CAROLINA POWER AND LIGHT CO., INC.

DOCKET NOS. 18,361 and 18,387

TESTIMONY OF MR. SAM C. HAMMOND
ACCOUNTING MANAGER - UTILITIES DIVISION

Q. MR. HAMMOND, WOULD YOU PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION?

A. My name is Sam C. Hammond and I reside in Chapin, South Carolina. I am employed by the South Carolina Public Service Commission, Utilities Division, as Accounting Manager.

Q. WOULD YOU PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR EXPERIENCE.

A. I received a B. S. Degree in Business Administration with an Accounting Major from the University of Southern Mississippi in 1949. Since that time, I have spent approximately 21 years in auditing with 15 years in State Government and 6 years in private industry. In addition to my auditing experience, I have also served as Comptroller for a textile plant and Comptroller for a small conglomerate corporation that had various interests. I have been with this Commission for the past five years and in my present position as Accounting Manager for the past four years.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to set forth in summary form Staff's findings and recommendations resulting from our study and examination of the books and records of the Company concerning the present rate case. These findings and recommendations are set forth in detail in the report of the Utilities Division with attached exhibits.

Q. MR. HAMMOND, I SHOW YOU THE REPORT WITH ATTACHED EXHIBITS TITLED "CAROLINA POWER AND LIGHT CO., INC., RATE CASE 1976, DOCKET NOS. 18,361 and 18,387, REPORT OF UTILITIES DIVISION, SOUTH CAROLINA PUBLIC SERVICE COMMISSION." WAS THIS REPORT PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes, it was, with the exception of the Electric Department's section of the report.

Q. (MARK FOR IDENTIFICATION). WOULD YOU EXPLAIN THE CONTENTS OF THIS REPORT?

A. As outlined in the index to Staff's report, Pages 1 through 36 contain an analysis of the report, with the remaining pages 37 through 91 containing supporting exhibits. My testimony will be keyed basically to Exhibit A shown on page 37 of the report, which is titled Operating Experience, Rate Base and Rate of Return. The Return on Rate Base in Exhibit A is shown for per book operations for Total Company and S. C. Retail. In addition, Staff has shown Rate of Return for normalized operations for Total Company, Total Wholesale, Total Retail and S. C. Retail both before and after the requested increase. All exhibits in Staff's report utilize a test year ended December 31, 1975, unless otherwise indicated.

Q. DO YOU HAVE ANY FURTHER EXPLANATION OF EXHIBIT A?

A. Yes. Staff prepared this Exhibit per books in compliance with this Commission's directive issued November 13, 1974, concerning components to be included in calculating Total Income for Return and Rate Base for electric utilities. The Exhibit's format is as follows:

Column (1): The Company's Per Book Operations are shown for test year 1975.

Column (2): Staff's Accounting and Pro Forma Adjustments made to normalize the operations of the Company, which are shown separately in Exhibit A-1.

Column (3): Staff's computation of Total Income for Return and Rate Base for Total Company after Accounting and Pro Forma Adjustments.

Column (4): Staff's Rate of Return computation for Total Wholesale after allocation of Accounting and Pro Forma Adjustments.

Column (5): Total Company Retail Operations are shown after allocation of Accounting and Pro Forma Adjustments.

Column (6): S. C. Retail Operations are shown as allocated from Total Company per books.

Column (7): Staff's Accounting and Pro Forma Adjustments allocated to S. C. Retail Operations.

Column (8): S. C. Retail Operations are shown after Accounting and Pro Forma Adjustments but prior to the effect of the requested increase.

Column (9): The effect of the requested increase of $22,487,000 and the related state and federal tax effect.

Column (10): Staff's Computation of the normalized test year for S. C. Retail after giving effect to the requested increase.

Q. WOULD YOU PLEASE ELABORATE ON THE CALCULATIONS IN EXHIBIT A IN THE SAME FORMAT AS YOU HAVE OUTLINED?

A. Shown in Column (1) are the results of per book operations for the test year, including those components for Total Income for Return and Original Cost Rate Base as outlined in this Commission's directive of November 13, 1974. Staff computed Net Operating Income of $110,866,000 which is the same as that shown on Davis Exhibit #1, Page 1 of 8. From this amount, Staff deducted Interest on Customer Deposits of $162,000 which, in effect, allows this amount as an operating expense. Also included is Customer Growth, Allowance for Funds During Construction and Income Tax-Credit, producing Total Income for Return of $191,447,000. Davis Exhibit #1 shows Total Income for Return per books of $167,018,000. The difference is due to Staff's inclusion of A.F.D.C. at the per book amount rather than the adjusted amount. Staff's adjustment to A.F.D.C. is shown in Column (2).

