

State of Florida



## Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

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**DATE:** February 17, 2005

**TO:** Director, Division of the Commission Clerk & Administrative Services (Bayó)

**FROM:** Division of Economic Regulation (Slemkewicz, Wheeler)  
Office of the General Counsel (C. Keating)

**RE:** Docket No. 050093-EI – Petition for approval of stipulation and settlement for special accounting treatment and recovery of costs associated with Hurricane Ivan's impact on Gulf Power Company.

**AGENDA:** 03/01/05 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\050093.RCM.DOC  
L:\PSC\LIBRARY\FILINGS\05\01205-05.PDF –  
ATTACHMENT A

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### Case Background

On February 2, 2005, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG) and Gulf Power Company (Gulf) filed a Joint Petition for Approval of Stipulation and Settlement (Stipulation). The purpose of the Stipulation is to provide a full and complete resolution of all matters and issues addressed in the Stipulation regarding the effects of Hurricane Ivan on Gulf Power Company's Accumulated Provision for Property Insurance. The Stipulation provides for Gulf to implement a surcharge to recover a jurisdictional amount of \$51,384,816, net of interest and taxes, related to the restoration activities resulting from the damage caused by Hurricane Ivan. This recommendation addresses the merits of the Stipulation. The Stipulation is attached hereto as Attachment A.

The Commission has jurisdiction over this matter pursuant to Sections 366.04, 366.05 and 366.06, Florida Statutes.

### Discussion of Issues

**Issue 1:** Should the Commission approve the Stipulation and Settlement?

**Recommendation:** Yes, the Commission should approve the Stipulation and Settlement.  
(Slemkewicz, Wheeler)

**Staff Analysis:** On September 16, 2004, Hurricane Ivan, a Category 3 storm, struck Gulf's service territory causing widespread and extensive damage to Gulf's plant and property including its transmission lines, distribution feeders, substations and Crist generation plant. As a result, 90% of Gulf's customers had their electric service disrupted. In order to repair its system and restore service to its customers, Gulf estimates that it will ultimately spend \$141.5 million once all of the repairs are completed and all of the costs are known. Gulf, like the other Florida investor-owned electric utilities, is self-insuring for storm damage to its transmission and distribution facilities through the use of a property insurance reserve account. This account also covers other property losses not covered by insurance, such as deductible amounts related to its insured power plants. The authorized amount of Gulf's annual accrual to the property insurance reserve is \$3.5 million.

Prior to Hurricane Ivan, Gulf had accumulated \$27.8 million in its property insurance reserve. As shown on Exhibit B to the Stipulation, the total estimated restoration costs related to Hurricane Ivan are \$124.3 million, net of insurance reimbursements. After the application of the \$27.8 million in the reserve, there is a \$96.5 million deficit remaining. Exhibit C to the Stipulation shows the amounts agreed to by the signatories to be deducted from the total \$96.5 million deficit that result in a net recoverable amount of \$51.7 million, or \$51,384,816 on a jurisdictional basis.

Staff has reviewed the provisions and attached exhibits of the Stipulation and believes it to be a reasonable resolution of the issues regarding the impact of Hurricane Ivan on Gulf's property insurance reserve. In the Stipulation, Gulf has agreed to exclude certain amounts, such as 1) that portion of storm restoration capital expenditures and cost of removal equal to the normal amount under normal operating conditions, 2) straight time labor costs of Gulf employees associated with storm recovery activities, 3) \$400,000 representing transportation costs associated with Gulf-owned vehicles, and 4) \$600,000 representing normal operating costs not chargeable to the property insurance reserve under the principles agreed to in Exhibit A. Also, Gulf is further reducing the deficit amount by making an additional \$14 million accrual to its property insurance reserve for 2004. By making this \$14 million additional accrual, Gulf, in effect, is sharing in the recovery of the storm restoration costs along with its ratepayers.

