

FLORIDA PUBLIC SERVICE COMMISSION
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Tallahassee, Florida 32399-0850

MEMORANDUM

January 25, 1996

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

FROM: DIVISION OF APPEALS (BELLAK) *RCB DS*
DIVISION OF RESEARCH & REGULATORY REVIEW (HEWITT)
DIVISION OF AUDITING & FINANCIAL ANALYSIS (REVELL) *DM JS Tappan*
DIVISION OF ELECTRIC & GAS (JENKINS) *JDJ*

RE: DOCKET NO. 951535-EI - PROPOSED REVISIONS TO RULE 25-6.0141, P.A.C., ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

AGENDA: 2/6/96 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

SPECIAL INSTRUCTIONS: I:\PSC\APP\WP\95153502.RCM

CASE BACKGROUND

As a result of a process which included meeting with the affected companies and Public Counsel on two occasions to discuss various aspects of the rule, staff recommended the attached amendments to Rule 25-6.0141, Allowance For funds Used During Construction. The purpose of the amendment is to increase the threshold of project qualification in order to limit AFUDC accrual treatment to projects with a significant financial impact on the company.

The amendment of Section (1)(a) of the rule specifies as eligible projects which may accrue allowance for funds used during construction (AFUDC) any project which involves gross additions to plant exceeding 0.5 percent of the total of electric plant in services (balance in Account 101) and completed construction not classified at the time of project commencement (balance in Account 106).

The amendment of Section (1)(f) provides that the utility may petition to include projects otherwise qualified for AFUDC treatment in rate base.

The rule amendment also deletes provisions in current Rule 25-6.0141(2)(c) and (d) concerning investment tax credits (ITC).

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FPSC-RECORDS/REPORTING

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Since the deadline for all ITC ruling requests was December 15, 1987, these obsolete provisions are eliminated.

Finally, subsection (8) of the amended rule provides an effective date of January 1, 1996 and allows companies a grace period to implement the provisions by January 1, 1999 or the company's next rate proceeding, whichever occurs first.

As indicated by the attached EIS, no increased staff workload is foreseen, or additional direct costs to other state or local governmental entities. No direct impact on small business is anticipated, or impacts on the ability of Gulf Power Company, Florida Public Utilities, Tampa Electric Company or Florida Power and Light Company to compete. Florida Power and Light Company believes that the proposed amendment would generate a competitive benefit for the company and reduce the potential for stranded investment from future construction. The amendment is not expected to affect the level of employment at these companies.

The EIS analysis of costs and benefits to the directly affected parties is complicated by the fact that the data requests reflected staff's original 1% suggested threshold. Because Gulf Power indicated that the change from \$25,000 to 1% of the affected accounts was too large and would significantly harm the company, staff reduced the threshold to 0.5%.

For its part, Florida Power and Light Company indicated that the amendments were appropriate and would result in administrative cost savings. Florida Power Corporation did not foresee significant costs unless separate FPSC (retail) and Federal Energy Regulation Commission (wholesale) books must be maintained or no phase-in period was provided.

As further set out in the EIS, the companies had various suggestions and refinements as listed under Reasonable Alternative Methods, which may be appropriately addressed during the rule amendment process.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission propose the attached amendments to Rule 25-6.01417

RECOMMENDATION: Yes. The Commission should propose the attached amendments to Rule 25-6.0141.

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STAFF ANALYSIS: As previously noted, the companies indicated that the amendments would either be of benefit, in the case of Florida Power and Light, or, generally speaking, would not affect costs. Gulf Power's specific concern that the 1% threshold was too large was addressed by staff by reducing the threshold to 0.5%.

Moreover, the deletion of obsolete provisions, such as those concerning ITC, is in accord with the program of removing such provisions from the body of Commission rules.

Finally, some of the specific refinements suggested by the companies, such as the need for a phase-in period and coordination of implementation with the company's next rate proceeding appear to be present in the amendments as currently drafted.

ISSUE 2: If no requests for hearing are received or comments filed, should the attached rule amendments be sent to the Secretary of State for adoption and this docket closed?

RECOMMENDATION: Yes.

RCM
Attachments

25-6.0141 Allowance For Funds Used During Construction.

