that “. . . [t]o establish a prima facie entitlement for interim relief, the commission, the petitioning party, or the public utility shall demonstrate that the public utility is earning outside the range of reasonableness on rate of return calculated in accordance with subsection (5).” Thus, Section 366.071(1), F.S., contemplates that a public utility may seek interim rate relief if the utility is earning outside the range of reasonableness.

Pursuant to Section 7 of the Stipulation, the parties agreed that the Company may seek to amend its base rates in the event that PEF’s retail base rate earnings fall below a 10 percent return on equity. The 10 percent threshold represents a level in which rates could be deemed to no longer be fair, just, and reasonable, and outside the range of reasonableness contemplated by Section 366.071(1), F.S. PEF has prefiled testimony and documentation which staff believes makes a prima facie showing that PEF is earning below the 10 percent threshold. Thus, staff believes that PEF has established a prima facie entitlement to interim rate relief pursuant to Section 366.071(1), F.S.

Furthermore, Section 366.071(5)(a), F.S., states that “. . . the commission shall determine the revenue deficiency or excess by calculating the difference between the achieved rate of return of a public utility and its required rate of return applied to an average investment rate base or an end-of-period investment rate base.” Pursuant to Section 366.071(5)(b)2., F.S., the required rate of return is calculated, in part, by using the last authorized rate of return on equity of the public utility. Pursuant to Section 366.071(5)(b)3., F.S., the utility’s last authorized rate of return on equity is “the minimum of the range of the last authorized rate of return on equity established in the most recent individual rate proceeding of the public utility. . . .” Section 366.071(5)(b)3., F.S., further provides that “[t]he last authorized return on equity for purposes of this subsection shall be established only: in the most recent rate case of the utility; in a limited scope proceeding for the individual utility; or by *voluntary stipulation* of the utility approved by the commission.”

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<sup>8</sup> See Order No. PSC-04-0721-PCO-GU, issued July 26, 2004, Docket No. 040216-GU, In re: Application for rate increase by Florida Public Utilities Company (citing Citizens v. Public Service Commission, 435 So. 2d 784, 786 (Fla. 1983); Citizens v. Mayo, 333 So. 2d 1, 5 (Fla. 1976)).



(emphasis supplied). According to the emphasized language in this subparagraph, it appears that PEF may satisfy this ROE requirement in one of two ways.

According to the plain language of Section 366.071(5)(b)3., F.S., PEF may satisfy the authorized ROE requirement in one of three ways. In this case, PEF entered into a voluntary stipulation which the Commission approved and which Commission staff believes provides a proxy for an authorized ROE for purposes of calculating revenue requirements and determining whether PEF is earning outside the range of reasonableness contemplated by Section 366.071(1), F.S. Therefore, based on the analysis above, staff believes that PEF has satisfied the requirements of Section 366.071(5), F.S., allowing the Commission to calculate PEF's revenue deficiency. Moreover, based on that analysis, it appears that PEF is earning outside the range of reasonableness contemplated by Section 366.071(1), F.S.

It is well settled that a public utility is entitled to an opportunity to earn a reasonable or fair rate of return on its capital. See United Tel. Co. of Florida v. Mann, 403 So.2d 962, 966 (Fla. 1981). In approving the 2005 Stipulation, the Commission clarified that, while the Stipulation did not diminish its "ongoing authority and obligation to ensure fair, just, and reasonable rates," it would give "great weight and deference to settlements, and enforce[e] them in the spirit in which they were reached by the parties." Order No. PSC-08-0945-S-EI, at 6-7. In keeping with the Commission's "ongoing authority and obligation to ensure fair, just, and reasonable rates," staff recommends that the Commission find that PEF is earning outside the outside the range of reasonableness contemplated by Section 366.071(1), F.S.

