State of Florida

# Public Service Commission

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COMMISSION CLERK

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

**DATE:** August 19, 2010

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

**FROM:** Division of Economic Regulation (Draper, A. Roberts)
Office of the General Counsel (Jaeger)

**RE:** Docket No. 100165-EI – Request to revise 2010 overhead/underground residential differential cost data by Gulf Power Company.

**AGENDA:** 08/31/10 – Regular Agenda – Tariff Filing – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Administrative

**CRITICAL DATES:** 12/01/10 (8-Month Effective Date)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\100165.RCM.DOC

## Case Background

Rule 25-6.078, Florida Administrative Code, (F.A.C), sets forth the responsibilities of electric investor-owned utilities' (IOU) for filing updated underground residential distribution (URD) tariffs for new subdivisions. This rule requires each IOU to file updated URD charges for Commission approval at least every three years, or sooner if its underground cost differential for the standard low-density subdivision varies from the last approved charge by 10 percent or more. The rule requires IOUs to annually file on or before October 15, a schedule showing the increase or decrease in the differential for the standard low-density subdivision.

On October 15, 2009, Gulf Power Company (Gulf) notified the Commission, pursuant to Rule 25-6.078, F.A.C., that its underground cost differential for the standard low-density subdivision decreased from the last approved differential by 16 percent. Gulf's current URD charges were approved in 2009.[1]

To comply with the 10 percent filing requirement of the rule, Gulf filed on April 1, 2010, a petition for Commission approval of revisions to its URD Tariff Sheet Nos. 4.25, 4.26, 4.26.1, and 4.26.2, and their associated charges. The URD tariffs apply to new residential developments and represent the additional costs Gulf incurs to provide underground distribution service in place of overhead service. By Order No. PSC-10-0354-PCO-EI, issued on June 4, 2010, the Commission suspended Gulf's proposed tariffs. On June 23, 2010, Gulf filed responses to staff's data requests.

This recommendation addresses Gulf's revised URD tariffs and their associated charges. The Commission has jurisdiction over this matter pursuant to Sections 366.03, 366.04, 366.05, and 366.05, Florida Statutes.

[1] Order No. PSC-09-0815-TRF-EI, issued December 10, 2009, Docket No. 090173-EI, In re: Request to revise underground residential differential rates by Gulf Power Company.

## Discussion of Issues

**Issue 1**: Should the Commission approve Gulf's revised Underground Residential Distribution (URD) tariffs and their associated charges?

**Recommendation**: Yes. (Draper, A. Roberts)

**Staff Analysis**: The URD charges represent the additional cost Gulf incurs to provide underground distribution service in place of overhead service, and are calculated as the differential between the costs of underground versus overhead service. Costs for the underground service have historically been higher than for standard overhead construction. The URD differential is paid by the customer (usually the developer) as a contribution in aid of construction (CIAC). The URD tariffs provide standard charges for certain types of underground service, and apply to new residential developments such as subdivisions and townhouses.

Gulf URD charges are developed based on two model subdivisions: (1) a 210-lot low density subdivision with a density of one or more, but less than six, dwelling units per acre; and (2) a 176-lot high density of six or more, dwelling units per acre. All four of the largest investor-owned electric utilities use the same standardized model subdivisions to develop their URD charges.

As stated in Rule 25-6.078(1), F.A.C., the URD differential is based on the utility's standard engineering and design practices. The difference between these numbers is the per-lot charge that customers must pay when requesting underground service in lieu of standard overhead service. The cost of both underground and overhead service includes the material and labor costs to provide primary, secondary, and service distribution lines, and transformers. The costs to provide overhead service also include poles. The costs to provide underground service also include trenching and backfilling. The utilities are required to use current cost data.

The following table shows Gulf's current and proposed URD differentials:

Table 1-1

| | Current URD differential per lot | Proposed differential per lot | Percent change |
|---|---|---|---|
| 210-lot low density subdivision | $312 | $263 | -16% |
| 176-lot high density subdivision | $213 | $259 | +22% |

The above per-lot charges apply if Gulf supplies and installs all equipment and materials. Gulf's URD tariff also provides for reduced charges if the customer chooses to supply and/or install the primary and secondary trench and duct system.

