BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of the Florida Industrial Power Users Group to Discontinue Florida Power & Light Company's Oil Backout Cost Recovery Factor.	)	DOCKET NO. 890148-EI ORDER NO. 22268 ISSUED: 12-5-89

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON, Chairman
THOMAS M. BEARD
BETTY EASLEY
GERALD L. GUNTER
JOHN T. HERNDON

ORDER DENYING DISCONTINUANCE OF FLORIDA POWER & LIGHT COMPANY'S OIL BACKOUT COST RECOVERY FACTOR

BY THE COMMISSION:

In connection with the February, 1989 hearing in Docket No. 890001-EI, the Florida Industrial Power Users Group (FIPUG) raised issues relating to discontinuance of Florida Power & Light Company's (FPL's) Oil Backout Cost Recovery Factor (OBCRF). FIPUG also filed a separate petition in this docket on January 27, 1989, which challenged FPL's past and present collection of oil backout cost recovery revenues pursuant to Rule 25-17.016, Florida Administrative Code. FIPUG also sought consolidation of the two dockets by a Motion to Consolidate Dockets or Hold Certain Issues in Docket No. 890001-EI in Abeyance.

The parties agreed to defer FIPUG's issues in Docket No. 890001-EI until the August, 1989 hearing in order to allow for discovery. Thereafter, the Commission ordered consolidation of Dockets No. 890148-EI and 890001-EI for hearing purposes only, with Docket No. 890148-EI to be heard by the full Commission on the last day of the scheduled hearings in Docket No. 890001-EI. Docket No. 890148-EI was later rescheduled to the first day of the hearing, August 22, 1989, so that all Commissioners could be present.

On February 15, 1989, FPL moved to dismiss FIPUG's petition. FPL's Motion was denied in Order No. 21361 on the grounds that FIPUG had stated a cause of action upon which it was possible to grant relief.

At the hearing in this matter, FPL reurged its Motion to Dismiss. The Commission granted the motion in part, dismissing that portion of FIPUG's petition regarding the continued qualification of FPL's Oil Backout Project and the continuation of FPL's Oil Backout Cost Recovery Factor.

In its petition, FIPUG requested that the Commission grant several forms of relief: determine that FPL's oil backout transmission project has failed to achieve the "primary purpose" which led the Commission to qualify it under Rule 25-17.016, Florida Administrative Code; disallow prospective application of the oil backout charge for recovery of costs associated with FPL's 500 kV transmission lines and order FPL to refund to customers all accelerated depreciation revenues associated with the inclusion of FPL's deferred Martin coal units in calculation of net savings pursuant to the oil backout rule; order FPL to terminate its oil backout charge; direct FPL to reflect the investment and revenues associated with its 500 kV lines in its surveillance reports and finally, instruct FPL that recovery of costs associated with the 500 kV transmission line must henceforth be accomplished through its base rates. Some of these claims were dismissed, as discussed above. For the reasons discussed below, we decline to grant the remaining relief requested by FIPUG, but find that FPL is not justified in charging a 15.6% return on the equity portion of its capital invested in its 500 kV transmission lines.

Capacity Deferral

FIPUG argues that all accelerated depreciation collected through the OBCRF must be refunded because the capacity deferral benefits from which the accelerated depreciation derives were not realized. The Actual Net Savings as defined in Rule 25-17.016, (two thirds of which are recovered as accelerated depreciation) are overstated, FIPUG alleges, because: (1) the construction cost estimates used by FPL for the Martin Units are too high; (2) the deferred units' in-service dates (1987 and 1988) should be deferred even further in time; (3) the Martin 700 MW Coal Units are not present in FPL's current generation expansion plan; and (4) the deferred units are "phantom plants" and thus don't exist at all.

We are compelled to note the contradictory nature of these arguments, particularly in light of the admission of FIPUG's witness, Mr. Jeffrey Pollock, that "the Project has enabled FP&L to import firm coal-by-wire capacity and to defer construction of the Martin Unit Nos. 3 and 4." Nonetheless, we will address each of these arguments below.

(1) Martin Cost Estimates. FPL's cost estimates for the Martin Units are based on the parameters of a 1979 Bechtel contract, updated for actual inflation and cost of capital. These figures were used in the original oil backout qualification proceeding precisely because they represented the contract cost of Martin Units 3 and 4 to FPL.

