

Angela Charles

From: Brian Armstrong <brian@brianarmstronglaw.com>
Sent: Thursday, March 31, 2016 2:00 PM
To: Filings@psc.state.fl.us
Cc: dbmay@hklaw.com
Subject: Docket no. 160060-EC: Complaint and Petition of the City of Cape Coral
Attachments: Cape Coral cover letter and FPL rate order in support.pdf

Name of filer: Brian P. Armstrong

Email address: brian@brianarmstronglaw.com

Docket No.: 160060

Description of filing: Cover letter and copy of Florida Power & Light rate order supporting the City of Cape Coral's request for a rate structure investigation

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Law Office of Brian Armstrong, PLLC
P.O. Box 5055
Tallahassee, FL 32314-5055
850-322-4097
brian@brianarmstronglaw.com

March 31, 2016

Ms. Carlotta S. Stauffer
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket No. 160060-EC: Complaint and Petition of the City of Cape Coral, Florida For An Investigation Into The Rate Structure Of Lee County Electric Cooperative, Inc.

Dear Ms. Stauffer:

Enclosed please find a copy of a rate order addressing a prior rate structure of Florida Power & Light Company which describes such rate structure as follows:

"The company's present RS-1 rate generally applies to residential customers within the incorporated areas of large municipalities. Its RS-2 rates generally apply to residential customers in smaller municipalities. The RS-3 rates apply to residential customers in unincorporated areas throughout its system. The company also maintains three general service rate groups, GS-1, GS-2, and GS-3, which have the same geographical application as the residential rates."

Re: Florida Power & Light Company, 19 P.U.R. 3d 417 (Fla. P.S.C.) at 12

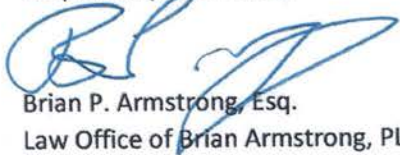
This order is submitted as confirmation of precedent for establishing rate structures in the manner suggested by the City of Cape Coral in its complaint and petition in this docket; **rate structure should reflect the unique circumstances in the Cape Coral/LCEC relationship which likely produce disparate costs of service for the City, its residents and businesses** (for the reasons discussed in the petition). Of particular note, in addition to the widely disparate number of customers per mile served (approximately 750 customers per mile in the City compared to only approximately 55 customers per mile served by LCEC in the remainder of its 2,100 square mile service territory), it must be considered that **LCEC is a distribution only utility; no generation assets exist as FPL provides 100% of the electricity used in the City of Cape Coral**; LCEC is only a middleman. Moreover, the LCEC service territory is comprised of two separate, non-contiguous areas with the City of Cape Coral in the northern, more populated portion.

Finally, this order confirms that **it is possible for an electric utility, any electric utility including a rural, not for profit electric cooperative, to perform cost of service studies for service within cities as well as outside of cities**. Please note that at one time, FPL performed cost of service studies for service within each large city, small city and the entirety of the remaining unincorporated areas which it served. **Just as the Commission required another electric cooperative to perform and submit for review cost of service information necessary to substantiate its rate structure for contributions in aid of construction**

collected by such utility (see the Chelco order addressed in the City's petition), the Commission should do no less for the City of Cape Coral, its residents and businesses so as to insure that no unreasonable or discriminatorily high rates are being charged to them.

A copy of this letter and attached rate order is being provided to counsel for LCEC.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'B.P. Armstrong', is written over the typed name.

Brian P. Armstrong, Esq.
Law Office of Brian Armstrong, PLLC
For the Firm

Cc: D. Bruce May, Esq., counsel for LCEC

19 P.U.R.3d 417, 1957 WL 100955 (Fla.P.S.C.)

Re Florida Power & Light Company

Docket No. 5098-EU, Order No. 2515

Florida Railroad and Public Utilities Commission

August 22, 1957

By the COMMISSION:

I. Nature of Proceeding

This is a proceeding to fix the rates and charges of Florida Power & Light Company for electricity. It was instituted by this commission on its own motion under the authority of Chap 366, Florida Statutes, 1955. This is the first general revision of the company's rates since it came under the jurisdiction of the commission on May 9, 1951.

II. Commission's Jurisdiction

Chapter 26545, Laws of Florida, Acts of 1951 (now Chap 366, Florida Statutes, 1955) became a law on March 9, 1951. Under the provisions of this law, the commission has exclusive jurisdiction over the rates and charges of public utilities, as defined therein. The law specifically provides that all rates being charged and collected by a public utility upon the effective date of the act shall be the lawful rates until changed in accordance with the rules, regulations, or orders of the commission or court decree. The present rates, therefore, of Florida Power & Light Company are the lawful rates for said company inasmuch as they have not been changed since the effective date of said act. The law also specifically provides that the commission shall have the authority to determine and fix fair, just, and reasonable rates to be charged or collected by any public utility for its service.

