



Public Service Commission

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

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (MERTA, LEE, SM ^{PER} 198
LESTER, L. ROMIG, ^{FR} SLEMKEWICZ, ^{DM} ^{RVE} ^{JDS} ^{ALM}
DIVISION OF ELECTRIC AND GAS (BREMANN) ^{RVE}
DIVISION OF LEGAL SERVICES (ELIAS)

RE: DOCKET NO. 971237-EI - PETITION FOR AUTHORITY TO INCREASE ANNUAL STORM FUND ACCRUAL COMMENCING JANUARY 1, 1997 TO \$35 MILLION BY FLORIDA POWER & LIGHT COMPANY

AGENDA: 06/16/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\971237.RCM

CASE BACKGROUND

By Order No. 24728, issued July 1, 1991, in Docket No. 910257-EI, the Commission approved Florida Power & Light Company's ("FPL" or "the Company") request to discontinue the annual accrual to its storm damage reserve. FPL asserted, and the Commission found, that given the level of insurance coverage in place for FPL's transmission and distribution (T&D) facilities, the balance in the reserve was sufficient.

In August of 1992, Hurricane Andrew severely damaged FPL's T&D system. While the damage claims related to Hurricane Andrew were paid, FPL's insurers canceled the coverage, effective May 31, 1993.

On April 19, 1993, FPL filed a petition to implement a self-insurance mechanism for storm damage to its T&D system and to resume and increase the annual contribution to its storm and property insurance reserve fund to \$7.1 million. The amount of \$7.1 million represented \$3 million embedded in rates for the storm

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fund accrual and an additional \$4.1 million for the traditional T&D insurance that was also embedded in rates. The \$7.1 million was not based upon a risk study that indicated the appropriate amount that should be accrued to the fund, given the expected exposure. Because of the expiration of FPL's T&D insurance on May 31, 1993, FPL requested consideration of its request on an emergency basis. A hearing on FPL's petition was held on May 17, 1993.

By Order No. PSC-93-0918-FOF-EI, issued June 17, 1993, in Docket No. 930405-EI, the Commission permitted the Company to implement a self-insurance approach or plan for the costs of repairing and restoring its T&D system in the event of hurricane, storm damage or other natural disaster. FPL also was granted the discretion to establish a line of credit for storm damage liquidity. In addition, FPL was required to submit a study detailing what it believed to be the appropriate amount that should be accrued annually to the reserve and what costs it intended to charge to the storm fund. Until the appropriate amount was determined, an annual accrual of \$7.1 million, net-of-tax, to the storm fund was set effective June 1, 1993. The Commission denied FPL's request to "pre-approve" a surcharge on customer bills for damages in the event the reserve balance was inadequate. The Commission left open the possibility for FPL to file a petition in the event of a shortfall in the reserve.

FPL filed the required study in October of 1993. FPL's 1993 study suggested that an annual accrual of \$20.3 million would allow for storm fund growth, decrease reliance on the customer bill surcharge mechanism and provide an adequate level of insurance. The study also indicated that in order to achieve minimal storm fund growth, a \$9 million annual accrual combined with a provision for emergency relief is required.

By Order No. PSC-95-0264-FOF-EI, issued February 27, 1995, in Docket No. 930405-EI, the Commission found the storm damage study submitted by FPL to be adequate. Based upon the study, the Commission allowed FPL to increase its annual storm damage accrual to \$10.1 million, effective January 1, 1994. The storm fund was to continue to be funded on a net-of-tax basis.

On September 28, 1995, FPL filed a petition to, among other things, increase its annual storm fund accrual to \$20.3 million commencing January 1, 1995; and to add approximately \$51.3 million of recoveries for damage due to Hurricane Andrew and the March 1993 Storm to the storm reserve and contribute the after tax amount to the storm fund. By letter dated November 14, 1995, the Company expanded its explanation of why it was appropriate to increase the annual accrual at that time. When the \$10.1 million annual accrual was approved, FPL stated it had anticipated that the availability of insurance would improve. Instead, the potential for commercial or other insurance was less than before. FPL asserted that since

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the only cost effective measure available at that time was self-insurance, an increase in the annual accrual was needed to provide an adequate level of insurance to FPL and its customers.

By Order No. PSC-95-1588-FOF-EI, issued December 27, 1995, in Docket No. 951167-EI, the Commission approved FPL's petition to increase the accrual to \$20.3 million, funded on a net-of-tax basis. As of December 31, 1997, the balance in the reserve was \$251.3 million.

On September 23, 1997, FPL filed a petition seeking authorization to increase its storm fund accrual to \$35 million, effective January 1, 1997.