(1) Construction work in progress (CWIP) or nuclear fuel in process (NFIP) not under a lease agreement that is not included in rate base may accrue allowance for funds used during construction (AFUDC), under the following conditions:

(a) Eligible projects. Any project that involves gross additions to plant in excess of 0.5 percent of the sum of the total balance in Account 101 - Electric Plant in Service, and Account 106 - Completed Construction not Classified, at the time the project commences ~~The following projects~~ may be included in CWIP or NFIP and accrue AFUDC:

- ~~1. Projects that involve gross additions to plant in excess of \$25,000 and~~
- ~~a. are expected to be completed in excess of one year after commencement of construction, or~~
- ~~b. were originally expected to be completed in one year or less and are suspended for six months or more, or are not ready for service after one year.~~

(b) Ineligible projects. The following projects may be included in CWIP or NFIP, but may not accrue AFUDC:

1. Projects, or portions thereof, that do not exceed the level of CWIP or NFIP included in rate base in the utility's company's last rate case.

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3 2. Projects where gross additions to plant are less
4 than 0.5 percent of the sum of the total balance in
5 Account 101 - Electric Plant in Service, and
6 Account 106 - Completed Construction not
7 Classified, at the time the project commences
8 \$25,000 or less.

9 ~~3. Projects expected to be completed in less than one~~
10 ~~year after commencement of construction.~~

11 ~~4. Property that has been classified as Property Held~~
12 ~~for Future Use.~~

13 (c) Unless otherwise authorized by the Commission, the
14 following projects may not be included in CWIP or NFIP, nor accrue
15 AFUDC:

- 16 1. Projects that are reimbursable by another party.
17 2. Projects that have been cancelled.
18 3. Purchases of assets which are ready for service
19 when acquired.
20 4. Portions of projects providing service during the
21 construction period.

22 (d) Other conditions. Accrual of AFUDC is subject to the
23 following conditions:

- 24 ~~1. Accrual of AFUDC is not to be reversed when a~~
25 ~~project originally expected to be completed in~~

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2 ~~excess of one year is completed in one year or~~
3 ~~less;~~

4 ~~2. AFUDC may not be accrued retroactively if a project~~
5 ~~expected to be completed in one year or less is~~
6 ~~subsequently suspended for six months, or is not~~
7 ~~ready for service after one year;~~

8
9 13. When a project is completed and ready for service,
10 it shall be immediately transferred to the
11 appropriate plant account(s) or Account 106,
12 Completed Construction Not Classified, and may no
13 longer accrue AFUDC;

14 24. Where a work order covers the construction of more
15 than one property unit, the AFUDC accrual shall
16 cease on the costs related to each unit when that
17 unit reaches an in-service status;

18 35. When the construction activities for an ongoing
19 project are expected to be suspended for a period
20 exceeding six (6) months, the utility shall notify
21 the Commission of the suspension and the reason(s)
22 for the suspension, and shall submit a proposed
23 accounting treatment for the suspended project; and

24 46. When the construction activities for a suspended
25 project are resumed, the previously accumulated
costs of the project may not accrue AFUDC if such

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2 costs have been included in rate base for
3 ratemaking purposes. However, the accrual of AFUDC
4 may be resumed when the previously accumulated
5 costs are no longer included in rate base for
6 ratemaking purposes.

7 (e) Subaccounts. Account 107, Construction Work in Progress,
8 and Account 120.1, Nuclear Fuel in Process of Refinement,
9 Conversion, Enrichment and Fabrication, shall be subdivided so as
10 to segregate the cost of construction projects that are eligible
11 for AFUDC from the cost of construction projects that are
12 ineligible for AFUDC.

13 (f) Prior to the commencement of construction on a project,
14 a utility may file a petition to seek approval to include an
15 individual project in rate base that would otherwise qualify for
16 AFUDC treatment per Section (1)(a).

17 (2) The applicable AFUDC rate shall be determined as follows:

18 (a) The most recent 13-month average embedded cost of
19 capital, except as noted below, shall be derived using all sources
20 of capital and adjusted using adjustments consistent with those
21 used by the Commission in the utility's ~~Company's~~ last rate case.

22 (b) The cost rates for the components in the capital
23 structure shall be the midpoint of the last allowed return on
24 common equity, the most recent 13-month average cost of short term
25 debt and customer deposits and a zero cost rate for deferred taxes

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2 and all investment tax credits. The cost of long term debt and
3 preferred stock shall be based on end of period cost. The annual
4 percentage rate shall be calculated to two decimal places.