III. The Utility Involved

Florida Power & Light Company, with its principal business offices located at 25 S. E. 2nd avenue, Miami 30, Florida, is the public utility involved in this proceeding. It is a Florida corporation operating as an integrated public utility engaged in the business of generating, purchasing, transmitting, distributing, and selling electric energy and for that purpose owns and operates generating plants, substations, transmission lines, and distribution systems in various parts of the state of Florida. It serves more than 600,000 customers and operates in Dade, Broward, Palm Beach, Hendry, Lee, Charlotte, Glades, Highlands, Sarasota, Manatee, Hardee, DeSoto, Hillsborough, Collier, Martin, Okeechobee, St. Lucie, Indian River, Brevard, Seminole, Volusia,

Flagler, Alachua, Bradford, Putnam, St. Johns, Clay, Union, Columbia, Suwannee, Baker, Nassau, and Duval counties.

Florida Power & Light serves probably the fastest growing territory in the United States. This utility has been a major contributing factor in the unprecedented growth of Florida's east coast section. It has done an outstanding job in meeting the everincreasing demand from the public for more and more electric energy. While the territory served by Florida Power & Light has grown in recent years beyond the fondest dreams of our most enthusiastic chamber of commerce, the utility itself has also experienced a strikingly similar and remarkable growth. At the end of 1951, when it first came under the jurisdiction of this commission, the utility's total plant in service was \$170,000,000 while at the end of 1956, it was \$325,000,000. Gross electric revenues for 1951 were \$53,000,000, but for 1956 they were \$108,000,000. For 1951 total kwh sales amounted to one billion six hundred million, whereas for 1956 they exceeded three billion six hundred million.

Amazing as the foregoing record may appear, there can be no question but what it will be eclipsed by the anticipated developments, the planned expansions, of the next five years. All reliable sources indicate that neither this utility nor the territory it serves has even begun to approach its reasonable potential. The company's construction budget for 1957 is \$66,000,000 and, with many plants under construction, its construction expenditures will be even greater in 1958.

IV. The Show Cause Order

On June 13, 1957 the commission, on its own motion, issued a show cause order directing Florida Power & Light Company to revise and reduce its rates and charges for electricity. The order recites that periodic reports filed by Florida Power & Light Company with the commission show that there has been a gradual but continuous increase in the utility's earnings so that, at the present time, the same appear to be excessively and unreasonably high. The order goes on to state that when tested by the commission's customary method of rate making (see Docket No. 3719-EU, in re Florida Power Corp. for authority to adjust its rates and charges for electric service, Order No. 1913, dated July 23, 1953 and reported in 99 PUR NS 129) the earnings of Florida Power & Light Company, for the twelve months ended December 31, 1956, were greatly in excess of 6 1/2 per cent of the reasonable value of the utility's property used and useful in serving the public and upon which it is entitled to earn a fair and reasonable return. The utility's earnings for the twelve months ended March 31, 1957, were even more excessive.

Based upon the periodic reports aforesaid, the commission found that the annual earnings of Florida Power & Light Company are so apparently excessive, and the rates and charges collected by it are so apparently unjust and unreasonable, that the same should be appropriately reduced.

In its show cause order the commission went on to find that the company's present schedule of rates and charges on file with the commission have not been revised to give full and proper recognition to the tremendous growth of certain portions of the territory served by said utility, and as a result, said rates and charges appear to give undue and unreasonable preference and advantage to some persons and localities and subject other persons and localities to undue and unreasonable prejudice and disadvantage.

The commission further found that the establishment of new basic rates for said utility will probably necessitate a complete reconsideration and revision of the company's automatic adjustments clauses based upon fuel costs and commodity indices, if a continuation of said adjustments, or either of them, are justified and found to be consistent with the public interest.

Based upon such findings which were set forth in the show cause order, the commission directed Florida Power & Light Company to revise its rates and charges for electricity on or before July 15, 1957, so that:

- (1) The company's rate of return, as customarily calculated by the commission (see Docket No. 3719-EU, Order No. 1913, aforesaid), will not exceed 6 1/2 per cent of the reasonable value of the utility's property used and useful in serving the public and upon which it is entitled to earn a fair and reasonable return.
- (2) Said rates and charges shall give full effect to the statutory requirement that the same shall be fair and reasonable with no undue preference for or prejudice against any person or locality.

If the utility failed to reduce its rates as directed, it became its duty under the terms of said order to show cause at a public hearing why the same should not be done.

The show cause order concluded by directing the commission's general counsel to hold a prehearing conference with the commission's staff, representatives of the utility, and any other interested parties who cared to participate, for the purpose of developing a method to be followed in presenting the revised rates and charges and making the same effective, as well as rules and regulations governing future proceedings in the event a public hearing should become necessary.

V. Prehearing Conference

As directed in the show cause order a prehearing conference was held in the hearing room of the commission in Tallahassee, Florida. The commission's staff, representatives of the utility, and representatives of two of the utility's large commercial customers attended and participated in the conference. As a result of said prehearing conference, and acting upon the recommendations of its General Counsel, the commission in effect amended its show cause order so that:

- (1) The date for the utility's response was postponed from July 15, 1957, to August 1, 1957; and
- (2) The utility, if it elected to make substantial reductions as directed, could at the same time contend for a return higher than 6 1/2 per cent and a more liberal rate base than that customarily used by the commission in fixing rates for electric utilities.

In permitting the utility, in its response to contend for a return in excess of 6 1/2 per cent, we recognize that there have been substantial increases in the cost of money in recent years, which fact would have some bearing upon the question of what constitutes a fair and reasonable return at the present time. While we have an open mind on what would constitute a fair return under present conditions, we feel that the burden is on the utility to show what return is required in order to meet its needs. In our show cause order, we used the 6 1/2 per cent return not because we think that represents a fair and reasonable return under present conditions, but because it was our last expression on what return an electric utility should be allowed to earn. With that as the point of beginning, it then became the duty of the utility to show that such a return would be no longer adequate.

