BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Florida Power & Light Company for Approval of Tax Savings Refund for 1987.	) DOCKET NO. 880355-EI) ORDER NO. 20659) ISSUED: 1-25-89	

The following Commissioners participated in the disposition of this matter:

KATIE NICHOLS, Chairman
THOMAS M. BEARD
GERALD L. GUNTER
JOHN T. HERNDON
MICHAEL McK. WILSON

APPEARANCES:

MATTHEW CHILDS, Esquire, Steel, Hector & Davis, 310 W. College Avenue, Tallahassee, FL 32301-1406
On behalf of Florida Power & Light Company.

ROBERT MORROW, Esquire, Sutherland, Asbill & Brennan, 1275 Pennsylvania Avenue, N. W., Washington, D. C. 20004
On behalf of the Coalition of Local Governments.

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On behalf of the Florida Industrial Power Users' Group.

STEVE BURGESS, Esquire, Office of the Public Counsel, c/o Florida House of, Representatives, The Capitol, Tallahassee, FL 32399-1300
On behalf of the Citizens of the State of Florida.

MICHAEL B. TWOMEY, Esquire, Florida Public Service Commission, Division of Legal Services, 101 East Gaines Street, Tallahassee, Florida 32399-0863
On behalf of the Commission Staff.

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Counsel to the Commissioners.

ORDER ON 1987 TAX SAVINGS REFUND

BY THE COMMISSION:

The Federal Tax Reform Act of 1986 reduced the maximum federal corporate income tax rate from 46% to 34%, effective July 1, 1987, resulting in an effective federal income tax rate for 1987 of 39.95%. While we determined that we would utilize our existing rule, Rule 25-14.003, Florida Administrative Code,

(the Tax Savings Rule or Rule) to address the change in tax rates, we recognized the inadequacy of the Rule using the "midpoint of the range of return approved by the Commission in the utility's last rate case" in the refund calculation and directed that the parties negotiate in an attempt to settle upon a more current and, therefore, lower equity rate for purposes of the Rule. As is reported in Order No. 17126, the parties were unable to reach agreement and we accepted Florida Power & Light Company's (FPL's) unilateral offer to utilize a return on equity rate of 13.6% for purposes of the Tax Savings Rule for 1987.

On March 1, 1988, pursuant to the Rule, FPL filed its Petition in which it proposed to refund to its customers $53,250,572 of 1987 tax savings. Pending a complete review of the calculations and underlying data supporting FPL's refund amount, we, in Order No. 19158, approved its refund proposal and the utility began making the refund in the form of billing credits in May, 1988.

The other parties to this docket, the Office of Public Counsel, the Coalition of Local Governments (CLG), the Florida Industrial Power Users' Group (FIPUG) and our Staff took the position that FPL's refund should be larger and an evidentiary hearing on the matter was held on November 28, 1988. As a result of this hearing, we found that FPL's tax savings refund was sufficient but additional interest should be paid.

Revenue Effect of 1987 Jurisdictional Tax Savings

The parties' positions on the revenue effect of FPL's 1987 jurisdictional tax savings ranged from FPL's and Staff's $79,503,730 to FIPUG's $108,900,000. Having considered the arguments, we are persuaded that the revenue effect should be limited to the actual tax savings experienced by FPL. In this case that amount is $79,503,730.

Effective Date of Interest

Rule 25-14.003(5)(e), Florida Administrative Code, provides that:

> "Refunds or collections shall be made to or from current customers of the utility at the time that such refunds or collections are to be effected. In either event, the utility shall refund or collect the amount with interest accruing on any outstanding balance from the date of overcollection or underpayment. Interest shall be set by the Commission." (Emphasis supplied).

FPL took the position that interest should be accrued from January 1, 1988 to April 28, 1988, arguing that the "overcollection" did not occur until January 1, 1988, since the tax savings for 1987 could not be accurately determined until December 31, 1987. In lieu of interest for 1987, the utility suggested that a working capital adjustment recognizing a refund liability to the customers would be appropriate. FPL witness Homer P. Williams, Jr., testified that the 1987 monthly balances of tax savings could not be accurately determined.

FIPUG witness Lane Kollen testified that interest should be calculated beginning January 1, 1987, with the assumption that one-twelfth of the tax savings dollars were earned each month, and with interest earned at the utility's weighted cost of capital.

Public Counsel witness Hugh Larkin testified that the accrued refund should be included as a reduction to working capital for 1987, which would effectively provide the ratepayers with an interest rate equivalent to the utility's overall cost of capital.