5 ~~(c) The treatment by the Commission of all investment tax~~
6 ~~credits at a zero cost rate shall be contingent upon a ruling from~~
7 ~~the Internal Revenue Service that such treatment will not, for~~
8 ~~companies elected to be treated under s. 46(f) (2) of the Internal~~
9 ~~Revenue Code, result in the forfeiture of the tax credits. Pending~~
10 ~~receipt of such a ruling, each utility shall continue to use the~~
11 ~~weighted overall cost of capital calculated in a manner consistent~~
12 ~~with the final IRS Regulation Section 1.46-6 published May 22,~~
13 ~~1986, as the cost of the utility's 4% and 10% investment tax~~
14 ~~credits.~~

15 ~~(d) Any such ruling request must be submitted to the~~
16 ~~Commission by December 15, 1987. The AFUDC cost rate for the~~
17 ~~investment tax credit for any company which fails to submit its own~~
18 ~~letter ruling request to the IRS shall be governed by the first~~
19 ~~letter ruling issued by the IRS in response to a request submitted~~
20 ~~pursuant to subsection 2(c) of this rule.~~

21 (3) Discounted monthly AFUDC rate A discounted monthly
22 AFUDC rate, calculated to six decimal places, shall be employed to
23 insure that the annual AFUDC charged does not exceed authorized
24 levels.
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2 (a) The formula used to discount the annual AFUDC rate to
3 reflect monthly compounding is as follows:
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$$5 \quad M = \left[\left(1 + \frac{A}{100} \right)^{1/12} - 1 \right] \times 100$$

6

7 Where:

8 M = discounted monthly AFUDC rate

9 A = Annual AFUDC rate

10 (b) The monthly AFUDC rate, carried out to six decimal
11 places, shall be applied to the average monthly balance of eligible
12 CWIP and NFIP that is not included in rate base.

13 (4) The following schedules shall be filed with each petition
14 for a change in AFUDC rate:

15 (a) Schedule A. A schedule showing the capital structure,
16 cost rates and weighted average cost of capital that are the basis
17 for the AFUDC rate in subsection (2).

18 (b) Schedule B. A schedule showing capital structure
19 adjustments including the unadjusted capital structure, reconciling
20 adjustments and adjusted capital structure that are the basis for
21 the AFUDC rate in subsection (2).

22 (c) Schedule C. A schedule showing the calculation of the
23 monthly AFUDC rate using the methodology set out in this Rule.

24 (5) No utility may charge or change its AFUDC rate without
25 prior Commission approval. The new AFUDC rate shall be effective

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2 the month following the end of the 12-month period used to
3 establish that rate and may not be retroactively applied to a
4 previous fiscal year unless authorized by the Commission.

5 (6) Each utility charging AFUDC shall include in its ~~June and~~
6 December Earnings Rate of Return Surveillance Reports to the
7 Commission Schedules A and B identified in subsection (4) of this
8 Rule, as well as disclosure of the AFUDC rate it is currently
9 charging.

10 (7) The Commission may, on its own motion, initiate a
11 proceeding to revise a utility's AFUDC rate.

12 (8) The provisions of this rule are effective January 1, 1996
13 and shall be implemented by all electric utilities no later than
14 January 1, 1999, or the utility's next rate proceeding, whichever
15 occurs first. Paragraphs (a) and (b) of subsection (1) shall not be
16 effective for any utility until it implements final rates in a
17 general rate case initiated after the effective date of this Rule.
18 ~~The foregoing notwithstanding, these provisions will become~~
19 ~~effective for all utilities no later than January 1, 1989.~~

20 Specific Authority: 350.127(2), 366.05(1), F.S.

21 Law Implemented: 350.115, 366.04(2)(a), 366.06(1), F.S.

22 History: New 8/11/86, Amended 11/13/86, 12/7/87, _____.

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M E M O R A N D U M

December 6, 1995

TO: DIVISION OF APPEALS (BELLAK)

FROM: DIVISION OF RESEARCH AND REGULATORY REVIEW (HEWITT) *BA* *12/11/95*

SUBJECT: ECONOMIC IMPACT STATEMENT; PROPOSED REVISIONS TO RULE 25-6.0141, FAC, ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

SUMMARY OF THE RULE

Currently Rule 25-6.0141, FAC, Allowance for Funds Used During Construction (AFUDC), describes the criteria for determining whether a project qualifies for accrual of AFUDC. These criteria include a minimum project cost (\$25,000) and a construction period in excess of one year.

The proposed amendment would change the criteria from a minimum dollar amount of \$25,000 to projects which exceed 0.5% of the sum in Account 101-- Electric Plant in Service, and Account 106--Completed Construction not Classified. The construction period criteria would be eliminated. Also, projects under a lease agreement would be excluded from accruing AFUDC.

The purpose of the amendments is to increase the cost threshold of a project which will qualify for accrual of AFUDC so that projects will only qualify if there will be a significant financial impact on the company. The rule also clarifies that a utility may seek approval to include a project in rate base that would otherwise qualify for AFUDC accrual.

