

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: May 23, 2007

TO: Commission Clerk (Cole)

FROM: Division of Economic Regulation (Lewis, Bulecza-Banks, Kummer, Lee, Slemkewicz)
Office of the General Counsel (Gervasi)

RE: Docket No. 060638-EI – Petition for approval of storm cost recovery surcharge to recover costs associated with mandatory storm preparedness initiatives, by Florida Public Utilities Company.

AGENDA: 06/5/07 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060638.RCM.DOC

Case Background

On April 25, 2006, the Commission issued Order No. PSC-06-0351-PAA-EI in Docket No. 060198-EI, requiring all investor-owned electric utilities to file plans and estimated implementation costs for ten (10) ongoing storm preparedness initiatives. On May 31, 2006, Florida Public Utilities Company (“FPUC” or the “Company”) filed its response to the Order. FPUC’s response estimated the annual incremental cost associated with implementing the storm hardening initiatives at \$425,000. FPUC also stated that the incremental cost of each initiative would have a substantial financial impact on the Company. FPUC proposed that the Commission provide the Company with rate relief to reduce the financial hardship and proposed

two methods for doing so. However, Docket 060198-EI was a generic docket addressing the adequacy of the storm hardening initiatives and the implementation plans and cost estimates filed by all the investor-owned utilities (IOUs), rather than how costs would be recovered. Consequently, the cost recovery proposals that FPUC raised in its May 31, 2006 filing were not addressed at that time.

On July 14, 2006, staff met informally with FPUC and the other IOUs to discuss the storm preparedness plans that had been filed and to seek clarification where needed. Subsequent to this meeting, on July 26, 2006, FPUC made another filing which projected that the incremental cost of implementing the ten storm preparedness initiatives for a period of ten years would average approximately \$700,000. That filing made no mention of cost recovery.

On September 19, 2006, the Commission issued Orders PSC-06-0781-PAA-EI and PSC-06-0778-PAA-EU, addressing the adequacy of the IOUs plans for implementing the ten initiatives and pole inspections for ongoing storm preparedness. On September 20, 2006, FPUC filed a petition for approval of a storm cost recovery surcharge to recover costs of implementing storm preparedness initiatives. On October 19, 2006, staff held a conference call with FPUC to discuss the Company's petition and its options for seeking recovery of costs associated with storm preparedness. On October 27, 2006, FPUC filed an amended petition for recovery of costs of implementing storm preparedness initiatives, primarily requesting a limited proceeding to increase base rates in lieu of a cost recovery clause. Alternatively, FPUC requested recovery by way of a ten year surcharge, the use of storm reserve funds, or temporary deferral of storm related costs until the next rate proceeding.

The Commission held two customer meetings in FPUC's service territory to explain the amended petition and the process the Commission would use to review and make a decision on the amended petition. The meeting for the Northwest Division was held in Marianna, Florida on May 1, 2007. Five customers spoke at the meeting and expressed concern about the possibility of their electric bill increasing. Customers were also angry that FPUC had recently required them to pay an additional deposit to secure their account. Customers said that FPUC should already be performing maintenance such as tree trimming and pole inspections as normal business practices and consequently should not incur increased costs to perform these functions. Customers were also concerned that they would be paying for system upgrades in other parts of FPUC's service territory (Northeastern Division) rather than upgrades to the Marianna area (Northwestern Division).

The meeting for the Northeast Division was held in Fernandina Beach, Florida on May 2, 2007. Four customers offered comments, including the Utilities Manager for the City of Fernandina Beach. The Utilities Manager read a City Commission resolution opposing FPUC's petition to recover costs associated with mandatory storm preparedness initiatives and requesting that the Office of Public Counsel represent the City in the limited proceeding. The City Commission believes that a storm hardening plan should be developed prior to any rate increase so facilities may be relocated, replaced or otherwise protected by means other than massive tree trimming efforts. The City has formed an Underground Utilities Committee to recommend a course of action concerning overhead utility lines. The City would like to work with FPUC to develop a storm hardening plan for their community. Two customers were concerned that FPUC

would over-trim trees, “hat-rack” trim, damage heritage live oaks, or otherwise harm the aesthetic value of their community. One customer was concerned about cross-subsidization between FPUC’s two service areas and wanted assurances that any rate increase would result in equitable benefits across the divisions. The customer felt that if one geographic area was more susceptible to storms or hurricanes than another, that it was not fair to expect all customers to pay higher rates to cover the increased costs FPUC would incur to storm-harden that area. Finally, one customer, a former FPUC employee, stated that during his time with the Company it had sought to keep costs low and to maintain good customer relations.

