**State of Florida**

# Public Service Commission

**CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD**
**TALLAHASSEE, FLORIDA 32399-0850**

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

**DATE:** June 14, 2005

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

**FROM:** Division of Economic Regulation (Fletcher, Ballinger, Breman, Colson, Greene, Kaproth, Kummer, Maurey, McNulty, Rendell, Revell, Romig, Slemkewicz, Wheeler, Willis)
Office of the General Counsel (Brubaker, Rodan)

**RE:** Docket No. 041272-EI – Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.

**AGENDA:** 06/21/05 – Regular Agenda – Posthearing Decision – Participation is Limited to Commissioners and Staff

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Baez

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\041272.RCM.DOC

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(Issues that were stipulated or withdrawn at the hearing are not reflected in the Table of Contents.)

## Case Background

The instant docket was opened on November 2, 2004, when Progress Energy Florida, Inc. ("PEF" or "Company") filed a Petition for implementation of a Storm Cost Recovery Clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan (Petition). The requested clause would provide for the recovery of approximately $251.9 million plus interest over two years.

On March 15 through 17, 2005, the Commission held customer service hearings in Ocala, Apopka, Bartow, St. Petersburg, and Clearwater. The Commission also held a customer service hearing which commenced on the first day of its technical hearing in Tallahassee. A total of 49 individuals spoke at these service hearings for which most represented city/county governments (i.e. mayors, commissioners, school superintendents, emergency management officials, etc.), local civic associations, various local chamber of commerce representatives, a water and wastewater utility representative, and representatives of other privately-owned companies. For the most part, these individuals' were highly complimentary towards PEF's hurricane restoration efforts.

On March 18, 2005, a prehearing conference was conducted in this docket. By Order No. PSC-04-1151-PCO-EI, issued November 18, 2004, an administrative hearing was held on March 30, 31, and April 1, 2005. The Office of Public Counsel (OPC), Florida Industrial Power Users Group (FIPUG), American Association of Retired Persons (AARP), Buddy L. Hansen and Sugarmill Woods Civic Association, Inc. (SMW), and Florida Retail Federation (FRF) have intervened in this proceeding.

## Approved Stipulations

At the hearing, the Commission found that the stipulations reached by the parties and supported by staff were reasonable, and accepted the stipulated matters as set forth below.

## Category One Stipulations

Those stipulations on which PEF, FIPUG, OPC, AARP/SMW, FRF, and staff agree:

1. With respect to replacements of plant items associated with 2004 post-storm repair and restoration activities, the parties stipulate and agree that PEF shall book to plant in service the normal cost of new plant additions under normal operating conditions, and shall book to the storm reserve (as extraordinary O&M) only the costs of new plant additions that exceed those normal amounts. PEF stipulates and agrees to verify that it has implemented this methodology and to provide final values for the portions of costs associated with new plant additions that it has booked to plant in-service and to the storm damage reserve, respectively, after it has completed the booking of relevant costs. PEF's current estimate of costs that it will book to plant in service using this methodology is approximately $47 million dollars.

This partial stipulation addresses only the appropriate accounting methodology to be employed for the accounting of costs associated with plant replacements, and does not prevent any party from challenging the reasonableness or prudence of any individual cost item. Further, the partial stipulation does not address the aspects of Issue 12 that treat retirements and cost of removal expense, which remain at issue. (This was a partial stipulation of Issue 12)

2. The parties stipulate and agree that PEF shall charge to the storm damage reserve only the costs of those materials and supplies that PEF actually used during the 2004 post-storm repair and restoration activities, thereby excluding from the storm damage reserve any costs associated with replenishing supplies and inventories. PEF stipulates and agrees that it will verify that it has implemented this approach in a report submitted in this docket after it has completed the process of booking all storm-related costs.

   This stipulation addresses only the appropriate accounting methodology to be applied to costs of materials and supplies, and does not prevent any party from challenging the reasonableness or prudence of any individual cost. (Issue 13)

3. The parties stipulate and agree as follows: (1) PEF shall accrue and collect interest on the amount of storm costs that the Commission authorizes PEF to collect from customers in this proceeding. (2) No interest shall accrue prior to the date on which the Commission's vote in this docket is rendered. (3) No interest shall accrue on any amount in excess of that which the Commission authorizes PEF to collect from customers. (4) If PEF collects from customers an amount greater than that authorized by the Commission, it shall refund the differential with interest. (5) PEF shall calculate interest by applying the 30-day commercial paper rate in the following manner: Using a 30-day Dealer Commercial Paper rate, as published in the Wall Street Journal, which is high-grade unsecured notes sold through dealers by major corporations. (This was a partial stipulation of Issue 19)

4. The parties stipulate and agree that PEF shall collect the amount of storm-related costs that the Commission authorizes it to recover from customers over a maximum period of 2 years. (Issue 23)

5. The parties stipulate and agree that the mechanism that the Commission approves for recovery of storm-related costs shall become effective 30 days following the date of the Commission's vote in this docket. Recovery shall begin with the first billing cycle of the following month. (Issue 24)

6. The parties stipulate and agree that PEF shall file tariffs reflecting the establishment of any Commission-approved mechanism for the recovery of storm-related costs from the ratepayers. (Issue 25)

**Category Two Stipulations**

Those stipulations on which PEF, FIPUG, FRF, and staff agree, and on which OPC and AARP/SMW take no position.

1. The methodology for allocation of storm recovery costs should be that which is proposed in PEF's petition. (Issue 21)

## Discussion of Issues

**Issue 1**: WITHDRAWN

**Issue 2**: Has PEF quantified the appropriate amount of non-management employee labor payroll expense that should be charged to the storm reserve? If not, what adjustments should be made?

**Recommendation**: No. PEF's non-management employee labor expense, except for customer service employees which is discussed in Issue 8, should be adjusted to reflect only the incremental costs above its budgeted levels for the calendar year 2004. To prevent PEF from collecting twice for its employees' regular pay, the Commission should disallow $5,140,639 of the amount PEF charged to the storm reserve. (Greene, Fletcher)

### Position of the Parties

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Florida Public Service Commission ("Commission") orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including Company personnel expenses, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: No. PEF has charged basic levels of non-management employee labor expense that customers paid for through base rates. By charging these expenses to the storm reserve, PEF is attempting to "double dip" by requiring customers to pay for them twice. To prevent this "double dipping," the Commission should only allow PEF to charge extraordinary expenses, incremental to base levels, to the storm reserve. Thus, $5.46 million of the amount PEF charged to the storm reserve should be disallowed.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: No. The Commission should prevent PEF's attempted "double dipping" by requiring it to charge only extraordinary expenses, incremental to base levels, to the storm reserve. This means only overtime labor expense of bargaining unit employees (and non-exempt management) should be charged to the storm reserve. $5.46 million of the amount PEF charged to the storm reserve should be disallowed.

**FRF**: No. Through its claimed storm-related costs, PEF is attempting to require its customers to pay twice for basis levels of non-management employee labor payroll expense. To correct this

inappropriate claim, $5.46 million of the amount PEF charged to the storm reserve should be disallowed.

**Staff Analysis**: OPC contends that PEF's proposal has customers paying twice for its non-managerial employees' regular salaries. (OPC BR 4) OPC Witness Majoros testified that PEF proposes to charge the full labor costs associated with storm recovery efforts to the storm damage reserve. (TR 687) He further testified that by moving all expenses associated with storm restoration to the storm reserve, without consideration of the normal level of expenditures funded through base rates, PEF has effectively required customers to pay twice for those costs. Mr. Majoros stated that this practice is referred to as double dipping. (TR 679) OPC further argues that PEF is attempting to obfuscate the issue of double dipping by bringing up the issue of its catch-up work. (OPC BR 5) Mr. Majoros concluded that regular pay salaries for bargaining unit and non-exempt employees, for both PEF and the service company, should be removed from the storm damage reserve. (TR 687, EXH 34)

FIPUG Witness Sheree Brown testified that PEF's proposal seeks to hold PEF harmless from any damages related to the storms, while increasing costs to residents and businesses in PEF's service territory. Further, Ms. Brown stated that PEF's proposal seeks 100% cost recovery from consumers, with no contribution from PEF. (TR 745) She asserted that PEF has reduced its normal operation and maintenance (O&M) expenses and has shifted these costs to hurricane damage accounts. This cost shifting resulted in favorable variances. She further explained that the favorable variances indicate that PEF spent less than it had originally budgeted, and that PEF's earnings from base rate revenues increased. (TR 757-759) Ms. Brown concluded that the Commission should reduce PEF's storm damage claim by the amount of normal O&M expenses that were shifted into the storm damage accounts, and that these costs should be expensed during the time period incurred. (TR 761) She further stated that any future expenses charged to the storm damage accounts should be limited to verifiable incremental costs incurred over and above PEF's budgeted O&M. (TR 761-762)

Ms. Brown explained under questioning that the decline in the Company's O&M cost from August through October indicated that costs were shifted out of normal O&M over into the storm damage account. She further explained that "[p]utting your finger on the actual amount, I believe, is an insurmountable task that we don't have the evidence now, and I don't even believe that Progress Energy has the, has the knowledge of, of being able to tie down the exact numbers." (TR 806-807) Ms. Brown concluded that her recommended adjustment to bring PEF's ROE down to the 10% level in 2004 takes into account all the double dipping issues and it resolves them. (TR 768-769, 807) As discussed in a later issue, staff disagrees with Ms. Brown's ROE adjustment.

PEF Witness Wimberly testified that PEF charged all direct costs related to the hurricanes to the storm damage reserve. (TR 540) He also stated that budgets cannot be used as a tool to predict and account for the cost of hurricanes. (TR 554) However, Mr. Wimberly acknowledged that the purpose of the budget is to predict and anticipate ordinary costs on an annual basis, including such costs as regular salaries. (TR 554-555) Mr. Wimberly further testified that PEF has incurred and continues to incur additional costs from overtime and contract labor for catch-up work which was estimated to be over $25 million. (TR 543, 581-582)

However, on cross-examination by PEF, Mr. Majoros testified that "[e]ven if some of the tasks have shifted to the future periods, the flexibility of the budgeting process may easily accommodate them." (TR 718-719) Mr. Majoros asserted that PEF should be required to demonstrate that it will incur financial harm as a consequence of the catch-up tasks following the completion of storm repairs and that it has failed to do so in this docket. (TR 719)

Under cross-examination, Mr. Wimberly also acknowledged that when PEF's employees reported for the regular workday and if that day was spent working on storm-related matters, then the regular eight-hour workday was charged to storm accounts. (TR 563) Mr. Wimberly asserted that if work is related to hurricane restoration, then those costs related to that work is automatically extraordinary and chargeable to the storm accounts. (TR 564) He also acknowledged that a normal eight-hour workday is not an extraordinary cost. Mr. Wimberly also agreed that there was nothing attached to his direct testimony to support the $25 million in catch-up work. (TR 568)

PEF Witness Portuondo testified that PEF is seeking to enforce only its understanding reached and followed since 1993 concerning how PEF should account and recover for direct storm-related expenses. (TR 259) Mr. Portuondo testified that PEF is not "gaming" the system by shifting normal labor costs covered by base rates to storm accounts reimbursable through a special cost-recovery clause resulting in double dipping. He asserted that Ms. Brown reaches her conclusion that the Company engaged in cost shifting by looking at only part of the picture. Mr. Portuondo further stated that PEF's normal demands did not go away during the storms. (TR 260)

Mr. Portuondo explained under questioning that there are a number of tasks that still need to be accomplished, including Commission proceedings and SEC financial reporting obligations. Mr. Portuondo asserted that PEF will not recover its costs incurred since its does not have revenues coming in, and if the revenue is not coming then PEF is not getting the revenues that would directly offset those costs. (TR 475, 477) However, Mr. Portuondo acknowledged that, prior to Hurricane Andrew, PEF's insurance did not cover lost revenues. (TR 475) On cross-examination by PEF, OPC Witness Majoros testified that the catch-up work estimates should not be an issue in this case since the Company did not make a claim for lost revenues, and PEF achieved positive revenue variances according to its internal management budget presentations. (TR 707)

Staff agrees with OPC Witness Majoros that base rates support a budgeted level of O&M expense, and that shifting normal (budgeted) O&M expenses into the storm reserve account would constitute double recovery. Based on the evidence in the record, staff believes that a favorable budget variance is a reasonable indicator that normal costs were shifted to the storm reserve account based on PEF's actual restoration cost approach. It is the utility's burden to prove that its requested costs are reasonable. Florida Power Corporation v. Creese, 413 So. 2d 1187, 1197 (Fla. 1982). Staff believes that PEF has failed to: 1) demonstrate that its customers would not pay twice for its normal non-management labor expense; 2) quantify any amount of lost revenues; and 3) support its estimated amount of catch-up costs as a result of the 2004 hurricane season. Therefore, staff recommends that PEF's non-management employee labor expense, except for customer service employees which are discussed in Issue 8, should be

adjusted to reflect only the incremental costs above its budgeted levels for the year end 2004. To prevent PEF from collecting twice for its employees' regular pay, the Commission should disallow $5,140,639 of the amount PEF charged to the storm reserve. In so recommending, staff notes that "it is the [Commission's] prerogative to evaluate the testimony of competing experts and accord whatever weight to the conflicting opinions it deems necessary." Gulf Power Co. v. FPSC, 453 So. 2d 799, 805 (Fla. 1984).

**Issue 3**: Has PEF properly treated payroll expense associated with managerial employees when determining the costs that should be charged to the storm reserve? If not, what adjustments should be made?

**Recommendation**: No. PEF's managerial employees' labor expense, except for customer service employees which is discussed in Issue 8, should be adjusted to reflect only the incremental costs above its budgeted levels for the calendar year 2004. To prevent PEF from collecting twice for its managerial employees' regular pay, the Commission should disallow $6,197,565 of the amount PEF charged to the storm reserve. (Greene)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including Company personnel expenses, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: No. No part of the payroll associated with exempt management employees should be charged to the storm reserve. The Commission should remove $6.40 million from the amount PEF seeks to recover from customers.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: No. No part of the payroll associated with exempt management employees should be charged to the storm reserve. The Commission should remove $6.40 million from the amount PEF seeks to recover from customers.

**FRF**: No. No part of payroll associated with exempt management employees should be charged to the storm reserve. To correct this inappropriate claim, $6.4 million of the amount PEF charged to the storm reserve should be disallowed.

**Staff Analysis**: Mr. Majoros concluded that regular pay salaries for exempt employees, for both PEF and the service company, should be removed from the storm damage reserve. (TR 687, EXH 34) As discussed in Issue 16, staff disagrees with FIPUG Witness Brown's ROE adjustment in order to account for any double recovery concerns. As discussed in Issue 2, staff believes the utility has not met its burden to support its lost revenues and catch-up work arguments to refute the double recovery concerns. In Issue 2, staff also agreed with OPC Witness Majoros that base rates support a budgeted level of O&M expense, and that shifting normal (budgeted) O&M expenses into the storm reserve account would constitute double recovery. It is the utility's burden to prove that its requested costs are reasonable. See Florida Power Corporation v. Creese.

Staff believes that PEF's attempt to distinguish its practice from double recovery based on the type of work performed is not supported in the record. Further, staff notes that PEF has neither demonstrated that its customers would not pay twice for its managerial labor expense nor supported its estimated amount of catch-up costs as a result of the 2004 hurricane season. As such, staff recommends that PEF's managerial employees' labor expense, except for customer service employees which is discussed in Issue 8, should be adjusted to reflect only the incremental costs above its budgeted levels for the year end 2004. To prevent PEF from collecting twice for its managerial employees' regular pay, the Commission should disallow $6,197,565 of the amount PEF charged to the storm reserve.

**Issue 4**: At what point in time should PEF stop charging costs related to the 2004 storm season to the storm damage reserve?

**Recommendation**: PEF should stop charging costs related to the 2004 storm season, including "sweeps" work, no later than July 1, 2005. (Revell)

**Position of the Parties**

**PEF**: PEF should stop charging costs related to the 2004 storm season to the Storm Damage Reserve when PEF has completed all of its storm-related work necessitated by Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: PEF should stop charging 2004 hurricane-related costs to the storm account when foreign utilities have left, PEF employees have returned to regular hours and the work is being performed by PEF employees and the contractors whom PEF engages on a routine, ongoing basis. Based on the record that date should be July 1, 2005.

**FIPUG:** PEF should stop charging such costs to the storm damage reserve effective January 1, 2005, or at the conclusion of storm restoration activities, whichever is sooner.

**AARP/SMW**: PEF should stop charging costs related to the 2004 storm season as of July 1, 2005.

**FRF**: PEF should stop charging such costs to the storm damage reserve effective January 1, 2005, or at the conclusion of storm restoration activities, whichever occurred first.

