BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

DOCKET NO. 060038-EI
FLORIDA POWER & LIGHT COMPANY

IN RE: FLORIDA POWER & LIGHT COMPANY'S PETITION FOR ISSUANCE OF A STORM RECOVERY FINANCING ORDER

APRIL 10, 2006

REBUTTAL TESTIMONY & EXHIBITS OF:

HUGH A. GOWER

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF HUGH A. GOWER

DOCKET NO. 060038-EI

APRIL 10, 2006

Q. Please state your name, address and occupation.

A. My name is Hugh Gower and my address is 7988 Beaumont Court, Naples, Florida 34109.

I am self employed as a consultant on public utility financial, economic regulation and cost containment and control matters. I also provide expert testimony on topics related to public utility economics and rate regulation in cases before public service commissions and courts.

Q. Did you previously submit direct testimony in this proceeding?

A. No.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring an exhibit consisting of five documents, HAG-1 through HAG-5, which is attached to my rebuttal testimony.

Q. Please summarize your educational and professional background.

A. I practiced public accounting for more than thirty years following receipt of a Bachelor of Science degree in Accounting and Economics from the University of Florida. Although I have experience in a number of industries, I

specialized in the public utility area. I am, or have been, registered as a Certified Public Accountant in several states and I am a member of the American Institute of Certified Public Accountants and the Florida Institute of CPAs. Further information regarding the nature of my work experience is contained in an appendix to my testimony.

PURPOSE AND SUMMARY

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to rebut assertions made and adjustments to FPL's actual storm damage repair and service restoration costs ("restoration costs") proposed by OPC witnesses Hugh Larkin, Jr. and Donna DeRonne ("OPC witnesses" or "OPC").

I will also explain methods of cost accounting which are used by businesses in general as well as by public utilities and comment on which are appropriate in dealing with storm events.

I will explain my evaluation that the adjustments OPC witnesses propose are inconsistent with the regulatory framework which underlies cost-based ratemaking which has been and will be of great importance to utilities and their customers.

Q. Please summarize your findings and recommendations from your evaluation of OPC witnesses Larkin and DeRonne's testimony and of the adjustments they propose to FPL's storm restoration costs.

A. First, the very foundation for OPC witnesses' proposed adjustments to FPL's restoration costs is that there has been a double recovery of these costs. This is a mere assumption and is false. Evidence shows that, to the contrary, no double recovery occurred and the effect of 2005 storms activity adversely impacted FPL's earnings (even though all restoration costs were excluded from earnings in reliance on regulatory precedents allowing for recovery).

Second, although OPC witnesses characterize their adjustments as "incremental costing", their work is, at best, a misapplication of incremental costing methods and is unsupported by any competent analysis.

Third, OPC witnesses' proposals are in conflict with the regulatory framework which underlies cost-based ratemaking which has benefited both customers and utilities alike. The "incremental costing" adjustments OPC witnesses propose should be rejected because they are not in the best interests of either customers or FPL.

REGULATORY FRAMEWORK

Q. Can you summarize your analysis of how the recommendations of OPC witnesses Larkin and DeRonne conflict with the regulatory framework of cost-based ratemaking?

A. Yes. In order to do this, it will be necessary to first lay out the elements of that regulatory framework.

Q. Is the setting of utility rates on the basis of actual costs widespread?

A. Almost universally, regulators with responsibility for setting the rates or prices for public utilities in the United States do so on the basis of the affected utility's actual cost of providing service to customers. This is the method historically applied by the FPSC. Use of cost-based ratemaking has a long history and is used because the regulated companies are not subject to market forces or competition to limit either their prices or profits to the same degree as companies which offer products or services in completely open, competitive markets.

Over a period of many years, the application of cost based ratemaking in numerous cases and the decisions of regulators and courts have developed a regulatory framework which defines the rights and obligations of utility customers and of utilities to maximize the benefits for both. This includes the procedures for determining fair and reasonable prices for utility services based on "cost of service".

Q. How does this regulatory framework affect the determination of fair and reasonable prices based on "cost of service"?

A. The term "cost of service" is exactly what it implies and is conceptually simple, but its application can be complex and it is often misunderstood, misinterpreted or misapplied. Under this regulatory framework, fair and reasonable prices include all and only the costs of activities undertaken by the utility to provide service. Costs are limited to those reasonably and prudently incurred for the provision of service. In addition to fuel, labor, supplies, taxes, depreciation and other operating expenses, utilities are entitled to include in their prices a reasonable return on the capital their owners and lenders have invested for the provision of utility service. These costs are usually measured for a year's period of time (called a "test period") and are matched against the quantity and quality of service expected to be provided during the period. "Cost of service" includes the cost of resources used or consumed during that period rather than the total amount the utilities may be committed to spend or may have already spent for such resources, or the total return on capital the utilities will need for all the years investors' capital is expected to be devoted to utility service. Further, expenses of activities unrelated to the provision of utility service are excluded from the price of utility services as are returns on capital not devoted to utility service.

Q. How are operating expenses, taxes and depreciation limited to those devoted to utility service in the cost-based rate setting process.

A. Operating expenses, taxes, depreciation, etc. are routinely accounted for and reported by utilities using the Uniform System of Accounts ("USOA") prescribed by FERC and adopted by this Commission. The USOA, through its detailed instructions, limits amounts recorded in "operating expenses" to the cost of those

resources consumed to conduct utility operations. Amounts applicable to non-utility activities are recorded in designated accounts separate and apart from those for utility operations. Likewise, USOA instructions explicitly separate construction related expenditures and costs from utility operating accounts.

In most cases, compliance with the USOA is subject to audit and verification by the utility regulators' staffs. This provides a high level of assurance that amounts recorded in utility operating expense accounts are appropriately limited to the operating costs of providing utility service and are appropriately classified for use in a rate setting proceeding.

Q. What does the capital upon which the utility investors are entitled to a return consist of?

A. The capital upon which utility investors are entitled to a return consists of debt and equity capital invested in the utility company. Equity capital generally consists of common stock outstanding, other paid-in capital and earnings retained in the business. Some utilities also issue preferred stock shares to finance part of their business. Debt capital generally used by utilities would include mortgage bonds, debentures and long-term notes of various kinds. In Florida, a utility's capital structure for ratemaking purposes also includes customer deposits and interim bank debt financing, if any, as well as cost free capital sources such as deferred income taxes.

Although the total amount of capital invested in any utility enterprise is easily

identified from the company's books and records, in cases where the utility is subject to more than one jurisdiction (federal and state for example), provides more than one kind of utility service, has non-utility operations or capital invested in utility assets under construction and not yet providing utility service, what part of that total capital is devoted to utility service it is not easily determinable. In such cases, the amount of capital devoted to utility service is estimated using the contra values of assets shown on the utility's books. The book value of assets devoted to the provision of utility service can be identified from detailed records generally available and utility rate analysts use such values to compute an amount called "rate base". Although "rate base" is derived from book asset values it really represents the amount of capital which investors have supplied for the provision of utility service. This is the amount of capital upon which investors are entitled an opportunity to earn a reasonable return.

Q. How do regulators who employ cost-based rate regulation determine what to allow utilities as a reasonable return on capital devoted to public service?

A. The capital structure of each regulated company is reflected on its books of account and shown on its annual reports to regulators. These records show how much of the utility's capital structure is common equity, preferred stock, debt or cost free capital. The cost of preferred stock and debt can be calculated. The cost of common equity is usually estimated using stock market data. The weighted cost of all forms of capital employed by the utility, including any cost free capital, is the "reasonable return" which regulators allow on investors' capital ("rate base").

These cost-based rate regulation practices yield prices for utility service based on historic original costs rather than current values of the resources devoted to utility service. No adjustment is made to the allowed return—or prices for service—when the market value of the utility's outstanding securities is greater than the amounts originally received by the utility from their issuance. Likewise, no adjustment to prices for service is made when the current value of assets devoted to utility service is greater than their original historic cost.

Courts have held that, however calculated, a reasonable return is one which is sufficient for the utility to maintain its credit standing and financial integrity, sufficient to attract capital at reasonable costs and commensurate with returns being earned on investments attended by corresponding risks.

Q. Are utility investors protected from risk when rates are set in this manner?

A. No, utility investments are not risk free. While the rate of return allowed on utility investors' capital is generally lower than might be earned in some other types of businesses, this does not signal the complete absence of risk. As with any business, utility investors carry the risk of the success or failure of the business. Among others, this includes normal weather variations, customer usage, and management's ability to control costs, competition from other providers, inflation, regulatory lag, market risks and product risk. It is the reasonable assurance that cost based rate regulation will be applied in such a way that the utilities have an opportunity to recover the necessary, reasonable and prudent costs of providing service which keeps required returns on capital lower

than in some other kinds of businesses.

History shows that due to factors both related and unrelated to the specific utility, some investors have suffered substantial capital losses, while others more fortunate realized capital gains on their investments. Clearly, investors are exposed to capital losses on the utility securities they hold.

Q. When a utility seeks to change its rates or prices under this regulatory framework, do regulatory authorities accept actual costs contained in the Company's books and reports for purposes of calculating the price needed to cover cost of service?

A. The actual amounts shown on the utility's books are the starting point for evaluating revenue requirements. However, in addition, actual revenues and costs are scrutinized and frequently adjusted to make sure that the cost of service is representative of that expected to be required to support the normal level of service in the future when the new rates will be in effect. For example, nonrecurring, out-of-period or extraneous expenses would be excluded (or allowed on a levelized basis) from operating expenses used for rate setting following the rules or practices and procedures applicable in the jurisdiction where application for approval of a rate change is made.

Q. Can you provide examples of transactions which would be nonrecurring, out-of-period or extraneous items which might be excluded from cost of service for rate setting purposes?