We agree with Staff witness Ann Causseaux that interest should begin being accrued on January 1, 1987, assuming one-twelfth of the 1987 tax savings was earned each month and with interest paid at the 30-day commercial paper rate as provided by Rule 25-6.109(4)(a), Florida Administrative Code.

We find that interest should begin being accrued at January 1, 1987, because it is obvious that the tax savings of $53 million were not earned between December 31, 1987 and January 1, 1988, and that the time value of this amount of money is substantial. Absent evidence from the utility or another party that the tax savings was earned in specific months, we find that it is reasonable to assume that one-twelfth of the annual total tax savings were earned in each month of 1987. Lastly, we reaffirm our decision in Order No. 19185 that the 30-day commercial paper rate as required by Rule 25-6.109(4)(a), Florida Administrative Code, shall be used in calculating the interest owed. The 30-day commercial paper rate is commonly used to calculate interest in fuel cost recovery proceedings, refunds for interim rate awards and other proceedings. It provides for an indisputable rate upon which to peg interest and simplifies the tax savings refund process.

O&M Adjustments

The issue of the proper amount of operating and maintenance (O&M) expenses to be included in FPL's 1987 tax savings is primarily a function of whether any adjustment should be made for a so-called "O&M benchmark," which would effectively hold FPL's allowable O&M expenses to a growth rate approximating increases in customers and inflation.

Public Counsel, FIPUG and CLG take the position that the O&M benchmark calculation is, in effect, a cap or ceiling on FPL's O&M expenses. They state that an O&M benchmark adjustment was made in FPL's last rate case and, therefore, argue that a similar adjustment is appropriate here. The Intervenors note that in FPL's last rate case, the Commission disallowed some $62 million in O&M expenses for the 1984 test year by applying the O&M benchmark or approximately 64% of FPL's benchmark variance for that year. They say use of the benchmark was, thus, an essential part of FPL's last rate case. Intervenors submit that ignoring the benchmark and merely excluding O&M expenses "specifically identified" in FPL's last rate case results in the utility's taxable income and the associated tax savings resulting from the reduction in the federal income tax rate being substantially understated. Furthermore, they say such an approach effectively permits FPL to pass through cost increases

above a level consistent with the Commission's determination in its last rate case and thereby reduce the refund otherwise due to ratepayers.

FPL states that it excluded all O&M expenses specifically identified and disallowed in its last rate case. It says that it did not remove O&M expenses above the calculated O&M benchmark for 1987 because to do so would: (1) be inconsistent with the scope, purpose and intent of the tax savings rule; (2) be inconsistent with the purpose and policy underlying the Commission's O&M benchmark analysis; (3) be inconsistent with instructions not to make such disallowances and (4) would result in the refund of hypothetical tax savings FPL never received.

As to the first point, FPL stresses that the Commission has always used the O&M benchmark as an "analytical tool" used to flag certain rapidly increasing costs for "closer scrutiny." FPL states that this "closer scrutiny" always included an opportunity to meet its burden of proving the expenses were reasonable and prudent. Applying the benchmark as urged by the Intervenors, says FPL, would result in the disallowance of a significant portion of its expenses with no proof that they were either unreasonable or imprudent and, more importantly, with no opportunity for FPL to demonstrate the reasonableness and prudence of these expenses. Thus, argues FPL, these expenses would be determined to be prima facie unreasonable or imprudent.

With respect to its second point, FPL says that it has been clear from the history of the adoption of the Tax Savings Rule that matters that would be considered in a rate proceeding, such as the O&M benchmark, would not be addressed in applying the Tax Savings Rule. Further, FPL states that the history of the Rule adoption, as well as a Commission Staff letter, clearly established that the quantification of tax savings was to be predicated on the monthly surveillance reports that all utilities must file with the Commission and which utilize actual O&M expenses, adjusted only for specific adjustments made by the Commission in the utility's most recent rate case.

FPL's third point is that the proposed application of the O&M benchmark creates an irreconcilable conflict with its obligation to provide adequate, sufficient and efficient service. To meet this obligation, FPL says that it must make such investment and incur such costs as are required. In this case, it adds, no party has offered any proof or even suggested that any O&M expenditures were unreasonable, imprudent or not properly related to the provision of electric utility service. FPL states that to arbitrarily limit its expenses could result in inadequate levels of service.

Lastly, FPL stresses that the Intervenors have not made a case justifying application of the O&M benchmark in either an evidentiary or policy sense.

Without ruling one way or the other on the prudence or reasonableness of FPL's O&M expenses, we agree that it is inappropriate to disallow the O&M expenses without competent and substantial evidence to support such a decision. The O&M benchmark is an "analytical tool" to be used in our analysis and not an automatic adjustment that must be made.

