

State of Florida



Public Service Commission

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DATE: FEBRUARY 3, 2000

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

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (MERTA)
DIVISION OF ELECTRIC AND GAS (BREMAN, D. LEE)
DIVISION OF LEGAL SERVICES (DATE) *RVE*

RE: DOCKET NO. 991834-EI - PETITION FOR APPROVAL OF DEFERRED ACCOUNTING TREATMENT FOR THE GULF COAST OZONE STUDY PROGRAM BY GULF POWER COMPANY.

AGENDA: 02/15/00 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\AFA\WP\991834.RCM

CASE BACKGROUND

At the November 22, 1999 hearing in Docket No. 990007-EI, the Commission decided not to include the costs for the Gulf Coast Ozone Study ("GCOS") Program in Gulf Power Company's ("Gulf" or "the Company") Environmental Cost Recovery Clause ("ECRC") factor for 2000. On December 3, 1999, Gulf filed a petition for approval of deferred accounting treatment for the costs associated with GCOS. The petition was submitted in lieu of briefing the matter.

Gulf is voluntarily participating in the GCOS with the Florida Department of Environmental Protection ("DEP") and various state agencies in Louisiana, Mississippi and Alabama. GCOS is a computer modeling analyses directed at developing a basis for assessment of

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the formation of ozone in Northwest Florida and for the coastal regions in Louisiana, Mississippi, and Alabama. Pursuant to a Memo of Understanding, the participants have tentatively agreed that the baseline model developed in this project will be used as a starting point for compliance strategies involving ambient ozone air standards by Gulf and the DEP.

The GCOS project was initiated in response to the Environmental Protection Agency's ("EPA") adoption of the eight-hour ambient air ozone standard in 1997 pursuant to its authority under the Clean Air Act Amendments of 1990. Gulf would be impacted by this standard as a result of having facilities in Escambia County. Escambia and Santa Rosa County have been jointly identified as potential ozone non-attainment areas under the standard.

The eight-hour ambient ozone air standard, which requires compliance by 2003, is contained in a rule promulgated by the EPA. The EPA's eight-hour ambient ozone air standard was overturned on appeal and the matter was remanded to EPA for further action. The EPA has requested review of the appellate decision by the United States Supreme Court. The appeal to the Supreme Court has made the 2003 deadline uncertain.

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DISCUSSION OF ISSUES

ISSUE 1: Should Gulf Power Company's petition for approval of deferred accounting treatment for the Gulf Coast Ozone Study Program be approved?

RECOMMENDATION: No. The Gulf Coast Ozone Study Program costs should be expensed as incurred. (MERTA, BREMAN, D. LEE)

STAFF ANALYSIS: Gulf is requesting approval for deferred accounting treatment for the GCOS project pending resolution of whether the EPA's eight-hour ambient ozone air standard will be applicable. Until such time that the EPA finalizes a new ambient ozone air standard, either through the current standard becoming valid or through a subsequent standard becoming final, whichever comes first, Gulf proposes to defer the expenses associated with the GCOS project in Account 182, Regulatory Assets. In addition, Gulf proposes to recover the costs associated with the GCOS project, including the amounts deferred and any ongoing costs, through the ECRC at the time the ambient ozone air standard becomes final.

In staff's opinion, the GCOS costs should be expensed as incurred. The criteria for creating regulatory assets are set out in Financial Accounting Standard ("FAS") 71. Paragraph 9 (b) of FAS 71 states:

If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

The Commission must first determine that costs are recoverable prior to creating regulatory assets. Clearly, the Commission's intent is that the costs not be recovered through the ECRC at this time, since the costs were not included in the ECRC factor for 2000. The Commission does not have any clear intent to permit recovery of these costs in the future unless the GCOS project is required by EPA for determining compliance with the new standard.

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Therefore, staff believes a regulatory asset should not be created and that the costs should be expensed as incurred.

GCOS costs for 1999 were \$61,000 and are expected to be approximately \$250,000 a year for the next 5 years. One percentage point on equity for Gulf is approximately \$5.9 million, so expensing the cost would reduce Gulf's ROE by approximately 4 basis points. In staff's opinion, the \$250,000 is an immaterial amount and can be easily absorbed in earnings. Based on its November 1999 Earnings Surveillance Report, Gulf was earning 12.97%, which is over its allowed 10.50% to 12.50% rate of return range effective November 3, 1999. Gulf's earnings were above the midpoint for eight months out of eleven during 1999. It, therefore, appears the Company's earnings are adequate. In staff's opinion, these expenses are being fully recovered by Gulf through base rates at no harm to the Company.

The ambient ozone air standard is subject to the review of the United States Supreme Court and it may be some time before the EPA finalizes a new standard. When a new standard becomes effective, and if the GCOS project is required by EPA for determining compliance with that standard, the prospective study costs could be requested for recovery through ECRC.

If the Commission votes to allow deferred accounting treatment for the GCOS project, it is staff's opinion that the costs to be deferred are those beginning January 1, 2000. No beginning date is stated in the instant petition. However, in response to interrogatories the Company indicated that it was asking for costs from January 2000 forward.

If the Commission approves the deferral, the amount to be deferred should be adjusted. If GCOS costs are approved for recovery through ECRC, they will be subject to an adjustment for the level of costs currently being recovered through base rates. At the ECRC hearing, staff believed that \$253,000 was the amount to be recovered for 2000. Upon further review, staff believes that the Company is recovering \$178,000 annually in environmental studies costs through base rates. Gulf recovered \$61,000 in GCOS costs through base rates in 1999. Based on interrogatory responses 18 and 19, the only environmental studies cost was the GCOS

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expense. Staff believes that an adjustment should be made for the amount in base rates, if GCOS costs are approved for deferred treatment. Therefore, the deferred amount should be the annual amount of GCOS costs reduced by the \$178,000 recovered through base rates.

It is staff's opinion that any deferred amount should be included in working capital in base rates and that no deferred interest or deferred return on the deferred amount should be allowed. To allow deferred interest or a deferred return on the deferred amount increases the cost to ratepayers. The deferred interest or deferred return may be small on an annual basis and could easily be absorbed by the Company. However, if it is years before the new standard is finalized, the deferred interest or deferred return could grow to a significant amount.

In the event that the GCOS project is denied recovery through ECRC, the entire deferred amount should be expensed immediately.

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ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes. If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (JAYE)

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is filed, this docket should be closed upon the issuance of a consummating order.