BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

ORIGINAL FILE COPY

In re: Petition of the Florida Industrial Power Users Group to Discontinue Florida Power and Light Company's Oil Backout Cost Recovery Factor.	DOCKET NO. 890148-EI Filed: August 21, 1989

FIPUG'S REQUEST FOR OFFICIAL NOTICE

The Florida Industrial Power Users Group ("FIPUG"), through its undersigned counsel, requests the Florida Public Service Commission ("Commission") to take official notice of the following items (attached):

1. Order No. 16907, dated December 2, 1986. In 1981, Florida Power and Light Company ("FPL") requested the Commission to allow it to place in rate base the cost of repairs to the Turkey Point nuclear steam supply. The Commission refused, on the basis that the items were the subject of ongoing litigation. FPL renewed its request in 1982 and tried yet again in 1983. The Commission denied each approach.

FPL persevered. In 1985 it requested the Commission to address the subject of the steam supply repairs on the basis of changed circumstances. (The "changed circumstances" cited by FPL were the extended duration of the litigation and the magnitude and growing materiality of the deferred charges.) The Commission did so.

2. Excerpt of the testimony of FPL witness Roberto Denis in Docket No. 830377-EU, testimony given on January 19, 1984. On

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Marsha Rule*
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that date, Mr. Denis testified that company's plans to build Martin 3 had been affected--not only by the Southern Company contract--but by decreases in load growth which occurred after the contract was entered.

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Attorney for the Florida
Industrial Power Users Group

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of FIPUG's Request for Official Notice has been furnished by U.S. Mail or by hand delivery* to the following parties of record, this 21st day of August, 1989.

Matthew M. Childs*
Steel, Hector & Davis
First Florida Bank Building
Suite 601
215 S. Monroe Street
Tallahassee, Florida 32301

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FIPUG-PA
Oil backout
recovery

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Florida Power and Light Company for Entitlement to Recover the Turkey Point Steam Generator Repair Costs.	)	DOCKET NO. 850782-EI
In re: Petition of Florida Power and Light Company to Include Martin Reservoir Repair and Enhancement Costs in Rate Base.	)	DOCKET NO. 850783-EI
	)	ORDER NO. 16907
	)	ISSUED: 12-02-86

The following Commissioners participated in the disposition of this matter:

JOHN R. MARKS, III, Chairman
GERALD L. GUNTER
JOHN T. HERNDON
KATIE NICHOLS
MICHAEL McK. WILSON

Pursuant to Notice duly issued, the Florida Public Service Commission held a public hearing in Tallahassee, Florida, on June 5, 1986. Having considered the record herein, the Commission now enters its final order.

APPEARANCES: Matthew M. Childs, Esquire, and Charles A. Guyton, Esquire, Steel, Hector and Davis, 320 Barnett Bank Building, Tallahassee, Florida 32301, appearing on behalf of Florida Power and Light Company.

Norris E. Shelkofsky, 9250 West Flagler Street, Post Office Box 529100, Miami, Florida 33152, appearing on behalf of Florida Power and Light Company.

Jack Shreve, Public Counsel, Stephen Burgess, Esquire and Carrie Hightman, Esquire, Office of Public Counsel, 624 Fuller Warren Building, 202 Blount Street, Tallahassee, Florida 32301, appearing on behalf of the Citizens of the State of Florida.

Prentice P. Pruitt, Esquire, 101 East Gaines Street, Tallahassee, Florida 32301, Counsel for the Commission.

Michael B. Twomey, Esquire, 101 East Gaines Street, Tallahassee, Florida 32301, appearing on behalf of the Commission Staff.

ORDER GRANTING PETITIONS REGARDING TURKEY POINT STEAM GENERATOR REPAIR COSTS AND MARTIN RESERVOIR REPAIR AND ENHANCEMENT COSTS

BY THE COMMISSION:

Background

In Florida Power and Light Company's (FPL) 1981 rate case (Docket No. 810002-EU) the utility sought to include in rate

FIPUG-PA
Oil Cashout
Recovery

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BY THE COMMISSION:

Background

In Florida Power and Light Company's (FPL) 1981 rate case (Docket No. 810002-EU) the utility sought to include in rate

base some $72,738,882 on a jurisdictional basis associated with repairs and enhancements to a reservoir built to provide cooling water for FPL's Martin Units 1 and 2. Prior to either of these units being placed into service a break occurred in the earthen dam in October, 1979 leading to considerable property damage and necessitating a review of the design and construction of the dam. A Board of Review commissioned by FPL recommended numerous corrective measures for the repair, including design alterations calculated to enhance the integrity of the dam. FPL spent $78,846,000 to place the reservoir back in service, but over $77,000,000 of that amount was related to dam modifications.

FPL sought inclusion of the costs of the rebuilt dam in rate base arguing that the rebuilt structure was "used and useful" and, further, that the failure of the original dam was not the fault of the utility. We agreed with Public Counsel that the costs resulting from the break of the dam should not be placed in rate base prior to the outcome of FPL's litigation against the consulting engineers and contractors who designed and built the original dam. Accordingly, in Order No. 10306, we held the repair and enhancement costs out of rate base and determined that the reasonableness and prudence of those costs would be considered in a ratemaking proceeding following the resolution of FPL's litigation. To avoid any prejudice to FPL, we authorized it to charge Allowance for Funds Used During Construction (AFUDC) to the repair and enhancement costs until the prudence issue was resolved.

In that same rate case, FPL sought to include in rate base some $63 million of Construction-Work-In-Progress (CWIP) related to ongoing steam generator repairs to its Turkey Point Units Nos. 3 and 4. FPL had brought suit against Westinghouse Electric Corporation (Westinghouse), who was the steam generator vendor. As with the Martin Dam repairs, we refused to place the requested amount in rate base, but authorized the accrual of AFUDC until such time as the rate base issue was resolved in ratemaking proceedings after the conclusion of FPL's litigation. FPL sought review of our decisions with the Florida Supreme Court, which affirmed.

While its review of the 1981 rate case was still before the court, FPL filed another rate case in 1982 (Docket No. 820097-EU), in which it again sought inclusion of all its investment in the Martin Reservoir and Turkey Point steam generators in rate base. We rejected FPL's request that the entire cost of enhancing and repairing the original dam should be included in rate base but modified our earlier position, stating:

> By the apparent admission of all parties, the original Martin Dam was something less than was needed to retain the waters of the Martin Reservoir. The new enhanced dam appears to be adequate for its purpose but the some $77 million of additional rate base sought for it in 1981 over and above its original construction cost was associated with design improvements as well as an expedited construction schedule. The total of original cost and reconstruction clearly exceeds the cost of the dam had it been properly constructed the first time. Evidence was presented in this case demonstrating that had the dam been properly designed and built at

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> the outset, it would have cost, on a jurisdictional basis, an additional $52,718,365.
>
> We believe that the utility is entitled to the costs associated with the dam had it been properly built initially and shall modify our earlier decision by allowing in rate base the additional $52,718,365 that it would have cost to build the dam correctly in the beginning.
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> The remaining $17,712,000 ($18,667,000 plant in service less $955,000 accumulated depreciation) requested by FPL associated with the Martin Dam shall remain excluded from rate base until such time as the matter is considered in ratemaking proceedings following the resolution of the litigation. At that time, parties will be given an opportunity to be heard on the issue of whether FPL was prudent in its handling of the reservoir incident. To avoid any prejudice to FPL, we shall continue to allow it to charge AFUDC to the amount excluded from rate base until such time as the matter is considered in ratemaking proceedings following the resolution of the litigation. Accordingly, we have reduced the proposed rate base by $17,712,000.

Order No. 11437 at 8-9

Although FPL had again requested the inclusion of the Turkey Point steam generator repairs in rate base, we found that there were neither changed circumstances nor a compelling rationale presented to us to warrant deviating from our earlier decision on the issue in Order No. 10306. We authorized FPL to continue computing AFUDC on the costs excluded from rate base until such time as the issue was resolved in a future ratemaking proceeding.

FPL followed our earlier treatment of the so-called "litigation items" in its 1983 rate case (Docket No. 830465-EI), updated us on the status of the litigation and raised concerns about the growing balances of accumulated deferred costs. In that case, in Order No. 13537, we determined to not include in FPL's rate base the cost of replacing the steam generators and the remaining investment in the Martin Reservoir.

Requested Relief

In November of 1985, FPL filed its petitions, which are the subjects of these two dockets and alleged that certain changed circumstances warranted the Commission changing the timing of its consideration of the prudence of the utility's conduct regarding the litigation items. First, FPL said that the deferred costs associated with the litigation items had grown to such an extent that they would be material for financial reporting purposes by the end of 1986. More specifically, FPL said that under the Financial Accounting Standard Board (FASB) Statement No. 71, the existing

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uncertainty of FPL's recovery of the litigation costs [illegible] result in it receiving a qualified opinion from its independent auditor in the absence of the Commission taking some action which would demonstrate that recovery of the litigation costs was "probable" as that term is defined for these purposes. Furthermore, FPL stated that an impending amendment to FASB Statement No. 71 would require a showing that recovery was "likely to occur." FPL asserted that failure to receive such an assurance would, under the proposed amendment, result in it having to write off the entire cost of the new generator replacements as well as all accumulated AFUDC if it did not receive an "except for" opinion on its financial statements which would preclude the use of those statements in Securities Exchange Commission filings.

