

FLORIDA PUBLIC SERVICE COMMISSION
Capital Circle Office Center • 2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

MEMORANDUM

April 18, 1996

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF APPEALS (BELLAK) *DES RCB*
DIVISION OF RESEARCH & REGULATORY REVIEW (HEWITT) *CH*
DIVISION OF AUDITING & FINANCIAL ANALYSIS (REVELL) *DMJS*
DIVISION OF ELECTRIC & GAS (R. BASS) *RBC* *503 7/11/8 100*

RE: DOCKET NO. 951535-EI - PROPOSED REVISIONS TO RULE 25-6.0141, F.A.C., ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

AGENDA: 4/30/96 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

SPECIAL INSTRUCTIONS: I:\PSC\AFA\WP\██████████

CASE BACKGROUND

As a result of a process which included meeting with the companies and other parties on several occasions, Staff recommended certain amendments to Rule 25-6.0141, Allowance for Funds Used During Construction (AFUDC). The purpose of the amendment is to increase the threshold of project qualification in order to limit AFUDC accrual treatment to projects with a significant financial impact on the company.

In general, the companies are in favor of changes to the rule. Florida Power & Light Company (FPL), Florida Power Corporation (FPC) and Florida Public Utilities Company (FPUC) are in favor of the primary recommendation. Tampa Electric Company (TECO) is in favor of the alternative recommendation. Gulf Power Company (GULF) prefers the uniform dollar threshold of the alternative recommendation, but favors a lower threshold of \$10,000,000. Gulf also questions whether a rule change is necessary.

The original proposed rule revision was discussed at the February 6, 1996 Agenda Conference. On the basis of company comments and questions raised by several Commissioners, this matter was deferred to a later agenda in order that these concerns and questions could be addressed. Staff has made revisions to the rule in the form of a Primary and Alternate version of the rule.

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FPSC-RECORDS/REPORTING

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DISCUSSION OF ISSUES

ISSUE 1: Should the Commission propose the attached amendments included in Attachment A to Rule 25-6.0141?

PRIMARY RECOMMENDATION: Yes. The Commission should propose the amendments to Rule 25-6.0141 included in Attachment A.

ALTERNATIVE RECOMMENDATION: No. As an alternative, the Commission should propose the amendments to Rule 25-6.0141 included in Attachment B.

STAFF ANALYSIS: As a result of the February 6, 1996 Agenda Conference and continuing discussions with the parties, Staff has developed a primary recommendation and an alternative recommendation. Staff believes that both versions are superior to the current rule.

The primary version (Attachment A) states that projects eligible to accrue AFUDC are those which involve gross additions to plant in excess of 0.5 percent of the sum of the total in Accounts 101 and 106 at the time the project commences, and are expected to take in excess of one year to complete. The primary recommendation is similar to the proposed rule discussed at the February 6 Agenda with the following changes:

The one year minimum construction duration requirement in the present rule (removed in the prior proposal) has been added back. All other references to the one year construction period dropped in the original proposal have also been added back. Paragraph (1)(f) has been added to allow companies to file a petition to seek approval to include projects in rate base which would normally accrue AFUDC. Paragraph (1)(g) has been added making it clear that the Commission may exclude from rate base an amount of CWIP that does not ordinarily qualify for AFUDC treatment if it is in the best interests of the ratepayers to do so. The accrual of AFUDC would be allowed on those excluded amounts. Paragraph (8) is added to require companies to include in their Forecasted Surveillance Report a list of individual projects commencing during the period which are expected to equal or exceed a gross cost of \$10,000,000. Paragraph (9) is added allowing the companies the option to implement the rule no later than January 1, 1999, or its next rate case, whichever occurs first.

The alternative version (Attachment B) states that eligible projects are those which involve gross additions to plant in excess of \$15,000,000 and are expected to take in excess of one year to

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complete. Paragraph (1)(f), as referred to in the above paragraph, is also included here. Paragraph (1)(g) has been added to allow a utility with less than \$100,000,000 gross plant in service to seek approval to accrue AFUDC on projects which would not otherwise qualify for AFUDC treatment. At the current time, this paragraph only applies to Florida Public Utilities Company. Paragraph (1)(h), identical to paragraph (1)(g) in the primary version above, is also included. Paragraph (8) is added allowing the companies the option to implement the rule no later than January 1, 1999, or its next rate case, whichever occurs first.

