BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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.	DOCKET NO. 930405-EI ORDER NO. PSC-93-0918-FOF-EI ISSUED: June 17, 1993

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
THOMAS M. BEARD
SUSAN F. CLARK
JULIA L. JOHNSON
LUIS J. LAUREDO

ORDER AUTHORIZING SELF-INSURANCE AND RE-ESTABLISHING ANNUAL FUNDING OF STORM DAMAGE RESERVE

On April 19, 1993, Florida Power and Light Company (FPL) filed its petition to implement a self-insurance mechanism for storm damage to its transmission and distribution (T&D) system and to resume and increase annual contribution to its storm and property insurance reserve fund. Because the expiration of FPL's current T&D insurance on May 31, 1993, FPL requested consideration of its request on an emergency basis. Pursuant to notice, a hearing on FPL's petition was held on May 17, 1993.

Prior to Hurricane Andrew, FPL had a T&D insurance limit of $350 million per occurrence with a 1992 premium of $3.5 million. The new T&D coverage that has been offered to FPL consists of a $100 million annual aggregate loss limit with a minimum premium of $23 million. In addition, FPL has been exploring other options for T&D coverage such as an industry-wide insurance program through Edison Electric Institute. However, the coverage available to FPL is expected to be only $35 million. Even if FPL opted to take advantage of this coverage, it would appear to be inadequate given the estimated $270 million of T&D damage caused by Hurricane Andrew.

None of the parties disagree with the premise that FPL needs to implement some type of self-insurance program for repairing and restoring its T&D system in the event of future hurricane or other storm damage. While there might be some controversy over the exact form of the self-insurance program, the record demonstrates the

need for self-insurance and the adverse effects that Hurricane Andrew has had on FPL's efforts to obtain reasonably priced T&D insurance at an adequate level of coverage.

We believe the concept of self-insurance for FPL's T&D facilities is a reasonable approach for FPL to follow at this time. Although some level of "traditional" insurance coverage might be currently available, it does not appear to be adequate to meet FPL's needs in either price or amount. In the future, a combination of self-insurance and traditional insurance may become a viable alternative that FPL should pursue.

Accordingly, we find that FPL shall implement a self-insurance approach for the costs of repairing and restoring its transmission and distribution system in the event of hurricane or storm damage.

In its petition, FPL also asks for Commission approval to establish $300 million of lines of credit dedicated to the payment of storm related T&D damages. FPL believes that in the event of a severe storm, $300 million of lines of credit will be necessary to provide assured and immediate cash flow above the liquidity in the Storm & Property Reserve to make the repairs required to the T&D system. FPL proposes to offset the carrying costs of these lines of credit against the annual contribution to the storm damage reserve.

Because FPL's liquidity, storm damage reserve and T&D inventory will continuously vary through time, it is difficult to establish a specific amount of lines of credit for storm damage needed by FPL. The needs will vary through time depending on FPL's circumstances.

FPL will have access to lines of credit, T&D inventory, temporary cash investments, and the cash portion of the Storm & Property Damage Reserve as sources of liquidity in the event of a storm, all of which will vary through time. Therefore, we do not decide that $300 million or any other amount is the appropriate line of credit amount. The company shall have the discretion to increase or decrease the amount of any line of credit established for storm damage liquidity. Because FPL's circumstances continuously change, we find that the amount of the lines of credit shall not be the subject of pre-approval by the Commission.

We find that FPL shall resume and increase its contribution to the Storm and Property Insurance Reserve Fund by $7.1 million, net-of-tax, effective June 1, 1993. The amounts contributed to the fund shall not be reduced by the commitment fees for any dedicated lines of credit.

Rule 25-6.0143, F.A.C., "Use of Accumulated Provision Accounts 228.1, 228.2, and 228.4", states, in part, the following:

> (4)(a) The provision level and annual accrual rate ... shall be evaluated at the time of a rate proceeding and adjusted as necessary. However, a utility may petition the Commission for a change in the provision level and accrual outside a rate proceeding....
>
> (c) No utility shall fund any account ... unless the Commission approves such funding....

FPL requested and the Commission granted that FPL stop its accrual to its fund in 1991. The earnings from the fund were to continue accruing to the fund. FPL has requested that it again begin contributing amounts to its fund.

