



MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager
VIA: Kathie G. Brooks, Budget and Performance Improvement Director
FROM: James J. Sutter, Internal Auditor 
DATE: August 17, 2010
AUDIT: Gas Franchise Fees and Utility Taxes Audit (TECO/Peoples Gas System, Inc.)
PERIOD: October 1, 2006 through June 30, 2008

This report is the result of a regularly scheduled audit of the revenues derived from franchise fees and utility taxes paid to the City's Finance Department by TECO/Peoples Gas System, Inc. during the specified audit period of October 1, 2006 through June 30, 2008.

INTRODUCTION

TECO Energy is a Standard & Poor's 500 energy company headquartered in Tampa, Florida. TECO Energy's four business units include Tampa Electric, a regulated electric utility serving nearly 667,000 customers in West Central Florida; Peoples Gas System Inc., Florida's largest natural gas distribution utility; TECO Coal, producer of coal in Kentucky and Virginia; and TECO Guatemala, owner of two power plants and an interest in Guatemala's largest distribution utility.

The focus of this audit, Peoples Gas System, Inc. was founded in 1895 and provides Florida's citizens and businesses with reliable, economical energy services. Offices are currently located in every major Florida metropolitan area to serve its nearly 345,000 residential, commercial and industrial customers through more than 9,200 miles of system infrastructure. Additionally, they work with builders and developers throughout the state to provide the option of natural gas appliances.

The City Commission through the ratification of Ordinance No. 90-2679 granted Peoples Gas System, Inc. a non-exclusive twenty year franchise to construct, operate and maintain gas system facilities in the City. Under the terms of the agreement valid through February 17, 2010, the contractor is required to pay the City franchise fees equaling 6% of their monthly gross revenue, file monthly returns within thirty days after the last day of the month or be subject to a one percent per month penalty, maintain sufficient insurance coverage, etc. The City has extended this expired agreement on a month-to-month basis as new terms are currently being negotiated.

Meanwhile, City Code Article III (Public Service Tax) Sections 102-151 through 102-158 details the remittance of utility taxes on every purchase in the City of electricity, metered gas, bottled gas and fuel oil. This utility tax of ten percent for gas purchases is to be remitted by the twentieth day of each month or late charges shall be levied. Other items addressed in the City Code include the need to maintain specific records and remit reports, the collection of utility taxes of four cents per gallon on the purchase of fuel oil, etc.

Although TECO/People's Gas System, Inc. is the City's primary source of gas utility taxes, there are nine other companies providing other gas services that reported revenues during the audit period but on a much lesser scale. Similarly, there are four oil companies remitting utility taxes. These other gas and oil companies were not included in the scope of our audit. The City received the following revenues in gas and oil franchise fees and utility taxes during the audit period:

Internal Audit Report
 TECO/Peoples Gas System, Inc.
 Gas Franchise Fees and Utility Taxes
 August 17, 2010

	10/01/06 – 09/30/07	10/01/07 – 09/30/08 *	Total
Peoples Gas Franchise Fees	\$636,265	\$587,707	\$1,223,972
Peoples Gas Utility Taxes	\$476,835	\$446,361	\$923,196
Other Companies' Gas Utility Taxes **	\$9,990	\$8,604	\$18,594
Other Companies' Oil Utility Taxes **	\$2,812	\$2,937	\$5,749
Total Remitted Revenues	\$1,125,902	\$1,045,609	\$2,171,511

* FY 07/08 reported revenue collections as of 06/30/08 or through the end of the audit period were \$451,730 (Peoples Gas Franchise Fees); \$345,295 (Peoples Gas Utility Taxes); \$7,530 (Other Companies' Gas Utility Taxes); and \$1,913 (Other Companies' Utility Taxes).

** These two items were listed for comparison purposes and were not included in the scope of our audit.

OVERALL OPINION

TECO Energy, the parent company of Peoples Gas System, Inc., is a large company with an internal control system that complies with the Sarbanes Oxley Act of 2002. Therefore, Internal Audit documented the internal control process but did not perform testing to determine its effectiveness. As a result, much of our testing focused on the review of requested electronic system generated reports and their subsequent comparison to the monthly documents and payments previously remitted to the City. Testing showed that these reports were accurate and sufficient but the following findings were identified that are in need of corrective action:

- TECO/Peoples Gas System, Inc. allows other third party gas suppliers to use their pipe lines to transport gas to their Miami Beach customers in exchange for a fee which results in an unearned franchise fee of \$242,679.12 to the City. Further, an estimated \$378,299.48 in utility taxes was not remitted by either TECO/Peoples Gas System, Inc. or these other third party gas suppliers to the City; thereby directly violating Article III of the Miami Beach City Code, and potentially exposing TECO/Peoples Gas System, Inc. and these other gas companies to criminal and civil penalties.
- The Finance Department did not indicate the date that 45% of the monthly franchise fee and utility tax returns were received. Additionally, the contractor did not comply with section 7 (d) of the franchise fee agreement by adding a statement directly attesting to the accuracy of the reported figures.
- City personnel did not adequately monitor the contractor's compliance with the signed agreement and City Code so that insurance and documentation shortcomings were not identified earlier.
- Discovered franchise fee and utility tax input errors into the City's Financial System were forwarded to the Finance Department for correction.

PURPOSE

The purpose of this audit is to determine whether compliance existed with selected provisions in the signed agreement and City Code Article III Section 102 for Public Service Tax; which includes testing for inadvertently omitted Miami Beach addresses; determining that correct fees are charged, collected, remitted and recorded in the City's Financial System; and whether delinquencies are effectively and timely pursued.

OBJECTIVES

1. Confirm by examination of the contractor's records that remitted franchise fee and utility tax payments were correctly calculated in accordance with the signed agreement and City Code.
2. Confirm that monthly franchise fee and utility tax returns were received timely. If not, were penalties levied accordingly.
3. Confirm that the Finance Department reviews the received returns for accuracy and sufficiency and enters them correctly into the City's Financial System.
4. Confirm that the contractor has maintained the appropriate insurance coverage addressed in Section 10 of the signed agreement.
5. Confirm that the contractor maintains an accessible local business office.
6. Confirm that the signed agreement and City Code are in agreement with the Florida Statutes.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding: *City Not Receiving Franchise Fees or Utility Taxes on TECO/Peoples Gas System, Inc.'s Transport Gas Transactions Ultimately Sold to Miami Beach Customers by Third Party Suppliers or Pool Managers*

Section 4 (f) of TECO/Peoples Gas System, Inc.'s signed Franchise Fee Agreement with the City defines gross revenues as the grantee's (TECO/Peoples Gas System, Inc.) gross sales of gas provided to residential, business and commercial customers within the corporate limits of the City, less any adjustments for uncollectible accounts, and exclusive of sales tax and utility taxes. Similarly, Section 102-152 of the City Code states "*There is hereby levied and imposed by the city upon every purchase in the corporate limits of the city of electricity, metered gas, bottled gas, and fuel oil included in or reflected by any bills required to be rendered by the seller to the purchaser.....*"

The City subsequently reviewed TECO/Peoples Gas System, Inc.'s Monthly Gross Revenue Summary Reports, which showed that they are not collecting or remitting franchise fees and utility taxes on revenues collected from other third party suppliers for the right to use TECO/Peoples Gas System, Inc.'s pipe lines to transport gas to their Miami Beach customers. TECO/Peoples Gas System, Inc. contends that these transport transactions do not constitute sales of gas and are therefore exempt from taxation or the Franchise Fee Agreement as they receive the natural gas from the third party supplier and re-deliver it to the customer. They maintain that these other third party suppliers are selling the gas to the end customers and should be responsible for remitting the appropriate monies to the City.

Internal Audit's calculations on the records provided show that \$242,679.12 and \$378,299.48 in franchise fees and utility taxes respectively would have been earned by the City during the audit period if these taxes were applied to revenues collected (excluding exemptions and adjustments) from these transport customers. These estimated amounts are most likely understated as they are based off the lower amounts paid by the other gas companies and not the higher amounts actually billed to and paid by the customer.

Internal Audit Report
TECO/Peoples Gas System, Inc.
Gas Franchise Fees and Utility Taxes
August 17, 2010

As defined in Section 102-151 of the Miami Beach City Code, a "seller" who shall be legally required to pay the Public Service Tax means "every person delivering electricity, metered gas, bottled gas, or fuel oil, or rendering telecommunication service to any purchaser thereof." It should be without dispute that TECO/Peoples Gas System, Inc. is in fact "delivering metered gas" and the delivered metered gas is to "any purchaser" in the City.

However, Internal Audit's review of remitted gas utility taxes found that only \$17,520.04 were received by the City during the audit period (excluding TECO/Peoples Gas System, Inc.). Consequently, we requested a listing of the companies paying transport charges and their monthly amounts from TECO/Peoples Gas System, Inc. Once received, Internal Audit was planning to audit these gas companies to ensure that the utility tax has been remitted to the City.