In addition, under current Rule 25-6.0141(2)(c) and (d), FAC, the Commission's treatment of investment tax credits (ITC) at a zero cost rate is contingent upon an IRS ruling under Section 46(f)(2) of the Internal Revenue Code. All ITC ruling requests were to have been sent to the Commission by December 15, 1987. Since that deadline for submission has passed, the proposed amendment would delete the outdated information from the rule, and thus comply with efforts to eliminate unnecessary or obsolete rules.

Finally, the proposed amendment states that the provisions of the rule are effective January 1, 1996, and allows a grace period to implement the provisions by January 1, 1999, or the Company's next rate proceeding, whichever occurs first.

DIRECT COSTS TO THE AGENCY AND OTHER STATE OR LOCAL GOVERNMENT ENTITIES

The proposed amendment allows a utility to file a petition to seek approval to include a project in rate base that would otherwise qualify for AFUDC treatment. The PSC staff would evaluate those petitions on a case-by-case basis. The proposed amendment is not expected to significantly increase workload for Commission staff since such petitions are expected to be rare. There should be no additional direct costs to other state or local governmental entities.

COSTS AND BENEFITS TO THOSE PARTIES DIRECTLY AFFECTED BY THE RULE

The proposed amendments would result in more stringent eligibility requirements, allowing fewer projects to be eligible to accrue AFUDC on construction projects. This would reduce administrative costs associated with the determination and calculation of eligible AFUDC expenses.

Data requests were sent to the affected investor-owned electric utilities (IOUs) with the original draft rule revisions containing a 1% threshold level, of the sum total in the Electric Plant in Service--Account 101 and Completed Construction not Classified--Account 106, above which projects would be allowed to accrue AFUDC. After comments by the affected utilities, the threshold in the draft rule revision was lowered to 0.5% of the total balance of the relevant accounts.

Florida Power and Light (FPL) states that the proposed rule changes "are appropriate and will streamline the accounting and budgeting process and reduce costs." If the proposed amendment (with a 1% threshold) is adopted, FPL expects to save approximately \$30,000 annually in administrative costs. FPL indicated a potential reduction in the amount of AFUDC capitalization of between \$20 million and \$30 million with a 1% threshold. With a lowered threshold to 0.5%, more projects would be eligible to accrue AFUDC.

Florida Public Utilities Company and Tampa Electric Company do not expect an increase in administrative costs from the proposed rule amendments. Gulf Power does not expect additional operating and management costs. However, Gulf Power indicated that it would have a reduction in AFUDC earnings with the increase in threshold from \$25,000 to 1% of the relevant accounts. It stated that the 1% threshold is too large and would result in significant harm to the Company. The proposed 0.5% threshold should have a lesser impact on AFUDC earnings.

Florida Power Corporation does not expect any significant change in costs to result from the adoption of the proposed rule revision, unless it is determined that separate books must be maintained for Florida Public Service Commission (retail) and the Federal Regulatory Commission (wholesale) jurisdictions. However, Florida Power estimated that if the proposed rule revisions were implemented without any phase-in period the Company would have recorded (based on 1995 activity) \$3.2 million less AFUDC for the nine-month period ended September 30, 1995; or a projected annual reduction in AFUDC of \$4.2 million.

The increased threshold for AFUDC would impact rate base by not allowing the inclusion of construction interest in rate base as frequently. Rate base would not be as large with the proposed amendment because less accrued interest will ultimately be included. Less accrued AFUDC interest in rate base will result in less depreciation for those projects which will impact net income. Less AFUDC interest in rate base will also result in less AFUDC earnings. With the higher threshold, projects that are not eligible to accrue AFUDC will be included in CWIP, and, therefore, included in rate base during the construction period for accounting purposes. AFUDC projects are not included in rate base until the construction project is completed.

Projects not eligible to accrue AFUDC during construction can be included in rate base for surveillance purposes, resulting in a lower achieved rate of return during the construction period than if the project were excluded from rate base. For those projects which are eligible to accrue AFUDC, the project costs plus the accrued interest are included in rate base once the construction period is over. In this instance, the achieved rate of return is also lowered, but only after construction is completed.

A company's future earnings on rate base will be impacted by the timing of a project's inclusion in rate base and whether the project cost includes accrued AFUDC. Gulf indicated that the company will have to "absorb the carrying costs of these projects prior to their in-service dates, and could result in significant harm." Tampa Electric expressed concern that even if a project is included in rate base, the company will not recover the associated revenue requirement until it has another rate change. However, the electric companies are not currently requesting rate increases in order to prepare for competition.