Separate from its petition for storm hardening cost recovery, FPUC submitted a Test Year Notification letter dated April 27, 2007. The Company intends to file its Minimum Filing Requirements and testimony by September 17, 2007, utilizing a 2008 projected test year. Docket No. 070304-EI has been opened to process the forthcoming general rate increase proceeding.

The upcoming rate case provides an opportunity to examine FPUC’s storm hardening costs, thus staff’s recommendation offers some accounting treatments that would allow costs to be deferred and also addresses FPUC’s amended petition. The Commission has jurisdiction over this subject matter pursuant to Sections 366.04, 366.05, and 366.076, Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission grant one of the methods included in FPUC's October 27, 2006, amended petition for recovery of the costs of implementing storm preparedness initiatives?

Recommendation: Yes. The Commission should grant the alternative method proposed by FPUC in its October 27, 2006, amended petition to temporarily defer, with interest at the commercial paper rate, the cost of compliance with the storm preparedness initiatives mandated by the Commission in Order No. PSC-06-0351-PAA-EI. The deferred costs should be recorded in Account 186, Miscellaneous Deferred Debits, pending the determination of the final disposition of those deferred costs. (Slemkewicz, Kummer)

Staff Analysis: In its Amended Petition dated October 27, 2006, the Company primarily requested an increase in base rates through a limited proceeding. The petition also contained three alternatives to a limited proceeding that would be acceptable to the Company if the Commission did not believe a base rate increase was appropriate. Alternative (a) was a temporary ten year surcharge. Alternative (b) was the use of storm reserve funds. Alternative (c) was to allow temporary deferral of storm related costs until the next rate proceeding. Staff recommends the Commission approve the deferral approach, alternative (c). The Commission should allow temporary deferral of the storm hardening related costs until FPUC's forthcoming rate proceeding. At that time, the Commission could allow FPUC to recover these deferred costs, plus interest at the commercial paper rate, in addition to the future annual costs in base rates.

FPUC's present electric base rates have been in effect since April 15, 2004, as reflected by Order No. PSC-04-0369-AS-EI.¹ In that docket, the Commission approved revised rates for the Company based on a test year ending December 31, 2004, common equity midpoint of 11.5% and an overall rate of return of 7.86%.

As stated in the case background, FPUC submitted a Test Year Notification letter dated April 27, 2007. The Company intends to file its Minimum Filing Requirements and testimony by September 17, 2007, utilizing a 2008 projected test year. Docket No. 070304-EI has been opened to process the forthcoming general rate increase proceeding. FPUC cited the increased expenses associated with the required storm hardening, among other factors, as reasons for the rate case. Because FPUC has filed a request for a full rate case, the cost of compliance with storm preparedness initiatives mandated by the Commission should be further reviewed based on audits and expert testimonies within the scope of the rate case.

In its request for a limited proceeding, FPUC estimates that, on average, the incremental annual revenue requirement to the Company to fund the initiative is estimated to be approximately \$700,000. FPUC states that while it recognizes the importance of the initiatives and the long-term benefit to its customers and all the citizens of the State, the implementation costs to the Company are significant. These costs were not known or anticipated at the time of the last rate case and are not reflected in the rates. FPUC is a relatively small distribution

¹ Issued April 6, 2004, in Docket No. 030438-EI, In re: Petition for rate increase by Florida Public Utilities Company.

company and states that it is not able to absorb such significant incremental costs without putting the Company in severe financial stress. FPUC states that it is already earning below its allowable rate of return as of June 2006, achieving an average return of 7.40% with a midpoint of 8.14%. The mandated provisions, although beneficial, would compromise the Company's continued ability to provide customers with sufficient, efficient service and maintain an appropriate return sufficient to ensure continued availability of capital. FPUC's achieved return on equity (ROE) was 8.66% for September 2006 and 7.04% for December 2006. The Company's currently authorized ROE range is 10.50% to 12.50%.

Pursuant to the Uniform System of Accounts, deferred costs, for which the final disposition is uncertain, are to be recorded in Account 186, Miscellaneous Deferred Debits. Therefore, the deferred storm preparedness costs should be recorded in Account 186 pending the determination of the disposition of those deferred costs in the forthcoming rate case. The interest to be accrued on the deferred storm preparedness costs should be at the commercial paper rate calculated in accordance with Rule 25-6.109(4), Florida Administrative Code.

