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Subject:	e-filing (Dkt. 060362-EI)
Attachments:	060362 MoBay Comments.s version.doc

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b. Docket No. 060362-EI

In re: Petition to Recover Natural Gas Storage Project Costs through Fuel Cost Recovery Clause by Florida Power & Light Company.

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 12 pages.

e. The document attached for electronic filing is Comments Regarding Florida Power & Light's Request to Charge the Carrying Costs for Stored Natural Gas through the Fuel Clause.

(See attached file: 060362 MoBay Comments.s version.doc)

Thank you for your attention and cooperation to this request.

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DOCUMENT NUMBER-DATE
07925 AUG 29 06
FPSC-COMMISSION CLERK

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

Petition to Recover Natural Gas Storage Project Costs through Fuel Cost Recovery Clause by Florida Power & Light Company	)	Docket 060362-EI Filed August 29, 2006

Comments Regarding Florida Power & Light's Request to Charge the Carrying Costs for Stored Natural Gas through the Fuel Clause

Pursuant to the Commission's vote at the Agenda Conference held on August 15, 2006, the Citizens of Florida (Citizens or OPC), through Harold McLean, Public Counsel, provide these comments on Florida Power & Light Company's request to charge the carrying costs for stored natural gas through the fuel clause.

Overview of the Relationship Between Base Rates and Cost Recovery Clauses

OPC calls on the Commission to consider FPL's instant request, and numerous others that are similar, in full context. By law, FPL has no competition for retail service in its service area—it gets 100% of all retail customers. FPL can even require a new customer to pay a "contribution in aid of construction" if FPL calculates that the customer otherwise would not be sufficiently profitable, and the customer cannot seek service from an alternative provider. By law, the Commission is obligated to authorize FPL to increase its rates and charges if FPL demonstrates that, despite prudent management and reasonable costs, it is not earning an adequate return (profit). Under regulation in Florida, not even natural catastrophes have prevented FPL from achieving sterling financial performance. In short, FPL, like other regulated power companies, arrives to this case in what any "retailer" in an unregulated environment would consider a favored and enviable position.

The utility's financial performance is dictated by two types of rate factors: base rates and special cost recovery clauses. Each has its defined role, and they are designed to work "in tandem" to yield reasonable rates. Because to exceed the intended purpose and scope of a special cost recovery clause would distort the overall functioning of the rate mechanisms, to the detriment of customers, the Commission should keep the relationships between these rate categories in mind as it considers FPL's request.

Base rates, designed to recover overall costs of providing service and yield a fair return to the utility, are set after an analysis of a test period. Based on this analysis, the Commission determines the total amount of revenues the utility requires to cover its overall costs and realize a fair return, then designs rates that will generate that revenue figure. General ratemaking recognizes that, after rates are set to take effect prospectively, the relationships between costs and revenues that resulted in those rates will change. The level of a particular cost may increase, or decrease, or (as in the case of a cost that is amortized over a period of years) the cost may go away altogether. Costs that were non-existent during the test period may arise after the rates take effect. But neither will revenues stay at the level that was factored into the ratemaking equation when the utility's overall revenue requirements were determined and rates were designed to generate the needed revenues. For instance, if rates were set at a level that renders each customer profitable at assumed consumption levels, and the utility adds customers, or consumption per customer goes up, or both occur, revenues may rise at a pace that outpaces costs and increase the utility's achieved overall return—notwithstanding increases in individual costs. In other words, factors that, standing alone, would tend to increase particular costs will be offset by factors that, standing alone, would work to either reduce other costs or to increase revenues. If on an overall basis revenues exceed costs, the utility is recovering its full "cost of service," even though particular costs may have increased since rates were set. It follows that one cannot conclude that an increase in a single cost is affecting a utility adversely without considering the overall relationship of total revenues and total costs.

In addition to the base rate mechanism described above, regulation has provided FPL (and other power companies) with special tools—in the form of cost recovery clauses—that enable the company to recover specific, volatile costs on a current basis outside of base rate considerations. These clauses provide stability to the company and reduce the need for frequent base rate cases. However, they create in the utility an incentive to regard as many costs as possible as candidates for inclusion in the clause. The reason is simple. Each dollar of costs that should be recovered through base rates, where it would be part of the overall comparison of total revenues and total costs, but instead flows through a cost recovery clause, is a dollar added to the utility's bottom line profit. For this reason, the Commission should be wary of claims that new or unusual costs belong in a cost recovery clause as opposed to being absorbed in base rates. If overall revenues are sufficient to absorb the full cost of providing service, including the cost the utility wants to pour through the clause, and still yield a fair rate of return, then a proposal to place the cost in a recovery clause may be an abuse of the clause, designed to increase rates without showing that current base rates are inadequate. In a very real sense, if a cost does not legitimately meet the definition of costs that qualify for a recovery clause, to allow the cost to flow through the clause will require the customer to pay it twice.

