Matilda Sanders

ORIGINAL

From:	ROBERTS.BRENDA [ROBERTS.BRENDA@leg.state.fl.us]
Sent:	Friday, November 17, 2006 3:01 PM
To:	Filings@psc.state.fl.us
Cc:	Bill Feaster; Bill Walker; Cecilia Bradley; Cochran Keating; jack_shreve@oag.state.fl.us; John McWhirter; John_Butler@fpl.com; Lisa Bennett; Mike Twomey; Natalie F. Smith (Natlie_Smith@fpl.com); Schef Wright; Tim Perry; Wade Litchfield
Subject:	e-filing (Dkt. No. 060362-EI)
Attachments:	060362 OPC Brief.sversion.doc

CMP ____
COM 5
CTR ____
ECR ____
GCL ____
OPC ____
RCA ____
SCR ____
SGA ____
SEC 1
OTH kimp

Electronic Filing

a. Person responsible for this electronic filing:

Charles J. Beck, Deputy Public Counsel
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330
beck.charles@leg.state.fl.us

b. Docket No. 060362-EI

In re: Petition to Recovery 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 15 pages.

e. The document attached for electronic filing is Citizens' Brief on MoBay Storage Facility Issues.

(See attached file: 060362.OPC Brief.sversion.doc)

Thank you for your attention and cooperation to this request.

Brenda S. Roberts
Secretary to Charles J. Beck, Deputy Public Counsel
Office of Public Counsel
Telephone: (850) 488-9330
Fax: (850) 488-4491

DOCUMENT NUMBER-DATE
10570 NOV 17 8
FPSC-COMMISSION CLERK

ORIGINAL

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 November 17, 2006

<u>Citizens' Brief on MoBay Storage Facility Issues</u>

The Citizens of Florida, through Harold McLean, Public Counsel, hereby file this brief on issues 1B, 1C, and 1D concerning the MoBay Storage Facility.

<u>Issue 1B</u>: Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *base gas charges*?

<u>Citizens' Position:</u> Base gas should be recovered over the 15-year life of the contract and amortized through the fuel clause. The decision to expense or capitalize an item should be directly matched with the period in which the cost incurred provides a benefit. Because the gas has to remain in storage for the full length of the contract and cannot be burned it should be capitalized and amortized over that same time period. Moreover, base gas correlates closer with base coal than non-recoverable oil. Base coal is used to support the coal pile and is not burned. Non-recoverable oil is removed as often as the storage tank is cleaned, and represents a minimal amount of the total capacity of the storage tank.

Discussion: Base Gas is the volume of gas that is required at all times in the facility in order to allow the extraction of the working gas volume. It essentially provides the right pressurization to allow access to the working gas. Yupp, Tr. 891. At MoBay, working gas takes up 50% of the total volume of gas, so that base gas encompasses 50% of the total volume and working gas encompasses the remaining 50% of the total volume. Yupp, Tr. 892.

Base gas will be present over the 15 year term of the MoBay agreement. It provides a benefit over the entire 15 year period of the agreement and must be present at all times in order to allow FPL access to its working gas Yupp, Tr. 904.

The decision to expense or capitalize an item should be directly matched with the period in which the cost incurred provides a benefit. Merchant, Tr. 949. Because the gas has to remain in storage for the full length of the contract and cannot be burned, it should be capitalized and amortized over that same time period. *Id.*

The staff PAA recommendation filed in this docket reaches the same conclusion. Staff said:

> "FPL proposed charging the cost of base gas to the fuel adjustment clause in the month when it is injected into the storage facility. Staff does not believe that this is an appropriate treatment for the cost of base gas. This treatment ignores the fact that the purpose, use, benefit and cost of base gas is applicable to the entire 15 year term of the storage agreement, not just the day that it is injected into storage. There is also the issue of possible intergenerational inequity. Today's ratepayers would be required to pay for the total cost of base gas that will benefit current and future ratepayers over the next 15 years. It is also possible that many of today's ratepayers will not be the ratepayers that benefit from the reduction in expense when FPL is compensated for the base gas at the end of the storage agreement." Staff recommendation dated August 3, 2006, at page 5; Merchant, Tr. 948.