In three previous oil backout proceedings (beginning with the April-September, 1987 period), FPL applied those cost estimates in calculating the actual net savings as allowed by the Oil Backout Rule. FIPUG and Public Counsel, both parties to the proceedings, did not contest their use. The Commission approved the OBCRF, thereby at least tacitly approving the cost estimates. There is no evidence in the record upon which to base any adjustment to the estimates. We believe that the Martin Unit 3 and 4 cost estimates are reflective of the construction costs FPL would have incurred had the units been built during the 1981-1987 time period, and are appropriately applied in calculating the OBCRF.

(2) Deferred Units' In-Service Dates. Had FPL not built the 500 kV line project, thus enabling the purchase of equivalent capacity from the Southern Company, construction of the Martin units would have begun in 1980 and 1982 to meet a Martin Unit 3 in-service date of June, 1987 and Martin Unit 4 in-service date of December, 1988.

FIPUG's witness, Mr. Pollock, suggests that FPL should have revisited its decision to construct (or not construct) the Martin Units and move outward in time their in-service dates. We are wholly unpersuaded by his speculative argument.

The record shows that, absent the project and UPS purchases: (a) from 1982 through 1988 the Martin units were the most economic choice for FPL to meet its projected capacity needs; (b) the units would have been needed to meet load and reserve requirements in 1987 even in the face of lower load forecasts; and (c) it would have been uneconomic for FPL to

defer those units rather than finish construction by the time the load forecasts were lowered. We believe that given the economic and technical circumstances during the 1980-1982 time period, FPL would have begun construction of the Martin Units absent the Oil Backout Project.

(3) Martin 700 MW Coal Units Absent from FPL's Current Generation Expansion Plan. Mr. Pollock correctly notes that the Martin Unit Nos. 3 and 4, both 700 MW pulverized coal plants, are absent from FPL's most current generation expansion plan. However, FPL's witness, Mr. S.S. Waters, confirmed that the utility's determination of need for electrical power plant pending before this Commission shows two units labelled Martin No. 3 and 4. These units utilize combined cycle technology (385 MW each) rather than pulverized coal. Mr. Waters explained the reasons for that change and affirmed that both the "old" and "new" Martin units were and are planned to run at very high capacity factors.

The only effective change to Martin Units 3 and 4 which has occurred in the current expansion plan is a technology substitution. In light of this, we find that Mr. Pollock's argument that the "old" units' absence from the current plan means they were not deferred is incorrect.

(4) "Phantom Plants". Mr. Pollock states that "[t]he Martin units have not been, and may never be, built." However, Mr. Waters explained that the deferral of the units:

> is the premise upon which capacity deferral benefits are based; the Martin Coal Units were not built due to the commitment to purchase power from the Southern Companies and FPL's ability to move that power over the Project.

(Tr. 394-395.)

FIPUG argues that capacity deferral benefits cannot be derived from plants which do not exist or are "illusory." The fact that the units were not built is the very benefit intended. This "avoided unit" concept is the same rationale we use to set firm capacity pricing for cogenerators.

In summary, we find that the Martin Coal Units 3 and 4 have been deferred as a result of the project and the original Southern Company purchases, and that FPL has appropriately included capacity deferral benefits in the calculation of Actual Net Savings, 2/3 of which is recovered as additional depreciation on the 500 kV lines.

Return on Equity

Rule 25-17.016(4)(e), Florida Administrative Code, requires the utility to use its actual cost of capital for the recovery period of the oil backout project. FPL has interpreted "the actual cost of capital" with respect to the return on equity to mean the 15.6% return on equity authorized in its last rate case. (Docket No. 830465-EI). However, the oil backout rule clearly states that only the actual costs associated with a project are subject to recovery through the OBCRF. Mr. Pollock contends that a 15.6% ROE does not represent the actual cost associated with the oil backout project.

We agree with FIPUG on this issue. FPL recovers all other costs under the oil backout project based on current rates. For example, FPL uses its current cost of debt in its oil backout filing whenever the cost of debt changes. There is no economic reason to recognize changes in the cost of debt, one capital structure component, but ignore the change in the cost of equity, another capital structure component.

While cost of equity testimony was not presented in this docket, Mr. Pollock's uncontroverted testimony indicates that FPL's actual cost of common equity is lower than 15.6%. Mr. Pollock stated that he is unaware of any regulatory commission which has authorized a 15% or higher ROE since 1987. In addition, he stated that the median authorized ROE has ranged from 12.8% to 13.0%, and that most awards have been in the 12.0% to 14.49% range. Finally, Mr. Pollock testified that the current Federal Energy Regulatory Commission benchmark ROE is 12.44%.