TECO/Peoples Gas System, Inc. initially refused to provide this information despite several requests. Subsequently, Internal Audit received the names of eleven companies called pool managers that participate in their Natural Choice program, which is a voluntary program originating in 1999/2000 that allows customers more options in choosing a natural gas commodity supplier. None of these pool managers remitted any utility taxes to the City during the audit period.

TECO/Peoples Gas System, Inc. refused again to provide information detailing which of these pool managers did business in Miami Beach and how much. They stated that they would only release this information based on the pool manager's approval, which has not been granted to date.

Finally, TECO/Peoples Gas System, Inc. is excluding revenues collected from trip charges, reconnect charges and e-check/credit card fees of 3.5%. These amounts vary each transaction and were not easily quantifiable for Miami Beach customers based on the records provided.

Recommendation(s):

TECO/Peoples Gas System, Inc. should remit the unpaid franchise fees and utility taxes on transport charges in accordance to the signed Franchise Fee Agreement and section 102-151 of the Miami Beach City Code. Further, Teco/Peoples Gas System, Inc. is legally obligated and should provide the City a listing of companies paying transport charges and the individual amounts taken as an exemption.

The City Administration should decide on how they wish to proceed against TECO/Peoples Gas System, Inc. and their refusal to supply more detailed information on the pool managers. Internal Audit believes that the City should consider not renewing their agreement with TECO/Peoples Gas System, Inc. which expired on February 18, 2010 unless the franchise fees and utility taxes are paid and the desired transport customer revenues information for the audit period is provided.

Any new agreement reached with the vendor should contain a provision whereby they are required to provide detailed timely information of any transport sales occurring to the City each month. Another option is to make TECO/Peoples Gas System, Inc. responsible for collecting the utility taxes on these transport sales from the pool managers and remit them directly to the City as they have the contractual relationship.

Internal Audit Report
TECO/Peoples Gas System, Inc.
Gas Franchise Fees and Utility Taxes
August 17, 2010

Finally, the City should consider whether trip charges, reconnect charges, etc. are taxable transactions for franchise fees. If these transactions are determined to be taxable, they should be included in the next Agreement by basing franchise fees on gross sales of all services provided to Miami Beach customers. Internal Audit also recommends that when long term contracts are signed, as in this situation (20 years), a provision should be included that allows the City unilateral authority to revisit the contractual terms and conditions of the Franchise Agreement in order to avoid any further monetary and financial determinates from reoccurring and adversely impacting the City.

TECO/Peoples Gas System, Inc.'s Response:

See attached response.

City Response:

A new franchise agreement is being negotiated with TECO that at a minimum will attempt to address on a go forward basis the issues associated with the capture of revenue from the franchise and utility tax for transported gas. An attempt will be made to collect monies outstanding in the process as well.

Internal Audit Observation:

While TECO/Peoples Gas System, Inc. disagrees with our finding and recommendation, Internal Audit believes that there is sufficient cause for the City to pursue the recommendations as stated. Companies listed as pooled managers will be contacted to determine if they have conducted business within the City and if so, they will be instructed to remit utility taxes on those amounts. Additionally, audits may be subsequently performed as directed by the City Administration.

2. Finding: *City's Finance Department Did Not Indicate Date that Monthly Reports are Received nor did TECO/Peoples Gas System, Inc. Attest to their Accuracy*

Testing found that Finance Department staff did not indicate the date received on 45% (9/20) of the monthly franchise fee returns. Similarly, nine of the received monthly utility tax returns or 45% did not indicate when they were physically received by the Finance Department.

Finally, Section 7 (d) of the signed franchise fee agreement states "*Each such statement {monthly returns} shall be sworn to by an authorized official of Grantee.*" Although all the tested monthly returns were properly signed by a TECO/Peoples Gas System, Inc. manager, they did not also contain a statement directly attesting to the accuracy of the reported figures.

Recommendation(s):

The City's Finance Department should always indicate the date that all payments are received. While the preferred approach is to use the time/date stamp, handwritten notations are also acceptable. Finally, subsequent remitted monthly returns should not only continue to contain an authorized official's signature but also a short statement attesting to the accuracy of the reported figures.

TECO/Peoples Gas System, Inc.'s Response:

TECO/Peoples Gas System, Inc. agrees to comply with by section 7 (d) of the franchise agreement and attest to the accuracy of the reported figures.