In its Amended Petition dated October 27, 2006, the Company requested an increase in base rates through a Limited Proceeding. The petition also contained three alternatives to a limited proceeding that would be acceptable to the Company if the Commission did not believe a base rate increase was appropriate. Alternative (a) was a temporary ten year surcharge. Alternative (b) was the use of storm reserve funds. Alternative (c) was to allow temporary deferral of storm related costs until the next rate proceeding. Staff recommends the Commission approve the deferral approach, alternative (c).

It is staff's belief that the deferral of the storm costs is the most appropriate approach for addressing the storm hardening costs. The Company filed a test year notification letter for a full revenue requirements rate case on April 27, 2007.² If any increase is approved under a limited proceeding, it could not go into effect until late summer. Customers would potentially be faced with three rate changes in a matter of months: once for the limited proceeding, again in January for fuel and purchased power rates, and a third time early in 2008 when the full rate case is completed. Staff believes deferral of the storm hardening costs for consideration in the full rate case is a more efficient way to address all the Company's concerns at one time. In addition, if the limited proceeding is protested, the Commission will be faced with conducting two full evidentiary hearings in a very short time frame for one company on essentially the same facts. While deferral may increase any allowed cost for storm initiatives if interest is allowed, it can be considered in the total context of the utility's operations to ensure that any offsetting benefits can also be captured. Below is a discussion on each of the options that staff rejected as non-optimal choices.

Limited proceeding - An approach seriously considered by staff is to allow recovery of storm initiative costs through a base rate increase through a limited proceeding that would only look at those specific costs. However, when the utility indicated that even with the limited proceeding increase, it would still be seeking a full revenue requirements rate case in early fall, it became apparent that holding two base rate proceedings in a relatively short time frame was inefficient

² Docket No. 070304-EI, In re: Petition for a Rate Increase by Florida Public Utilities Company.

and would result in unnecessary rate instability for customers who could see three rate increases in less than six months. In addition, considering the storm initiative costs in the context of the utility's total operations will allow capture of any ancillary benefits that might not be obvious in a limited proceeding.

10 year surcharge - One proposal is for a temporary storm cost recovery surcharge, which would be in effect for ten years or until the next rate base proceeding when the additional costs could be incorporated within base rates. Staff has two basic concerns about this approach. A ten year surcharge is not "temporary." Staff also questions how effectively the Company can project costs and usage for that time period to adequately set such a charge. As discussed above, the costs FPUC is seeking to recover are simply investment in plant and equipment and other associated matters which would normally be included in base rates in a full revenue requirements proceeding where all costs and benefits can be considered. It sets a dangerous precedent to allow a utility to recover recurring costs through a surcharge simply because the costs weren't known at the time of the utility's last rate case. To do so simply undermines the entire role of full base revenue requirements review and turns ratemaking into a "cost-plus" calculation, without consideration of the total revenue/cost picture of the utility.

Use of storm reserves - Another approach is to use the storm reserve funds to cover any incremental increase in annual recurring storm-related or preparedness costs over existing levels from the last rate proceeding. One-time expenditures and the annual return on capital costs related to storm preparedness could also be allowed recovery from storm reserves. Once the reserve is depleted, a surcharge could be implemented to recover the remaining ongoing costs, if a rate proceeding is not completed in the interim, as well as fund any possible future storm damage costs. Using storm reserves to cover the cost of ordinary investment in plant defeats the intended purpose of the reserves. Storm reserves are designed to assist the utility in restoring service after a storm. If it is depleted by ordinary investment in plant operations, there will be no reserve to deal with storms. This could result in the Company - and customers - experiencing much longer outages, or higher restoration costs.

For the forgoing reasons, staff recommends the Commission grant the alternative method proposed by FPUC in its October 27, 2006 amended petition to temporarily defer, with interest at the commercial paper rate, the cost of compliance with the storm preparedness initiatives mandated by the Commission in Order No. PSC-06-0351-PAA-EI. The deferred costs should be recorded in Account 186, Miscellaneous Deferred Debits, pending the determination of the final disposition of those deferred costs.

Docket No. 060638-EI

Date: May 23, 2007

Issue 2: Should this docket be closed?

Recommendation: Yes, if no protest is filed within 21 days of the proposed agency action order by a person whose interests are substantially affected, no further action will be required and this docket should be closed upon the issuance of a consummating order. (Gervasi)

Staff Analysis: If no protest is filed within 21 days of the proposed agency action order by a person whose interests are substantially affected, no further action will be required and this docket should be closed upon the issuance of a consummating order.