A. Receipts or disbursements from the settlement of litigation relating to events over

which disputes arose in prior years would be examples of both nonrecurring and out-of-period items. Unexpected proceeds from insurance claims could be both extraneous and nonrecurring. Other examples of costs excluded from a test year's cost of service (or included on a levelized basis) would include debt redemption costs, extraordinary property losses, fuel conversion costs or natural gas conversion costs.

The effects of abnormal weather such as severe tropical storms and hurricanes are considered to be nonrecurring or are for other reasons excluded from cost of service. In most cases, revenues and expenses for the test period are adjusted to amounts associated with normal weather so that revenue requirements are set to exclude the effects of all abnormal weather.

Q. Are all rates and prices of utilities set as you have just briefly described?

A. For many years this was the general approach. However, it became necessary to alter this procedure when the price of major cost of service components became volatile and difficult to predict. For example, after many years of relatively stable energy costs, by the mid 1970s the prices of oil, gas and coal began to rise so rapidly that general rate proceedings to change prices enough to recover those costs could not be prosecuted with sufficient speed and became administratively and economically infeasible. Thus, fuel costs were, for the most part, separated from "base rates" and covered by special billing factors. A number of other costs are also included in billing factors separate from base rates for a variety of reasons. This simplifies and expedites the regulatory process for dealing with

these items by narrowing the issues which need to be considered, while limiting recovery to actual costs and providing adequately for their recovery by utilities.

Q. Are the extraordinary or nonrecurring expenses you mentioned excluded from cost of service because they are not necessary, reasonable or prudent expenses applicable to the provision of utility service?

A. No, on the contrary, they are clearly necessary, reasonable and prudent costs of providing utility service. They are excluded from a test period cost of service to avoid rates being set to cover costs which are volatile or abnormally high in one period. Other methods of providing for the recovery of such costs are available, such as amortization over a period of years, or the use of separate billing factors. Key to the success of the cost-based rate setting process is the assurance provided that utilities will have an opportunity to recover all necessary, reasonable and prudently incurred costs.

Q. Why is there a separate storm cost recovery factor?

A. In the course of a general rate proceeding which adjusts base rates to an appropriate level, the cost of storm restoration is, for the most part, excluded from costs upon which rates are based as a (hopefully) nonrecurring item. Although some amount of cost may be included to allow for a build up of a reserve against future natural disasters, for the most part these costs are excluded to mitigate the rate impact when storm events occur and so that base rates do not include amounts for events which may or may not occur and/or because the actual

restoration costs are difficult to predict.

Q. Are the costs of storm damage repair and service restoration necessary costs which utilities should be entitled to recover?

A. Clearly such costs are necessary, reasonable and prudent costs of providing utility service including the restoration of service following a storm event. As the greatest part of such costs is excluded from base rates, the only reasonable regulatory treatment is to allow utilities an opportunity for after-the-fact recovery of the actual amount of storm restoration costs (not covered by a reserve) through a special billing factor.

Q. Please summarize the relationship between utilities and customers under the regulatory framework of cost-based rate making.

A. Under this regulatory framework, utilities are obligated to provide safe, adequate, reliable service to all customers willing and able to pay for service within their designated service area. Utilities are able to establish reasonable rules and regulations concerning matters as safety, payment terms and other commercial aspects. Utilities providing service under such regulation are, as are all businesses, entitled to legal protection of their privately owned-property. Among other things, this means that utilities are entitled to charge a fair and reasonable price which covers the costs they incur to provide service and are also protected against confiscation of their property. A reasonable opportunity to recover all necessary, reasonable and prudently incurred costs of providing service (including return) is a key element of this regulatory framework.

Customers are entitled to safe, adequate and reliable service, and customers must pay the fair and reasonable prices set or approved by the applicable regulatory commission and which are limited to the actual costs of providing service.

Q. Has this regulatory framework benefited utilities and their customers?

A. Yes, this regulatory framework has benefited both utilities and their customers. Utilities benefit because where this framework is employed in a stable, responsible manner, it is easier for utilities to finance the facilities required to meet customers' needs.

Customers also benefit because this regulatory framework assures adequate, reliable service at prices lower than they might otherwise be. Importantly, regulation helps avoid duplicate facilities which might otherwise exist and also avoids price increases as current values increase.

In view of the capital intensity of the industry, the generally lower capital costs have also significantly lowered utility prices. Finally, this regulatory framework avoids wide swings in prices which might otherwise occur when substantial variations in demand or resource availability arise.

STORM COST RECOVERY PRICIPLES

Q. One of the "principles" Mr. Larkin asserts (Page 4) should underlie the restoration costs approved for recovery in this case is "...The Public Service Commission should look to the business risk which was borne by FPL's customers in regard to the storm damage they incurred as a proxy for the business risk which FPL should have to bear" do you agree?

A. No, I do not. The primary reasons Mr. Larkin's "principle" should not be relied upon were well summarized in the 1996 Order No. 14859 (contained in Document No. HAG-1) issued by the Hawaii Public Utilities Commission (HPUC) in deciding a similar hurricane storm cost issue involving Citizens Utilities Company. Because the same basic principles of utility regulation should be applied in the FPL case, I quote the HPUC reasoning:

> "As pointed out by the Consumer Advocate...the legislature has charged this commission with the authority to balance the interests between the utility's ratepayers and its shareholders with respect to who should bear the...restoration and repair costs. After considerable review, consideration, and balancing of these interests, we do not find it just, reasonable, or in the public interest to require Citizens' shareholders to bear any of the ...restoration and repair costs.
>
> Our decision is based in a large part on the long-standing regulatory compact. The regulatory compact has two

aspects: (1) in return for a monopoly franchise, utilities accept the obligation to serve all comers; and (2) in return for agreeing to commit capital necessary to allow the utilities to meet the obligation, utilities are assured a fair opportunity to earn a reasonable return on the capital prudently committed to the business. In Wash. Util. and Trans. Comm'n v.Puget Sound Power & Light Co. ,62 P.U.R. 45th 557,581 (1984), the Washington Commission explained the regulatory compact in this fashion:

> "The social and economic compact of utility regulation begins with the premise that a regulated utility has an obligation to serve the public. A utility possesses an unending obligation to provide service to anyone within the service territory of that utility who demands service in accordance with approved tariffs. However, in order for the social duty to serve to be viable, the compact must also provide for a utility to recover expenses it prudently undertakes to meet the obligation."

Q. Mr. Larkin criticizes the basis on which storm restoration costs are recovered in Florida as "customer supplied insurance". Is he correct in this assertion?

A. No he is not. Rule 25-6.0143 of the Florida Administrative Code (shown in

Document No. HAG-3) specifies relative to the use of Account 228.1 Accumulated Provision for Property Insurance-

> "(1)(a) 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 provisions for the deductible amounts contained in property loss insurance policies held by the utility as well as retrospective premium assessments stemming from nuclear accidents under various insurance programs covering nuclear generating plants...."

While Mr. Larkin's characterization disparages the provisions of the rule, the assignment of property loss risks in this fashion has been in place for a number of years and was chosen as the method most consistent with the interests of both customers and utilities. The Commission's Rule as well as its regulatory treatment for many years recognize both the extraordinary nature of hurricanes, accident, fire, flood, nuclear accidents and similar type hazards as well as the necessity and prudence of carrying out restoration. Historically the Commission has tried to levelize the impact of such costs on rates.

COST ACCOUNTING PRACTICES

Q. Is the incremental cost method which OPC witnesses propose to apply in this case a valid costing method?

A. Yes, it is a valid costing method, but not as proposed by OPC.

Q. Can you explain why their proposals are not valid application of the incremental costing method?

A. Yes, but first it would be helpful to explain how and when businesses utilize incremental and other costing methods.

Businesses which undertake multiple activities or provide multiple products of services must employ some cost accounting method to assign costs and expenses to those activities, products or services and obtain information for a number of purposes. Two choices are fully distributed or fully allocated costs ("fully distributed") and incremental costs.

Q. Can you briefly explain those costing methods?

A. Incremental costs generally mean those costs incurred to perform some incremental activity or produce additional products or services. Fully distributed cost generally means that all actual costs for a period are assigned to the activities performed or products or services produced during the period.

Q. Is either method appropriate in any circumstance?

A. Whether costs can appropriately be assigned on a fully distributed or incremental basis depends on not only the uses for which cost information is needed, but also

the circumstances under which activities are performed or products or services produced.

Incremental cost accounting is more apt to be employed by enterprises involved in providing products or services competitively or where the resources needed to produce such products or services are separate and distinct from those required for a company's other products and services. Fully distributed cost accounting is more often employed by businesses whose expenses are largely common to all its activities or products and services. Utilities are one of the latter type businesses and in practice generally employ fully distributed cost methods consistent with the USOA accounting instructions as well as predominant regulatory practices.

Q. Can you illustrate circumstances in which these cost accounting methods might be applied?

A. Yes. Assume for purposes of illustration that a manufacturer of bicycles produces a certain number of its product each year and that its work is carried out in a rented plant by one supervisor and four employees. This manufacturer sees that there is a market for tricycles in addition to the bicycles it produces. In considering whether to enter the market with this additional product, it finds that two manufacturing employees (in addition to those already employed) will be needed. In addition, it ascertains that additional manufacturing floor space along with different size wheels and certain additional materials will be required. The sum of the cost of these additional resources would be the incremental cost of

adding tricycles to its production. Using this information, the manufacturer can determine the price with which it can compete in the tricycle market. By adding these incremental costs and the expected revenues to its existing bicycle revenues and production costs, the manufacturer can ascertain whether it would be better off doing so. The manufacturer can make this determination using either the incremental or fully distributed cost method.

Q. Are there circumstances in which one of these cost accounting methods would not be appropriate or provide useful information?