During the February 6, 1996 agenda several questions were raised concerning the recommended changes. The following discussion addresses the questions.

(1) A question was raised concerning whether there was a need to change the rule at all since, in one company's opinion, the current rule was operating well. However, Staff believes that the changing realities of the industry and the marketplace require changes in this rule.

In 1972, Docket 72609-PU was opened to determine the appropriate accounting treatment for construction in the electric industry, and specifically to determine if any changes needed to be made to the Commission's accounting treatment of AFUDC that had been in place since 1962. Companies then had the option of charging AFUDC and not including CWIP in rate base, or including CWIP in rate base and not charging AFUDC. At that time, several utilities had large construction programs underway, including nuclear plants, with lead times as long as 10 years. In the order which came out of that docket, the Commission chose to retain the provision that the change from one method to the other could be made only with Commission approval during a rate case proceeding.

The rule has undergone several revisions since that time. The present rule requires that projects costing over \$25,000 and taking one year or more to complete may accrue AFUDC; projects not meeting these criteria may not accrue AFUDC. The original discretion to accrue AFUDC or add it immediately to rate base was removed. Staff believes that a \$25,000 floor for the accrual of AFUDC is too low, and probably should have been greater than this amount to begin with. As stated previously, the purpose of these amendments is to raise the threshold for project qualification to larger projects which are material in nature and that would have a significant financial impact on the company. The \$25,000 floor is not a material amount for the major companies. Staff's proposals raise the AFUDC accrual floor to amounts which are material. A higher

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amount will be more consistent with Generally Accepted Accounting Principals (GAAP). Higher project limits for the accrual of AFUDC will have the effect of lowering total project costs included in rate base. This will benefit all ratepayers in the long-term since a lower rate base lessens the companies' revenue requirements and ultimately will result in lower rates.

It has been argued that two projects built by two separate companies should cost the same and that changes in the AFUDC rule will cause the costs to vary. It is true that accrual of AFUDC increases the total capitalized plant; however, the dollar amounts expended are the same. The company expends the amount currently, rather than deferring capital costs and recovering them over the life of the asset. This is only one of many costs that will vary between any two companies. The capital costs, the labor costs, and material costs may vary significantly. While it would be ideal for two identical plants to cost the same amount, in reality, they will not. AFUDC is only one more component that will vary. It should be pointed out that each utility has its own unique AFUDC rate.

Competition has been raised as an issue. Florida does not currently have retail competition. The shape and form of restructuring is unknown to the industry. What is known is that it is important to get regulated costs comparable to the true economic costs. These changes to the AFUDC rule are a positive step in that direction. At the time the changes are known, all rules will have to be evaluated to determine their applicability.

(2) Another question was raised regarding the allocation factors used to separate retail and wholesale projects for surveillance purposes. In general, costs which cannot be directly assigned to either wholesale or retail are separated between jurisdictions on the basis of proportional MW load. Timely updates of these factors can be important. If the proportion of total load being sold as wholesale changes, and the separations factors are not updated, too much or too little cost can be allocated to the retail jurisdiction for surveillance purposes. At the current time, the investor-owned utilities use separation studies conducted at varied times to allocate plant-in-service accounts. Staff currently is reviewing the frequency of and the method used by each utility to develop allocation factors.

(3) Another concern of the Commission with regard to Staff's original proposal was that with the changed accrual levels of AFUDC, projects which would have previously accrued AFUDC before going into rate base would now go straight into rate base and would not be subject to Commission review. The final determination of

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the prudence of projects has always rested with the Commission. This is not changed under Staff's new proposals. The Commission will retain its ability to review any or all projects during or after construction for prudence.

Our recommendation that projects under 0.5 percent of rate base not accrue AFUDC but be included immediately in rate base, means that Florida Power & Light, for example, would be able to include projects as large as approximately \$79,000,000 in rate base as constructed. A project of this size is not material from an accounting standpoint for a company with a gross plant in service exceeding \$15 billion. It was pointed out, however, that it still represents a great deal of money and should have some sort of Commission review. In order to make clear the Commission's intent, Staff has included new language in both the primary and the alternative proposal to address this. Paragraph (1)(g) in the primary version of the proposed rule, and paragraph (1)(h) in the alternative version of the proposed rule, state that, on a prospective basis, the Commission may on its own motion determine that a certain portion of CWIP should be excluded from rate base and allow the utility to accrue AFUDC on the excluded portion. Staff believes that this paragraph and the reporting requirement of paragraph (1)(f) in both versions of the rule give the Commission the ability to monitor these significant projects.