Staff computed an Original Cost Rate Base for Total Company per books of $2,307,158,000. The Company's computation on Davis Exhibit #6, page 2 of 3, shows a total Rate Base of $2,307,558,000. The difference is attributable to Working Capital Allowance computation. Staff's computation of Working Capital is included as Exhibit A-3. Also, a reconciliation of differences in computations for Total Income for Return and Rate Base is included as Exhibits A-4 and A-5, respectively. Staff's computation produced a Rate of Return for Total Company Per Books of 8.30%.

Q. WOULD YOU NOW EXPLAIN THE ACCOUNTING AND PRO FORMA ADJUSTMENTS FOUND IN COLUMNS 2 AND 7 OF YOUR EXHIBIT A?

A. The Company's test year operations were normalized by Adjustments 1 through 13. Shown in Column 2 is the Total Company Adjustment and Column 7 includes that portion of the Adjustment allocated to S. C. Retail Operations based on the Company's Jurisdictional Allocation Study. The Company's and Staff's Adjustments are presented separately in Exhibit A-1 consisting of pages 1 through 9 and are explained in detail in the analysis to Exhibit A-1. Since the adjustments are explained in Staff's report, I will discuss only those which differ from the Company's.

Adj. 2 - O & M Expense Adjustments - In Account #930, "Miscellaneous General Expenses," the Company included $366,793 for "National and Local Institutional Advertising Expenses". Of this amount, $37,747 was attributable to Energy Conservation. Staff agrees with advertising to conserve energy, but is of the opinion that advertising to promote the Company and its image should be borne by the stockholders rather than the ratepayers. As a result, Staff made an adjustment to decrease O & M Expenses by ($329,046) on system total. This has the effect of transferring Institutional Advertising, excluding Conservation, to below-the-line for rate making purposes. Staff allocated the S. C. Retail portion of the adjustment by use of the Company's Jurisdictional Allocation Study. The Factor computed for S. C. Retail was 16.14% or ($53,108).

Also included in Account #930, "Miscellaneous General Expenses", for the test year were Dues to various Chambers of Commerce totaling $11,614. Staff feels that these expenditures are not necessary to electric operations and has excluded this amount from O & M Expenses. S. C. Retail O & M Expenses were decreased by ($1,874).

Adj. 5 - State Income Tax Adjustments

State Income Taxes were adjusted by Company and Staff to reflect the State Income Tax effect of Revenue and Expense Adjustments. The Company's computation resulted in a decrease to State Income Taxes of ($1,620,568) for Total System and ($481,268) for S. C. Retail. Staff's Adjustment to Revenue and Expense items produced a decrease of ($1,944,826) with ($477,969) apportioned to S. C. Retail.

Adj. 6 - Federal Income Tax Adjustments

Federal Income Taxes were also adjusted to reflect the tax effect of all revenue and expense adjustments. Company Adjustments resulted in a projected decrease to Federal Income Taxes of ($23,254,922) for Total System and ($3,619,140) for S. C. Retail. Staff's adjustments produced a decrease to Federal Income Taxes of ($22,935,761) for Total System and ($3,594,332) for S. C. Retail. The difference is attributable to the tax effect of O & M Expense Adjustments made by Staff whic were not made by the Company.

Adj. 7 - Provision for Deferred Income Taxes Adjustments - Included as an adjustment to Deferred Income Taxes is a proposal by the Company to normalize the tax benefits of certain items which have previously been "flowed-through" to the benefit of

current ratepayers. These items consist of (1) the tax effect of capitalized items (Property Taxes and Pension Costs) which are deductible for tax purposes totaling $3,279,000 for Total Company and (2) a portion of the tax benefits arising from the difference between book depreciation and accelerated depreciation totaling $12,335,000. The tax benefits arising from both of the above-mentioned items have previously been under the "flow-through" method, thereby reducing the current book income taxes and increasing Net Operating Income. The proposed adjustment requires an increase to Deferred Income Taxes in the amount of $15,614,000 for the test year for Total Company. By this normalization method taxes are not deferred for future ratepayers. Over the life of the asset, taxes will be normal as if the Company had used straight-line depreciation.