The proposed amendments to the language regarding investment tax credits do not benefit or cost the utilities since the companies have not been required to request an IRS ruling since 1987.

REASONABLE ALTERNATIVE METHODS

Gulf Power Company expressed concern over the administrative costs of having to calculate the balance of "Electric Plant in Service/Completed Construction not Classified" each month. The company suggests that, since the eligible project's proposed criteria (originally 1% percent of Electric Plant in Service) would require a calculation of the Electric Plant balance, the criteria should be based on prior year-end balances. This would save the administrative costs of making the calculation on a monthly basis.

Tampa Electric makes a suggestion regarding the concern that an increase in rate base will not be recovered with an appropriate return. The company suggests that the

. . . implementation of the new calculation method should be required at the time of each company's next price change. This would ensure that each utility will be able to adequately recover the expenditures required to maintain and expand the system that provides reliable electric service to all ratepayers.

Florida Power Corporation (FPC) proposes the Nuclear Fuel eligible for AFUDC should be qualified in a separate manner than the proposed amendment. Florida Power Corporation asserts that if the cost of a batch of Nuclear Fuel equals or exceeds the percent threshold of the balance in Account 120.3--Nuclear Fuel Assemblies in Reactor at the time the batch procurement commences, it should be eligible to accrue AFUDC. Florida Power & Light (FPL) believes that if Construction Work In Progress (CWIP) and Nuclear Fuel in Process (NFIP) will not accrue AFUDC, then their balances should be included in the rate base.

Florida Power Corporation (FPC) proposes that two accounts be excluded from the calculation of eligibility requirements threshold: Electric Plant in Service and Completed Construction not Classified. The company asserts that these two accounts be excluded since the functions represented by the accounts normally do not accrue AFUDC. Furthermore, Florida Power Corporation proposes:

. . . that the capitalization structure cost rate calculations for short term debt and customer deposits be consistent with the methodology utilized for Surveillance reporting, with the exception that investment tax credits (ITC's) be eliminated. ITC's are not a

source of financing new construction. Also, the reporting of the AFUDC rate should be included once a year (December) in Surveillance reporting.

However, staff maintains that ITCs should not be eliminated. A utility will have other pre-existing sources of capital such as debt or stock issued years ago. Pre-existing sources of capital are not used to finance current construction; and ITC is no different from other pre-existing sources of capital that are not being used to finance current construction. Therefore, ITC should not be treated differently nor eliminated.

Finally, Florida Power and Light proposes that projects currently under construction should be grandfathered and continue to accrue AFUDC even though they would not otherwise be eligible under the proposed rule. FPL added, however, that if the Commission determines to grandfather projects currently under construction, the Commission should not make the grandfathering mandatory.

IMPACT ON SMALL BUSINESSES

No direct impact on small businesses is foreseen as Gulf Power Company, Florida Public Utilities Company, Tampa Electric Company, Florida Power Corporation, and Florida Power & Light Company are not small business as defined in Section 288.703(1), Florida Statutes (1991).

IMPACT ON COMPETITION

Florida Power and Light believes the proposed amendment would generate a competitive benefit for the company. If the proposed amendment is adopted, the amount of AFUDC capitalized by FPL would be reduced. This reduction in the amount of AFUDC capitalized, plus the compounding thereof, could improve FPL's ability to compete in the future and reduce the potential for stranded investment from future construction. But, the company stated that CWIP and MFIP no longer eligible for AFUDC must be included in rate base for all regulatory purposes so that adequate provision is made to recover the carrying costs of these investments.

Gulf Power Company, Florida Public Utilities, Tampa Electric Company, and Florida Power Corporation do not expect the proposed rule amendments to impact their ability to compete.

IMPACT ON EMPLOYMENT

Gulf Power Company, Florida Public Utilities Company, Tampa Electric Company, Florida Power Corporation, and Florida Power & Light Company indicated they do not expect the proposed rule amendment to affect the level of employment in their companies.

METHODOLOGY

Data requests were sent to the Investor-Owned Electric Utilities to collect additional economic information. Since that date, changes have been made to the proposed revisions, and the economic impacts are based on the original proposed threshold of 1% in this EIS. A 0.5% threshold would change the impacts expected but the change may not be one-half of the estimates because the size and cost of projects may not be linear. Discussions were held with technical and legal staff. Related rules and statutes were examined and referenced. Standard microeconomic analysis was used to determine the estimated impact.

CBH tf/d-afudc.tnf