

State of Florida



# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

**DATE:** July 22, 2010

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Draper, Buys, Davis, Kummer, Maurey)  
Office of the General Counsel (Bennett, Jackson)

*EID K DB EJA ALM CRB*

**RE:** Docket No. 100143-EI – Evaluation of study by Florida Power & Light Company on prepayment billing option for retail customers.

**AGENDA:** 08/03/10 – Proposed Agency Action – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Administrative

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\100143.RCM.DOC

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### Case Background

On March 17, 2010, the Commission issued Order No. PSC-10-0153-FOF-EI (Final Order) in Docket No. 080677-EI.<sup>1</sup> The Final Order was a culmination of the rate case proceeding which commenced on March 18, 2009, with the filing of a petition for a permanent rate increase by Florida Power & Light Company (FPL).

The Final Order required FPL to file, no later than March 1, 2010, a study evaluating the merits of a prepayment option in lieu of monthly billing. This matter arose from customer testimony presented at the June 19, 2009, Ft. Myers service hearing in FPL's rate case proceeding. Mr. Balogh and Mr. Morgan presented a prepayment concept, which would provide

<sup>1</sup> Order No. PSC-10-0153-FOF-EI, issued March 17, 2010, in Docket No. 080677-EI, In re: Petition for increase in rates by Florida Power & Light Company.

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customers the option to pay their electric bills in advance, and receive a discount from FPL. The customers would borrow money to pay their electric bill at an interest rate that would be less than the discount rate offered by FPL, and thus save money. As a result of the customer testimony, the Commission ordered FPL to evaluate such a proposal, and provide a study to the Commission no later than March 1, 2010. FPL filed its study on March 1, 2010. On May 21, 2010, FPL responded to staff's data request. On May 14 and June 1, 2010, Mr. Balogh and Mr. Morgan responded to staff's data requests.

This recommendation addresses FPL's study. The Commission has jurisdiction over this matter pursuant to Chapter 366, Florida Statutes (F.S.), including Sections 366.041, 366.06, 366.07, and 366.076.

### Discussion of Issues

**Issue 1:** What further action, if any, should the Commission take on FPL's prepayment study filed on March 1, 2010?

**Recommendation:** The Commission should take no further action. (Draper, Davis)

#### **Staff Analysis:**

##### Consultants' proposal

At the Ft. Myers service hearing, Mr. Frank Balogh and Mr. Don Morgan (consultants) proposed that FPL allow customers to prepay their electric bills based on estimated usage for one year, and receive a discount on the prepayment equal to FPL's overall cost of capital. Mr. Balogh recommended that FPL use a discount rate of 8.35 percent. According to the consultants, the customer would secure the prepayment through cash or third party financing. The consultants presented an analysis at the service hearing that purported to show that at a 8.35 percent discount rate, Lee County could save \$950,000 and Collier County over \$1,000,000 on their respective annual electric bills.

Mr. Balogh further testified at the Ft. Myers service hearing that, in 1995, under the prospect of deregulation, FPL considered a prepayment pilot program in Collier County. Mr. Balogh also testified that FPL pays 7 percent on commercial deposits and that FPL has a prepayment component in its facilities rental agreement. In a letter provided to the Commission at the Ft. Myers service hearing, Mr. Balogh also stated that customers prepay through the capacity cost recovery clause for future facilities that may or may not be constructed. In the letter, Mr. Balogh further stated that a 2003 IRS ruling opened the door to tax-exempt bond financing for long term energy contracts, and that public utilities have prepaid electric and gas energy contracts worth billions for the wholesale side of the business.

In addition to Mr. Balogh and Mr. Morgan, Mr. Delony, Public Utilities Administrator for Collier County Public Utilities, testified at the Ft. Myers service hearing supporting the prepayment option as a cost-saving concept for larger use customers.