A second changed circumstance FPL noted was that the anticipated length of the Turkey Point litigation, originally thought likely to be concluded by 1985, was now being projected to be concluded in 1988 at the earliest.

In the face of these changed circumstances, FPL requests that we now consider the prudence of the litigation efforts with regard to the Turkey Point steam generator replacements and we

1. Determine that FPL is entitled to recover the repair costs together with deferred depreciation and AFUDC accumulated until the effective date of a change in base rates allowing the recovery of such costs.

2. Continue the accumulation of deferred depreciation and AFUDC until FPL's base rates are next changed at which time these amounts would be placed in rate base.

3. Determine that the total accumulated deferred depreciation and AFUDC will be amortized over five years beginning when FPL's base rates are next changed to allow recovery of the repair costs, and

4. Grant such other relief as is reasonable and appropriate.

With regard to the unrecovered Martin Reserve costs, FPL stated that it had just several motions for summary judgment in its suit against the designers and builders of the Martin Reservoir, which decisions were upheld on appeal. The effect of the federal court's ruling was that the potential liability of the design engineer, Mid Valley, Inc., was limited to $50,000 of property damage insurance. Mid Valley, Inc. is required by contract to carry. Faced with a maximum possible recovery of only $50,000 versus the cost of continuing the litigation, FPL successfully sought dismissal of the suit. Thus, FPL submitted that the precondition for a Commission resolution of prudence on the Martin Reservoir had been met. In its Petition regarding the Martin Reservoir repair and enhancement costs not included in rate base, FPL requested that the Commission

1. Include the total accumulated investment and deferral associated with the repair and enhancement of the Martin Plant reservoir site as of December 31, 1985 in rate base.

uncertainty of FPL's recovery of the litigation costs ... result in it receiving a qualified opinion from its independent auditors in the absence of the Commission taking some ... which would demonstrate that recovery of the litigation costs was "probable" as that term is defined for GAAP purposes. Furthermore, FPL stated that an impending amendment to FASB Statement No. 71 would require a showing that recovery was "likely to occur." FPL asserted that failure to receive such an assurance could, under the proposed amendment, result in it having to write off the entire cost of the Turkey Point generator replacements as well as all accumulated AFUDC if it did not receive an "except for" opinion on its financial statements, which would preclude the use of those statements in Securities Exchange Commission filings.

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2. Continue the accumulation of deferred depreciation and AFUDC until FPL's base rates are next changed at which time these amounts would be placed in rate base.

3. Determine that the total accumulated deferred depreciation and AFUDC will be amortized over five years beginning when FPL's base rates are next changed to allow recovery of the repair costs; and,

4. Grant such other relief as is reasonable and appropriate.

With regard to the unrecovered Martin Reservoir ... FPL stated that it had lost several motions for summary judgment in its suit against the designers and builders of the Martin Reservoir, which decisions were upheld on appeal. The result of the federal court's ruling was that the potential liability of the design engineer, Mid-Valley, Inc., was limited to $50,000 of ... liability damage insurance Mid-Valley, Inc. was required by contract to carry. Faced with a maximum ... recovery of only $50,000 versus the cost of ... litigation, FPL successfully sought dismissal of the suit. Thus, FPL submitted that the precondition to ... resolution of prudence on the Martin Reservoir has been met. In its Petition regarding the Martin Reservoir repair and enhancement costs not included in rate base, FPL requested that the Commission:

1. Include the total accumulated investment and deferrals associated with the repair and enhancement of the Martin Plant reservoir site as of December 31, 1985 in rate base.

effective January 1, 1986;

2. Terminate the accrual of AFUDC and the deferral of depreciation coincident with the inclusion of these costs in rate base;

3. Determine that the accumulated deferred depreciation and AFUDC be recovered through a five year amortization when FPL's base rates are next changed; and

4. Grant other relief found reasonable and proper.

Prehearing Activities

Due to the similarity of accounting issues, these two dockets were consolidated for hearing. Prior to hearing, the Office of Public Counsel proposed three issues which dealt with the potential adjustment of FPL's return on equity. As is reported in Order No. 15624-A, Commissioner Wilson, as Prehearing Officer, struck two of the issues because they fell outside the scope of the dockets, but restated the third to raise an issue (No. 5 in the proceeding) concerning the appropriate carrying charge (AFUDC rate) to be applied to the Turkey Point steam generator repair costs. In a related matter, FPL later filed a Motion to Exclude or Strike the Prefiled Testimony and Exhibits of David Parcell and a Portion of the Testimony of Hugh Larkin claiming that these Public Counsel witnesses had violated the terms of Order No. 15624-A by Mr. Larkin's use of Mr. Parcell's suggested rate of return on equity to assess the reasonableness of FPL's current rates and the adequacy of its earnings. As is reported in the Prehearing Order, Order No. 16175, Commissioner Wilson viewed Public Counsel's voluntary withdrawal of certain of Mr. Parcell's testimony as meeting one of FPL's objections. He also ruled that Mr. Larkin's testimony would be heard as prefiled, that the parties would be required to brief Issue 11 in post-hearing briefs and that the Commission at its Agenda Conference on this case would rule on Issue 11 to determine the extent to which Mr. Larkin's testimony would be considered in deciding the remaining issues.

The Hearings

Joint hearings were held in Dockets Nos. 850782-EI and 850783-EI in Tallahassee on June 5-6 and July 16, 1986. At the hearings, Public Counsel sponsored three witnesses: Mr. Hugh Larkin, Jr., a consultant with Larkin & Associates, Certified Public Accountants; Dr. David Parcell, an economics consultant with Technical Associates, Inc. and Mr J. Patrick Parrish, a consulting engineer with Parrish Engineering, Inc. The testimony of Mr. Charles R. Skinker, Jr., a retired professional engineer sponsored by Public Counsel, was inserted in the record without Mr. Skinker appearing. FPL presented the following witnesses: Mr. C. O. Woody, Group Vice President, Nuclear Energy of FPL; Mr. William F. Swiger, Consulting Engineer of Buhl, Idaho; Mr. Howard James Dager, Jr., Vice President in charge of Power Plant Engineering, General Engineering, Construction and Project Management of FPL; Mr. Wilfred E. Coe, Vice President in charge of Fuel Resources, Power Supply and System Planning of FPL; Mr. Gerald M.

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Florence, Insurance Consultant and Director of Administration of Southeast Toyota Distributors, Inc., Mr. E. L. Hoffman, Manager of Research and Regulatory Accounting of FPL, and Mr. Homer . Williams, Jr., Comptroller of FPL. Additionally, the testimony of the following FPL witnesses was inserted in the record without them being required to appear: Mr. Charles L. Ballard, Director of Corporate Contracts of FPL, Mr. Sidney S. Grainger, Senior Project Manager in the Power Plant Engineering Department of FPL, Mr. Carl E. Falk, Sr., Consulting Professional Engineer with S. Levy Incorporated, and Mr. H. Thomas Young, Project Site Manager at the Turkey Point Nuclear Plant of FPL. Nineteen exhibits, many of which were composites, were received into evidence. The transcript of the proceedings comprises approximately 900 pages.

The Stipulated Agreement

Subsequent to the hearings in this case but prior to our consideration of the matter at our Agenda Conference, our Staff and FPL entered into an Agreement (Appendix A), which, if approved by us, would resolve several of the issues in these dockets. Having reviewed the Agreement, we find that its terms are reasonable and that approving it would be in the public interest. Accordingly, we approve the Agreement and shall indicate in the remainder of this Order the issues affected by it.

Turkey Point Steam Generator Repair Costs

In November, 1965, FPL contracted with Westinghouse to provide the nuclear steam supply system (NSSS) and turbine generators for Turkey Point Units Nos. 3 and 4. At the same time FPL contracted with the Bechtel Corporation to provide design engineering, procurement and construction services for the balance of plant. Turkey Point Unit No. 3 began commercial operation on December 4, 1972 at a cost of $107 million. Turkey Point Unit No. 4 began commercial operation on September 7, 1973 at a cost of $98 million.

Over the course of the next several years, Westinghouse steam generators suffered a number of corrosion problems. To combat these problems Westinghouse recommended a series of changes in the water chemistry for the secondary water system which runs through the steam generator. While the various changes in water chemistry specifications met varying degrees of success in solving the corrosion problems they were introduced to address, in each instance the change in water chemistry gave rise to another corrosion problem.

The most serious corrosion problem experienced at the Turkey Point steam generators was denting of the steam generator tubes due to corrosion of the carbon steel tube support plates. Denting was first evident at the Turkey Point units in March, 1975. As a result of the denting problem, FPL began plugging steam generator tubes at its Turkey Point nuclear units. By late 1976, it was clear that the steam generators would have to be overhauled or replaced. Because of economic and safety considerations, FPL chose to replace the existing steam generators.

