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Subject: Electronic filing in Docket No. 041272-EI - Progress Energy Base Rate Increase Case
Attachments: Progress Energy storm SMW post hearing brief On Issues 15 and 16 April 26,2005.doc

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2. The filing is to be made in Docket No. 041272-EI, In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Francis, Jeanne, and Ivan, by Progress Energy Florida, Inc.

3. The filing is made on behalf of Sugarmill Woods Civic Association, Inc.;

4. The total number of pages is 12; and

5. Attached to this email in Word format is Sugarmill Woods Civic

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Association, Inc.'s Post Hearing Brief.

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BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.	DOCKET NO. 041272-EI FILED: April 26, 2005

SMW POST HEARING BRIEF ON ISSUES 15 AND 16

Pursuant to Order No. PSC-04-1151-PCO-EI, issued November 18, 2004, Sugarmill Woods Civic Association, Inc. files its Post Hearing Statement Of Issues, Positions And Brief On Issues 15 and 16, as follows:

Sugarmill Woods Civic Association, Inc. ("SMW") will submit its brief on issues 15 and 16 in this document and a statement of issues and positions in a separately filed document.

Combined Brief On Issues 15 and 16

ISSUE 15: **Does the stipulation of the parties that the Commission approved in Order No. PSC-02-0655-AS-EI affect the amount or timing of storm-related costs that PEF can collect from customers? If so, what is the impact?**

SMW: *Yes. Based on the stipulation, the amount of costs that Progress Energy can recover from customers should be zero until its return on equity falls to 10%. The timing of Progress Energy collecting any costs from customers is also controlled in the stipulation by language that states its return on equity must fall to 10% before it can petition for a change in base rates and charges.*

ISSUE 16: **In the event that the Commission determines the stipulation approved in Order No. PSC-02-0655-AS-EI does not affect the amount of costs that PEF can recover from ratepayers, should the responsibility for those costs be apportioned between PEF and retail ratepayers? If so, how should the costs be apportioned?**

SMW: *Yes. Investors are paid to accept risks, including the potential for storm damage, and the Commission should not insulate investors from that risk by placing 100% of the risk on customers. A 10% ROE is more than adequate currently to provide investors with a reasonable return. Therefore, even if the Commission were to

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determine that the 2002 stipulation does not require this result, the 10% ROE criterion is a reasonable basis on which to apportion the storm-related costs.*

ARGUMENT

No Recovery For Past Operating Expenses Absent Pre-existing Recovery Clause

It is fundamentally important to understand that investor-owned electric utilities in Florida are not "cost, plus" business that are statutorily entitled to be indemnified by their customers so that they receive a "guaranteed" profit for any period of time, but particularly for a past period. This, however, is precisely what Progress Energy Florida, Inc. ("PEF") is seeking in this docket. Rather, the investor-owned electric utilities are regulated monopolies whose rates are set prospectively with the goal of giving the utility an opportunity of being able to recover its reasonable, necessary and prudent costs of providing the service, as well as of earning a reasonable return on its investment necessary to provide the service. Thus, if a utility's rates were set based upon a given rate base, level of annual operating expenses, number of customers and approved overall rate of return, including on equity, the subsequent placement in service of an expensive generating unit could increase both rate base and operating expenses with the result that the earned return would decrease, assuming that the customer count and revenues remained unchanged. Likewise, an increase in operating costs subsequent to rates being established, could pull down a utility's earned return if all other factors, such as customer count and annual revenues, remained the same. Conversely, an increase in customers and/or sales to them could result in an increase in a utility's earned return if the incremental costs of serving the new customers or load were less than the additional revenues obtained.

As the Commission should be aware from the general testimony in this case alone, it has long been the Commission's practice of establishing an approved range of return on equity ("ROE") consisting of an approved mid-point upon which rates are usually set, a "floor" or

minimum ROE, usually one percentage point or 100 basis points below the mid-point, and a "ceiling" or maximum ROE 100 basis points above the approved mid-point. Any earned ROE within the 200 basis point range is conclusively considered "reasonable," although prospectively subject to the challenge that circumstances have made the range itself either too high or too low for current conditions. A return below the approved range would be considered insufficient and might be a basis for a utility seeking higher rates. Likewise, a return above the ceiling would be considered excessive and could be the basis for either the Commission or customers to seek a rate decrease.