**Staff Analysis**: OPC Witness Majoros testified that PEF plans to charge hurricane-related work still remaining after the storms have passed and operations have returned to normal. (TR 689) Mr. Majoros contends that PEF should stop charging 2004 hurricane-related costs to the storm account when PEF employees have returned to regular hours and the work is being performed by PEF employees and the contractors whom PEF engage on a routine, ongoing basis. (TR 690) However, OPC states that determining the proper point has been difficult to determine. (OPC BR 9)

The position of FIPUG and the FRF is that charges to the storm reserve should cease no later than January 1, 2005. However, PEF Witness Rogers testified that the majority of the crews assigned to the repair of the transmission system were still working ten-hour days, five or six days a week to complete the catch up and restoration work. (TR 188-189) PEF Witness McDonald was unable to state whether crews assigned to the repair of the distribution system had returned to a normal work week. (TR 143-144) PEF Witness Lyash testified that restoration work should be completed by the second quarter of 2005. (TR 75) PEF Witness Wimberly stated that sweeps is work that was not be done during the initial restoration efforts. (TR 544)

Given the extensive repairs necessary to PEF's system, staff believes it is unrealistic to stop accruals to the storm damage reserve at the conclusion of storm restoration activities or January 1, 2005, whichever occurred first. Even using the latest date of January 1, 2005, for the completion of all repairs, as FIPUG and FRF recommend, only allows PEF less than a three-

month period of time after the hurricanes to make these repairs. As discussed above, PEF was still incurring overtime costs for repairs after that date; in fact these repairs were continuing through the hearings in this case in late March, 2005. (TR 188-189)

Staff recommends that PEF should stop charging costs related to the 2004 storm season, including sweeps works, no later than July 1, 2005.

**Issue 5**: Has PEF charged to the storm reserve appropriate amounts relating to employee training for storm restoration work? If not, what adjustments should be made?

**Recommendation**: Yes. PEF has not charged any pre-season hurricane storm restoration employee training costs to the storm reserve, and no adjustments are necessary. (Revell)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including the Company's expenses to train employees for storm restoration work, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: Yes. PEF witnesses testified PEF has not charge the storm account for employee training. Employee training, including that related to storm restoration work, is a basic function that PEF must provide. Related expenses are not extraordinary, and should not be charged to the storm damage reserve.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: No. Employee training, including that related to storm restoration work, is a basic function that PEF must provide. Related expenses are not extraordinary, and should not be charged to the storm damage reserve.

**FRF**: No. Employee training is a basic function, and accordingly, the costs for such training are not appropriately charged to the storm damage reserve and not appropriately recovered through any storm surcharge.

**Staff Analysis**: OPC states that employee training, including storm restoration training, is part of the normal operations of the Company and should not be charged to the storm damage reserve. (OPC BR 9) PEF Witness McDonald stated that participants are assigned roles under the storm plan which may differ from their regular responsibilities and that as a result it is imperative that they be effectively trained. (TR 117) Participants are defined as PEF, Progress Energy Carolinas (PEC), and outside resources that may be called upon for storm restoration work. (TR 117) Mr. McDonald further stated that this training is normally completed during the second quarter of each year, with readiness drills conducted in May of each year. (TR 117)

PEF Witness Rogers testified that the Transmission Department's Storm Plan consisted of four elements. Those elements are pre-season activities, pre-storm activities, damage assessment and repair, and recovery follow-up activities. Ms. Rogers also stated that the pre-season activities included the necessary arrangements prior to the storm or hurricane season to insure that the Company was prepared. (TR 164-165) Ms. Rogers later testified that pre-season activities occur on a yearly basis, and as a result costs are included in the annual budget. (TR 187)

Both Mr. McDonald and Ms. Rogers testified that no pre-season hurricane costs were charged to the storm account. (TR 142, 187) Since PEF has testified that there are no pre-season storm training costs charged to the storm account, and there is no indication in the record by any other party that there were any improper costs charged to the account for employee training for storm restoration work, staff recommends that no adjustment should be made.

**Issue 6**: Has PEF properly quantified the costs of tree trimming that should be charged to the storm reserve? If not, what adjustments should be made?

**Recommendation**: No. PEF should be allowed to charge only the incremental cost of tree trimming above its normal, budgeted levels for calendar year 2004. The Commission should disallow $1.4 million of the amount PEF charged to the storm reserve. (Fletcher, Breman)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including the costs of tree trimming incurred to respond to and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: No. PEF should be allowed to charge only the incremental cost of tree trimming above its normal, budgeted levels for year end 2004. PEF's variance was a positive $1.4 million, meaning PEF charged a portion of the normal budgeted amount to the storm reserve. The Commission should disallow the $1.4 million amount.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: No. PEF should be allowed to charge only the increment above its normal, budgeted levels. PEF's variance between budgeted amounts and actual expenses during the period of restoration was a positive $1.4 million, meaning it charged a portion of the normal amount to the storm reserve. The Commission should disallow this amount.

**FRF**: No. The Commission should disallow $1.4 million of PEF's claimed storm-related costs related to tree-trimming.

**Staff Analysis**: OPC contends that PEF should be allowed to charge only the incremental cost of tree trimming above its normal, budgeted levels for the calendar year 2004. (OPC BR 11) Based on information provided by PEF, OPC Witness Majoros testified that PEF's tree trimming expenses were under budget for the months during and following the hurricanes. (TR 679) He asserted that base rates support a budgeted level of O&M expense. (TR 679) He further testified that, by moving all expenses associated with the storm repair effort to the storm reserve, without taking into account the normal level of expenditures funded by base rates that customers pay, PEF effectively requires customers to pay twice for the costs. (TR 679) He stated that this practice is referred to as double dipping. (TR 679) Mr. Majoros concluded that there should be a $3.9 million adjustment based on the favorable budget variance for tree trimming as of October 2004. (TR 547, 688, 731)

PEF Witness Wimberly testified that the tree trimming budget for December 2004 showed that it was unfavorable by $2.8 million, but was favorable by $1.4 million for the year-end 2004. (TR 547) Through cross-examination by PEF, Mr. Majoros did agree that his $3.9 million adjustment for tree trimming should be changed based on Mr. Wimberly's rebuttal testimony. (TR 727) Mr. Majoros stated that because Mr. Wimberly testified the budget has

turned negative by $2.8 million the adjustment should be zero. (TR 547, 688, 731-732) Through redirect examination, Mr. Majoros stated that he believed that the $2.8 million unfavorable variance was for the calendar year 2004, not for only the month of December 2004. (TR 547, 740)

During cross-examination, PEF Witnesses McDonald and Mr. Wimberly explained that restoration tree trimming is different from PEF's budgeted production trimming, wherein restoration or spot trimming involves identifying individual trees/limbs that are interacting with the Company's facilities and hindering the ability to restore service and production trimming involves trimming based on the growth patterns of trees that occur in the Company's right-of-ways. (TR 154-155, 585-586) Mr. Wimberly further added that production trimming is paid on a per-mile basis. (TR 586)

As discussed in Issue 16, staff disagrees with FIPUG Witness Brown's ROE adjustment in order to account for any double-dipping concerns. As discussed in Issue 2, staff believes the utility has not met its burden to support its lost revenues and catch-up work arguments to refute the double dipping concerns. As previously mentioned, staff agrees with OPC Witness Mr. Majoros that base rates support a budgeted level of O&M expense and that shifting normal O&M expenses into the storm reserve account would constitute double dipping.

Without the level of information from a detailed incremental cost analysis, staff believes that a favorable budget variance is a reasonable indicator that normal costs were shifted to the storm reserve account under the Company's actual restoration cost approach. It is the utility's burden to prove that its requested costs are reasonable. See Florida Power Corporation v. Cresse. Staff notes that PEF has failed to demonstrate that the customers would not be paying twice for the normal tree trimming expenses. Based upon the evidence of record, staff recommends that PEF should be allowed to charge only the incremental cost of tree trimming above its normal, budgeted levels for the calendar year 2004. As a result, staff recommends that $1.4 million of the amount PEF charged to the storm reserve should be disallowed.

**Issue 7**: Has PEF properly quantified the costs of company-owned fleet vehicles that should be charged to the storm reserve? If not, what adjustments should be made?

**Recommendation**: No. PEF should be allowed to charge only the incremental fuel costs associated with extra shifts. As a result, the Commission should disallow $3,043,014 of the amount PEF charged to the storm reserve. (Fletcher, Breman)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including expenses related to Company-owned fleet vehicles, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: No. PEF has charged vehicle depreciation expense and base levels of vehicle operating expense to the storm damage reserve which are covered by base revenues. To include them in the storm reserve would allow PEF to "double dip." The Commission should limit recovery of vehicle-related costs to the incremental fuel costs associated with extra shifts. It should adjust the amount that PEF seeks to recover by $3.04 million.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: No. PEF should charge only extraordinary expenses, incremental to normal levels it would have incurred in any event, to the storm reserve. PEF has charged vehicle depreciation expense and base levels of vehicle operating expense to the storm damage reserve. These expenses are covered by base revenues that customers provide. The Commission should limit recovery of vehicle-related costs to the incremental fuel costs associated with extra shifts. It should adjust the amount that PEF seeks to recover by $3.04 million.

**FRF**: No. Through its claimed storm-related costs, PEF is attempting to require its customers to pay twice for basic levels of vehicle fleet expenses. The Commission should limit recovery of vehicle-related costs to only incremental fuel costs associated with extra shifts, and should thus disallow $3.04 million of the amount that PEF seeks to recover through its proposed surcharges.

**Staff Analysis**: OPC contends that PEF is seeking to charge vehicle depreciation expense and base levels of operating costs to the storm reserve. (OPC BR 12) Based on information provided by PEF, OPC Witness Majoros testified that PEF's storm reserve account includes the following Company-owned fleet vehicle expenses: 1) $909,000 for depreciation; 2) $702,000 for fuel; 3) $1.6 million in maintenance; and 4) $222,000 in overhead. He stated that, although Company vehicles have been used in the storm recovery effort, these vehicles have already been included in the annual budget. (TR 687; EXH 35) He asserted that base rates support a budgeted level of O&M expense. (TR 679) He further testified that, by moving all expenses associated with the storm repair effort to the storm reserve, without taking into account the normal level of expenditures funded by base rates that customers pay, PEF effectively requires customers to pay twice for the costs. (TR 679)

Mr. Majoros stated that depreciation and vehicle overhead would be the same regardless of whether they are used for storm damage restoration or used in the regular course of business. (TR 687, 688) He asserted that the only extraordinary vehicle cost that the Company incurred is the incremental cost of fuel, due to longer daily operations. (TR 688) Based on the assumption that vehicles were in use 16 hours per day during storm restoration, rather than the normal 8 hours per day, Mr. Majoros recommended that one-half of the fuel expense be included in the storm reserve. (TR 688) Mr. Majoros concluded that an adjustment of $3,043,015 related to vehicle expense should be removed from the amount PEF charged to the storm reserve account. (TR 688)

PEF Witness Wimberly stated that the Company charged all direct costs, including vehicle expense, related to the hurricanes to the storm reserve consistent with long-standing Commission orders, policy, and utility practice, as explained in the rebuttal testimony of PEF Witness Portuondo. (TR 539-540) Mr. Wimberly argued that Mr. Majoros' adjustment to reduce the fuel cost by half is based on the actual money spent on fuel during the hurricane restoration process, not the budget. (TR 546) Mr. Wimberly contended that Mr. Majoros overreaches here because he made no effort to determine the budgeted amount of fuel for the days of the hurricane restoration effort from the annual Energy Delivery budget for 2004. (TR 546) In its brief, OPC argued that Mr. Wimberly does not refute that these vehicles would be used 8 hours per day irrespective of the storms. (OPC BR 14)

As discussed in Issue 16, staff disagrees with FIPUG Witness Brown's ROE adjustment in order to account for any double-dipping concerns. As discussed in Issue 2, staff believes the utility has not met its burden to support its lost revenues and catch-up work arguments to refute the double dipping concerns. As previously mentioned, staff agrees with OPC Witness Mr. Majoros that base rates support a budgeted level of O&M expense and that shifting normal O&M expenses into the storm reserve account would constitute double dipping.

Staff also agrees with Mr. Majoros that vehicle depreciation, maintenance, and overhead would be incurred regardless of the storms in 2004. It is the utility's burden to prove that its requested costs are reasonable. See Florida Power Corporation v. Cresse. Staff notes that PEF has failed to demonstrate that the customers would not be paying twice for the normal vehicle expenses and failed to quantify any incremental increases for fuel, maintenance, and overhead. Based upon the evidence of record, staff recommends that PEF should be allowed to charge only the incremental fuel costs associated with extra shifts. As a result, staff recommends that $3,043,014 million of the amount PEF charged to the storm reserve should be disallowed.

The following table shows the calculation of staff's vehicle expense adjustment.

| | |
|---|---|
| Depreciation | $ 909,352 |
| Half of Fuel Expense ($702,796/2) | 350,898 |
| Maintenance | 1,560,600 |
| Overhead | 222,164 |
| Total Vehicle Expense Adjustment | $3,043,014 |

**Issue 8**: Has PEF properly determined the costs of call center activities that should be charged to the storm damage reserve? If not, what adjustments should be made?

**Recommendation**: No. The Commission should disallow $625,852 of the amount PEF charged to the storm reserve which represents the regular pay for call center activities. Further, in the future, PEF should adjust call center activity expenses charged to the storm reserve by the incremental difference of call load experience during and immediately after hurricanes with the actual prior 3-year average call load during the same time period involved. (Fletcher)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including the costs of call center activities, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC:** PEF should charge only extraordinary levels of call center expenses, incremental to normal levels, to the storm damage reserve account. OPC has not formulated a numerical adjustment at this time.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: PEF should charge only extraordinary levels of call center expenses, incremental to normal levels, to the storm damage reserve account.

**FRF**: No. PEF's claimed storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**Staff Analysis**: PEF stated that it has not deducted its budgeted O&M expenses from the storm reserve. (TR 680-681) OPC contends that PEF should charge only extraordinary levels of the call center expenses, incremental to the normal levels, to the storm damage account. (OPC BR 14) OPC Witness Majoros stated that OPC developed some guidelines designed to ensure that only extraordinary expenses would be booked to the storm reserve account and that he endorsed those guidelines. (TR 672) Mr. Majoros testified that call center activities should be excluded except for non-budgeted overtime associated with the storm event. (TR 674) He further testified that, by moving all expenses associated with the storm repair effort to the storm reserve, without taking into account the normal level of expenditures funded by base rates that customers pay, PEF effectively requires customers to pay twice for the costs. (TR 679) Mr. Majoros asserted that call center expenses for the storm cost recovery should be limited to the call overloads created by the storms. (TR 688)

Mr. Majoros stated that he had reviewed PEF's internal management budget presentations to determine the amount of normal O&M expenses shifted to the storm reserve. (TR 679) Although PEF's internal budget has been reviewed by Mr. Majoros, in its brief, OPC

stated that it has not formulated a numerical adjustment for call center activities at this time. (TR 679, OPC BR 15) Staff notes that FIPUG Witness Brown testified that it is an insurmountable task to put your finger on the actual amount of normal O&M expenses shifted to the storm reserve because she does not believe PEF has the knowledge to enable the utility to tie down the exact numbers. (TR 806-807) Staff agrees, in principle, with Mr. Majoros that call center activities should be excluded except for non-budgeted overtime associated with the storm event because the normal payroll expense is recovered through base rates.

In determining the appropriate amount of labor payroll in the storm reserve, staff has previously recommended that the regular salaries of management and non-management employees, except for call center employees, that were charged to the storm reserve be disallowed. PEF provided breakdown of the total salaries charged by department and by type of pay (i.e. regular, extended pay, special pay, double time, and overtime, etc.). (EXH 34) PEF has recorded total "FPC CUSTOMER SERVICE" payroll expense of $1,063,949 in the storm reserve. (EXH 34) PEF Witness Lyash testified that PEF had over 425 associates dedicated to handling outage calls during the storms and that there are normally 250 customer service representatives handling calls 24 hours a day, seven days a week. (TR 71) As such, this indicates that approximately 59% (250 normal employees divided by 425 employees designated during the storms) of call center expenses charged to the storm reserve were normal expenses.

It is the utility's burden to prove that its requested costs are reasonable. See Florida Power Corporation v. Cresse. Staff notes that PEF has failed to demonstrate that the customers would not be paying twice for the normal call center expenses. Based on the evidence in the record, staff recommends that $625,852 (approximately 59% of $1,063,949) of the amount PEF charged to the storm reserve should be disallowed. Further, consistent with Mr. Majoros' testimony, staff recommends that, in the future, PEF should adjust call center activity expenses charged to the storm reserve by the incremental difference of call load experience during and immediately after hurricanes with the actual prior 3-year average call load during the same time period involved.

**Issue 9**: Has PEF appropriately charged to the storm reserve any amounts related to advertising expense or public relations expense for the storms? If not, what adjustments should be made?

