Kimberley Pena

From: Kimberley Pena
Sent: Thursday, October 28, 2010 3:45 PM
To: John Slemkewicz; Lisa Bennett
Cc: Carol Purvis; Mary Anne Helton; Andrew Maurey
Subject: RE: Docket No.100410-EI, ITem No. 22

Per this e-mail, we will place the recommendation filed on 10/04/2010 (DN 08294-10) on the 11/09/2010 Commission Conference.

From: Carol Purvis
Sent: Thursday, October 28, 2010 3:18 PM
To: Kimberley Pena
Subject: FW: Docket No.100410-EI, ITem No. 22

From: Marshall Willis
Sent: Wednesday, October 27, 2010 9:28 AM
To: Carol Purvis
Cc: Mary Anne Helton; Lisa Bennett; John Slemkewicz; Andrew Maurey
Subject: RE: Docket No.100410-EI, ITem No. 22

Please place the same staff recommendation on the November 9, 2010 agenda.

From: Carol Purvis
Sent: Tuesday, October 26, 2010 4:28 PM
To: John Slemkewicz; Lisa Bennett
Cc: Mary Macko; Katie Ely; Kimberley Pena; Carol Purvis
Subject: Docket No.100410-EI, ITem No. 22

At the October 26, 2010 Commission Conference, the Commissioners deferred Docket No. 100410-EI and 090130-EI, Item No. 22, to the November 9, 2010 Commission Conference.

Please advise **immediately** if this item is to be placed on the November 9, 2010 Conference agenda, and if the same recommendation will be used or if a new one will be filed.

If the recommendation is to be placed on a conference agenda other than the November 9, 2010, please file a revised CASR with Katie Ely by Friday, October 29, 2009.

State of Florida

Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: October 4, 2010

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Slemkewicz, Maurey, Cicchetti, Springer, Willis)
Office of the General Counsel (Bennett)

RE: Docket No. 100410-EI – Review of Florida Power & Light Company's earnings.

AGENDA: 10/12/10 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: ~~Pending~~ All Commissioners – ac

PREHEARING OFFICER: ~~Pending~~ Administrative – ac

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: Take up after Docket Nos. 080677-EI and 090130-EI

FILE NAME AND LOCATION: S:\PSC\ECR\WP\100410.RCM.DOC

Case Background

On September 14, 2010, Florida Power & Light Company (FPL or Company) submitted its May and June 2010 Earnings Surveillance Reports (ESR) as required by Rule 25-6.1352, Florida Administrative Code (F.A.C.). Per these reports, FPL's actual achieved returns on equity (ROE) were 11.28 percent and 11.43 percent for May and June 2010, respectively. These returns exceed the top of FPL's currently authorized ROE range of 9.00 percent to 11.00 percent, with a 10.00 percent midpoint.[1] Rule 25-6.1353, F.A.C., requires investor-owned electric utilities, not subject to an earnings cap, to file an annual Forecasted ESR each year by March 1 of the

[1] Order No. PSC-10-0153-FOF-EI, issued March 17, 2010, in Docket No. 080677-EI, In re: Petition for increase in rates by Florida Power & Light Company (Final Order).

forecasted year. FPL requested, and was granted, an extension to file its Forecasted ESR until 30 days after the Commission approves the Stipulation and Settlement (Stipulation)[2] or, if not approved, until 30 days after the Commission decides the Reconsideration Motions.[3] The extension request was based on FPL's assertion that, until the Stipulation or Reconsideration Motions are decided, the uncertainty surrounding the forecast inputs would result in a forecast that would not be meaningful.

Due to concerns over the high level of FPL's actual earnings, an informal meeting, noticed to all parties of Docket No. 080677-EI, was held on September 22, 2010, to discuss potential excess earnings for 2010. On September 29, 2010, FPL submitted a letter[4] in response to staff's request for a letter giving the Commission jurisdiction over any earnings in excess of an 11.00 percent ROE. In that letter, FPL declined to make such a commitment.

This recommendation addresses the actions that the Commission should take regarding FPL's potential overearnings. The Commission has jurisdiction over this matter pursuant to Chapter 366, Florida Statutes (F.S.), including Sections 366.041, 366.06, 366.07, and 366.071, F.S.

[2] The Stipulation and Settlement, filed in Docket No. 080677-EI, In re: Petition for increase in rates by Florida Power & Light Company, is scheduled as Item 14 on the October 12, 2010, Commission Conference.
[3] Reconsideration Motions have been filed in Docket No. 080677-EI, In re: Petition for increase in rates by Florida Power & Light Company.
[4] Document No. 08211-10, in Docket No. 100410-EI.

Discussion of Issues

Issue 1: Should the Commission initiate a review of Florida Power & Light Company's earnings?

