**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building, 101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

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

 **August 24, 2015**

**TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)**

**FROM: DIVISION OF AUDITING & FINANCIAL ANALYSIS (LEE, SLEMKEWICZ, MAILHOT)**

 **DIVISION OF ELECTRIC & GAS (TAYLOR)**

 **DIVISION OF LEGAL SERVICES (JOHNSON)**

**RE: DOCKET NO. 931231-EI - FLORIDA POWER AND LIGHT - REQUEST FOR CHANGE IN DEPRECIATION RATES BY FLORIDA POWER AND LIGHT COMPANY**

**AGENDA: 02/21/95 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\931231.RCM**

 **CASE BACKGROUND**

 Two orders have been issued in this docket - PSC-94-1199-FOF-EI and PSC-94-1173-FOF-EI. On October 17, 1994, FPL filed a protest to Order No. PSC-94-1173-FOF-EI. An evidentiary hearing has been scheduled for September 22, 1995.

 The recommendation herein addresses an unresolved issue deferred by Order No. PSC-94-1199-FOF-EI regarding the appropriate amortization period for the remaining unrecovered costs associated with major overhaul and asbestos abatement projects completed during the 1988 - 1993 period. While there was no disagreement between Florida Power and Light Company (FPL or Company) and staff regarding the amount of unrecovered costs or that amortization for these costs is appropriate, the difference in opinion resided with the period of amortization. Both parties agreed that these costs are non-life related (represent plant no longer in service) and therefore, should be written off as fast as economically practicable. FPL proposed that it would be both appropriate and economically practicable to recover these costs over a 4-year period beginning January 1, 1994 through December 31, 1997. Staff opined that these costs should be amortized as soon as economically feasible. For this reason, the Commission deferred its decision regarding the amortization period until January, 1995 when a more accurate picture of FPL's achieved 1994 earnings would be known.

 The November 1994 surveillance report for FPL has been received and Staff has made a cursory review. Staff is now ready to proceed with its recommendation.

 This recommendation also addresses the amortization of the deferred costs associated with the Martin Reservoir and Turkey Point steam generators. Beginning with FPL's 1981 rate case in Docket No. 810002-EU and continuing through various dockets to the present time, these costs have been deferred until new base rates are established in a general rate proceeding. Changed circumstances warrant a review of the appropriateness of continuing the deferral of these costs.

 **DISCUSSION OF ISSUES**

**ISSUE :** What should be the amortization period to recover the non-life related costs of $46,272,579 associated with major overhaul and asbestos abatement projects completed during the 1988 - 1993 period?

**RECOMMENDATION:** Both FPL and Staff agree that the $46,272,579 net costs should be amortized during 1994. [LEE]

**STAFF ANALYSIS:** FPL has agreed to amortize over a 1-year period beginning January 1, 1994 the remaining net costs associated with the major overhaul and asbestos abatement projects completed during the 1988 - 1993 period. In fact, the write-off of these costs has been recognized in surveillance reports filed since issuance of Order No. PSC-94-1199-FOF-EI. The Company has been able to incur this additional expense and still achieve earnings within its authorized range. The November surveillance report indicates a 12-month return on equity of 12.25% inclusive of the additional non-life related amortization.

**ISSUE 2:** Should the Commission authorize FPL to begin the amortization of the accumulated deferred costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements, effective January 1, 1995?

**RECOMMENDATION:** Yes. FPL should be authorized to begin the amortization of the accumulated deferred costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements, effective January 1, 1995. [SLEMKEWICZ]

**ISSUE BACKGROUND:** In FPL's 1981 rate case in Docket No. 810002-EU, the Company sought to include the costs associated with the repairs and enhancements to a reservoir built to provide cooling water for the Martin Plant Units Nos. 1 and 2. In October 1979, a break occurred in the earthen dam leading to considerable property damage and a review of the construction of the dam. Because the repair and enhancement costs were the subject of litigation, the Commission ordered that they not be included in the rate base and would only be considered in a ratemaking proceeding following the resolution of FPL's litigation. To avoid any prejudice to FPL, it was authorized to accrue a deferred return on the repair and enhancement costs. (Order No. 10306)

 In that same rate case, FPL sought to include the cost of steam generator repairs at its Turkey Point Plant Units Nos. 3 and 4. FPL had brought suit against Westinghouse Electric Corporation, the steam generator vendor, seeking to recover the cost of the repairs. As with the Martin Reservoir repairs, the Commission refused to include the costs in rate base, but authorized the accrual of a deferred return until such time as the rate base issue was resolved in ratemaking proceedings after the conclusion of the litigation.