As a further result of the prehearing conference, the commission entered a formal order requiring the utility to support any proposed revision in rates with the following information:

- (1) A separation between the company's gas and electric operations.
- (2) A detailed statement of the rate base proposed by the company for testing its earnings from the operation of its electric plant. The rate base should cover the twelve months ended May 31, 1957 as the test year.
- (3) An exhibit showing the company's earnings requirements with its component parts in detail.
- (4) A statement of the estimated rate of return to be earned on the proposed rate base by application of the proposed rates and charges.
- (5) A proposed revision of the various automatic adjustment clauses used by the company, together with supporting details.
- (6) A proposed spread of the revised rates between the different classes of service and the different geographical locations served by the company so as to show the effect of the reductions on the various classes and locations.

(7) Information of the same character and in the same detail as that furnished annually by all electric utilities for the twelve months ending on September 30th of each year. The period to be covered by this information, however, would be the twelve months ended May 31, 1957.

VI. *The Utility's Response*

The utility elected to reduce and revise its rates and charges rather than enter upon a prolonged rate case and, without waiting for the August 1st deadline, filed with the commission on July 8th its proposed reduction and revision of rates and charges for electricity. The proposal, together with supporting data, complied with the method prescribed by the commission as a result of the prehearing conference. The company estimated that its proposed reductions and revisions would amount to approximately \$4,423,000 when tested by its operations for the twelve months ended May 31, 1957, which, as we have stated, was previously accepted by the commission as the operating period to be used in testing the utility's earnings.

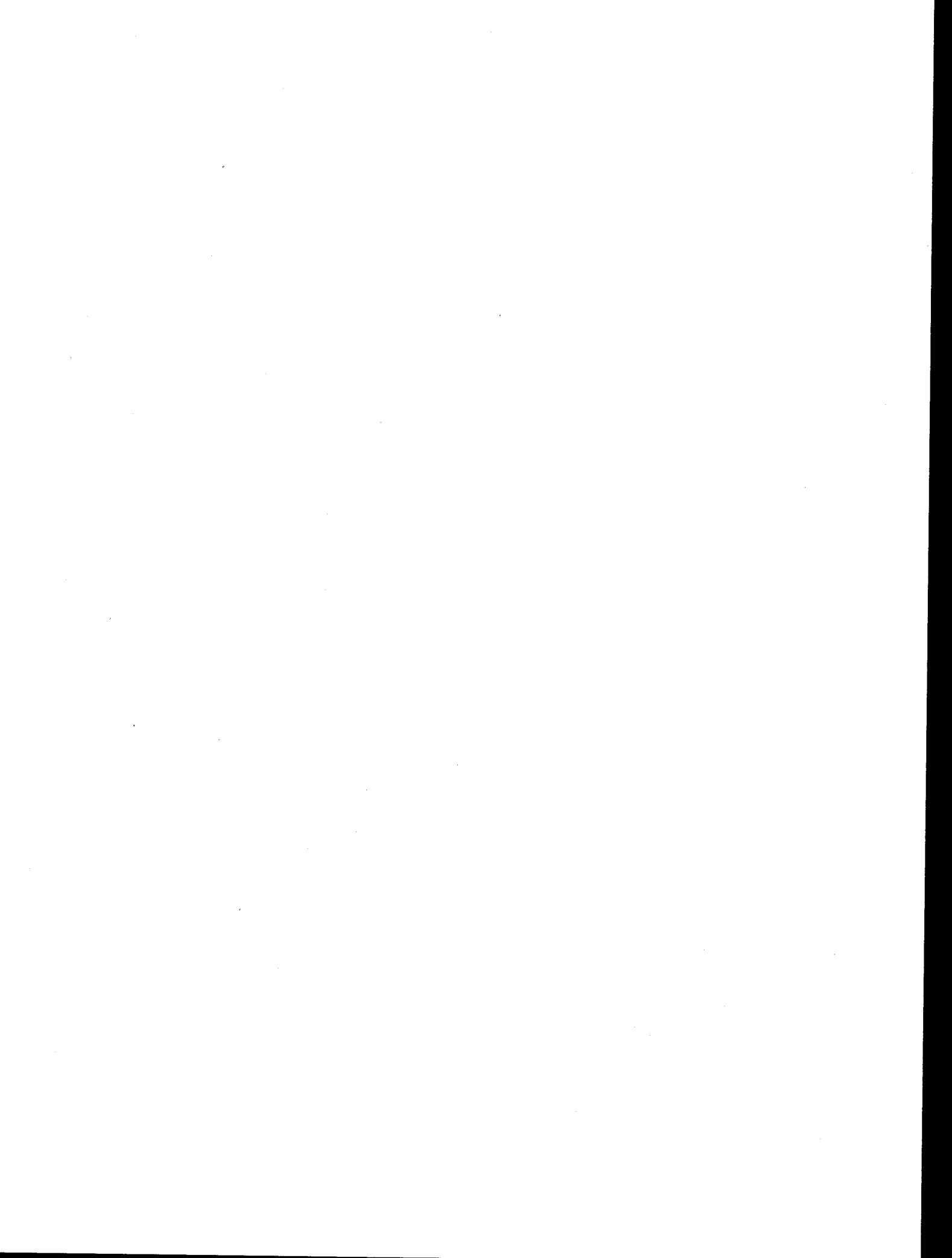
A. *The Utility's Rate Base*

The utility has strenuously objected to the determination of either a rate base or a rate of return in this proceeding. It contends that it is unnecessary to use either of these time-honored rate-making tools. It insists that the commission need do nothing more than find that the proposed rates are reasonable and permit them to become effective.

