

State of Florida



## Public Service Commission

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

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**DATE:** June 8, 2006

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

**FROM:** Division of Economic Regulation (Slemkewicz, Maurey, Draper, Kummer, Springer)  
Office of the General Counsel (Brubaker, Helton)

**RE:** Docket No. 060154-EI – Petition for issuance of storm recovery financing order pursuant to Section 366.8260, F.S. (2005), by Gulf Power Company.

**AGENDA:** 06/20/06 – Decision on Stipulation Prior to Hearing – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Tew

**CRITICAL DATES:** If the Commission does not approve the proposed stipulation, the parties have agreed to toll the time limitations established by Section 366.8260, Florida Statutes, by 60 days to June 22, 2006, for a decision in this matter, and July 22, 2006, for the issuance of a financing order.

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\060154.RCM.DOC  
ATTACHMENTS NOT AVAILABLE ONLINE

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### Case Background

On February 22, 2006, Gulf Power Company (Gulf or Company) initiated a proceeding before the Commission in this docket seeking either (1) a financing order pursuant to Section 366.8260, Florida Statutes, to securitize through the issuance of storm-recovery bonds (a) the

remaining balance of the stipulated recovery amount of Gulf's storm-recovery costs associated with Hurricane Ivan, (b) Gulf's storm-recovery costs associated with Hurricanes Dennis and Katrina; and (c) the addition of approximately \$70 million to Gulf's property insurance reserve; or (2) two additional surcharges designed to recover (a) Gulf's storm-recovery costs associated with Hurricanes Dennis and Katrina, and (b) the addition of approximately \$70 million to Gulf's property insurance reserve. By Order No. PSC-06-0152-PCO-EI, issued February 28, 2006, a formal evidentiary hearing on Gulf's petition was scheduled for May 31 – June 2, 2006.

On May 11, 2006, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG), the Florida Retail Federation (FRF), the AARP, and the Company filed a Stipulation and Settlement Agreement (Stipulation) to resolve the issues pending between the parties in this proceeding without the need for litigation. By Order No. PSC-06-0404-PCO-EI, issued May 12, 2006, the parties' request to toll the hearing proceedings was granted in order to afford the Commission an opportunity to consider the proposed Stipulation.

Staff and the parties met on May 26, 2006, to discuss Gulf's May 24, 2006, responses to staff questions concerning the various provisions of the Stipulation. By separate letter dated June 1, 2006, Gulf provided, on behalf of all the parties, additional clarification with regard to several provisions of the Stipulation, and addressed certain provisions of the Stipulation with which staff had expressed concern. This recommendation addresses the merits of the Stipulation and the Stipulation clarifications contained in the May 24, May 30 and June 1, 2006, letters. The Stipulation is attached hereto as Attachment A. Gulf's clarification letter, dated June 1, 2006, is attached hereto as Attachment B. Gulf's responses to staff's data requests, dated May 24, 2006, and May 30, 2006, are attached hereto as Attachment C. Exhibit No. RJMc-1 attached to the prefiled direct testimony of R. J. McMillan, filed February 22, 2006 in this docket, is attached hereto as Attachment D.

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

### **Discussion of Issues**

**Issue 1:** Should the Commission approve the implementation of the proposed Stipulation and Settlement Agreement?

**Recommendation:** Although staff has concerns regarding the interest rate specified in the Stipulation as discussed in the body of the staff analysis, the Commission should approve the implementation of the proposed Stipulation and Settlement Agreement with Paragraph 4 modified to include the streamlined formal request procedure alternative, expiration limits and other clarifications as presented in Gulf's June 1, 2006, letter. (Slemkewicz, Maurey, Draper)