A. Yes. Assume further that in investigating the possibility of adding tricycles to its production, the manufacturer finds that it is unable to rent or otherwise acquire usable manufacturing space and that it is unable to employ the two additional employees it will need to manufacture tricycles. Its alternative is to shut down part of its bicycle manufacturing and utilize that space and two of its workers presently involved with the bicycle manufacturing to undertake the tricycle production. But because of its bicycle sales orders and delivery commitments, it will have to put its remaining bicycle manufacturing staff-- or all of its staff-- on overtime. In these circumstances, the previously identified incremental costs would not be useful for either pricing tricycles or evaluating whether the manufacturer would be better off to make the additional product. At a minimum, in order to make proper incremental cost calculations, the manufacturer would have to consider the overtime for bicycle and/or tricycle production which would result from undertaking the tricycle manufacturing. It would also have to take into account the cost of any other resources it redeployed from bicycle production

to tricycle production. Its old bicycle cost information supplemented with the original "incremental cost" information would not provide true cost information nor would it be useful in evaluating whether it would be better off to add the tricycle product or not.

Q. How does this illustration relate to FPL's storm restoration costs in this docket?

A. OPC witnesses Larkin and DeRonne's proposal to "cost" storm restoration efforts using "incremental" costs is flawed just as in the second scenario in the hypothetical example I just described. First, it excludes some costs clearly caused by the storm restoration activities. Overtime, employee assistance, vacation buy-backs and back-fill work come easily to mind as do some of the other labor and transportation costs which, although actually devoted to the storm restoration, they propose be excluded. Like the hypothetical bicycle manufacturer, FPL's normal business activity and service provision has been seriously disrupted by the additional activities of dealing with storm events. Normal service is, until service restoration can be completed, disrupted. In such situations, it's "all hands to the rescue" and normal work activities are temporarily suspended but must be completed at a later time. Clearly, incremental costing in such circumstances does not fairly recognize the true cost of storm restoration. The actual restoration costs need to be known and, since such costs were excluded when base rates were set, must be properly accounted for or an opportunity for their recovery will be denied. Requiring the use of the "incremental" cost method for storm events as OPC witnesses propose would result in a recovery amount less than the

actual storm damage repair and service restoration costs prudently incurred by FPL.

MISAPPLICATION OF INCREMENTAL COSTING

Q. **Why do OPC witnesses Larkin and DeRonne recommend use of "incremental" costing for FPL's storm restoration costs?**

A. Both OPC witnesses suggest that use of "incremental" costs is necessary because the cost of internal resources devoted to storm restoration are "covered by base rates" and use of actual costs will result in a "double recovery" by FPL.

Q. **Is this correct?**

A. No it is not. Assuming arguendo that the cost of such internal resources were included in base rates (whenever they were set), what Mr. Larkin and Ms. DeRonne seem not to have observed is that customer consumption does not continue during the service interruptions storms cause. And when there is no consumption, there is no revenue with which to recover such costs.

Q. **What evidence of "double collection" do Mr. Larkin and Ms. DeRonne provide?**

A. None. The comments of U.S. Court of Appeals Judge Prettyman in the Mississippi River Fuel Corp. v. Federal Power Commission (163, F. 2d 433,437 (1947)) case (contained in Document No. HAG-4) are apropos to this situation:

> "Expenses (using that term in its broad sense to include

not only operating expenses but depreciation and taxes) are facts. They are to be ascertained, not created, by the regulatory authorities. If properly incurred, they must be allowed as part of the composition of rates. Otherwise, the so-called allowance of a return upon investment, being an amount over and above expenses, would be a farce."

Although Judge Prettyman's comments addressed expenses, they are also applicable to revenues. They do not exist on the basis of an assumption; they need to "be ascertained".

Q. Mr. Larkin cites a definition in Kohler's Dictionary for Accountants as support for the use of "incremental" costs. Are OPC witnesses Larkin and DeRonne's proposed adjustments of actual storm damage and service restoration costs based on incremental costs?

A. No, they are not. Mr. Larkin and Ms. DeRonne have misapplied incremental costing by basing their proposed adjustments to the amount of restoration costs for 2005 largely on the difference between actual non-storm related costs and original departmental budgets. Such budget-actual variances do not represent incremental costs. Further, no effort was made to determine what part of the variance, if any, was due to the storms. They also ignore incremental offsetting costs. For example, OPC proposes to exclude millions of dollars of regular payroll of employees who worked on the restoration

effort and correctly charged their time to storm restoration costs. OPC would remove this entire amount from storm recovery while ignoring the millions of directly related cost increases because backfill and catch up costs were incurred to perform essential activities which, but for storms, would have been performed by those employees involved in the restoration effort.

As a result of these errors and omissions, OPC's proposed "incremental" cost does not accurately capture the true actual "incremental" costs of storm restoration to the extent that FPL employed internal resources in that effort.

OPC's calculation of "incremental" costs has further significant problems with measurement.

Q. What measurement problems are inherent in OPC's proposed "incremental cost" of storm damage and service restoration?

A. In its effort to prevent their assumed double recovery of costs by FPL, OPC proposes to exclude from charges to the storm damage reserve the "base rate recoverable" cost of resources utilized in the service restoration effort. In addition to the unanswered question of whether there has, in fact, been a double recovery, another question which needs to be considered is whether the amount of costs "recovered through base rates" during the period of the service restoration can be determined when base rates were set in years prior to the storm event.

Q. Why is this a question which should be considered?

A. Staff has acknowledged in its response to interrogatory No. 49 that "...it is unclear what specific costs of any kind are included in base rates".

Q. Do you agree with staff that it's unclear what specific costs are included in base rates?

A. Yes, I do. This is a conclusion which is true in most circumstances and the reason is that rates represent prices found by regulators to be fair and reasonable on the basis of evidence presented in a rate case. Normally, rates – the actual prices – are set by relating the total cost of service and the sales volumes found allowable for the test period and which are expected to be representative of operating conditions when the new rates will be applied. In addition, a number of other factors are usually considered in devising the actual tariff prices. These include the number of customers, value, customer usage characteristics, conservation, consistency with prior charges, ease of administration and customer understanding. Consequently, actual tariff rates are rarely equal to the exact amount of cost of service approved in a rate filing for each class of customer or each volume category within classes.

It would be unreasonable to expect that the relationship between the key variables used in the calculation of rates, such as number of customers, weather, demand and sales volumes, as well as operations expense and capital investment levels would remain the same as they were during the test period. These variables change for any number of valid reasons. The longer it has

been since the test period used for rate setting, the more improbable the determination with any degree of reliability a quantifiable amount of any particular current cost of service element (such as depreciation, operations expense or income taxes) such rates recover. Prices set on any basis cannot provide a lasting link to or preserve the relative values between the key variables which were the basis for their calculation.

Q. Is the fact that a cost element was included in a budget for a period affected by storm activity certain proof of "double recovery" by FPL?

A. No it is not. OPC's conclusion that an amount included in an operating budget for a period several years subsequent to an actual test period from which rates were set represent a like amount currently recovered from customers in base rates is an assumption rather than a fact. Even if it could be determined that a cost is "included in base rates", recovery of any cost through base rates takes place only to the extent that actual revenues cover such costs. Unfortunately, OPC has focused only on what costs might have been included in base rates, whenever they were set, and ignores whether there were sufficient revenues in the periods affected by storm activity to cover such costs. OPC simply assumes there has been a double recovery. In addition to failing to consider revenues for the periods affected by storm activity, OPC's proposed adjustments are subjective in nature and have no substantive analysis or support.

Q. Explain how OPC's adjustments are subjective and without substantive analysis or support.

A. OPC proposes to identify "incremental costs" by subtracting from actual service restoration costs differences between budget and actual costs for 2005 without sufficient analysis to determine if the variance is storm related or not. Such calculations are subjective and incomplete.

At deposition Mr. Larkin was asked:

> "Q. Is it your opinion that differences between budgeted and actual amounts relied upon by Larkin and Associates, in applying the incremental cost method, could only have been caused by charging costs to the storm cost?
>
> A. It is a conclusion we reached..."

(Larkin deposition, page 47, line 16, attached as Doc. No. HAG-2)

Q. Mr. Larkin criticizes FPL for its assertion that use of a budget amount is not a good way to identify incremental costs. Do you agree with Mr. Larkin?

A. No, I do not. Mr. Larkin defends his criticism on the basis that FPL has based numerous projected rate case data elements, including revenues, expenses and plant investment balances on its budget process. While this is no doubt true, the broken link in his "connection" is that budgets do not identify "incremental" costs. Rather their purpose is to identify the total actual cost of

resources used to carry out numerous operating and non operating activities. Further, no rate case test period approved by the Commission that I'm aware of included storm restoration costs (other than relatively small accruals to set up the storm reserve)...or any other effects of major storm activity. Rate case filings include normal weather only.

It's also true as Mr. Larkin asserts that the Commission has approved projected rate case data derived at least initially from use of FPL's budget system. For the same reason noted above, this has nothing to do with "incremental costs" since budget data does not deal with that type of costing. Further, attempts to use "incremental costs" represent a departure from the reasonable and fair cost accounting directives contained in the USOA. Essentially, the USOA directs accounting for the actual costs of all activities undertaken in the provision of utility service, construction or other activities.

INCONSISTENCY WITH USOA

Q. Mr. Larkin cites USOA Plant Accounting instruction No. 10 dealing with improvements to minor items of property as an example of the USOA supporting use of incremental costs. Do you agree that this is support in the USOA for use of incremental costs?

A. No, I do not. Rather than supporting incremental costing, it is support for use of an estimate when the actual cost of an improvement cannot be identified directly.

Mr. Larkin ignores the overriding and more directly applicable USOA instructions which make it clear that actual costs are the overriding accounting objective in the USOA instructions.

A good example is Accounting Instruction 9, "distribution of pay and expenses of employees" (included as Document No. HAG-5) which states:

> "The charges to electric plant, operating expenses and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work..."