The amount of the contribution requested is $7.1 million, net-of-tax, less any commitment fees for dedicated lines of credit. The company requested that the contributions begin on June 1, 1993.

The amount of $7.1 million represents $3 million embedded in rates for the storm fund and an additional $4.1 million for the traditional T&D insurance that is embedded in rates. The $7.1 is not based upon a study that indicates the appropriate amount that should be accruing to the fund, but represents the amounts in base rates for the associated items. FPL witness Hoffman testified that the appropriate amount should be determined in a rate case in accordance with the rule.

The evidence suggests that the annual expected amount of storm damage expenses is approximately $19.5 million. However, witness Hoffman states that amount is not appropriate for the storm damage reserve since it does not take into account the amount of the reserve in place and the storm damage mechanism proposed by the Company. He further testified that a Monte Carlo simulation analysis, a probability model, needs to be performed.

We do not believe that $7.1 million, net-of-tax, is the appropriate amount to go to the fund, but the record in this expedited case does not support an amount that we believe is appropriate. We find that FPL shall submit a study indicating the appropriate amount that should be contributed to the fund annually. The study shall be filed three months from the date of the vote in this docket. Until the appropriate amount is determined, FPL should fund at the $7.1 million, net-of-tax, level beginning June 1, 1993. This is with the understanding that the amount beginning June 1, 1993 may be trued-up depending upon our findings based upon the submitted study.

From the record in this docket it is unclear what storm related expenses FPL intends draw from the reserve fund. For example it is unclear whether normal salaries would be charged to the fund if employees worked on storm related tasks. In addition, employees repairing storm damage would be required to spend time away from their everyday work tasks which would result in "catch up" expense. It is unclear from the record whether FPL intends to draw "catch up" expense from the reserve fund. The record reflects that such "catch up" expense is not recoverable under FPL's current insurance policy. In addition it is unclear whether the cost of damaged assets would be accounted for at replacement cost or net book value. For example, if there were $100 million of net book value of assets that were destroyed and it took $200 million to replace those, what accounting entries would be made?

FPL shall address these questions in the company study discussed above. The company shall also provide information concerning the treatment of all Hurricane Andrew related transmission and distribution damages under its existing policy. The company study shall include a listing of the type of storm related expenses FPL intends to draw from the reserve fund, and what type of accounting entries would be made for each item.

FPL also requested that the $7.1 million be reduced by the commitment fees associated lines of credit. FPL witness Hoffman testified that the costs for other lines of credit are run through base rates. We believe there is no reason to treat the cost of these lines of credit any differently. There are costs associated with FPL's access to the markets. Therefore we find that the commitment fees shall not be offset against the $7.1 million contributed to the storm damage reserve.

Accordingly, we find that FPL shall submit a study detailing what it believes the appropriate amount that should be annually accrued to the reserve. The company shall include in the study the costs it intends to charge to the reserve. The study shall be filed with the Commission no later than three months after the vote in this docket.

FPL seeks approval for a Storm Loss Recovery Mechanism that would guarantee 100% recovery of expense from ratepayers, over and above the base rates in effect at the time of implementation. This would effectively transfer all risk associated with storm damage directly to ratepayers, and would completely insulate the utility from risk. We decline to approve such a mechanism at this time.

FPL's cost recovery proposal goes beyond the substitution of self-insurance for its existing policy. The utility wants a guarantee that storm losses will have no effect on its earnings.

We believe it would be inappropriate to transfer all risk of storm loss directly to ratepayers. The Commission has never required ratepayers to indemnify utilities from storm damage. Even with traditional insurance, utilities are not free from this risk. This type of damage is a normal business risk in Florida.

FPL's proposal does not take into account the utility's earnings or achieved rate of return. If the company was already earning an adequate return on equity, its storm-related expenses could be amortized in whole or in part over five years. If the magnitude of the loss is great, the utility could draw on its line of credit and then petition the Commission to act quickly to allow expense recovery from ratepayers.

Storm repair expense is not the type of expenditure that the Commission has traditionally earmarked for recovery through an ongoing cost recovery clause. Conservation, oil backout, fuel and environmental costs are currently recoverable under Commission created cost recovery clauses. These expenses are different from storm repair expense in that they are ongoing rather than sporadic expenditures.