Prior to the introduction of fuel adjustment clauses in the 1960's, virtually all costs of producing electricity were recovered through base rates with the result that unexpected operating cost increases, even extraordinary costs, were not recoverable in future rates. If the increases were expected to be recurring, then the utility might be forced to seek increased rates so as to maintain reasonable earnings. If the expense were non-recurring, even if large, then the utility could expect to either have to completely absorb the expense through earnings or, at best, be allowed to amortize it as an expense in the future over a period of years. While more and more operating expenses have been allowed to be recovered through cost recovery clauses over the years, thus greatly reducing the risk to utility management and shareholders, like the environmental, capacity and conservation cost recovery clauses, these clauses typically have been statutorily authorized. There is no statute allowing or requiring that customers pay a surcharge through a clause mechanism for damage due to hurricanes or other storms, and the Commission's precedents do not include a single example of a storm surcharge until the provisional surcharge approved in the pending Florida Power & Light Company case. In fact, as the Commission should now be aware, all Commission precedent regarding the "recovery" of

storm damage costs rejected the concept of a "recovery clause" or customer surcharge and instead required customers to pay for the storm damage through accruals to a storm reserve against which costs were expensed. There is no Commission precedent for allowing customers to be surcharged for storm expenses, let alone a surcharge mechanism that requires customers to pay every dollar of storm recovery costs so that a utility's shareholders' profits are unaffected.

SMW believes the surcharge recovery sought by PEF in this case should be rejected because it would effectively transfer all risk associated with storm damage directly to ratepayers, thus completely insulating the utility and its shareholders from the clearly foreseeable business risk of facing hurricanes in Florida. Additionally, the requested surcharges should be denied because they do not take into account whether requiring the utility and its shareholders to bear all or a portion of the storm damage recovery costs would allow it to remain within the range of reasonableness on its allowed return on equity.

Commission Orders Do Not Support Surcharge Under These Facts

The prior orders of this Commission on the subject of storm damage recovery require PEF, and its shareholders, to share in the business risk of hurricane exposure in Florida and to bear a portion of the recovery costs, so long as doing so does not force the utility to fall below the minimum of its last approved range on return on equity. Aside from being consistent with the Commission's prior orders, such a result is fair given that many of PEF's customers suffered not only a loss of electric service during these four hurricanes, but additional unreimbursed financial losses. Requiring that the customers should bear even greater expense solely so PEF and its shareholders are completely insulated and suffer no financial loss is not only unfair, it is contrary to the Commission's precedents on the subject.

The Commission's rules and prior orders actually argue against PEF's requested relief. In Order No. PSC-93-1522-FOF-EI, the "Order Granting Request To Self-Insure," the Commission noted that PEF's storm damage reserve balance had been entirely depleted on two occasions and was allowed to recharge through base rates without dollar for dollar surcharges being levied on its customers. Specifically, the Commission stated at Page 4 of that order:

> Exhibit JS-1, Part C, attached to the testimony of John Scardino, presents a summary of storm damage experience from the period 1973-1993. The reserve balance remained at $1,643,000 from 1981 to 1985, when it was completely wiped out by $4,440,000 in storm damage from hurricanes Elena and Kate. The reserve was rebuilt to $4,244,000 by 1992, and was then depleted by the October 1992 tornadoes followed by the March 1993 "storm of the century."

Thus, the PEF storm damage reserve balance historically was funded by an annual accrual approved typically during the course of a base rate proceeding. Approved storm expenses were charged against the balance with the result that PEF's balance was "wiped out" on at least two occasions after which it was replenished at the rate of the approved annual accrual. There was no customer surcharge.

The Commission's resolution of PEF's request in Order No. PSC-93-1522-FOF-EI was clearly consistent with the Commission's rule on the subject, Rule 25-6.0143, F.A.C., meaning that the storm and other losses not covered by insurance would be charged to Account No. 228.1 Accumulated Provision for Property Insurance. With respect to the level and annual accrual rate for account, the rule provides:

> (4)(a) The provision level and annual accrual rate for each account listed in subsections (1) through (3) shall be evaluated at the time of a rate proceeding and adjusted as necessary. However, a utility may petition the Commission for a change in the provision level and accrual outside a rate proceeding.

SMW interprets this rule to mean that PEF could seek a change in the provisional level and annual accrual rate either during the course of its upcoming rate proceeding or outside of one, but not that it could seek a surcharge. If sought within the coming rate proceeding, the Commission would presumably allow the new annual accrual rate in the total annual revenues approved during the rate case. If changes were sought and approved outside a rate proceeding, as here, there is nothing in the rule to suggest customer surcharges would be approved. Rather, as in the Gulf Power case, which is discussed below, it is likely that the increased accrual would be taken against the utility's profits if prior orders were followed.