In June, 1981, FPL took advantage of an unrelated but lengthy outage due to an electrical generator failure and began

Florence, Insurance Consultant and Director of Administration of Southeast Toyota Distributors, Inc.; Mr. E. L. Hoffman, Manager of Research and Regulatory Accounting of FPL; and Mr. Homer P. Williams, Jr., Comptroller of FPL. Additionally, the testimony of the following FPL witnesses was inserted in the record without them being required to appear: Mr. Charles L. Ballard, Director of Corporate Contracts of FPL, Mr. Sidney S. Grain, Senior Project Manager in the Power Plant Engineering Department of FPL, Mr. Carl E. Falk, Sr., Consulting Professional Engineer with S. Levy Incorporated, and Mr. H. Thomas Young, Project Site Manager at the Turkey Point Nuclear Plant of FPL. Nineteen exhibits, many of which were composites, were received into evidence. The transcript of the proceedings comprises approximately 900 pages.

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Subsequent to the hearings in this case but prior to our consideration of the matter at our Agenda Conference, our Staff and FPL entered into an Agreement (Appendix A), which, if approved by us, would resolve several of the issues in these dockets. Having reviewed the Agreement, we find that its terms are reasonable and that approving it would be in the public interest. Accordingly, we approve the Agreement and shall indicate in the remainder of this Order the issues affected by it.

Turkey Point Steam Generator Repair Costs

In November, 1965, FPL contracted with Westinghouse to provide the nuclear steam supply system (NSSS) and turbine generators for Turkey Point Units Nos. 3 and 4. At the same time FPL contracted with the Bechtel Corporation to provide design engineering, procurement and construction services for the balance of plant. Turkey Point Unit No. 3 began commercial operation on December 4, 1972 at a cost of $107 million. Turkey Point Unit No. 4 began commercial operation on September 7, 1973 at a cost of $98 million.

Over the course of the next several years, Westinghouse steam generators suffered a number of corrosion problems. To combat these problems Westinghouse recommended a series of changes in the water chemistry for the secondary water system which runs through the steam generator. While the various changes in water chemistry specifications met varying degrees of success in solving the corrosion problems they were introduced to address, in each instance the change in water chemistry gave rise to another corrosion problem.

The most serious corrosion problem experienced at the Turkey Point steam generators was denting of the steam generator tubes due to corrosion of the carbon steel tube support plates. Denting was first evident at the Turkey Point units in March, 1975. As a result of the denting problem, FPL began plugging steam generator tubes at its Turkey Point nuclear units. By late 1976, it was clear that the steam generators would have to be overhauled or replaced. Because of economic and safety considerations, FPL chose to replace the existing steam generators.

In June, 1981, FPL took advantage of an unrelated but lengthy outage due to an electrical generator failure and began

the replacement of the steam generators on its Turkey Point Unit No. 3. The electrical generator was repaired by February, 1982, but the steam generator outage continued until April 10, 1982 when Unit No. 3 was restored to commercial operation. The total duration of the steam generator replacement outage for Turkey Point Unit No. 3 was 290 days. On October 9, 1982, replacement of the steam generators at Turkey Point Unit No. 4 began, and the replacement was completed on May 16, 1983. Building on its experience from the steam generator replacement on Unit No. 3, FPL reduced the outage of Unit No. 4 to 218 days, an improvement of 72 days.

As of December 31, 1985, FPL's investment in the steam generator replacements at Turkey Point Units Nos. 3 and 4 was:

Unit	Total Company	Jurisdictional
No. 3	$ 89,045,560	$ 86,648,213
No. 4	75,912,666	73,868,892
Total	$ 164,958,226	$ 160,517,105

Additionally, because these amounts had not been placed in rate base, FPL had accumulated $15,897,960 of deferred depreciation and $55,215,117 of AFUDC associated with this investment through December 31, 1985.

Turkey Point Issues

Issue 1: Were the costs to repair the Turkey Point steam generators prudently incurred?

FPL presented expert testimony showing that it was prudent in its selection of Westinghouse to design and manufacture the original steam generators at Turkey Point. These witnesses also testified that FPL had operated the steam generators prudently and consistent with Westinghouse's specifications but that the steam generators had still experienced irreversible, continuing corrosion damage. FPL witnesses stated that the utility had acted prudently in determining to replace the steam generators as the most effective response to the corrosion damage. They testified, further, that the steam generator replacements were carried out efficiently and expeditiously, which has allowed these units to continue to produce economical power for the benefit of the utility's customers.

Our Staff conducted an independent review of the steam generator failures and their replacements and took the position that the steam generator problem was the result of a generic design defect and, further, that the resultant repair costs were prudently incurred. Public Counsel took the position that he did not object to FPL's entitlement to recover the Turkey Point steam generator repair costs.

In view of the record in this case and the positions of the parties, we find that the costs to repair the Turkey Point steam generators were prudently incurred.

Issue 2: What is the total cost associated with repairing the Turkey Point steam generators?

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Issue 2: What is the total cost associated with repairing the Turkey Point steam generators?

Based upon the uncontroverted testimony of FPL's witnesses, I find that the total jurisdictional cost of repairing Turkey Point Units Nos. 3 and 4, including accumulated deferred depreciation and AFUDC, was $215,71[illegible] as of December 31, 1985.

> Issue 11: Whether it is legally permissible to order FPL to cease the accrual of a carrying charge and the deferral of depreciation associated with the Turkey Point steam generator replacements for the reasons advanced by Mr. Larkin?
>
> Issue 3: Should the Turkey Point steam generator repair costs be included in rate base immediately?
>
> Issue 4: Should FPL be allowed to continue to accrue a carrying charge for the Turkey Point steam generators?
>
> Issue 5: If the Commission determines that the cost to repair the Turkey Point steam generators was prudently incurred and that the accumulated costs and carrying charges should not now be put in rate base, what carrying charge rate should be applied?
>
> Issue 6: Should the depreciation expense for the steam generator repairs continue to be deferred?

As stated earlier, FPL asked that it be allowed to continue the accumulation of deferred depreciation and AFUDC on the steam generator repair costs until the effective date of a change in its base rates, at which time the repair costs would be placed in rate base and the total accumulated deferred depreciation and AFUDC would be amortized over five years. FPL submitted that this treatment was mandated by the Commission's earlier action of holding these costs out of rate base even though they had not been proven either unreasonable or imprudent and by the Commission's repeated assertions in its orders and in a Supreme Court brief that FPL would be allowed to continue the accrual of AFUDC until these costs were placed in base rates. FPL argued that denying it the treatment promised for the litigation items would be beyond the limits of our ratemaking authority and would represent impermissibly arbitrary action.

Public Counsel's Mr. Larkin argued that the replacement steam generator repair costs should be placed in rate base immediately and without a concurrent change in base rates. He said that such treatment was justified because current returns on equity for FPL were in the range of 13% to 14% as testified to by Public Counsel's witness Mr. David Parcell. Mr. Larkin argued that FPL's current rates were sufficient to allow FPL to earn a return in that range even if FPL's current revenues were compared to a rate base that included the costs related to the Turkey Point steam generators. Thus, Mr. Larkin and Public Counsel have urged that FPL should not be allowed [illegible] to defer current costs which will have to be borne by future ratepayers, when its current rates are sufficient to cover those same costs.

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We consider it unnecessary to answer the question of whether the steam generator repair costs can be placed in rate base immediately because FPL, which had the apparent right to insist that the costs stay out until its next rate case, has agreed with our Staff that these costs shall be placed in rate base as of January 1, 1987. Additionally, FPL agreed that the accumulation of deferred costs associated with the steam generator repairs would cease effective January 1, 1987. Pursuant to this Agreement, Public Counsel will see his position on this issue fulfilled and FPL's ratepayers will benefit from the cessation of the accrual of AFUDC and the deferral of depreciation on this substantial investment. We further believe this result to be in the best interest of FPL's ratepayers and approve it.

The Agreement obviates the need to decide if FPL should be allowed to continue to accrue a carrying charge for the Turkey Point steam generators as well as determining what that rate should be. Likewise, we are not required to address Issue 6, which asks whether the depreciation expense for the steam generator repairs should continue to be deferred.

The Agreement also provides that the recovery of the accumulated deferred costs associated with the litigation items shall commence with the effective date of new base rates established in a general rate proceeding for FPL and be amortized over five years. We have approved the Agreement because we believe it to be in the best interest of FPL's ratepayers and we accept the five year amortization schedule as being a reasonable portion of the integral agreement. Furthermore, the five year amortization is consistent with our Staff's recommendation that it is not appropriate to recapitalize depreciation expense that has already been taken.

Lastly, our approval of the Agreement negates the necessity of addressing whether it is legally permissible to order FPL to cease the accrual of a carrying charge and the deferral of depreciation associated with the steam generators since FPL has agreed that these actions shall cease as of January 1, 1987.