FPL claims that expensing the entire amount of base gas in the first year is cheaper for customers in the long run than matching the expense of the base gas over the period of time during which it provides a benefit. *See, e.g.,* Yupp, Tr. 902-903. First of all, this claim is highly dependent on the discount factor used in the net present value analysis. Yupp, Tr. 903-904. The result will vary depending on the discount factor. Second, this analysis ignores the fundamental question of whether the base gas provides a benefit over more than one accounting period and whether it should therefore be treated as a capital asset. It might be true, depending on the discount factor used, that expensing virtually any asset has a lower net present value than properly accounting for the item as an asset, no matter whether the asset is a building, a generating plant, or anything else. That doesn't make it proper policy to expense every capital asset. As is true with other assets, the Commission should look at the time period over which the asset provides a benefit and spread that cost over that time period. In this case the cost of base gas should be spread over the term of the agreement, which is 15 years.

Issue 1C: Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *carrying costs on natural gas stored in inventory?*

Citizens' Position: No. The estimated $7 million in annual carrying charges are not appropriate to be recovered through the fuel clause for several reasons. Carrying costs on fuel inventory are typically and historically base rate items and inappropriate to include in the fuel clause. These costs also do not result in any fuel savings, nor are they volatile or related to inventory adjustments, as required by Order No. 14546. Further, the physical hedging costs allowed by the Hedging Order were hedging transaction costs or incremental operating and maintenance expenses and the Hedging Order did not provide for rate of return components on fuel inventory to be recovered through the fuel docket. Finally, requesting recovery of costs which would typically and historically be recovered in base rates violates the 2005 Rate Case Settlement approved by the Commission. Accordingly, the carrying costs on gas inventory should be recovered through base rates not the fuel clause.

Discussion:

The Rate Case Settlement

The agreement between FPL and consumer parties to settle FPL's most recent case required FPL to freeze their base rates for four years. A freeze on base rates, however, would be meaningless if FPL were allowed to shift items normally recovered through base rates to other charges, such as fuel charges. Accordingly, the agreement forbids FPL from petitioning the Commission for any new surcharges to recover costs that are of a type that traditionally and historically would be recovered through base rates. Order no. PSC-05-0902-S-EI issued September 14, 2005, at 12. In the same vein, the consumer 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. If it were any way else, the freeze on base rates would be meaningless. If FPL could shift items from base rates into the fuel clause, there would in effect be no freeze on base rates at all.

The 1985 Fuel Order

The rate case settlement prohibition against shifting base rate items to other charges leads to the question of whether the carrying cost on stored natural gas is an item that traditionally and historically would be recovered through base rates.

The seminal case setting forth the criteria for determining whether a cost is properly a base rate item or a fuel cost item is order no. 14546 issued July 8, 1985. Volatility is the key to deciding whether a cost should be recovered through base rates or the fuel clause, according to this order. The order states:

> "Prudently incurred fossil fuel related expenses which are subject to volatile changes should be recovered through an electric utility's fuel adjustment clause….." "All other fuel related costs should be recovered through base rates" Order no. 14546 at page 2.

Using "volatility" as a criteria for determining whether a cost belongs in base rates or the fuel clause, carrying costs come down squarely on the side of base rates. Carrying costs for a stable amount of fuel contained in a storage facility are not volatile and therefore should be recovered through base rates. Merchant, Tr. 953.

The staff PAA recommendation recognizes the historic treatment of carrying costs on fuel inventory as a base rate item. According to staff, "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. Therefore, the associated inventory carrying costs are included in, and recovered through, base rates." Staff recommendation dated August 3, 2006, at page 6.

O&M expenses at storage facilities were specifically cited in the 1985 Fuel order as a type of cost which belongs in base rates. According to the order "These costs are relatively fixed and do not tend to fluctuate significantly even with changes in the number and sizes of deliveries. As these costs are closely akin to other O&M expenses, they are more properly recovered through base rates. Order no. 14546 issued July 8, 1985, at page 3.