The major highlights contained in the Stipulation are as follows:

- Financial Impact of Hurricane Ivan on Gulf Power's Property Insurance Reserve:

\$141,510,000	Estimated Total Hurricane Ivan Costs
(-)\$ 17,210,000	Estimated Insurance Reimbursement after Deductible
(-)\$ <u>27,800,000</u>	Storm Reserve Balance as of 8/31/04
\$ 96,500,000	Estimated Ivan Deficit

- Normal annual property insurance reserve accrual of \$3.5 million is insufficient to eliminate the negative balance resulting from Hurricane Ivan and to build a reasonable balance to be available for future storm events within a reasonable period of time.
- Implementation Date – 30 days following the date of PSC approval.
- Gulf agrees to exclude the following costs from this recovery mechanism:
  - 1) \$23,100,000 – Estimated Capital Costs
  - 2) \$ 3,300,000 – Estimated Cost of Removal
  - 3) \$ 3,400,000 – Straight Time Labor Costs
  - 4) \$ 400,000 – Company-Owned Vehicle Costs\*
  - 5) \$ 600,000 – Other Normal Operating Costs\*
  - 6) \$14,000,000 – Additional Accrual to Property Reserve in 2004\*  
 \$44,800,000 – Gulf’s Total Cost Exclusions from this recovery mechanism

\*Fixed amounts as agreed between parties to Stipulation and Settlement.

- Ivan Deficit Cost Recovery – Collect approved amount through a monthly surcharge to customer bills based on a 24 month recovery period, subject to true-ups:

\$ 96,500,000	Total Estimated Ivan Deficit
<u>(44,800,000)</u>	Gulf’s Total Cost Exclusions
\$ 51,700,000	Ivan Deficit Cost Recovery Amount
<u>x .9939036</u>	Retail Jurisdictional Factor
\$ 51,384,816	Retail Cost Recovery Amount
<u>1,866,963</u>	Interest
\$ 53,251,779	Retail Cost Recovery Amount including Interest
<u>x 1.00072</u>	Revenue Tax Factor
\$ 53,290,120	Total Ivan Deficit Cost Recovery Amount (Before gross receipts tax)

- \$2.71/month surcharge for 1000 kWh residential bill based on a 24 month recovery period (\$2.78/month including gross receipts tax increase).
- Surcharge will be subject to refund until Commission order is rendered final.
- Regular monthly accrual to the property insurance reserve and any additional accruals shall be used to accumulate a reserve for future losses and such accruals shall not affect the amount to be recovered pursuant to this Stipulation and Settlement.
- Gulf will provide an actual/estimated cost true-up by July 1, 2005.
- Parties retain the right to challenge any actual costs.

- No increase in base rates to take effect prior to March 1, 2007.
- Gulf may seek rate relief in the event of another catastrophic storm or event.
- Securitization:
  - 1) The Florida Legislature may enact legislation that would allow for securitization of storm recovery financing under terms of a financing order.
  - 2) Gulf Power shall have the right to petition the Commission for the entry of such an order in accordance with the terms of the legislation. Any additional amounts requested pursuant to such petition shall not exceed \$27.8 million, and such additional amount shall be used exclusively for replenishing the property insurance reserve.

Most of the provisions and exhibits are self-explanatory, but several of the items merit comment. These are as follows:

SECTION 4 and EXHIBIT A: These items adopt criteria and guidelines that delineate and define the restoration costs that can be charged to, or should be excluded from, the property insurance reserve as a result of damages caused by Hurricane Ivan. One item of particular note is the exclusion of all base salaries and normal, budgeted overtime from all bargaining unit labor costs. Another is the elimination of operating expenses and overheads for company-owned vehicles. Gulf is also prohibited from recovering any amounts associated with uncollectible expenses or lost revenues. However, the Stipulation provides that these items do not set any precedent for the types of costs that can be charged as a result of future storms.

EXHIBIT C: This exhibit shows the calculation of the requested \$51,384,816 jurisdictional surcharge, net of interest and taxes. Items 3 through 8, shown below, delineate the charges that have been excluded from the total estimated Hurricane Ivan deficit of \$96.5 million.

- 3) \$23,100,000 – Estimated Capital Costs
  - 4) \$ 3,300,000 – Estimated Cost of Removal
  - 5) \$ 3,400,000 – Straight Time Labor Costs
  - 6) \$ 400,000 – Company-Owned Vehicle Costs
  - 7) \$ 600,000 – Other Normal Operating Costs
  - 8) \$14,000,000 – Additional Accrual to Property Reserve in 2004
- \$44,800,000 – Total Cost Exclusions from the recovery surcharge

Item 8 is particularly noteworthy in that Gulf is reducing the amount to be collected from the ratepayer by increasing its 2004 property insurance reserve accrual by \$14 million. Gulf has already adjusted its books for 2004 to include not only the additional \$14 million accrual but the additional capital and expense exclusions noted in 3 through 7. As a result, Gulf's return on equity for 2004 is 11.91% as reported in its December 2004 Earnings Surveillance Report. This is within the company's return on equity range, of 10.75% to 12.75%, authorized in its last rate proceeding. Gulf's ability to have the stockholders absorb part of the recovery costs and offer an additional accrual of \$14 million to the storm reserve was due to the company exceeding its last authorized return on equity range for 2004. It is important to note that Gulf has absorbed costs sufficient to bring its rate of return close to the midpoint of Gulf's authorized range.