**Recommendation**: No. The Commission should disallow $1,496,270 of the amount PEF charged to the storm reserve. The amount represents the advertising expense and public relations expense that is estimated to be included in base rate O&M expense. Further, in the future, PEF should exclude budgeted advertising and public relations expense from its storm damage reserve. (Romig)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including the Company's storm-related advertising and media expenses, incurred to prepare for, respond to, and recover from Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: PEF has a basic obligation as a public utility to keep its customers informed, particularly during emergencies. Customers should not be required to pay a surcharge to receive the benefits of this basic function. All advertising and/or public relations expense that PEF charged to the storm reserve, amounting to $2,428,891, should be disallowed.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: PEF has a basic obligation as a public utility to keep its customers informed, particularly during emergencies. Customers should not be required to pay a surcharge to receive the benefits of this basic function. All advertising and/or public relations expense that PEF charged to the storm reserve, amounting to $2,428,891, should be disallowed.

**FRF**: No. PEF has a basic obligation to keep its customers informed, particularly during emergencies. The Commission should disallow $2.4 million of advertising and public relations expense that PEF charged to the storm reserve.

**Staff Analysis**: PEF Witness Portuondo testified that PEF charges special advertising and media costs associated with customer information, public education and safety to its Storm Damage Reserve. (TR 224) PEF Witness Lyash testified that PEF's communication plan includes proactive advertising and media communication of public awareness and safety messages before, during, and after the storm; working with the media to provide customers with estimated times of restoration; communicating directly with individual customers; and communicating with local, county, and state officials to keep them informed of PEF's activities. (TR 68) In his prefiled testimony, Witness Lyash describes PEF's extensive communication effort before, during and following the four storms. PEF's efforts included, but were not limited to, reinforcing key preparation and safety messages to its customers through print, radio, and television, increasing staffing in its Customer Service Centers to provide the latest information to its customers, and providing professional personnel for each county Emergency Operations Center as well as the state Emergency Operations Center. (TR 69-75) PEF Witness McDonald testified regarding the

importance of frequent communications to state and local governments, the Commission, and PEF's retail commercial, industrial, governmental, residential and wholesale customers. As Witness McDonald testified, these constituencies are dependent upon the communicated information to make critical decisions of their own, therefore the timeliness and accuracy of PEF's status reports are critical. (TR 117-118)

As stated by Witness Lyash, the total cost for communications associated with the four storms, including the Customer Service Center activities addressed in Issue 8, was $3.6 million. This $3.6 million has been included in the O&M expenses of $251.9 million. (TR 73)

OPC, Sugarmill Woods, AARP and FRF take the position that the Commission should disallow $2,428,891, or the rounded $2.4 million, in advertising and/or public relations expense. FIPUG takes the position that PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred, but it has not quantified the incremental amount. Further, it cannot be determined how the $2,428,891 stated in the other parties' positions was derived or why it differs from PEF's $3.6 million. OPC Witness Majoros testified that the amount charged to the storm damage reserve account should exclude all expenses associated with advertising expense. (TR 673) He also testified that he was unable to quantify the call center expenses, which is a part of the $3.6 million. (TR 688)

In Commission proceedings, advertising expenses are generally examined on a case-by-case basis. If the utility's advertising expenses are found to be informational, educational or safety-related in nature and beneficial to its ratepayers, the Commission generally allows recovery. If, on the other hand, advertising expenses are found to be institutional, image-building or provide no benefit for the regulated ratepayer, the Commission generally disallows recovery. See Order No. PSC-02-0787-FOF-EI, Docket No. 010949-EI, issued June 10, 2002, In re: Request for rate increase by Gulf Power Company, Order No. PSC-03-0038-FOF-GU, Docket No. 020384-GU, issued January 6, 2003, In re: Petition for rate increase by Peoples Gas System, Order No. PSC-04-0128-PAA-GU, Docket No. 030569-GU, issued February 9, 2004, In re: Application for rate increase by City Gas Company of Florida, Order No. PSC-04-0565-PAA-GU, Docket No. 030954-GU, issued June 2, 2004, In re: Petition for rate increase by Indiantown Gas Company, and Order No. PSC-04-1110-PAA-GU, Docket No. 040216-GU, issued November 8, 2004, In re: Application for rate increase by Florida Public Utilities Company.

Staff has no reason to believe that the costs that were expended for advertising, communications and public relations expense fail to meet the Commission's criteria of being recoverable as they are believed to be informational, safety-related and beneficial to its regulated ratepayers. In addition, due to the circumstances of the four back-to-back storms, staff believes that these costs were expended under extraordinary circumstances. However, as shown by Witness Lyash, the advertising and public relations expenses are closely related and combined into the one $3.6 million category included in PEF's request for storm damage recovery. Furthermore, as stated throughout this recommendation, staff is recommending recovery through the storm recovery reserve of the costs that are over and above normal O&M costs.

Because the record does not establish the normal advertising and public relations expense and because of the apparent close interrelationship between the Customer Service Center, advertising expenses and public relations expenses, staff recommends that the same percentage, i.e. 59%, be applied to the remaining $2,536,051 ($3,600,000 less $1,063,949 (payroll)), and the resulting $1,496,270 be disallowed. This $1,496,270 adjustment is in addition to the $625,852 reduction for Customer Service Center personnel recommended in Issue 8. Further, staff recommends that, in the future, PEF should exclude budgeted advertising and public relations expense from its storm damage reserve.

**Issue 10**: Has uncollectible expense been appropriately charged to the storm damage reserve? If not, what adjustments should be made?

**Recommendation**: Yes. Uncollectible expense has been appropriately charged to the storm damage reserve. No adjustments should be made. (Romig)

**Position of the Parties**

**PEF**: Yes, consistent with the Commission-approved self insurance plan, Commission orders and policy, and prior utility practice in accordance with Commission orders and policy, PEF is entitled to recover all of its direct storm-related costs, including uncollectible expenses incurred as a result of Hurricanes Charley, Frances, Ivan, and Jeanne.

**OPC**: The storm damage reserve is intended for the costs of repairing the physical system and restoring service. "Uncollectible expense" does not meet PEF's own definition of includible costs. The Commission should adjust PEF's request by $2.25 million to remove all uncollectible expense.

**FIPUG**: PEF should not charge uncollectible expense to the storm damage reserve

**AARP/SMW**: PEF should not charge uncollectible expense to the storm damage reserve. The use of the reserve should be limited to the extraordinary costs of repairing PEF's system and restoring service. Uncollectible expense does not fall into this category. In addition, the determination as to whether uncollectible expense was attributable to the storms is speculative. The Commission should disallow $2.25 million of the amount PEF seeks to recover for uncollectible expense.

**FRF**: No. Uncollectible expense is not properly charged to the storm damage reserve because it is foreign to the restoration effort. No uncollectible expense should be allowed for recovery through this proceeding, and the Commission should accordingly disallow $2.25 million of the amount that PEF seeks to recover for uncollectible expense.

**Staff Analysis**: Bad-debt write-offs of $2.25 million due to storm damage are included in PEF Witness Wimberly's Major Storm Cost Estimate Summary. (TR 558, EXH 26) PEF Witness Portuondo testified that the Company includes in its O&M costs charged to the Storm Reserve all actual repair activities and those activities directly associated with storm damage and restoration activities. (TR 222-223) He further stated that one of the items PEF charges to the Storm Damage Reserve is identifiable bad debt write-offs due to storm damage. (TR 224)

OPC, SMW, AARP and FRF take the position that the Commission should disallow the $2.25 million. The intervening parties believe that uncollectible expense should not be included because it does not fall into the category of repairing PEF's system and restoring service. Further, they believe that it cannot be determined if the uncollectible expense was attributable to the storms.

OPC Witness Majoros stated that OPC's Storm Damage Guidelines specifically exclude uncollectible expense. (TR 672-674) He testified that the amount is speculative, and unlike other

types of expenses which will ultimately be trued-up, uncollectible expense is likely to remain speculative as there is no way to determine if a customer's account must be written off specifically due to the storm, or for other reasons. Witness Majoros goes on to state that PEF has failed to demonstrate the actual amount of uncollectible expense it may have incurred due to the storms. (TR 688-689)

Staff believes that there can be a direct relationship between hurricane activity and the level of bad debts that is supportable if not directly identifiable. Staff also believes that bad debt expense should not automatically be excluded from recovery through the storm damage reserve simply because it does not fall into the category of repairing PEF's system and restoring service.

PEF Witness Wimberly testified that there was an increase in bad debts incurred during the course of the hurricanes. Mr. Wimberly stated that the bad debt costs have increased and are coming in as predicted. The Company produced Late-Filed Exhibit 52, entitled Description of the Normal Accounting for Bad Debt. The description outlines PEF's normal accounting for bad debt expense and the effect on the related accounts, including the reserve. The exhibit also included PEF's calculation of $2.25 million, which is the combination of two separate components. First, the July 29, 2004, projection of net write-offs for 2005 was $5.7 million, versus the September 5, 2004, projection of $7.3 million for 2005, which represents a $1.6 million increase from escalated arrears from Hurricane Charley. According to the Company, this $1.6 million did not include the impacts of Hurricanes Frances, Ivan or Jeanne. Second, the projection of the remaining $650,000 is included to represent the potential maximum impacts of all four storms.

Staff reviewed PEF's methodology and accounting process for recording bad debt and the related accounts. Staff also reviewed the Commission's past practice of handling uncollectible expense and the bad debt factor in base rate proceedings. Staff believes that not carving out the uncollectible expense that is directly related to the storms for recovery through the Storm Damage Reserve could result in the write-offs that were directly attributable to the storms being rolled into future base rates through the rolling 12-month average, or it could result in no recovery at all, depending upon how these costs are viewed in rate case proceedings. Staff believes that allowing recovery through the storm damage reserve will help prevent the possible skewing of the bad debt expense and the bad debt factor which is a component of the base rate revenue expansion factor. Therefore, staff believes that it is preferable to recover the write-offs that are directly related to the hurricanes through the Storm Damage Reserve.

Staff believes that PEF has shown that its $2.25 million of uncollectible expense for 2005 is directly associated with storm damage and restoration activities and that the Company's testimony supports that it is experiencing bad debt costs that are in line with its $2.25 million predictions. For the above reasons, no adjustment is recommended.

**Issue 11**: Should PEF be required to offset its storm damage recovery claim by revenues it has received from other utilities for providing assistance in their storm restoration activities? If so, what amount should be offset?

**Recommendation**: No. The assistance provided by PEF employees to other utilities has no direct relationship with storm damage expenses that the Company incurred as a result of the 2004 hurricanes. No adjustment should be made to the storm reserve for any revenues received for assisting other utilities in their restoration efforts. (Fletcher)

**Position of the Parties**

**PEF**: Hurricane restoration work for other utilities is no different than hurricane restoration work for the Company; revenues received from other utilities offset the costs of deploying workers to those utilities. When they complete the assignments, they return to their work at PEF at PEF's expense. There are no excess revenues that can be used to offset PEF's unrelated storm damage recovery.

**OPC**: No position.

**FIPUG**: PEF should be required to offset its storm-related costs with those revenues that it received for recovery of costs associated with the level of normal operating and maintenance expenses that would have otherwise been incurred by PEF since the effective date of the Stipulation and Settlement. In the future, PEF should credit such revenues to the storm damage reserve.

**AARP/SMW**: PEF should be required to offset its storm-related costs with those revenues that it received for recovery of costs associated with the level of normal operating and maintenance expenses that would have otherwise been incurred by PEF since the effective date of the Stipulation and Settlement. In the future, PEF should credit such revenues to the storm damage reserve.

**FRF**: Yes. PEF should be required to offset its storm-related costs with those revenues that it received for recovery of costs associated with the level of normal operating and maintenance expenses that would have otherwise been incurred by PEF since the effective date of the Stipulation and Settlement.

**Staff Analysis**: FIPUG Witness Brown testified that PEF has assisted other utilities with storm damage repairs. (TR 762) Specifically, she stated that PEF assisted Dominon Power with its restoration efforts after Hurricane Isabel and that the Company was reimbursed $1.1 million for labor and associated taxes and benefits. (TR 762) Ms. Brown argued that the normal hourly costs for those PEF employees that assisted would have already been recovered through base rates. (TR 762) She stated that PEF also assisted Entergy in restoration efforts after Hurricane Lili and assisted PEC in storm restoration efforts. (TR 762)

Ms. Brown asserted that if PEF is allowed to recover its storm damage costs through a recovery clause, it should not be allowed to retain any revenues received for assisting other utilities in their restoration efforts to the extent that the revenues were to reimburse PEF for

normal O&M expenses. (TR 763) She argued that it would constitute double dipping, if the revenues received for normal wages, benefits, and payroll taxes of PEF employees who assisted other utilities in their restoration efforts were not offset against PEF's storm damage expenses. (TR 763) Ms. Brown concluded that PEF should be required to credit the storm damage reserve in the future by revenues received for normal wages, benefits, and payroll taxes when assisting other utilities in storm-related activities. (TR 763)

PEF Witness Portuondo testified that Ms. Brown ignores the fact that PEF employees who were diverted from their normal tasks had to return to those activities after they completed their assistance to other utilities. (TR 274) He stated that the services which those employees performed outside PEF's service territory did not benefit its customers nor did its customers pay for those services. (TR 274) Mr. Portuondo argued that PEF used the base rates it collected from customers to pay for the normal work that these employees were expected to perform before and after their out-of-state assignment. (TR 274) He explained that, at the same time, the Company used the revenues collected from other utilities to defray the cost of the services these employees provided outside PEF's territory. (TR 274) Mr. Portuondo concluded that it was illogical to credit PEF's customers with revenues collected outside its territory for work that benefited other customers. (TR 274-275)

Staff agrees with PEF Witness Portuondo that no credit should be made for revenues collected outside its territory for work that benefited other customers. Staff believes the assistance provided by PEF employees to other utilities has no direct relationship with storm damage expenses that the Company incurred as a result of the 2004 hurricanes. Based on the evidence in the record, staff recommends that no adjustment should be made to the storm reserve for any revenues received for assisting other utilities in their restoration efforts. In so recommending, staff notes that "it is the [Commission's] prerogative to evaluate the testimony of competing experts and accord whatever weight to the conflicting opinions it deems necessary." See Gulf Power Co. v. FPSC.

**Issue 12**: Has PEF appropriately removed from the costs it seeks in its petition all costs that should be booked to the reserve for cost of removal expense as the cost of removing plant damaged during the storm? If not, what adjustments should be made?

**Recommendation**: No. PEF has removed an estimated $47 million from the storm reserve and applied this amount to its plant-in-service accounts. Staff recommends that an additional $8.4 million should be removed from the storm damage reserve based upon the ratio of cost of removal to cost of retirements. This amount should be booked to PEF's cost of removal reserve. (Colson, Kaproth)

**Position of the Parties**

**PEF**: Yes, the Company has appropriately accounted for the cost of removal as part of the capital costs that will be deferred to the Company's next base rate proceeding and, therefore, no further adjustments should be made.

**OPC**: PEF understated the amount of cost of removal expense (COR) that should be charged to its cost of removal reserve. To reflect PEF's own analysis of COR embedded in its depreciation rates, the Commission should reduce PEF's request by $8 million.

**FIPUG**: PEF's storm-related costs should be limited to those that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: With respect to damaged plant that was removed following the 2004 storms, PEF should charge normal average amounts of cost of removal expense to the cost of removal reserve, where the cost of removal expense related to said plant that it has been collecting from customers over time through depreciation rates now resides. PEF has understated the cost of removal expense to be charged to the reserve for cost of removal by approximately $10 million. The effect is to overstate costs charged to the storm damage reserve by this amount.

**FRF**: No. PEF's claimed storm-related costs should be limited to those that are incremental to the level of normal expenses that would have otherwise been incurred. Additionally, PEF's allowed storm costs should be offset by approximately $8 million of removal costs for which PEF's customers have already paid through the depreciation charges embedded in base rates.

**Staff Analysis**: As referenced previously in this recommendation, the Commission approved at hearing the following stipulation proposed by staff and all parties:

> With respect to replacements of plant items associated with 2004 post-storm repair and restoration activities, the parties stipulate and agree that PEF shall book to plant in service the normal cost of new plant additions under normal operating conditions, and shall book to the storm reserve (as extraordinary O&M) only the costs of new plant additions that exceed those normal amounts. PEF stipulates and agrees to verify that it has implemented this methodology and to provide final values for the portions of costs associated with new plant additions that it has booked to plant in-service and to the storm damage reserve, respectively, after it has completed the booking of relevant costs. PEF's current estimate of costs that

> it will book to plant in service using this methodology is approximately $47 million dollars.
>
> This partial stipulation addresses only the appropriate accounting methodology to be employed for the accounting of costs associated with plant replacements, and does not prevent any party from challenging the reasonableness or prudence of any individual cost item. Further, the partial stipulation does not address the aspects of Issue 12 that treat retirements and cost of removal expense, which remain at issue.