Considering PEF's earnings in evaluating its request for storm cost recovery is not only fair to its customers and in accord with the Settlement Agreement, it is thoroughly consistent with Commission Order Number PSC-93-1522-FOF-EI:

> If FPC experiences significant storm related damage, it can petition for appropriate regulatory action. In the past, this Commission has allowed recovery of prudent expenses and has allowed amortization of storm damage expenses. Extraordinary events such as hurricanes have not caused utilities to earn less than a fair rate of return. FPC shall be allowed to defer storm damage loss over the amount in the reserve until we act on any petition filed by the company. (Emphasis supplied)

SMW believes this language is abundantly clear in indicating that PEF has not only the burden of proving storm expenses incurred were necessary, prudent and reasonable in their amount, but that the financial accounting for those expenses will result in less than a fair rate of return for the utility if it is not allowed to surcharge its customers for the total. PEF does not address this point in its petition. Rather PEF is seeking to have the storm expense item considered in isolation from any of its other financials. Furthermore, the above language of the order indicates that the main goal of the Commission earlier was to assure PEF that any extraordinary expenses associated with storm damage would not cause it to earn less than a fair rate of return. The Commission's

goal clearly was not to provide a dollar for dollar pass through that would insulate PEF from the financial effects of the storms and maintain its earnings to the sole benefit of its shareholders.

As discussed at the outset here and throughout the testimony of Public Counsel's cost of capital witness, not only does the 10 percent equity return "floor" in the Settlement Agreement provide a minimal fair return on equity for use in determining the shareholders' share of costs to be borne, such a 10 percent equity return is more than fair in the current market.

In addressing Gulf Power Company's 1995 storm damages, that utility's storm damage reserve balance was also allowed by this Commission to go "negative" without it receiving a surcharge outside base rates. The Commission's overall decision in that Gulf Power Company case was clearly driven by a consideration of the impact of the storm expense on the utility's earnings, as should be the result here.

In 1995, after experiencing over $25 million in damages from Hurricanes Erin and Opal, Gulf Power sought permission to increase its annual accrual from $1.2 million to $3.5 million beginning in 1996 and to amortize approximately $9 million of the hurricane related expenses to the accumulated provision account over the five-year period from 1996-2000. It also sought permission to apply any earning over 12.75 percent return on equity for calendar year 1995 to the accumulated provision account. The Commission approved the request to increase the annual accrual to $3.5 million but denied Gulf Power's request to increase the annual accrual effective January 1, 1996 and instead required it to make the change effective January 1, 1995 because the storm recovery costs would not be "expensed" to that year, as feared by Gulf Power, but merely charged to the accumulated provision account. On this point, the Commission said:

> The Company is not required to expense the $9 million in 1995 because the Commission Rule 25-6.0143(4)(b), Florida Administrative Code, entitled "Use of Accumulated Provision Accounts 228.1, 228.2, and 228.4" states that:

> . . . Charges shall be made to accumulated provision Accounts regardless of the balance in those accounts.
>
> When the Commission considered this rule, we realized that there could be times when charges to the accumulated provision account could exceed the balance in the account, resulting in a negative balance.

Page 4, Order No. PSC-96-0023-FOF-EI (Emphasis supplied.)

In the same Gulf Power case, the Commission stated that the utility could address a negative balance by being given the flexibility to increase its annual accrual above the $3.5 million already approved, when it believed its earnings would allow it to do so. That is, Gulf Power would be allowed to bring its accumulated provision account positive and to a more reasonable level, but by use of its profits, not by either raising its base rates immediately or by surcharging its customers. Specifically, the Commission addressed the point at Page 4, Order No. PSC-96-0023-FOF-EI, saying:

> After charging the accumulated provision account for actual hurricane related expenditures, a negative balance will result. Even with the approval of the increase in the annual accrual to $3.5 million, effective October 1, 1995, the accumulated provision account will have a negative balance until late 1997, assuming no further charges are made due to future storm activity. This obviously is not desirable since the Company is in a self-insurance position. Therefore, we find it appropriate to allow the Company the flexibility to increase its annual accrual to the accumulated provision account when the Company believes it is in a position, from an earnings standpoint, to do so. Once the accumulated provision account balance reaches $12 million or such other level approved by us, the Company shall not increase its accrual above the annual accrual amount last approved by the Commission. (Emphasis supplied.)