Internal Audit Report
TECO/Peoples Gas System, Inc.
Gas Franchise Fees and Utility Taxes
August 17, 2010

City Response:

The City's Finance Department will indicate the date payments are received by the department in order to avoid any discrepancies as to when payments have been received. If payments are received electronically, the Finance Department will provide a printout of the electronic payment. Recommendations pertaining to language in the agreement and the recommended statement from the contractor attesting the accuracy of the report have been furnished to the Public Works Department for inclusion in the next contract.

3. Finding: *No Contract Monitor Designated*

There is no specific City employee assigned to monitor the contractor's agreement to ensure compliance with the listed terms. For example, the City did not have a valid approved insurance policy on file. When subsequently requested and received from the contractor, the listed coverage was \$2,000,000 less than required and the City was not named as an additional insured. Upon notification, TECO/Peoples Gas System, Inc. amended their policy and resubmitted it where it was approved by the City's Risk Manager.

Recommendation(s):

Going forward, TECO/Peoples Gas System, Inc. should maintain the required insurance coverage and remit the policy annually for review by the City's Risk Manager. The City should assign an individual to ensure that the terms are complied with, that required documents are maintained and submitted, etc. A more proactive approach is to use the Eden System's Contract Management Module whereby all relevant information can be centralized and monitored.

City Response:

The Public Works Department will be responsible for monitoring this agreement in the future. The City's Eden System's Contract Management module will be utilized to track relevant information for the agreement.

4. Finding: *Incorrect Financial System Entries*

Review of the Finance Department's entries into the City's Financial System for TECO/Peoples Gas System, Inc.'s franchise fee and utility tax payments found the following deficiencies:

- General ledger account number 011-8000-313400 (Franchise Fees – Gas) for the 2006/07 fiscal year mistakenly included September 2006's franchise fee payment rather than in the prior year.
- General ledger account number 011-8000-314420 (Utility Tax – Peoples Gas) for the 2005/06 fiscal year was overstated by \$69,147.02 due to the inclusion of August 2006's payment thrice. One was processed by the Central Cashier and two more were inadvertently included in journal entry 12-094 posted on 11/30/06. Therefore, the 2006/07 fiscal year balance was understated by the same amount when the incorrect entries were corrected by journal entry number 01-062.
- General ledger account number 011-8000-313400 (Franchise Fees – Gas) is understated for the 2007/08 fiscal year by \$57,588.97 while general ledger account number 011-8000-314420 (Utility Tax – Peoples Gas) was overstated by the same amount. The cause is the incorrect entry of Peoples Gas System, Inc.'s lower utility tax payments for November 2007 through March 2008 in the franchise fees account and vice versa.

Internal Audit Report
TECO/Peoples Gas System, Inc.
Gas Franchise Fees and Utility Taxes
August 17, 2010

- General ledger account number 011-8000-313400 (Franchise Fees – Gas) mistakenly included Reliable Waste Service's payment of \$648.80 in the 2007/08 fiscal year.

The Finance Department was notified of the 2007/08 fiscal year miscodings and journal entries were prepared to correct the recording of these payments.

Recommendation(s):

Finance Department supervisors should closely review general ledger entries at year end to help ensure that listed general ledger balances are accurate and properly accrued.

City Response:

The September 2006 payment was recorded in FY 2007 due to the timing of receipt. Normally September payments are not received within 45 days of year end, which is the end of our accrual period. In the fiscal year ended September 30, 2007 the City started to accrue subsequent receipts to ensure 12 payments were properly recorded within each account. Journal entries to the general ledger are reviewed on a monthly basis by the Chief Accountant before posting to the general ledger. At the end of the fiscal year, the Revenue Division staff has a review process in place to ensure that 12 payments are recorded to the revenue account 011-8000-313400 and 011-8000-314420. Finance Department supervisors will closely review general ledger entries at year end to help ensure that listed general ledger balances are accurate and properly accrued.

EXIT CONFERENCE

An exit conference call was held on January 20, 2010 with David M. Keene, Manager – Taxes Other than Income, TECO/Peoples Gas System, Inc., James Sutter, Internal Auditor and Mark Coolidge, Senior Auditor. Their written management responses were received on February 12, 2010 whereby they disagreed to our findings and stated their position. Subsequent meetings were held with the City Administration to discuss how to resolve these outstanding audit issues prior to negotiating a new franchise agreement with the contractor. Finally, management responses were received from applicable City departments.

