

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: November 29, 2018

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Accounting and Finance (M. Andrews, Perez, Mouring) *M*
Division of Economics (Higgins, McNulty) *MA*
Division of Engineering (Thompson, Ellis) *TW* *9/24* *73*
Office of the General Counsel (Schrader, J. Crawford) *KS* *JSC*

BSJ
ALM

RE: Docket No. 20180155-EI – Petition for approval of regulatory assets related to the retirements of Lauderdale Units 4 and 5 and Martin Units 1 and 2, by Florida Power & Light Company.

AGENDA: 12/11/18 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Clark

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

Case Background

On March 1, 2018, the Commission approved Florida Power & Light Company's (FPL or Company) petition for determination of need for the Dania Beach Clean Energy Center (DBEC) Unit 7. The DBEC petition proposed to modernize Lauderdale Plants, by retiring Units 4 and 5 in the fourth quarter of 2018 and replace them in mid-2022 with DBEC Unit 7.¹ In April 2018, FPL included in its annual Ten-Year Site Plan its plan to retire Martin Units 1 and 2 in the fourth quarter of 2018.

¹ Order No. PSC-2018-0150-FOF-EI, issued March 19, 2018, in Docket No. 20170225-EI, *In re: Petition for Determination of Need for Dania Beach Clean Energy Center Unit 7, by Florida Power & Light Company.*

On August 17, 2018, FPL filed the instant Petition seeking approval to create regulatory assets and defer recovery of the amounts related to the retirement of Lauderdale Units 4 and 5 (Lauderdale) and Martin Units 1 and 2 (Martin). At the time of their expected retirements, FPL states that the total unrecovered costs for the Lauderdale and Martin Units are estimated to be \$287 million and \$372 million, respectively.² As proposed, the recovery of the regulatory assets would be deferred until base rates are next reset in a general base rate proceeding.

The Sierra Club is listed as an interested party in this docket. Although it has not officially intervened in this proceeding, the Office of Public Council (OPC) filed a letter dated November 8, 2018, in this docket identifying certain concerns it has with the Petition filed by FPL.

This recommendation addresses FPL's request for authority to create regulatory assets representing the remaining net book value of the Lauderdale and Martin Units at retirement and the Company's request for authority to defer recovery of the regulatory assets until FPL's base rates are next reset in a general base rate proceeding. The Commission has jurisdiction over this matter pursuant to Sections 366.04 and 366.06, Florida Statutes (F.S.).

² Document No. 07145-2018, Staff's Fourth Data Request

Discussion of Issues

Issue 1: Should the Commission approve FPL's request to create regulatory assets related to the retirement of Lauderdale Units 4 and 5 and Martin Units 1 and 2?

Recommendation: Yes, the Commission should approve FPL's request to create regulatory assets related to the retirement of Lauderdale Units 4 and 5 and Martin Units 1 and 2. The approval to record the regulatory assets for accounting purposes does not limit the Commission's ability to review the amounts and recovery period for reasonableness in future proceedings in which the regulatory assets are included for recovery. (M. Andrews, Thompson, Higgins)

Staff Analysis: On August 17, 2018, FPL filed the instant Petition seeking approval to create regulatory assets for the amounts representing the remaining net book value, at retirement, of Lauderdale Units 4 and 5 and Martin Units 1 and 2.

FPL has an ongoing program to modernize its fossil fuel generating units based on cost-effectiveness. By Order No. PSC-2018-0150-FOF-EI, the Commission approved the need for the Dania Beach Clean Energy Center (DBEC).³ The DBEC is essentially a modernization/repowering of FPL's existing Lauderdale Plant. Specifically, the Company is planning to retire Units 4 and 5 at the end of the fourth quarter of 2018 and bring into service Unit 7 in mid-2022. The DBEC Unit 7 modernization project, which includes the retirement of Lauderdale Units 4 and 5, is projected to save FPL customers an estimated \$300 million in cumulative present value of revenue requirements (CPVRR). The CPVRR savings are expected to begin accumulating in 2021.