While the changed circumstances of this case required our early consideration of the repair costs, we expect FPL to vigorously pursue its litigation and credit the award, if any, to the benefit of its customers.

Martin Reservoir Repair and Enhancement Costs

The Martin Reservoir was designed to serve as a cooling pond for the waste heat from FPL's two 775 MW units located there. The surface area of the reservoir was approximately 6,700 acres and was formed by an encircling embankment or dam some 17.2 miles in length. The original dam was a homogenous embankment constructed of fine sand, which was compacted in layers to a crest elevation of 50 feet. The upstream face of the dam had a design slope of 2 to 1 and was protected against wave erosion by an exterior layer of soil-cement. The downstream face was constructed at a slope of 3 to 1 and was grassed for erosion protection.

The Martin Reservoir was designed and built by Mid-Valley, Inc., a wholly-owned subsidiary of Brown & Root, Inc. When FPL was preparing for the permitting of the Martin Reservoir in

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1972 it was already familiar with Mid-Valley's capabilities and was satisfied with its work in connection with a contract to build FPL's Sanford Units Nos. 4 and 5 and the associated cooling pond, as well as a contract to provide preliminary permit engineering for the Manatee cooling water reservoir. During the engineering and construction work on the reservoir, FPL utilized an independent board of experts, called the Board of Consultants, to review the work in an auditing and advisory capacity.

During the construction of the Martin Plant project FPL undertook a comprehensive risk management program entitled the Martin Project Risk Management Plan. This plan, which was effective January 1, 1974, provided coverage for workmen's compensation/employer's liability, comprehensive general liability, aggregate bodily injury, aggregate property damage and all risk, builders' risk property insurance. From the time FPL accepted Mid-Valley's proposal for design services for the Martin Reservoir in March, 1971 until the project insurance plan went into effect, FPL considered that its potential property damage at the reservoir site was minimal and relied upon the insurance provisions of the Mid-Valley contract then in effect. This contract limited Mid-Valley's liability for property damage to the $50,000 of property damage insurance required by the contract.

In November of 1974, some eight months after the issuance of the permits for construction of the embankment, FPL became aware that the Assistant Martin County Engineer, Mr. Skinker, had concerns about the design of the embankment. During the course of the next several years FPL attempted to address Mr. Skinker's concerns and convince him that the project was safe. Mr. Skinker's primary concern appeared to be over the location of the phreatic line (the line of saturation in the embankment) and the possibility of water seepage through an earthen embankment composed of native soils. In any event, whether Mr. Skinker's concerns were allayed or not, it appears that his superiors were satisfied with the design as all necessary permits were issued and the work continued to its completion. The Martin Reservoir was filled on April 4, 1978 after 57 days of pumping operations. From that date until it breached, FPL undertook a comprehensive inspection program of the reservoir that exceeded Mid-Valley's requirements.

At approximately 11:30 p.m. on October 30, 1979 some 600 feet of the embankment was washed away as the result of a breach that occurred in the vicinity of some old railroad borrow pits. Some $20 million in liability claims arose as a result of the flooding following the breach. Of these claims, FPL paid $750,000, which was the amount of its self-insured retention, while its insurance paid for the remainder.

Shortly after the breach, FPL commissioned a separate board of experts, independent of FPL, Mid-Valley and the Board of Consultants to conduct an investigation of the failure. This body, known as the Board of Review, ultimately concluded that the failure occurred by "piping" in the foundation material. Piping results when seepage at a downstream face of the embankment is fast enough to dislodge and carry away particles of soil. Over time a circular hole or "pipe" may develop which erodes its way into the embankment toward the source of water. The Board of Review could not definitively determine the cause of the piping but speculated that the most likely cause was "piping in shallow or moderate depth sand

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layers of the old railroad borrow pits." The railroad borrow pits were the source of railbed construction materials and were located in close proximity to the breach.

As a result of the investigations into the failure of the embankment, FPL determined that it should be redesigned to include: 1) filtered drains in the dam and its foundation; 2) upstream impervious blankets or cutoffs; 3) improved drainage systems; 4) enhanced monitoring instruments and more detailed surveillance and monitoring programs; and, 5) the complete filling of the railroad borrow pits.

The modifications to the embankment were substantial and required large portions to be completely rebuilt. Although FPL calculated that the repair and enhancement work would have taken some 18 months under a normal work schedule, it accelerated its operations and completed its work on the embankment by November 12, 1980. Filling operations began three days later and were completed by January 20, 1981. The testing of Martin Unit No. 1 began during the fill operations and that unit was placed into commercial service on December 22, 1980 in time to help meet the system peak.

As indicated at the beginning of this order, FPL spent over $78,000,000 repairing and enhancing the Martin Reservoir and over $77,000,000 of that was related to modifications designed to enhance the dam. In Order No. 11437, entered in FPL's 1982 rate case, we authorized FPL to include in its rate base $52,718,365 related to the Martin Reservoir repairs and enhancements. This amount represented the jurisdictional portion of $59,965,000 of plant in service, less $3,067,515 of accumulated provision for depreciation, which we concluded would have been the additional cost to build the enhanced reservoir had the enhancements been included when the original reservoir was constructed instead of four years later. The balance, now increased by AFUDC to $19,805,717 as of December 31, 1985 that has been excluded from rate base and which is at issue here was composed primarily of the effects of escalation due to enhancing the reservoir four years later than the original installation, overtime payments resulting from the accelerated work schedule, a $1,419,423 deficit between the Direct Costs of Reservoir Repairs and Insurance Recovery of Property Damage to the Reservoir, and duplicated costs, among some others.

Martin Dam Issues

Two of the remaining issues in this case involve whether FPL should have more completely protected itself from loss in its contract with Mid-Valley and FPL should have changed the design of the original embankment based upon the concerns of Mr. Skinker, the Assistant County Engineer and whether

> Issue 7: Was FPL prudent in entering into a contract with Mid-Valley that limited Mid-Valley's liability for the negligent performance of the contract given the low levels of insurance required of Mid-Valley in the contract?

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FPL's position is that Mr. Parrish, an engineer, offered opinions well beyond his limited area of expertise. Specifically, FPL says that Mr. Parrish's opinion on the probability of its legal success was offered without a proper and expert knowledge of either the applicable legal principles or engineering facts of the case. Secondly, FPL states that Mr. Parrish's judgment on the adequacy of its insurance program was based upon an incomplete understanding of insurance practices in general and the Martin insurance plan in particular. FPL adds that it meets Mr. Parrish's test of prudence in that it did obtain "adequate insurance" to protect itself and its customers from the potential cost of damages arising from Mid-Valley's design errors, omissions or negligence. FPL submits that simply because there are some costs that were ultimately not covered by insurance, does not mean that the insurance was inadequate. FPL says that such logic requires an exercise in hindsight, which the Supreme Court has found inappropriate.

FPL also argues that it is important to keep in mind how effectively the Martin insurance plan operated. Specifically, it says that beyond its deductible the plan paid $19,400,101 of claims by third parties against FPL for losses due to the breach. Additionally, the property damage policy was sufficient to pay for insurable property losses to the Martin site in the amount of $5,350,000. In total the Martin insurance plan paid for almost $25 million of losses.

FPL supports its claim of prudence by arguing that the limitation of liability to the $50,000 of insurance coverage was only material during the period prior to the implementation of the project insurance plan. Importantly, FPL says that this short period of time involved planning and design activities that presented very little potential for property damage. FPL argues that once the project insurance plan was in effect, requiring individual contractors, such as Mid-Valley, to carry additional property damage insurance could have resulted in overlapping or redundant coverage and unnecessary expense.

FPL stresses that requiring Mid-Valley to have had additional property insurance would not have yielded any additional insurance recovery to FPL because its own insurance fully responded to and covered all losses insurable under a property insurance policy. The key point here being that the vast majority of the $19 million at issue here was related to enhancement costs. The enhancement costs, in turn, were a result of the decision to build a better dam the second time

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FPL stresses that requiring Mid-Valley to have had additional property insurance would not have yielded any additional insurance recovery to FPL because its own insurance fully responded to and covered all losses insurable under a property insurance policy. The key point here being that the vast majority of the $19 million at issue here was related to enhancement costs. The enhancement costs, in turn, were a result of the decision to build a better dam the second time

and not solely as a result of the breach in the original dam. Since the enhancements were improvements to the property, and not a loss, they were not insurable.

While FPL acknowledges that it might have been possible for it to carry errors and omissions (E&O) insurance or to require Mid-Valley to carry it, it states that its insurance witness, Mr. Florence, the only insurance expert to testify, listed numerous reasons why property insurance was preferable to E&O insurance. Additionally, Mr. Florence testified that even if Mid-Valley had, it could have obtained E&O coverage, only small amounts of coverage would have been available. He added that if E&O coverage had been required and available, it might have resulted in the recovery of some $2.8 million of the $19.8 of costs at issue here but only after surmounting substantial hurdles, such as proving Mid-Valley's negligence caused the damages, sufficient policy limits, and no change in insurance, among others. Even if these hurdles were overcome, Mr. Florence testified that he thought that this maximum potential recovery would have to be offset by the cost of premiums FPL would have to pay ($400,000) and the cost of litigation to secure a recovery ($1,300,000). Mr. Florence concluded that requiring Mid-Valley to carry E&O coverage would have been money very poorly spent.