In addition, Electric Plant Instructions 3, "components of construction cost" (also included in Document No. HAG-5) states:

> "A. For major utilities, the cost of construction properly includable in the electric plant accounts shall include where applicable, the direct and overhead costs as listed and defined hereunder..."

Items listed include contract work, labor, materials and supplies, transportation, special machine service, shop service, protection, injuries and

damages, privileges and permits, rents, engineering and supervision, general administration capitalized, engineering services, insurance, law expenditures, taxes, allowance for funds used during construction, earnings and expenses during construction, training costs, studies, and asset retirement costs. Each of these categories is explained in some detail, but the thrust is clearly to provide a fully distributed cost accounting for construction activities (as opposed to incremental costs).

INCONSISTENCY WITH REGULATORY FRAMEWORK

Q. OPC witness Larkin suggests on page 21 of his direct testimony that the "weather effects" of storm outages are similar to normal heating or cooling season variations and should be borne by stockholders. Do you agree?

A. No, I do not. Mr. Larkin might not have thought this assertion through completely. The weather effects of major storm events are clearly unlike and far more extreme than normal weather variations. Aside from the suspension of consumption and revenues due to outages (which do not occur in normal weather conditions), as evidence in this case shows, the costs of service restoration can be enormous. Such risks are not covered by the returns normally allowed by regulators.

Q. Do regulatory authorities generally employ incremental cost accounting methods?

A. No. In my experience, the predominant cost accounting method used for regulatory purposes is the fully distributed method. This is the method used for assignment of costs between jurisdictions, between classes of customers or between regulated and non regulated activities.

Aside from inconsistency with other cost assignments which are an intrinsic part of utilities' routine accounting practices and procedures, OPC's methodology understates the actual cost of storm restoration. The actual cost of such efforts is important information for management, regulators and other interested parties. Provided with the actual cost of storm restoration, all parties can then make more informed decisions as to recovery or other matters. Most importantly, since actual storm restoration costs have been, for the most part, excluded from base rates, their exclusion from the storm recovery factor would mean such costs would never be recovered.

Q. Would it be possible to use the incremental cost method to determine the actual cost of the storm restoration incurred by FPL?

A. If done properly, it could. When viewed in light of the fact that the cost of such storm recovery efforts has been largely excluded from cost of service used to set rates, the entire cost of the restoration effort is the "incremental cost" of the storm events.

Q. Does the use of internal resources which would have otherwise been deployed to normal operations and maintenance activities in the storm

recovery effort result in a double recovery of costs by FPL?

A. No, it does not. If a double recovery were to occur, it would be apparent that FPL was better off having suffered the storm damage than if it had not. For this to occur in spite of the loss of kilowatt hour sales and revenues for the periods affected by storm activity, amounts charged to normal operations and maintenance expenses would have had to decline by a greater amount than the revenue loss so that its operating income for such periods would go up instead of down. When asked at deposition whether this is true, Mr. Larkin responded

> "Well, that's almost a mathematical certainty." (Larkin deposition at p. 44, Doc. No. HAG-2)

In reaching their conclusion that there has been a "double recovery" OPC witnesses have ignored evidence to the contrary. As shown clearly on Mr. Davis' Document No. 10, even if FPL is granted recovery of all of the storm restoration costs it has requested in this proceeding, the 2005 storm events will have reduced its pre tax income by $47 million.

When the facts are considered, it is clear that FPL is not better off than before the storm events and there most definitely has been no double recovery of costs.

Q. At page 22 of her testimony, Ms. DeRonne suggests reducing FPL's 2005 storm restoration costs by the $9,095,845 FPL billed to other utilities under the mutual assistance program. What is her basis for this?

A. Ms. DeRonne's basis is that other utilities that assisted FPL in its restoration effort billed FPL for that assistance and FPL properly included those amounts

in its cost of storm restoration. She apparently failed to notice that the cost of assistance FPL provided and billed to other utilities was not included in either FPL's storm restoration costs or its operations and maintenance expenses for 2005. If directed to reduce to its storm restoration costs by the amount of these billings, it would mean that FPL would have to absorb such costs. This treatment comports with no costing theory I know of and would be patently improper and unfair.

THE RIGHT APPROACH TO COSTING STORM RESTORATION

Q. What is the right approach to costing the storm damage repair and service restoration efforts?

A. The right approach is one which supports the fundamental principle that FPL should be entitled to recover all storm restoration costs. (This does not mean that a mere assumption of inclusion in base rates or in revenues is conclusive evidence of being "recovered".) The actual cost approach which had been used prior to the 2004 storm cost recovery proceeding is the most straight forward of any cost accounting choices, is consistent with USOA directions and supported by existing well controlled accounting procedures already in place. Unless evidence of a double recovery of costs exists, it is the most reasonable and practical approach to follow.

It is not impossible to employ an incremental cost method to identify and account for the costs of storm damage and service restoration and meet the

objective of providing for recovery of all such costs. It is, however, a more difficult method to apply and may unnecessarily increase the internal accounting costs and/or regulatory costs without providing any commensurate benefit.

Q. Should the amount of storm damage repair and service restoration costs include contingencies for work not yet done?

A. Yes. It is necessary and appropriate to estimate the costs of work yet to be done in order to get the best measure of the total cost of such efforts so that appropriate rates can be determined. This is in principle no different than estimating the costs of future pension obligations, nuclear fuel disposal costs, nuclear plant decommissioning costs or fossil plant dismantlement costs—except that estimates for storm recovery costs do not require projections for so many years. A contingency reflects the fact that because of the extent and complexity of the restoration effort there is a great likelihood that either additional restoration work or higher costs of identified work, or both, will develop as the effort progresses. If such costs were not estimated and included in charges to the Storm Damage Reserve and charges to customers, the current charges to customers would be understated and future customer charges would be overstated.

Q. Is it proper to accrue for the cost of restoration work not done by the date set by the FPSC for "cut off" of charges to the storm reserve?

A. Yes, it is. In many cases actual known restoration work is postponed for reasons of operating economies. These should be accrued for and included in

charges to the storm reserve. Denial of the inclusion of such costs could be an incentive for uneconomic decisions which would not benefit customers.

SUMMARY

Q. Please summarize your testimony.

A. OPC witnesses Larkin and DeRonne have provided no evidence to support their assertion of a double recovery by FPL, but have merely assumed it to be so. The actual facts contradict these assertions.

The cost accounting methods proposed by Mr. Larkin and Ms. DeRonne are at odds with the guidance in the USOA and predominant regulatory practices and are inappropriate for use in the circumstances following a major storm event. Such cost accounting methods are not easily applied and on an ongoing basis would increase FPL's accounting costs without providing and commensurate benefits. Further, OPC witnesses have clearly misapplied the incremental cost method in this case and the adjustments to FPL's restoration costs would result in a significant under recovery by FPL.

Cost based ratemaking has provided enormous benefits to FPL and its customers and the FPSC should take great care to preserve the regulatory framework upon which it is based.

The adjustments which OPC witnesses Larkin and DeRonne propose to apply

"incremental costing" are in conflict with the regulatory framework of cost based ratemaking and should be rejected as not being in the best interests of FPL or its customers.

Q. Does this conclude your testimony?

A. Yes it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF HUGH A. GOWER

DOCKET NO. 060038-EI

APPENDIX

Q. Briefly describe the nature of your work experience.

A. From 1975 until 1992, I served as the Southeastern Area Director of the public utility and telecommunications practice for Arthur Andersen & Co. (now Andersen LLP). This area of the practice included work for electric, gas, telephone, water & wastewater utilities, motor carriers and airlines. I had responsibility for supervising the work done for clients, training of firm personnel and administrative matters, in addition to the direct responsibility for work done for numerous clients in this and other areas of the practice.

Serving those clients for which I had direct responsibility, I performed independent audits of the financial statements issued by public utilities and other companies in reports to investors and regulators. I participated in and supervised audits of various statements and schedules and other data required either annually or in connection with rate applications before federal or state regulatory authorities. I have also provided services in connection with the issuance of billions of dollars of securities by public utilities. I have consulted with public utilities and others regarding the economic effects of business transactions or rate-making matters as well as the proper accounting

for the economic effects of such transactions or matters.

I have directed revenue requirement studies involving analysis of rate base, operating revenues and expenses as well as the analysis of specific transactions or alternative rate-making proposals for various cost-of-service components. I have also directed studies to determine the proper assignment of cost of service between customer classes, regulatory jurisdictions or between regulated and nonregulated operations. I have provided expert testimony in cases before regulatory commissions and courts.

I participated in the development of accounting and management information systems designed to promote close control over utility resources such as materials, fuel and construction costs. I have directed the preparation of financial forecasts, conducted independent reviews of financial forecasts and directed the development of financial forecasting models. I participated in management audits, the purpose of which was to assess whether management systems and procedures promoted economy and efficiency in utility operations. I have directed detailed reviews of organization, operating procedures and operating costs for several utilities covering such areas as production, distribution, transportation and administrative areas. I have also assisted utilities with the analysis of root causes of differences between actual costs and original budgets for nuclear plant construction projects.

I have directed depreciation studies which, based on analyses of utility plant investments, retirement transactions, salvage or cost of removal, developed equitable depreciation rates with which to affect capital recovery during the service lives of the assets. I also developed plans which were accepted by regulators to equitably assign the future outlays for spent nuclear fuel disposal, nuclear plant decommissioning and fossil plant dismantlement costs to customers receiving service, considering the effects of inflation, the time value of money and other variables.

I was a representative of the American Institute of Certified Public Accountants on the Telecommunications Industry Advisory Group which advised the Federal Communications Commission on certain matters in connection with the development of its Uniform System of Accounts (Part 32). In this connection, I chaired the Auditing and Regulatory Subcommittee which dealt with issues involving compliance with generally accepted accounting principles ("GAAP") when regulatory rate-setting methods were based on practices at variance with GAAP.

