State of Florida

Commissioners:
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DIVISION OF APPEALS
DAVID E. SMITH
DIRECTOR
(904) 413-6245

# Public Service Commission

July 1, 1996

Mr. Carroll Webb
Joint Administrative Procedures
Committee
120 Holland Building
Tallahassee, Florida 32399

Re: Docket No. 951535-EI, Proposed Revisions to Rule 25-6.0141, F.A.C., Allowance for Funds Used During Construction (AFUDC)

Dear Mr. Webb:

Enclosed are an original and two copies of the following materials concerning the above referenced proposed rule:

1. A copy of the rule.

2. A copy of the F.A.W. notice.

3. A statement of facts and circumstances justifying the proposed rule.

4. A federal comparison statement.

5. A statement of the impact of the rule on small business.

6. An economic impact statement.

7. A statement that the agency has chosen the regulatory alternative that imposes the lowest net cost to society.

If there are any questions with respect to this rule, please do not hesitate to call on me.

Sincerely,

Richard C. Bellak

Richard C. Bellak
Associate General Counsel

AMD60141 MRD
Enclosures
cc: Division of Records & Reporting

DOCUMENT NUMBER-DATE
07041 JUL-1 96
FPSC-RECORDS/REPORTING

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.

2. Projects where gross additions to plant are less than 0.5 percent of the sum of the total balance in

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Account 101 - Electric Plant in Service, and Account 106 - Completed Construction not Classified, at the time the project commences ~~$25,000 or less~~.

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

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

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

1. Projects that are reimbursable by another party.
2. Projects that have been cancelled.
3. Purchases of assets which are ready for service when acquired.
4. Portions of projects providing service during the construction period; or

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

~~1. Accrual of AFUDC is not to be reversed when a project originally expected to be completed in excess of one year is completed in one year or less.~~

~~2. AFUDC may not be accrued retroactively if a project expected to be completed in one year or less is~~

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~~subsequently suspended for six months, or is not ready for service after one year;~~

1~~3~~. When a project is completed and ready for service, it shall be immediately transferred to the appropriate plant account(s) or Account 106, Completed Construction Not Classified, and may no longer accrue AFUDC;

2~~4~~. Where a work order covers the construction of more than one property unit, the AFUDC accrual shall cease on the costs related to each unit when that unit reaches an in-service status;

3~~5~~. When the construction activities for an ongoing project are expected to be suspended for a period exceeding six (6) months, the utility shall notify the Commission of the suspension and the reason(s) for the suspension, and shall submit a proposed accounting treatment for the suspended project; and

4~~6~~. When the construction activities for a suspended project are resumed, the previously accumulated costs of the project may not accrue AFUDC if such costs have been included in rate base for ratemaking purposes. However, the accrual of AFUDC may be resumed when the previously accumulated costs are no longer included in rate base for ratemaking purposes.

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

(f) A utility may file a petition to seek approval to include a project in rate base that would otherwise qualify for AFUDC treatment per Section (1)(a).

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

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

(b) The cost rates for the components in the capital structure shall be the midpoint of the last allowed return on common equity, the most recent 13-month average cost of short term debt and customer deposits and a zero cost rate for deferred taxes and all investment tax credits. The cost of long term debt and preferred stock shall be based on end of period cost. The annual percentage rate shall be calculated to two decimal places.

~~(c) The treatment by the Commission of all investment tax credits at a zero cost rate shall be contingent upon a ruling from the Internal Revenue Service that such treatment will not, for companies elected to be treated under s. 46(f)(2) of the Internal~~

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~~Revenue Code, result in the forfeiture of the tax credits. Pending receipt of such a ruling, each utility shall continue to use the weighted overall cost of capital calculated in a manner consistent with the final IRS Regulation Section 1.46-6 published May 22, 1986, as the cost of the utility's 4% and 10% investment tax credits.~~

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

(3) Discounted monthly AFUDC rate. A discounted monthly AFUDC rate, calculated to six decimal places, shall be employed to insure that the annual AFUDC charged does not exceed authorized levels.

(a) The formula used to discount the annual AFUDC rate to reflect monthly compounding is as follows:

$$M = \left[\left(1 + \frac{A}{100}\right)^{1/12} - 1\right] \times 100$$

Where:

M = discounted monthly AFUDC rate

A = Annual AFUDC rate

(b) The monthly AFUDC rate, carried out to six decimal places, shall be applied to the average monthly balance of eligible

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CWIP and NFIP that is not included in rate base.