Disregarding the method of ascertainment, the utility insists that its earnings must equal or exceed 7 per cent on its total capitalization if its ability to attract capital is to remain unimpaired. With reference to the various elements of capital, it takes the position that its earnings must be as follows:

Capital	Amount	Int. — Div. or Earnings	Per Cent
Long-term Debt	\$163,601,000	\$5,913,000	3.61
Preferred Stock	36,250,000	1,615,000	4.45
Customers Deposits	11,039,000	607,000	5.50
Common Equity	113,765,000	15,927,000	14.00
Total	\$324,655,000	\$24,062,000	7.41

The commission's staff and the company were not in accord on what would constitute a proper rate base for testing the utility's earnings. Neither were they in agreement on whether a rate base and a rate of return would be necessary in this proceeding. The staff, therefore, arranged for a



conference with representatives of the utility for the purpose of arriving at some area of agreement, if possible. The conference was held but the parties were unable to reconcile their differences and the staff submitted its recommendations for the consideration of the commission. We will discuss those recommendations later in this order.

While insisting upon earnings which would be in excess of 7 per cent on total capitalization, and urging that it was unnecessary for the commission to determine what the utility referred to as a theoretical rate base and a theoretical rate of return, the company, nevertheless, submitted in its response the various elements which it believes should be used in developing the rate base. The rate base submitted by the utility, as of May 31, 1957, is as follows:

Plant and Reserves	Electric
Plant in Service	\$335,893,000
Construction Work in Progress:	
(a) Completed and in Service	5,032,000
(b) No Interest Capitalized	24,032,000
Plant Held for Future Use	164,000
Plant Acquisition Adjustments	7,648,000

Total Plant	\$372,769,000
Less: Plant Reserves	
(a) Depreciation	\$53,467,000
(b) Amortization of Account 100.5	4,669,000
(c) Amortization of Limited Term Investment	53,000

Total Property Less Property Reserves	\$314,580,000
Additions:	
Port Everglades Land in 'Other Physical Property,' should now be	
'Plant Held for Future Use'	\$241,000
Miscellaneous Special Funds	37,000

Deferred Debts — Construction Contract Advances	273,000	
Capital Stock Expense — Cost of Obtaining Equity Capital	958,000	
	
Subtotal	\$316,089,000	
Working Capital		
Current Assets — End of Month	\$49,785	
Less: Current Liabilities (Excluding Customers Deposits) — End of Month	30,660	
	
Net Working Capital	\$19,125	(18,781)*
	
Total Rate Base	\$334,870,000	

(*The Current Assets and the Current Liabilities were for the company's combined gas and electric operations. The company allocated \$18,781 of the difference to electric operations.)

Compared with the foregoing rate base as developed by the utility, it reported total capitalization of \$324,655,000 as of May 31, 1957.

B. Fuel Adjustment Clause

In its response to the show cause order the utility proposed a revision in its Fuel Adjustment Clause. The proposed revision was found to be acceptable by the staff in so far as its total revenue effect is concerned. However, the staff recommended that the proposed Fuel Adjustment Clause be approved only for temporary application pending a full investigation of similar clauses of all other electric utilities under the jurisdiction of this commission for the purpose of changing the same, if found to be practicable, from a percentage increase applied to the total bill to an incremental increase to each kwh consumed.

The present Fuel Adjustment Clause employed by the utility provides for an adjustment of one-eighth of one per cent for each one per cent change in the price of fuel oil from a base price of \$1.47 per barrel. An illustration may be helpful in understanding how this adjustment works in actual application. Assuming a present cost of \$3 per barrel for fuel oil, we subtract therefrom the base price of \$1.47 to find an increase of \$1.53 which represents a change of 104 per cent. Applying the

formula of one-eighth of one per cent for each one per cent change, we arrive at a fuel adjustment of 13 per cent. The total electric bill would then be increased 13 per cent to permit the utility to recover the increased cost of fuel oil which is not taken into consideration in fixing the kwh rates.

The proposed Fuel Adjustment Clause provides for four-tenths of one per cent adjustment for each 5 1/2 cents change in the price of fuel oil from a base price of \$1.50 per barrel. Assuming again that the present price of fuel oil is \$3 per barrel, we have \$3 less the base price of \$1.50 which, of course, leaves an increase of \$1.50. If we divide this \$1.50 increase by the 5 1/2 cents change, we find there have been 27 changes. The 27 changes multiplied by the four-tenths of one per cent gives us an adjustment of 10.8 per cent which is then applied to the total electric bill.

C. Commodity Adjustment Clause

In its response the utility also proposed a revision of its present Commodity Adjustment Clause. The staff found this proposed revision to be acceptable.