O&M expenses are a completely different type of expense than the carrying costs of gas fuel inventory, even though O&M expenses, like carrying costs, are relatively stable costs which properly belong in base rates. Examples of operating and maintenance expenses include items such as salaries or chemicals. They are the types of costs incurred on an annual basis to operate the company. Merchant, Tr. 981.; Dubin, Tr. 923-924. Carrying costs, on the other hand, relate to the rate of return component that the Commission allows the utility to earn on their investment. The carrying cost includes debt, the recovery of interest cost, the rate of return on equity, the inclusion of customer deposits, and deferred income taxes. Together, these items develop the overall rate of return that a utility is allowed to earn. Merchant, Tr. 981.

For this case, the significance of the base rate treatment of O&M expenses in the 1985 fuel order is that the treatment of this specific type of expense was changed by the 2002 hedging order for hedging transaction costs. Carrying costs, in contrast, were not changed by the hedging order, and thus continue to be recovered through base rates consistent with the treatment afforded by the 1985 fuel order.

The 2002 Hedging Order

FPL's entire position hinges on whether the 2002 Hedging Order modified the criteria set forth in the 1985 fuel order to allow recovery of gas fuel carrying costs through the fuel clause. Without such a modification, the criteria of "volatility" set forth in the 1985 Fuel Order places the carrying charges associated with gas fuel inventory in the base rate category.

Nothing in the Hedging Order changes the treatment of fuel inventory, whether it is coal, oil, or gas. The 2002 Hedging Order only modified the treatment of certain hedging transaction costs that would otherwise be base rate items under the 1985 Fuel Order, and those modifications do not include carrying costs.

First, the hedging order applies to hedging *transactions*. The order gives the following examples of the types of transactions contemplated: 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. Order no. PSC-02-1484-FOF-EI issued October 30, 2002, at pages 5-6. Each of these examples relate to transactions. None give the slightest hint that it would apply to or change the existing treatment of fuel storage, because it was never intended to do that. The examples in the order are for types of transactions typically considered hedges. The normal, traditional way to recover a rate of return on assets is through base rates, not fuel charges.

Second, 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). The order does not apply to incremental carrying costs, which are not even mentioned in the order. Instead, only the treatment of incremental operating and maintenance expenses is modified by the order.

Carrying costs are rate of return components included in base rates and would never be considered an operating or maintenance expense of a utility. 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.

Since the 2002 Hedging Order does not change the classification for the carrying costs on gas fuel inventory, such costs remain base rate costs, just as they have been for decades.

TECO and Gulf Power Treat Carrying Costs on Fuel Inventory as Base rate Items

Unlike FPL, both Gulf Power and TECO treat the carrying cost of gas fuel inventory as base rate items.

Gulf considers the carrying costs of natural gas inventory to be recovered through base rates. Exhibit 1, Gulf Power response to staff interrogatory 18. The carrying costs on any off-site stored fuel are considered to be recovered through base rates. Exhibit 1, Gulf Power response to staff interrogatories 26 and 28. In fact, the Commission approved Gulf Power's inclusion of gas inventory in working capital in Gulf's last base rate case, docket No. 010949-EI.

The gas inventory was related to Gulf's gas storage agreement with Bay Gas. Merchant, Tr. 952.

Similarly TECO does not recover any type of carrying cost for natural gas through the fuel clause. Exhibit 1, TECO panel deposition at page 23. The carrying cost of gas would be a base rate item. Exhibit 1, TECO panel deposition at page 79.

FPL Recovers its Costs for Base Rate Items

FPL has attempted to portray the proper base rate classification of its carrying costs for gas fuel inventory as "denying" FPL recovery of its costs. *See, e.g.,* Dubin, Tr. 1032, 1041. This claim ignores basic rate making fundamentals and the intended structure of the rate case settlement.