The staff audit report of PEF in this docket (EXH 41), sponsored by Staff Witness Jocelyn Y. Stephens, stated that the audit was conducted to summarize storm costs by storm and resource type and selected resource categories for testing. Witness Stephens provided two audit disclosures that dealt with Issue 12. Audit Disclosure No. 1 addresses the capital expenditures. She stated that after reviewing the monthly accrual to the storm damage account, PEF was unable to indicate which of the actual costs would be transferred to plant and which would be transferred to O&M expenses. As stated above, PEF stipulates and agrees to book to plant in service the normal cost of new plant additions under normal operating conditions, and shall book to the storm reserve (as extraordinary O&M) only the costs of new plant additions that exceed those normal amounts.

Audit Disclosure No. 3 addresses removal labor costs. According to Staff Witness Stephens, PEF isolated dollars for removal labor cost but did not include these dollars in the capital estimate total. Staff Witness Stephens recommended that an adjustment be made to remove these costs from the storm reserve account and include them in the capital account.

PEF Witness Javier Portuondo stated that it was PEF's intent all along to make sure that the cost of removal was removed from the total final storm damage reserve as well as any other capital related expenditures. Mr. Portuondo testified that PEF intends to retire approximately $19 to $20 million of plant associated with storm damage. He also said that the ratio of cost of removal to retirements is approximately 5%. Mr. Portuondo stated that the 5% ratio assigned to cost of removal vs. retirements is the amount PEF would have envisioned expending to accomplish the removal of the retirements. He also stated that PEF has estimated approximately $1.2 million for storm related cost of removal based on this percentage. Mr. Portuondo admitted that the cost of removal rate is much lower than PEF consultant's theoretical calculation in its current depreciation study. (TR 324-326)

OPC Witness Michael J. Majoros believes that PEF has failed to provide the necessary accounting documentation that demonstrates the procedures it will apply for plant additions, cost of removal, and capital replacements made necessary by storm damage. (TR 678, lines 3–9) He stated that PEF should provide the actual cost of removal accounting entries. He further states that PEF's current cost of removal reserve for transmission and distribution facilities ($528 million, EXH 30) compared to the cost of retirements is 42%. Mr. Majoros testified that the cost of removal expense due to storm damage should be recalculated using the ratio derived from PEF's current depreciation study or PEF's most recent study that relates current cost of removal

to the cost of retirements. He stated that if the most recent depreciation study ratio (42%) was used by PEF, then the minimum cost of removal would be $8.4 million. (TR 738)

Staff believes that the cost of removal expense, which was not stipulated and remains at issue, needs to be adjusted. PEF's past depreciation studies show that the ratio of the cost of removal to the cost of retirements is significantly higher than the 5% that PEF has assigned. Information provided by PEF to OPC (EXH 30) was the basis for Mr. Majoros' calculation of 42% for cost of removal to cost of retirements. According to PEF's response to OPC's third set of interrogatories (EXH 6, p.19):

> When the final cost of all Hurricane replacement assets installed is calculated, PEF will record a charge for all calculated removal cost to the accumulated depreciation expense account for the calculated removal cost. To date this transaction has not been recorded as final cost and all work has not been completed related to all fixed asset replacements. The removal cost will be treated similarly to the replacement of fixed assets and will not be applied to the storm damage fund.

Staff and PEF agree that PEF collects the cost of removing an item of plant through depreciation rates supported by the base rates and will not be applied to the storm damage fund. (EXH 6, p. 19). Staff recommends that any calculated removal costs for plant damaged or destroyed by the Hurricanes should reflect the rate that PEF is currently using to calculate removal cost. Staff disagrees with PEF that 5% of retirements is the rate that PEF should use to calculate storm damage removal cost. PEF has not provided any evidence in the record to support the use of this rate.

Staff believes that the ratio (42%) used by Mr. Majoros is a reasonable number, and is supported by the record. Therefore, staff recommends that the storm damage reserve be adjusted by $8.4 million, and that this amount should be included in PEF's capital account.

**Issue 13**: **STIPULATION – CATEGORY ONE STIPULATION, NUMBER 2**.

**Issue 14**: Taking into account any adjustments identified in the preceding issues, what is the appropriate amount of reasonable and prudently incurred storm-related costs to be charged against the storm damage reserve subject to true-up?

**Recommendation**: Based on staff's preceding and subsequent recommendations, the appropriate amount of reasonable and prudently incurred storm-related costs to be charged against the storm damage reserve subject to true-up is $271,479,765 ($285,111,150 system). (Fletcher)

**Position of the Parties**

**PEF**: No adjustments are warranted based on the resolution of the preceding issues, and PEF is entitled to recover all of its storm-related costs that it is seeking in this matter, $251.9 million, based on its estimates.

**OPC**: OPC's position is that the amount sought by PEF should be reduced by a minimum of $29 million as a result of the resolution of Issues 1-14. OPC does not agree that the adjustments from the resolution of Issues 1-14 necessarily represent that these costs are reasonable and prudent expenditures.

**FIPUG**: The appropriate amount of storm-related costs to be charged against the storm damage reserve should reflect only those costs that are incremental to the level of normal operating and maintenance expenses that would have otherwise been incurred.

**AARP/SMW**: The amount sought by PEF should be reduced by a minimum of $31.5 million as a result of the resolution of issues 1-14.

**FRF**: Based on the foregoing issues, PEF's claimed storm-related costs to be charged against the storm damage reserve should be reduced by at least $33 million.

**Staff Analysis**: PEF Witness Portuondo testified that PEF's self-insured storm damage reserve currently accrues $6 million annually and will have a balance of $46.9 million as of December 31, 2004, before any offset for storm-related costs in 2004. (TR 215, 221) He stated that the storm-related costs experienced by PEF are currently estimated at approximately $366.3 million on a total system basis. (TR 215, 221; EXH 29) Of this amount, Mr. Portuondo explained that approximately $311.4 million are storm-related O&M expenses on a total system basis. (TR 215, 221; EXH 25) He stated that PEF has incurred capital expenditures of $54.9 million on a total

system basis to date as a result of the four hurricanes and that those expenditures will be carried by PEF until its next base rate adjustment. (TR 225)

Based on staff's preceding and subsequent recommendations, staff recommends that the appropriate amount of reasonable and prudently incurred storm-related costs to be charged against the storm damage reserve subject to true-up is $271,479,765 ($285,111,150 system). The following table shows staff's calculation.

| | | |
|---|---|---|
| PEF Estimated 2004 Storm Damage Expenses | | $366,337,926 |
| Less: Amount of Capital Expenditures Deferred to Next Rate Case | | 54,926,450 |
| Total PEF System O&M Expenses | | $311,411,476 |
| Less: Staff Adjustments | | |
| Issue 2 – Non-Management Payroll Expense…..… | ($5,140,639) | |
| Issue 3 – Managerial Payroll Expense…….. | (6,197,565) | |
| Issue 6 – Tree Trimming Expenses…….. | (1,400,000) | |
| Issue 7 – Vehicle Expenses…….. | (3,043,014) | |
| Issue 8 – Call Center Costs…….. | (625,852) | |
| Issue 9 – Advertising & Public Relations Expense.. | (1,496,270) | |
| Issue 12 – Costs of Removal…… | (8,400,000) | (26,303,340) |
| Total Staff System O&M Expenses Before Netting Reserve Balance | | $285,108,136 |
| Retail Jurisdictional Separation Factor | | 0.952189225 |
| Total Staff Retail O&M Expenses Before Netting Reserve Balance | | $271,476,895 |

With all the capital and O&M expense adjustments discussed above, staff notes that PEF's 2004 achieved ROE would be reduced from 13.48% to 12.66%, which represents a reduction of 82 basis points.

**Issue 15**: Does the stipulation of the parties that the Commission approved in Order No. PSC-02-0655-AS-EI affect the amount or timing of storm-related costs that PEF can collect from customers? If so, what is the impact?

**Recommendation**: No. As a result of the extraordinary 2004 hurricane season, PEF incurred incremental costs which were not budgeted for and accounted for in base rates. Staff believes that the incremental costs associated with the 2004 hurricanes should not be considered as a base rate item as such term is used in the Settlement. As such, recovery of these costs is neither expressly permitted nor expressly prohibited by the Settlement; these types of costs simply are not contemplated by the Settlement at all. Therefore, the Settlement, as approved in Order No. PSC-02-0655-AS-EI, should not affect the amount or timing of recovery of incremental, prudently-incurred storm-related costs. Even if the Settlement were to be read as addressing these costs, staff believes that, in light of the extraordinary circumstances of the 2004 hurricane season and the extent of storm damages incurred by PEF, the Commission should exercise its authority in the public interest to permit recovery of these costs as set forth in staff's recommendations on the other issues. (Brubaker)

**Position of the Parties**

**PEF**: No, the Settlement has no bearing on PEF's Petition under the Commission-approved self-insurance plan, the Commission's orders and policy, and utility practice consistent with the Commission's orders and policy.

**OPC**: Neither PEF's transparent effort to circumvent the 10% ROE provision of the stipulation (request for "cost recovery clause") nor PEF's later effort to rewrite its terms ("reduced revenues – only trigger") enables PEF to escape the clear, plain confines of the stipulation. Nor have circumstances changed in a way that would present a basis in which the Commission could modify PEF's obligation. A deal is a deal.

**FIPUG**: Yes. The Commission should recognize PEF's obligations under the Stipulation and Settlement, as well as a fair and equitable balance of PEF and ratepayer interests. This can be accomplished by requiring PEF to expense that portion of the storm damage costs that would reduce its after-tax return on equity for 2004 to 10%. The remainder could be recovered through a short-term base rate rider with interest on the unamortized net-of-tax balance.

**AARP/SMW**: *Yes. Based on the stipulation, the amount of costs that Progress Energy can recover from customers should be zero until its return on equity falls to 10%. The timing of Progress Energy collecting any costs from customers is also controlled in the stipulation by language that states its return on equity must fall to 10% before it can petition for a change in base rates and charges.

**FRF**: Yes. The 2002 Progress Stipulation requires that PEF defray storm-related costs from earnings to the point that its return on equity has fallen to 10%. If the costs were deferred and amortized, approximately $102 million after-tax for 2004 and a likely-similar amount for 2005, would have been borne by PEF during 2004 and 2005, while base rates under the Stipulation were still in effect. Thus, any recovery by PEF via surcharges should be reduced by these amounts.

**Staff Analysis**:

Background

The Commission approved the Settlement of PEF's last rate case by Order No. PSC-02-0655-AS-EI, issued May 14, 2002, in Docket No. 000824-EI, In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light. Among other things, the Stipulation and Settlement agreement (Stipulation or Settlement) provided that PEF (formerly Florida Power Corporation or FPC) will not use the various cost recovery clauses to recover new capital items which traditionally and historically would be recoverable through base rates, except as provided for in Section 9 of the Settlement regarding PEF's Hines Unit 2. The Settlement further provides that PEF will not petition for an increase in its base rates and charges, including interim rate increases, that would take effect prior to December 31, 2005. The Settlement does not explicitly address hurricane related costs. The pertinent sections are as follows:

> 4. No Stipulating Party will request, support, or seek to impose a change in the application of any provision hereof. The Stipulating Parties other than FPC will neither seek nor support any additional reduction in FPC's base rates and charges, including interim rate decreases, that would take effect prior to December 31, 2005 unless such reduction is initiated by FPC. FPC will not petition for an increase in its base rates and charges, including interim rate increases, that would take effect prior to December 31, 2005, except as provided in Section 7. ...
>
> 7. If FPC's retail base rate earnings fall below a 10% ROE as reported on an FPSC adjusted or pro-forma basis on an FPC monthly earnings surveillance report during the term of this Stipulation and Settlement, FPC may petition the Commission to amend its base rates notwithstanding the provisions of Section 4. The other Stipulating Parties are not precluded from participating in such a proceeding. This Stipulation and Settlement shall terminate upon the effective date of any Final Order issued in such proceeding that changes FPC's base rates. …
>
> 12. … FPC will not use the various cost recovery clauses to recover new capital items which traditionally and historically would be recoverable through base rates, except as provided in Section 9.

Argument of the Parties

At issue is whether the Commission, by its Order No. PSC-02-0655-AS-EI, affects the amount or timing of storm-related costs that PEF can collect from customers pursuant to its petition in this docket; and, if so, what the impact on the amount or timing is. PEF contends that the Settlement has no bearing on PEF's petition to establish a storm recovery clause. The intervenors assert that the request to establish a storm recovery clause is an attempt to circumvent the terms of the Settlement, and that PEF should realize no recovery of its 2004 storm costs from customers until its return on equity has fallen to 10%.

In support of its position, PEF argues that the Settlement provides that PEF will not petition for an increase in its base rates and charges that would take effect prior to December 31, 2005; further, PEF is allowed to petition the Commission to amend its base rates if its retail base earnings fall below a 10% ROE. PEF contends that its petition to establish a storm cost recovery clause does not involve an increase in base rates and charges, and that the storm-related costs that PEF seeks to recover under a Storm Cost Recovery Clause were not and cannot be included in a base rate proceeding. (PEF BR 34) PEF contends that the costs of severe storms like the 2004 hurricanes are too volatile, irregular in their occurrence, and unpredictable to be addressed in base rates. Rather, base rates are set to defray other, normal recurring costs of running the utility. (Id.) PEF contends that the intervenors' witnesses all agreed that the 2004 hurricanes and the costs incurred by PEF were unprecedented in nature and that the hurricane costs were volatile and unpredictable, and that PEF's base rates did not include the 2004 hurricane costs. (PEF BR 35) PEF argues that the Settlement, which settled a base rate proceeding, is inapplicable to the Company's Petition for recovery of its 2004 hurricane costs. PEF contends that is untenable and unfair for intervenors to suggest that PEF must use its base rate revenues to absorb all or part of the costs of volatile, non-recurring expenses that base rates were never intended to recover in the first place. (PEF BR 36)

PEF also contends that the Commission should reject the intervenors' arguments that the Company should share the 2004 hurricane-related costs with its customers by applying its earnings toward those costs, suggesting the 10% ROE figure in the Company's Stipulation is, in any event, a fair and reasonable way to allocate the Company's storm-related costs. (PEF BR 36) PEF believes that this construction of the Settlement is inaccurate. PEF argues that Rule 25-6.0143(4)(c), Florida Administrative Code, which governs the Storm Damage Reserve, requires that "each and every loss or cost which is covered by the account shall be charged to that account and shall not be charged directly to expenses. Charges shall be made to accumulated provision accounts regardless of the balance in those accounts." PEF asserts that it would thus be precluded from expensing storm-related costs in 2004 to the point that the Company's return is limited to a 10% ROE without obtaining a waiver of the Rule by the Commission. (PEF BR 37) PEF contends that in urging the Commission to force PEF to divert its base rates and revenues to cover these expenses, the Intervenors are seeking an additional reduction in PEF's base rates in violation of Paragraph 4 of the Settlement. (PEF BR 39) Further, PEF asserts that it is unfair and inconsistent with sound regulatory policy to reduce PEF's earnings to the "bottom line" when "the evidence demonstrates that PEF's performance during the 2004 hurricanes was everything the Commission and customers should want a utility to do and more." (PEF BR 41)

In support of its position, OPC argues that PEF's request for a storm cost recovery clause is an attempt by PEF to evade its obligations under the Settlement. PEF notes that the Commission denied a request by Florida Power & Light Company to establish a similar clause in 1993, by Order No. PSC-93-0918-FOF-EI, issued June 17, 1993, in Docket No. 930405-EI, In re: Petition to implement a self-insurance mechanism for storm damage to transmission and distribution system and to resume and increase annual contribution to storm and property insurance reserve fund by Florida Power & Light Company. (OPC BR 24) OPC contends that PEF's request in the instant docket should likewise be denied as an unsuitable mechanism, stating that PEF's attempt to create a clause now can not alter the fact that, at the time of the Settlement, the parties did not provide for storm cost treatment in any way other than through

base rates. (OPC BR 24-25) OPC supports its argument that PEF's request is not a true clause in that a legitimate cost recovery clause is perpetual in nature, and PEF's proposal would terminate after two years. Further, a true clause is not confined to the cost of a specific event, and PEF's proposal is to collect $252 million, which it quantifies as the cost of specific storm events, over a specific time frame. (OPC BR 25)

OPC also contends that PEF has incorrectly asserted that the 10% trigger applies only to an unanticipated reduction in revenues, as opposed to an increase in costs, noting that, during the hearing, PEF witness Portuondo asserted that the parties to the Settlement intended the 10% return on equity threshold to apply only in the event PEF miscalculated revenues. (OPC BR 25-26) OPC states that Mr. Portuondo admitted during cross-examination that the Settlement does not contain any distinction between reductions in earnings caused by increased costs as opposed to reductions in earnings caused by lower revenues. OPC contends that the language of the Settlement does not imply or even remotely suggest the existence of such a distinction, and that PEF instead has come up with an after-the-fact interpretation that impermissibly opposes the clear language of the Settlement. (OPC BR 26)

In summary, OPC posits that PEF can neither circumvent the 10% ROE provision of the Settlement by requesting a cost recovery clause, nor rewrite the Settlement's terms by asserting that only reduced revenues can trigger the 10% provision. OPC contends that PEF must be held to the clear, plain confines of the Settlement; and that circumstances have not changed in a way that would present a basis in which the Commission could modify PEF's obligation.