The present Commodity Adjustment Clause provides for one-eighth of one per cent adjustment for each whole point above or below 100 in the Monthly Wholesale Price Index of 'Commodities Other than Farm Products.' This adjustment works in this manner. The present index is 186 which is 86 points above the 100 base. One-eighth of one per cent of the 86 points equals 10.75 per cent and this is the amount now being added to total electric bill as a result of the application of this adjustment clause.

The proposed Commodity Adjustment Clause provides for three-tenths of one per cent adjustment for each whole point below 120 or above 130 in the Monthly Wholesale Price Index of 'Commodities Other than Farm Products and Foods.' The index used in the present clause is not a regularly published index, but is one compiled and made available upon request by the U. S. Department of Commerce. The index used in the proposed clause is regularly published monthly by the same department. At the present time, there will be no commodity adjustment as a result of the proposed Commodity Adjustment Clause because the index is now at 126, with the trend falling off slightly, and it must be over 130 before an upward adjustment in the electric bill would result. At the same time the index must be below 120 before a downward adjustment in the electric bill would result from the application of the Adjustment Clause. This particular index reached 120 in December of 1955 and has never exceeded 127.

VII. The Staff's Recommendations

The commission's staff was unable to agree with the utility's contention that it is unnecessary for the commission to determine either a rate base or a rate of return in this proceeding to fix the rates and charges of Florida Power & Light Company.

Likewise, the staff was unable to concur in the conventional rate base proposed by the utility or its insistence that the utility must have earnings which will be in excess of 7 per cent of total capitalization.

As a result of its inability to concur with the utility, the staff filed formal written recommendation with the commission setting forth what it conceived to be a proper rate base and rate of return to be earned thereon by the utility.

The staff's recommendations, if approved, would require the utility to make further reduction of \$302,000 over and above the \$4,423,000 proposed by the company, or total reductions of \$4,725,000.

A. The Staff's Rate Base

The staff's recommended rate base is as follows:

Plant and Reserves	Electric
Plant in Service	\$335,892,867
Construction Work in Progress:	
(a) Completed and in Service	5,953,926
(b) No Interest Capitalized	13,738,392
Plant Held for Future Use	405,181
Plant Acquisition Adjustments	7,648,048

Total Plant	\$363,638,414
Less Plant Reserves:	
(a) Depreciation	\$53,466,630
(b) Amortization of Account	
100.5	4,669,493
(c) Amortization of Ltd. Term	

Invest.	52,863
(d) Storm Damage	6,958,267
(e) Customers Adv. for Const.	154,996
(f) Contributions in Aid of Const.	1,081,994
.....	
Total Plant Less Property	
Reserves	\$297,254,171
Additions	
Working Capital:	
(a) Materials and Supplies	\$5,197,125
(b) Fuel	768,086
(c) Cash	4,588,287
.....	
Total Gross Working Capital	\$10,535,508
Less:	
(a) Income Tax Payment Lag	\$3,430,301
(b) Annual Deferral Income Tax	1,925,000
.....	
Total Net Working Capital	\$5,150,207
.....	
Total Rate Base	\$302,404,378

B. The Staff's Recommended Rate of Return

In its recommendations the staff has represented to the commission that, under present conditions, the utility is entitled to earnings which will very nearly approach 7 per cent on the rate base of \$302,404,378, In support of its position, the staff takes the position that whereas 6 1/2 per cent was reasonable in the Florida Power Corporation rate case of 1953 (99 PUR NS 129), the present tight money market, increasing interest rates, and continued inflation all conspire to make a

similar rate of return for the utility in this proceeding unrealistic and inadequate. The staff bottoms its recommended higher rate of return on the philosophy that when value is greatly affected by changing conditions, such changes may and should be compensated from time to time by varying the rate of return consistent with existing conditions, including the circumstances of the money market, so that the equity owners of a public utility will receive an amount to which they are at the time fairly entitled. Under this philosophy, the staff takes the position that the earnings of a utility must be just and reasonable having consideration for all circumstances that in the sphere of finances affect and influence investments of this sort.

In its recommendations the staff points out that public utilities in Florida face the tremendous task and responsibility of securing hundreds of millions of dollars in new capital during the next five years if they are to keep pace with the unprecedented growth of this state. In no other state are the public utilities confronted with such increasing demands for service. If their earnings are unreasonably restricted, it is the feeling of the staff that Florida's utilities will be unable to finance their expansion programs advantageously and the public will be unable to secure essential services.

In recommending a rate of return of slightly less than 7 per cent, the staff calls attention to the fact that the industrial growth of Florida, which is just now beginning to attract national attention, will not continue to its full fruition unless the utilities, upon which industry depends, are able to meet the heavy demands that this type customer generates. At the same time, the staff cautions, Florida is becoming a veritable haven for those elderly citizens who have retired from active labor and must live on small pensions. The constantly rising cost of living presents a considerable problem for this fast increasing part of Florida's population. The staff concludes that the interest of the utilities and the interest of their customers are complementary and the two must receive full consideration if regulation is to achieve its real purpose — the regulation of public utilities in the public interest.

C. The Staff's Proposed Reductions

The staff's recommendations would require the utility to effect further reductions in the sum of \$302,000. The staff recommends that this additional reduction be obtained by some further revisions in the tariffs submitted by the utility.