 In 1982, FPL filed another rate case (Docket No. 820097-EU) in which it again sought the inclusion of all of its investment in the Martin Reservoir and Turkey Point steam generators. Although the Commission did allow FPL to include the enhancement costs as if the dam had been constructed properly in the beginning, the repairs were still excluded pending the resolution of the litigation. The Turkey Point steam generator repairs were also excluded from rate base pending the resolution of the litigation. FPL was authorized to continue accruing a deferred return on the excluded amounts. (Order No. 11437)

 In its 1983 rate case (Docket No. 830465-EI), FPL did not seek to include the costs of the Turkey Point steam generators or the Martin Reservoir that were still the subject of pending litigation. FPL raised concerns about the growing balances of the accumulated deferred costs associated with the two items. In Order No. 13537, the Commission determined that the costs should continue to be excluded from the rate base.

 In November of 1985, FPL filed two petitions seeking the recovery of the Turkey Point Steam Generator Repair costs (Docket No. 850782-EI) and the Martin Reservoir Repair and Enhancement costs (Docket No. 850783-EI), collectively referred to as the "Litigation Items". FPL alleged that certain changed circumstances warranted the Commission changing the timing of its consideration of the prudence of the Company's conduct regarding the litigation items. First, FPL stated that the deferred costs associated with the litigation items had grown to such a level that they would become material for financial reporting purposes. Due to the uncertainty of the recovery of the litigation costs, FPL contended that it could receive a qualified opinion from its independent auditors unless the Commission took some action that would demonstrate that recovery of the costs was probable. A second changed circumstance cited by FPL was that the Turkey Point steam generator litigation, originally thought likely to be concluded by 1985, was being projected to be concluded in 1988 at the earliest. The Martin Reservoir litigation had reached a point where a federal court had limited the reservoir's design engineer's potential liability to $50,000. Faced with a maximum potential recovery of only $50,000 versus the cost of continuing the litigation, FPL sought and was granted a dismissal of its suit. Therefore, FPL contended that it should be allowed to include and recover the litigation costs the next time that FPL's base rates were changed.

 In Order No. 16907, issued December 2, 1986, the Commission approved an agreement that: (1) ended the deferral of the accrued return and depreciation; (2) placed the litigation items and the associated accumulated deferred costs in rate base; and (3) authorized the recovery of the accumulated deferred costs to commence with the effective date of new base rates established in a general rate proceeding and be amortized over a five year period.

**STAFF ANALYSIS:** At the time that Order No. 16907 was issued, no one would have imagined that over eight years would pass without FPL's base rates being changed in a general rate proceeding. Given the current economic, competitive, and regulatory environments, it does not appear that FPL will be involved in a rate case in the foreseeable future. Currently, the deferred amounts subject to the five year amortization are $12,644,089 for the Martin Reservoir and $98,214,576 for the Turkey Point steam generators. The annual amortization amounts, based on a five year amortization period, would be $2,528,818 and $19,642,915, respectively. The total annual amortization of $22,171,733 would decrease FPL's return on equity by approximately .41% each year.

 The uncertainty regarding a possible commencement date for the amortization of the litigation items costs is of concern to the Staff. It has been more than 16 years since the events occurred that gave rise to the deferred litigation costs. The accounting profession is becoming more and more sensitive to the issue of regulatory agencies allowing utilities to defer costs without implementing a reasonable timetable for allowing recovery of those costs. The total deferred costs of $110,858,655 are significant even to FPL. It is possible that FPL's independent auditors could determine that FPL no longer meets the criteria in FASB Statement Nos. 71 and 90 for continued deferral of the litigation costs and require it to write-off the entire amount in one year in order to receive an unqualified audit opinion. These accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) and address the accounting for the effects of certain types of regulation and for the abandonment and disallowance of plant costs. Basically, the regulated enterprise must demonstrate that recovery of the deferred asset is likely and that recovery will commence within a reasonable time period. An immediate write-off would reduce FPL's return on equity by over 2.00%.

 Staff believes that consideration must also be given to the ramifications of the continued existence of a long-term regulatory asset that is not being amortized. In a special report titled "Deferred Charges Revisited" released by Fitch Research on January 9, 1995, the rating service discussed the issue of deferred charges and regulatory assets in light of the new competitive environment. The report stated:

 With competition in the electric market, investors are wary of utilities' deferred assets. The capitalization of utilities' expenses as assets depends on two underlying assumptions: utilities will continue to operate in a monopoly marketplace; and regulatory commissions can and will determine utility revenues based on costs. However, these assumptions are now in question. Regardless of how the future electric power market evolves, it is unlikely that investors will be able to rely on previous regulatory arrangements as an assurance that deferred assets will be recovered.