If FPL experiences significant storm-related damage, it can petition the Commission for appropriate regulatory action. In the past, the Commission has acted appropriately to allow 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, and FPL has shown no reason to believe that the Commission will require a utility to book exorbitant storm losses without recourse.

Therefore, we decline to authorize the implementation of a Storm Loss Recovery Mechanism, in addition to the base rates in effect at the time, for the recovery, over a period of five years, of all prudently incurred costs in excess of the reserve to repair or restore T&D facilities damaged or destroyed by a storm.

If a hurricane strikes, FPL can petition at that time for appropriate regulatory action. In the past, we have acted appropriately to allow recovery of prudent expenses and allowed storm damage amortization. We do not believe that regulated utilities should be required to earn less than a fair rate of return because of extraordinary events such as hurricanes or storms.

If FPL suffers storm damage and finds it necessary to draw on its lines of credit, it will be able to request that some or all of the storm related costs be passed on to the customers. In such an emergency situation, this Commission will act quickly to protect the company and its customers. FPL shall be allowed to defer the

storm damage loss until the Commission acts on any petition filed by the company.

The Commission will expeditiously review any petition for deferral, amortization or recovery of prudently incurred costs in excess of the reserve. Our vote today does not foreclose or prevent further consideration at a future date of some type of a cost recovery mechanism, either identical or similar to what has been proposed in this petition. The Commission could implement a cost recovery mechanism, or defer the costs, or begin amortization, or such other treatment as is appropriate, depending on what the circumstances are at that time.

Given our decision not to authorize implementation of a Storm Loss Recovery Mechanism, we find that the issue of whether FPL should authorized to increase customer rates if its earned return on equity is within the allowed range is moot.

Given our decision not to authorize implementation of a Storm Loss Recovery Mechanism, we find that the issue of when the five year amortization period should begin is moot.

Given our decision not to authorize implementation of a Storm Loss Recovery Mechanism, we find that the issue of how the total cost eligible for recovery should be allocated to the various rate classes is moot.

We find that it is not necessary to approve the reasonableness of FPL's estimate of future hurricane activity and related damages to reach our decision on FPL's petition.

We find that FPL shall not be required to increase its Storm and Property Insurance Reserve to recognize the annual accruals which have been included in customer rates but were suspended at the company's request beginning January 1, 1991, by Order No. 24728, entered in Docket No. 910257-EI on July 1, 1991.

Order No. 24728 issued July 1, 1991, permitted FPL to discontinue its annual charge to the Reserve Fund, effective January 1, 1991. However, the Commission required the fund's earnings to be reinvested in the fund. Office of Public Counsel witness Larkin argues that the Company should be required to increase the reserve fund level "to reflect the amounts that would have accrued to the storm and property insurance reserve fund from January 1, 1991 though the present, since ratepayers have continued to provide the amounts through rates." He states that customer rates were not decreased in any way to reflect the change and the ratepayers still continue to pay the $3 million annual amount through rates. Exhibit 9 indicates that the fund would be increased by $7,912,650 and the reserve would be increased by

$8,312,450 to restate the fund and reserve as though the charges had not been discontinued.

While it is true that customer rates were not reduced, FPL received Commission approval through an order to discontinue charging the reserve. In the order, the Commission stated that the "Reserve Fund is sufficient at its present level to cover possible losses." The decision to discontinue the accrual was based on the best information available. Since that time, it is obvious that facts and circumstances have changed. FPL shall not be required to retroactively fund the reserve.

We find that FPL shall file, at least annually, beginning with the year ended December 31, 1993 a report reflecting the company's efforts in obtaining reasonably priced T&D insurance coverage or other alternatives to replace the self-insurance approach approved in this docket.

FPL's witness Hoffman recognized that market conditions could quickly change and that reasonably priced insurance might become available: "our not taking this insurance may signal to the market that it's just not reasonable. And we may see some price movement in the not too distant future. We don't expect it during this hurricane season, but it might happen fairly quickly". Thus, the company should, on an ongoing basis, continue its efforts to obtain reasonably priced insurance from the traditional market.