In support of its position, FIPUG also asserts that the proposed creation of a storm cost recovery clause "is nothing more than an attempt to do an end run around [PEF's] Stipulation and Settlement and to do it in a manner that is contrary to past Commission practice." FIPUG alleges that PEF has rejected the historic base rate approach to recovering storm costs because it would otherwise lose excessive 2004 profits, because PEF agreed in the Settlement that it wouldn't seek a base rate increase unless the after-tax return on equity falls below 10%. (FIPUG BR 9)

FIPUG contends that the Commission's orders and the Commission's rule on the storm reserve clearly demonstrate that storm damage expenses are part of base rates. For instance, in Order No. PSC-03-0918-FOF-EI, which established the storm damage reserve for FPL, the Commission acknowledged that hurricane-related expenses were included in base rates and, therefore, declined to create a 100% pass-through mechanism such as the clause Progress proposes in this case. In Order No. PSC-93-1522-FOF-EI, which approved the creation of a storm reserve fund for PEF, the Commission noted that PEF was collecting for transmission and distribution property damage in its base rates. In addition, Rule 25-6.0143, Florida Administrative Code, governs the treatment of storm-related costs, and provides that balances in these storm accounts are to be evaluated at the time of a rate proceeding and adjusted as necessary, while permitting a utility to petition this Commission for a change in the provision level and accrual rate outside of a rate proceeding. (FIPUG BR 9-10)

FIPUG contends that the Commission has at its disposal several methodologies for dealing with PEF's storm damages that are consistent with the terms of the Settlement. FIPUG recommends that PEF should bear all storm expenses to the point that its earnings fall to a 10%

ROE, with the remainder being borne by the ratepayers. In recognition that this is a base rate case, instead of using a cost recovery clause to collect the storm damage costs, the Commission should use a temporary adjustment to base rates by creating a storm damage base rate rider to allow recovery of the ratepayers fair share of the costs over a two year period. (FIPUG BR 10) FIPUG believes that this approach comports with the action taken by the Commission in the past whereby PEF and Gulf Power Company have applied excess earnings to reduce storm damage expense. (FIPUG BR 10) In addition, FIPUG also recommends a variation on the risk-sharing approach: for 2004, the Commission should require PEF to book the amount of storm damage expense to bring its after tax return on equity to 10%. In 2005, the Commission should allow that return to increase to the 12.5% return authorized in 1994, with excess earnings applied to reduce the storm damage costs. Then, for 2006, PEF would be allowed to earn the return the Commission finds to be proper in the pending rate case, Docket 050078-EI. (FIPUG BR 11)

SMW contends that the Settlement prohibits PEF from recovering any storm costs from its customers until its return on equity falls to 10%. SMW believes that not only does the 10% equity return "floor" in the Settlement provide a minimal fair return on equity for use in determining the shareholders' share of costs to be borne, such a 10% equity return is more than fair in the current market. (SMW BR 7) SMW's primary position is that the storm expense incurred by PEF should be amortized over an appropriate time period and that there should be no surcharge to customers. However, SMW contends that if there is a surcharge, then the amount of the recovery should be determined, not based on the amount that PEF spent, but the amount of storm cost recovery expenses that remain after PEF's shareholders absorbed costs sufficient to bring its earnings to the minimum of a fair rate of return on equity, which, pursuant to the Settlement Agreement, is 10%. (SMW BR 11)

FRF contends that the Settlement requires PEF to defray storm-related costs from earnings to the point that its return on equity has fallen to 10%. FRF further asserts that PEF's request to establish a storm cost recovery clause would violate the Settlement, and that PEF seeks to charge rates that require its captive customers to bear effectively all of the risks and all of costs incurred due to the 2004 storms while preserving for itself a ROE of approximately 13.5%, approximately 350 basis points above the ROE that PEF agreed to in the Settlement and similarly far above any reasonable ROE under current market conditions. (FRF BR 3-4) FRF contends that the Commission must ensure that PEF's rates, considered in their totality, are fair, just, and reasonable. In this case, FRF believes that this requires that PEF's earnings and its achieved rate of ROE be taken into account and, accordingly, that any storm surcharge approved by the Commission allow PEF to earn a 10% after-tax ROE for 2004 and 2005, as required by the Settlement. (FRF BR 5)

FRF states that storm-related expenses typically are, and have historically been, recovered through changes in base rates, but in this case, such base rate changes are limited due to the Settlement. FRF agrees that PEF has the right to seek base rate relief to get its base rates to a level that would provide PEF with the opportunity to earn a rate of return on equity of 10.0%, consistent with the Settlement. (FRF BR 11) FRF believes that a 10% after-tax ROE is fair to PEF within the terms of the 2002 Stipulation, and it is generous relative to current market conditions. (FRF BR 8)

Staff Analysis

Over a six week period in 2004, PEF's service area was struck by four hurricanes, during which time PEF experienced over two million cumulative customer outages, and a company-estimated $366 million in storm-related costs. (TR 65-66, 73) At hearing, all of the intervenors' witnesses agreed that four hurricanes in Florida over one year's time was an unprecedented event. (TR 618, 706, 805, 844) OPC witness Majoros did not dispute the fact that the 2004 hurricane season caused severe damage to the company's transmission and distribution system, and SMW witness Stewart agreed that the storm-related costs that PEF incurred in 2004 as a result of the four hurricanes were also unprecedented. (TR 706, 844) PEF contends that, as even OPC's witness agreed, the job of preparing for, responding to, and recovering from four hurricanes in 2004 was a massive undertaking, requiring thousands of PEF employees and outside workers unfamiliar with PEF's accounting methods focusing all of their efforts on restoring service as quickly and safely as possible. (PEF BR 28)

As noted by PEF witness Lyash, PEF has a Storm Damage Reserve for O&M expenses associated with storm damage which customers support through base rates; at the end of 2004 the value of the Reserve was $46.9 million. (TR 73-74) PEF's Storm Damage Reserve was established by Order No. PSC-93-1522-FOF-EI, issued October 15, 1993, in Docket No. 930867-EI, In Re: Petition of Florida Power Corporation for authorization to implement a self-insurance program for storm damage to its T&D Lines and to increase annual storm damage expenses. At that time, PEF (formerly Florida Power Corporation or FPC) had been collecting $1 million annually in base rates for transmission and distribution (T&D) property damage, with a company estimate that $3 million would be adequate to begin rebuilding a storm damage reserve, based on the 20-year history of actual storm damage incurred by the Company. Id. at 3. The reserve's annual accrual amount was raised to $6 million annually by Order No. PSC-94-0852-FOF-EI, issued July 13, 1994, in Docket Nos. 940621-EI, In Re: Investigation into Currently Authorized Return on Equity and Earnings of Florida Power Corporation, and 930867-EI, In Re: Petition for Authorization to Implement a Self-Insurance Program for Storm Damage to its Transmission and Distribution (T & D) Lines and to Increase Annual Storm Damage Expense by Florida Power Corporation. Id. at 2.

Both FIPUG and SMW's witnesses testified that PEF's base rates are not set to cover the costs of hurricanes like those experienced in 2004. (TR 805, 845) PEF witness Portuondo testified that it would be neither practical nor cost-effective to provide coverage for all storm-related costs the Company might experience. (TR 218) Mr. Portuondo further testified that:

> The Storm Damage Reserve is intended to address the likely level of storm costs that might result from study findings that 53% of the storms simulated a total cost of less than $5 million and the probability of a storm occurrence is only 23.3% a year. The annual accruals to the Reserve were not designed to cover costs of potentially catastrophic hurricane seasons because the Company's studies that provided the basis for these accruals have shown a low probability that the most severe storms or series of storms would severely impact its service territory.… When considering these studies in the early to mid-1990's, it was the Commission's considered judgment to avoid collecting from customers the

> significant additional reserves that would be needed to cover the costs of catastrophic storms that were unlikely to occur. Instead, the Commission decided to provide utilities the opportunity to seek recovery of the costs associated with catastrophic storms if and when the need might arise. As we are all too aware, the hurricane season of 2004 has presented that need. (TR 218-219)

Staff notes in particular language in Order No. PSC-93-1522-FOF-EI, in which the Commission stated that:

> [FPC] proposes that, in the event that actual experience from storm damage exceeds the reserve balance at any given point in time, the excess costs should be deferred through the creation of a regulatory asset to be recovered from the customers over a five year period through a mechanism to be determined by this Commission.
>
> This Commission already has a rule in place to govern the use of Account 228.1, Accumulated Provision for Property Insurance. Rule 25-6.0143(4)(b), Florida Administrative Code, provides that, "...each and every loss or cost which is covered by the account shall be charged to that account and shall not be charged directly to expenses. Charges shall be made to accumulated provision accounts regardless of the balance in those accounts."
>
> If FPC experiences significant storm related damage, it can petition for appropriate regulatory action. In the past, this Commission has allowed recovery of prudent expenses and has allowed amortization of storm damage expense. Extraordinary events such as hurricanes have not caused utilities to earn less than a fair rate of return. FPC shall be allowed to defer storm damage loss over the amount in the reserve until we act on any petition filed by the company.
>
> No prior approval will be given for the recovery of costs to repair and restore T&D facilities in excess of the Reserve balance. However, we will expeditiously review any petition for deferral, amortization or recovery of prudently incurred costs in excess of the reserve.

Id. at 4-5 (Emphasis added).

The intervenors contend that PEF's request to establish a storm cost recovery clause is inappropriate, and for various reasons, runs contrary to the terms of the Settlement which was approved in Order No. PSC-02-0655-AS-EI. As discussed in Issue 20, staff agrees that a storm cost recovery clause is not the most appropriate vehicle to collect the amount of any storm-related costs which the Commission may authorize for recovery. The Intervenors also contend that PEF can not request recovery of its storm-related costs until such time as its retail base rate earnings fall below a 10% ROE, as provided in Section 7 of the Settlement. As addressed herein and in Issue 16, staff does not agree with this assessment.

Neither PEF nor the intervenors could have reasonably foreseen that the outcome of the 2004 hurricane season, and the damages and costs incurred by the utility, would be on an order

of magnitude above anything that PEF, or its customers, had previously experienced. PEF incurred incremental costs which were not budgeted nor accounted for through base rates. Indeed, the record evidence suggests it would have been imprudent to require PEF's customers to fund in advance the substantial additional reserves that would be needed to cover the costs of catastrophic storms, which, statistically speaking, were unlikely to occur. At its current level, PEF's storm reserve will cover only a fraction of the expenses incurred by the company to restore service to its customers and repair its T&D facilities damaged by the hurricanes. Staff believes that by Order No. PSC-93-1522-FOF-EI, the Commission contemplated that relief could be made available for a utility which has experienced such extraordinary expenditures, subject to a review of the prudency of those costs.

The Settlement provides that PEF will not petition for an increase in its base rates and charges during the term of the Settlement, and that PEF will not use the various cost recovery clauses to recover new capital items which traditionally and historically would be recoverable through base rates. Certainly, the recovery of typical storm damages has historically been addressed through the storm reserve and has been budgeted for and recovered through base rates. However, the magnitude of the damages and costs associated with the 2004 hurricane season were unprecedented and extraordinary in nature. Given this extraordinary nature, staff does not believe that the incremental costs associated with the 2004 hurricanes constitute a base rate item, such as would be addressed by the Settlement. Recovery of these incremental, prudently-incurred hurricane costs is distinguishable from the types of increases in base rates that staff believes is contemplated by the Settlement. Further, PEF is not seeking recovery for capital items which would be barred by Section 12 of the Settlement. The Settlement neither expressly permits nor expressly prohibits the recovery of these extraordinary costs; rather, the Settlement simply does not address the treatment of costs of this unprecedented nature and magnitude. Staff believes it would be unfair to read the Settlement as barring the recovery of prudently-incurred, extraordinary restoration costs. These are not typical expenses which have been accounted for in base rates. Therefore, staff believes that neither the Settlement nor Order No. PSC-02-0655-AS-EI should affect the amount or timing of recovery of these incremental storm-related costs.

Even if the Settlement were to be read as addressing the incremental costs at issue in this proceeding, staff believes that, in light of the extraordinary circumstances of the 2004 hurricane season and the extent of storm damages incurred by PEF, the Commission should exercise its authority in the public interest to address the costs as set forth in staff's recommendations in the other issues. The Commission has a longstanding commitment to support and encourage negotiated settlements. Further, the principle of administrative finality assures that there will be a terminal point in proceedings at which the parties and the public may rely on an agency's decision as being final and dispositive of the rights and issues involved therein. See Peoples Gas System, Inc. v. Mason, 187 So. 2d 335 (Fla. 1966) (the inherent authority of the Commission to modify its final orders is a limited one).

However, the Commission is also charged to act in the public interest. Assuming for the sake of argument that PEF's proposal were inconsistent with Order No. PSC-02-0655-AS-EI (approving the Settlement), the Commission's obligation to act in the public interest nevertheless authorizes it to revisit that Order, should the circumstances require it. For example, in Peoples Gas System, supra, the Florida Supreme Court vacated a Commission Order which modified its

previous approval of a territorial service agreement. In support of its decision, the Court stated that the vacated Commission order was not entered on rehearing or reconsideration as permitted by the Commission's rules of procedure, it was entered more than four years after the entry of the order which it purported to modify, and it was not based on any change in circumstances or on any demonstrated public need or interest. The Court also recognized, however, the differences between the functions and orders of courts and those of administrative agencies, particularly those regulatory agencies which exercise a continuing supervisory jurisdiction over the persons and activities regulated, and which are usually concerned with deciding issues according to a public interest that often changes with shifting circumstances and passage of time. Id. at 339. The Court noted that pursuant to Sections 366.03, 366.04, 366.05, 366.06, and 366.07, Florida Statutes, the legislature has given the Commission broad powers to regulate the operation of electric utilities. Id. Furthermore:

> Nor can there be any doubt that the Commission may withdraw or modify its approval of a service area agreement, or other order, in proper proceedings initiated by it, a party to the agreement, or even an interested member of the public. However, this power may only be exercised after proper notice and hearing, and upon a specific finding based on adequate proof that such modification or withdrawal of approval is necessary in the public interest because of changed conditions or other circumstances not present in the proceedings which led to the order being modified. This view accords requisite finality to orders of the Commission, while still affording the Commission ample authority to act in the public's interest.

Id. at 339-340.

Even if the Settlement were read as prohibiting the recovery PEF seeks in its petition, staff believes that the evidence adduced in this case demonstrates that the circumstances surrounding the 2004 hurricane season – and the resulting costs incurred by PEF – were unprecedented, and truly extraordinary in nature. At discussed above, PEF's current storm reserve will cover only a fraction of the expenses incurred by the company to restore service to its customers and repair its T&D facilities damaged by the hurricanes. Staff believes that by Order No. PSC-93-1522-FOF-EI, the Commission contemplated that relief could be made available for a utility which has experienced such extraordinary expenditures, subject to a review of the prudency of those costs.

Neither PEF nor the intervenors could have reasonably foreseen that the outcome of the 2004 hurricane season, and the extraordinary damages and costs incurred by the utility. The facts in this case demonstrate a profound change in circumstances from those under which the Settlement was originally entered and approved. Staff believes it would be unfair for the utility to be foreclosed from recovering its prudent restoration costs under these circumstances. The Commission's mandate to act in the public interest requires the Commission to balance the interests of both the utilities it regulates and those of the customers. As noted in Peoples Gas System, supra, the Commission has a continuing supervisory jurisdiction over the persons and activities it regulates, and must decide issues according to a public interest that often changes with shifting circumstances and passage of time. Were a determination to be made that the

Settlement addresses the costs at issue in this case, staff nevertheless recommends that, in light of the extraordinary circumstances of the 2004 hurricane season and the extent of storm damages and costs incurred by PEF, the Commission should exercise its authority in the public interest to address the costs as set forth in staff's recommendations on the other issues.

**Issue 16**: In the event that the Commission determines the stipulation approved in Order No. PSC-02-0655-AS-EI does not affect the amount of costs that PEF can recover from ratepayers, should the responsibility for those costs be apportioned between PEF and retail ratepayers? If so, how should the costs be apportioned?

**Recommendation**: No. Staff recommends that PEF be allowed to recover all reasonable and prudently incurred storm damage costs identified and approved by the Commission. (Maurey, Slemkewicz)

**Position of the Parties**

**PEF**: No, the Company is entitled to recover all reasonable and prudently incurred storm costs, in accordance with Commission-approved procedures for accounting for these costs.