**Staff Analysis:** On July 10, 2005, Hurricane Dennis struck Gulf's service territory causing widespread and extensive damage to Gulf's plant and property including its transmission lines, distribution feeders, substations and Plant Crist's cooling tower. As a result, approximately 67 percent of Gulf's customers had their electric service disrupted. On August 29, 2005, Hurricane Katrina struck Gulf's service territory causing further damage to Gulf's plant and property including its generating facilities at Plant Daniel in Mississippi. As a result, approximately 33 percent of Gulf's customers had their electric service disrupted. The total estimated jurisdictional cost for storm restoration activities for Hurricanes Dennis and Katrina was \$63.6 million. The estimated insurance reimbursements were \$900,000, leaving a jurisdictional balance of \$62.7 million of unrecovered storm restoration costs. Gulf further reduced this amount by voluntary exclusions of \$9.4 million to a net jurisdictional balance of \$53.3 million of unrecovered storm restoration costs. The calculation of these amounts is shown on Exhibit No. RJMc-1 attached to the prefiled direct testimony of R. J. McMillan, filed February 22, 2006, in this docket. (See Attachment D)

On February 22, 2006, Gulf initiated a proceeding before the Commission in this docket seeking either (1) a financing order pursuant to Section 366.8260 of the Florida Statutes to securitize through the issuance of storm-recovery bonds: (a) the remaining balance of the stipulated recovery amount of Gulf's storm-recovery costs associated with Hurricane Ivan (\$13,583,000); (b) Gulf's storm-recovery costs associated with Hurricanes Dennis and Katrina (\$54,261,000); and (c) the addition of approximately \$70 million to Gulf's property insurance reserve; or (2) two additional surcharges designed to recover (a) Gulf's storm-recovery costs associated with Hurricanes Dennis and Katrina; and (b) the addition of approximately \$70 million to Gulf's property insurance reserve.

On May 11, 2006, the parties filed a Stipulation and Settlement Agreement (Stipulation) to resolve the issues pending between the parties in this proceeding without the need for litigation. The Stipulation is attached hereto as Attachment A.

The major highlights contained in the Stipulation, as originally filed, are as follows:

- Gulf will extend the current storm cost recovery surcharge for 27 months (April 2007 through June 2009). For residential customers using 1,000 kWh, the current charge is \$2.57.
- Gulf will continue the \$3.5 million annual accrual to the storm reserve.

- Gulf's limited discretionary authority to make additional accruals to the storm reserve will continue.
- No definite amount for the replenishment of storm reserve is set.
- The unrecovered storm costs will be carried as a debit (negative) balance in the storm reserve.
- Interest will be calculated on the after-tax balance of the deficiency using a 30-day Dealer Commercial Paper rate equivalent to Gulf's actual rating as published by the Federal Reserve.
- The Storm Reserve will continue to be funded.
- Gulf would be authorized to establish, at its option, an automatic interim surcharge of up to 80 percent of the claimed storm damage costs, subject to refund, whenever cumulative storm-recovery costs in excess of \$10 million are incurred in any calendar year in perpetuity.
- Parties retain the right to contest the collection of any costs or amounts requested by Gulf in subsequent proceedings, however, parties may not protest the implementation of the interim surcharge at the time of implementation.
- Gulf retains the right to petition the Commission for cost recovery of any future damages and to replenish any storm reserve account either through securitization, surcharge, base rate relief or other cost recover mechanism.
- Gulf would be allowed to recover 50 percent of its incremental costs (travel expenses, expert witness fees, etc.) incurred with its petition for a financing order not to exceed \$300,000.
- The time limits specified by Section 366.8260, Florida Statutes, for a Commission decision and issuance of a financing order will be tolled for 60 days from June 22, 2006, (decision) and July 7, 2006 (order), respectively.
- The provisions of the Stipulation are contingent upon the approval of the Stipulation in its entirety by the Commission prior to June 30, 2006

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

Paragraph 1: This provision extends the current surcharge for all rate classes (\$2.57 per 1,000 kWh for a residential customer) for 27 months through the last billing cycle in June 2009. The current surcharge is scheduled to expire following the last billing cycle for March 2007.

Gulf estimates that the extension of the current surcharge will generate approximately \$61 million in additional revenues. The additional funds will be used first to offset the remaining Hurricane Ivan costs, then to offset the Hurricane Dennis and Hurricane Katrina costs, and any remaining funds will be used to replenish the storm reserve. Gulf will also continue its \$3.5 million annual accrual to the storm reserve. Assuming that there are no charges against the reserve, Gulf has estimated that the storm reserve balance would be \$27.9 million by June 30, 2009. This also assumes that no additional discretionary accruals are made to the storm reserve beyond the \$6 million already accrued for 2005. Extending the current surcharge through June 2009 would allow Gulf to fully recover its 2005 storm costs and end the surcharge period with a positive reserve balance.