##### Prepayment program description

In its study, FPL proposed a process under which a prepayment billing option could be implemented. Each year, FPL would forecast the customer's monthly bills and discount based on estimated monthly consumption, currently approved rates, current short-term debt cost rate, and the number of days the bill is being prepaid. The customer's discounted prepayment amount would be determined based on the sum of the estimated monthly bills less the sum of the monthly discount. In addition, customers would be required to pay a nonrefundable administrative adder designed to recover the administrative costs of the prepayment program. Each month, FPL would determine the actual bill amount based on actual consumption. If any time during the year the prepayment balance is not sufficient to cover the current month's actual

bill, the customer would be billed the difference at the applicable rate. If at the end of the year there is a remaining prepaid balance, the customer would be issued a credit.

Summary of FPL's prepayment study

FPL concluded in its study that it cannot recommend moving forward with a prepayment program. FPL provided three main reasons to support its conclusion.

First, FPL states that the discount rate of 8.35 percent used in the consultant's proposal is not the appropriate rate to use in such a program. FPL believes the 8.35 percent references FPL's overall weighted cost of capital, which is actually 6.65 percent as approved in the Final Order. Furthermore, FPL states in the study that the overall weighted cost of capital is not the appropriate discount rate to use in such a program, as this cost of capital is traditionally used for the financing of capital projects in excess of one year and includes both a long-term debt and an equity component. In contrast, FPL states, the discounted prepayment program contemplates an annual discounted prepayment, and thus the participants would not be bearing any equity risk associated with the program. FPL concludes that the appropriate rate to use for a discounted prepayment program is FPL's short term debt rate, which is currently 2.11 percent. Such a discount rate, FPL states, is unattractive for any potential prepayment plan participants and it would be unlikely that customers would derive a benefit from such a program.

Second, FPL states that Mr. Balogh incorrectly assumed that participating customers would pay their annual electric bill all at once prior to the start of the year and that FPL would have use of the funds and/or earn interest on the funds for a full year. FPL asserts that, since the participating customer's actual monthly bill will be deducted from the prepaid amount, thereby reducing the prepaid balance ratably over the year, Mr. Balogh's calculations overstated the value of the interest FPL could earn on the prepaid amount.

Finally, FPL explains in its study that there are incremental costs that would be incurred by FPL to implement and administer a prepayment program. FPL contends that these additional costs would need to be funded by the participants to avoid cross subsidization. Specifically, FPL states the incremental cost include billing system costs and operational costs. FPL estimates the upfront cost to implement changes to the billing system to enable the prepayment option to be approximately \$733,000. In response to staff's data request, FPL states the \$733,000 does not account for the inclusion of a prepayment participation fee in its billing system or including the fee as a line item on the customer's bills. Incorporating that functionality would increase the cost estimate by approximately \$500,000. The operational costs include initial set up costs of \$134,000 in year 1, and ongoing annual operating costs of \$54,000. Operational costs include the cost of a billing project manager and an additional employee. In response to staff's data request, FPL notes that a single governmental customer typically has hundreds of individual billing accounts, all of which would have to be reconciled against the prepayment. In addition, FPL states that there would be no reduction in monthly meter reading and billing attributable to a prepayment program.

FPL states in its study that it contracted with an independent firm to research other utilities that have implemented any type of prepayment program. FPL states that this research could not find a program where customers prepaid their bills annually and were provided a

discount based on the utility's cost of capital. Pennsylvania did have some discounted prepayment programs related to pending deregulation in the state, but it was not a cost-based discount rate.

### Staff Analysis

#### Appropriate discount rate

The primary factor for determining if the proposed prepayment program is feasible is the discount rate. FPL proposes that the discount rate be consistent with its cost of short-term debt which is 2.11 percent (per most recent rate case). The consultants proposed a discount rate of 8.35 percent.

FPL reasons that the discounted prepayment program contemplates short-term payments (less than one year) and would effectively provide short-term financing to FPL with the principal repaid over a one year period. FPL explains that the actual discount rate would be one-half of 2.11 percent or 1.055 percent if the time value of money is considered. FPL indicates that the amount of the customer's bill would be deducted from the prepaid sum each month thereby reducing the balance in the customer's account to zero at the end of the year. Therefore, an average balance of one-half of the funds would be available for use throughout the entire year.