The implication from the Fitch report is that as the electric industry moves towards increased competition, the utilities with higher deferred asset concentration and higher electric production costs will face greater risk that future revenue may not be sufficient to recover prior investments in regulatory assets and deferred charges.

 It is the Staff's opinion that it was the Commission's intent that the amortization of the litigation costs would begin within a relatively short time span, certainly no longer than five years. However, due to unforeseeable circumstances in the electric utility industry as a whole, an emphasis has been placed on implementing cost reductions in lieu of seeking general rate increases. Although FPL has been involved in numerous other proceedings such as tax savings and Modified Minimum Filing Requirements (MMFR) reviews, it has not been before the Commission in a general rate proceeding, in which new base rates would be established, as was contemplated in Order No. 16907.

 As noted in Issue 1, FPL's November 1994 return on equity was 12.25%, inclusive of virtually all of the $46,272,579 costs associated with the major overhaul and asbestos abatement projects. Even with these costs included, FPL is still earning within its authorized return on equity range of 11.00% to 13.00%. All other things remaining equal, FPL has sufficient earnings to absorb the $22,171,733 annual amortization of the litigation items and still earn within its authorized return on equity range.

 At the present time, FPL is involved in an MMFR review in Docket No. 950071-EI. It might be possible to address the litigation items in that docket and to eventually determine that the amortization should be started. However, that docket is not scheduled to be concluded until December 1995, assuming that no protests are filed. Although the amortization could be made effective as of January 1, 1995, it is Staff's opinion that this issue should be addressed on a more current basis in this docket.

 Staff, therefore, recommends that the Commission authorize FPL to begin amortizing the deferred costs associated with the Martin Reservoir and the Turkey Point steam generators effective January 1, 1995.

**ISSUE 3:** What are the appropriate annual amortization amounts for the deferred costs associated with the Martin Reservoir and the Turkey Point steam generators?

**PRIMARY RECOMMENDATION:** FPL should record annual amortization expense of at least $2,528,818 for the deferred costs associated with Martin Reservoir and annual amortization expense of at least $19,642,915 for the deferred costs associated with the Turkey Point steam generators, until the deferred costs are fully amortized. [MAILHOT]

**ALTERNATIVE RECOMMENDATION:** The appropriate equal annual amortization amounts for each year of the five year amortization period are $2,528,818 for the Martin Reservoir and $19,642,915 for the Turkey Point steam generators. [SLEMKEWICZ]

**PRIMARY STAFF ANALYSIS:** The primary Staff recommendation requires FPL to amortize a minimum of one fifth of the deferred costs each year until the deferred costs are fully amortized. However, it also allows FPL the flexibility to record additional amortization of the deferred costs each year, if it so chooses. The alternative Staff recommendation requires FPL to amortize exactly one fifth of the deferred costs each year over a five year period.

 As discussed in Issue 2, the deferred costs consist of deferred depreciation expense and a deferred return on assets. These amounts were deferred from 1981 through 1986, at a time when there was uncertainty as to the outcome of litigation involving these assets. If the final outcome of the litigation had been known at the time, it is likely that these costs would not have been deferred, since they are costs which are properly attributable to that time period.

 Now the Commission must determine the appropriate future time period over which to recover these deferred costs. Primary Staff believes that these deferred costs should be recovered as quickly as is economically practicable. Ideally, if FPL had sufficient earnings, these amounts should be amortized immediately. Due to efficiency measures implemented by FPL and the non-recurring amortization expense recommended in Issue 1, primary Staff believes that FPL will have sufficient earnings in 1995 and beyond to amortize at least one fifth of these deferred costs each year and still earn within its authorized return on equity.

 Primary Staff recommends that the Commission grant FPL additional flexibility so that the Company can amortize more than one fifth of the deferred costs in a calendar year. Potentially, this additional flexibility furthers primary Staff's goal of amortizing the deferred costs as quickly as is economically practicable.

 In addition, primary Staff believes that this additional flexibility can act as an incentive plan for FPL. By allowing FPL to record more amortization expense it encourages FPL to be as efficient as possible, since the Company knows that it can use any improved earnings from its efficiency gains to amortize these deferred costs. The Company realizes that amortizing these costs as quickly as possible is in its best interest, since it better prepares FPL for the possibility of competition in the future.