The retirement of Martin Units 1 and 2 in the fourth quarter of 2018 was included in FPL's 2018 Ten-Year Site Plan provided to the Commission in April 2018. Both units have been in operation for approximately 38 years and are inefficient as compared to the rest of FPL's generating fleet. For example, Martin Units 1 and 2 have average net heat rates of 11,943 and 11,488 British thermal units/kilowatt-hour (BTU/kWh), respectively; whereas, FPL's newest combined cycle (CC) unit has an average net heat rate of 6,699 BTU/kWh. FPL considered whether retiring the units early versus continuing to operate the units through their originally planned retirement date was more economic. The alternatives considered to replace Martin Units 1 and 2 were upgrading the combustion turbine (CT) components of some of FPL's existing CC units, or repowering Martin Units 1 and 2. FPL ultimately determined that upgrading the CT components of some of its existing CC units was the most cost-effective option.

The combined capacity of Martin Units 1 and 2 is 1,626 MW, and FPL expects 1,526 MW of additional capacity from the upgrades to other units. FPL's current resource plan, including the early retirement of Martin Units 1 and 2, upgrades to the CT components of existing CC units, and a short-term purchased power agreement in 2028 is expected to allow FPL to continue to maintain its twenty percent planning reserve margin criteria. FPL would still be capable of maintaining its reserve margin if it were to continue to operate Martin Units 1 and 2; however, FPL states its customers would not benefit from the economic savings associated with retiring the units. The retirement of Martin Units 1 and 2 is expected to result in approximately \$491

³ Id.

million in CPVRR savings to FPL’s customers as compared to continuing to operate the units and the savings are expected to begin accumulating in 2019.

In its Petition, FPL estimated a retirement date for Lauderdale Units 4 and 5 of October 1, 2018, and a retirement date for Martin Units 1 and 2 of December 1, 2018. In response to staff’s third data request, FPL now estimates that the Lauderdale and Martin Units will be retired on or about December 31, 2018.⁴ According to Revised Attachment KF-1, in its response to staff’s fourth data request, FPL states that the unrecovered net book values for the Lauderdale and Martin Units at the time of retirement are estimated to be approximately \$287 million and \$372 million, respectively.⁵ Staff notes that per the Company’s most-recent depreciation study filed in 2016, in Docket No. 160062-EI (later consolidated with Docket No. 160021-EI), the expected retirement year for Lauderdale Units 4 and 5 is 2033 and the expected retirement year for Martin Units 1 and 2 is 2031.⁶

Table 1-1 below reflects the estimated plant in service, reserve, and remaining net book value amounts associated with the relevant Lauderdale and Martin Units at the specified dates.

Table 1-1
Net Book Values Associated with Lauderdale Units 4 and 5
and Martin Units 1 and 2

Plant	Plant in Service	Reserve	Net Book Value
Plant Lauderdale (as of 12/31/2018)	\$479,165,675	\$192,128,935	\$287,036,741
Plant Martin (as of 12/31/2018)	\$778,405,489	\$406,856,880	\$371,548,609
Total*	\$1,257,571,164	\$598,985,815	\$658,585,350

Source: In Response to Staff’s Fourth Data Request.
 FPL’s Revised Attachment KF-1.

* Differences due to rounding

Due to the early retirement of the Lauderdale and Martin Units, certain entries must be made to FPL’s books and records. Rule 25-6.0436(6), Florida Administrative Code (F.A.C.), requires the compilation of an annual depreciation status report showing changes to categories of depreciation that will require revision. In addition, Rule 25-6.0436(7)(a), F.A.C., provides that:

⁴ Document No. 07095-2018, Staff’s Third Data Request

⁵ Document No. 07145-2018, Staff’s Fourth Data Request

⁶ Order No. PSC-16-0560-AS-EI, issued December 15, 2016, in Docket No. 160021-EI, *In re: Petition for rate increase by Florida Power & Light Company*; Docket No. 160061-EI, *In re: Petition for approval of 2016-2018 storm hardening plan, by Florida Power & Light Company*; Docket No. 160062-EI, *In re: 2016 depreciation and dismantlement study by Florida Power & Light Company*; and Docket No. 160088-EI, *In re: Petition for limited proceeding to modify and continue incentive mechanism, by Florida Power & Light Company*.