As proposed, the Stipulation does not include any true-up provision for matching the revenues collected against any incurred costs. The extension of the surcharge is not intended to recover any specific amount of storm costs. In addition, the Stipulation does not establish any target level for the replenishment of the storm reserve. Therefore, it is not necessary to true-up the revenues. However, the \$53.3 million of 2005 storm costs are still subject to audit and review. Any resulting adjustments would be credited or debited to the reserve as appropriate.

Paragraphs 2 and 5: These provisions provide for the calculation of interest on the after-tax unrecovered deficiency in the storm reserve. The interest rate to be used is the 30-day Dealer Commercial Paper rate equivalent to Gulf's actual rating as published by the Federal Reserve. This rate differs from the Commission's usual practice of prescribing the 30-day commercial paper rate for high grade, unsecured notes sold through dealers by major corporations in multiples of \$1,000 as regularly published in the Wall Street Journal. The latter is the interest rate specified in Rule 25-6.109, Florida Administrative Code. Staff does not believe there is a compelling reason to depart from the long-standing Commission practice of using the 30-day commercial paper rate specified in Rule 25-6.109, Florida Administrative Code for the calculation of interest in the instant case. While this rate is most commonly associated with the calculation of interest for refunds, this rate has also been used in numerous other applications. Examples include the calculation of interest on fuel over and under recoveries for all electric utilities, deferred revenue associated with Tampa Electric Company's 1995 earnings sharing plan, and Florida Power & Light Company's unrecovered balance of reasonable and prudently incurred storm damage restoration costs associated with the 2004 and 2005 storm seasons.<sup>1</sup> Although the incremental difference between the interest rate proposed in the Stipulation and the interest rate specified in Rule 25-6.109, Florida Administrative Code, is minimal in the instant case at this point in time, for administrative efficiency staff believes the appropriate interest rate for the calculation of interest should be consistent with the interest rate used for all other regulatory purposes.

Paragraph 4: As originally filed, this provision provides that in the event Gulf incurs cumulative costs for storm-recovery activities in excess of \$10 million during any calendar year,

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<sup>1</sup> Order No. PSC-05-1252-FOF-EI, issued December 23, 2005, in Docket No. 050001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor; Order No. PSC-97-0436-FOF-EI, issued April 17, 1997, in Docket No. 950379-EI, In re: Investigation into earnings for 1995 and 1996 of Tampa Electric Company; Order No. PSC-06-0464-FOF-EI, issued May 30, 2006, in Docket No. 060038-EI, In re: Petition for issuance of a storm recovery financing order by Florida Power & Light Company.

Gulf, at its own option, would be able to collect, subject to refund, an interim surcharge for up to 80 percent of the claimed costs for storm-recovery activities. The interim surcharge would be implemented upon 30 days notice to Gulf's customers. For purposes of calculating the interim surcharge, Gulf can choose a recovery period of not less than 24 months and not greater than 36 months.

If the Commission approves the Stipulation as filed, Gulf would file tariff sheets with the Commission that provide the form of the notice that would be mailed to customers if Gulf implements the interim surcharge. By approving the form of the notice that would be mailed to customers, the Commission essentially allows Gulf to initiate, at a future date, an interim surcharge of an unspecified amount upon 30 days notice to its customers without further Commission review or approval.

In its responses to Staff Data Requests, Gulf and the parties clarified what information would be included in the notice to customers. The notice would include the reason for the interim surcharge (identification of the storm(s) and the estimated costs being recovered), the authority under which the interim surcharge is being implemented (reference to the approved Stipulation and Commission order), the interim surcharge by rate schedule, and the effective dates of the interim surcharge.

At the May 26, 2006 meeting with the parties, staff expressed its concerns regarding the implementation of the 80 percent interim surcharge, especially the automatic implementation of potentially numerous and concurrent surcharges as well as the perpetual nature of the approval being sought. Gulf filed a letter, dated June 1, 2006, that clarified the parties' intent concerning the implementation and operation of Paragraph 4 and presented an alternative to the pre-approval procedure for the 80 percent interim surcharge for the Commission's consideration.