Westlaw.
PUR Slip Copy
1996 WL 497174 (Hawai'i P.U.C.)
(Cite as: 1996 WL 497174 (Hawai'i P.U.C.))

H

Re Citizens Utilities Company, Kauai Electric Division
Docket No. 94-0097
Docket No. 94-0308
(Consolidated)
Dec. & Order No. 14859

Hawaii Public Utilities Commission
August 07, 1996

Before Naito, chairman, and Yamada and Pai, commissioners.

BY THE COMMISSION:

DECISION AND ORDER

I.

INTRODUCTION

*1 On July 21, 1994, KAUAI ELECTRIC DIVISION (KE) OF CITIZENS UTILITIES COMPANY (Citizens) filed an application for approval of a rate increase, revised rate schedules, and tariff rule changes in Docket No. 94-0097. In its application, KE sought approval of a general rate increase of $23,657,544 in additional revenues for test year 1995, aimed largely at recovering expenses resulting from the destruction of plant and equipment by Hurricane Iniki in 1992. [FN1]

KE served copies of its application on the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs (Consumer Advocate) and Mayor Joann Yukimura. Pursuant to Hawaii Revised Statutes (HRS) § 269-16, which requires that the commission hold a public hearing on an application for a rate increase upon notice as provided in HRS § 269-12, the commission held a public hearing on KE's application on September 22, 1994, at Wilcox Elementary School in Lihue, Kauai.

On September 6, 1994, the United States Department of Defense (the DOD), through the Department of the Navy, filed a timely motion to intervene in Docket No. 94-0097. On October 3, 1994, the County of Kauai (Kauai County); Vernelle Aguiar, Donna Kamaunu and Carla Akau, by their attorney the Legal Aid Society of Hawaii (Legal Aid); Clara Fraticelli, Tomasa Acoba, Bonifacio Acoba, Daniel Johnson, Mabel Branco and Ernest Branco, by their attorney the Seniors' Law Program (Seniors' Law Program); and Loka Partners also filed timely motions to intervene.

By Order No. 13596, filed on October 13, 1994, the commission took the following action in Docket No. 94-0097: (1) the Consumer Advocate was made a party; (2) the DOD and Kauai County were made intervenors; (3) Legal Aid and the Seniors' Law Program were made participants [FN2] ; and (4) Loka Partners was denied intervention.

On October 24, 1994, KE filed an application for approval of a statewide surcharge to recover repair and restoration costs resulting from Hurricane Iniki (statewide surcharge application). KE served copies of its statewide surcharge application on

Hurricane Iniki that will never be recovered from its ratepayers.

2. The stipulation entered into by KE, the Consumer Advocate, and the DOD in Docket No. 7517, and approved by the commission in Decision and Order No. 12064, allows challenges to Iniki restoration investment only on the basis of prudence.

3. The historic 'regulatory compact' for the past 100 years between a utility and its regulators supports the inclusion of Iniki restoration plant in rate base. Citizens should not be at risk from recovering its Iniki investment because it relied on this regulatory compact in voluntarily providing disaster recovery support.

4. Disallowance of Iniki restoration investment and extraordinary storm expenses would cause the required rate of return on equity for KE and other Hawaii utilities to escalate because of increased risk to investors.

5. KE's decision to self-insure its transmission and distribution plant has benefitted ratepayers through lower rates in the past. Thus, recovery of Iniki restoration costs should be borne by the same ratepayers who benefitted from self-insurance.

6. KE's utility services cannot be compared to an unregulated business in a competitive market because, among other reasons, such unregulated businesses do not have a duty to serve their customers.

As pointed out by the Consumer Advocate and the DOD, by Act 337, the legislature has charged this commission with the authority to balance the interests between the utility's ratepayers and its shareholders with respect to who should bear the Iniki restoration and repair costs. After considerable review, consideration, and balancing of these interests, we do not find it just, reasonable, or in the public interest to require Citizens' shareholders to bear any of the Iniki restoration and repair costs.

*6 Our decision is based in a large part on the long-standing regulatory compact. The regulatory compact has two aspects: (1) in return for a monopoly franchise, utilities accept the obligation to serve all comers; and (2) in return for agreeing to commit capital necessary to allow the utilities to meet the obligation, utilities are assured a fair opportunity to earn a reasonable return on the capital prudently committed to the business. In Wash. Util. and Trans. Comm'n v. Puget Sound Power & Light Co., 62 P.U.R. 45th 557, 581 (1984), the Washington Commission explained the regulatory compact in this fashion:

> The social and economic compact of utility regulation begins with the premise that a regulated utility has an obligation to serve the public. [A] utility possesses an unending obligation to provide service to anyone within the service territory of that utility who demands service in accordance with approved tariffs. However, in order for the social duty to serve to be viable, the compact must also provide for a utility to recover expenses it prudently undertakes to meet the obligation. (Emphasis original.)

This regulatory compact has been recognized in this [FN8] and other jurisdictions [FN9] in the regulatory treatment accorded extraordinary storm losses and expenses in the past. In light of Citizens' (through KE) duty to serve and to make prudent investments to meet its obligation, it was expected that Citizens would quickly restore and repair its damaged facilities immediately after Iniki. Indeed, conscious of its obligation and relying on past regulatory practice that recognized

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

Docket No: 060038-EI
Filed: March 24, 2006

In re: Florida Power & Light Company's Petition for Issuance of a Storm Recovery Financing Order,

---

TELEPHONIC DEPOSITION OF HUGH LARKIN, JR.

Monday, April 32, 2006
10:01 a.m. - 1:00 p.m.

700 Universe Boulevard
Juno Beach, Florida 33408

Reported By:
Pamela J. Sullivan, RPR
Notary Public, State of Florida
Esquire Deposition Services
West Palm Beach Office Job #793063

storm restoration costs, that the only way FPL would have increased its profits due to the storms is if it had cost savings caused by the storm greater than $51,354,000, or whatever that lost revenue figure would be, based upon the weather?

A. Had increased its earnings? I guess your assumption is that we would have gotten the $51 million, but for the storm. But since we did have the storm, in order to come out even, we'd have to reduce costs by $51,354,000?

Q. Right.

A. Well, that's almost a mathematical certainty. Yeah, if you assume one is -- if you lose 51 million in one place, you have to make it up in another place to come out to the same place. Yep, I would agree with that. That's mathematical -- that's a mathematical certainty.

Q. Please turn to Page 8 of your testimony.

A. Okay.

Q. Lines nine to 13 of your testimony, the question introduces a discussion of use of variances and estimates. I think you've also got a similar discussion at Page 14.

A. Okay.

Q. Do you want to look at those or --

don't know. You just accept the -- that approach as being a method which will result in an acceptable end result.

Q. What kinds of things in business can cause differences between amounts budgeted at the beginning of a year and actual amounts determined to have been spent by year end?

A. Well, just timing can cause differences, when an expense is charged one month, as opposed to another.

Q. How about additions of work?

A. There might be more work or less work. That's possible.

Q. Unforeseen developments in the business, other than hurricanes, maybe?

A. That's possible.

Q. Is it your opinion that differences between budgeted and actual amounts relied upon by Larkin and Associates, in applying the incremental cost method, could only have been caused by charging costs to the storm cost?

A. It is a conclusion that we reached, and a conclusion that the Commission should apply, just like they're going to assume that everything you charged into the work order was a legitimate cost, just like they're going to assume that you did your level best to complete

FLORIDA ADMINISTRATIVE CODE ANNOTATED

The Official Compilation of the Rules and Regulations of Florida Regulatory Agencies filed with the Department of State under the Provisions of Chapter 120, Florida Statutes

COMPILED BY
THE EDITORIAL STAFF OF THE PUBLISHER

VOLUME 5

LexisNexis®

PUBLIC SERVICE COMMISSION

(*The following rule chapters have been repealed or transferred. See the Repealed and Transferred Table for past history.)

25-1	Rules Governing Internal Organization And Operation*
25-2	Rules Governing Practice And Procedure*
25-3	Railroad Companies*
25-4	Telephone Companies
25-5	Motor Carriers*
25-6	Electric Service By Electric Public Utilities
25-7	Gas Service By Gas Public Utilities
25-8	Application For Authority To Issue And Sell Securities
25-9	Construction And Filing Of Tariffs By Public Utilities
25-10	Water And Sewer Systems*
25-11	Telegraph Companies*
25-12	Safety Of Gas Transportation By Pipeline
25-13	Price Commission*
25-14	Limitation On Rates, Charges And Tariffs
25-15	Air Carriers*
25-16	Freight Forwarders*
25-17	Conservation
25-21	Rules Governing Internal Organization And Operation
25-22	Rules Governing Practice And Procedure
25-23	Rail Transportation*
25-24	Telephone Companies
25-25	Purchasing – General Purchasing Procedures
25-30	Water And Wastewater Utility Rules
25-40	Exceptions To The Uniform Rules Of Procedure

they are directly associated with the construction project and shall be charged to particular jobs or units on the basis of the amounts of such overheads to the end that each job or unit shall bear its equitable portions of these costs and that the entire cost of the unit both direct and overhead shall be deducted from the plant accounts at the time the property is retired.

(9) All maintenance costs, whether the work is done by the utility or under contract, shall be expensed. Unusual or extraordinary expenses can be amortized over a reasonable period of time as determined by the Commission. The costs of keeping equipment and plant in good condition shall be accounted for as maintenance expenses. Included in this classification are the costs of material and labor associated with the upkeep of plant such as:

(a) The training of maintenance personnel and the testing of equipment and facilities.

(b) The cost of ordinary repairs, refurbishment, repainting and rearrangements of plant.

(c) Miscellaneous expenses like shop repairs, tool expenses and motor vehicle expenses.

(d) The cost of performing work to prevent failure, restore serviceability or maintain or realize the life expectancy of the plant.