Prior to the retirement of major installations, the Commission shall approve capital recovery schedules to correct associated calculated deficiencies where a utility demonstrates that (1) replacement of an installation or group of installations is prudent and (2) the associated investment will not be recovered by the time of retirement through the normal depreciation process.

FPL's current depreciation rates authorized in Order No. PSC-2016-0560-AS-EI (2016 Settlement Agreement) are based on retirement years of 2033 for Lauderdale and 2031 for Martin. Therefore, the investment in the Lauderdale and Martin Units will not be fully recovered through the existing depreciation process due to the early retirement of the Units. Thus, staff recommends it is appropriate to create regulatory assets for the amounts representing the remaining net book value of Lauderdale Units 4 and 5 and Martin Units 1 and 2 at retirement. In addition, staff notes that the approval to record the regulatory assets for accounting purposes does not limit the Commission's ability to review the amounts and recovery period for reasonableness in future proceedings in which the regulatory assets are included for recovery.

Issue 2: Should the Commission allow FPL to defer recovery of the Lauderdale and Martin regulatory assets until FPL's base rates are next reset in a future rate proceeding?

Recommendation: No, the Commission should not approve FPL's request to defer recovery of the Lauderdale and Martin regulatory assets to a future general base rate proceeding. FPL should be required to begin amortizing the regulatory assets associated with Lauderdale Units 4 and 5 and Martin Units 1 and 2 upon retirement. The annual amortization amounts should be \$21.5 million for the Lauderdale Units and \$31.9 million for the Martin Units, for both base rate and clause recovery combined. (M. Andrews, Moring)

Staff Analysis: According to Revised Attachment KF-1, the estimated unrecovered net book value associated with the retirement of Lauderdale Units 4 and 5 is approximately \$287 million. For Martin, in addition to the retirement of Units 1 and 2, the Company is also proposing to retire certain associated transmission facilities. The estimated unrecovered net book value related to the Martin retirement is approximately \$372 million.

In its Petition, FPL states that pursuant to Paragraph 14⁷ of the 2016 Settlement Agreement, the Company is prohibited from requesting an amortization rate during the term of the Agreement, thus the early retirement of these units will require that future revisions be made to the depreciation rates, amortization, and capital recovery schedules. Moreover, because of the specific terms of 2016 Settlement Agreement related to continuing depreciation and amortization rates until base rates are next reset in a general base rate proceeding, FPL argues the creation of a regulatory asset in this instance does not involve deferral of costs that would otherwise be recovered, in part, during the term of the Agreement. Therefore, FPL concludes that creation of regulatory assets and deferral of cost recovery are appropriate in this instance.

FPL cites to Order No. PSC-2016-0361-PAA-EI⁸ which approved Gulf Power Company's (Gulf) request to create a regulatory asset associated with the early retirement of Smith Units 1 and 2 (Smith) and to defer costs and seek recovery through rates at a later time as support for its request. Gulf's request to defer amortization of the Smith regulatory asset related to the early retirement of the Smith Units was approved to begin on January 1, 2018, as part of a settlement agreement approved by Order No. PSC-17-0178-S-EI.⁹

On November 8, 2018, OPC filed a letter in this docket in which it identifies certain issues it has with the proposed treatment of the early retirement of Lauderdale Units 4 and 5 and Martin Units 1 and 2 as proposed by FPL in its Petition. OPC states that it does not object to the early

⁷ Paragraph 14 of FPL's 2016 Settlement Agreement states:

The Parties agree that the provisions of Rules 25-6.0436 and 25-6.04364, F.A.C., pursuant to which depreciation and dismantlement studies are generally filed at least every four years will not apply to FPL and until FPL files its next petition to change base rates. The depreciation rates and dismantlement accrual rates in effect as of the Implementation Date shall remain in effect until FPL's base rates are next reset in a general base rate proceeding.