As pointed out by Public Counsel, a significant problem in reviewing the insurance issue is the fact that most, if not all, of the individuals responsible for contract negotiations are deceased. We cannot change that fact and, thus, we must attempt to analyze the issue in terms of the record presented to us. In doing so, we must determine whether FPL's decision was reasonable and prudent considering what the decision-makers knew or reasonably could be expected to know at the time of the decision.

Considering this standard and the record in this case, we find that FPL's insurance coverages were reasonable and prudent. In doing so, we find that FPL reasonably protected itself and its customers by placing its own property insurance rather than relying on an architect/engineer contract without a limitation of liability clause. Further, we find that the decision was consistent with the industry practice, as testified to by Mr. Florence, of architects and engineers seeking to limit their liability in cases involving large projects, where a single failure could bankrupt a design firm.

> Issue 8: Should FPL have changed the design of the reservoir when the Assistant County Engineer (Mr. Skinker) raised questions about the reservoir embankment?

As noted earlier, Mr. Skinker, the Martin County Assistant Engineer, raised some concerns about the embankment early in the permitting process and the embankment did, in fact, ultimately fail.

While it may be appealing to consider Mr. Skinker's concerns prophetic, our task is to determine whether Mr. Skinker's concerns were relevant to the ultimate failure and, then, even if they were, whether FPL's response to his concerns was reasonable and prudent under the circumstances.

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William F. Swiger, a witness in this case, who is a consulting engineer and former Vice President and Senior Consulting Engineer of Stone and Webster Engineering Corporation. Mr. Swiger is a Civil Engineer and holds a Master of Science from Harvard University with a major field of study in soil mechanics and foundation engineering. During his career, Mr. Swiger had the responsibility for the design of a number of major embankment dams and served as a consultant on design for a large number of other major dams, including the Martin Dam. Mr. Swiger has participated in the investigation of the failure of seven dams. Other members of the Board of Review included two Professors of Civil Engineering and a retired geologist from the U. S. Army Corps of Engineers.

As discussed earlier, this body concluded that the breach in the embankment occurred from "piping" that most likely resulted from the proximity of a portion of the embankment to the old railroad borrow pits. In very simple terms, this board of experts concluded that the most likely cause of the breach was that a very small segment of the 17.2 mile embankment had been built over or too close to an inadequate foundation. They concluded the railroad borrow pits then precipitated the underground piping that caused the breach.

Mr. Skinker's concerns or reservations focused on the design of the reservoir embankment and the ability of water to seep through the earthen embankment itself. However, the record in this case demonstrates that the cause of the failure and the breach was not seepage through the embankment but rather through the foundation soils below the embankment. Our review of the record discloses that FPL acted reasonably and prudently in addressing the concerns raised by Mr. Skinker. We, therefore, find that there is no record basis for a finding that FPL acted either unreasonably or imprudently by not changing the design of the original dam as a result of Mr. Skinker's questions.

> Issue 9: Should the repair and enhancement costs ($19,805,717 - Total Company, $19,272,494 Jurisdictional) and accumulated deferred charges ($2,726,400 - Deferred Depreciation; $9,917,689 AFUDC) associated with the Martin Reservoir be placed in rate base?

The evidence in the record of this case concerning the prudence of the Martin Reservoir costs is uncontroverted with the exception of the insurance issue and Mr. Skinker's concerns, which we have resolved. That evidence reveals the propriety of FPL's initial decision to build a reservoir as well as the manner it selected and supervised the designer and builder. Further, the record discloses the propriety of modifying the dam following its breach and the decision to accelerate the construction of the enhanced dam so that the Martin Plant would be available to help meet an expected winter peak. Lastly, the record discloses no basis for defalcating that any of the costs of building the enhanced dam were imprudent or unreasonable. Accordingly, we find that the $19,272,494 (jurisdictional as of December 31, 1985) associated with the Martin Reservoir repairs and enhancements were reasonably and prudently incurred and should be included in rate base. Additionally, we find that the accumulated deferred costs associated with the Martin Reservoir shall be deemed to have ceased as of January 1, 1986. The recovery of

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In view of the above, it is

ORDERED by the Florida Public Service Commission that Florida Power and Light Company's Petitions regarding the Turkey Point Steam Generator Repair Costs and Martin Reservoir Repair and Enhancement Costs are granted as described in the body of this Order. It is further

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ORDERED that the costs associated with the Martin Reservoir and the Turkey Point Steam Generator Repairs shall be placed in rate base effective January 1, 1986 and January 1, 1987, respectively. It is further

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ORDERED that the tax savings due to the reduction of the Federal corporate income tax rate effective July, 1987, not otherwise subject to refund pursuant to Rule 25-14.03, Florida Administrative Code, will be sufficient to provide the revenue requirements for the litigation costs included in rate base. It is further

ORDERED that the Agreement entered into between Florida Power and Light Company and the Commission Staff and appended to this Order is approved. It is further

ORDERED that this docket be closed.

BY ORDER of the Florida Public Service Commission this 2nd of December, 1986.

STEVE TRIBBLE, DIRECTOR
Division of Records and Reporting

(S E A L)

MRT

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Commissioner Herndon Dissents

I respectfully dissent regarding the finding that FP&L was prudent in entering into a contract with Mid-Valley which limited the latter's liability for negligent performance. I also dissent with regard to the Commission's related inclusion into rate base of repair and enhancement costs for the Martin County Reservoir.

My dissent should not be construed as reflecting a belief that FP&L was imprudent. Rather, I am of the opinion that, due to the absence of any witnesses who were actually parties to the contract negotiations, no decision can be reached. I submit that the Commission is unable to determine whether FP&L was prudent or not from the available evidence. Without more compelling evidence, I cannot concur with my colleagues' conclusions.

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes (1985), to notify parties of any administrative hearing or judicial review of Commission orders that may be available, as well as the procedures and time limits that apply to such further proceedings. This notice should not be construed as an endorsement by the Florida Public Service Commission of any request for further proceedings or judicial review, nor should it be construed as an indication that such request will be granted.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within 15 days of the issuance of this order in the form prescribed by Rule 25-22.60, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court by the filing of a notice of appeal with the Director, Division of Records and Reporting and the filing of a copy of the notice and the filing fee with the Supreme Court. This filing must be completed within 30 days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

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AGREEMENT

Florida Power & Light Company ("FPL") and the Staff of the Florida Public Service Commission ("Staff") in recognition of: FPL's continued expressed need to obtain a decision by the Florida Public Service Commission ("Commission") in Dockets 850782-EI and 850783-EI prior to the end of 1986; the reduction of the Federal Corporate Income Tax Rate effective July 1987 ("Income Tax Rate Reduction"); and the consequences of a continued accrual of Allowance for Funds Used During Construction ("AFUDC") on the costs and investments which are the subject of Dockets 850782-EI and 850783-EI agree as follows:

1. The accrual of AFUDC on the investment in the facilities which are the subject of Dockets 850782-EI and 850783-EI ("Litigation Items") and the deferral of depreciation thereof shall cease effective January 1, 1987 and January 1, 1986 respectively.

2. The costs associated with the Litigation Items in Dockets 850782-EI and 850783-EI which the Commission allows the Company to recover from retail ratepayers, together with the accumulated deferred costs (collectively referred to as "Litigation Costs") shall be placed in the rate base of FPL effective January 1, 1987 and January 1, 1986 respectively; it being understood that the accumulation of deferred costs associated with the Litigation Items which are the subject of Docket 850783-EI will cease effective January 1, 1986 and the accumulation of deferred costs which are the subject of Docket 850782-EI will cease effective January 1, 1987.

3. The recovery of the accumulated deferred costs associated with the Litigation Items found appropriate by the Commission shall commence with the effective date of new base rates established in a general rate proceeding for FPL and be amortized over five years.

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4. The Commission will find that tax savings due to the Income Tax Rate Reduction not otherwise available for refund pursuant to Rule 25-14.03 will be sufficient to provide the revenue requirements associated with Litigation Costs; it being understood that any refund or other adjustment resulting from the Income Tax Rate Reduction for 1987 shall be calculated consistent with the method prescribed by current Rule 25-14.03 and fully reflect the inclusion of all Litigation Costs in FPL's rate base and the expenses associated with the Litigation Items.

5. It is understood that a Commission' determination that the agreements contained herein are appropriate and implementation thereof by Commission Order shall not be precedent in any future proceeding except as provided herein.

Dated this 30 day of October, 1986.

Florida Power & Light Company

By

Florida Public Service Commission Staff

By

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

Proceedings to Implement Cogeneration Rules.

DOCKET NO. 830377-EU

MORNING SESSION - 2nd DAY

VOLUME IV

Pages 434 through 625

FPSC Hearing Room 106
Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32301

Thursday, January 19, 1984

Met pursuant to adjournment at 9:00 a.m.