Perhaps the most convincing evidence that FPL's actual cost of equity is significantly lower than 15.6% is FPL's voluntary reduction of ROE in 1988 (Order No. 18340) and 1989 (Order No. 20451). FPL was entitled to use its authorized equity return of 15.6% for purpose of the tax savings rule (Rule 25-14.003, Florida Administrative Code), calculating AFUDC rates, and as

an equity ceiling for surveillance purposes, but voluntarily reduced this ROE to 13.6%. We very much doubt that FPL would stipulate to an ROE of 13.6% for its non-oil backout rate base if 13.6% were less than the company's actual cost of equity capital.

Given current market conditions, we believe that FPL's actual cost of equity capital is lower than 13.6%. However, in the absence of cost of equity testimony in this docket, we note that the 13.6% offered by this utility in the 1987, 1988 and 1989 tax savings dockets is closer to its actual cost of equity than the 15.6% ROE authorized in Docket No. 830465-EI. Therefore, we find that FPL is not justified in charging a 15.6% return on the equity portion of its capital invested in the 500 kV transmission lines.

We find that the 13.6% ROE used for this utility in the tax savings docket more closely approximates FPL's actual cost of equity capital, and that excess revenues collected from April 1, 1988 through September 30, 1989 using the 15.6% ROE should be refunded to customers, with interest. This timeframe reflects the stipulation between FIPUG and FPL in Docket No. 890001-EI. (Attachment A to Order No. 20784):

> c. FPL agrees that if any adjustment is made to FPL's OBCRF as a result of the proceedings in a later scheduled hearing in Docket No. 890001-EI and/or Docket No. 890148-EI, as a result of consideration of the "Issues," any amounts ordered to be refunded shall be subject to refund as though the Commission had considered and reached a decision on the "Issues" in the hearing held on February 22 in Docket No. 890001-EI...

The hearing referenced in this stipulation covered fuel adjustment periods beginning April 1, 1988. That is, the oil backout cost recovery amounts for the periods beginning April 1, 1988 were never finally approved. In keeping with the intent and spirit of this stipulation, we find that a 13.6% ROE should be used to calculate the oil backout revenue requirements beginning April 1, 1988. Beginning October 1, 1989, the OBCRF was calculated using a 13.6% ROE; therefore,

the calculation of the revenues to be refunded should end September 30, 1989. The amount to be refunded will be determined at the February, 1990 hearing in Docket No. 900001-EI for inclusion in the April-September, 1990 OBCRF.

ITC Amortization

Accelerated depreciation is the driving factor for investment tax credit (ITC) amortization. We find that additional ITC amortization should be refunded to FPL's customers as a result of the accelerated depreciation recovered by FPL.

FPL amortizes its ITC's generated by the oil backout investments by using a composite amortization rate. The composite amortization rate is developed on a company-wide basis by dividing the book depreciation expense by the depreciable assets that generated the ITC's. The current amortization rate is 4%, which implies a life of 25 years on a composite basis. If only the oil backout assets were considered, the depreciable life would have been considerably shorter since the oil backout assets were recovered over a seven year period, and ratepayers paying for oil backout assets would have received the benefit of the amortization.

The Internal Revenue Code (IRC) and applicable Regulations require that ITC's for an Option 2 utility such as FPL's project earn a weighted rate of return for ratemaking purposes and be amortized above-the-line. The ITC amortization must be no more rapid than ratable (over the depreciable book life). The Regulations allow the use of a composite rate. FPL's current approach does not violate the IRC or the Regulations.

Customers who paid for recovery of the accelerated depreciation of the oil backout assets should receive the benefits of the associated ITC amortization. The amortization method used by FPL will not accomplish this goal, as admitted by FPL's witness, Mr. Donald Babka, on cross-examination.

Thus, there is a mismatch of the ratepayers who paid for the recovery of the oil backout assets and the ratepayers who will receive the benefit of the ITC amortization. In addition, the ratepayers are required to pay a return on the unamortized balance of ITC's.

As of August 1989, $17,780,000 of ITC's remain unamortized due to FPL's method of ITC amortization, even though the plant generating the ITC's (the 500 kV line) has been fully recovered. This amount should have been amortized at the same rate the oil backout assets were recovered. Therefore, the unamortized balance should be returned to ratepayers as soon as is practicable, which we find to be through the OBCRF to be established for the April, 1990 through September, 1990 time period. This period was chosen to account for the ITC amortization currently included in the calculation of the OBCRF for October 1, 1989 through March 31, 1990. If this amortization is not considered, it is possible that too much amortization could be passed to the ratepayers, resulting in a normalization violation.