⁸ Order No. PSC-16-0361-PAA-EI, issued August 29, 2016, in Docket No. 160039-EI, *In re: Petition for approval of regulatory asset related to the retirement of Plant Smith Units 1 and 2, by Gulf Power Company.*

⁹ Order No. PSC-17-0178-S-EI, issued May 16, 2017, in Docket No. 160186-EI, *In re: Petition for rate increase by Gulf Power Company*, and Docket No. 160170-EI, *In re: Petition for approval of 2016 depreciation and dismantlement studies, approval of proposed depreciation rates and annual dismantlement accruals and Plant Smith Units 1 and 2 regulatory asset amortization, by Gulf Power Company.*

retirement of the facilities nor the creation of the regulatory assets. However, OPC asserts that FPL's proposed treatment violates the terms and conditions of the 2016 Settlement Agreement.

OPC states that it recognizes that the early retirement of the Lauderdale and Martin Units will trigger the need to establish capital recovery schedules to correct for the associated deficiencies. However, OPC disagrees with FPL that a conflict is created between Paragraph 14 of the 2016 Settlement Agreement and Rule 25-6.0436(7)(a), F.A.C., such that it would require that the recovery of the regulatory assets and determination of amortization be deferred.

OPC argues that FPL should be required to establish capital recovery schedules and begin amortization upon the early retirement dates of Lauderdale Units 4 and 5 and Martin Units 1 and 2. To avoid a violation of the 2016 Settlement Agreement, OPC further asserts that FPL should be required to amortize the regulatory assets associated with Lauderdale Units 4 and 5 and Martin Units 1 and 2 in an amount no less than the amount of depreciation collected annually for these units used to set rates for the 2016 Settlement Agreement.

In this matter, the Commission has the discretion to defer recovery of the regulatory assets as requested by FPL or to order the amortization of the regulatory assets to begin following retirement as proposed by OPC. Rule 25-6.0436(7)(a), F.A.C.,¹⁰ specifies that prior to the retirement of major installations, such as power plants, the Commission shall approve capital recovery schedules to correct associated deficiencies if the retirement of the unit is prudent and the investment will not be recovered through the normal depreciation process. Both FPL and OPC are in agreement that the decision to retire the Lauderdale and Martin Units is prudent and that the investment will not be recovered through the normal depreciation process. Their point of disagreement is when the recovery of the unrecovered net investment should begin.

The language in Paragraph 14 of the FPL 2016 Settlement Agreement and Paragraph 7¹¹ of the Gulf 2013 Settlement Agreement are almost identical with respect to the discussion of depreciation and amortization accrual rates.¹² However, while the language in the settlement agreements is very similar, there are certain nuances that OPC argues distinguish Gulf's request

¹⁰ Rule 25-6.0436(7)(a), F.A.C., states:

Prior to the retirement of major installations, the Commission shall approve capital recovery schedules to correct associated calculated deficiencies where a utility demonstrates that (1) replacement of an installation or group of installations is prudent and (2) the associated investment will not be recovered by the time of retirement through the normal depreciation process.

¹¹ Paragraph 7 of Gulf's 2013 Settlement Agreement states:

The depreciation and amortization accrual rates in effect as of the effective date of this Agreement shall remain in effect throughout the Term. The Parties agree that the provisions of Rules 25-6.0436 and 25-6.04364, F.A.C., pursuant to which depreciation and dismantlement studies are filed at least every four years will not apply to the Company during the Term and that the Commission's approval of this Agreement shall excuse the Company from compliance with the filing requirement of these rules during the Term.