(e) The cost of repairing material for reuse.

(f) The cost of restoring the condition of plant damaged by attrition, acts of nature, fire or other casualties (other than the cost of replacing retirement units).

(g) The cost of inspecting after repairs have been made.

(h) Direct field supervision of maintenance.

(i) The cost of general supervision and engineering associated with maintenance work.

(10) Engineering unclassified time shall be expensed.

(11) A minimum capitalization criterion of $1,000 is imposed for each retirement unit as set forth in the List for the Office Furniture and Equipment, Stores Equipment, Tools, Shop and Garage Equipment, Laboratory Equipment, Power Operated Equipment, Communication Equipment and Miscellaneous Equipment Accounts.

Specific Authority 350.127(2), 366.05(1) FS. Law Implemented 350.115, 366.04(2)(f), 366.041, 366.06(1) FS. History–New 9-6-87, Amended 3-19-92, 3-18-97, 11-8-99.

25-6.0143 Use of Accumulated Provision Accounts 228.1, 228.2 and 228.4.

(1) Account No. 228.1 Accumulated Provision for Property Insurance.

(a) 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 provisions for the deductible amounts contained in property loss insurance policies held by the utility as well as retrospective premium assessments stemming from nuclear accidents under various insurance programs covering nuclear generating plants. A schedule of risks covered shall be maintained, giving a description of the property involved, the character of risks covered and the accrual rates used.

(b) Charges to this account shall be made for all occurrences in accordance with the schedule of risks to be covered which are not covered by insurance. Recoveries or reimbursements for losses charged to this account shall be credited to the account.

(2) Account No. 228.2 Accumulated Provision for Injuries and Damages.

(a) This account may be established to meet the probable liability, not covered by insurance, for deaths or injuries to employees or others and for damages to property neither owned nor held under lease by the utility. When liability for any injury or damage is admitted or settled by the utility either voluntarily or because of the decision of a Court or other lawful authority, such as a workman's compensation board, the admitted liability or the amount of the settlement shall be charged to this account.

(b) Charges to this account shall be made for all losses covered. Detailed supporting records of charges made to this account shall be maintained in such a way that the year the event occurred which gave rise to the loss can be associated with the settlement. Recoveries or reimbursements for losses charged to the account shall be credited to the account.

(3) Account No. 228.4 Accumulated Miscellaneous Operating Provisions.

(a) This account may be established for operating provisions which are not covered elsewhere. This account shall be maintained in such a manner as to show the amount of each separate provision established by the utility and the nature and amounts of the debits and credits thereto. Each separate provision shall be identified as to purpose and the specific events to be charged to the account to ensure that all such events and only those events are charged to the provision accounts.

(b) Charges to this account shall be made for all costs or losses covered. Recoveries or reimbursements for amounts charged to this account shall be credited hereto.

(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.

(b) If a utility elects to use any of the above listed accumulated provision accounts, each and every loss or cost which is covered by the account shall be charged to that account and shall not be charged directly to expenses. Charges shall be made to accumulated provision accounts regardless of the balance in those accounts.

(c) No utility shall fund any account listed in subsections (1) through (3) unless the Commission approves such funding. Existing funded provisions which have not been approved by the Commission shall be credited by the amount of the funded balance with a corresponding debit to the appropriate current asset account, resulting in an unfunded provision.

Specific Authority 366.05(1) FS. Law Implemented 350.115, 366.04(2)(a) FS. History–New 3-17-88.

25-6.0144 Fair Value of Energy Produced While Testing Electric Generating Units.

(1) This rule defines the "fair value" of energy generated while testing an electric generating unit under construction and before the unit is declared commercial, in conformity with the Uniform System of Accounts as adopted by the Commission.

(2) The Uniform System of Accounts for electric utilities requires that:

(a) earnings and expenses during construction constitute a component of construction costs;

(b) earnings include revenues received or earned for power produced by generating plants during the construction period which is sold or used by the utility; and

LEXSEE 82 U.S. APP. D.C. 208

MISSISSIPPI RIVER FUEL CORPORATION v. FEDERAL POWER COMMISSION et al.

No. 9181

UNITED STATES COURT OF APPEALS DISTRICT OF COLUMBIA

82 U.S. App. D.C. 208; 163 F.2d 433; 1947 U.S. App. LEXIS 3142

November 19, 1946, Argued
May 28, 1947, Decided

COUNSEL: [1]**

Mr. William A. Dougherty, of New York City, with whom Messrs. Max O'Rell Truitt, of Washington, D.C., and James Lawrence White of Pittsburgh, Pa., were on the brief, for petitioner.

Mr. Charles E. McGee, Assistant General Counsel, Federal Power Commission, of New York City, pro hac vice, by special leave of Court, with whom Mr. William Bradford Ross, General Counsel, Federal Power Commission, of Washington, D.C., and Mr. Alvin A. Kurtz, Attorney, Federal Power Commission, of Alexandria, Va., were on the brief, for respondent Federal Power Commission. Mr. Milford pspringer, Principal Attorney Federal power Commission, of Washington, D.C., also entered an appearance for respondent Federal Power Commission.

JUDGES:

Before GRONER, Chief Justice, and CLARK and PRETTYMAN, Associate Justices.

OPINIONBY:

PRETTYMAN

OPINION:

[*436]

This is a rate case and is before us on a petition to review and and set aside an order of the Federal Power Commission. n1 Petitioner is a natural gas pipeline company.

Petitioner's first point relates to the 6% rate of return found by the Commission to be reasonable. It claims that this finding does not accord with the precepts of fair play, because, [**2] it says, the whole hearing procedure was upon an assumed 6 1/2% rate of return, and a 6% rate was first mentioned in the principal brief of Commission counsel before the Commission. It further says that in eleven prior natural gas cases since the Natural Gas Act was passed, 6 1/2% was allowed, and that the general financial picture as to utilities has not changed since those cases. It further says that the finding as to the rate of return is not based upon substantial evidence and that the Commission did not consider the evidence of petitioner on the point.

The order of investigation which inaugurated the proceeding and likewise the order setting the hearing, recited that the inquiry would concern petitioner's rates and charges. This was sufficient notice that the rate of return would be considered. At the hearing both the Commission staff and the company introduced evidence upon the matter. That produced by the Commission staff included voluminous economic and statistical data. That evidence shoed that the price of long-term money generally, and similarly such costs to utilities, including natural gas companies, had declined in the period preceding the test year 1943 used [**3] in the case at bar. The earnings-price ratios of common stocks of natural gas companies held by the public were, so far as this evidence showed, in some cases up and in some cases down between 1937 and 1943, and no general pattern in that respect is discernible. Those ratios varied in 1943 from 7.29% to 29.71%, and the trend between 1937 and 1943 varied, among companies, from a decline of four points to an increase of eighteen points.

We have examined the eleven cases to which petitioner refers. Four of them were consent orders. Two companies had common stock only. One had $ 8,000,000 of 5 1/2% debentures outstanding against a rate base of $ 48,000,000, the balance being represented by common stock. Another had about half its rate base represented by long-term debt of which the cost was 2.88%, and a little less than a fourth represented by preferred stock at

5.86%. In another, the Commission based its 6 1/2% allowance upon a theoretical capitalization of 40% bonds at 3 1/2%, 20% preferred stock at 5 3/4%, and 40% common stock at 8%. All of those cases were decided in 1943 or earlier and rested upon data antedating that year. The great differences between the financial circumstances [**4] in those cases and in this create a wide difference between the overall rate of return allowable in so far as the court is concerned.

Under the rule laid down by the Supreme Court in the Hope Natural Gas Company case, n2 the court is restricted in its review of a Commission rate of return allowance to a test of the end result of the order and, of course, the adequacy of the findings and the sufficiency of the evidence supporting [*437] the findings. About half of the capital of this petitioner is represented by 2 1/2% long-term notes and the other half by equity capital. From the standpoint of the cost-of-capital fule, the 6% rate of return allowed would meet the obligation of the 2 1/2% notes and allow about 9 1/2% on the common stock and surplus. The record does not furnish any other statistical test of the end result of the allowance on the equity capital. The average yield of electric utilities on common stock for 1943 was found to be 7.3%, and the evidence shows tht natural gas companies are regarded by the public as less desirable and therefore require higher yields. But petitioner does not point to any evidence of the extent of the margin between the two industries [**5] in common stock yield requirements. Petitioner asserts certain risks in its business but gives us no statitical measure of those risks by which to test the conclusion of the Commission.

Upon this evidence we cannot say that the rate of return allowed by the Commission was beyond the limit of its power, either as unreasonable, insufficient, or unsupported by substantial evidence.

Petitioner's next point relates to the determination of certain costs of the company's regulable n3 business. Its business consists in part of the sale of natural gas to public utilities for resale, and in part of sales to industrial consumers. The former part is subject to regulation by the Federal Power Commission; the latter is not. n4 In order to determine fair and reasonable rates for those sales which are under its jurisdiction, the Commission must of course, determine the costs involved in those sales. This necessitates an allocation of costs as between those sales which are subject to this regulation and those which are not.

The regulated sales in this case, being the sales to utility companies for resale, are easily identified. The problem is to ascertain the costs incurred prerequisite to [**6] such sales, and so to be borne by those customers. This is a question of fact. Expenses (using that term in its broad sense to include not only operating expenses but depreciation and taxes) are facts. They are to be ascertained, not created, by the regulatory authorities. If properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce. Costs incurred for specific sales are easily assigned to them. But since many supplies are purchased, salaries and wages paid, expenses incurred, and facilities used to serve all customers, it is necessary to apportion such costs in order to ascertain the costs applicable to certain customers. A number of methods are available. One is the demand-commodity method.