In the response to staff's data request dated May 14, 2010, the consultants proposed a discount rate of 8.35 percent. As FPL points out, this proposed discount rate is greater than the company's recently approved weighted average cost of capital of 6.65 percent. This weighted average cost of capital includes long-term debt and common equity components which do not align with the short-term nature (one-year or less) of the funds that would be made available by the prepayments. Further, FPL states that if the discount rate were set above FPL's avoided cost of short-term debt, the customers participating in the prepayment program would be subsidized by non-participating customers.

As explained in their response to staff's data request, the consultants stated that their proposed 8.35 percent rate is based on the discount rate used in calculations for FPL's renewable energy tariff QS-2<sup>2</sup> and FPL's Facility Rental Service Agreement contracts. The QS-2 tariff provides for a term of at least 10 years. The facility rental service agreements are generally five years or more in length and thus are not aligned with the short-term nature of the annual prepayment. In their analysis, the consultants assumed FPL would be able to earn interest at a rate of 5 percent on the monthly declining balance and that the prepayment amount would decline in equal monthly increments. The difference between the amount of the discount and the amount of interest income represents a short fall in revenue that would ultimately have to be subsidized by other customers. In the example proposed by the consultants, the discount of \$951,900 (discount of 8.35 percent on \$11,400,000) would allow FPL to earn \$282,969 if it were able to invest the prepaid funds at 5 percent interest. The difference between the \$951,900 discount given and the \$282,969 interest earned is \$668,031 as shown in Table 1-1 below, which was provided by the consultants in response to staff's data request.

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<sup>2</sup> Rate Schedule QS-2 is FPL's standard offer contract for purchase of firm capacity and energy from a renewable energy facility or qualifying facility with a design capacity of 100 KW or less.

Table 1-1

Present Value Calculation @ 5%  
 on the Lee County Prepayment of \$10,448,100

Last year's energy costs	\$11,400,000
Discount 8.35%	<u>\$951,900</u>
	\$10,448,100

<u>Month</u>	<u>Monthly Principle Payment</u>	<u>Remaining Balance</u>	<u>Interest Earned</u>
		\$10,448,100	
1	\$870,675	\$9,577,425	\$43,533.75
2	\$870,675	\$8,706,750	\$39,905.94
3	\$870,675	\$7,836,075	\$36,278.13
4	\$870,675	\$6,965,400	\$32,650.31
5	\$870,675	\$6,094,725	\$29,022.50
6	\$870,675	\$5,224,050	\$25,394.69
7	\$870,675	\$4,353,375	\$21,766.88
8	\$870,675	\$3,482,700	\$18,139.06
9	\$870,675	\$2,612,025	\$14,511.25
10	\$870,675	\$1,741,350	\$10,883.44
11	\$870,675	\$870,675	\$7,255.63
12	<u>\$870,675</u>	<u>\$0</u>	<u>\$3,627.81</u>
	\$10,448,100		\$282,969.38

The consultants proposal is also premised on the possibility that a utility customer may avail themselves of third party financing. Under the consultant's theory, the utility customer would borrow the amount of the prepayment at a rate lower than the offered discount rate. The difference between the two rates, or the spread, would provide a cost savings to the customer. The consultants claimed that they met with Bank of America officials to discuss the cost of financing a prepayment plan and were given the impression that an estimated loan rate would be approximately 250 to 300 basis points over the London Interbank Offered Rate (LIBOR). As of July 8, 2010, the one-year LIBOR rate was 1.16 percent. The interest rate on the prepayment loan hypothetically would be approximately 3.66 to 4.16 percent. Under this scenario, the rate at which the customer could borrow funds would be greater than the discount rate offered by FPL.

Therefore, the premise of the customer financing the amount of the prepayment would not be financially feasible at this time.