¹² Order No. PSC-16-0560-AS-EI, issued December 15, 2016, in Docket No. 160021-EI, *In re: Petition for rate increase by Florida Power & Light Company*; Docket No. 160061-EI, *In re: Petition for approval of 2016-2018 storm hardening plan, by Florida Power & Light Company*; Docket No. 160062-EI, *In re: 2016 depreciation and dismantlement study by Florida Power & Light Company*; and Docket No. 160088-EI, *In re: Petition for limited proceeding to modify and continue incentive mechanism, by Florida Power & Light Company*, p. 20, and Order No. PSC-13-0670-S-EI, issued December 19, 2013, in Docket No. 130140-EI, *In re: Petition for rate increase by Gulf Power Company*, p. 12.

for deferral of recovery associated with the regulatory asset created for the early retirement of the Smith Units from FPL's request for deferral of recovery associated with the regulatory assets created for the early retirement of the Lauderdale and Martin Units.

While FPL asserts that the decision in the Gulf case supports its request in the instant docket, the Gulf Order states there were extenuating circumstances in the Gulf case that makes its reliance as precedent in the instant case problematic.¹³ For example, representatives of both Gulf and OPC spoke in agreement during the discussion of the Plant Smith item during the Commission Conference held on August 9, 2016. Specifically, both parties agreed that the relief sought by Gulf was unique to the specific circumstances regarding Plant Smith as it relates to obligations under Gulf's 2013 Settlement Agreement. Most notably, the parties shared an understanding that "the early retirement of Plant Smith was contemplated as a possibility during the discussions around the stipulation and is consistent with and contemplated by the stipulation."¹⁴ In effect, the parties came to an understanding on the terms of their shared settlement agreement. Staff is not aware of any such understanding between FPL and OPC that the early retirements of the Lauderdale and Martin Units in the fourth quarter of 2018 were contemplated as possibilities during the discussions that preceded FPL's 2016 Settlement Agreement.

Another concern regarding FPL's assertion that it cannot begin the amortization of the Lauderdale and Martin regulatory assets until base rates are reset in the Company's next base rate proceeding is the fact that FPL is currently amortizing a regulatory asset associated with the early retirement of another power plant that was newly created during the term of this same 2016 Settlement Agreement. The Commission approved a separate settlement agreement between FPL and OPC which allowed FPL to establish a regulatory asset for the remaining net book value of FPL's share of the St. Johns River Power Park (SJRPP) and to commence amortization of the associated base rate portion of the regulatory asset at a date earlier than the next base rate adjustment.¹⁵ Instead of commencing amortization of the base rate portion of the SJRPP regulatory asset at the time FPL's base rates are next reset in a general rate case and continuing thereafter for ten years as proposed by FPL, the parties agreed, and the Commission approved, amortization to begin six months after retirement of the SJRPP facility and continue over a 15-year period.¹⁶ The important point is the amortization of a newly created regulatory asset is not only permitted during the term of the 2016 Settlement Agreement, it is currently occurring for a separate regulatory asset associated with the early retirement of another power plant.

The final point to address concerns the recovery of costs. As both FPL and OPC assert, the goal of Paragraph 14 of the 2016 Settlement Agreement was to hold depreciation and amortization expenses level except for growth during the term of the Agreement. Once the Lauderdale and Martin Units are retired, FPL must cease recording depreciation expense for these assets. The

¹³ Order No. PSC-16-0361-PAA-EI, issued August 29, 2016, in Docket No. 160039-EI, *In re: Petition for approval of regulatory asset related to the retirement of Smith Units 1 and 2, by Gulf Power Company*, p. 3.

¹⁴ Document No. 06708-2016 (Transcript from August 9, 2016, Commission Conference for Docket No. 160039-EI), p.p. 3, 5-6.