The rate case settlement froze base rates for four years and prohibited FPL from shifting base rate type costs to other charges. FPL's rate case used a projected 2006 test year. No one, however, actually expects that all expenses and revenues will exactly match the expenses and revenues contained in the forecast, nor does anyone expect expenses and revenues to be frozen over a four year period. The only thing one can be certain of is that the actual expenses incurred and revenues received over the course of the four year settlement will be different from expenses and revenues forecasted in the 2006 test year.

Typically, some expenses and revenues are higher than forecasted, and some are lower than forecasted. Additionally, some expenses will be incurred which were not forecasted at all, and some expenses include in the forecast will not be incurred. *See generally* Dubin, Tr. 1046-1049.

The way to determine whether the company is recovering its costs is to look at its earned return. According to FPL, if the company is earning a reasonable rate of return, it is recovering its cost. Dubin, Tr. 1049. FPL's most recent surveillance report filed at the Commission shows that FPL is earning above the middle of the range of a very reasonable return on equity. Merchant, Tr. 994. Accordingly, FPL is recovering its costs, and it will continue to recover its costs while it is earning a return.

The rate case settlement agreement contemplated that FPL would experience varying revenues and costs over the four year period of the settlement. Part of the agreement required FPL to freeze base rates, including all items traditionally and historically included in base rates. There is risk and reward for all parties in such an agreement, and part of the risk for FPL is that it will recover its costs through its existing base rates. To date, FPL is easily recovering its costs, as evidenced by its actual achieved return on equity. FPL may do well or even exceedingly well during the term of the agreement, or it may not. But as long as it is earning a return on equity, it is recovering its costs. To claim that proper treatment of its gas fuel inventory carrying costs as a base rate item "denies" it cost recovery ignores fundamental rate making and the structure of the rate case settlement.

<u>ISSUE 1D</u>: Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *carrying costs on unamortized amounts of base gas*?

<u>Citizens' Position:</u> No. The carrying costs associated with the unamortized balance of base gas should be recovered through base rates, not the fuel clause. Purchasing base gas is a capital asset similar to gas inventory. Consistent with Citizen's position in Issue 1B above, this unamortized asset is normally included in base rates as a component of the working capital calculation and included in rate base to which the company's rate of return is applied. The carrying costs on the unamortized balance of base gas will be approximately $4 million in first year assuming a 15-year amortization period.

Discussion: The same principles discussed in response to issue 1B apply to this issue. Carrying costs associated with fuel inventory are historically and traditionally base rate items.

Respectfully submitted,

HAROLD MCLEAN
PUBLIC COUNSEL

s/ Charles J. Beck
Charles J. Beck
Deputy Public Counsel
Fla. Bar No. 217281

Office of Public Counsel
c/o The Florida Legislature
111 W. Madison Street
Room 812
Tallahassee, FL 32399-1400

(850) 488-9330

Attorney for Florida's Citizens

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 17th day of November, 2006.

s/ Charles J. Beck
Charles J. Beck

Lisa Bennett
William Keating
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

R. Wade Litchfield
Natalie Smith
700 Universe Boulevard
Juno Beach, FL 33408

Mr. Bill Walker
Vice President, Regulatory Affairs
Florida Power & Light Company
215 S. Monroe Street, Suite 810
Tallahassee, FL 32301-1859

Timothy J. Perry, Esquire
McWhirter Law Firm
117 S. Gadsden Street
Tallahassee, FL 32301

John W. McWhirter, Jr., Esquire
McWhirter Law Firm
400 North Tampa Street, Ste. 2450
Tampa, FL 33602

Michael B. Twomey
Post Office Box 5256
Tallahassee, FL 32314-5256

Robert Scheffel Wright, Esq.
John T. LaVia, III, Esq.
Young van Assenderp, P.A.
310 West College Avenue
Tallahassee, FL 32301

Bill Feaster, Manager
Regulatory Affairs
Florida Power & Light Co.
215 S. Monroe Street, Suite 810
Tallahassee, FL 32301

Jack Shreve, Esq.
Cecilia Bradley, Esq.
Office of the Attorney General
The Capitol-PL01
Tallahassee, FL 32399-1050

John T. Butler, Esq.
Florida Power & Light Company
9250 West Flagler Street
Miami, FL 33174