It should be noted, however, that our present refusal to apply the O&M benchmark in this docket does not leave the Intervenors, or any other substantially affected party, without a remedy with which to address their perceived grievances. If the Intervenors believe that a complete examination of FPL's revenues and expenses would disclose that its rates are "unjust, unreasonable, unjustly discriminatory, or in violation of law" they may request a public hearing for the purpose of determining just and reasonable rates.

Pension Expense

In FPL's most recent general rate case, we included for ratemaking purposes all of the utility's projected pension expenses to be funded. In 1987, in recognition of the fact that its employee pension fund was substantially overfunded, FPL did not make any contributions. FPL had, however, implemented the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 87 (SFAS 87) Employer's Accounting for Pensions in 1986. This standard recognizes, among other things, that the economic cost of a pension plan may vary from the amount contributed to the pension trust fund for any given period. That is the case here where SFAS 87 yields a negative $22.5 million pension cost when no contributions were made to the fund. The result of utilizing this standard in 1987 without adjustment was a book pension cost of a negative $22.5 million, which would have increased FPL's "excess" tax savings and, hence, its customer refund. Reasoning from its experience in its own last rate case where its contributions and funded amounts were equal, FPL made a "regulatory" adjustment reversing its negative $22.5 million pension cost, so that its pension expense for ratemaking purposes was zero. FPL believes they made this adjustment pursuant to Section 210 of SFAS which recognizes pension cost differences "created by the actions of the regulator."

For the purposes of this case only, we will accept FPL's adjustment zeroing out its negative pension expense. With respect to on-going pension issues, we will address all such issues in Docket No. 881170, Review of Utility Pension Accounting to Determine the Need for Formal Commission Policy later in this year. Accordingly, we find that FPL's 1987 pension expenses should not be restated to reflect negative pension expense.

Accelerated Amortization of Unprotected Excess Deferred Taxes

FIPUG took the position that of the total amount of excess deferred taxes, some $96.3 million were "unprotected", meaning that we have the ability and the discretion to require that they be disposed of without violating federal tax policies and thus jeopardizing FPL's ability to utilize accelerated depreciation for tax purposes. FIPUG stated that, as a matter of policy, we should require FPL to return the unprotected excess deferred taxes to customers as expeditiously as practicable. Noting that a shorter period would be appropriate, FIPUG recommended that the unprotected excess deferred taxes be amortized over five years to comport with the Commission's prior rule relating to excess deferred taxes. FIPUG submitted that, taking into account the rate base effect of accelerated amortization,

customers would require an additional $25.5 million in refunds annually for five years. Public Counsel and the Coalition of Local Governments agreed with FIPUG's position.

FPL took the position that it had treated its deferred taxes in a manner consistent with Commission Staff Advisory Bulletin No. 30, issued on May 10, 1988, which stated that, effective from January 1, 1987, excess deferred taxes were to be flowed-back under the average rate assumption method of the Internal Revenue Code. FPL noted that while its customers would receive the benefit of credits on their bills for five years, its capital costs would escalate during the same period due to the loss of zero-cost capital (the excess deferred taxes) being replaced with costed capital. This, said FPL, would result in the customers being left with increased capital costs and an increase in income tax expense at the end of five years. The result, then, would be a lowered annual revenue requirement for years one through five, but an increased revenue requirement for years six through twenty.

Our Staff agreed with FPL, stating that the practical aspects of the long-run increased revenue requirements and rate instability associated with the rapid flow-back argued against it. Staff also noted that Rule 25-14.005, Florida Administrative Code, referred to by FIPUG, had been repealed and, furthermore, when in effect, had, by its own provisions, been inapplicable to proceedings pursuant to the Tax Savings Rule.

For the reasons cited by FPL and our Staff, we find that FPL's unprotected excess deferred taxes should not be amortized on an accelerated basis for purposes of calculating the utility's 1987 tax savings pursuant to the Tax Savings Rule.

SUMMARY

As a result of this proceeding, we have determined that FPL owes an additional $1,673,136 in interest through December, 1988, over and above the $54,771,646 already refunded in 1988. FPL shall continue to accrue interest on the amount until it is refunded in conjunction with its Tax Savings Refund for calendar year 1988.

In view of the above, it is

ORDERED by the Florida Public Service Commission that Florida Power and Light Company shall refund an additional $1,673,136, plus accrued interest, in the manner described in the body of this Order, as a result of its excess tax savings in 1987, as defined by Rule 25-14.003, Florida Administrative Code.

By ORDER of the Florida Public Service Commission, this 25th day of JANUARY, 1989.

STEVE TRIBBLE, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.