At the present time, the company maintains several rate groups for different geographical application. One of the primary purposes of the show cause order was to eliminate certain preferences and prejudices which existed because of the utility's present rate structure.

1. Present Rate Structure

The company's present RS-1 rate generally applies to residential customers within the incorporated areas of large municipalities. Its RS-2 rates generally apply to residential customers in smaller municipalities. The RS-3 rates apply to residential customers in unincorporated areas throughout its system. The company also maintains three general service rate groups, GS-1, GS-2, and GS-3, which have the same geographical application as the residential rates. In its response, the utility proposed the elimination entirely of its RS-3, GS-2, and GS-3 rate groups. Customers presently in the RS-3 group in the unincorporated areas in the vicinity of the larger municipalities would, under the company's proposal, be placed in RS-1. Similarly, those in RS-3 in the vicinity of the smaller municipalities would be placed in RS-2. Some municipalities formerly in RS-2 were placed in RS-1. This proposed regrouping within itself would result in substantial reductions in rates paid by those customers affected by the proposed change. Under the company's proposal, all customers under either of the present general service rates would be placed in the GS-1 group.

The present minimum rates for the different groups are as follows:

RS-1 — \$1.00	for the first 14 kwh
RS-2 — 1.25	for the first 14 kwh
RS-3 — 1.50	for the first 14 kwh
GS-1 — 1.00	for the first 14 kwh
GS-2 — 1.25	for the first 14 kwh
GS-3 — 1.50	for the first 14 kwh

Under the company's proposal, the minimum would be:

RS-1 — \$1.10	for the first 14 kwh
RS-2 — 1.10	for the first 14 kwh
GS-1 — 1.10	for the first 14 kwh

The staff has revised the minimum rates so that, in its opinion, the public will be benefited and the additional \$300,000 reductions will be obtained. The staff has recommended the following minimum rates:

RS-1 — \$1.10	for the first 16 kwh
RS-2 — 1.25	for the first 16 kwh
GS-1 — 1.10	for the first 16 kwh

GS-2 — 1.25

for the first 16 kwh

In recommending the two general service rates, it was the staff's opinion that general service rates geographically should be related to the corresponding residential rates.

The staff recommended some further changes in the rate group breaking points. Such changes were:

RS-1: After the first 16 kwh, then
 4.950 for the next 36 kwh, and
 2.750 for the next 130 kwh.

RS-2: After the first 16 kwh, then
 4.950 for the next 56 kwh, and
 2.750 for the next 110 kwh.

Under the foregoing changes proposed by the staff, further reductions of approximately \$302,000 would be accomplished making the total reductions \$4,725,000 as compared with the \$4,423,000 proposed by the company.

VIII. Utility's Objections to Staff Recommendations

Copies of the staff's recommendations were furnished to the utility, the press, and various public representatives. The staff requested that the commission hold a formal conference in its hearing room in Tallahassee, Florida, at 11 A.M., August 19, 1957, for the purpose of considering said recommendations as well as any objections thereto by any interested party. The conference was held as requested and the commission's general counsel, on behalf of the staff, presented the recommendations together with oral argument in support thereof. The chairman of the board of Florida Power & Light presented the utility's objections to the staff's recommendations and made oral argument in support of the utility's position. No other interested parties participated in the presentation or oral arguments, although the representative of one large commercial customer attended the conference.

The utility continued to urge that it is unnecessary for the commission to determine in this proceeding either a rate base or a rate of return. It reiterated its contention that the utility must have earnings of something in excess of 7 per cent on total capitalization in order to advantageously finance its expansion program. Specifically, the utility took exceptions to the staff's treatment of Storm Damage Reserve, Construction Work in Progress, and Working Capital Allowance, in determining the rate base. However, the utility announced that it acquiesced in the total reductions

of \$4,725,000 as recommended by the staff and would like to make such reductions effective at the earliest date possible so that it could get back to the important business of financing its large expansion program.

IX. Conclusions of Law

We have carefully considered the entire record herein, including the utility's annual, quarterly, and special reports, the staff's recommendations, the utility's objections thereto, and the oral arguments presented at the formal conference before the full commission, and it is our opinion that the commission must as a matter of law determine a rate base and a rate of return when fixing the rates to be charged by a public utility. It is our further opinion that under our statutory authority, we may not use total capitalization itself as the rate base upon which the utility is entitled to earn a fair and reasonable return.

The statute, Chap 366, Florida Statutes, 1955, specifies what value shall be used in fixing rates for electric utilities. The law provides that:

'The commission shall investigate and determine the actual legitimate costs of the property of each utility company, actually used and useful in the public service, and shall keep a current record of the net investment of each public utility company in such property which value, as determined by the commission, shall be used for rate-making purposes and shall be the money honestly and prudently invested by the public utility company in such property used and useful in serving the public, less accrued depreciation, and shall not include any good-will or going-concern value or franchise value in excess of payment made therefor.' [§366.06(2)].