The calculation of Gulf's proposed URD charges includes the following steps. First, Gulf updates its charges to reflect actual 2008 labor and material costs. This is how the traditional installed cost of the underground project has been calculated. Second, in addition to the initial installation costs, Gulf's proposed URD charges incorporate the differences in the net present value of operational costs between underground and overhead systems, including average historical storm restoration costs over the life of the facilities, as required by Rule 25-6.078(4), F.A.C.

The effect of each of the calculations on the URD differential is shown in the table below.

Table 1-2

| Line | | 210-lot low density subdivision | 176-lot high density subdivision |
|---|---|---|---|
| A. | Current URD differential per lot | $312 | $213 |
| B. | Impact of updated material and labor costs | $19 | $69 |
| C. | Impact of operational costs differential | ($68) | ($23) |
| D. | Proposed URD charge per lot – rounded (A+B+C) | $263 | $259 |
| E. | Net difference (A-D) | ($49) | $46 |

Updated Material and labor costs

As shown in Line B of Table 1-2, material and labor costs increased by $19 for the low density subdivision and by $69 for the high density subdivision. Gulf explained in its answer to staff's first data request, that the cost per-lot charge for the high density subdivision was understated in the previous 2009 filing. This was due to an inadvertent error in the calculation of overhead construction labor costs, resulting in a differential that was understated. The correction of this error would have resulted in a higher URD charge for the high density subdivision in the 2009 filing.

Labor costs in the URD calculation consist of two parts: direct labor costs, and an engineering and staff adder. Direct labor costs represent the labor costs of the actual construction crew installing the overhead and/or underground system. The engineering and staff adder captures the cost of supervision and of the engineers who design the system, and is applied to the total cost of the job (less meters and transformers). Gulf explained that due to an internal restructuring, Gulf shifted certain positions from the direct labor costs to the engineering and staff adder. This move of positions resulted in a decrease of the direct labor costs, and an increase of the engineering and staff adder from 22 percent to 44 percent, resulting in a slight increase in the overall material and labor costs. Gulf explained the restructuring was done to gain efficiencies in the way Gulf operates its business.

Calculation of operational cost difference

Subsection (4) of Rule 25-6.078, F.A.C., prescribes that the differences in net present value (NPV) or operational costs, including storm restoration costs, over the life of the facilities, between underground and overhead systems, be included in the URD charge. Operational costs include operations and maintenance (O&M) costs and capital costs. Gulf's methodology to calculate the operational cost difference has been approved in Order No. PSC-09-0815-TRF-EI. Gulf's analysis of its historical 2008 operational costs shows that overhead facilities are more expensive to operate and maintain than equivalent underground facilities, resulting in a decrease in the differential for both subdivision models as shown in Line C of Table 1-2. In accordance with Rule 25-6.078, F.A.C., Gulf began implementing new record keeping and accounting measures to separately identify operational costs for underground and overhead facilities, including storm related costs. Gulf used actual 2008 data to identify its overhead and underground operational costs, including storm restoration expenses.

To account for overhead and underground operational costs in the URD charge, Gulf determined its overhead and underground 2008 distribution plant in service costs and the operational expenses associated with that investment. Gulf then escalated the O&M expenses at 2 percent (a decrease from 2.2 percent in the previous filing), to adjust for inflation over a period of 32 years, which is the expected plant life. To calculate the NPV of the operational costs, Gulf used the after-tax weighted average cost of capital of 7.92 percent. Gulf then calculated operational cost multipliers for overhead and underground subdivisions, which are based on the NPV of the operational expenses as a percentage of the investment. The resulting overhead lines operating cost multiplier is 0.62184, and underground lines operating multiplier is 0.35591, which is a slight decrease for both multipliers from the previous filing. The multipliers are applied to the overhead and underground labor and material costs for each subdivision.

Staff has reviewed Gulf's proposed URD charges and their accompanying work papers, and believes the charges are reasonable and recommends approval.

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

**Recommendation**: Yes. If issue 1 is approved, the tariffs should become effective on August 31, 2010. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order. (Jaeger)

**Staff Analysis**: If issue 1 is approved, the tariffs should become effective on August 31, 2010. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order.