After Staff's May 7, 1998, recommendation was filed, FPL requested a meeting. Staff, FPL, and the Office of Public Counsel (OPC) met twice on May 14, 1998. At those meetings, FPL offered several revisions to its request which are acceptable to staff. OPC has not, as of this writing, taken a position on the revised proposal. This recommendation reflects Staff's opinion taking into consideration the concerns raised by FPL.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission approve Florida Power & Light's request to increase its annual storm damage accrual from \$20.3 million to \$35 million?

RECOMMENDATION: No. The Commission should continue the current \$20.3 million annual storm damage accrual. In addition, the Commission should require FPL to file a study addressing the reasonableness of the level of the reserve and the accrual by no later than December 31, 2002. (BREMAN, LEE, L. ROMIG, MERTA, LESTER)

STAFF ANALYSIS: FPL attached to its petition two reports prepared by EQE International, Inc. (EQE) as support for increasing the accrual. The first is a Hurricane Loss Estimation Study for Transmission and Distribution Assets. This study is a probabilistic analysis of FPL's potential T&D replacement costs due to hurricane events. No nuclear expenses or events were included in this study. The analysis addresses different storm tracks, various storm intensities, storm frequencies, the geographic location of existing T&D facilities, as well as FPL's experiences with storm damages to T&D facilities. EQE concluded that FPL's annual accrual for funding T&D hurricane restoration should be \$42.3 million because this figure is representative of FPL's expected annual damage estimate. EQE also indicated that FPL's highest reasonable risk in any single year within the next 50 years is approximately \$559 million. These results are indexed to achieving sufficient coverage for all the damage caused by 98% of all storm events over a 50 year period. Appendix E of the study shows that distribution facilities comprise 80% or \$35 million of the expected annual damage.

FPL is asking for an annual accrual of only \$35 million to a storm fund which will be used for transmission restorations, distribution restorations and possibly certain nuclear events not covered by other insurance. Staff agrees with FPL to the extent that a 98% coverage level for all events over a 50 year period is excessive. Staff is not persuaded that any harm will result to FPL's ratepayers if the annual contribution remains at its current level as long as the fund is used primarily for T&D restorations due to significant weather events.

The second report FPL attached to its petition is titled Storm Reserve Solvency Analysis. This report addresses policy considerations for capping the fund as well as the reasonableness of certain funding levels assuming an annual damage level of \$42.3 million. While this report is informative, it provides no specific

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conclusions on the fund cap amount nor on the appropriate funding level for regulatory purposes because it assumes an annual damage amount which neither FPL nor Staff believe to be appropriate for regulatory purposes.

FPL has requested to increase its annual storm damage accrual to \$35 million. The study filed by FPL determined that \$42.3 million was the average annual damage to FPL's T&D assets, and thus, the appropriate level of annual funding for hurricane restoration. Staff recommends that FPL continue the current \$20.3 million annual accrual since a \$370 million level in the reserve would be reached in a reasonable length of time. The March 31, 1998 balance of \$246.2 million is approaching that level already, and given past history where FPL has not made full use of the reserve, the balance should continue to grow fairly rapidly.

In its Petition, FPL stated that "a funding level sufficient to protect against another 'Andrew type' event" is appropriate". An Andrew type event is defined by FPL in its Petition at page 2, as \$350 million, which reflects inflation and system growth since 1992. However, in response to Staff's data request, FPL stated that the \$350 million covers T&D only and an additional \$20 million is necessary for property deductibles under the traditional insurance coverage which it currently holds. Rule 25-6.0143(1)(a), Florida Administrative Code (F.A.C.), provides, among other things, that insurance deductibles may be charged against the reserve account. Therefore, Staff believes the reserve level should include this amount for insurance deductibles, and that a reasonable level for the reserve is \$370 million in 1997 dollars.

The requested \$35 million accrual will allow the reserve to reach Andrew level in approximately 3 years, while the current \$20.3 million accrual will attain this level in approximately 4 years, given minimal future charges to the reserve. This calculation includes a reduction to the reserve of \$14.5 million in charges associated with the 1998 "Groundhog Day" storm. In either scenario, any charges against the reserve will lengthen the amount of time needed to reach the \$370 million.

FPL has two lines of credit totaling \$900 million; \$300 million is specifically designated for storm damage. FPL also has approximately \$152 million, net-of-tax, in a funded reserve. It should be noted that the after tax amount in the fund equates to approximately \$247 million in storm costs. This is true because the amounts contributed to the fund are not tax deductible until actual storm costs are incurred i.e., the difference between the \$152 million and \$247 million is the tax benefit realized when FPL takes a deduction for the expenses. Staff believes that FPL's

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financial resources from the lines of credit and the fund should be sufficient to cover most storm emergencies. However, the costs of storm damage incurred over and above the balance in the reserve and the costs of the use of the lines of credit would still have to be recovered from the ratepayers.