As discussed in Issue 2, the 2005 Stipulation does not prohibit PEF requesting interim rate relief. Under the Section 14 of the Stipulation, PEF does not have an authorized return on equity range for the purpose of addressing earnings levels because the revenue sharing mechanism, detailed in the Stipulation, was designed to be the appropriate and exclusive mechanism to address earnings levels.<sup>9</sup> As discussed previously, the Intervenors contend that PEF has no established ROE; thus, PEF cannot request interim rates. However, this argument, taken to its logical conclusion, would pose that there are no circumstances under the 2005 Stipulation under which PEF could request interim rate relief. This argument is clearly inconsistent with Section 7 of the Stipulation, which specifically contemplates interim relief may be available to PEF under the circumstances described in that section. If the Stipulation allows PEF to seek an interim increase, then this provision was not meant to preclude PEF from being able to make a prima facie case for requesting interim rates under the statute.

In this case, the 2005 Stipulation set the threshold for requesting a rate base increase to be when retail earnings fall below 10 percent. Pursuant to the Stipulation, PEF has made a prima facie case that its retail earnings have fallen below the 10 percent threshold, and may therefore seek a rate base increase. In PEF's petition for rate increase, PEF used the threshold (earning below 10 percent) as the lower limit for its authorized ROE when calculating interim rates.

In Order No. PSC-05-0945-S-EI, the Commission approved the Stipulation specifying that it established rates that are fair, just, and reasonable. Both the Intervenors as well as the

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<sup>9</sup> Order No. PSC-05-0945-S-EI, at 21-22.

Company agree that Section 7 of the Stipulation provides that the Company may seek to amend its base rates in the event that PEF's retail base rate earnings fall below the 10 percent threshold, notwithstanding Section 4. Therefore, staff believes that the 10 percent threshold adopted by the parties in the Stipulation represents a level below which rates are no longer fair, just, and reasonable thereby entitling PEF to petition the Commission to amend its base rates. PEF has presented prefiled testimony and documentation supporting that it is earning outside the 10 percent threshold. Accordingly, staff recommends that PEF has shown a prima facie entitlement for interim relief and is entitled to the proposed interim increase, as discussed in Issue 4.

**Issue 4:** Is Progress Energy Florida, Inc.'s proposed 2008 interim test year rate base of \$5,098,765,000 appropriate?

**Recommendation:** Yes. The appropriate 2008 interim test year rate base for PEF is \$5,098,765,000. (Slemkewicz)

**Staff Analysis:** In its filing, the Company proposed an interim test year thirteen month average rate base of \$5,098,765,000 for the period ended December 31, 2008. Staff has reviewed the rate base adjustments made in the current interim filing for consistency with the Stipulation approved in the Company's last rate case proceeding.<sup>10</sup> Based on staff's preliminary review, it appears that PEF has made the applicable and appropriate adjustments that are consistent with the Stipulation. Staff's recommendation of whether PEF is entitled to the proposed interim increase is discussed in Issue 3. If it is determined that interim relief should be granted to PEF in this case, staff agrees that \$5,098,765,000 is the appropriate amount of rate base for the 2008 interim test year. The calculation is shown on Attachment A.

It should be noted that 2008 is the historical test year that was utilized in part to develop the 2010 projected test year for the requested permanent base rate increase. The 2008 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

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<sup>10</sup> Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

**Issue 5:** Are Progress Energy Florida, Inc.'s proposed return on equity of 10.00 percent and its overall cost of capital of 7.84 percent reasonable for the purpose of determining interim rates?

**Recommendation:** Yes. PEF's proposed return on equity of 10.00 percent and overall cost of capital of 7.84 percent are reasonable for purposes of determining interim rates. (Maurey)

**Staff Analysis:** For purposes of its interim rate request, PEF used an overall cost of capital of 7.84 percent based on a return on equity (ROE) of 10.00 percent and the capital structure for the historical test year ended December 31, 2008. According to PEF, both the ROE and the adjustments recognized in the capital structure are consistent with the Stipulation approved in 2005 by Order No. PSC-05-0945-S-EI.<sup>11</sup> Paragraph 7 of the Stipulation states the following:

If PEF's retail base rate earnings fall below a 10% return on equity as reported on a Commission adjusted or pro-forma basis on a PEF monthly earnings surveillance report during the term of the Agreement, PEF may petition the Commission to amend its base rates notwithstanding the provisions of Section 4, either as a general rate proceeding or as a limited proceeding under Section 366.076, F.S.