 Although the total deferred costs are $110,858,655, the effect of amortizing these costs on revenue requirements is approximately $131.4 million due to income taxes. Primary Staff believes that under favorable economic conditions and with efficiency gains, FPL may be able to amortize these costs in two or three years rather than five years. Primary Staff believes that by granting flexibility to FPL now, in early 1995, the Commission is providing an additional incentive to FPL for 1995, probably 1996 and possibly 1997.

 Primary Staff recommends that the Commission order FPL to record annual amortization expense of at least $2,528,818 for the deferred costs associated with Martin Reservoir and annual amortization expense of at least $19,642,915 for the deferred costs associated with the Turkey Point steam generators, until the deferred costs are fully amortized.

**ALTERNATIVE STAFF ANALYSIS:** Per Order No. 16907, it was determined that the deferred costs would be amortized over a five year period once the amortization had begun. This implies that the costs would be amortized in equal annual increments during the five year period. Under this scenario, the equal annual amortization amounts would be $2,528,818 ($12,644,089 5 years) for the Martin Reservoir and $19,642,915 ($98,214,576 5 years) for the Turkey Point steam generators.

 In the alternative Staff's opinion, it is not appropriate to authorize the Company to have the discretion to arbitrarily increase the annual amortization amount, thereby reducing earnings, to achieve a level of earnings that has been predetermined by the Company. In effect, FPL could use this mechanism to "true up" its earnings to a target level. Theoretically, FPL could choose to amortize the entire amount in 1995 and reduce its return on equity by approximately 2.00%. It is this uncertainty as to when, and to what extent, FPL might choose to exercise its option to arbitrarily reduce its earnings that the alternative Staff objects to. If five years is no longer an appropriate amortization period, a shorter period could be selected. However, the annual amortization amount should remain fixed during each year of the period.

 Based on the five year amortization period authorized in Order No. 16907, the alternative Staff recommends that the deferred costs be amortized in equal annual increments.

**ISSUE 4:** Should the Proposed Agency Action Order sever the issues relating to the amortization period for the overhaul and asbestos projects (Issue 1) and the issues relating to the amortization of costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements (Issues 2 and 3)?

**RECOMMENDATION:** Yes. Any protest filed to any of the actions proposed in the Order should be specific as to the action being protested. If no protest is filed to any specific action within 21 days of the issuance of the Order, then such action should become final. [JOHNSON]

**STAFF ANALYSIS:** The amortization period for the overhaul and asbestos projects (Issue 1) and the amortization of costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements (Issues 2 and 3) are separate and distinct issues. Because these matters are unrelated, a protest as to one should not affect or delay the other from becoming final.

**ISSUE 5:** Should this docket be closed?

**RECOMMENDATION:** No. This docket should remain open pending the September 22, 1995 evidentiary hearing scheduled as a result of FPL's protest of PAA Order No. PSC-94-1173-FOF-EI issued in this docket. [LEE, JOHNSON]

**STAFF ANALYSIS:** This docket should remain open pending the evidentiary hearing scheduled in this docket for September 22, 1995.

ISSUE 1: What should be the amortization period to recover the non-life related costs of $46,272,579 associated with major overhaul and asbestos abatement projects completed during the 1988 - 1993 period?

RECOMMENDATION: Both FPL and Staff agree that the $46,272,579 net costs should be amortized during 1994.

ISSUE 2: Should the Commission authorize FPL to begin the amortization of the accumulated deferred costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements, effective January 1, 1995?

RECOMMENDATION: Yes. FPL should be authorized to begin the amortization of the accumulated deferred costs associated with the Turkey Point Steam Generator Repairs and the Martin Reservoir Repairs and Enhancements, effective January 1, 1995.

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ALTERNATIVE RECOMMENDATION: The appropriate equal annual amortization amounts for each year of the five year amortization period are $2,528,818 for the Martin Reservoir and $19,642,915 for the Turkey Point steam generators.

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RECOMMENDATION: Yes. Any protest filed to any of the actions proposed in the Order should be specific as to the action being protested. If no protest is filed to any specific action within 21 days of the issuance of the Order, then such action should become final.

ISSUE 5: Should this docket be closed?

RECOMMENDATION: No. This docket should remain open pending the September 22, 1995 evidentiary hearing scheduled as a result of FPL's protest of PAA Order No. PSC-94-1173-FOF-EI issued in this docket.