BEFORE: COMMISSIONER JOSEPH P. CRESSE
COMMISSIONER JOHN R. MARKS, III

APPEARANCES:

(As heretofore noted.)

REPORTED BY: CAROL C. CAUSSEAUX, CSR, RPR
JOY KELLY, CSR, RPR
Official Commission Reporters

638-1 Attachment 2

A That is one of the facts that comes with the territory of deriving joint ownership benefits.

Q All right, and that then led you to put aside St. Johns Unit No. 1 as the potential avoided unit on your system and led you to Martin 3, is that correct?

A Yes. When one concludes all the cancellation costs and quickly makes an assessment, even if the unit can be cancelled the residual costs which occur, you can clearly see that they are substantially less than the cost of oil.

Further, I would like to point out another reason why I have been led to the conclusion that these are not a resonable candidate. The in-service date of this unit is 1987. As the rule clearly provides, commitments must be made two years prior to the in-service date of the unit and, as the final order on the previous docket identifies, there must be sufficient confidence, greater confidence, that sufficient cogeneration capacity, or qualifying facility capacity, will be available to defer the construction of the unit. That puts us to 1985, January 1 of 1985, as the date where we would have to have capacity to defer that unit. That is just an additional factor.

Q Mr. Denis, I would like to talk to you about Martin 3 now. As I understand your prefiled testimony, you have indicated that you currently have an in-service date of that unit as January 1, 1993, is that correct?

A The analysis performed absent cogeneration pursuant to the rules leads us to that conclusion.

Q All right. What was the original in-service date of Martin 3?

A I would think approximately 1986. I don't know the month by initially 1986.

Q What lead you to conclude that without cogeneration, as you were requested to do in your interrogatories, the in-service date should be deferred from 1986 to 1993?

A Based on planning analysis and criterias applied, as described in the interrogatory, it was determined that the absence of the cogeneration, firm cogeneration capacity which was expected would cause that unit to be accelerated one year from a planning perspective, not from a company commitment perspective.

Q Well, sir, I am just trying to make sure that you followed the procedure that we asked you to in the interrogatories, and that was to analyze your system needs and your available capacity resources and determine when you would need another unit if you had no firm capacity commitments from cogenerators. I take it that your response is that in doing that you arrived at the January 1, 1983 date?

A Yes, correct.

Q Now, as I understand it, before you performed that analysis that we asked you to in the interrogatories, I

believe the company had previously earlier in-service dates for Martin 3?

A Yes.

Q And I want to know if you made the decision to defer to 1993 from those earlier dates in part in reliance on any firm cogeneration capacity.

A Not at the time those decisions were made. Cogeneration projections were not included in our company's planning projections.

Q Well, if you did not defer it on the basis of cogeneration, what was the basis for the deferral until 1993?

A During the early part of 1981, as we all recall, and some of the escalating oil prices, the significant issue was the oil backout, which still is. At that time we entered into purchases of coal power from the Southern System, approximately 2000 megawatts. In addition to that, as we have gone through time and as we have all experienced, there have been drops in customer use. The forecast has also changed. So it is a combination of the dropping of the forecast and increasing resources.

Q (By Ms. Davis) So then it is your testimony that you got to the 9th from the mid '80s in-service date to the 1993 date due to reductions in your load and to the purchase of firm capacity from Southern System?

A Yes.

Q During that time, did you have any commitments for firm capacity supplies from any cogenerator or small power producer?

A No.

Q Now, I'd like to talk to you about your estimated cost of Martin 3 that's contained in Appendix I. Commissioners, that's been marked for identification as Exhibit 5-G.

COMMISSIONER CRESSE: There's a bunch of pages.

MS. DAVIS: Yes, sir, and the page that I'm interested in asking some questions about, first of all is Interrogatory No. 19 which is the last one. And I would like to direct your attention to Page 2 of 15 of Interrogatory No. 19.

Q (By Ms. Davis) My question is that interrogatory response there shows that you have estimated that a cost in 1983 dollars of Martin 3 of $1,141 per kilowatt. In arriving at this cost estimate, how did you treat common costs?

A You're referring to the first column under Unit 3. I would have to say the common costs are included in that.

Those are the costs being incurred with the construction and accounted for in the construction of Unit 1 and includes some common facilities.

Q Now is it your position that it's that cost estimate that we should use in pricing cogeneration capacity?

A No, it is not. As I clarified on Issue No. 5 I believe it was, I believe the common costs or even economy of scale costs or whatever costs should be allocated equally among the units at the site.

Q So then for cogeneration pricing purposes, looking on Page 2 of 15, you would use the cost of $1,006 per kw?

A Yes, I would for that site.

Q All right. Now this page shows that you have a cost of $2,460 per kw as of your in-service date of 1993. Can you tell us what costs you estimated in the oil backout docket for Martin 3 when you, I believe, had an estimated in-service date of 1987?

A That will take a minute to calculate. Approximately $2807.

Q Now, does your $2807 estimate in 1987 include common costs?

A Yes, it did.

Q So it's directly comparable to the 2460?

A As far as the base estimate, yes, the components.

Q Can you please tell me what caused you to change

your estimate from 1987 to the time when you prepared your response to this interrogatory such that your estimated cost for Martin 3 dropped to the extent that it did?

A Yes, very simply put it boils down to two and that is the assumptions used to carry the costs from present day costs on out through time. At the time the assumptions for future escalation of plant cost was 8½%, in this docket our estimate incurred estimated use for company planning is 6½% or 6.23 I believe is the right figure.

Also, at the time, if you will recall inflation was at higher rates, marginal cost of capital and the outlook of the future cost of capital was significantly greater. We were looking at 17% AFUDC rates; we're looking at 14% rates AFUDC currently. We believe we made the best projection we could at the time. We also believe now that we're making the best projection that we can which only proves the worth of projections, which is one of the problems associated with trying to set a price here today. It's uncertainty.

Q So then you explain the difference between those two estimates as being due solely to different assumptions with regard to inflation and your cost of capital?

A Yes. The base estimate design for the plant is identical.

Q Now, would you please flip over to Page 9 of 15.

A Yes.

Q Does that show that in arriving at your current estimate of cost of Martin Unit No. 3 that you assumed an 18% cost of equity?

A Yes.

Q What is your current approved cost of equity?

A I couldn't say with certainty, but it's 15.85 or 15.65, somewhere in there; subject to check.

Q Would you agree then that using an 18% cost of equity would affect both the value of deferral payments that a QF would receive and the AFUDC rate that would be used to compute the plant in-service cost?

A A change in the cost of capital assumption does change the cost of the unit, yes.

Q What is your current AFUDC rate?

A Approved embedded?

Q Yes.

A I do not know.

Q All right. Let me ask you this: Is the AFUDC rate that you assumed in making your estimate of Martin 3, 14½%?

A Yes, it's an incremental AFUDC rate. It has been calculated in this fashion for purposes of economic analysis. There may be little relationship to the way that the company's actual -- for book purposes AFUDC rate is computed.

Q Mr. Denis, why did you assume that your Martin

Unit 3 plant would use or would have heat rate of 10,500 BTUs per kilowatt hour?

A That is based on planning studies and we do not have any experience with coal units. It's an estimate based on planning studies; it's based on information derived from other utilities, information submitted to this Commission as part of an annual planning workshop and so forth. It is purely an estimate of a scrubber unit.

Q All right. If you flip back to Page 5 of 15, you indicated there that you estimated $14.47 per kw per year as O&M associated with Martin 3.

A Yes.

Q Is that simply fixed O&M?

A No. You know, again, we get into the issue of categorizing O&M and into fixed O&M and variable O&M and we may all be talking past each other as to what is what. I will tell you how that cost was derived and just give you an assessment.

In order to derive expected or projected O&M costs we looked at units in our system of similar size and the O&M costs of those units. Mainly the Manatee Units. A three-year average of the O&M -- total O&M costs associated with that unit were established.

A study had been done by our Power Resources Department and looking at the staffing levels and manpower

levels associated with other coal facilities around the country of similar design. It was determined that the staffing level is 2.6 times greater than that required for a similar oil unit. So O&M costs, all O&M costs were multiplied by a factor of 2.6.

In addition to that it was determined the quantity of limestone that would be used for the scrubbers since this would be a scrubber unit, was determined and estimated and then added into this total cost. So we arrrived at a total cost, not a component cost.

Q Do you think it's proper to estimate your expected O&M costs for a coal unit from one of your oil-fired units?

A It was evidently justified to our personnel who did this study and looking at total O&M costs and then looking at a gross-up factor based on personnel on the site on payroll.

Q How did you get the 2.6? I mean I take it that that's what you used to translate from an oil-fired to a coal-fired plant, is that right?

A Yes. It was basically on an industry survey, a survey of other utilities.

Q So you compare your result of 14.47 to the estimated cost of, for example, TECO?

A Yes, it's significantly lower, I admit that.

Q All right.

A By order of magnitude, twice I believe.