**OPC**: Yes. Investors are paid to accept risks, including the risk of storm damage. To reward investors for assuming the risk and then insulates them of placing all of the risk on ratepayers would be inequitable. Under current economic conditions, 10% ROE is a reasonable and adequate return. Even without a stipulation, using 10% ROE criteria to measure shareholders' responsibility is reasonable.

**FIPUG**: Yes. As discussed in the testimony of Sheree L. Brown, ordering PEF to immediately expense $142.7 million, and limiting the amount to be recovered from customers to $121.8 million, will result in a fair and equitable resolution of the issues.

**AARP/SMW**: Yes. Investors are paid to accept risks, including the potential for storm damage, and the Commission should not insulate investors from that risk by placing 100% of the risk on customers. A 10% ROE is more than adequate currently to provide investors with a reasonable return. Therefore, even if the Commission were to determine that the 2002 stipulation does not require this result, the 10% ROE criterion is a reasonable basis on which to apportion the storm-related costs.

**FRF**: Yes. Even if the Commission determines that the Stipulation does not apply, the Commission should limit PEF's recovery to an amount that is sufficient, considered with PEF's existing base rates, to provide PEF with the opportunity to earn a 10% ROE. This is a generous ROE under current market conditions and will result in PEF's customers compensating PEF's shareholders generously for the risks that they take.

**Staff Analysis**: The Company has proposed that it be allowed to recover all direct costs associated with its storm damage restoration efforts. (TR 83-84) The intervenors to this docket recommend that the Commission first require PEF to expense that portion of storm damage restoration costs necessary to take the Company's 2004 earned return on equity (ROE) to 10% before allowing PEF to recover the remaining balance of reasonable and prudently incurred storm-related costs. (TR 607, 693, 766) Based on PEF's December 2004 Earnings Surveillance Report, the Company would have to record approximately $113.2 million in additional expenses to reach an ROE of 10.0%. (EXH 54)

As discussed in Issue 15, staff believes that the Stipulation and Settlement ( Stipulation) approved in Order No. PSC-02-0655-AS-EI, should not affect the amount or timing of the storm-related costs that PEF can collect from its ratepayers. The Commission has expressly stated in Order No. PSC-93-0918-FOF-EI, issued June 17, 1993, in Docket No. 930405-EI, that it is free to consider a variety of options in the event a company petitions for recovery of prudently incurred costs in excess of its storm damage reserve "depending on what the circumstances are at the time." (TR 302-305)

The intervenors argue that if the Stipulation does not apply in this case to limit PEF's recovery, the Commission should nevertheless apply by analogy some of the principles underlying that Stipulation, In particular, the intervenors contend that PEF should be allowed to recover storm damage restoration costs only to the extent that such costs, if expensed in 2004, would reduce its 2004 earnings below the 10% threshold contained in Section 7 of the Stipulation. All intervenors agree that the total amount of storm damage restoration costs incurred as a result of the 2004 hurricane season, if expensed in 2004, would take PEF's earned ROE below that 10% threshold, such that partial recovery of those costs should be permitted. (OPC BR 2, FIPUG BR 15, AARP/SMW BR 11, FRF BR 4)

Staff believes that the 10% ROE threshold should not be applied in the manner advocated by the intervenors. While Section 7 of the Stipulation specifies that PEF may petition for a rate increase only in the event its base rate earnings fall below a 10% ROE, the Stipulation is silent with respect to what return level the Company may be brought back to as a result of its requested rate relief. (Order No. PSC-02-0655-AS-EI, page 16) Moreover, Section 3 of the Stipulation states, "Effective on the Implementation Date, FPC (now known as PEF) will no longer have an authorized Return on Equity (ROE) range for the purpose of addressing earnings levels, and the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels." (Order No. PSC-02-0655-AS-EI, pages 14-15) Because PEF does not have an ROE range during the term of the Stipulation, staff believes the Company is within its right to petition for recovery of all reasonable and prudently incurred storm-related costs to maintain the return it was otherwise entitled to earn. (TR 261-265, 384, 430, 434)

Staff is not convinced that any sharing is appropriate under the circumstances of this case. Consequently, staff recommends that PEF be permitted to recover from its ratepayers the full amount of the reasonable and prudently incurred storm damage restoration costs approved by the Commission in Issue 17, without regard to the effect of that recovery on PEF's return on equity. (TR 261-265, 494-496)

However, as the intervenor witnesses in this docket have testified, making the ratepayers responsible for the Company's recovery of all reasonable and prudently incurred storm damage restoration costs insulates investors from this risk. (TR 610-613, 751, 786-787) The Commission has recognized that cost recovery clauses, such as the storm cost recovery clause proposed by the Company in this docket, have reduced investor risk.

> Each time we approve a clause for the recovery of utility expenses or capital costs, the overall volatility of the utility's earnings before interest and taxes (EBIT) is reduced. This has the effect of reducing business

> risk. This reduced business risk should then result in a lower average cost of capital (required rate of return) over the long run. While it can be argued that currently authorized ROEs may not reflect the reduced risk resulting from the guaranteed recovery of prudently incurred environmental costs, ROEs set prospectively should reflect this reduced risk.

Order No. PSC-94-0044-FOF-EI, issued January 12, 1994, in Docket No. 930613-EI, In Re: Petition to Establish an Environmental Cost Recovery Clause Pursuant to Section 366.0825, Florida Statutes, by Gulf Power Company, page 14.

PEF Witness Portuondo testified that the Company's petition specifically seeks recovery of storm damage restoration costs through a "Storm Cost Recovery Clause." (TR 222) Absent the statutory authority of Section 366.0825, Florida Statutes, PEF's request for a storm cost recovery clause in the instant docket appears analogous to Gulf Power Company's request for an environmental cost recovery clause. (TR 226-227) Staff believes that this reduced risk exists whether the recovery mechanism is a cost recovery clause or a surcharge.

The requested treatment for the recovery of storm damage restoration costs appears to be more favorable to PEF than the treatment afforded its affiliated utility, Progress Energy Carolinas (PEC). Witness Portuondo conceded that the regulatory framework in North and South Carolina did not permit PEC to implement a surcharge for the recovery of storm damage restoration costs associated with Hurricanes Ivan and Isabel and the unnamed ice storms that caused significant damage in its service territory. Instead, PEC was required to amortize these costs. (TR 421-422) To the extent the Company's request for a storm cost recovery is approved, this treatment sends a signal to investors and the market that even in the face of the extensive damage wrought by the "catastrophic and unprecedented" hurricane season of 2004, the Florida Commission continues to be supportive of the financial integrity of PEF and, by extension, the long-run best interests of its ratepayers. (TR 21, 78, 290, 610-613, 695, 786-787, 805, 844)

Consistent with the Commission's finding in Order No. PSC-94-0044-FOF-EI and the testimony in the record, to the extent that all prudent and reasonable costs associated with storm damage restoration are borne by the ratepayers irrespective of the Company's earnings, investors are exposed to less risk on a going-forward basis. The fact that ratepayers, not shareholders, bear the risk of storm damage cost recovery should be taken into account in the determination of the Company's investor-required ROE in its next base rate proceeding.

**Issue 17**: What is the appropriate amount of storm-related costs to be recovered from the customers?

**Recommendation**: Based on staff's preceding and subsequent recommendations and the most recent commercial paper rate, the appropriate amount of storm-related costs to be recovered from the customers is $231,839,389. (Fletcher)

**Position of the Parties**

**PEF**: The appropriate amount is all direct storm-related costs incurred to prepare for, respond to, and recover from the 2004 hurricanes, consistent with the Commission-approved self-insurance plan, Commission orders and policy, and prior practice in accordance with Commission orders and policy. The Company's direct storm-related O&M costs, including costs exceeding charges under normal operating conditions for capital expenditures, as allocated to the Company's retail jurisdiction, is, based on its estimates, $251.9 million.

**OPC**: Taking OPC's adjustments into account, the appropriate surcharge amount is $115 million.

**FIPUG**: $121.8 million total system, with $115.9 million recoverable from retail ratepayers.

**AARP/SMW**: If the Commission does not totally reject surcharge recovery in this docket and defer expense recovery from customers to an adjustment of the storm accrual and amortization over five years, the amount sought by PEF in this case should be reduced by a minimum of $141 million.

**FRF**: The amount appropriately recoverable from PEF's customers is defined by the amount claimed by PEF, $251.9 million, less $33 million in double-counted or overstated costs, less $102 million after-tax for 2004, less the amount of PEF's earnings constituting an after-tax ROE greater than 10% for 2005. For example, if PEF's 2005 earnings exceeded those necessary to provide an after-tax 10% ROE by $60 million, the amount recoverable through surcharges would be approximately $57 million.

**Staff Analysis**: After the storm damage reserve is applied, PEF Witness Portuondo testified that the remaining amount of storm-related O&M expense is $264.5 million, or $251,850,486 million allocated to the Company's retail jurisdiction that PEF seeks to recover. (TR 216, EXH 25) Assuming recovery in equal amounts over two years with interest and a commencement date of January 1, 2005, Mr. Portuondo recommended recovery of $132.2 million in 2005 and $128 million in 2006. (TR 215-216) He stated that the true-up of estimated costs to actual costs, with interest at the commercial paper rate would be applied to any over or under-recoveries. (TR 216) Based on staff's preceding and subsequent recommendations and the most recent commercial paper rate, staff recommends that the appropriate amount of storm-related costs to be recovered from the customers is $231,613,565. The following table shows staff's calculation.

| | |
|---|---|
| Total Staff System O&M Expenses Before Netting Reserve Balance | $285,108,136 |
| Less: 12/31/04 Reserve Balance | (46,915,219) |
| Total Staff System O&M Expenses Net of Reserve Balance | $238,192,917 |
| Retail Jurisdictional Separation Factor | 0.952189225 |
| Staff Amount to Recover from Customers Before Interest and Taxes | $226,804,729 |
| Plus: Interest Per Staff | 4,867,856 |
| Staff Amount to Recover from Customers with only Interest | $231,672,585 |
| Revenue Tax Multiplier | 1.00072 |
| Total Staff Amount to Recover from Customers | $231,839,389 |

**Issue 18**: If recovery is allowed, what is the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery?

**Recommendation**: The appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery is to record the costs as a regulatory asset in a subaccount of Account 182.1, Extraordinary Property Losses. (Slemkewicz)

**Position of the Parties**

**PEF**: The appropriate accounting treatment would be treatment that is consistent with that provided for in any other cost recovery mechanisms approved by the Commission.

**OPC**: The unamortized balance approved for recovery from customers should be reported as a regulatory asset and maintained in a separate subaccount.

**FIPUG**: The storm damage account should be credited each month with the actual costs recovered from ratepayers.

**AARP/SMW**: The unamortized balance approved for recovery from customers should be reported as a regulatory asset and maintained in a separate subaccount.

**FRF**: The storm damage account should be credited each month with the actual costs recovered from ratepayers.

**Staff Analysis**: Although not specifically addressed by the witnesses at the hearing or in the parties' briefs, the purpose of this issue was to determine the appropriate account in which to record the approved deferred storm-related costs during the period that they are being amortized. Once an amount is approved for recovery and amortization, it meets the definition of a regulatory asset. In this instance, the appropriate account is Account 182.1, Extraordinary Property Losses. This account was specifically created to include extraordinary losses, such as unforeseen damages to property, which are not covered by insurance or other provisions. This would include the Commission-determined amount of the storm-related costs, approved for future recovery, that exceeded the balance in the storm damage reserve. In order to assist in the tracking and review of the amounts included in this account and their subsequent amortization, a separate subaccount of Account 182.1 should be established to record these transactions. This accounting treatment would be appropriate for use regardless of whether a cost recovery clause or a surcharge is approved as the appropriate recovery mechanism.

Based on the foregoing, staff recommends that the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery is to record the costs as a regulatory asset in a subaccount of Account 182.1, Extraordinary Property Losses. Staff would also note that this would be the "normal" accounting treatment for Commission approved deferral and future recovery of extraordinary property losses.

**Issue 19**: What is the appropriate methodology to calculate the interest charged on the amount of storm-related costs permitted to be recovered from customers?

**Recommendation**: Staff recommends that PEF be allowed to charge interest at the applicable 30-day commercial paper rate on the unamortized balance of storm damage restoration costs permitted to be recovered from ratepayers. In addition, staff recommends that an adjustment be made in the calculation of interest to recognize the storm-related deferred taxes not included in the Company's upcoming rate case. This adjustment reduces the interest carrying charge on the unamortized balance of storm-related costs by approximately $2 million. (Maurey)

**Position of the Parties**

**PEF**: The accrual and collection of interest on the amount of storm-related costs in excess of the Storm Damage Reserve, consistent with practice under other cost recovery clauses, reimburses PEF for its carrying costs on those amounts, and interest should be calculated at the current commercial paper rate.

**OPC**: OPC adopts FIPUG's position.

**FIPUG**: Each month, PEF should calculate interest on outstanding net-of-tax balance of the storm damage account, which shall be the outstanding balance of the storm damage account less 38.575% taxes, consistent with the testimony and exhibits of Sheree L. Brown.

**AARP/SMW**: No position.

**FRF**: Yes, if any recovery via a surcharge is allowed, PEF should charge interest, at the commercial paper rate, on the outstanding storm damage account minus the income tax savings realized by PEF.

**Staff Analysis**: All parties that have taken a position on this issue agree that, to the extent recovery of storm damage restoration costs is granted through a storm cost recovery clause or surcharge, PEF should be allowed to charge interest at the applicable 30-day commercial paper rate. (TR 227, 748; Category One Stipulation No. 3) The aspect of this issue that must still be decided is the appropriate balance on which the commercial paper rate should be applied.

Consistent with Rule 25-6.0143(4)(b), Florida Administrative Code, PEF booked storm damage restoration costs to its Storm Damage Reserve for regulatory purposes. (TR 496-497) For tax purposes, however, PEF expensed the storm damage restoration expenses in 2004. (TR 276) This treatment resulted in the Company booking additional accumulated deferred taxes of approximately $135.8 million. (EXH 49) While this is a temporary timing difference that will be reversed as the storm damage surcharge is collected, in the meantime the deferred taxes are a source of cost-free capital to the Company. (TR 276, 748, 780)

In its petition, PEF dealt with the storm-related deferred taxes by including a certain amount in its capital structure. (TR 400) FIPUG Witness Brown testified that the Company should recognize the storm-related deferred taxes in the calculation of interest carrying charge on the unamortized balance of any storm-related costs the Company is permitted to recover from

ratepayers. Specifically, she testified that the Company should only be allowed to charge interest on the net-of-tax balance of the storm damage account. (TR 771)

All things being equal, including the storm-related deferred taxes in the capital structure as zero-cost capital would result in a greater benefit to ratepayers than using the deferred taxes as an offset to the unamortized storm damage balance in the interest calculation. (TR 399-401) However, in the instant case, all things are not equal.

The ratepayers only benefit from the inclusion of storm-related deferred taxes in the capital structure if rates are reset when the deferred taxes are present. Because the Company is using 13-month average balances in a December 31, 2006 projected test year, by operation of math, over half of the storm-related deferred taxes will have turned around and therefore will not be recognized in the rate case. To capture the value of the storm-related deferred taxes for the benefit of the ratepayers, staff proposes a compromise approach.

Because the Company's petition is predicated on including a certain portion of storm-related deferred taxes in the capital structure, staff recommends the Commission leave this amount intact and afford it the treatment it would ordinarily receive in the rate case. However, for the remaining portion of storm-related deferred taxes that, by operation of math, are not included in the capital structure, staff recommends the Commission use the information from Exhibits 25 and 49 provided by PEF Witness Portuondo and Exhibit 39 provided by FIPUG Witness Brown to determine the net-of-tax balance for purposes of calculating interest carrying charge. (EXH 25, 39, 49) Specifically, staff recommends interest be calculated on the net-of-tax balance for the period July 2005 through June 2006. Interest will be calculated on the remaining balance, without any adjustment for deferred taxes, for the period July 2006 through June 2007. This adjustment reduces the interest carrying charge on the unamortized balance of storm-related costs by approximately $2 million. In this manner, staff believes the Commission can capture the value of that portion of the storm-related deferred taxes for the benefit of PEF's ratepayers that would have otherwise gone unrecognized.

**Issue 20**: What mechanism should be used to collect the amount of the storm-related costs authorized for recovery?

**Recommendation**: A temporary surcharge is the appropriate mechanism for recovery of approved costs. PEF should immediately file tariffs containing initial surcharge factors by rate class to be effective for cycle 1 meter readings for August 2005 and ending with the last cycle for December 2005. In conjunction with the adjustment clause filings for calendar year 2006, PEF should file revised factors to be in effect for the period January through December of 2006. In conjunction with the adjustment clause filings for calendar year 2007, PEF should file revised factors that will be in effect for the period January through July of 2007. The surcharge factors should be derived using updated kilowatt hour sales forecasts consistent with the three recovery periods, and should reflect the storm-related costs, including any interest, approved by the Commission for recovery. The two filings following the initial filing should incorporate a true-up of estimates of costs and sales to actual costs and sales. Any over- or under-recovery remaining at the end of the period should be refunded or recovered through the fuel adjustment clause. As is true in any case, the Commission maintains its authority to consider all matters relevant and germane to setting rates on a going-forward basis. If deemed appropriate, staff recommends that this could include a modification to the method for recovery of all or a portion of the storm restoration costs which may be approved in this docket, in a subsequent rate, securitization, or other appropriate proceeding. (Wheeler, Kummer)

**Position of the Parties**

**PEF**: The proper mechanism for the recovery of all of PEF's direct storm-related costs arising from Hurricanes Charley, Frances, Ivan, and Jeanne is a Storm Cost Recovery Clause.