Mr. Babka repeatedly stated his concern that the utility's entire unamortized ITC balance of $453 million could be placed at risk if an amortization rate specific to the oil backout clause was used. He further requested that FPL be allowed to get a letter ruling from the IRS regarding use of an amortization rate specific to the oil backout clause. This conservative approach would ensure that the ratepayers are not harmed in the long run by loss of the ITC's.

We believe that our ruling would not cause a violation of normalization requirements. However, to ensure that the ratepayers are not harmed in the long run by the remote possibility of loss of $453 million of ITC's, we will allow FPL to request a letter ruling on this issue, with monies placed subject to refund, with interest, while the letter ruling is pending. The "subject to refund" provisions should begin April 1, 1990, when the new OBCRF is put into effect. We will require that FPL submit a draft of the ruling request to Commission Staff and the parties to this docket within 60 days of the date of the vote in this docket. All parties and Staff will be allowed to participate in drafting the final version of the request to be presented to the Commission for approval. If the parties cannot agree upon the language to be included in the letter ruling request, our Staff will address the alternatives in a recommendation to the Commission, and we will address it at an agenda conference. The parties should be allowed to participate in all phases of the letter ruling process, including any conferences of right. FPL shall notify Commission Staff and the parties of any communication with the IRS on this matter, and upon receipt of the final letter

ruling, shall file a copy thereof in this docket.

Capacity Charge Collection

FIPUG argues that FPL should be required to collect capacity charges for the Southern System UPS charges through base rate mechanisms. We disagree.

Rule 25-17.016(4)(d) Florida Administrative Code states:

> Once approved by the Commission, the costs of a qualified oil-backout project shall continue to be recovered through the Oil-Backout Cost Recovery Factor until such time as they are included in the base rates of the utility.

Thus, FPL must continue to recover the Southern System UPS charges through the OBCRF until such time as they are included in base rates, which would normally be at the time of the utility's next rate case.

Oil Backout Tax Savings

FIPUG questioned whether there were any oil backout Project tax savings due to the change in the federal corporate income tax rate. We find that there are no tax savings associated with the oil backout project. However, as previously discussed, use of a 15.6% return on equity overstates FPL's cost of equity capital and is therefore inappropriate at this time.

For 1987 and 1988, FPL was required to refund tax savings in accordance with Rule 25-14.003, Florida Administrative Code. In that rule, "tax savings" are defined as the "difference between the tax expenses for a utility calculated under the previously effective corporate income tax rates and those calculated under the newly effective, reduced corporate income tax rates." For oil backout purposes, the utility has included current tax rates in its factor and has been recovering income taxes related to oil backout at the current income tax rates. Therefore, tax savings related to oil backout do not exist.

Discontinuance of the Oil Backout Cost Recovery Factor

FIPUG further argued that Rule 25-17.016(6), Florida Administrative Code, requires the discontinuance of the Oil Backout Cost Recovery Factor when FPL's transmission line costs are fully recovered. We find that it does not. While FIPUG correctly states that the OBCRF must terminate when costs of the project have been recovered, the line itself is only one component of the entire project. Although the transmission line should now be fully depreciated, the Oil Backout Rule requires that cost recovery continue until all project costs are fully recovered or are included in rate base.

We further find that FIPUG's argument that the recovery of oil backout project costs through an energy-based charge is unfair and unduly discriminatory is barred by the doctrines of res judicata and administrative finality. We have consistently rejected this claim in the past. The doctrine of administrative finality mandates that we reject it once more. As FPL pointed out in Appendix A of its brief, entitled "FIPUG's Six Prior Arguments That An Energy Based Oil Backout Charge is Unfair or Inequitable", FIPUG made this same argument in five previous dockets: Docket No. 810241 (the adoption of the oil backout rule); Docket No. 820155-EU (FPL and Tampa Electric Company's oil backout project qualification); Docket No. 820001-EU (FPL's initial oil backout cost recovery in the fuel docket); Docket No. 820097-EU (FPL's 1982 rate case); and Docket No. 830465-EI (FPL's 1984 rate case). We reject FIPUG's attempt to raise the same arguments in this docket. We note that, absent inclusion of the project in rate base, FIPUG's requested relief to discontinue recovery of oil backout project costs in an energy-based oil backout charge is inconsistent with Rule 25-17.016 and therefore not permitted by Section 120.68(12)(b), Florida Statutes.