There is nothing new or novel about the demand-commodity formula. It has long been used, by both utilities and regulatory authorities, in the composition of rate structures. n5 Customers desire different [*438] types of service. If the costs necessitated by the several services differ, different rates are justified, if not required. Functional [**7] analyses of costs are therefore made. The cost of each class of service is considered to be the composite of the costs of its functional elements. The basis of the demand-commodity formula is the difference between costs which occur by reason of required plant and equipment capacity and costs which occur directly in the handling of the gas. The company must have the capacity to supply certain demands when made. That capacity must be available whether or not it is being used at any particular moment. Thus, such costs do not vary from time to time but, generally speaking, continue constant, or substantially so. They are demand, or capacity, or fixed costs. Other costs are incurred only when, as and if gas is being made, transported or sold. They related to the commodity itself. They are commodity, or volumetric, or variable costs. They obviously vary with the sales.

There are three steps in the employment of the demand-commodity method of finding the costs necessitated by the type of service afforded individual users. The first step is the ascertaining of the individual dollar amounts of the various items of cost, i.e., depreciation, taxes, cost of gas, engineering, etc. This [**8] is rarely controversial, since it is a routine accounting operation. Second, it must be determined for each item of cost whether by its nature it is a demand cost or a commodity cost, or if not classifiable wholly in either of these categories, the proportions thereof to be assigned as demand and as commodity. The third step is the apportionment of total demand cost and of total commodity cost to each customer or class of customers- in the instant case, to customers comprising petitioner's regulable business and to those constituting the non-regulable business.

Code of Federal Regulations

18

Parts 1 to 399

Revised as of April 1, 2005

Conservation of Power and Water Resources

Containing a codification of documents of general applicability and future effect

As of April 1, 2005

With Ancillaries

Published by
Office of the Federal Register
National Archives and Records
Administration

A Special Edition of the Federal Register

costs incidental to the design, development or implementation of an experimental facility, a plant process, a product, a formula, an invention, a system or similar items, and the improvement of already existing items of a like nature; amounts expended in connection with the proposed development and/or proposed delivery of alternate sources of electricity; and the costs of obtaining its own patent, such as attorney's fees expended in making and perfecting a patent application. The term includes preliminary investigations and detailed planning of specific projects for securing for customers non-conventional electric power supplies that rely on technology that has not been verified previously to be feasible. The term does not include expenditures for efficiency surveys; studies of management, management techniques and organization; consumer surveys, advertising, promotions, or items of a like nature.

32. *Retained Earnings* (formerly earned surplus) means the accumulated net income of the utility less distribution to stockholders and transfers to other capital accounts.

33. *Retirement units* means those items of electric plant which, when retired, with or without replacement, are accounted for by crediting the book cost thereof to the electric plant account in which included.

34. *Salvage value* means the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale; or, if retained, the amount at which the material recoverable is chargeable to materials and supplies, or other appropriate account.

35. *Service life* means the time between the date electric plant is includible in electric plant in service, or electric plant leased to others, and the date of its retirement. If depreciation is accounted for on a production basis rather than on a time basis, then service life should be measured in terms of the appropriate unit of production.

36. *Service value* means the difference between original cost and net salvage value of electric plant.

37. *State* means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

38. *Subsidiary Company* in the case of Major utilities means a company which is controlled by the utility through ownership of voting stock. (See *Definitions* item 5B, *Control*). A corporate joint venture in which a corporation is owned by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group is a subsidiary company for the purposes of this system of accounts.

39. *Utility*, as used herein and when not otherwise indicated in the context, means any public utility or licensee to which this system of accounts is applicable.

General Instructions

1. *Classification of utilities.*

A. For purpose of applying the system of accounts prescribed by the Commission, electric utilities and licensees are divided into classes, as follows:

(1) *Major.* Utilities and licensees that had, in each of the last three consecutive years, sales or transmission service that exceeded any one or more of the following:

(a) One million megawatt-hours of total sales;

(b) 100 megawatt-hours of sales for resale;

(c) 500 megawatt-hours of power exchanges delivered; or

(d) 500 megawatt-hours of wheeling for others (deliveries plus losses).

(2) *Nonmajor.* Utilities and licensees that are not classified as *Major* (as defined above), and had total sales in each of the last three consecutive years of 10,000 megawatt-hours or more.

B. This system applies to both Major and Nonmajor utilities and licensees. Provisions have been incorporated into this system for those entities which, prior to January 1, 1984, were applying the Commission's Uniform System of Accounts Prescribed for Public Utilities and Licensees subject to the Provisions of the Federal Power Act (Class C and Class D) [part 104 of this chapter, now revoked]. The notations *(Nonmajor)* and *(Major)* have been used

financial and operating statements directly from such records at the end of each accounting period according to the prescribed accounts.

4. *Accounting Period.*

Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto, as nearly as may be ascertained, shall be entered in the books of the utility. Amounts applicable or assignable to specific utility departments shall be so segregated monthly. Each utility shall close its books at the end of each calendar year unless otherwise authorized by the Commission.

5. *Submittal of Questions.*

To maintain uniformity of accounting, utilities shall submit questions of doubtful interpretation to the Commission for consideration and decision.

6. *Item Lists.*

Lists of *items* appearing in the texts of the accounts or elsewhere herein are for the purpose of more clearly indicating the application of the prescribed accounting. The lists are intended to be representative, but not exhaustive. The appearance of an item in a list warrants the inclusion of the item in the account mentioned only when the text of the account also indicates inclusion inasmuch as the same item frequently appears in more than one list. The proper entry in each instance must be determined by the texts of the accounts.

7. *Extraordinary Items.*

It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. These items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the forseeable future. (In determining significance, items should be considered individually and not in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate. To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary. (See accounts 434 and 435.)

7.1 *Prior period items.*

A. Items of profit and loss related to the following shall be accounted for as prior period adjustments and excluded from the determination of net income for the current year:

(1) Correction of an error in the financial statements of a prior year.

(2) Adjustments that result from realization of income tax benefits of pre-acquisition operating loss carryforwards of purchased subsidiaries.

B. All other items of profit and loss recognized during the year shall be included in the determination of net income for that year.

8. *Unaudited Items (Major Utility).*

Whenever a financial statement is required by the Commission, if it is known that a transaction has occurred which affects the accounts but the amount involved in the transaction and its effect upon the accounts cannot be determined with absolute accuracy, the amount shall be estimated and such estimated amount included in the proper accounts. The utility is not required to anticipate minor items which would not appreciably affect the accounts.

9. *Distribution of Pay and Expenses of Employees.*

The charges to electric plant, operating expense and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period.

10. *Payroll Distribution.*

from the difference between the amount of the liability for the asset retirement obligation in account 230, Asset retirement obligations, and the amount paid to settle the obligation, shall be accounted for as follows:

(1) Gains shall be credited to account 421, Miscellaneous nonoperating income, and;

(2) Losses shall be charged to account 426.5, Other deductions.

E. Separate subsidiary records shall be maintained for each asset retirement obligation showing the initial liability and associated asset retirement cost, any incremental amounts of the liability incurred in subsequent reporting periods for additional layers of the original liability and related asset retirement cost, the accretion of the liability, the subsequent measurement changes to the asset retirement obligation, the depreciation and amortization of the asset retirement costs and related accumulated depreciation, and the settlement date and actual amount paid to settle the obligation. For purposes of analyses a utility shall maintain supporting documentation so as to be able to furnish accurately and expeditiously with respect to each asset retirement obligation the full details of the identity and nature of the legal obligation, the year incurred, the identity of the plant giving rise to the obligation, the full particulars relating to each component and supporting computations related to the measurement of the asset retirement obligation.

Electric Plant Instructions

1. *Classification of electric plant at effective date of system of accounts (Major utilities).*

A. The electric plant accounts provided herein are the same as those contained in the prior system of accounts except for inclusion of accounts for nuclear production plant and some changes in classification in the general equipment accounts. Except for these changes, the balances in the various plant accounts, as determined under the prior system of accounts, should be carried forward. Any remaining balance of plant which has not yet been classified, pursuant to the requirements of the prior system, shall be classified in accordance with the following instructions.

B. The cost to the utility of its unclassified plant shall be ascertained by analysis of the utility's records. Adjustments shall not be made to record in utility plant accounts amounts previously charged to operating expenses or to income deductions in accordance with the uniform system of accounts in effect at the time or in accordance with the discretion of management as exercised under a uniform system of accounts, or under accounting practices previously followed.

C. The detailed electric plant accounts (301 to 399, inclusive) shall be stated on the basis of cost to the utility of plant constructed by it and the original cost, estimated if not known, of plant acquired as an operating unit or system. The difference between the original cost, as above, and the cost to the utility of electric plant after giving effect to any accumulated provision for depreciation or amortization shall be recorded in account 114, Electric Plant Acquisition Adjustments. The original cost of electric plant shall be determined by analysis of the utility's records or those of the predecessor or vendor companies with respect to electric plant previously acquired as operating units or systems and the difference between the original cost so determined, less accumulated provisions for depreciation and amortization and the cost to the utility with necessary adjustments for retirements from the date of acquisition, shall be entered in account 114, Electric Plant Acquisition Adjustments. Any difference between the cost of electric plant and its book cost, when not properly includible in other accounts, shall be recorded in account 116, Other Electric Plant Adjustments.

D. Plant acquired by lease which qualifies as capital lease property under General Instruction 19. *Criteria for Classifying Leases,* shall be recorded in Account 101.1, Property under Capital Leases, or Account 120.6, Nuclear Fuel under Capital Leases, as appropriate.

2. *Electric Plant To Be Recorded at Cost.*

A. All amounts included in the accounts for electric plant acquired as an

operating unit or system, except as otherwise provided in the texts of the intangible plant accounts, shall be stated at the cost incurred by the person who first devoted the property to utility service. All other electric plant shall be included in the accounts at the cost incurred by the utility, except for property acquired by lease which qualifies as capital lease property under General Instruction 19. *Criteria for Classifying Leases*, and is recorded in Account 101.1, Property under Capital Leases, or Account 120.6, Nuclear Fuel under Capital Leases. Where the term *cost* is used in the detailed plant accounts, it shall have the meaning stated in this paragraph.