The Company has not used its Storm Damage Reserve and Fund for all storm losses. Since 1946, except for Hurricane Andrew in 1992, charges against the reserve and the fund have been minimal and the balances in these accounts have steadily increased, due not only to the current accrual, but also to the earnings on the fund and insurance reimbursements. FPL does not use its reserve for all the losses provided for in Rule 25-6.0143 (1)(a), F.A.C.; the reserve is only used for losses not covered by insurance which are the result of storm/wind damages and nuclear accidents. According to FPL's answer to Interrogatory No. 6,

FPL does not charge self-insured losses to T&D property resulting from storm/wind damages where restoration efforts are handled under normal operations. In general, eligible losses would be charged in instances where the severity of damages result in restoration efforts of longer than three days and or where full activation of FPL's command center and service center Storm Organization is required.

In 1995, FPL requested, and was authorized, to "restore the reserve" for Hurricanes Gordon (\$5 million) and Erin (\$6 million) costs; in effect, the charges to the reserve were reversed, the fund was not charged and the repair costs were charged to earnings. If the Company continues these practices, the reserve balance should grow to the \$370 million level in approximately 4 years. It should be mentioned, however, that FPL does intend to charge the reserve approximately \$14.5 million for the 1998 Ground Hog Day Storm.

In the event FPL experiences catastrophic losses, it is not unreasonable or unanticipated that the reserve could reach a negative balance. Rule 25-6.0143(4)(b), F.A.C., recognizes that charges to a reserve may exceed the reserve balance resulting in a negative balance, as was the case of Gulf Power Company in Order No. PSC-96-0023-FOF-EI, issued January 8, 1996, in Docket No. 951533-EI. According to FPL's Response to Interrogatories 1 and 2, it has never experienced a negative reserve balance since the reserve's inception in 1946. The December 1997 balance of FPL's reserve was \$251.3 million, which Staff believes is sufficiently high to protect against most emergencies. In cases of catastrophic

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loss, FPL continues to be able to petition the Commission for emergency relief as reflected in Order No. PSC-95-1588-FOF-EI.

The Commission has approved target reserve balances for other electric utilities and discontinued accrual to FPL's reserve from 1991 through 1993. Order No. PSC-96-1334-FOF-EI (Gulf Power Company's petition for approval of special accounting treatment of expenditures related to Hurricane Erin and Opal) issued November 5, 1996, in Docket No. 951433-EI, approved a target level for the reserve between \$25.1 and \$36 million. The Commission approved a reserve target amount of \$55 million for Tampa Electric Company (TECO) in Order No. PSC-95-0255-FOF-EI (Investigation into currently authorized return on equity) issued February 23, 1995, in Docket No. 930987-EI. In the TECO case, the Commission stated that suspension of the accrual would be determined when the storm damage reserve achieved the target balance. In addition, the Commission recognized that the target balance would be achieved in 13 years, assuming no storm losses. The Commission found FPL's \$76.6 million reserve to be sufficient and discontinued its accrual by Order No. 24728 (Petition to discontinue annual contribution to Storm and Property Insurance Reserve Fund) issued July 1, 1991. It should be mentioned that at that time, FPL was covered by insurance protection. Below is a chart depicting the four major electric companies' storm damage balances and accrual at March 31, 1998.

COMPANY	ANNUAL ACCRUAL	RESERVE BALANCE @ MARCH 31, 1998	RESERVE BALANCE TARGET
FPL	\$20.3 MILLION	\$246.2 MILLION	N/A
FPC	\$6 MILLION	\$19.6 MILLION	N/A
GULF	\$3.5 MILLION	\$180.7 THOUSAND	\$25.1 - \$36 MILLION
TECO	\$4 MILLION	\$17 MILLION	\$55 MILLION

Staff recommends that FPL be ordered to continue the current \$20.3 million annual accrual and file a study addressing the reasonableness of the level of the reserve and accrual by no later than December 31, 2002.

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ISSUE 2: Should FPL's requested January 1, 1997 effective date of an increased annual accrual be approved?

RECOMMENDATION: This issue is moot if the Commission accepts Staff's recommendation in Issue 1. (MERTA, L. ROMIG)

STAFF ANALYSIS: This issue is moot if the Commission accepts Staff's recommendation in Issue 1.

If the Commission votes to increase FPL's accrual, it is our understanding that the Company has no objection to a January 1, 1998 implementation date, since the docket could not be completed in 1997.