Thus, the statute fixes the nature of the rate base to be used by the commission in the exercise of its rate-making authority. This proceeding is essentially one for the purpose of fixing lawful rates to be charged and collected by Florida Power & Light Company for electricity. The duty of the commission is not altered by the fact that the utility has elected to acquiesce in the recommended reductions in present rates rather than project this into a conventional adversary proceeding. The commission's duty remains the same. It must fix rates that will be just and reasonable. The performance of that duty requires, in our opinion, the determination of a rate base and a rate of return. Otherwise, the fixing of rates would be an arbitrary exercise of statutory authority. The utility, its investors, the rate-paying public, and the reviewing court, if any, must be advised concerning the method employed by the commission in arriving at its conclusion that the resulting rates are in fact reasonable.

The Wisconsin Public Service Commission, in fixing the rates for Commonwealth Telephone Company for its Two Rivers exchange, 70 PUR NS 5, 10, said that:

'The rates herein prescribed are arrived at without determining any rate base, and without determining any specific figure as constituting a 'fair rate of return' on anything that may be claimed to be a proper rate base. The rates herein prescribed are estimated and intended to afford approximately an annual net profit of a determined number of dollars which we think it reasonable for the utility to enjoy from the operation of its business.'

The order of the Wisconsin Commission was ultimately reviewed by the supreme court of Wisconsin (73 PUR NS 97, 99, 100) and reversed with the following language:

'The commission's order in this case was ...arbitrary and unlawful How can the commission or the reviewing court or the utility or the public determine whether the profit is proper unless the commission makes specific findings of the relevant facts and circumstances? The commission must determine what those are and set them forth as required by law. Those essential facts which control each case will then determine the rate base. If the rule were otherwise, the courts would have no rule to apply upon review, and the commission could on rehearing in this same case a year hence determine that the present rate is unreasonable and that [an even greater profit] would be reasonable for the [utility] to enjoy; and the consumers would then be bound by the commission's abstract conclusion of 'reasonableness.' ...The present method of the commission is improper and must be abandoned.'

Other courts in other jurisdictions have followed the reasoning of the supreme court of Wisconsin and we believe that it has enunciated a sound philosophy which should be followed by all regulatory agencies charged with the responsibility of fixing just and reasonable rates for public utility services. That is the philosophy of this commission and the one we shall follow in the exercise of our statutory authority over public rates and charges.

X. Findings of Fact

We believe that the recommendations of the staff are consistent with the requirements of the statute and should be approved and adopted by this commission. Some reference, however, should be made to the utility's specific objections to three elements comprehended in the staff's recommendations concerning the rate base.

A. Storm Damage Reserve

The Storm Damage Reserve maintained by the utility amounts to \$6,958,267. The staff did not allow this reserve as a part of its recommended rate base. This reserve has been created by the annual charge of \$720,000 to operating expenses. It is not a funded reserve and the Estimated Construction Budget filed annually with the commission specifically states that this accrual will

be used in financing the anticipated construction for the year. We believe that this annual accrual is a sound business practice and a proper charge against operating expenses. The staff has not recommended that this annual charge to operating expenses be eliminated. It is our opinion that it should be continued and we find no objection to the utility using it for construction purpose when it is not needed for storm damage replacement. However, should it be eliminated as an annual charge against operating expenses for storm damage and merely converted to surplus as increased net operating income, the earnings of the company would be unreasonably increased by that amount. The staff has treated this reserve in the same way it treated depreciation reserve and we think justifiably so. Storm damage is a form of depreciation and frequently utilities comprehend this element in their depreciation rate. This reserve fund has been provided by the ratepayer and certainly he should not be required to provide the fund and then a substantial profit on that fund for the benefit of the utility. We find that the Storm Damage Reserve in the sum of \$6,958,267 is properly deducted from the rate base.

B. Working Capital

The utility has contended that Working Capital Allowance should be predicated on the current cash position of the company. The staff takes the position that this method is unsound and, in support of its position, points to the fact that frequently a utility's current liabilities exceed its current assets. Taking the company's own records, the staff illustrated its position by showing that the December 31, 1953, balance sheet of the company listed current assets of \$18,600,000, whereas its current liabilities were \$20,900,000, leaving a negative cash position of \$2,300,000. We concur with the staff that this method of arriving at the Working Capital Allowance is fraught with danger. We believe that the method employed by the staff is the better method. They have allowed approximately seventy-three days' supply of materials and supplies which is the full average balance maintained in this account by the company for the test year. The staff has allowed the full average balance maintained by the company in its fuel inventory account and would have undoubtedly allowed more had the utility sufficient storage facilities to carry a larger supply. The staff allowed sufficient cash for sixty days' operating expenses, less (1) fuel cost, which was otherwise provided for, (2) storm damage expense, and (3) interchange of power, neither of which requires any immediate cash outlay. We believe that these are reasonable and adequate allowances. On the theory that the allowance of working capital is not necessary where the ratepayer has otherwise provided funds which may be used for that purpose, the staff reduced the working capital allowance by the amount of federal income tax accruals and deferrals which are not required immediately by the utility for income tax payments. The staff deducted 17 1/2 per cent of the utility's currently payable federal income taxes because the company has seventeen months in which to pay twelve months' taxes. The staff also deducted the entire amount of federal income taxes deferred beyond the tax year on the theory that the full amount of these taxes were available for use by the utility for any purpose and were not immediately required for the payment of the deferred taxes. The staff's method of reducing the gross working capital allowance is an accepted

regulatory practice in most jurisdictions and has been consistently used by this commission in many of its rate proceedings.