Gulf provided the following clarifications and modifications regarding the implementation of the 80 percent interim surcharge in Paragraph 4:

At the outset, we wish to confirm the representations and statements of intent set forth in our letter dated May 24, 2006 containing Gulf's Responses to Staff Data Requests, subject to any further clarification or modification specifically expressed in this letter. With regard to the interim surcharge provisions of the Stipulation, it is the intent of all parties that Gulf be permitted (but not obligated) to seek authority from the Commission to implement an interim surcharge on an expedited basis whenever the threshold conditions set forth in the Stipulation are satisfied and subject to certain limitations as clarified below. Under the terms of the Stipulation, such an interim surcharge will be collected "subject to refund" during the period from its implementation until the Commission makes a final determination on Gulf's subsequent petition for a "final" or non-interim surcharge based on the same storm restoration activities that gave rise to the request for interim relief. The amount of the interim surcharge will be based on the recovery of a specified amount (over a period of not less than 24 months and not greater than 36 months) that does not exceed 80% of Gulf's estimated incremental costs for storm-recovery activities that are consistent with the criteria and guidelines contained in Exhibit A to the Ivan

Storm Costs Stipulation and Settlement Agreement approved by the Commission in Order No. PSC-05-0250-PAA-EI. For purposes of calculating the interim surcharge, Gulf is entitled to utilize estimates of its incremental incurred costs prepared by Gulf in good faith in accordance with the foregoing criteria and guidelines. In its subsequent petition for a “final” or non-interim surcharge, Gulf is not restricted by the Stipulation with regard to the methodology it may propose for identification of recoverable costs and may seek costs that do not meet the criteria and guidelines agreed to for interim purposes, nor is Gulf limited in any way by the estimates prepared for use in calculating the interim surcharge amount. Likewise, in regards to the proceedings on Gulf’s subsequent petition, the other counterparties to the Stipulation retain all rights to contest the collection of any amounts sought by Gulf.

Finally, the counterparties to the Stipulation recognize a need to address an ambiguity that exists regarding the duration of the agreement regarding expedited implementation of an interim surcharge. Towards that end, the counterparties agree that their agreement to the provisions of paragraph 4 regarding the possible implementation of an interim surcharge shall remain in effect until the earliest of: (1) the effective date of new permanent base rates for Gulf as set by the Commission; (2) the issuance of storm recovery bonds pursuant to a financing order entered by the Commission; or (3) eight years after the Commission’s acceptance and approval of the Stipulation and Settlement Agreement as a comprehensive settlement of all issues raised in Docket No. 060154-EI. By this letter, all of the counterparties to the Stipulation request that the Commission acknowledge and incorporate this provision for an expiration date in any order issued by the Commission accepting and approving the Stipulation and Settlement Agreement. In this regard, it is important to consider that the proposed settlement set forth in the Stipulation (including, specifically, the agreement to provisions for possible expedited implementation of an interim surcharge to address future storm-activity costs) is in lieu of the requested issuance of storm recovery bonds to be repaid over a period eight years that would have resulted in an immediate restoration of a positive balance in Gulf’s property insurance reserve of approximately \$80 million.

(Gulf’s June 1, 2006 clarification letter, pp. 2, 3-4)

Staff notes that Section 366.04, Florida Statutes, provides that the Commission has the jurisdiction to regulate and supervise each public utility with respect to its rates and service. Section 366.05, Florida Statutes, provides that the Commission has the power to prescribe fair and reasonable rates and charges by public utilities. Section 366.06, Florida Statutes, provides that a public utility shall not charge any rate not on file with the Commission, and that all applications for changes in rates shall be made to the Commission in writing under its rules and regulations. Furthermore, the Commission shall have the authority to determine and fix fair, just, and reasonable rates that may be charged by any public utility for its service.