Based on its reading of the Stipulation, PEF believes this language entitles the Company to request an interim rate increase to bring the Company's earnings up to an ROE of 10.00 percent.

As discussed in the Joint Intervenors' consolidated response to PEF's request for interim relief, the "Intervenors vigorously object to this interpretation as contrary to the plain meaning of the Stipulation and the revenue sharing mechanism that it established." Pursuant to Section 366.071(2)(a), F.S., the appropriate ROE for purposes of determining an interim rate increase is the minimum of the Company's currently authorized ROE range. However, at the present time PEF does not have an authorized ROE range. In pertinent part, Paragraph 14 of the 2005 Stipulation states: "effective on the Implementation Date, PEF will not have an authorized return on equity range for the purpose of addressing earnings levels, and the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels." Because PEF does not have an authorized ROE range and therefore no "last authorized minimum return on equity," the Intervenors contend the proposed relief is not available to PEF and the Company's request should be denied.

Staff disagrees with the Intervenors' arguments and, for the reasons discussed in Issue 3, recommends that PEF may be granted interim rates under the terms of the Stipulation and the interim statute. Staff agrees that the capital structure for the historical test year ended December 31, 2008, and an ROE of 10.00 percent results in an overall cost of capital of 7.84 percent. Attachment B details the calculation of the Company's overall cost of capital.

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<sup>11</sup> Order No. PSC-05-0945-S-EI, Issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

**Issue 6:** Is Progress Energy Florida, Inc.'s proposed 2008 interim test year net operating income of \$391,486,000 appropriate?

**Recommendation:** Yes. The appropriate 2008 interim test year net operating income for PEF is \$391,486,000. (Slemkewicz)

**Staff Analysis:** The proposed interim test year net operating income of \$391,486,000 is the twelve month amount for the year ended December 31, 2008. Staff has reviewed the net operating income adjustments made in the current interim filing for consistency with the Stipulation approved in the Company's last rate case proceeding.<sup>12</sup> Based on staff's preliminary review, it appears that PEF has made the applicable and appropriate adjustments that are consistent with the Stipulation. Staff's recommendation of whether PEF is entitled to the proposed interim increase is discussed in Issue 3. If it is determined that interim relief should be granted to PEF in this case, staff agrees that \$391,486,000 is the appropriate amount of net operating income for the 2008 interim test year. The calculation is shown on Attachment A.

It should be noted that 2008 is the historical test year that was utilized in part to develop the 2010 projected test year for the requested permanent base rate increase. The 2008 historical test year data is currently being audited as part of the normal ratemaking review process in this docket.

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<sup>12</sup> Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

**Issue 7:** Is Progress Energy Florida, Inc.'s proposed interim net operating income multiplier of 1.6343 appropriate?

**Recommendation:** Yes. PEF's proposed interim net operating income multiplier of 1.6343 is appropriate. (Slemkewicz)

**Staff Analysis:** On MFR Schedule G-18, the Company calculated a net operating income multiplier of 1.6343 using a 35 percent federal income tax rate and a 5.5 percent state income tax rate. Additionally, the Company applied a .072 percent factor for regulatory assessment fees. Staff has reviewed the Company's calculation of the net operating income multiplier and is not proposing any adjustments. Therefore, staff recommends that 1.6343 is the appropriate net operating income multiplier. The calculation is shown below.