Item 15 on Exhibit C is the inclusion of \$1,866,963 of interest on the unrecovered portion of the estimated recoverable deficit of \$51,700,000. The interest rate used, although not spelled out in the settlement, is 3.45% over the two year recovery period. The interest rate, like the cost estimates, is also subject to true-up based on the actual interest rate obtained by Gulf for the recovery period.

SECTION 5 and EXHIBIT D: Section 5 of the Stipulation states that the storm recovery surcharge shall be allocated among the rate classes based on the cost of service methodology approved in Gulf Power's most recent rate case. The computation of the surcharges by rate class is shown in Exhibit D to the Stipulation. Implementation of the proposed storm damage surcharge recovery factors will result in a \$2.78 increase in the 1,000 kilowatt hour residential bill, to \$87.91. The \$2.78 increase includes \$2.71 attributable to the recovery factor and \$0.07 attributable to the State gross receipts tax. The total bill effect does not include any local taxes or franchise fees.

Under the terms of the Stipulation, the factors will remain in effect for 12 months, after which they will be revised to reflect any differences between projected and actual costs, and between projected and actual revenues collected. Following the second 12-month period, any remaining over- or under-recovery amounts will be addressed as part of the true-up in the next fuel and purchased power cost recovery proceedings.

Staff has three concerns with the method used to allocate the storm surcharge recovery factors by rate class, as discussed below.

12 CP vs. 12 CP & 1/13<sup>th</sup> AD. Column A in Exhibit D contains demand allocator percentages by rate class that were used to develop the 2005 capacity, conservation, and environmental cost recovery factors as filed in the most recent fuel and purchased power cost recovery proceeding. These allocation percentages are based on each rate class's estimated contribution to the average of the 12 monthly system peaks (i.e., the 12 CP method) for the projected calendar year 2005.

In the capacity, conservation, and environmental cost recovery clauses, the 12 Coincident Peak and 1/13<sup>th</sup> Average Demand method (12 CP & 1/13<sup>th</sup> AD) is used. This method differs slightly from the 12 CP method because it allocates 1/13<sup>th</sup> of the total costs on an energy, or average demand basis. The 12 CP & 1/13<sup>th</sup> AD method is also used for the allocation of production and transmission costs in rate case proceedings, including Gulf's most recent rate case in Docket No. 010949-EI. Therefore, staff believes that it would have been more appropriate to use this method to allocate storm damage costs.

Incorrect Forecast. Further, staff would note that the percentages in column A of the attachment were developed based on an incorrect forecast of the 2005 kilowatt hour sales for two rate classes. Specifically, a portion of the kilowatt hour sales attributable to the General Service – Non-Demand (GS) rate class were inadvertently included in the General Service – Demand (GSD) rate class. This results in an understatement of the GS demand responsibility, and correspondingly, an understatement of the costs allocated to that class. These percentages were then applied to the total proposed recovery amount of \$53.3 million to allocate the dollars to be recovered by rate class (column B). These totals by rate class were then divided by the correct kilowatt hour sales projected for years 2005 and 2006 to derive the recovery factors by rate class

shown in column D. Because the column A percentages were based on an incorrect forecast by rate class, the allocation of dollars and the factors by rate class are not correct.

If the allocation percentages in column A were based on the correct forecast of 2005-06 sales as shown in column C of Attachment D, the factors by rate class that would result are shown in the “Revised Factor” column of the table below. Note that residential customers (RS) are not affected by this change. The General Service – Non-Demand (GS) rate class is most affected. The remaining commercial and lighting classes are also affected to a lesser degree.