**OPC**: The mechanism must be a temporary surcharge applied to PEF's individual base rates. PEF's proposed alternative of a "cost recovery clause" is an effort to circumvent its obligation under the 2002 stipulation.

**FIPUG**: Such costs should be collected as a separately stated charge on customer's bills for the period of recovery.

**AARP/SMW**: A temporary surcharge to base rates. Within 90 days of the Commission's vote, PEF should submit a final report detailing its actual costs and the amount collected by application of the surcharge. 60 days later, parties should be required to identify any costs they object to. The Commission should conduct appropriate proceedings on any disputed costs and then order PEF to "true up" the amounts to be collected to match the amounts finally determined to be recoverable from customers.

**FRF**: Such costs should be collected as a separately stated charge, pursuant to a base rate rider, on customer's bills for the period of recovery. The FRF does not agree that, as a general matter or principle, a surcharge mechanism is appropriate in this or any other case. The FRF is agreeable to this mode of cost recovery, if any recovery is allowed, because in substance it will achieve the results that PEF would be entitled to under the Stipulation.

**Staff Analysis**: Staff recommends that any storm costs approved for recovery be treated as a temporary surcharge, not a cost recovery clause. While staff believes that the impact on customers' bills is the same under either mechanism, staff has concerns about approving a clause to recover extraordinary costs, particularly on a retroactive basis.

Parties' Arguments

PEF's petition asked for a two-year limited Storm Cost Recovery Clause. (TR 215) The arguments for a cost recovery clause are based on the limited nature of the requested recovery, the volatility and unpredictability of storm related costs, and the desirability of matching recovery with cost incurrence. (TR 227-229, 257) Further, PEF notes that the Commission stated previously that it would consider a cost recovery clause in the orders establishing the self-insurance programs. (TR 304) PEF further suggests that since the costs did not occur in a test year, recovery would not be allowed in its pending rate case. (TR 257, 269) PEF also suggests that if the costs "have to be recovered from the ratepayers," they necessarily must be recovered outside of base rates, and revenues and a cost recovery clause mechanism is the only way to do that in a timely manner. (TR 258, PEF BR 16) As further evidence of appropriateness of the clause recovery mechanism for storm damage costs, PEF cites the clause recovery of security expenditures incurred in response to the September 11, 2001 terrorist attacks, which were traditionally treated as base rate costs. (TR 229) Like the security costs, PEF agrees with the Commission's logic that it is important to align the recovery of the costs with the cost incurrence so that customers who benefited from the expenditures paid for them. (TR 229)

OPC, FIPUG and FRF maintain that PEF's request for a cost recovery clause is an attempt to circumvent the Stipulation approved by Order No. PSC-02-0655-AS-EI, which prohibits PEF from raising its base rates prior to January 1, 2006, absent a Return on Equity (ROE) threshold. (TR 595-596, 748, 752, 766) The intervenors argue that the Stipulation gave the utility an unlimited upside on earnings in exchange for foregoing base rate increases, unless PEF's ROE fell below 10%. (TR 692-693, 761, 765) OPC and SMW also note that there was no cost recovery clause in place at the time the costs were incurred and that the only provision for storm cost treatment was through base rates. (TR 56, OPC BR 24) It would therefore be inappropriate to use a clause which did not exist at the time costs were incurred to recover the costs. FRF argues that storm related costs have traditionally been recovered through base rates and that PEF's petition for relief could be considered a request for base rate relief envisioned under the Stipulation, assuming PEF's ROE fell below 10% as a result of the costs. (FRF BR 16) FIPUG maintains that Commission orders clearly state that storm costs are part of base rates, citing the FPL order wherein the Commission specifically declined to implement a cost recovery clause like the one proposed by PEF in this case. (FIPUG BR 9)

Staff Discussion

Staff recognizes the similarities in customer impact between styling the recovery mechanism as a "temporary surcharge" or a "cost recovery clause." However, staff believes there are some fundamental differences between the two concepts which must be recognized, and which supports staff recommendation that a temporary surcharge is a more appropriate mechanism.

PEF is asking for recovery for pre-determined costs which occurred prior to the adoption of the clause. (TR 215) Although cost recovery clauses have true-up mechanisms, they are essentially forward-looking. Rates are based on projected costs and trued-up to actual. When the current clauses were adopted, Commission orders specifically stated that they would be applicable only prospectively, to costs incurred after the adoption of the clause. Order No. 9974 issued April 24, 1981, in Docket No. 810050-PU, In re: Conservation Cost recovery clause, notes that Commission Order No. 9273, issued March 7, 1980, established the energy cost conservation clause for conservation costs expected to be incurred starting January 1, 1981. Similarly, the Oil Back-out Clause was approved in Order 11210, issued September 29, 1982, in Docket No. 820001-EU, In re: Investigation of fuel cost recovery clauses of electric utilities, for recovery of costs of oil back-out projects for the period October 1, 1982 through March 31, 1983. On February 24, 1992, the Commission issued Order 25773 in Docket No. 910794-EI, In Re: Generic Investigation of the proper recovery of purchased power capacity cost by investor-owned electric utilities, establishing the Capacity Cost Recovery Clause for all utilities for costs beginning October 1992. The Commission was even more specific in Order No. PSC-94-0044-FOF-EI, p. 43, approving an environmental cost recovery clause for Gulf Power Company. In that order the Commission said:

> One issue before us is whether it is appropriate to recover costs through the Environmental Cost Recovery Clause (ECRC) that were incurred before the effective date of the ECRC legislation. We shall only approve recovery of expenses incurred after April 13, 1993 for Gulf Power Company. Statutes are applied on a prospective basis unless there is a specific exception within the language of the statute. Thus, costs incurred prior to the effective date of the statute would not be eligible for recovery through the clause. The allowance of expenses incurred prior to the establishment of an environmental cost recovery clause is inappropriate. (Order p. 2-3)

Staff agrees with PEF that cost recovery clauses were designed to recover costs which are volatile and unpredictable. (TR 227-229) Staff also agrees with PEF that all four current clauses address costs that are unpredictable, volatile and irregular, due to forces outside the utility's control. (TR 228) The original purpose of recovery clauses was to address on-going costs which could fluctuate between rate cases and unduly penalize either the utility or customers, if such costs were included in base rates. (SMW BR 3) PEF in its petition asked for a time-limited "clause," which is contrary to the concept and operation of existing clauses which address recurring costs. (TR 314) In addition, staff agrees with OPC that a true clause is not limited to a specific event. (TR 315) The two year limitation proposed by PEF looks more like a temporary surcharge than a recovery clause because it does not contemplate the need for such a clause on an on-going basis.

Staff is also concerned with the precedent of establishing a specific clause for any extraordinary expense a utility might incur between rate cases. Although the Commission has decided to include security costs in the fuel cost recovery factor (TR 229), staff believes that decision was based on an immediate need to protect the health, safety and welfare of the utility and its customers, and that there was a basis for believing the costs would be recurring on some level. Order No. PSC-01-2516-FOF-EI, issued December 26, 2001, in Docket No. 010001-EI, In

re: Fuel and purchased power cost recovery clause and generating performance incentive factor, states:

> We believe that approving recovery of this incremental power plant security cost through the fuel clause sends an appropriate message to Florida's investor-owned electric utilities that we encourage them to protect their generation assets in extraordinary, emergency conditions as currently exist.

(Order p. 4) That Order also notes that to date, FPL was the only utility to request such recovery and that as more was known about the security costs, other recovery mechanisms might be used. (Order p. 4)

Staff is concerned that using a cost recovery clause to recover a single extraordinary cost is inconsistent with the traditional application of such clauses and could create a troublesome precedent for recovering a single expense without consideration of the Company's total operation. This idea of a limited proceeding has rarely been used in the electric industry for that very reason. As some costs go up, some go down and absent extraordinary circumstances, all balancing impacts should be considered in setting rates. The fact that the storm damage reserve has been sufficient for 12 years would indicate that it is an appropriate mechanism for normal, year-to-year storm expenses. Under the previous Commission orders cited, utilities maintain the right to ask for assistance should the storm damage reserve be insufficient, as in 2004, but that ability does not translate into the need for a cost recovery clause.

If at some point in the future the Commission wishes to consider the establishment of a storm cost recovery clause for prospective expenses, in addition to or in place of the self-insurance mechanism, that is its prerogative. However, since no such clause existed prior to the incurrence of the costs to be recovered, the requested recovery period is finite and limited in nature, and such costs are not ongoing and are currently treated in base rates, staff recommends that the Commission approve a temporary surcharge mechanism for storm cost recovery instead of a recovery clause mechanism.

In Issue 23, the parties have stipulated that any costs approved for recovery shall be collected over a maximum period of two years. In Issue 24, the parties have stipulated that any approved mechanism be effective thirty days following the Commission vote, and that recovery under the mechanism will begin with the first billing cycle of the following month. If the Commission approves these stipulations, the initial storm cost recovery factors will be applied to PEF's cycle 1 billings beginning August 2005. Recovery will continue until the last cycle of July 2007. In Issue 21, the parties have stipulated to the method to be used to allocate costs to the rate classes.

Staff recommends that PEF's storm cost recovery factors be modified as described in the testimony of PEF witness Portuondo. (TR 462-465) PEF should immediately file tariffs containing initial surcharge factors by rate class to be effective for cycle 1 meter readings for August 2005 and ending with the last cycle for December 2005. In conjunction with the adjustment clause filings for calendar year 2006, PEF should file revised factors to be in effect for the period January through December of 2006. In conjunction with the adjustment clause

filings for calendar year 2007, PEF should file revised factors that will be in effect for the period January through July of 2007. Any over- or under-recovery remaining at the end of the period should be refunded or recovered through the fuel adjustment clause. Staff believes that this methodology will insure the timely and accurate recovery of Commission-approved storm-related costs from PEF's customers.

As is true in any case, the Commission maintains its authority to consider all matters relevant and germane to setting rates on a going-forward basis. If deemed appropriate, staff recommends that this could include a modification to the method for recovery of all or a portion of the storm restoration costs which may be approved in this docket, in a subsequent rate, securitization, or other appropriate proceeding.

**Issue 21**: **STIPULATION – CATEGORY TWO STIPULATION, NUMBER 1**

**Issue 22**: What is the proper rate design to be used for PEF to recover storm-related costs?

**Recommendation**: Storm-related costs should be recovered from all rate classes on a per - kilowatt hour basis. If the Commission decides that a per-kilowatt rate design is appropriate for those rate schedules that include a demand charge, then PEF should be required to submit demand charges that are differentiated based on metering voltage. (Wheeler)

**Position of the Parties**

**PEF**: PEF proposes allocating the costs among rate classes using the Company's last approved cost of service study, i.e., allocating production demand-related costs using the 12 Coincident Peak and 1/13$^{th}$ Average Demand method, production energy-related costs based on energy usage, transmission costs using the 12 CP method, and distribution costs using the Non-Coincident Peak method. This allocation of charges under the Storm Cost Recovery Clause mirrors the allocation of costs under other approved cost recovery clauses.

**OPC**: No position.

**FIPUG**: For the purposes of GSD, CS and IS rates, such costs should be recovered through a demand charge consistent with the testimony and exhibits of Sheree L. Brown.

**AARP/SMW**: No position.

**FRF**: For the purposes of GSD, CS, and IS rates, such costs should be recovered through a demand charge consistent with the testimony and exhibits of FIPUG Witness Sheree L. Brown. Recovery through an energy charge is inconsistent with the allocation of these costs, which are allocated on the basis of class coincident peak (transmission) and non-coincident peak (distribution) demands.

**Staff Analysis**: This issue addresses the manner in which storm related costs are collected from the rate classes, which is commonly referred to as rate design. It does not address the manner in which costs are allocated to the rate classes. The allocation method to be used was the subject of an approved stipulation in Issue 21. (Category Two Stipulation, No. 1)

PEF has proposed a rate design that recovers storm costs on a per-kilowatt hour, or energy basis, from all of the rate classes. As stated in the rebuttal testimony of PEF Witness Portuondo, this is the rate design that is used for all of PEF's existing recovery clauses. (TR 271)

With the exception of fuel, the majority of costs recovered through PEF's clauses (i.e., capacity, environmental, and conservation costs) are allocated to the rate classes on a demand basis.

In her testimony, FIPUG Witness Brown advocates a rate design that would recover costs from demand-billed rate classes on a per-kilowatt basis, because most of the costs that PEF is seeking to recover are allocated to the rate classes on a demand basis. (TR 771-772) Demand-billed rate classes are those classes that bill customers based on both their energy usage, which is measured in kilowatt hours (kWh), and their maximum demand for the month, which is measured in kilowatts (kW). For PEF, these rate classes include the General Service – Demand (GSD), Curtailable (CS), and Interruptible (IS) rate schedules.

In her testimony, Witness Brown develops per kW demand charges based on PEF's requested recovery and allocation of costs. However, as pointed out in the rebuttal testimony of PEF Witness Portuondo (TR 272-273), the charges do not appear to be correct because the rates are higher for transmission level metered customers than for primary and secondary distribution metered customers. In fact, higher level voltage customers should pay lower rates than lower voltage customers.

Staff believes that for the sake of simplicity in applying and calculating rates, the per kW hour rate design proposed by PEF is adequate, and should be approved. The Commission has approved the same rate design in the capacity, environmental, and conservation cost recovery clauses, in which a substantial portion of the costs are allocated on a demand basis. If, however, the Commission decides that a per kW rate design is appropriate for PEF's GSD, CS and IS rate schedule storm cost recovery charges, staff recommends that PEF file storm recovery factors for these classes that are properly differentiated by metering voltage. As stated by Witness Portuondo, such recovery factors should result in primary distribution charges that are 1% less than secondary charges, and transmission level charges that are 2% lower than the secondary charges. (TR 272-273)

**Issue 23**: **STIPULATION – CATEGORY ONE STIPULATION, NUMBER 4**

**Issue 24**: **STIPULATION – CATEGORY ONE STIPULATION, NUMBER 5**

**Issue 25**: **STIPULATION – CATEGORY ONE STIPULATION, NUMBER 6**

**Issue 26**: What are the effects, if any, of the study that PEF (then Florida Power) submitted to the Commission in Docket No. 930867-EI on February 28, 1994 and Order No. PSC-94-0852-FOF-EI, issued in Docket Nos. 940621-EI and 930867-EI on July 13, 1994 on the manner in which PEF may account for storm-related costs in this proceeding?

**Recommendation**: The methodology proposed in PEF's Study does not represent the standard by which the Commission must determine which costs are appropriately charged to PEF's storm damage reserve. In Order No. PSC-94-0852-FOF-EI, the Commission did not expressly approve the methodology proposed in PEF's Study, and made no finding that the methodology was "reasonable" or "appropriate" or otherwise should be used as the continuing standard for charging costs to the storm damage reserve. Staff recommends that the Commission determine which costs are appropriately charged to PEF's storm damage reserve consistent with staff's recommendations in the other issues. (Brubaker)

**Position of the Parties**

**PEF**: The Study and Order are dispositive regarding PEF's costs because the Study was required for Reserve accruals and charges, the Docket was held open, and the Study was approved for the accrual and the Dockets closed. Further, a similar FP&L Study was deemed adequate, PEF charged costs using its Study for ten years, and the Study constitutes sound policy because it mirrors insurance, is easy to administer, avoids incremental cost approach issues, and fairly approximates the hurricane's disruptive impact.

**OPC**: PEF's 1994 study is not legally dispositive of the accounting issues in this docket. In the order that closed PEF's self-insurance docket, the Commission did not address, much less approve, PEF's proposed accounting methodology. Moreover, PEF's sole justification of the study was based on the administrative complication of using separate accounting for insurance and regulatory purposes. PEF has no T&D insurance; because of changed circumstances, PEF's sole justification is no longer operative.

**FIPUG**: The February 28, 1994 study and Order No. 94-0852-FOF-EI are not dispositive of issues regarding the manner in which PEF should account for the storm-related costs in this proceeding. In the Order, the Commission found only that the amount of PEF's annual accrual to the storm fund should be increased. It made no findings regarding PEF's study, and did not prejudge cost recovery from PEF's ratepayers under the "self-insurance" mechanism.