#### Other concerns

Staff notes that it is important to distinguish the consultant's prepayment option from a prepaid metering program that is similar to a prepaid cell phone or calling card. The Commission recently approved a residential prepaid metering tariff for Choctawhatchee Electric Cooperative (CHELCO).<sup>3</sup> Under CHELCO's tariff, payment is made in advance. When a customer's account balance is depleted through usage, the electric service will be subject to immediate disconnection. Customers opting for the prepaid metering tariff will be responsible for an administrative fee to cover the cost of monitoring payments and usage, and do not receive a discount on the prepaid amount.

There are several other items that are also of concern when offering a prepayment discount. A significant portion of a customer's bill is fuel related. Since the fuel costs are passed through to the customers based on actual fuel costs, if a discount were given to one class or group of customers, the other customers not receiving a discount would have to make up the difference. In addition, there would be administrative costs to FPL for establishing procedures for handling the prepayment program. Since the consultant's proposal is targeted toward municipalities, it would require changing billing procedures to reconcile the prepayment to the municipality's multitude of accounts. Staff agrees that any administrative costs should be recovered from the participating prepayment program customers.

Mr. Balogh and Mr. Morgan appear to compare the Nuclear Power Plant Cost Recovery mechanism described in Rule 25-6.0423, Florida Administrative Code, to the type of prepayment option they are suggesting. The two are quite different. Utilities are allowed by Section 366.93, F.S., to recover certain costs associated with the siting, design, licensing, and construction of certain types of power plants as those costs are incurred. This provision reduces the amount of capitalized cost included in rates when the power plant goes on line. It is not a prepayment of future expenses, but a recovery of actual costs incurred during the construction of the plant, prior to the time the plant goes into service.

Mr. Balogh also failed to state exactly how the IRS ruling on tax exempt bonds negates the concerns raised by FPL on revenue shortfalls, or exactly how the prepaid wholesale power contracts were similar to what he is proposing here.

In his June 7, 2010 response to staff discovery, Mr. Balogh argues that there is a conservation effect from prepayment of bills and cites to a table on page 65 in FPL's study. The referenced table is a summary of prepayment programs other U.S. utilities offer and was provided by FPL's consultant E-Source. Several of the programs or pilots are called "Pay As You Go." Some of the prepayment programs offered by other utilities claim that customer usage declined among participating customers. However, FPL's study notes that none of these

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<sup>3</sup> Order No. PSC-10-0357-TRF-EC, issued June 4, 2010, in Docket No. 100079-EC, In re: Request for approval for new prepaid metering rates and changes to net metering rates and changes to net metering rates and miscellaneous service charges by Choctawhatchee Electric Cooperative, Inc.

programs are similar to the program Mr. Balogh is suggesting. It is also counter intuitive that a discounted rate would encourage conservation. The conservation effect noted in FPL's study appears to be associated with monthly prepaid programs similar to the one approved for CHELCO, discussed above. It is reasonable to assume that if customers can see how their prepaid balance declines on a daily basis, they are more likely to adjust their lifestyle to reduce their electricity consumption and avoid disconnection when the balance reaches zero. This cost/usage nexus is absent from the prepayment plan proposed by the consultants.

#### Conclusion

Based on the above, staff recommends that the Commission take no further action on FPL's prepayment study. If the Commission wishes to direct FPL to develop a prepayment option, FPL should be directed to further evaluate a prepayment option and bring to the Commission a proposed tariff.



Docket No. 100143-EI

Date: July 22, 2010

**Issue 2:** Should this docket be closed?

**Recommendation:** No. If no person whose substantial interests are affected by the PAA files a protest within 21 days of the issuance of the order, a consummating order will be issued. Once this action is complete, this docket should be closed administratively. (Bennett)

**Staff Analysis:** If no person whose substantial interests are affected by the PAA files a protest within 21 days of the issuance of the order, a consummating order will be issued. Once the consummating order has been issued, this docket should be closed administratively.