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

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

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

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

(5) No utility may charge or change its AFUDC rate without prior Commission approval. The new AFUDC rate shall be effective the month following the end of the 12-month period used to establish that rate and may not be retroactively applied to a previous fiscal year unless authorized by the Commission.

(6) Each utility charging AFUDC shall include in its ~~June and~~ December Earnings ~~Rate of Return~~ S~~s~~urveillance R~~r~~eports to the Commission Schedules A and B identified in subsection (4) of this Rule, as well as disclosure of the AFUDC rate it is currently charging.

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

(8) The provisions of this rule are effective January 1, 1996

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

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

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

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

CODING: Words underlined are additions; words in ~~struck through~~ type are deletions from existing law.

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 951535-EI

| RULE TITLE: | RULE NO.: |
|---|---|
| Allowance for Funds Used During Construction | 25-6.0141 |

PURPOSE AND EFFECT: 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.

SUMMARY: Projects can accrue AFUDC which exceed 0.5% of the sum in Account 101-Electric Plant in Service and Account 106-Completed Construction not classified. Projects under a lease agreement are excluded. Prior to commencement of a project, a utility can seek permission to include a project in rate base which would otherwise accrue AFUDC. The rule requires a schedule of projects which would equal or exceed a gross cost of $10,000,000 to be included in the utility's Forecasted Surveillance Report. The rule takes effect January 1, 1996, but allows an implementation grace period until January 1, 1999 or the company's next rate proceeding, whichever occurs first.

RULEMAKING AUTHORITY: 350.127(2), 366.05(1), FS.

LAW IMPLEMENTED: 350.115, 366.04(2)(a), 366.06(1), FS.

WRITTEN COMMENTS OR SUGGESTIONS ON THE PROPOSED RULE MAY BE SUBMITTED TO THE FPSC, DIVISION OF RECORDS AND REPORTING, WITHIN 21 DAYS OF THE DATE OF THIS NOTICE FOR INCLUSION IN THE RECORD OF THE PROCEEDING.

HEARING: IF REQUESTED WITHIN 21 DAYS OF THE DATE OF THIS NOTICE, A HEARING WILL BE HELD AT THE DATE AND PLACE SHOWN BELOW:

TIME AND DATE: 9:30 A.M., August 8, 1996.

PLACE: Room 152, Betty Easley Conference Center, 4075 Esplanade Way, Tallahassee, Florida.

THE PERSON TO BE CONTACTED REGARDING THIS RULE AND THE ECONOMIC IMPACT STATEMENT IS: Director of Appeals, Florida Public Service Commission, 2540 Shumard Oak Blvd., Tallahassee, Florida 32399.

THE FULL TEXT OF THE RULE IS:

25-6.0141 Allowance For Funds Used During Construction.

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

(a) Eligible projects. <u>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</u> ~~The following projects~~ may be included in CWIP or NFIP and accrue AFUDC<u>.</u>~~:~~

~~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) No change.

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.

2. Projects where gross additions to plant are less than 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 ~~$25,000 or less~~.

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

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

(c) No change.

1. through 4. No change.

(d) No change.

~~1. Accrual of AFUDC is not to be reversed when a project originally expected to be completed in excess of one year is completed in one year or less;~~

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

1~~3~~. No change.

2~~4~~. No change.

3~~5~~. No change.

4~~6~~. No change.

(e) No change.

(f) A utility may file a petition to seek approval to include a project in rate base that would otherwise qualify for AFUDC

<u>treatment per Section (1)(a).</u>

(2) No change.

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

(b) No change.

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

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

(3) through (5) No change.

(6) Each utility charging AFUDC shall include in its ~~June and~~ December <u>Earnings</u> ~~Rate of Return~~ <u>S</u>~~s~~urveillance <u>R</u>~~r~~eports to the Commission Schedules A and B identified in subsection (4) of this

Rule, as well as disclosure of the AFUDC rate it is currently charging.

(7) No change.

(8) The provisions of this rule are effective January 1, 1996 and shall be implemented by all electric utilities no later than January 1, 1999, or the utility's next rate proceeding, whichever occurs first. ~~Paragraphs (a) and (b) of subsection (7) shall not be effective for any utility until it implements final rates in a general rate case initiated after the effective date of this Rule. The foregoing notwithstanding, these provisions will become effective for all utilities no later than January 1, 1989.~~

Specific Authority: 350.127(2), 366.05(1), FS.

Law Implemented: 350.115, 366.04(2)(a), 366.06(1), FS.