**AARP/SMW**: The documents are not dispositive of issues regarding how PEF should account for costs in this proceeding. The Commission made no findings regarding the accounting methodology that PEF advanced in the document. The Commission should not find the study persuasive on the merits because PEF's approach has the counterintuitive and prejudicial effect on customers of requiring ratepayers to pay normal O&M costs a second time through inclusion in the amount of storm-related costs that PEF proposes to collect from customers.

**FRF**: For the purposes of GSD, CS, and IS rates, such costs should be recovered through a demand charge consistent with the testimony and exhibits of FIPUG Witness Sheree L. Brown. Recovery through an energy charge is inconsistent with the allocation of these costs, which are

allocated on the basis of class coincident peak (transmission) and non-coincident peak (distribution) demands.

**Staff Analysis**:

Background

By Order No. PSC-93-1522-FOF-EI, issued October 15, 1993, in Docket No. 930867-EI, In re: Petition of Florida Power Corporation for authorization to implement a self-insurance program for storm damage to its T&D lines and to increase annual storm damage expenses, the Commission authorized PEF (formerly Florida Power Corporation or FPC) to implement a self insurance approach for the costs of repairing and restoring its transmission and distribution systems in the event of hurricane, storm damage or other natural disaster through annual contributions to its Storm and Property Insurance Reserve Fund ("Storm Reserve"). In addition, the Commission required PEF to prepare and submit a study evaluating the amount that should be annually accrued to the reserve. The Order further specified at page 4 that:

> FPC's study shall provide information concerning the treatment of T&D damages under its existing policy, a listing of the type of storm-related expenses FPC intends to draw from the reserve fund, and what type of accounting entries will be made for each item.

Pursuant to Order No. PSC-93-1522-FOF-EI, PEF filed its Study in February 1994. By Order No. PSC-94-0852-FOF-EI, issued July 13, 1994, in Docket Nos. and 930867-EI and 940621-EI, In re: Investigation into currently authorized return on equity and earnings of Florida Power Corporation, the Commission approved a proposal by PEF wherein it agreed to cap its 1994 earnings at a 12.50% ROE, to apply any overearnings to first accelerate the Sebring going concern value and then increase the storm damage accrual, and to permanently increase its storm damage accrual from $3,000,000 to $6,000,000 annually, effective January 1, 1994. The Order stated at page 2 that:

> The appropriate storm damage accrual level is currently under review in Docket No. 930867-EI. A study has been submitted in that docket and our review of that study indicates that an increase above the current $3,000,000 annual accrual is needed. Accordingly, we find that FPC's proposal to permanently increase its storm damage accrual is reasonable and hereby approve the proposal.

This constitutes the sole reference to the Study in Order No. PSC-94-0852-FOF-EI.

Argument of the Parties

At issue is whether the Commission, by Order No. PSC-94-0852-FOF-EI, approved the methodology proposed in PEF's Study concerning the types of costs to be charged to the Storm Reserve and, in turn, whether the Commission's decisions in this docket are limited to determining whether PEF complied with that methodology. PEF's Study proposed a replacement or actual restoration cost approach to determine the storm-related costs charged to

the storm reserve; specifically, that the costs of the actual repair activities and those activities directly associated with storm damage and restoration activities would be charged to the reserve. The intervenors contend that PEF's methodology was never approved by the Commission, and that the correct accrual method is to charge to the storm reserve only those incremental costs incurred over and above PEF's budgeted O&M.

PEF argues that the Commission, by Order No. PSC-94-0852-FOF-EI, approved use of its "replacement cost" methodology recommended in the Study, and that it can not apply a new standard retroactively. Each of the Intervenors takes the position that the Study and Order No. PSC-94-0852-FOF-EI are not legally dispositive of the Commission's decisions in this docket concerning what costs are appropriately charged to the Storm Reserve.

In support of its position, PEF asserts that, pursuant to the Study, it proposed a self-insurance program for transmission and distribution (T&D) storm damage to the Commission that replicated the operation of third-party insurance. PEF contends that it replicated its prior, third-party T&D insurance methodology by accounting for all direct costs incurred to prepare for, respond to, and recover from the 2004 hurricanes. (PEF BR 17-18). PEF further states that when this methodology is applied in the self-insurance program, PEF's customers, rather than the third-party insurance company, are responsible for all direct costs incurred during the 2004 hurricanes.

PEF contends that, by Order No. PSC-94-0852-FOF-EI, the Commission specifically considered how to account for storm-related expenses, and also evaluated, accepted, and approved the Study's accounting for storm-related costs and the accrual to the storm damage reserves. PEF asserts that it has applied the methodology for accounting for storm-related costs set forth in its Study for ten years through nine hurricanes and major storms before the 2004 hurricanes without any objection, and that this methodology was approved by the Commission and represents sound regulatory policy. (PEF BR 19, 27) PEF contends that, based on a review of the Study, the Commission had to be aware of the types of costs that PEF would charge to the storm reserve for collection when the Commission accepted the accrual amount in the Study. (PEF BR 21). PEF argues that at no prior time was any question raised about its accounting for storm-related costs, and that to change its method for doing so now is unfair and improper retroactive ratemaking. (PEF BR 24)

In its brief, PEF cites extensively in support of its position to a similar Study which the Commission required Florida Power & Light Company (FPL) to file, which was to address the appropriate amount to be contributed annually to FPL's Storm Reserve; and the types of costs that FPL intended to charge to its Storm Reserve. Order No. PSC-93-0918-FOF-EI, issued June 17, 1993, in Docket No. 930405-EI, In re: Petition to implement a self-insurance mechanism for storm damage to transmission and distribution system and to resume and increase annual contribution to storm and property insurance reserve fund by Florida Power and Light Company (FPL's study, once filed, was addressed in Order No. PSC-95-0264-FOF-EI, issued February 27, 1995, in Docket No. 930405-EI.) Both PEF and FPL's studies advocate the actual restoration cost approach, without adjustment, with respect to what costs should be charged to the reserve. (PEF BR 25) PEF contends that in Order No. PSC-05-0264-FOF-EI (and in subsequent Order No. PSC-95-1588-FOF-EI, issued December 27, 1995, in Docket 951167-EI, which increased

the storm reserve accrual after Hurricane Andrew), the Commission "found the storm damage study submitted by FPL to be adequate;" thus, a similar finding should be read with respect to PEF's Study. (PEF BR 23)

In support of its position, OPC first contends that a separate basis exists for concluding the Study is not dispositive of the appropriate choice of accounting methodology in this docket. In its study, PEF justified the choice of the "replacement cost" methodology with this statement:

> However, the Company believes its insurance program will continue to be a combination of traditional insurance coverage along with some level of self insurance. Any requirement to use an approach other than replacement cost would place undue administrative burden on the Company which would presumably occur at a time when Company efforts would need to be dedicated to restoration of service and related activities. (H.E. 42 at p. 9)

(OPC BR 31)OPC contends that the only support provided by PEF lies in the claim that maintaining two sets of books – one for insurance claims and another for regulatory purposes – would amount to an administrative burden. OPC cites PEF Witness Portuondo as agreeing with this assessment of the study, which confirms that PEF currently has no commercial insurance on transmission and distribution assets. (TR 336-338; OPC BR 31) With respect to those categories of plant, OPC contends that the premise of the Study is wholly invalid. (Id.)

OPC also criticizes PEF's reliance on FPL's study, stating that, like the PEF Study, the principal justification offered by FPL was to avoid the burdens associated with employing two separate accounting methodologies. (EXH 43 at p. 8; OPC BR 31) OPC contends that FPL purported that its total restoration cost was less expensive than an incremental methodology. However, OPC states that this assertion was entirely dependent on treating lost revenues as a cost. Once lost revenues are removed from the equation, the same exercise shows FPL's method to be more expensive than the incremental approach. (EXH 43 at Attachment 1, p. 1 of 6; OPC BR 31)

In support of its position, FIPUG agrees that PEF disclosed in its Study the method by which it would use to book costs to the storm damage reserve. Essentially, at that time PEF said costs attributable to the storm would be booked to the storm reserve. However, FIPUG contends that few would realize that the utility meant to include normal costs as storm expense as well as incremental costs the storm brought on. (FIPUG BR 6) FIPUG notes that since the Study was filed there has never been a docketed proceeding where the methodology that PEF uses to charge costs to the storm damage reserve has been addressed. FIPUG contends that the Study was conducted with base rates in mind, and that in the instant docket, PEF is asking for a guaranteed cost recovery mechanism that is something entirely different. FIPUG asserts that a base rate proceeding enables the Commission to not only examine the prudency of the costs charged, but it also can eliminate "double dipping," related storm costs to an excess depreciation reserve, and implement some form of cost sharing by restricting the utility's return. (FIPUG BR 7)

Staff Analysis

Staff believes that Order No. PSC-94-0852-FOF-EI was not intended to approve the methodology proposed in PEF's Study as the standard by which the Commission must determine which costs are appropriately charged to PEF's storm damage reserve. Staff believes that a review of the Order itself, and a review of other Commission orders, strongly suggest that such approval was not intended for the purpose asserted by PEF in this proceeding.

PEF's request to self-insure was approved by Order No. PSC-93-1522-FOF-EI. That Order required PEF to file the Study for the express purpose of "evaluating the amount that should be annually accrued to the reserve." Order PSC-94-0852-FOF-EI is titled as follows: "Notice of Proposed Agency Action Order Establishing Earnings Cap for 1994, Accelerating Amortization, and Increasing Storm Damage Reserve." The Order itself does not does not remark upon the prudency of, or in any way reference, the methodology PEF recommends with respect to accruing costs to the storm reserve. The Order does not in fact mention the Study at all, except only to state that "[a] study has been submitted in that docket and our review of that study indicates that an increase above the current $3,000,000 annual accrual is needed." Id. at 2. As its title indicates, the Order addresses PEF's proposal to offset any overearnings for 1994 by accelerating amortization on the Sebring going concern value and then by increasing the storm damage accrual, and increasing the storm reserve accrual to $6,000,000 annually.

Staff also finds PEF's reliance on the Commission's treatment of FPL's study to be misplaced. Staff cautions that there is currently an issue as to the legal effect, if any, of FPL's 1993 storm cost study and Order No. PSC-95-0264-FOF-EI have on the decisions to be made in Docket No. 041291-EI. Without prejudicing the determinations to be made in that docket, staff notes that while the Commission found the FPL study sufficient to indicate the appropriate annual amount to be contributed to FPL's Storm Reserve, it did not approve the $7.1 million annual accrual proposed in the study. Order No. PSC-95-0264-FOF-EI at p. 4. Further, with respect to the types of costs to be charged to the Storm Reserve, the Commission did not expressly approve the methodology proposed in FPL's study and made no finding that the methodology was reasonable or appropriate, or was otherwise approved as the continuing standard for charging costs to the storm damage reserve. Finally, the Commission concluded Order No. PSC-95-0264-FOF-EI by finding only that the Study was "adequate." Id. at 6. Staff notes that not even this at-best highly generalized finding was made in Order No. PSC-94-0852-FOF-EI regarding PEF's Study.

In this context, staff believes that the only finding that can reasonably be made from Order No. PSC-94-0852-FOF-EI regarding PEF's study is that it indicated that an increase above the then-current $3,000,000 annual accrual was needed, which is precisely – and exclusively – what that Order has to say about the Study. Construing the Order as proposed by PEF – as approving PEF's proposed methodology – requires going beyond the language and findings in the Order.

Staff's believes that its view of Order PSC-94-0852-FOF-EI is consistent with Commission orders addressing the same issue with respect to the other three large investor-owned electric utilities in Florida. In particular, in Order No. PSC-95-0255-FOF-EI ("TECO

Order")[1], issued approximately one year after Order No. PSC-94-0852-FOF-EI, the Commission addressed the exact same issue with respect to TECO. In that Order, which was entitled "Notice of Proposed Agency Action Order Approving Storm Damage Study," the Commission specifically found that the replacement cost approach proposed in a study submitted by TECO was "a reasonable methodology for determining the appropriate amounts to be charged to the storm damage reserve." The Commission noted that TECO's proposed approach was consistent with the provisions of TECO's prior insurance coverage. Despite having made a specific finding that TECO's proposed approach was reasonable – a finding notably absent from Order No. PSC-94-0852-FOF-EI – the Commission went on to explain the extent of its authority to review costs charged to TECO's storm damage reserve:

> While we sympathize with Staff's concerns regarding the appropriateness of particular proposed expenses listed by TECO, it is our understanding that this list is merely setting forth examples of expenses that the utility may wish to charge against storm damage reserves. The list is a general guideline of categories to be recovered; it is neither all inclusive or exclusive. Because of the unpredictable nature of any given storm, it seems premature to make a determination of the prudency of any particular charge at this time. In the event of a storm, the utility will bear the burden of showing that specific charges against reserves are prudent and reasonable. . . . We retain the right to review the costs and disallow any that are found to be inappropriate.

Order No. PSC-95-0255-FOF-EI, at p. 4. (Emphasis added).

Based on this Order, it is clear to staff that the Commission, by retaining the authority to review the prudence and reasonableness of costs charged to the storm damage reserve, also intended to retain its authority to determine whether a particular *category* of costs was appropriately charged to the storm damage reserve. The Commission left the burden on the utility to show that specific charges against storm damage reserves are appropriate.

Staff's review of Commission orders related to other electric utilities shows that the Commission intended that each utility be held to the same standard. Most notably, in an Order addressing a request by Gulf Power Company (Gulf) to amortize hurricane-related expenses to its storm damage reserve, the Commission cites the TECO Order in the same breath as Order No. PSC-95-0264-FOF-EI (FPL) as the standard for the Commission's review of costs charged to a utility's storm damage reserve:

> The expenses related to the two hurricanes named above have not been reviewed by the Commission. In Order No. PSC-95-0264-FOF-EI, issued February 27, 1995, related to the self-insurance mechanism for Florida Power & Light Company, the Commission stated: "...we have the authority to review any expenses charged to the reserve for reasonableness and prudence." In Order No. PSC-95-0255-FOF-EI, issued February 23, 1995, related to Tampa Electric

[1] Issued February 23, 1995, in Docket No. 930987-EI, In re: Investigation into Currently Authorized Return on Equity of Tampa Electric Company. (TECO)

> Company's self-insurance mechanism, the Commission stated: "[w]e retain the right to review the costs and disallow any that are found to be inappropriate."
>
> In accordance with our prior treatment of expenses related to individual utility self-insurance mechanisms, we retain the right to review Gulf's charges to the Accumulated Provision for Property Insurance Account related to these two storms, at any time, for reasonableness and prudence and to disallow any that are found to be inappropriate.

Order No. PSC-96-0023-FOF-EI, issued January 8, 1996, in Docket No. 951433-EI, In re: Petition for Approval of Special Accounting Treatment of Expenditures Related to Hurricane Erin and Hurricane Opal by Gulf Power Company, at p. 4.

PEF correctly states that at no prior time has a question been raised about its accounting for storm-related costs. However, staff believes that this fact only bolsters the position that the methodology has indeed never been approved or in any manner been put at issue prior to the instant docket. Had the Commission intended that Order PSC-94-0852-FOF-EI give approval to PEF's methodology, staff believes that it would have expressly stated as much, and that several if not all intervenors in the instant docket would have almost certainly objected to such a decision at that time. Certainly, staff does not advocate any reading of Order PSC-94-0852-FOF-EI which would require the Commission to abrogate its authority to review the prudence and reasonableness of costs, or categories of costs, charged to a utility's storm damage reserve.

In conclusion, staff recommends that the Commission find that Order No. PSC-94-0852-FOF-EI was not intended to approve the methodology proposed in PEF's Study as the standard by which the Commission must determine which costs are appropriately charged to PEF's storm damage reserve. In Order No. PSC-94-0852-FOF-EI, the Commission did not expressly approve the methodology proposed in PEF's study, and made no finding that the methodology was "reasonable" or "appropriate" or otherwise should be used as the continuing standard for charging costs to the storm damage reserve. Staff agrees with the intervenors that PEF has failed to provide adequate justification as to why its methodology is the one which should be used in this proceeding. Staff therefore recommends that the Commission determine which costs are appropriately charged to PEF's storm damage reserve consistent with staff's recommendations in the other issues.

**Issue 27**: Should the docket be closed?

**Recommendation**: No. This docket should remain open to address the true-up of the actual storm restoration costs. The docket should be closed administratively once staff has verified that the true-up is complete. (Brubaker)

**Position of the Parties**

**PEF**: Yes.

**FIPUG**: No. The docket should remain open to enable parties and the Commission to ensure that PEF collects the appropriate amount.

**AARP/SMW**: No. The docket should remain open to enable parties and the Commission to ensure that PEF collects the appropriate amount.

**FRF**: No. The docket should remain open to ensure that PEF collects the appropriate amount of costs, as determined by the Commission, including an appropriate credit against claimed 2004 storm costs for 2005 earnings above a 10% ROE.

**Staff Analysis**: This docket should remain open to address the true-up of the actual storm restoration costs. The docket should be closed administratively once staff has verified that the true-up is complete.