JS:MC:mc

(Audit performed by Mark Coolidge, Senior Auditor)

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cc: Jorge Gomez, Assistant City Manager
Fred Beckmann, Public Works Director
Patricia Walker, Chief Financial Officer
Jose Cruz, Budget Officer
David M. Keene, Manager – Taxes Other than Income, TECO/Peoples Gas System, Inc.

Attachment A - TECO Energy's Response from Company's legal Council

Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit

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IN REPLY REFER TO:

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February 12, 2010

VIA E-MAIL ATTACHMENT

James J. Sutter, Internal Auditor
Budget and Performance Improvement
Internal Audit Division
City of Miami Beach
1700 Convention Center Drive
Miami Beach, Florida 33139

Re: Internal Audit Report – Gas Franchise Fees and Utility Tax Audit
(TECO/Peoples Gas System, Inc.)

Dear Mr. Sutter:

This firm, which has regularly provided legal services to Peoples Gas System (“Peoples”) for over 30 years, has been asked by Peoples to respond in detail to the findings and recommendations set forth in Audit Finding 1 of the Internal Audit Report referenced above. This letter constitutes such detailed response.

Audit Finding 1. Finding 1 in the Internal Audit Report (the “audit report”) deals with (i) the franchise fee payable by Peoples Gas System (“Peoples”) under its franchise agreement with the City (Ordinance No. 90-2679), (ii) the utility tax authorized by Section 166.231, *Florida Statutes*, and imposed by the City of Miami Beach (the “City” or “Miami Beach”) through Section 102-152 of the Miami Beach City Code, (iii) an alleged failure by Peoples to provide certain information to the City’s auditor, and (iv) Peoples’ exclusion (presumably from the base to which the percentage rates of franchise fees and utility taxes are applied) of revenues collected from trip charges, reconnect charges and e-check/credit card fees of 3.5%. The finding also includes certain recommendations. Each of these matters is addressed separately below.

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 2

PEOPLES’ RESPONSE

Franchise Fee

Audit Finding 1, with respect to franchise fees, is correct in stating that Peoples is not remitting franchise fees on the gas supplied to Peoples’ transportation customers by third-party suppliers of the gas. However, Peoples does not collect any revenues from these third-party suppliers. Peoples transports the gas purchased by its Miami Beach transportation customers from third-party suppliers and delivers it to those customers. The third-party suppliers merely sell the gas to Peoples’ customers, and have no right to transport on the Peoples distribution system. Peoples collects no revenues from its transportation customers that are derived from the sale of the gas that is delivered to them. It should be noted that Peoples doesn’t even know what these customers pay to the third-party suppliers for the gas they purchase.

Until about 20 years ago (August 1, 1990, after the ratification by the Miami Beach City Commission of the Peoples franchise agreement), Peoples purchased all of its gas from Florida Gas Transmission Company (“FGT”), which delivered the gas to Peoples at various points of interconnection in Florida between FGT’s interstate pipeline and Peoples’ distribution system (“Gate Stations”). Peoples then sold the gas to its customers (including customers in Miami Beach) at its cost of gas plus its Florida Public Service Commission-approved tariff rate. Effective August 1, 1990, FGT and Peoples began to provide a different service to certain large volume customers in Florida – most of them industrial customers. Instead of buying gas from Peoples, these customers began purchasing their gas from suppliers (other than FGT or Peoples) outside the State of Florida. FGT then transported the customer-owned gas from points outside Florida to a Peoples Gate Station in Florida. Peoples thereafter transported the customer-owned gas and delivered it to the customers who had purchased it. It should be noted that this change in the manner in which FGT operated (which forced PGS to change the manner in which it operated) was mandated by the Federal Energy Regulatory Commission.

In connection with what, at the time, was a new service, Peoples’ bill to the transportation customer was (and remains) for transportation only, not for the sale of the gas (to which the customer had taken title, and continues to take title, outside Florida). Thus, Peoples no longer collected the purchase price for the gas from the customer, since the gas was purchased by the customer from a seller other than Peoples. The service described above was later made available to larger-volume commercial customers, and in 2001 was made available to all of Peoples’ non-residential customers. Peoples collected and remitted in the past, and continues to collect and remit, franchise fees on sales of gas made by Peoples to its non-transportation customers in Miami Beach, the vast majority of which are residential and very small

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 3

commercial customers.