Recommendation: Yes. (Maurey)

Staff Analysis: FPL filed its May and June 2010 ESRs on September 14, 2010. For May and June 2010, the Company reported achieved ROEs of 11.28 percent and 11.43 percent, respectively. Pursuant to the Final Order, FPL's authorized ROE is 10.00 percent, with a range of 9.00 percent to 11.00 percent.[5] Thus, revenues received by FPL resulting in the Company's ROE exceeding 11.00 percent may constitute overearnings.

In a publicly noticed meeting held on September 22, 2010, staff met with FPL and the parties to Docket No. 080677-EI to discuss the Company's potential overearnings. At this informal meeting, staff requested FPL file a letter (earnings cap letter) granting the Commission jurisdiction over the disposition of any revenues received by the Company in 2010 that are determined to result in FPL's achieved ROE exceeding 11.00 percent for the year. On September 29, 2010, FPL filed a letter in which it declined to grant the Commission this jurisdiction and instead respectfully requested a recommendation regarding the proposed Stipulation be presented to the full Commission for its consideration. Had an earnings cap letter been received by the Commission, there would have been no need to open the instant docket. In addition, the filing of this recommendation does not prohibit the Company from reconsidering its decision and filing an earnings cap letter.

In both its September 29, 2010 letter referenced above and the September 14, 2010 letter that accompanied its May and June 2010 ESRs, FPL asserts that the Company would not be overearning if weather conditions had been normal. Staff notes that a weather normalization adjustment as suggested by FPL is only appropriate for purposes of setting rates in a rate case, not for purposes of evaluating actual earnings. Thus, staff disagrees with the Company's assertion that the reported earnings for May and June 2010 that result in an ROE greater than 11.00 percent do not constitute potential overearnings.

Staff appreciates that it's the Company's and the other Signatories' contention that the terms of the Stipulation are intended to alleviate the issue of potential overearnings. However, staff cannot presume that the Stipulation will be approved by the Commission. In addition, while Paragraph 7 of the Stipulation discusses the mechanism the Company is expected to use to maintain earnings within the range of 9.00 percent to 11.00 percent during the term of the Stipulation, staff cannot independently verify if the mechanism, as claimed by FPL in its September 29, 2010 letter, will in fact be able to mitigate the total amount of the identified potential overearnings. Pursuant to the Final Order, FPL is required to amortize the depreciation reserve surplus of approximately $894.6 million over a period of four years.[6] This equates to an annual amortization of approximately $224 million. While staff is aware that the Company has

[5] Order No. PSC-10-0153-FOF-EI, page 132.
[6] Order No. PSC-10-0153-FOF-EI, page 86.

been recording some amount of amortization of the depreciation reserve surplus,[7] staff has been unable to determine if reversal of this amortization will be sufficient to offset the identified overearnings to bring the achieved ROE to no greater than 11.00 percent as intended by Paragraph 7.

In the absence of an earnings cap letter or an approved Stipulation that adequately addresses the level of identified overearnings, staff believes the Commission must attach jurisdiction over potential overearnings in order to protect those funds for future disposition. It should also be noted that FPL has requested and received the automatic 31 day extension provided by Rule 25-6.352, F.A.C., to file its July 2010 ESR. It is anticipated that when the July and August 2010 ESRs are received, the Company's reported ROEs will be greater than the returns reported on the May and June 2010 ESRs. Moreover, FPL has not filed its Forecasted ESR for 2010. In the face of potential overearnings by FPL on an actual basis and without the benefit of forecasted earnings for the year, staff recommends the Commission initiate a review of the Company's earnings for the reasons discussed above and hold revenues subject to refund as discussed in Issue 2.

[7] Florida Power & Light Company, Quarterly Report (Form 10-Q), at 38 (August 6, 2010).

Issue 2: Should the Commission order FPL to hold earnings, for the 12-month period ending March 31, 2011, in excess of the authorized 11.00 percent maximum of the ROE range subject to refund under bond or corporate undertaking?

Recommendation: Yes. The Commission should order FPL to hold earnings, for the 12-month period ending March 31, 2011, in excess of the authorized 11.00 percent maximum of the ROE range subject to refund under a corporate undertaking. (Slemkewicz, Cicchetti, Springer, Bennett)

Staff Analysis: Staff first became aware of FPL's potential overearnings when the Company filed its May and June 2010 ESRs on September 14, 2010. Per these reports, FPL's actual achieved ROEs were 11.28 percent and 11.43 percent for May and June 2010, respectively. These returns exceed the top of FPL's currently authorized ROE range of 9.00 percent to 11.00 percent, with a 10.00 percent midpoint. As discussed in Issue 1, staff met with FPL and interested parties to discuss potential excess earnings for 2010.