<u>Line</u>	<u>Description</u>	
1	Revenue Requirement	100.000%
2	Gross Receipts Tax	0.000%
3	Regulatory Assessment Fee	(0.072)%
4	Bad Debt Rate	<u>(0.313)%</u>
5	Net Before Income Taxes	99.615%
6	Combined State/Federal Income Tax @ 38.575%	<u>(38.426)%</u>
7	Revenue Expansion Factor	<u>61.189%</u>
8	Net Operating Income Multiplier (100/61.189)	<u>1.6343</u>

**Issue 8:** Should Progress Energy Florida, Inc.'s requested interim revenue increase of \$13,078,000 be granted?

**Recommendation:** If it is determined that interim relief should be granted to PEF in this case, the appropriate interim revenue increase for PEF should be \$13,078,000. (Slemkewicz)

**Staff Analysis:** PEF requested interim rate relief of \$13,078,000 for the test year ended December 31, 2009. This would allow the Company to earn an overall rate of return of 7.84 percent and the minimum return on equity of 10.00 percent. Staff's recommendation of whether PEF is entitled to the proposed interim increase is discussed in Issue 3. If it is determined that interim relief should be granted to PEF in this case, staff agrees that \$13,078,000 is the appropriate interim revenue increase for the 2008 interim test year.

After a determination of the permanent rate increase has been made, the interim rate increase will be reviewed to determine if any portion should be refunded to the ratepayers.

	<u>(000)</u>
Jurisdictional Adjusted Rate Base	\$5,098,765
Adjusted Overall Rate of Return	x <u>7.84%</u>
Jurisdictional Adjusted Revenue Requirement	\$399,488
Jurisdictional Adjusted Net Operating Income	<u>(391,486)</u>
Income Deficiency/(Excess)	\$8,002
Net Operating Income Multiplier	x <u>1.6343</u>
Interim Revenue Increase/(Decrease)	\$13,078
Annualized Base Rate Revenues	-:- <u>1,438,378</u>
Percentage Increase	<u>0.91%</u>

**Issue 9:** Should Progress Energy Florida, Inc.'s requested percentage increase factor of 1.70 percent be approved?

**Recommendation:** No. If it is determined that relief should be granted to PEF in this case, the appropriate percentage increase factor is 0.91 percent. If approved, PEF should file revised tariff sheets reflecting the 0.91 percent increase factor. (Draper)

**Staff Analysis:** According to Rule 25-6.0435(2), Florida Administrative Code (F.A.C.), the percentage increase factor is applied uniformly to all existing base rates and charges to derive the interim base rates and charges. PEF presented two percentage increase factor calculations in its interim rate relief MFR Schedule G-20. The first calculation uses annualized 2008 base revenues to arrive at a percentage increase factor of 0.91 percent. In addition, PEF provided a calculation based on base revenues for the period July through December 2008. In other words, PEF spread the \$13 million interim revenue increase over a 6-month period instead of a 12-month period. That calculation yields a percentage increase factor of 1.70 percent, which is the percentage increase factor for which PEF seeks approval.

In his prefiled testimony, PEF witness Toomey stated that the 1.70 percent increase was calculated in accordance with Section 366.071(5), F.S., and represents the additional revenues required to achieve a 10 percent return on equity for the calendar year 2008. Staff disagrees with PEF's assertion that the statute prescribes how the percentage increase factor is determined. Instead, the statute prescribes how the revenue deficiency is calculated. The purpose of interim is to provide rate relief during the pendency of a rate case. Interim is not a method for the recovery of past revenue deficiencies as implied by PEF's request.

Rule 25-6.0436(2), F.A.C., states that the requested interim increase in base revenues shall be divided by interim test year base rate revenues to derive a percentage increase factor. The interim test year is 2008. It has been Commission practice to calculate the percentage increase factor based on annual base revenues. The Commission last set interim rates in Florida Public Utilities Company (FPUC) 2007 rate case.<sup>13</sup> In that case, the calculation of the percentage increase factor was based on 2006 base revenues in the same manner recommended here. PEF provided no evidence that the Commission in the past deviated from its own rule requiring the use of annual base revenues.