Mr. Hoffman indicated that FPL is evaluating the possibility of participating in the industry wide program which may become available. The evidence suggests, that if there is any coverage available, it would begin in August of this year. It appears that the maximum amount that would be available to FPL would be about $35 million.

However, exhibit 5 shows that in the event of Category III or less storm landing only in FPL's service territory, the current reserve and $35 million in insurance would cover most of the expected damage. If this coverage proves cost-effective and available, it would diminish the risk to FPL's ratepayers. Thus, the company should continue to evaluate this option.

It is axiomatic that insurance is not an exact science. To be successful, an insurance company must, over the long term, collect premiums and earn investment income that exceed the claims paid and operating expenses incurred. The ability to do that depends on an accurate assessment of the risks assumed. FPL's analysis suggest that in the event of a Category V storm in its service area the "estimated damage" to the T&D system is approximately 422 million dollars. If this estimate is wrong or if circumstances change, the current combination of reserves and

available liquidity might not be adequate. Further, the cost-effectiveness of alternatives would be evaluated against an incorrect standard. Thus, the company should continue to evaluate and update its best estimate of the likelihood and degree of damage to its T&D system from this peril.

Mr. Hoffman recognized that the other Florida investor-owned electric utilities would face similar difficulties in obtaining reasonably priced T&D insurance when their policies expire later this year. He conceded that there could be some benefit to a cooperative risk sharing plan among the investor-owned utilities. Approaching the market for traditional insurance as a group could make an underwriter more receptive to assuming the risk. Assuming that traditional insurance continues to be unavailable or unreasonably priced, there could be considerable benefits derived from a pooled reserve and shared lines of credit approach. It could prove cost-effective over time, for all the ratepayers to fund one reserve and/or combine to obtain excess levels of coverage over the amount of the reserve. We believe this option must be fully evaluated.

Accordingly, the company shall, on an ongoing basis, evaluate alternative plans to provide protection against the risks associated with storm damage to its transmission and distribution system. The company shall file with the Commission, an annual report, beginning on January 1, 1994 addressing: 1) its efforts to obtain traditional insurance for this risk; 2) the status of the proposed industry-wide program and any decision made to participate or not to participate in that program; 3) an update of its evaluation of the company's exposure and the adequacy of the reserve; and 4) its assessment of the feasibility and cost-effectiveness of a risk sharing plan among the investor-owned electric utilities in Florida.

In consideration of the foregoing, it is

ORDERED by the Florida Public Service Commission that FPL shall be permitted to implement a self insurance approach for the costs of repairing and restoring its transmission and distribution system in the event of hurricane, storm damage or other natural disaster. It is further

ORDERED that this Commission will neither approve nor disapprove $300 million as an appropriate line of credit amount dedicated to providing liquidity for storm-related transmission and distribution system repairs. It is further

ORDERED that FPL shall resume and increase its contribution to the Storm and Property Insurance Reserve Fund by $7.1 million, net-of-tax, effective June 1, 1993. The amounts contributed to the fund shall not be reduced by the commitment fees for any dedicated lines of credit. It is further

ORDERED that FPL shall submit a study indicating the appropriate amount that should be contributed to the Storm and Property Insurance Reserve Fund annually. The company shall include in the study the types of costs it intends to charge to the reserve and information concerning the treatment of all Hurricane Andrew related transmission and distribution damages under its existing policy. The study shall be filed three months from the date of the vote in this docket. It is further

ORDERED that we decline to authorize the implementation of a Storm Loss Recovery Mechanism, in addition to the base rates in effect at the time, for the recovery, over a period of five years, of all prudently incurred costs in excess of the reserve to repair or restore T&D facilities damaged or destroyed by a storm. It is further

ORDERED that FPL shall not be required to increase its Storm and Property Insurance Reserve to recognize the annual accruals which have been included in customer rates but were suspended at the company's request beginning January 1, 1991, by Order No. 24728, entered in Docket No. 910257-EI on July 1, 1991. It is further

ORDERED that FPL shall file, at least annually, beginning January 1, 1994, a report reflecting the company's efforts in obtaining reasonably priced T&D insurance coverage or other alternatives to replace the self-insurance approach approved in this docket.

By ORDER of the Florida Public Service Commission this 17th day of June, 1993.

STEVE TRIBBLE, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.