For purposes of our presentation, Staff disallowed a portion of the adjustment for capitalized items totaling $3,279,000. Though Staff is basically in agreement with the normalization method of accounting, we feel that a change to full normalization is a burden on the current ratepayer.

Since the Company was actually under the Partial "flow-through" method during the test year, Staff used, to some extent, the same treatment for rate-making purposes, and would recommend that the Company achieve full normalization for future rate-making purposes. Therefore, Staff's adjustment totals $12,335,000 for Total Company and $2,197,325 for S. C. Retail.

Adj. 12 - Materials and Supplies Adjustments

Included in Account #155 as a part of Materials and Supplies for the test year was "Merchandise" of $8,222. Since Materials

and Supplies is a part of Rate Base upon which investors are entitled to earn a rate of return, Staff has eliminated "Merchandise" as being unrelated to the sales of electricity. Staff computed an allocation factor of .1556 for S. C. Retail from the Company's Jurisdictional Allocation Study. Amount allocated to S. C. Retail was $1,279.

As a part of the Company's last rate application, Docket Nos. 17,134 and 17,336, before this Commission, an adjustment was proposed to increase fuel supply to an August, 1974, price level based on a 1973 test year. The adjustment was proposed due to the rapidly rising prices of coal. Since the price of coal has been decreasing, Staff feels that a similar adjustment should be made to reflect that decrease for this proceeding. Staff has, therefore, adjusted the end of year coal inventory to April 30, 1976 average cost per ton which were the latest figures available at the time of preparation of this report. Even though this adjustment emcompasses a known change occurring beyond the test year, Staff has, in previous cases, accepted adjustments for known changes up to the date of filing a rate application. Staff is of the opinion that this adjustment is necessary to more accurately reflect future expectations of coal prices.

The revaluation of the ending inventory to April 30, 1976 average cost ($25.57) per ton decreased ending inventory by ($1,339,212). Staff computed an allocation factor of .1454 from the Company's Jurisdictional Allocation Study resulting in a decrease to inventory allocated to S. C. Retail of ($194,721).

Q. MR. HAMMOND, WOULD YOU SUMMARIZE THE EFFECT OF THE PREVIOUSLY MENTIONED ADJUSTMENTS ON TOTAL COMPANY AND S.C. RETAIL OPERATIONS?

A. Column 3 reflects Staff's computation of a normalized year after adjustment for total company and included in Column 8 is S. C. Retail Operations as adjusted. The net effect of all Accounting and Pro Forma Adjustments decreased Total Income for Return by ($55,991,000) and decreased Rate Base by ($33,015,000) for Total Company. Therefore, Rate of Return after adjustments is decreased from 8.30% to 5.96%.

After Adjustments were allocated to S. C. Retail Operations, Total Income for Return is decreased by ($8,853,000) while Rate Base is decreased by ($4,811,000). Rate of Return after Adjustments for S. C. Retail is decreased from 8.69% to 6.17%.

Q. WOULD YOU PLEASE DESCRIBE COLUMN #9?

A. This is the calculation of the effect of the requested increase. Based on the proposed rates, it is projected that the Company would receive $22,487,000 additional gross annual revenues. The requested increase is summarized on Exhibit C. After the related tax effect of $11,528,000 the Company would have additional Income Available for Return of $10,959,000

Q. WOULD YOU NOW SUMMARIZE COLUMN #10?

A. Column #10 reflects a normalized year's operations for S. C. Retail after the proposed increase. Based on Total Income for Return of $31,672,000 and Rate Base of $334,611,000, Rate of Return is projected at 9.47% after the requested increase.

Q. MR. HAMMOND, DOES THIS CONCLUDE YOUR TESTIMONY ON EXHIBIT A?

A. Yes, it does.

Q. DO YOU HAVE ANY COMMENT ON ANY OF THE OTHER EXHIBITS CONTAINED IN STAFF'S REPORT?

A. Shown on Exhibit E, Staff has allocated the S. C. Retail Rate Base, as found appropriate in Exhibit A, according to the respective capitalization ratios. Based on this allocation, the Return on Common Equity after the proposed increase is 12.90%. This compares with a Return of 12.18% shown on Davis Exhibit #6, Page 3 of 3.