Paragraph 4 of the Stipulation essentially delegates to Gulf the Commission's statutory authority for authorizing a change in rates. In staff's opinion, the parties have agreed to a stipulation provision that requires that the Commission abdicate its legislative mandate to set rates in a manner consistent with its statutes and rules. Paragraph 4 of the Stipulation would permit Gulf to automatically implement, at its sole discretion and upon notice to customers, an unspecified amount in interim charges, with no opportunity for the Commission to set limits on the amount, duration, or nature of those charges, except as provided by the Stipulation. Gulf, at its own option, can choose to implement, or not implement, the interim surcharge whenever it accumulates in excess of \$10 million in storm-recovery costs within a calendar year. Under this scenario, Gulf could implement multiple surcharges within a single calendar year that would run concurrently. The provision is silent regarding the offsetting of storm-recovery costs by any positive balance in the storm reserve before seeking recovery of accumulated costs. In its responses to the Staff Data Request, Gulf stated that it intends to defer implementation of an interim surcharge as long as a positive balance exists in the storm reserve. It should also be noted that this automatic interim surcharge provision, as originally filed, has no expiration date and would operate in perpetuity.

Gulf has stated that the automatic interim surcharge, included in its original Stipulation, is necessary to allay financial community concerns related to Gulf's decision to forego seeking the \$70 million replenishment of the storm reserve. Gulf's concern is the delay between the incurrence of the costs and the subsequent recovery of those costs.

It is staff's belief that a mechanism for seeking interim relief for the recovery of storm-recovery costs already exists. Gulf, as well as any other investor-owned electric utility, can petition the Commission to implement a storm cost recovery surcharge on an interim basis pending the review and final disposition of the storm-recovery costs. On November 19, 2004, FPL filed a petition to implement a storm surcharge subject to refund in Docket No. 041291-EI, In re: Petition for authority to recover prudently incurred storm restoration costs related to 2004 storm season that exceed storm reserve balance, by Florida Power & Light Company. Staff issued its recommendation on December 21, 2004, for consideration at the January 4, 2005 Agenda Conference. The decision to implement the interim surcharge was delayed until the January 18, 2005, Agenda Conference due to the intervenors' questioning of the Commission's authority to approve the interim surcharge. It was determined that the Commission did have the authority to approve the implementation of the interim surcharge. FPL was subsequently authorized to implement the interim surcharge effective February 17, 2005 by Order No. PSC-05-0187-PCO-EI, issued February 17, 2005.

Although it took approximately 90 days from the time that FPL filed its petition until the interim surcharge went into effect, the decision was delayed 14 days in order to resolve the questions regarding the Commission's authority. Absent that delay, the interim surcharge could have become effective in approximately 76 days. In addition, staff's initial recommendation was delayed by the necessity to respond to the various challenges to the Commission's authority. Thus, the Commission already has a vehicle available to offer Gulf the expedited interim relief it seeks, without abdicating its rate-setting authority. Upon a timely interim request by Gulf, staff would make every effort to expedite the Commission's consideration of a requested interim surcharge.



Staff recommends that the Commission not approve Paragraph 4 of the Stipulation regarding the implementation of a pre-approved automatic 80 percent interim surcharge as originally filed. The clarifications concerning the 80 percent interim surcharge have been previously discussed. However, staff recommends approval of Gulf's alternative also made in its June 1, 2006, letter:

In order to give effect to the foregoing, Gulf hereby modifies its responses to Staff Data Request items 3, 4 and 5 in our letter of May 24, 2006 to provide the following additional alternative for the Commission's consideration during its deliberations regarding whether to accept and approve the Stipulation and Settlement Agreement as requested in the joint petition submitted on May 11, 2006. As an alternative to the "pre-approval" tariff concept outlined in the May 24 letter, if it is the Commission's preference, Gulf commits that it will file a streamlined formal request for each proposed implementation of an interim surcharge under the Stipulation at the time it seeks authority to implement an interim surcharge. This streamlined formal request will contain the surcharge rate schedule(s) that will be added to the Company's Tariff for Retail Service upon the Commission's approval of Gulf's request to implement an interim surcharge under the Stipulation, a description of the factual basis for implementing the interim surcharge (i.e. information demonstrating that the threshold conditions exist and the calculation of the surcharge amount is consistent with the terms of the Stipulation), and a proposed schedule for filing a subsequent petition for either the "final" or non-interim surcharge or the entry of a financing order pursuant to Section 366.8260 of the Florida Statutes (2005). Under this alternative, in order to give effect to the intent of the parties for an expedited initiation of an interim surcharge that is subject to refund, it is hoped that the Commission and its Staff would expedite their review and consideration of the request for interim relief in recognition that full review will be available on Gulf's subsequent request for "final" or non-interim relief. If the Commission concludes that Gulf's request for interim relief is consistent with the Stipulation, it would then enter an order authorizing implementation of the interim surcharge, subject to refund, following the notice to Gulf's customers described in paragraph 4 of the Stipulation. Under either the pre-approval tariff scenario or the streamlined formal request and review scenario, the Commission would be approving interim relief and reserving for subsequent proceedings the full and complete opportunity to review Gulf's request for "final" or non-interim relief.