(4) A question was raised whether allowing large projects in rate base over the construction period, rather than all at once at the completion of the project, as is the case with projects which accrue AFUDC, would give companies the opportunity to hide overearnings. This is a possibility, but would be highly unlikely to happen in practice. A project of \$80,000,000, in the case of FP&L would require much detailed planning, construction bids, and in the majority, if not all cases, would require more than a year in construction time. Such a project would qualify for AFUDC treatment under the existing rule. To severely impact earnings, a project would have to be completed in an extremely short period of time. In FP&L's case, such a project would impact the return on equity by approximately 16 basis points. This approximates an \$11,200,000 effect on earnings. A much easier way for a utility to avoid an overearning situation is to increase maintenance expenses. This requires far less planning, can usually be started sooner, and has a dollar for dollar effect on earnings.

(5) Another question raised concerned current ratepayers paying for projects which will benefit future ratepayers. This could occur if large amounts of CWIP which will not be in service for a long period of time were included in rate base. Increasing

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the floor from \$25,000 to 0.5 percent of gross plant as recommended in the primary recommendation, or \$15,000,000 of gross plant as proposed in the alternative recommendation, would result in more projects being included in rate base. However, large, long term projects, such as power plants, will still accrue AFUDC unless the Commission specifically approves inclusion in rate base. Not all construction is solely for the benefit of future ratepayers. There are many projects which are built in order to increase the reliability of service or replace aging or obsolete equipment and facilities. In some cases, facilities in high growth areas reach capacity and must be expanded.

Currently, projects, such as Gulf's Continuous Emission Monitors project at Plant Daniel, that are classified as CWIP and accrue AFUDC, are recovered on an on-going basis through a cost recovery clause when they are classified as plant in service. The capital costs associated with CWIP that does not accrue AFUDC is recovered during construction. Under the rule change, the impact of larger construction projects will be phased-in by capital costs being recovered on a more current basis.

The increase in rate base caused by larger amounts of CWIP would not result in increased rates until a company filed a rate case. In the interim, however, increases in rate base due to CWIP would have the effect of reducing earnings. Staff does not believe this will be a major problem. Staff also believes that the advantages to the ratepayers through lower rates over time than they otherwise would be, and the better competitive position this revised rule will place the utilities in, outweighs the possibility that some present ratepayers will pay for future facilities that may be placed in service after they leave the system.

Economic Impact Statement

As indicated by the attached EIS, we foresee no increased staff workload, and no additional direct costs to other state or local governmental entities. We anticipate no direct impact on small business, and no impacts on the ability of any of the utilities to compete. Florida Power & Light Company believes that the proposed amendment will generate a competitive benefit for the Company and reduce the potential for stranded investment from future construction. The amendment is not expected to affect the level of employment at these companies.

Gulf Power Company believes that the timing of a project's inclusion in rate base will impact future earnings, in that a higher threshold for AFUDC accrual would force the Company to

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absorb the carrying costs of projects prior to the in-service date. For this reason, the Company is in favor of a \$10,000,000 threshold for accrual. Tampa Electric Company (TECO) states that if projects are included in rate base the Company would not recover the associated revenue requirement until it filed for a rate increase. TECO favors a threshold of \$15,000,000 for accrual. Florida Power & Light Company and Florida Power Corporation support the 0.5 percent threshold for AFUDC accrual. Florida Power & Light Company indicated that the amendments would reduce administrative costs. Florida Power Corporation does not expect a significant change in administrative costs unless separate FPSC (retail) and Federal Energy Regulatory Commission (wholesale) books must be maintained.

In summary, Staff believes that the present minimum of \$25,000 for AFUDC accrual is too low and should be increased. We also believe that it should be a minimum based on the size of each utility. For that reason we support the Primary version of the rule.

ISSUE 21: If no responses for hearing are received or comments filed, should the attached rule amendments be sent to the Secretary of State for adoption and this docket closed?

PRIMARY RECOMMENDATION: Yes.

PRIMARY

25-6.0141 Allowance For Funds Used During Construction.