C. Construction Work in Progress

The utility separated its construction work into two categories, (1) Construction Work in Progress — Completed and in Service, and (2) Construction Work in Progress — On Which No Interest is Capitalized. The first category amounted to \$5,953,926 according to the staff's recommendations and there appears to be no controversy concerning the allowance of this as a part of the rate base. This item represents construction work which has been completed and cut into service. However, it has not yet been transferred from the construction accounts to the plant accounts. The staff has included this item in the rate base. The second category amounts to \$24,032,000 according to the utility. The staff allowed only \$13,738,392 of this amount in the rate base. The utility discontinued charging interest during construction in 1954 and announced by means of a footnote to its balance sheet that henceforth it would include all such construction work in its rate base. After some controversy with the commission over this item, the utility was allowed to discontinue charging interest during construction but was required to delete the footnote and leave the matter for future determination should a rate case develop.

It is the opinion of the staff that the inclusion of construction work on which no interest is capitalized should depend upon factors other than the charging of interest. It divides the construction work into three categories, namely; (1) construction designed to reach new customers; (2) construction that will replace worn or outmoded facilities; and (3) construction designed to improve present facilities, but not replacing old equipment. The staff argues that the first category should not be included in the rate base because present customers should not be required to pay a return on property intended to serve future customers unless consideration is also given to the potential revenue to be derived from such future customers. Then, too, if the additional revenue is to be considered, the additional expense to be incurred in operating the new plant must be considered. Such revenue and expense figures could be nothing more than estimates and would not provide a sound basis for determining the new plant's contribution to the company's overall earnings.

The staff also argues that construction work intended to replace worn or outmoded equipment should not be included in the rate base for the obvious reason that its inclusion would require the customer to pay a return on excess plant. If the one is included then the other should be retired, otherwise they both remain in the rate base and the customer must pay a return on both.

Construction work designed to improve present service but not replacing old equipment, in the opinion of the staff, should be included in the rate base.

From the records of the company, the staff ascertained that the utility had construction work in progress involving minor jobs costing \$50,000 or less, and on which interest during construction is never charged, amounting to \$3,019,962. The staff included that in its rate base. Likewise, the staff ascertained that the utility will cut into service about the first of September, 1957, the first 160,000 kw unit of its new Ft. Lauderdale plant. This generating plant will contribute little, if any, additional revenue to the utility, but primarily will enable it to bring its generating capacity more in line with the demand for electric energy presently being experienced by the company. The staff included \$10,581,500 for this item. Thus the staff has included in the rate base the total sum of \$13,738,392 for construction work in progress not completed and in service and on which no interest has been capitalized.

We concur in the staff's treatment of construction work in progress and believe that it affords the utility an opportunity to earn a return on every dollar which it has dedicated to the public service and upon which the present ratepayers should be required to pay a return.

D. Effect of Reductions on Earnings

The utility's calculations showing it required a return of 7.41 per cent on total capitalization employed total capital outstanding at the end of the period. We do not consider that to be the proper way to ascertain earnings on capital. The proper procedure, in our opinion, would be to use the average capital outstanding during the year rather than year-end balances. For a test year only the outstanding capital is at work and upon that dividends are paid and the company's cost of money is calculated. On the basis of average capital outstanding for the test period, the company's earnings were as follows:

		Int. — Div.	
Capital	Amount	or Earnings	Per Cent
Long-term Debt	\$147,297,000	\$4,717,000	3.20
Preferred Stock	35,623,000	1,587,000	4.45
Customers Dep.	11,039,000	607,000	5.50
Common Equity	105,466,000	16,645,000	15.78
.....			
Total	\$299,425,000	\$23,556,000	8.17

Earnings on common equity at the rate of 15.78 per cent or even 14 per cent appear unreasonably high. The staff's investigation reveals that 131 electric utilities in the United States for the year

1956 earned an average of 10.56 per cent on common equity capital and 5.80 per cent on total capital.

We recognize along with the staff that Florida utilities are presently experiencing greater growth than those of any other state. Likewise, we too know that tight money and higher interest rates have plagued the utilities more and more since the first of 1957. Nevertheless, these financing problems do not appear to be sufficient to justify such a wide differential between the earnings of a Florida utility and the average for the nation as a whole. We sincerely feel that Florida utilities must have better earnings than the utilities of other states especially during this period of the state's greatest growth and development. However, in our opinion, the disparity should not be so great.

The utility reported net operating income for the test period of \$23,355,659. When tested by the staff's recommended rate base of \$302,404,378 its return was 7.72 per cent. The net cost to the company of the recommended reductions of \$4,725,000, after taxes, will be \$2,234,122 which would reduce the net operating income for the test period to \$21,121,537 giving the utility a return of 6.98 per cent which we find to be just and reasonable.

E. The Recommended Rates and Charges

We have previously referred herein to the rates and charges proposed by the utility and recommended by the staff. We will not prolong this order for the purpose of discussing them in further detail. It is estimated that the rates and automatic adjustment clauses proposed by the utility when revised as recommended by the staff will result in reducing the utility's revenues by approximately \$4,725,000 giving the utility a return of 6.98 per cent on a rate base of \$302,404,378. Such rates and charges will be just and reasonable and substantially remove the preferences and discriminations previously referred to herein and in the show cause order. The rates and charges recommended by the staff should become effective with all meters read on and after August 26, 1957.