Also, for Commission information purposes, included on Page 2 of Exhibit E is a computation for Return on Common Equity without the adjustment for full normalization as proposed by the Company. This method would afford the same treatment as used by the Company in prior rate proceedings. This method produces a Return on Common of 14.76% after the requesed increase.

Q. MR. HAMMOND, DO YOU HAVE ANY COMMENTS WITH REFERENCE TO THE PROCEDURES FOR IMPLEMENTING THE FUEL ADJUSTMENT CLAUSE PROPOSED BY THE COMPANY'S DAVIS EXHIBIT 3, RIDER NO. 39?

A. Yes, the Staff recognizes that various procedures for implementing an Automatic Fuel Adjustment are utilized by one or more utilities under the jurisdiction of this Commission. Any procedure will consist of four related but separate steps.

These are (1) determining the cost to be passed through; (2) distributing those costs to the rate payers; (3) collecting the distributed costs from the ratepayers; and (4) accounting for the related expenses and revenues that are produced by the transaction. It is the Accounting Staff's recommendation that

the procedures outlined in Commission Order No. 19,002 in Docket No. 18,632 be followed. In other words, each month's fuel cost above base is charged to that month's usage and billing of revenues is deferred 60 days to enable the Company to use actual costs. The Company should use an expense deferral or a revenue accrual method to account for any lag in collections. Mr. Harris of the Staff will testify subsequently regarding the proper components of the clause.

Question 410.9

Complete the attached form entitled, "Financial Statistics," for the most recent 12-month period and for the years ended December 31, 1975 and December 31, 1974.

Response

See following page.

ATTACHMENT FOR ITEM NO. 410.9 FINANCIAL STATISTICS

	Twelve Months Ended March 31 1977	December 31 1976	December 31 1975	December 31 1974
	(dollars in millions)			
Earnings available to common equity	$104.6	$91.4	$69.4	51.6
Average common equity (Daily Weighted Average)	$780.1	$748.0	627.2	537.7
Rate of return on average common equity	13.41%	12.22%	11.07%	9.60%
Times total interest earned before FIT: Gross income (incl. AFDC) + current and deferred FIT ÷ total interest charges + amortization of debt discount and expense	3.02	2.77	2.09	2.02
Times long-term interest earned before FIT: Gross income (incl. AFDC) + current and deferred FIT ÷ long-term interest charges + amortization of debt discount and expense	3.09	2.81	2.18	2.21
Bond ratings (end of period)				
Standard and Poor's	A	A	A	A
Moody's	Baa	Baa	Baa	A
Times interest and preferred dividends earned after FIT: Gross income (incl. AFDC) ÷ total interest charges + amortization of debt discount and expense + preferred dividends	1.91	1.79	1.60	1.53
AFUDC	$50.0	$48.8	$59.9	$54.6
Net income after preferred dividends	$104.6	$91.4	69.4	51.6
%	47.80%	53.39%	86.31%	105.81%
Market price of common	$22.375	$24.125	$20.00	$10.875
Book value of common	$23.31	$22.76	$22.02	$23.35
Market-book ratio (end of period)*	.960	1.060	.908	.466
Earnings avail. for common less AFDC + depreciation and amortization, deferred (Non-Current) taxes, and invest. tax credit adjust.-deferred	$226.4	$196.7	$103.5	$47.3
Common dividends	$59.1	$56.8	$46.2	$37.4
Ratio	3.828	3.466	2.241	1.266
Short-term debt				
Bank loans	-	-	-	$50.3
Commercial paper	-	-	-	81.3
Capitalization (Amount)				
Long-term debt	$1,103.5	$1,103.4	$1,155.2	$1,034.1
Preferred stock & Preference stock	336.0	336.0	336.0	288.1
Common equity	841.5	819.6	715.9	548.5
	$2,281.0	$2,259.0	$2,207.1	$1,870.7
Capitalization (Percent)				
Long-term debt	48.4	48.8	52.3	55.3
Preferred stock & Preference stock	14.7	14.9	15.3	15.4
Common equity	36.9	36.3	32.4	29.3
	100.0	100.0	100.0	100.0

*If subsidiary company, use parent's data.

Question 410.10

In addition to providing responses to the preceding specific questions, review the previously submitted financial information and provide updated information in any areas where material changes have occurred or where new information is available.

Response

Response provided on pages 1, 2, 3, 3A, 4, 4A, 4B, 4C, 4D, 5, 5B, 5C, 5D, 5E and 6.