The Commission's authority to take jurisdiction over overearnings has been long settled. In April 1995, in Docket No. 950379-EI, Tampa Electric Company (TECO) was brought before the Commission for an overearnings investigation. TECO had filed a Forecasted ESR indicating that it would be overearning for 1995. In that proceeding, Commission staff recommended that the Commission take jurisdiction over the overearnings for 1995. Before the Commission voted on staff's recommendation, TECO proposed to defer its overearnings which the Commission accepted.[8] Subsequently TECO and intervening parties entered into an agreement, part of which included an agreement by TECO to refund its 1995 and 1996 overearnings.[9] The law has not changed since that 1995 legal analysis was conducted in Docket No. 950379-EI, which concluded that the Commission's authority to attach jurisdiction to potential overearnings is not limited to a prospective twelve-month period. After considerable review, legal staff is in agreement with the legal opinion contained in the staff recommendation. Current Commission staff continues to believe that the Commission has inherent authority to attach jurisdiction over utility overearnings.

The action that staff recommends in this docket is preliminary in nature. If the Commission agrees with staff's recommendation, the Commission still has a duty to conduct a review, after the actual March 2011 results are known, to determine the amount and appropriate disposition of FPL's overearnings, if any. United Telephone Co. of Florida v. Beard, 611 So. 2d 1240 (Fla. 1993). Staff's recommendation at this time is only that FPL, based on its own data provided in its actual ESRs, be required to hold earnings in excess of the maximum of its ROE range under a corporate undertaking subject to refund. This differs from the TECO proceeding which was based on forecasted, not actual, overearnings. The questions of whether a refund will be ordered, and the amount of the refund, would be addressed later.

The Florida Legislature has declared the Commission's regulation of public utilities to be in the public interest, and has deemed Chapter 366, F.S., to be an exercise of the police power of

[8] Order No. PSC-95-0580-FOF-EI, issued May 10, 1995, in Docket No. 950379-EI, In Re: Investigation into earnings for 1995 and 1996 of Tampa Electric Company.
[9] Order No. PSC-96-0122-FOF-EI, issued January 23, 1996, in Docket No. 950379-EI.

the state for the protection of the public welfare with all provisions of Chapter 366 to be liberally construed for the accomplishment of that purpose. See Section 366.01, F.S. In addition, Section 366.07, F.S., provides that whenever the Commission finds the rates proposed, demanded or collected by any public utility unjust, unreasonable, or excessive, the Commission shall determine and fix fair and reasonable rates to be imposed in the future.

The Commission's inherent authority to prevent detriment to ratepayers resulting from unjust or unreasonable earnings has been well recognized by the courts. In United Telephone Co. of Florida v. Beard, supra, the Supreme Court of Florida stated:

> We agree with the Commission that the unusual factual circumstances of this case, namely the length of time since the company's last full rate proceeding and the drop in interest rates, would have resulted in "unjust, unreasonable, [and] unjustly discriminatory" earnings for United, to the detriment of its ratepayers. Section 364.14(1), Fla. Stat. (1989). Accordingly, we find that the Commission had the inherent authority to conduct a limited proceeding in this case, even before specific legislation conferred the express authority to do so. Cf. Southern Bell Tel. & Tel. Co. v. Bevis, 279 So. 2d 285 (Fla. 1973) (Court approved Commission's inherent authority to make interim rate increase). 611 So. 2d at 1243

Section 364.14, F.S., relied on by the Court in United Telephone Co. of Florida v. Beard, was the telecommunications equivalent to Section 366.07, F.S.[10] Section 366.07, F.S., confers to the Commission the same broad grant of authority over electric and gas utility rates that Section 364.14, F.S. conferred over telecommunications rates before price cap regulation. Both statutes contain language allowing the Commission to protect ratepayers from unjust and unreasonable rates.

The case of Southern Bell v. Bevis, supra, referred to in the passage quoted above, predates both the file and suspend statute (enacted in 1974) and the interim statute (enacted in 1980). In that case, the Court rejected the Commission's argument that it could not set rates without a comprehensive review, stating that nothing precluded the Commission from subjecting the increase to a refund provision. The Court found that a range of alternatives suitable to the particular circumstances of the case was available to the Commission, including the imposition of a reasonable refund provision to protect both the company and its customers.

In United Telephone v. Mann, 403 So. 2d 962 (Fla. 1981), the Court upheld the Commission's order subjecting earnings to refund down to the authorized rate of return, pursuant to Section 364.14, F.S. (the telecommunications equivalent to Section 366.07, F.S.). The Court stated that the Commission could order moneys held subject to refund, "upon finding that a company is earning revenues in excess of its maximum allowable rate of return." 407 So. 2d at 966. The Court relied on the Commission's inherent authority, outside of the file and suspend

[10] While the telecommunications industry has moved towards de-regulation, the electric industry in Florida has not. The legal analysis regarding the court's interpretation of Chapter 364 as applicable to Chapter 366 continues to be valid and in fact both statutes remain the same today as in the 1995 opinion.

and interim statutes, to capture revenues subject to refund. The Court found a broad range of alternatives (including capturing money subject to refund), that did not necessarily flow from the file and suspend and interim statutes, to be inherent in the Commission's general rate setting authority set forth in Section 364.14, F.S.