History: New 8-11-86, Amended 11-13-86, 12-7-87, ________.

NAME OF PERSON ORIGINATING PROPOSED RULE: Jay Revell.

NAME OF SUPERVISOR OR PERSON(S) WHO APPROVED THE PROPOSED RULE: Florida Public Service Commission.

DATE PROPOSED RULE APPROVED: April 30, 1996.

If any person decides to appeal any decision of the Commission with respect to any matter considered at the rulemaking hearing, if held, a record of the hearing is necessary. The appellant must ensure that a verbatim record, including testimony and evidence forming the basis of the appeal is made. The Commission usually makes a verbatim record of rulemaking hearings.

Any person requiring some accommodation at this hearing because of a physical impairment should call the Division of Records and Reporting at (904) 413-6770 at least five calendar days prior to the hearing. If you are hearing or speech impaired, please contact the Florida Public Service Commission using the Florida Relay Service, which can be reached at: 1-800-955-8771 (TDD).

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

March 29, 1996

TO: DIVISION OF APPEALS (BELLAK)

FROM: DIVISION OF RESEARCH AND REGULATORY REVIEW (HEWITT) CBH PD DMW

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

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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 could be included in construction work in progress (CWIP) or nuclear fuel in process (NFIP) and qualified for accrual of AFUDC. These criteria include a minimum project cost ($25,000) and a construction period in excess of one year.

The proposed amendments would change the cost criterium from a minimum dollar amount of $25,000 to projects which exceed 0.5% (Primary Recommendation) of the sum in Account 101--Electric Plant in Service, and Account 106--Completed Construction not Classified; or, projects which exceed a gross addition to plant of $15,000,000 (Alternative Recommendation). 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.

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.

Also, prior to the commencement of construction on a project, a utility would be able file a petition to seek approval to include the project in rate 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, for surveillance purposes, included in rate base during the construction period. 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 Power Company (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 Company (TECO) 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, in order to prepare for competition, the electric companies are not currently requesting rate increases. Data requests were sent to the affected investor-owned electric utilities (IOUs) with both the Primary Rule and Alternative Rule proposals. The Primary Rule contains a 0.5% 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. The Alternative Rule proposal contains a fixed amount of $15,000,000 for the threshold level before a project would be allowed to accrue AFUDC.

Florida Power and Light (FPL) favors reducing the amount of AFUDC capitalized and states that the proposed primary rule changes "are appropriate and will streamline the accounting and budgeting process and reduce costs to FPL's customers." But, FPL thinks that the previously proposed percentage threshold of 1% would be better. The most significant cost to FPL would be the impact on shareholders that would result from the proposed rule changes because reducing the amount of AFUDC capitalized would reduce FPL's earnings (net

REASONABLE ALTERNATIVE METHODS

Reasonable alternative methods are proposed with the primary and alternative rule recommendations.

Gulf 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 an eligible project's criteria 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.

TECO 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.

FPC proposes that Nuclear Fuel eligible for AFUDC should be qualified in a separate manner than the proposed amendment. FPC 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. 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.

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, FPC proposed:

> . . . 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 capitol such as debt or stock issued years ago. Pre-existing sources of capitol are not used to finance current construction; and the percentage method as it is more equitable and has no significant effect on the company's ability to compete. But, a specific dollar threshold amount would put the larger utilities at a competitive disadvantage.

Gulf believes that the alternative threshold of $10,000,000 is far superior to the primary proposal for competitive reasons. Florida Public Utilities does not expect the proposed rule amendments to impact its ability to compete.

IMPACT ON EMPLOYMENT

Gulf, FPUC, TECO, FPC, and FPL 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. 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/e-afud2e.tnf

Rule 25-6.0141
Docket No. 951535-EI

## STATEMENT OF FACTS AND CIRCUMSTANCES JUSTIFYING RULE

The prior rule had a threshold for AFUDC accrual which was too low. The amended rule insures that only projects which are material with respect to a company's financial assets will accrue AFUDC.

## STATEMENT ON FEDERAL STANDARDS

There is no federal standard on the same subject.

## STATEMENT OF IMPACT ON SMALL BUSINESS

No impact on small business is anticipated.

## STATEMENT THAT THE AGENCY HAS CHOSEN THE REGULATORY ALTERNATIVE THAT IMPOSES THE LOWEST NET COST ALTERNATIVE TO SOCIETY

The Commission has chosen the regulatory alternative that imposes the lowest net cost to society.