PEF witness Toomey attached PEF's proposed tariff sheets to his testimony filed in Docket No. 090144-EI to reflect both the 1.70 percent increase requested in this docket and the Bartow Repowering project increase factor requested in Docket No. 090144-EI. If the Commission denies or modifies the interim and/or Bartow Repowering increase request, PEF should file revised tariff sheets to reflect the Commission vote in this docket and Docket No. 090144-EI.

Using a 0.91 percent increase factor will raise the 1,000 kWh residential bill by \$0.41, while using a 1.70 percent increase factor as proposed by PEF will raise the 1,000 kWh residential bill by \$0.77.

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<sup>13</sup> See Order No. PSC-07-0897-PCO-EI, issued November 5, 2007, in Docket No. 070304-EI, In re: Petition for rate increase by Florida Public Utilities Company.



Docket No. 090079-EI  
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Staff recommends that if it is determined that relief should be granted to PEF in this case, the appropriate percentage increase factor is 0.91 percent. The calculation of the factor is shown in Issue 8.

**Issue 10:** How should the interim revenue increase for Progress Energy Florida, Inc. be distributed among the rate classes?

**Recommendation:** The percentage increase factor approved in Issue 9 should be applied uniformly to all existing base rates and charges to derive the interim base rates and charges, as required by Rule 25-6.0435, F.A.C. The interim rates should go into effect with the first billing cycle in July 2009. The Company should give notice to customers of the interim increase commencing with the June 2009 bills to coincide with the notice staff is recommending PEF provide for the Bartow Repowering project in Docket No. 090144-EI. (Draper)

**Staff Analysis:** In Issue 8, staff recommended an interim increase of \$13,078,000 and in Issue 9 staff recommended a percentage increase factor of 0.91 percent. Rule 25-6.0435, F.A.C., requires that any percentage increase factor be applied uniformly to all existing base rates and charges to derive interim base rates and charges. In its MFRs, Schedule G-22, PEF shows present rates and proposed interim rates for all rate classes. Staff notes that on MFR Schedule G-22, PEF utilized the 0.91 percent increase factor recommended by staff to calculate the annualized revenue requirements, rather than the 1.70 percent increase factor that PEF used in its proposed tariffs. If the Commission approves a different percentage increase factor, PEF should refile MFR Schedule G-22, for staff's review, to show the calculation of all base rates and charges based on the Commission-approved percentage increase factor.

PEF requested that the interim rates go into effect with the first billing cycle in July 2009. The Bartow Repowering increase, if approved in Docket No. 090144-EI, would also go in effect with the first billing cycle in July 2009. The Company should give notice to its customers of the interim increase commencing with the June 2009 bills to coincide with the notice staff is recommending PEF provide for the Bartow Repowering project, if approved. A copy of the notice should be submitted to staff for approval prior to its issuance.

**Issue 11:** What is the appropriate security to guarantee the amount collected subject to refund?

**Recommendation:** The appropriate security to guarantee the funds collected subject to refund is a corporate undertaking. (Maurey)

**Staff Analysis:** PEF has requested that all funds collected subject to refund be secured by a corporate undertaking. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed the financial statements to determine if PEF can support a corporate undertaking for a portion of the total amount of its interim rate increase of \$13,078,000. Based on an estimated six-month collection period of interim rates for PEF, staff has determined the maximum amount of revenues that may need to be protected is \$6,539,000. PEF's 2006, 2007, and 2008 financial statements were used to determine the financial condition of the Company. This analysis shows PEF has experienced a decline in its equity ratio in 2008, but the 42 percent equity ratio is still sufficient. The equity balance, while declining on a relative basis, is still significantly greater than the amount under consideration for a corporate undertaking. In addition, net income has been on average 53 times greater than the requested corporate undertaking amount. PEF's financial performance has demonstrated adequate levels of profitability, liquidity, and interest coverage to offset the decline in the equity ratio.