As OPC will develop in more detail below, these relationships play a particularly important role when rates are set—not through traditional rate cases (typically called "revenue requirements cases" or "base rate proceedings")—but through a settlement of parties. A settlement reflects the result of bargaining, in which each side gives something up in return for something it wants. In recent cases before the Commission, settlements have included, among other provisions, terms that prevent the utility from seeking an increase in base rates and prevent customers from seeking a reduction in base rates. However, such a "bargain" would be rendered meaningless if the utility were able to circumvent the agreement by pouring costs that typically are recovered through base rates through a cost recovery clause. In that situation, customers would have given up the right to ask for downward rate relief without receiving effective protection from "back door" base rate increases. Accordingly, when OPC enters such an agreement it insists on a provision that prevents a utility from flowing through a cost recovery clause costs that are of a kind typically recovered through base rates. The current settlement agreement with FPL contains such a provision.

FPL will likely argue that the Commission should allow the utility to flow a cost through the clause because the utility otherwise would have a disincentive to take action that will lower costs to ratepayers. To acquiesce to this rationale would gut basic precepts of regulation. More precisely, utilities are obligated to serve *at the lowest reasonable cost*. For meeting their obligations, utilities are rewarded through an opportunity to earn a fair return. The return is a function of the overall relationship of total revenues and total costs.

Basic Position Regarding FPL's Request to Charge the Carrying Costs for Stored Natural Gas Through the Fuel Clause

The rate case settlement agreement between Florida Power & Light Company and consumer parties prohibits FPL from petitioning the Commission for any new surcharges to recover costs that are of a type that traditionally and historically would be, or are presently, recovered through base rates. The carrying cost for fuel inventory, both traditionally and historically, is a cost which is recovered through base rates, and FPL will recover the carrying costs for stored natural gas through its base rates. Allowing these carrying charges to be flowed through the fuel clause would go against the traditional and historical treatment of these costs as well as the provisions of the rate case settlement.

The Carrying Costs for Fuel Inventory are Traditionally and Historically Base Rate Costs

The staff recommendation shows that fuel inventory, whether it is coal, oil or gas, is a normal component of working capital that is included in rate base for ratemaking purposes.[1] The carrying cost, which is a rate of return (including profit) on this investment, is recovered through base rates.

Order No. 14546[2] from the 1985 fuel clause docket sets forth the fundamental criteria used by the Commission to determine whether a cost should be recovered through base rates or the fuel clause. Prudently incurred fossil fuel-related expenses which are subject to volatile changes are recovered through an electric utility's fuel adjustment clause.[3] The volatile costs described in the order are for fossil fuel-related charges which are incurred by the utility for goods obtained or services provided prior to the delivery of fuel to the electric utility's dedicated storage facilities. The order states that all other fossil fuel-related costs should be recovered through base rates.[4]

There can be little question that the carrying cost for a relatively stable amount of fuel contained in a storage facility is not "volatile" and therefore should be recovered through base rates. Carrying costs are simply the rate of return earned on the utility's investment, which in this case is the investment in fuel contained in a storage facility. The rate of return, or carrying cost, on a relatively stable amount of fuel is itself a relatively stable amount properly included in base rates.

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[1] Staff Recommendation dated August 3, 2006, at page 6.

[2] Order No. 14546, issued on July 8, 1985, in Docket No. 850001-EI.

[3] Order 14546 at page 3.

[4] *Id.*

Base rate treatment is in fact how these costs have been traditionally and historically treated by the Commission. The staff recommendation notes that fuel inventory, whether it is coal, oil or gas, is a normal component of working capital included in rate base which provides for base rate treatment of the carrying costs. This is both generally true for fuel inventory and specifically true in at least one instance for stored gas analogous to the situation in this case. In Gulf Power's most recent rate case, Gulf Power proposed and the Commission approved inclusion of the company's gas fuel inventory at the Bay Gas storage facility in Gulf Power's working capital. This treatment of stored gas fuel inventory by Gulf Power at the Bay Gas storage facility verifies staff's general observation set forth in its recommendation and confirms that FPL should be considering such costs as base rate costs as well.