B. When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis (see, however, definition 9). In the entry recording such transition, the actual consideration shall be described with sufficient particularity to identify it. The utility shall be prepared to furnish the Commission the particulars of its determination of the cash value of the consideration if other than cash.

C. When property is purchased under a plan involving deferred payments, no charge shall be made to the electric plant accounts for interest, insurance, or other expenditures occasioned solely by such form of payment.

D. The electric plant accounts shall not include the cost or other value of electric plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of electric plant shall be credited to accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledgers of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions concurrently be recorded as a credit.

3. *Components of construction cost.*

A. For Major utilities, the cost of construction properly includible in the electric plant accounts shall include where applicable, the direct and overhead cost as listed and defined hereunder:

(1) *Contract work* includes amounts paid for work performed under contract by other companies, firms, or individuals, costs incident to the award of such contracts, and the inspection of such work.

(2) *Labor* includes the pay and expenses of employees of the utility engaged on construction work, and related workmen's compensation insurance, payroll taxes and similar items of expense. It does not include the pay and expenses of employees which are distributed to construction through clearing accounts nor the pay and expenses included in other items hereunder.

(3) *Materials and supplies* includes the purchase price at the point of free delivery plus customs duties, excise taxes, the cost of inspection, loading and transportation, the related stores expenses, and the cost of fabricated materials from the utility's shop. In determining the cost of materials and supplies used for construction, proper allowance shall be made for unused materials and supplies, for materials recovered from temporary structures used in performing the work involved, and for discounts allowed and realized in the purchase of materials and supplies.

NOTE: The cost of individual items of equipment of small value (for example, $500 or less) or of short life, including small portable tools and implements, shall not be charged to utility plant accounts unless the correctness of the accounting therefor is verified by current inventories. The cost shall be charged to the appropriate operating expense or clearing accounts, according to the use of such items, or, if such items are consumed directly in construction work, the cost shall be included as part of the cost of the construction

(4) *Transportation* includes the cost of transporting employees, materials and supplies, tools, purchased equipment, and other work equipment (when not under own power) to and from points of construction. It includes amounts paid to others as well as the cost of operating the utility's own transportation equipment. (See item 5 following.)

(5) *Special machine service* includes the cost of labor (optional), materials and

supplies, depreciation, and other expenses incurred in the maintenance, operation and use of special machines, such as steam shovels, pile drivers, derricks, ditchers, scrapers, material unloaders, and other labor saving machines; also expenditures for rental, maintenance and operation of machines of others. It does not include the cost of small tools and other individual items of small value or short life which are included in the cost of materials and supplies. (See item 3, above.) When a particular construction job requires the use for an extended period of time of special machines, transportation or other equipment, the net book cost thereof, less the appraised or salvage value at time of release from the job, shall be included in the cost of construction.

(6) *Shop service* includes the proportion of the expense of the utility's shop department assignable to construction work except that the cost of fabricated materials from the utility's shop shall be included in *materials and supplies.*

(7) *Protection* includes the cost of protecting the utility's property from fire or other casualties and the cost of preventing damages to others, or to the property of others, including payments for discovery or extinguishment of fires, cost of apprehending and prosecuting incendiaries, witness fees in relation thereto, amounts paid to municipalities and others for fire protection, and other analogous items of expenditures in connection with construction work.

(8) *Injuries and damages* includes expenditures or losses in connection with construction work on account of injuries to persons and damages to the property of others; also the cost of investigation of and defense against actions for such injuries and damages. Insurance recovered or recoverable on account of compensation paid for injuries to persons incident to construction shall be credited to the account or accounts to which such compensation is charged Insurance recovered or recoverable on account of property damages incident to construction shall be credited to the account or accounts charged with the cost of the damages.

(9) *Privileges and permits* includes payments for and expenses incurred in securing temporary privileges, permits or rights in connection with construction work, such as for the use of private or public property, streets, or highways, but it does not include rents, or amounts chargeable as franchises and consents for which see account 302, Franchises and Consents.

(10) *Rents* includes amounts paid for the use of construction quarters and office space occupied by construction forces and amounts properly includible in construction costs for such facilities jointly used.

(11) *Engineering and supervision* includes the portion of the pay and expenses of engineers, surveyors, draftsmen, inspectors, superintendents and their assistants applicable to construction work.

(12) *General administration capitalized* includes the portion of the pay and expenses of the general officers and administrative and general expenses applicable to construction work.

(13) *Engineering services* includes amounts paid to other companies, firms, or individuals engaged by the utility to plan, design, prepare estimates, supervise, inspect, or give general advice and assistance in connection with construction work.

(14) *Insurance* includes premiums paid or amounts provided or reserved as self-insurance for the protection against loss and damages in connection with construction, by fire or other casualty injuries to or death of persons other than employees, damages to property of others, defalcation of employees and agents, and the nonperformance of contractual obligations of others. It does not include workmen's compensation or similar insurance on employees included as *labor* in item 2, above.

(15) *Law expenditures* includes the general law expenditures incurred in connection with construction and the court and legal costs directly related thereto, other than law expenses included in protection, item 7, and in injuries and damages, item 8.

(16) *Taxes* includes taxes on physical property (including land) during the period of construction and other taxes properly includible in construction costs before the facilities become available for service.

(17) *Allowance for funds used during construction* (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) of this subparagraph. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$$A_f = s(S/W) + d(D/D+P+C)(1-S/W)$$
$$A_e = [1-S/W][p(P/D+P+C) + c(C/D+P+C)]$$

A_f=Gross allowance for borrowed funds used during construction rate.
A_e=Allowance for other funds used during construction rate.
S=Average short-term debt.
s=Short-term debt interest rate.
D=Long-term debt.
d=Long-term debt interest rate.
P=Preferred stock.
p=Preferred stock cost rate.
C=Common equity.
c=Common equity cost rate.
W= Average balance in construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication, less asset retirement costs (See General Instruction 25) related to plant under construction.

(b) The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in §35.13 of the Commission's Regulations Under the Federal Power Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdictions. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment, and fabrication shall be estimated for the current year with appropriate adjustments as actual data becomes available.

NOTE: When a part only of a plant or project is placed in operation or is completed and ready for service but the construction work as a whole is incomplete, that part of the cost of the property placed in operation or ready for service, shall be treated as *Electric Plant in Service* and allowance for funds used during construction thereon as a charge to construction shall cease. Allowance for funds used during construction on that part of the cost of the plant which is incomplete may be continued as a charge to construction until such time as it is placed in operation or is ready for service, except as limited in item 17, above.

(18) *Earnings and expenses during construction.* The earnings and expenses during construction shall constitute a component of construction costs.

(a) The earnings shall include revenues received or earned for power produced by generating plants during the construction period and sold or used by the utility. Where such power is sold to an independent purchaser before intermingling with power generated by other plants, the credit shall consist of the selling price of the energy. Where the power generated by a plant under construction is delivered to the utility's electric system for distribution and sale, or is delivered to an associated company, or is delivered to and used by the utility for purposes other than distribution and sale (for manufacturing or industrial use, for example), the credit shall be the fair value of the energy so delivered. The revenues shall also include rentals for lands, buildings etc., and miscellaneous receipts not properly includible in other accounts.

(b) The expenses shall consist of the cost of operating the power plant, and other costs incident to the production and delivery of the power for which construction is credited under paragraph (a), above, including the cost of repairs and other expenses of operating and maintaining lands, buildings, and other property, and other miscellaneous and like expenses not properly includible in other accounts.

(19) *Training costs* (Major and Nonmajor Utilities). When it is necessary that employees be trained to operate or maintain plant facilities that are being constructed and such facilities are not conventional in nature, or are new to the company's operations, these costs may be capitalized as a component of construction cost. Once plant is placed in service, the capitalization of training costs shall cease and subsequent training costs shall be expensed. (See Operating Expense Instruction 4.)

(20) *Studies* includes the costs of studies such as nuclear operational, safety, or seismic studies or environmental studies mandated by regulatory bodies relative to plant under construction. Studies relative to facilities in service shall be charged to account 183, Preliminary Survey and Investigation Charges.

(21) *Asset retirement costs.* The costs recognized as a result of asset retirement obligations incurred during the construction and testing of utility plant shall constitute a component of construction costs.

B. For Nonmajor utilities, the cost of construction of property chargeable to the electric plant accounts shall include, where applicable, the cost of labor; materials and supplies; transportation; work done by others for the utility; injuries and damages incurred in construction work; privileges and permits; special machine service; allowance for funds used during construction, not to exceed without prior approval of the Commission, amounts computed in accordance with the formula prescribed in paragraph (a) of paragraph (17) of this Instruction; training costs; and such portion of general engineering, administrative salaries and expenses, insurance, taxes, and other analogous items as may be properly includable in construction costs. (See Operating Expense Instruction 4.) The rates and balances of short and long-term debt, preferred stock, common equity and construction work in progress shall be determined as prescribed in paragraph (b) of paragraph (17) of this Instruction.

4. *Overhead Construction Costs.*

A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

B. As far as practicable, the determination of pay roll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

C. For Major utilities, the records supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each electric plant account, and the bases of distribution of such costs.

5. *Electric Plant Purchased or Sold.*

A. When electric plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, after the effective date of this system of accounts, the costs of acquisition, including expenses incidental thereto properly includible in electric plant, shall be charged to account 102, Electric Plant Purchased or Sold.

B. The accounting for the acquisition shall then be completed as follows:

(1) The original cost of plant, estimated if not known, shall be credited to account 102, Electric Plant Purchased or Sold, and concurrently charged to the appropriate electric