Staff believes PEF has adequate resources to support a corporate undertaking in the amount requested. Based on this analysis, staff recommends that a corporate undertaking of \$6,539,000 is acceptable. This brief financial analysis is only appropriate for deciding if the Company can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this proceeding.

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**Issue 12:** Should this docket be closed?

**Recommendation:** No. This docket should remain pending the Commission's final resolution of the Company's requested rate increase. (Fleming, Klancke, Sayler, Young)

**Staff Analysis:** This docket should remain open pending the Commission's final resolution of the Company's requested rate increase.

PROGRESS ENERGY FLORIDA, INC.  
 DOCKET NO. 090079-EI  
 INTERIM TEST YEAR  
 DECEMBER 31, 2008

	As Filed by Company	Adjustments			Interest Synch	Total Adjustments	Total Adjusted Rate Base
<b>RATE BASE</b>							
Plant in Service	\$9,064,768,000					\$0	\$9,064,768,000
Accumulated Depreciation	(4,241,738,000)					0	(4,241,738,000)
Net Plant in Service	4,823,030,000	0	0	0	0	0	4,823,030,000
Nuclear Fuel - No AFUDC (Net)	76,439,000					0	76,439,000
Property Held for Future Use	26,578,000					0	26,578,000
Construction Work in Progress	157,043,000					0	157,043,000
Net Utility Plant	5,083,090,000	0	0	0	0	0	5,083,090,000
Working Capital	15,675,000					0	15,675,000
<b>Total Rate Base</b>	<b>\$5,098,765,000</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$5,098,765,000</b>
<b>INCOME STATEMENT</b>							
Operating Revenues	\$1,509,250,000	0	0	0	0	0	\$1,509,250,000
Operating Expenses:							
Operation & Maintenance - Fuel	7,169,000					0	7,169,000
Operation & Maintenance - Other	576,675,000					0	576,675,000
Depreciation & Amortization	277,577,000					0	277,577,000
Taxes Other Than Income	104,979,000					0	104,979,000
Income Taxes - Current/Deferred	158,945,000					0	158,945,000
Investment Tax Credit (Net)	(5,460,000)					0	(5,460,000)
(Gain)/Loss on Disposition	(2,121,000)					0	(2,121,000)
Total Operating Expenses	1,117,764,000	0	0	0	0	0	1,117,764,000
<b>Net Operating Income</b>	<b>\$391,486,000</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$391,486,000</b>
<b>OVERALL RATE OF RETURN</b>	<b>7.68%</b>					<b>0.00%</b>	<b>7.68%</b>
<b>RETURN ON EQUITY</b>	<b>9.67%</b>					<b>0.00%</b>	<b>9.67%</b>

Docket No. 090079-EI  
 Date: May 7, 2009

PROGRESS ENERGY FLORIDA, INC.  
 DOCKET NO. 090079-EI  
 INTERIM TEST YEAR  
 DECEMBER 31, 2008

ATTACHMENT B

**CAPITAL STRUCTURE**

**AS FILED BY COMPANY**

	<u>Amount</u>	<u>Ratio</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>	
Long Term Debt	\$2,138,938,000	41.95%	6.27%	2.630%	
Short Term Debt	37,355,000	0.73%	3.87%	0.028%	
Preferred Stock	21,093,000	0.41%	4.51%	0.019%	
Customer Deposits - Active	113,431,000	2.22%	6.23%	0.139%	
Customer Deposits - Inactive	630,000	0.01%	0.00%	0.000%	
Common Equity	2,551,396,000	50.04%	10.00%	5.004%	
Deferred Income Taxes	298,993,000	5.86%	0.00%	0.000%	
FAS 109 DIT - Net	(72,187,000)	-1.42%	0.00%	0.000%	
Tax Credits - Weighted Cost	9,116,000	0.18%	8.28%	0.015%	
<b>Total</b>	<b><u>\$5,098,765,000</u></b>	<b><u>100.00%</u></b>		<b><u>7.835%</u></b>	<b>7.84% Rounded</b>