Audit Finding 1 suggests that additional franchise fees “would have been earned by the City during the audit period if [the franchise fee was] applied to revenues collected (excluding exemptions and adjustments) from these transport customers.” There are no additional fees payable by Peoples as a result of service the company provides to its transportation customers within the City because Peoples collected no revenues from these customers other than the revenues reported to the City.

No franchise fees are due on Peoples’ revenues except those derived from the sale of gas within the City. Section 7 of the Peoples franchise agreement with the City states that Peoples shall pay franchise fees to the City as consideration for the grant of the right to occupy the streets and other rights-of-way in the City for the purpose of constructing, operating and maintaining Peoples’ facilities. It also states that “the Franchise Fee shall be calculated as an amount equal to six percent (6%) of the Gross Revenues” of Peoples. The term “Gross Revenues” is defined in Section 4(f) of the franchise agreement as “the Grantee’s gross sales of gas provided to . . . [all] customers within the corporate limits of the City, less any adjustments for uncollectible accounts, and exclusive of sales tax and utility taxes.”¹ Peoples provides no “sales of gas” to its transportation customers. The “sales of gas” to these customers are provided by persons other than Peoples and, under the terms of the franchise agreement, are not includible as “Grantee’s gross sales of gas.” Therefore, no franchise fee is payable by Peoples to the City with respect to these sales (*i.e.*, the additional franchise fees to which reference is made in Audit Finding 1). These sales are not made by Peoples and it is not required under the explicit and unambiguous terms of the franchise agreement to pay the City any franchise fees with respect to the same. (As previously noted, Peoples doesn’t even know what these customers pay to the third-party suppliers from which they purchase the gas, and would therefore have no basis for calculating the franchise fees even if the franchise agreement required that franchise fees be paid on the revenues attributable to such sales.)

With respect to franchise fees, this is not a case of first impression. Peoples has been granted franchises by over 100 Florida cities. In cases where the franchise agreement with a city imposed a franchise fee on Peoples’ “sale(s) of gas to its customers within the city,” Peoples has never been required to pay to the city any franchise fees with

¹ If “Gross Revenues” was defined as those “from the Grantee’s sale or delivery” or “sale and transportation” of gas within the City, then franchise fees would be payable on the transportation charges Peoples receives from its transportation customers. Under the existing franchise, which is the subject of the audit, no franchise fees are payable on such revenues. Even if “Gross Revenues” was defined as just stated, no franchise fee would be payable by Peoples on the cost of the gas purchased by its transportation customers because the customers pay their suppliers for the gas and Peoples derives no revenues from the sales made to the customer by the third-party suppliers.

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 4

respect to (i) revenues Peoples derives from the transportation of gas purchased by transportation customers from persons other than Peoples or (ii) revenues derived by the third-party suppliers from their sales of the gas to Peoples’ transportation customers.

Utility Tax

Audit Finding 1, with respect to utility taxes, is correct in stating that Peoples is not collecting from third-party suppliers of the gas, or remitting to the City, utility taxes on the purchases of gas by Peoples’ transportation customers. The finding is incorrect in stating that any revenues are collected from these third-party suppliers “for the right to use TECO/Peoples Gas System, Inc.’s pipe lines to transport gas to their Miami Beach customers.” Peoples transports the gas purchased from third-party suppliers by its Miami Beach transportation customers and delivers it to those customers. The third-party suppliers merely sell the gas to Peoples’ customers, and have no right to transport on the Peoples distribution system. Again, it should be noted that Peoples doesn’t even know what these customers pay to the third-party suppliers for the gas they purchase.

As stated in the above response with respect to franchise fees, Peoples ceased sales of gas to its transportation customers about 20 years ago. Instead of buying gas from Peoples, these customers purchase their gas from suppliers (other than FGT or Peoples). Peoples merely transports the customer-owned gas and delivers it to the customers who have purchased it. Peoples’ bill to these customers is for transportation only, not for the sale of the gas (which the customer has purchased from a supplier other than Peoples). Thus, Peoples no longer collects the purchase price for the gas from the customer (*i.e.*, Peoples is no longer “seller” of the gas).

Audit Finding 1 suggests that additional utility taxes “would have been earned by the City during the audit period if these taxes were applied to revenues collected (excluding exemptions and adjustments) from these transport customers.” There are no utility taxes payable by Peoples as a result of service provided to its transportation customers within the City because Peoples collects no revenues to which the utility tax applies.