The staff recommendation provides an estimate of $5.9 million annually for the carrying costs, or rate of return, on FPL's investment in working gas inventory.[5] Under staff's proposal to amortize base gas over a fifteen year period, the initial annual carrying costs on the base gas would be about $3.8 million year and would gradually decrease as the amount of base gas is amortized.[6] The initial combined annual carrying costs for base and working gas at MoBay would therefore be about $9.7 million. FPL's treatment of carrying costs at the Bay Gas storage facility adds about another $1 million per year, for total annual carrying costs at issue in this docket in excess of $10 million per year.

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[5] Staff recommendation at page 4, paragraph e.
[6] See FPL response to late filed data request 8.

The Rate Case Settlement Prohibits Recovery of Traditionally and Historically Base Rate Costs Through New Surcharges

Part of the agreement reached with Florida Power & Light in March, 2005, to settle its rate case prohibited FPL from petitioning the Commission for any new surcharges to recover costs that are of a type that traditionally and historically would be or are presently recovered through base rates.

In the same vein, all of the parties agreed that we would neither seek nor support any reduction in FPL's base rates and charges that would take effect during the term of the agreement.

This was a bargain that had benefits for both sides. FPL was assured of stability in its base rates, and customers were assured that FPL would not seek to recover items traditionally and historically recovered through base rates through other charges. In other words, the types of things in base rates couldn't be recovered somewhere else. If it were any other way, the freeze on base rates would be meaningless.

The agreement states that FPL would not petition for any new surcharges to recover costs of a type that traditionally and historically would be recovered through base rates <u>*or*</u> are presently recovered through base rates. The "*or*" is important. Costs are covered by the agreement if they are in base rates *or* are the type historically and traditionally recovered in base rates, like the fuel inventory carrying costs at issue here, even if not specifically identifiable in base rates.

Carrying Costs for Fuel Inventory Do Not Qualify as a Hedge

FPL argues that the gas storage facility is a physical hedging transaction which exempts it from the usual rules of what constitutes base rate items and what constitutes fuel clause items. The storage of fuel is no more a hedging transaction than is filling up the gas tank in a car. It's simply a way to store fuel so that it will be available to burn. Of course, in the broadest conceivable sense, *any* storage of fuel is a hedge against not having fuel, but the hedging order did not suddenly change the traditional, historic base rate treatment of fuel storage into a hedging transaction.

The hedging order, order no. PSC-02-1484-FOF-EI issued October 30, 2002, does not contemplate changing normal base rate items to hedging transactions. The resolution of issues attached to the order gives examples of the types of transactions contemplated, and this is what it lists: transaction costs associated with derivatives (e.g. fees and commissions), gains and losses on futures contracts, premiums on options contracts, and net settlements from swaps transaction. None of the examples give the slightest hint that it would apply to and change the existing treatment of fuel storage, because it was never intended to do that. All of the examples in the order are for types of transactions more typically considered hedges.

In addition, carrying costs are not the types of costs contemplated by the order -- even for those transactions that are covered hedging transactions. According to paragraph four of the resolution of issues attached to the order,

> "each investor-owned electric utility may recover through the fuel and purchased power cost recovery clause prudently-incurred *incremental operating and maintenance expenses* incurred for the purpose of initiating and/or maintaining a new of expanded non-speculative financial and/or physical hedging program designed to mitigate fuel and purchased power price volatility for its retail customers.... " (emphasis added).

Carrying costs are rate of return components included in base rates and would never be considered an operating or maintenance expense of a utility. Thus, even if fuel storage were the type of transaction covered by the hedging order (and fuel storage isn't), it still would not be covered by the hedging order because it is not an incremental operating and maintenance expense.

Conclusion

We are not opposed to the MoBay agreement and in fact support the procurement of additional gas storage capacity by FPL. The issue isn't whether it's a good idea for FPL to procure additional inventory for its natural gas; the issue is whether the carrying costs related to this gas inventory are a base rate item covered by the settlement agreement.

FPL's request would fundamentally alter the traditional and historic rate base treatment of fuel inventory. Fuel inventory, whether coal, oil or gas, has been traditionally treated as an element of working capital, and the carrying costs of working capital are recovered through base rates. This is exactly the treatment used by Gulf Power and approved by the Commission for Gulf Power's stored gas located at the Bay Gas storage facility. The Commission should require FPL to do the same thing in this case.

Respectfully submitted,

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DOCKET NO. 060362-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S. Mail or hand-delivery to the following parties on this 29th day of August, 2006.

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