(1) Construction work in progress (CWIP) or nuclear fuel in process (NFIP) not under a lease agreement that is not included in rate base may accrue allowance for funds used during construction (AFUDC), under the following conditions:

(a) Eligible projects. The following projects may be included in CWIP or NFIP and accrue AFUDC:

1. Projects that involve gross additions to plant in excess of 0.5 percent of the sum of the total balance in Account 101 - Electric Plant in Service, and Account 106. Completed Construction not Classified, at the time the project commences \$25,000 and
 - a. are expected to be completed in excess of one year after commencement of construction, or
 - b. were originally expected to be completed in one year or less and are suspended for six months or more, or are not ready for service after one year.

(b) Ineligible projects. The following projects may be included in CWIP or NFIP, but may not accrue AFUDC:

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1. Projects, or portions thereof, that do not exceed the level of CWIP or NFIP included in rate base in the utility's company's last rate case.
2. Projects where gross additions to plant are less than 0.5 percent of the sum of the total balance in Account 101 - Electric Plant in Service, and Account 106 - Completed Construction not Classified, at the time the project commences \$25,000 or less.
3. Projects expected to be completed in less than one year after commencement of construction.
4. Property that has been classified as Property Held for Future Use.

(c) Unless otherwise authorized by the Commission, the following projects may not be included in CWIP or NFIP, nor accrue AFUDC:

1. Projects that are reimbursable by another party.
2. Projects that have been cancelled.
3. Purchases of assets which are ready for service when acquired.
4. Portions of projects providing service during the construction period.

(d) Other conditions. Accrual of AFUDC is subject to the following conditions:

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1. Accrual of AFUDC is not to be reversed when a project originally expected to be completed in excess of one year is completed in one year or less;
2. AFUDC may not be accrued retroactively if a project expected to be completed in one year or less is subsequently suspended for six months, or is not ready for service after one year;
3. When a project is completed and ready for service, it shall be immediately transferred to the appropriate plant account(s) or Account 106, Completed Construction Not Classified, and may no longer accrue AFUDC;
4. Where a work order covers the construction of more than one property unit, the AFUDC accrual shall cease on the costs related to each unit when that unit reaches an in-service status;
5. When the construction activities for an ongoing project are expected to be suspended for a period exceeding six (6) months, the utility shall notify the Commission of the suspension and the reason(s) for the suspension, and shall submit a proposed accounting treatment for the suspended project; and

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6. When the construction activities for a suspended project are resumed, the previously accumulated costs of the project may not accrue AFUDC if such costs have been included in rate base for ratemaking purposes. However, the accrual of AFUDC may be resumed when the previously accumulated costs are no longer included in rate base for ratemaking purposes.

(e) Subaccounts. Account 107, Construction Work in Progress, and Account 120.1, Nuclear Fuel in Process of Refinement, Conversion, Enrichment and Fabrication, shall be subdivided so as to segregate the cost of construction projects that are eligible for AFUDC from the cost of construction projects that are ineligible for AFUDC.

(f) Prior to the commencement of construction on a project, a utility may file a petition to seek approval to include an individual project in rate base that would otherwise qualify for AFUDC treatment per Section (1)(a).

(g) On a prospective basis, the Commission, upon its own motion, may determine that it is in the best interests of the ratepayers to exclude an amount of CWIP from a utility's rate base that does not qualify for AFUDC treatment per Section (1)(a) and to allow the utility to accrue AFUDC on that excluded amount.

(2) The applicable AFUDC rate shall be determined as follows:

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(a) The most recent 13-month average embedded cost of capital, except as noted below, shall be derived using all sources of capital and adjusted using adjustments consistent with those used by the Commission in the utility's ~~Company's~~ last rate case.

(b) The cost rates for the components in the capital structure shall be the midpoint of the last allowed return on common equity, the most recent 13-month average cost of short term debt and customer deposits and a zero cost rate for deferred taxes and all investment tax credits. The cost of long term debt and preferred stock shall be based on end of period cost. The annual percentage rate shall be calculated to two decimal places.

~~(c) The treatment by the Commission of all investment tax credits at a zero cost rate shall be contingent upon a ruling from the Internal Revenue Service that such treatment will not, for companies elected to be treated under s. 46(f) (2) of the Internal Revenue Code, result in the forfeiture of the tax credits. Pending receipt of such a ruling, each utility shall continue to use the weighted overall cost of capital calculated in a manner consistent with the final IRS Regulation Section 1.46-6 published May 22, 1986, as the cost of the utility's 4% and 10% investment tax credits.~~

~~(d) Any such ruling request must be submitted to the Commission by December 15, 1987. The AFUDC cost rate for the investment tax credit for any company which fails to submit its own~~

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~~letter ruling request to the IRS shall be governed by the first letter ruling issued by the IRS in response to a request submitted pursuant to subsection 2(c) of this rule.~~

(3) Discounted monthly AFUDC rate. A discounted monthly AFUDC rate, calculated to six decimal places, shall be employed to insure that the annual AFUDC charged does not exceed authorized levels.