¹⁵ Order No. PSC-2017-0415-AS-EI, issued October 24, 2017, in Docket No. 20170123-EI, *In re: Petition for approval of arrangement to mitigate unfavorable impact of St. Johns River Power Park, by Florida Power & Light Company*.

¹⁶ Order No. PSC-2017-0415-AS-EI, p. 6.

2017 depreciation expense associated with these assets is approximately \$53.4 million.¹⁷ OPC asserts that if expenses are reduced as proposed by FPL, the amount of the expense reduction will inure to the benefit of FPL.¹⁸ As such, deferring the recovery of the Lauderdale and Martin regulatory assets in this instance would allow the Company to effectively recover some of the plant costs twice, first through base rates during the period of deferral and again through the amortization of the regulatory assets when the base rates are next reset. In addition, if the regulatory assets are established, FPL will also earn a return on the balances recorded in the regulatory assets. Because there is no requirement to file a general base rate proceeding at the expiration of the minimum term, or December 31, 2020, in the 2016 Settlement Agreement, this extra recovery would go on indefinitely if FPL's Petition is approved as proposed.

Both FPL and OPC are signatories to the 2016 Settlement Agreement. Having had no role in the negotiation of this Agreement, staff is unable to discern the intent of the parties beyond what was memorialized in the Agreement. There is nothing in the 2016 Settlement Agreement that specifically states FPL must defer the amortization of the newly created regulatory assets until the next time base rates are reset. There is also nothing in the Agreement that specifically states that FPL must begin the amortization immediately following the retirement of the units that gave rise to the newly created regulatory assets.

Prior to retirement, the net book value of the Lauderdale and Martin Units of approximately \$659 million is recorded in rate base in the form of net plant and the associated annual depreciation expense of approximately \$53.4 million (based on the 2017 annual amount of depreciation) is recorded on the income statement. Under FPL's proposal, following the retirement of the Units, the net book value of the Lauderdale and Martin Units of approximately \$659 million will continue to be recorded in rate base in the form of regulatory assets but the annual depreciation expense associated with these assets will cease to be recorded on the income statement. Under OPC's proposal, following retirement of the Units, the net book value of the Lauderdale and Martin Units of approximately \$659 million will be recorded in rate base in the form of regulatory assets and approximately \$53.4 million will continue to be recorded on the income statement as annual amortization expense. Under all three scenarios, approximately \$659 million will be recorded in rate base but in only two of the scenarios will the net expense level be left unaffected.

Based on the above, staff recommends that FPL be required to begin amortization of the regulatory assets upon the early retirement dates of Lauderdale Units 4 and 5 and Martin Units 1 and 2. In addition, the annual amortization amounts should be \$21.5 million for the Lauderdale Units and \$31.9 million for the Martin Units, for both base rate and clause recovery combined. These amounts are based on the 2017 actual level of depreciation expense associated with these assets in base rates and clause recovery combined.¹⁹ The 2016 Settlement Agreement requires that, "at such time as FPL shall next file a general base rate proceeding, it shall simultaneously file new depreciation and dismantlement studies and propose to reset depreciation rates and

¹⁷ Document No. 07145-2018, Staff's Fourth Data Request.

¹⁸ FPL is currently earning a return on equity (ROE) of 11.60 percent. This level of earnings is at the top of FPL's authorized ROE range. (FPL September 2018 Earnings Surveillance Report.)

¹⁹ Document No. 07145-2018, Staff's Fourth Data Request

dismantlement accrual rates in accordance with the results of those studies.”²⁰ Thus, at the time FPL files its next depreciation study, in conjunction with its next rate proceeding, this matter can be brought before the Commission to determine if the amortization of these regulatory assets should be adjusted going forward.

²⁰ Order No. PSC-16-0560-AS-EI, p. 26.

Issue 3: Should this docket be closed?

Recommendation: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (Schrader)

Staff Analysis: At the conclusion of the protest period, if no protest is filed this docket should be closed upon the issuance of a consummating order.