In Citizens v. Public Service Commission, 425 So. 2d 534 (Fla. 1982), the Court indicated that it did not intend a narrow reading of United Telephone v. Mann, supra. The Court stated that it has consistently recognized the broad legislative grant of authority conferred upon the Commission and the considerable license the Commission enjoys as a result of that delegation. Citizens, v. Public Service Commission reaffirmed the sentiment expressed in the 1973 Southern Bell v. Bevis case: the Commission has a broad range of discretion, which remains unimpaired with the passage of the interim and file and suspend statutes, to protect against unreasonable rates, even to the point of conditioning revenues on the outcome of future hearings. Where a utility itself has demonstrated substantial overearnings, the Commission has the inherent authority to protect ratepayers by requiring the utility to hold earnings in excess of the maximum of its ROE range, under bond or corporate undertaking, subject to refund.

Attaching jurisdiction over a portion of current rates believed to be excessive will not harm the utility. FPL will be provided an opportunity to challenge both the factual and legal basis for any revenues held subject to refund. No one is harmed if the Commission should later determine that it must remove the refund condition without ordering any refunds. The utility is not harmed if it has an opportunity to present its case and is put on notice that its revenues are not unconditional.

Based on legal staff's research, the 1995 legal analysis set out in the TECO docket is still valid. The cases cited in the 1995 recommendation have not been overturned. The statutes cited are still in effect. And in numerous dockets over the years, Commission staff has requested letters giving the Commission jurisdiction over overearnings. And the various water, wastewater, electric, gas, and telecommunication utilities have complied. Therefore, as in the TECO docket, staff recommends that the Commission order FPL to hold any March 2011 earnings in excess of the maximum of the range of its authorized rate of return on equity (11.00 percent) subject to refund under a corporate undertaking. If staff's recommendation is adopted by the Commission, a review should be conducted, after the March 2011 results are known, to determine the amount and appropriate disposition of FPL's overearnings.

Based on the most recent ESR submitted to the Commission for the 12-month period ended June 30, 2010, staff estimates the current amount of overearnings to be approximately $53.5 million. This amount could fluctuate up or down based on the actual level of earnings through the 12-month period ending March 31, 2011. As discussed in the Case Background, FPL has not submitted a Forecasted ESR for calendar year 2010.

The evaluation of overearnings is typically determined on an annual basis using a 12-month period. The preferable 12-month period is a calendar year. In this case, however, FPL was still operating under a revenue sharing plan, not ROE regulation, for January through March

2010, pursuant to a stipulation approved in Docket No. 050045-EI.[11] As a result, staff recommends using the 12-month period of April 1, 2010, through March 31, 2011, as the appropriate period for the review of FPL's earnings. The initial review would be based on FPL's March 2011 ESR.

Staff recommends that all funds held subject to refund be secured by a corporate undertaking. The criteria for a corporate undertaking include sufficient liquidity, ownership equity, profitability, and interest coverage to guarantee any potential refund. Staff reviewed FPL's 2007, 2008, and 2009 financial statements to determine if FPL can support a corporate undertaking for an estimated overearnings amount. FPL's financial performance demonstrates adequate levels of liquidity, ownership equity, profitability, and interest coverage to guarantee the potential refund.

Staff believes FPL has adequate resources to support a corporate undertaking. Based on this analysis, staff recommends that a corporate undertaking of up to $400 million is acceptable. This brief financial analysis is only appropriate for deciding if the Company can support a corporate undertaking in the amount proposed and should not be considered a finding regarding staff's position on other issues in this proceeding.

The March 2011 ESR is not due to be filed until May 15, 2011. In order to protect the ratepayers' interests, staff believes that FPL should be required to hold earnings, for the 12-months ending March 31, 2011, in excess of the authorized 11.00 percent maximum of the ROE range subject to refund under a corporate undertaking.

[11] Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050045-EI, In re: Petition for rate increase by Florida Power & Light Company.

Issue 3: Should this docket be closed?

Recommendation: No. This docket should remain open until staff has reviewed FPL's historical earnings data for the year ending March 31, 2011, and the Commission has determined the amount and appropriate disposition of overearnings. (Bennett)

Staff Analysis: Pursuant to United Telephone Co. of Florida v. Beard, 611 So. 2d 1240 (Fla. 1993), the Commission should conduct a review, after the March 2011 results are known, to determine the amount and appropriate disposition of FPL's overearnings.