The City’s legislative authority to levy the utility tax imposed by the City under Section 102-152 of the Miami Beach City Code is found in Section 166.231, *Florida Statutes*, which authorizes municipalities to levy a tax (as pertinent here) on the “purchase of . . . metered natural gas” within the municipality. Under the statute, the amount of the tax may not exceed “10 percent of the payments received by the seller of the taxable item (*i.e.*, gas) from the purchaser for the purchase of such service.” Peoples “receives” no payments from its transportation customers for their “purchase” of natural gas from third-party suppliers. Payments for that gas are “received” by the third-party sellers of the gas, and the customers’ “purchases” of the gas are made from the third-party

Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit

James J. Sutter, Internal Auditor
February 12, 2010
Page 5

suppliers, not from Peoples. The tax is authorized by the statute to be imposed by a municipality such as Miami Beach on the “purchase” of gas, and the seller of the gas is merely an agent of the City for purposes of collecting and remitting the tax; that is, the tax authorized by the statute is not imposed on the seller of the gas, but on the purchase of the gas.

Section 102-152 of the Miami Beach City Code levies and imposes

on every purchase within the corporate limits of the city of . . . metered gas . . . included in or reflected by any bills required to be rendered by the seller to the purchaser as provided in subsection (1) of this section, a tax based upon a charge made by the seller thereof, as follows:

(1) When the seller renders a bill to the purchaser to cover such purchase . . . , the amount of the tax shall be ten percent, exclusive of governmental charges and taxes, on the total amount shown on such bill as due and payable on account of the purchase of . . . metered gas. . . .

(emphasis supplied)

With respect to Peoples’ transportation customers, including those located within the corporate limits of Miami Beach:

- a. No purchase of gas is included or reflected by any bill to such customers rendered by Peoples;
- b. There is no amount shown on any bill rendered by Peoples to such customers that is due and payable on account of the purchase of the gas Peoples delivers to the customers; and
- c. There is no charge made by Peoples for the gas it delivers to the customers (*i.e.*, Peoples is not the seller of the gas).

Contrary to the facts, the statute and the City Code provisions, Audit Finding 1 focuses on the City Code definition of “seller” as every person “delivering . . . metered gas . . . to any purchaser thereof.” That term, however, must be read and construed in the context of the tax imposed, which is on the “purchase” of gas as discussed above. Further, the use of the term “seller” in the operative provisions of Section 102-152 (also discussed above) makes it clear that Peoples’ delivery of gas to a customer does not make it liable for collecting the tax imposed by Section 102-152 from a person who purchased the gas from a third party whose bill the purchaser is responsible for paying. Peoples’

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 6

transportation-only customers have no responsibility or liability to Peoples for paying for the gas they purchase from others. Peoples doesn’t know what these customers pay for their gas.

With respect to utility taxes, this is not a case of first impression. Peoples operates in more than 100 Florida cities, virtually all of which impose the utility tax authorized by Section 166.231, *Florida Statutes*. Peoples has never been required to pay to any city any utility taxes with respect to (i) revenues Peoples derives from the transportation of gas purchased by transportation customers from persons other than Peoples or (ii) revenues derived by the third-party suppliers from their sales of the gas to Peoples’ transportation customers.

Information Allegedly Not Supplied by Peoples to the Auditor

Audit Finding 1 states that Peoples refused to provide certain information requested by the City’s auditor, specifically (i) a listing of the companies paying transport charges and their monthly amounts from TECO/Peoples Gas and (ii) information detailing which of eleven pool managers did business (and how much) in Miami Beach. The finding states that Peoples either refused, or initially refused, to provide the requested information. Neither the franchise agreement between Peoples and the City (see Section 11 of the franchise agreement) nor the provisions of the City Code pertaining to the utility tax requires Peoples to provide the information requested by the auditor.

Section 11 of the franchise agreement grants the City access only to “the books and records of the Grantee concerning Grantee’s operations” within the City. Peoples has provided all such records requested by the City’s auditors and has no obligation to provide records pertaining to the operations of third parties such as the persons from which Peoples’ transportation customers purchase gas.

With respect to the utility tax, Section 102-155 of the Miami Beach City Code requires a seller to establish and maintain appropriate accounts and records of all purchases of metered gas in the City, which show the price charged on each purchase, the time period covered thereby, the amount of tax levied and imposed and the date of payment thereof. To the extent Peoples sells gas within the City, the City’s auditor was provided access to all Peoples’ records of such sales. Section 102-155 does not require Peoples to maintain, or to provide to the City, the information Peoples is alleged in Audit Finding 1 not to have provided to the City’s auditor. Indeed, Peoples does not maintain records of the sales of gas made by third parties, and would have no information from which to prepare any such records.