Rule 25-17.016 (4)(e), Florida Administrative Code, requires that "The Oil-Backout Cost Recovery Factor applicable to a qualified oil-backout project shall be estimated every six months in conjunction with the Fuel and Purchase Power Cost Recovery Clause...." and that [a] true-up adjustment, with interest, shall be made at the end of each six-month period to reconcile differences between estimated and actual data." Thus, FIPUG's claim that this rule does not specify how project costs be recovered is confusing. Although the rule does not specify that the oil backout cost recovery factor be applied on

an energy basis, an energy-based charge is consistent with the rule. Indeed, it is difficult to conceive of any non-energy based recovery scheme which would be consistent with this section of the rule. We believe that FIPUG's position on this issue is inconsistent with the rule.

Further, FIPUG may not now challenge the use of the Martin Coal units in calculating deferred capacity savings to be used in the calculation of Actual Net Savings since it has, in three prior proceedings in which FIPUG was a party, failed to raise the issue, not objected to stipulated Factors and failed to request reconsideration. However, had FIPUG objected in any of the three prior proceedings in which deferred capacity savings were calculated using the deferred Martin Coal units, the rule would have required the same result: once approved, recovery of the project continues. Although FIPUG is not precluded from contesting calculations derived using the Martin Unit cost estimates in upcoming periods, we will not allow FIPUG to contest the fact of approval. In fact, FIPUG's requested refund of oil backout revenues would constitute illegal retroactive ratemaking at this point, with the exception of project expenses collected after March 1988, which are still properly subject to Commission scrutiny.

We disagree with FIPUG's position that all oil backout revenues may be properly refunded. FIPUG points to the Florida Supreme Court decision in Gulf Power Co. v. Florida Public Service Commission, 487 So. 2d 1036 (Fla. 1986) as support for the position that funds collected through the fuel adjustment clause may be refunded. However, that case dealt with the refund of fuel expenses imprudently incurred. The Supreme Court upheld the Commission's order of a $2,200,000 refund of excessive fuel costs, pointing out that the "authorization to collect fuel costs close to the time they are incurred should not be used to divest the commission of the jurisdiction and power to review the prudence of these costs." (Id. at 37) Thus, the decision was predicated on the Commission's ability to review the prudence of the utility's fuel expenditures, which is not analogous to the relief requested by FIPUG: retroactive disapproval of the project for cost recovery purposes. FIPUG has presented no evidence that FPL imprudently incurred expenses. Rather, FIPUG's claims amount to an attack on the application of the Oil Backout Rule rather than a request for scrutiny of project expenses.

Based on the foregoing, it is

ORDERED that, except insofar as relief is granted herein,

the Petition of the Florida Industrial Power Users Group to Discontinue Florida Power & Light Company's Oil Backout Cost Recovery Factor is denied. It is further

ORDERED by the Florida Public Service Commission that Florida Power & Light Company recalculate its Oil Backout revenue requirements and Oil Backout Cost Recovery Factor for the period April 1, 1988 through September 30, 1989, using a 13.6% return on equity rather than 15.6% as previously calculated. It is further

ORDERED that Florida Power & Light Company submit testimony in support of its recalculated Oil Backout revenue requirements and Oil Backout Cost Recovery Factor in connection with the February, 1990 hearing in Docket No. 900001-EI. It is further

ORDERED that the amount to be refunded to Florida Power & Light Company's ratepayers due to the recalculated revenue requirements and factor will be determined at the February, 1990 hearing in Docket No. 900001-EI, and shall be included in the utility's April - September 1990 Oil Backout Cost Recovery Factor. It is further

ORDERED that, beginning April 1, 1990, Florida Power & Light Company shall place subject to refund a sum of money equal to the revenue effect of the unamortized balance of Investment Tax Credits existing at that date, plus interest from that date forward. It is further

ORDERED that Florida Power & Light Company request a letter ruling from the Internal Revenue Service regarding use of an amortization rate specific to Rule 25-17.016, Florida Administrative Code, in accordance with the terms and provisions of this Order. It is further

ORDERED that this docket shall remain open for further proceedings pending Florida Power & Light Company's receipt of the letter ruling from the Internal Revenue Service as ordered herein.

BY ORDER of the Florida Public Service Commission, this 5th day of DECEMBER, 1989.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

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 fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (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.

M E M O R A N D U M

December 4, 1989

TO : DIVISION OF RECORDS AND REPORTING

FROM : DIVISION OF LEGAL SERVICES (RULE) MER

RE : DOCKET NO. 890148-EI - ORDER DENYING DISCONTINUANCE OF FLORIDA POWER & LIGHT COMPANY'S OIL BACKOUT COST RECOVERY FACTOR

22268

Attached is Order Denying Discontinuance of Florida Power & Light Company's Oil Backout Cost Recovery Factor regarding the above-referenced docket which is ready to be issued.

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Attachment