(Gulf's June 1, 2006 clarification letter, p. 3)

Staff does recommend approval of Paragraph 4 as modified by the clarifications and the alternative proposal included in Gulf's June 1, 2006 letter. These include the following provisions:

- Gulf will submit a streamlined formal request for each proposed implementation of an interim surcharge under the Stipulation rather than the proposed pre-approval procedure.

- The duration of the agreement regarding the expedited implementation of an interim surcharge will expire at the earliest of: (1) the effective date of new base rates set by the Commission; (2) the issuance of storm recovery bonds pursuant to a financing order entered by the Commission; or (3) eight years after the Commission's acceptance and approval of the Stipulation.

CONCLUSION: In staff's opinion, all of the provisions of the Stipulation, except for Paragraph 4 as originally filed, are a reasonable resolution of the issues regarding the impacts of Hurricane Dennis and Hurricane Katrina on Gulf's storm reserve. Staff believes that Paragraph 4, as originally filed, concerning the 80 percent interim surcharge is unnecessary and would effectively deprive the Commission of its statutory authority to review and authorize any change in Gulf's rates and charges.

However, the clarifications and the alternative presented in Gulf's June 1, 2006 letter concerning the 80 percent interim surcharge in Paragraph 4 resolve staff's concerns regarding the operation and implementation of the 80 percent interim surcharge. Therefore, staff recommends that the Commission approve the Stipulation with Paragraph 4 modified by the clarifications and the alternative presented in Gulf's June 1, 2006, letter.

Docket No. 060154-EI

Date: June 8, 2006

**Issue 2:** If the Commission approves the extension of the Ivan Deficit Cost Recovery Surcharge, should Gulf file a revision to tariff sheet No. 6.25?

**Recommendation:** Yes. (Draper)

**Staff Analysis:** The current storm recovery surcharge is shown on tariff sheet No. 6.25 and is called the Ivan Deficit Cost Recovery Surcharge. The tariff includes language stating that the purpose of the Ivan Deficit Cost Recovery Surcharge is to recover costs associated with the stipulated Hurricane Ivan expenses. If the Commission approves the Stipulation including the provision to extend the current surcharge until the last billing cycle in June 2009, Gulf should file a revised tariff sheet for administrative approval by staff to rename the surcharge, restate its purpose, and to allow for the extension of the surcharge until June 2009.

**Issue 3**: Should this docket be closed?

**Recommendation**: If the Commission does not approve the Stipulation as discussed in Issue 1, the docket should remain open, and new dates for the remaining discovery period, Prehearing Conference, Hearing, and post-hearing activities, which have been tolled for the Commission's consideration of the Stipulation, should be established by the Prehearing Officer. If the Stipulation is approved, the docket should be closed once staff has received and approved the revised tariff sheet discussed in Issue 2. (Brubaker)

**Staff Analysis**: If the Commission does not approve the Stipulation as discussed in Issue 1, the docket should remain open, and new dates for the remaining discovery period, Prehearing Conference, Hearing, and post-hearing activities, which have been tolled for the Commission's consideration of the Stipulation, should be established by the Prehearing Officer. If the Stipulation is approved, the docket should be closed once staff has received and approved the revised tariff sheet discussed in Issue 2.