Generally, Staff does not recommend approval of items that effect prior fiscal years, since the books for that year are already closed. Although the Company filed its Petition in September 1997, it was impractical, considering review time, to file a recommendation during 1997. However, if the Commission votes to increase FPL's annual accrual, the increase should become effective January 1, 1998.

ISSUE 3: Should regulatory requirements be imposed to safeguard the reserve and fund related to storm damage for T&D facilities?

RECOMMENDATION: Yes. The fund and reserve should be used only for uninsured storm/wind losses to T&D and insurance deductibles or as otherwise directed by the Commission. FPL should be ordered to file a methodology for separating T&D and Other by December 31, 1998. (MERTA, L. ROMIG)

STAFF ANALYSIS: FPL is the only electric utility with a funded reserve for storm damage. Staff believes that safeguards are needed to ensure that the reserve and fund are used only for the purposes defined by the Commission. Although there have been no problems in the past, the order should contain language to emphasize that the fund and reserve should be used only for uninsured storm/wind losses to T&D, insurance deductibles or as otherwise directed by the Commission. They should not be used for nuclear property, losses to production assets, or other corporate purposes. Rule 25-6.0143(1)(a), F.A.C., states:

This account may be established to provide for losses through accident, fire, flood, storms, nuclear accidents and similar type hazards to the utility's own property or property leased from others, which is not covered by insurance. This account would also include provision for the deductible amounts contained in property loss insurance policies held by the utility as well as retrospective programs covering nuclear generating plants. . . .
(Emphasis supplied)

Under the permissive language of the Rule, Staff believes the use of the reserve and fund can be restricted. Therefore, Staff recommends that the Storm Reserve and Fund be used only for uninsured losses to T&D, insurance deductibles or as otherwise directed by the Commission.

The second safeguard Staff recommends is the separation of transmission, distribution, and other amounts for purposes of the reserve, fund and expense. It should be stressed that this is not a physical separation, but merely an accounting allocation on paper that should not affect the fund investments or any insurance risk. In data requests, Staff asked FPL to develop a separations methodology for T&D, Nuclear, and Other, however the Company did not answer the question. The Company's response:

Question 1:

If the Commission were to require FPL to allocate the Reserve and Fund between transmission, distribution, nuclear and other, what methodology would it use?

Response 1:

Florida Power & Light (FPL) believes it is inappropriate to allocate the reserve and fund to transmission, distribution, nuclear and other and is not aware of any methodology that could be used to appropriately allocate the Storm Reserve and Fund between functions. Previous insurance coverage for storm damage to Transmission and Distribution property was not separable. If by dividing the current Storm Reserve and Fund balances into discrete portions, FPL would be required to insure

Transmission and Distribution property separately, any hope of future insurability would be virtually eliminated, resulting in higher costs and less flexible risk management. It would be counter productive to create an artificial separation of funds when any real storm will have a mixture of Transmission and Distribution damages which will differ from the hypothetical separation. A separation may not be in the best interests of ratepayers, until and unless changes in regulation make such separation appropriate. In addition, any separation of the Funds between functions resulting in the liquidation or retirement of certain investments could result in losses accruing to the Storm Fund.

Staff does not understand why a reasonable methodology could not be developed by the Company. FPL's study based its separation of T&D on the replacement value of the T&D assets. Therefore, Staff recommends that FPL be ordered to file a methodology for separating T&D and Other by December 31, 1998. Staff believes that this is a prudent measure given the regulatory climate across the country.

ISSUE 4: Should FPL establish a trust fund?

RECOMMENDATION: No. However, the Commission should require FPL to file a study addressing this issue by December 31, 1998. (LESTER)

STAFF ANALYSIS: FPL should not be required to establish a trust fund at this time. However, the Commission should require FPL to file a study addressing the feasibility of a trust fund for the storm fund by December 31, 1998.

Currently, the storm fund is not a trust fund, and Staff does not have enough information to recommend whether or not FPL should establish a trust fund. The advantage of a trust fund is that the funds could only be released by the trustee for the intended purpose as defined in the trust agreement. This would assure the Commission that the storm fund accrual, recovered through the company's rates, is used only for its intended purpose. Many allowances, such as nuclear decommissioning accruals and pension

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expense, are subject to trust funds. However, the tax consequences of having a trust fund, as opposed to not having one, have not been fully explored by Staff. Therefore, Staff recommends that the Commission require FPL to file a feasibility study on making the storm fund a trust fund.

ISSUE 5: Should this docket be closed?

RECOMMENDATION: Yes. This docket should be closed if no person, whose interests are substantially affected by the proposed action, files a protest within the 21 day protest period. (ELIAS)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is file, this docket should be closed.

If after receiving the studies in Issues 3 and 4, Staff believes it is necessary to institute different accounting or establish a trust, we will open a new docket.