Rate Schedule	Factor As Filed (Cents per kWh)	Revised Factor (Cents per kWh)	Difference (Cents per kWh)
RS, RSVP	.271	.271	.000
GS	.184	.261	+.077
GSD, GSDT, GSTOU	.230	.229	-.001
LP, LPT	.204	.196	-.008
PX, PXT, RTP, SBS, CSA	.164	.161	-.003
OS-I/II	.105	.104	-.001
OS-III	.170	.167	-.003

Distribution Costs. Staff also notes that a large proportion of the damage for which Gulf is seeking recovery most likely was incurred on its distribution system. Under the Commission’s most recently approved cost of service methodology, distribution costs are primarily allocated to the rate classes based on Class, or Non-Coincident peak, contribution. Staff believes that a more accurate allocation would result if the costs were divided into functional areas (i.e., production, transmission, and distribution) and then allocated using the appropriate allocator for each functional area.

Staff notes that the Stipulation, by its terms, is contingent upon approval in its entirety. As noted below, staff believes that the Stipulation, taken as a whole, provides a reasonable resolution of the issues regarding the effects of Hurricane Ivan on Gulf’s property insurance reserve. Thus, despite the concerns identified above, staff believes the Stipulation should be approved.

SECTION 6: This provision preserves the rights of the parties to challenge the reasonableness, prudence, and conformance with the Stipulation of any actual costs included in the surcharge to be recovered from the ratepayers. Though not explicitly stated, the Commission also has the authority, and retains the jurisdiction, to review and challenge any such costs on its own motion.

CONCLUSION: In staff’s opinion, the provisions of the Stipulation are a reasonable resolution of the issues regarding the impact of Hurricane Ivan on Gulf’s property insurance reserve. First, the filing of this Stipulation, if adopted by the Commission, avoids the potential filing of a separate cost recovery petition. This has the effect of saving all parties the time and expense that would be incurred in processing a cost recovery petition through the Commission. Second, the Stipulation also resolves the apparent overearnings of Gulf for 2004. Third, this

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Stipulation resolves many of the issues that have been raised by the staff and other parties in storm cost recovery dockets involving other utilities. These include the exclusion of costs normally attributable to base rates, such as normal O&M expenses, normal cost of removal and normal capitalized amounts. And fourth, the Stipulation recognizes a sharing of restoration costs between Gulf's ratepayers and Gulf's stockholders. Gulf has agreed to absorb \$14 million of these costs in earnings.

In staff's opinion, the requested surcharge balances the interests of the ratepayers and Gulf. Staff, therefore, recommends that the Stipulation is in the public interest and that the Commission should approve the Stipulation settling all of the issues regarding the impact of Hurricane Ivan on Gulf's property insurance reserve.

**Issue 2:** What is the appropriate implementation date for the surcharge set forth in the Stipulation?

**Recommendation:** The proposed surcharge should apply to meter readings taken on or after 30 days from the date of the Commission's vote. Assuming that the Commission votes to approve the Stipulation on March 1, 2005, the surcharge should begin to be applied to meter readings on or after March 31, 2005. If the Commission's order approving the Stipulation is timely protested by a person whose substantial interests are affected by the Commission's decision, the surcharge should remain in effect with all revenues held subject to refund pending the Commission's final order. (Slemkewicz, Wheeler, C. Keating)

**Staff Analysis:** Pursuant to Section 2 of the Stipulation, the Stipulation is to become effective on the day following the Commission's vote approving the Stipulation. This provision also provides that the starting date for the full term of the Stipulation will be 30 days following the Commission's vote and will be referred to as the "Implementation Date." Assuming an affirmative vote by the Commission on March 1, 2005, the effective date would be March 2, 2005, and the Implementation Date would be March 31, 2005. This implementation date is consistent with the requirement that the approved charges not apply to meter readings taken less than 30 days after the date of the vote approving such charges.

In addition, Section 3 provides that any amounts collected through the surcharge are subject to refund until the Commission's order is rendered final and is no longer subject to further administrative or judicial proceedings. Thus, if the Commission's order approving the Stipulation is timely protested by a person whose substantial interests are affected by the Commission's decision, the surcharge should remain in effect with all revenues held subject to refund pending the Commission's final order.



**Issue 3:** If the Commission approves the proposed storm damage Stipulation and Settlement, should Gulf Power Company be required to file tariff revisions reflecting the storm damage surcharge recovery factors by rate class?

**Recommendation:** Yes. Gulf should be required to file the tariff revision for administrative approval. (Wheeler)

**Staff Analysis:** If the Commission approves the stipulation, Gulf should be required to file revisions to its tariff that reflect the application of the storm damage surcharge recovery factors by rate class that are contained in Attachment D to the stipulation. Staff recommends that it be permitted to administratively approve the tariff revisions.

**Issue 4:** 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. (C. Keating)

**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.