Q Do you have any opinion as to why it's about half of what TECO estimated?

A Why TECO's is twice as much as ours?

Q Uh-huh.

A No, I do not.

COMMISSIONER CRESSE: Let me get a point square in my mind just how much difference there is. If I understand correctly you have a 1993 cost estimate of 2559 a year?

WITNESS DENIS: Yes, sir.

COMMISSIONER CRESSE: And that's approximately $2.14 and TECO is 4.41; is that right, a month; TECO's estimate I believe is on Page 7 of the prehearing order, is that correct? And they have 4.41.

MS. DAVIS: 4.49.

COMMISSIONER CRESSE: Pardon?

MS. DAVIS: 4.49.

COMMISSIONER CRESSE: Avoided O&M costs, yeah, for TECO is 1993 -- excuse me that's 4.77.

MS. DAVIS: 4.77.

COMMISSIONER CRESSE: Okay, I was looking at the staff column.

WITNESS DENIS: Again, I would say and I would not characterize that their numbers are wrong or our numbers are wrong, it's one of those areas that in the State of

Florida there is just no -- there is no experience with a scrubber unit, and I would submit that one easy way to take care of this is to tie it to an actual index or use actual O&M costs incurred and that way we don't have to be guessing as to what's the appropriate number.

Q (By Ms. Davis) All right. On Page 6 of the pre-hearing order you indicate, or it is indicated that the company agrees with the plant and O&M escalation rates proposed by staff. Is that a correct statement of your position?

A Yes. They appear in reasonable range as to the numbers that have been submitted.

Q If you look back on Page 6 of 15 of your interrogatory response, No. 19, and Page 7 that shows a different set of plant and O&M escalation rates, did you use the escalation rates shown in your interrogatory response to compute your estimate of Martin 3?

A Yes, I did.

Q If you use the ones prepared by staff, do you think your estimate would be lower?

A The plant escalation rate, they really look to me to be very close -- unless I compound out the numbers for the ten years and tell you exactly if the compounding of the number turns out to be lower of course the answer is yes.

Q All right.

A For the O&M it appears that they would be lower. Again, it would be close. Our reason for stipulating to the numbers is I think they are within the range of reasonableness.

Q Okay. Mr. Denis, in view of the fact that the Commission this morning identified an additional issue as what should we do if we get enough comitted capacity to defer MacInnes Unit 1 for at least ten years, and in view of the fact that you have testified that you believe the in-service date for Martin No. 3 is January 1st 1983, I conclude that you may very well have the second statewide avoided unit, and in view of that fact I would like to ask you to recalculate your cost estimate of Martin Unit No. 3 using your current approved cost of equity and your current AFUDC rate, and using the plant escalation rates proposed by staff that you agreed with on Page 6. And that the exhibit that I would like for you to furnish would show the cost parameters as they are laid out on Page 6 and the payment schedules as they appear on Page 7 of the prehearing order.

COMMISSIONER CRESSE: What is the number for that, Counselor?

MS. DAVIS: That would be Exhibit 5-K.

(Late-filed Exhibit No. 5-K identified.)

MR. BUTLER: A point of clarification if I may, the request asks for the current approved cost of equity and the current approved AFUDC rate. I'm not familiar with

that, but it strikes me that it may not be the same, that the cost of equity used in the current approved AFUDC rate may not be our current approved cost of equity. Are they the same?

COMMISSIONER CRESSE: Mid point of your current authorized rate of return set at the last rate case was 15.85. Is that the figure you want to use?

MS. DAVIS: Yes, sir. For the cost of equity, and we want them to use whatever their current approved AFUDC rate is even if they are not the same.

COMMISSIONER CRESSE: Do you want it just for the cost of equity, current AFUDC rate or do you want the AFUDC rate in total to be their current AFUDC rate?

MS. DAVIS: The second.

COMMISSIONER CRESSE: Use your current approved AFUDC rate, that's what we're asking for, don't confuse it by the cost of equity. It's calculated therein.

Q (By Ms. Davis) Mr. Denis, when you make this calculation, we would also like you to continue to allocate the common costs of Martin as you did originally, make no change in that. And with that I'd like to ask you one more question and that is the testimony of Mr. Turner indicated that he would attach a 25% confidence interval on either side for his estimate of MacInnes Unit 1. Do you have an opinion as to similar confidence levels that we should attach to your

estimates of Martin 3?

A No, I do not.

Q You couldn't say whether we might want to view this with a 25% suspicion on either side or something greater or lesser than that?

A No, I do not. I would say that there is some confidence in the current base -- today's estimate. Where the end confidence comes out, where we're dealing in the future, 10, 15 years and that's where I would not care to attach any level of confidence.

Q All right. Also during Mr. Turner's cross examination yesterday the issue arose as whether any cost for Martin Unit 3 that have already been incurred and therefore are unavoidable have been included in your cost estimates? Can you tell me one way or the other whether that's --

A I do not believe that any costs have been incurred.

MS. DAVIS: Okay, thank you very much.

BY MR. ZAMBO:

Q Mr. Denis, referring to the appendix to your testimony, specifically your response to interrogatory 12 of the staff's first set, the statement appears there that -- to the effect that as uncertainty in the planning environment increases the planned reserve margin should also increase. Does the uncertainty that you're referring to there, is that in reference to the reliability or

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August 29, 1989

Mr. Steve Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399

Re: Docket No. 890148-EI, Petition of the Florida Industrial Power Users Group to Discontinue Florida Power and Light Company's Oil Backout Cost Recovery Factor.

Dear Mr. Tribble:

ACK ____
AFA 1
APP ____
CAF ____
CMU ____
CTR 1
EAG ____
LEG 1
LIN 6
OPC ____
RCH ____
SEC 1
WAS ____
OTH ____

During the hearings in the above case, FIPUG witness Jeffry Pollock identified, by means of an ERRATA sheet, several changes to his prefiled direct and rebuttal testimony. Mr. Pollock has prepared revised pages to his testimony which incorporate the changes he identified on the stand. I am distributing copies of the revised pages, and ask that they be substituted for the originals.

Thank you for your assistance.

Yours truly,

Joseph A. McGlothlin

JAM/jfg
Enclosures
cc: Carol Causseaux
Commissioners
Parties of Record

Rebuttal Revised Pages
DOCUMENT NUMBER-DATE
08679 AUG 29 1989
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DOCKET NO. 890148-EI

REVISED PAGE NOS. 6-8, 24-25, 29-31 & 37

TO DIRECT TESTIMONY OF JEFFRY POLLOCK

dramatic decrease in oil costs. As a consequence, $2.2 billion of projected net energy cost savings have failed to materialize. In fact, circumstances prevailing today suggest that the function being served by the Transmission Project is not oil displacement but to enable FP&L to meet the growing demands of its service territory. Oil displacement is possible only when the utility has surplus capacity. While in the past FP&L's reserve margins were generally above the levels necessary to maintain reliable service, the future promises to be much different. For this reason, FP&L has signed new UPS Agreements. These Agreements entitle FP&L to purchase up to 900 MW of firm capacity through the year 2010. Rather than a temporary "coal bubble," the UPS Agreements, instead, have become a long-term source of base load capacity. FP&L considers these purchases to be a vital cog in its generation expansion plan.

These dramatic changes in circumstances, coupled with the fact that the Oil Backout Rule prohibits the inclusion of any projects whose primary purpose is to meet load growth, justify discontinuing the OBCRF at this time. While it is understandable that the expectation and fear of continuing rising oil prices, which dominated everyone's thinking in 1981-1982, swayed FP&L and the Commission to treat the recovery of the Transmission Project under the OBCRF, the Project has not produced the expected results. Consequently, there is no longer any valid justification for continuing to recover oil backout costs through kWh charges. The Transmission Project revenue

requirements and the UPS capacity charges should be collected through base rates.

Besides the above-described changes in circumstances, there are two other reasons for discontinuing the OBCRF. First, FP&L is not in compliance with the Oil Backout Rule because (1) it is recovering costs which are clearly related to load growth, and (2) by assuming a 15.6% return on equity, the utility is recovering more than its actual costs associated with the Oil Backout Project. The Rule clearly states that only the actual costs associated with a project are subject to recovery under the OBCRF. FP&L agreed to utilize a 13.6% ROE in determining the refunds under the Income Tax Savings Rule but it did so excluding the Oil Backout Project. Excluding the rate base and net income associated with the OBCRF in applying the Rule resulted in FP&L understating the required refund by about $6.7 million.

Second, the continued recovery of what are essentially demand-related costs through a kWh charge is unduly discriminatory. As a result, Rate GSLD/CS customers are paying 28% more in revenues than their corresponding responsibility for the oil backout costs.