Section 102-156 of the Miami Beach City Code requires a seller, who delivers gas to another seller in the City to be resold by such other seller, to report to the City the

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy’s Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 7

names of the other sellers and the quantities of gas sold to them. This is not the information requested by the City’s auditors. In fact, Peoples makes no sales of gas for re-sale within the City of Miami Beach.

Peoples’ Exclusion of Revenues Collected From Trip Charges, Reconnect Charges, etc.

Audit Finding 1 states that Peoples is excluding (presumably from the base to which the percentage rates of franchise fees and utility taxes are applied) revenues collected by Peoples for trip charges, reconnect charges and e-check/credit card fees of 3.5%. The finding does not state whether this is appropriate or inappropriate, but the auditor’s recommendations suggest that whether revenues derived from these charges should be taxable is an issue that should be considered by the City when a new franchise is granted to Peoples. None of these charges is for “sales of gas.” Therefore, none is subject to the franchise fees or utility taxes that are the subject of the Internal Audit Report. It should be noted that Florida sales and use taxes, gross receipts taxes and the utility tax are not imposed on revenues derived from the charges mentioned. In addition, the custom in virtually every franchise Peoples has been granted by the municipalities in which it operates has been to exclude charges such as these from the definition of Gross Revenues.

Auditor’s Recommendations

As should be clear from the foregoing (and from the plain language of the franchise agreement and the utility tax provisions of the Miami Beach City Code), there is no factual, legal or rational basis for the recommendation that Peoples should remit any “unpaid franchise fees and utility taxes on transport charges.” Nothing in Audit Finding 1 relates to any unpaid fees or taxes on transport charges, only to the auditor’s concern that Peoples did not collect or remit fees or taxes on sales of gas made within the City by persons other than Peoples (sales and purchases as to which Peoples is not required to collect or remit fees or taxes).

The recommendation referenced above also states that Peoples “is legally obligated and should provide the City a listing of companies paying transport charges and the individual amounts taken as an exemption.” Again, there is no factual, legal or rational predicate for this conclusory statement. As shown by the plain language of the franchise agreement and the utility tax provisions of the Miami Beach City Code), Peoples is simply not required to maintain the “listing” referenced in this recommendation.

Likewise, since the foregoing responses disclose clearly that Peoples has correctly calculated the amounts of franchise fees payable to the City under the franchise

**Internal Audit Report -TECO/Peoples Gas System, Inc.
Attachment A – TECO Energy's Response to Audit**

James J. Sutter, Internal Auditor
February 12, 2010
Page 8

agreement and the utility taxes payable to the City under the applicable provisions of the City Code, and has provided all information required by the recordkeeping provisions of the agreement and the City Code, there is no factual, legal or rational basis for Audit Finding 1's suggestions (i) that the "City Administration should decide on how they wish to proceed against [Peoples] and their refusal to provide more detailed information on the pool managers," or (ii) that "the City should consider not renewing" its franchise agreement with Peoples.

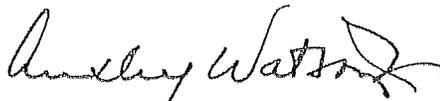
This response does not address Audit Finding 1's suggestions regarding what the City should consider in negotiating a new franchise agreement with Peoples, or findings in the Internal Audit Report other than those set forth in Audit Finding 1.

Conclusion

Audit Finding 1 (including the recommendations contained therein) should be rejected in its entirety because it has no legal, factual or rational basis when considered in conjunction with the plain language of either the City's franchise agreement with Peoples or the utility tax provisions of the Miami Beach City Code. The auditor's focus in this finding appears to be on what he "wished" the language had been, rather than on the language as it actually exists in the documents. A proper audit would have considered Peoples' performance or compliance based solely on the language of the documents governing its performance and compliance.

Peoples appreciates the opportunity to provide service to the City of Miami Beach and numerous residents and businesses within the City's corporate limits, as well as the opportunity to provide the foregoing information with respect to the severe deficiencies and erroneous analyses expressed in Audit Finding 1. If you, the City's legal counsel, or any other City official has questions regarding, or wants to discuss, any of the foregoing, I will be happy to do so.

Sincerely,



ANSLEY WATSON, JR.

AWjr/a

cc: David M. Keene, Manager – Taxes Other Than Income, Peoples Gas System
Matthew R. Costa, Esquire, Corporate Counsel, TECO Energy, Inc.