If holding of this Gulf Power case were applied to PEF's petition, the Commission would merely allow PEF to determine the level of accrual to accumulated provision for 2004 and 2005

that it believes it is in a position to support "from an earnings standpoint" and without any surcharges to its customers. Such a result would clearly be consistent with the Settlement Agreement.

The Commission's treatment of FPL's request for storm damage relief in one of the first cases on the subject is also consistent with the outcome sought by SMW. Specifically, in Order No. PSC-93-0918-FOF-EI, issued June 17, 1993, the Commission authorized FPL to begin a self-insurance plan for storm damage and to re-establish annual funding of its storm damage reserve. In rejecting a specific Storm Loss Recovery Mechanism proposed by FPL, the Commission stated its unwillingness to shift storm damage costs fully on the backs of customers, saying:

> FPL seeks approval for a Storm Loss Recovery Mechanism that would guarantee 100% recovery of expense from ratepayers, over and above the base rates in effect at the time of implementation. <u>This would effectively transfer all risk associated with storm damage directly to ratepayers, and would completely insulate the utility from risk. We decline to approve such a mechanism at this time</u>. (Emphasis supplied.)

SMW believes that it is incorrect to suggest the Commission left the door open for completely insulating utilities from storm risks in the future by the emphasized language above. Rather, while the above quote may appear ambiguous on the issue of subsequently insulating electric utilities completely from business risks, including those associated with storms, the statement should be considered in the context of the rest of language of the order and subsequent Commission orders on the subject. For example, the text immediately following the quote above makes clear: (1) that the Commission has never contemplated completely insulating utilities from business risks, including storm damages; and (2) that it was unlikely to approve recovery of

storm damage expenses through an ongoing cost recovery clause. Specifically, the Commission stated:

> FPL's cost recovery proposal goes beyond the substitution of self-insurance for its existing policy. The utility wants a guarantee that storm losses will have no effect on its earnings. We believe it would be inappropriate to transfer all risk of storm loss directly to ratepayers. The Commission has never required ratepayers to indemnify utilities from storm damage. Even with traditional insurance, utilities are not free from this risk. This type of damage is a normal business risk in Florida.
>
> FPL's proposal does not take into account the utility's earnings or achieved rate of return. If the company was already earning an adequate return on equity, its storm-related expenses could be amortized in whole or in part over five years. If the magnitude of the loss is great, the utility could draw on its line of credit and then petition the Commission to act quickly to allow expense recovery from ratepayers.
>
> Storm repair expense is not the type of expenditure that the Commission has traditionally earmarked for recovery through an ongoing cost recovery clause. Conservation, oil backout, fuel and environmental costs are currently recoverable under Commission created cost recovery clauses. These expenses are different from storm repair expense in that they are ongoing rather than sporadic expenditures.
>
> * * *
>
> Therefore, we decline to authorize the implementation of a Storm Loss Recovery Mechanism, in addition to the base rates in effect at the time, for the recovery, over a period of five years, of all prudently incurred costs in excess of the reserve to repair or restore T&D facilities damaged or destroyed by a storm.
>
> If a hurricane strikes, FPL can petition at that time for appropriate regulatory action. In the past, we have acted appropriately to allow recovery of prudent expenses and allowed storm damage amortization. We do not believe that regulated utilities should be required to earn less than a fair rate of return because of extraordinary events such as hurricanes or storms.

Pages 5-6, Order No. PSC-93-0918-FOF-EI (Emphasis supplied.)

Conclusion

This Commission's prior orders have consistently made clear that it would not transfer all risks of storm loss directly to ratepayers so that there would be no effect on a utility's earnings. To be consistent with precedent and fair to consumers, SMW's primary position is that the storm expense incurred by PEF should have to be amortized over an appropriate time period -- perhaps five years – and that there should be no surcharge to customers. If, however, there is a surcharge, then the amount of the recovery should be determined, not based on the amount that PEF spent, but the amount of storm cost recovery expenses that remain after PEF's shareholders absorbed costs sufficient to bring its earnings to the minimum of a fair rate of return on equity, which, pursuant to the Settlement Agreement, is 10 percent.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing has been furnished to the following individuals as indicated in the service list on this 26th day of April, 2005.

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