Besides discontinuing the OBCRF, FIPUG also recommends that the Commission order FP&L to refund $285 million of revenues collected under the OBCRF that are associated with accelerated depreciation. Under the Rule, FP&L has included two-thirds of any positive net savings which it alleges have occurred. (These savings are utilized as accelerated depreciation to reduce the net investment of

the Project.) The only reason for collecting any net savings in the OBCRF is the fact that, since June 1987, FP&L has included the costs associated with deferred coal-fired generation capacity in the net savings calculation . FP&L's theory is that, but for the construction of the Transmission Project, it would have built and placed into commercial operation three coal-fired units--in June 1987 (Martin Unit 3); December 1988 (Martin Unit 4); and January 1990 (Unsited Unit 1). Consequently, 700 MW of deferred capacity benefits were included in the net savings calculation beginning in June 1987 and an additional 700 MW of savings were included beginning in December 1988.

FIPUG contends that it is improper to include deferred capacity in the net savings calculation. First, FP&L concedes that the Transmission Project would have been built in any case, even in the absence of the Oil Backout Rule.

Further, the units in question have not been, and may never be, built. Consequently, the investment which FP&L is using to calculate the deferred capacity carrying charges is neither used nor useful. As a matter of accepted regulatory practice, utilities cannot include in their rates the recovery of costs of facilities that are not used and useful, absent extraordinary circumstances. There are no longer any extraordinary circumstances to justify this practice. To require ratepayers to pay higher rates because of the deferral of three, nonexistent, coal-fired units would be tantamount to paying twice for the same capacity. This is because two-thirds

Schedule 7, Page 2 demonstrates that the projected winter peak reserve margins would generally be lower both with and without the coal-by-wire capacity. In fact, the projected winter peak reserve margin without the coal-by-wire resources would remain below 15% during most of the forecast period.

The above analysis and FP&L's own statements concerning the importance of the coal-by-wire capacity compel the conclusion that the primary purpose of the transmission lines--both now and in the future--is to enable FP&L to meet its growing system demands.

Q DIDN'T THE COMMISSION, IN 1982, BELIEVE THAT THE COAL-BY-WIRE PURCHASES WERE A TEMPORARY PHENOMENON?

A Yes. Quoting from the Final Order in Docket No. 820155-EU, the Commission stated that:

> "Southern expects to have power produced from coal-fired generation available for sale on a firm basis in varying amounts through the mid-1990s. **This is sometimes referred to as the coal bubble.** Because of the projected price differential between coal and oil, FP&L, who relies heavily on oil-fired generation, has purchased up to 2,000 MW of Southern's coal-by-wire." (Order No. 11217, Page 2, emphasis added)

Similarly, on Page 8 of the same Order, the Commission quoted FP&L's Witness, Mr. Scalf, who testified that:

> ". . . the 500 kV line project appears to be a unique and short-lived coal bubble . . ."

Q **WHAT IS THE CURRENT STATUS OF THE COAL-BY-WIRE PURCHASES?**

A In June 1988, FP&L entered into new Agreements with The Southern Company under which Southern will be obligated to provide up to 900 MW of firm capacity beginning in 1993 and continuing through the year 2010. These new UPS Agreements are similar to the original Agreements which ramp down beginning in 1993.

Q **WHAT IS THE SIGNIFICANCE OF THE NEW UPS AGREEMENTS WITH SOUTHERN?**

A According to FP&L, these purchases are, in fact, a vital cog in its current generation expansion plan (Source: FP&L's Ten-Year Power Plant Site Plan: 1988-1997). Extending the coal-by-wire purchases for an additional fifteen years means that FP&L will be purchasing firm capacity for at least twenty-eight years. Rather than providing a temporary source of capacity, the UPS Agreements are nearly the equivalent of owning base load generation--both from a planning and an operating perspective.

Q **DOES THE OIL BACKOUT RULE PERMIT THE INCLUSION OF PROJECTS WHOSE PRIMARY PURPOSE IS TO SERVE INCREASED LOAD?**

A No. Quoting the Rule:

> "The Oil-Backout Cost Recovery Factor shall not be used for either the recovery of the costs of a project the primary purpose of which is to serve increased megawatt demand or for the recovery of the costs of a new generating unit." [Rule 25-17.016,F.A.C., Paragraph (2)(b)]

Q **HOW MUCH OF THE OIL BACKOUT COSTS WOULD BE ALLOCATED TO GSLD/CS CUSTOMERS IF THEY WERE TREATED LIKE ALL OTHER NON-NUCLEAR PRODUCTION AND TRANSMISSION CAPITAL COSTS?**

A In FP&L's last rate case, about 14.3% of the non-nuclear production and transmission capital costs were allocated to the GSLD and CS rate classes.

Q **HOW DOES THIS COMPARE TO THE PERCENTAGE OF COSTS RECOVERED FROM THE GSLD/CS RATE CLASSES UNDER THE OBCRF?**

A The corresponding percentage of oil backout costs recovered from the GSLD/CS rate classes is 18.3%. As shown in Exhibit JP-1 ( ), Schedule 10, the GSLD/CS revenue responsibility is four percentage points, or 28%, higher than the corresponding cost responsibility assuming that the oil backout costs were treated the same as all other non-nuclear production and transmission capital costs. Given that $2.2 billion of promised fuel savings have failed to materialize and the fact that the coal-by-wire purchases made possible by the Project are a vital cog in FP&L's plans to meet future load growth, it would be unduly discriminatory to continue the extraordinary rate-making practice of charging the GSLD/CS classes rates which are 28% higher than their corresponding cost responsibility, as is presently the case under the OBCRF in which costs that are essentially demand-related costs are recovered solely on a kilowatt-hour basis.

Q **HAS THE COMMISSION EVER ADOPTED A COST ALLOCATION METHOD IN WHICH ALL FOSSIL STEAM PRODUCTION AND TRANSMISSION-RELATED COSTS WERE CLASSIFIED AND ALLOCATED ON ENERGY?**

A No. To my knowledge, the Commission has never approved a cost-of-service method in which all production and transmission fixed costs are allocated to customer classes based solely on kilowatthour sales at the meter. I recognize, of course, that the Commission has employed various energy-based allocation methods in certain base rate cases, including FP&L. In FP&L's last base rate case, however, only 7% of the non-nuclear production and transmission costs were classified to energy, and they were, unlike the OBCRF, allocated relative to energy at the generation level rather than sales at the meter. The Commission has always recognized, both in class cost-of-service studies and in the Fuel and Purchased Power Cost Adjustment Clause, that it is appropriate to adjust energy-related costs to recognize differences in losses.

Q **ARE THE OIL BACKOUT COSTS DEMAND-RELATED?**

A The UPS capacity charges are the major component of the costs which FP&L is passing through the OBCRF. These costs are demand-related because the capacity being purchased is needed by FP&L to maintain system reliability; that is, to meet the projected peak loads and to provide adequate reserves. The continued coal-by-wire purchases are a vital cog in FP&L's plans to maintain system reliability in light of current projections of summer and winter peak demands. Further,

these costs are functionally equivalent to the capital costs associated with FP&L's non-nuclear generating resources. The Commission has previously classified these costs primarily to demand.

Similarly, the Transmission Project also provides substantial reliability benefits to FP&L and, therefore, these costs are also demand-related. As previously noted, the Project has enabled FP&L to import firm coal-by-wire capacity and to defer the construction of the Martin Unit Nos. 3 and 4. Because of the Project, FP&L's system is less vulnerable to the type of incidents which formerly would have caused severe outages. These benefits are described in a November 1980 study by Stone & Webster commissioned by FP&L entitled "Review of Planning and Operation of Bulk Power Transmission System." On Page 5-2, the Report states:

> "FP&L's system operators are today loading the transmission system to the point where single contingencies such as line or generator trips cause damage to equipment if operator action is not taken in a reasonable time. While it is acceptable to operate the system in this manner, it is not good practice to plan the system so that it must be stretched to the limit of operator ingenuity even when the generation plans remain on schedule and the load growth rates meet predictions."

Another section of this Report states the following:

> "Currently, to prevent system separation upon loss of the largest unit, power transferred to Florida from Southern Company would have to be limited to essentially zero. This limit is caused by voltage dips near Kingsland, Georgia that occur during the stability swing following the loss of a unit in Florida." (Page 4-1)

practice, utilities are not allowed to raise rates to reflect the cost of plans rejected. Yet, this is exactly what is happening in the OBCRF by allowing FP&L to include deferred capacity costs associated with the Martin and unsited coal-fired units. To now require ratepayers to pay higher rates to reflect deferred capacity carrying charges would be tantamount to charging twice for the same capacity.

Q **PLEASE EXPLAIN.**

A The OBCRF is comprised of three elements: (1) all costs of the Transmission Project; (2) the costs associated with the firm UPS capacity; and (3) two-thirds of any positive net savings. Because the present coal-oil energy cost differential is not sufficient to offset the very high UPS capacity charges, the only reason that FP&L is able to claim positive net savings is due to the inclusion of deferred capacity costs of the Martin and Unsited coal units in the net savings calculation. Recall, however, that the availability of firm UPS capacity allowed FP&L to defer the Martin units. Therefore, recovering <u>both</u> the UPS capacity costs <u>and</u> the Martin deferred capacity carrying charges, simultaneously, would effectively result in a double recovery of the same capacity.