(a) The formula used to discount the annual AFUDC rate to reflect monthly compounding is as follows:

$$M = [(1 + \frac{A}{100})^{1/12} - 1] \times 100$$

100

Where:

M = discounted monthly AFUDC rate

A = Annual AFUDC rate

(b) The monthly AFUDC rate, carried out to six decimal places, shall be applied to the average monthly balance of eligible CWIP and NFIP that is not included in rate base.

(4) The following schedules shall be filed with each petition for a change in AFUDC rate:

(a) Schedule A. A schedule showing the capital structure, cost rates and weighted average cost of capital that are the basis for the AFUDC rate in subsection (2).

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(b) Schedule B. A schedule showing capital structure adjustments including the unadjusted capital structure, reconciling adjustments and adjusted capital structure that are the basis for the AFUDC rate in subsection (2).

(c) Schedule C. A schedule showing the calculation of the monthly AFUDC rate using the methodology set out in this Rule.

(5) No utility may charge or change its AFUDC rate without prior Commission approval. The new AFUDC rate shall be effective the month following the end of the 12-month period used to establish that rate and may not be retroactively applied to a previous fiscal year unless authorized by the Commission.

(6) Each utility charging AFUDC shall include in its ~~June and December~~ Earnings Rate-of-Return Surveillance Reports to the Commission Schedules A and B identified in subsection (4) of this Rule, as well as disclosure of the AFUDC rate it is currently charging.

(7) The Commission may, on its own motion, initiate a proceeding to revise a utility's AFUDC rate.

(8) Each utility shall include in its Forecasted Surveillance Report a schedule of individual projects that commence during that forecasted period and that are estimated to equal or exceed a gross cost of \$10,000,000. The schedule shall include the following minimum information:

(a) Description of the project.

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(b) Estimated total cost of the project.

(c) Estimated construction commencement date.

(d) Estimated in-service date.

(9)(b) The provisions of this rule are effective January 1, 1996 and shall be implemented by all electric utilities no later than January 1, 1999, or the utility's next rate proceeding, whichever occurs first. Paragraphs (a) and (b) of subsection (1) shall not be effective for any utility until it implements final rates in a general rate case initiated after the effective date of this Rule. The foregoing notwithstanding, those provisions will become effective for all utilities no later than January 1, 1989.

Specific Authority: 350.127(2), 366.05(1), F.S.

Law Implemented: 350.115, 366.04(2)(a), 366.06(1), F.S.

History: New 8/11/86, Amended 11/13/86, 12/7/87, _____.

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ALTERNATIVE

25-6.0141 Allowance For Funds Used During Construction.

(1) Construction work in progress (CWIP) or nuclear fuel in process (NFIP) not under a lease agreement that is not included in rate base may accrue allowance for funds used during construction (AFUDC), under the following conditions:

(a) Eligible projects. The following projects may be included in CWIP or NFIP and accrue AFUDC:

1. Projects that involve gross additions to plant in excess of \$15,000,000 ~~25,000~~ and
 - a. are expected to be completed in excess of one year after commencement of construction, or
 - b. were originally expected to be completed in one year or less and are suspended for six months or more, or are not ready for service after one year.

(b) Ineligible projects. The following projects may be included in CWIP or NFIP, but may not accrue AFUDC:

1. Projects, or portions thereof, that do not exceed the level of CWIP or NFIP included in rate base in the utility's ~~company's~~ last rate case.

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2. Projects where gross additions to plant are \$15,000,000 ~~25,000~~ or less.
3. Projects expected to be completed in less than one year after commencement of construction.
4. Property that has been classified as Property Held for Future Use.

(c) Unless otherwise authorized by the Commission, the following projects may not be included in CWIP or NFIP, nor accrue AFUDC:

1. Projects that are reimbursable by another party.
2. Projects that have been cancelled.
3. Purchases of assets which are ready for service when acquired.
4. Portions of projects providing service during the construction period.

(d) Other conditions. Accrual of AFUDC is subject to the following conditions:

1. Accrual of AFUDC is not to be reversed when a project originally expected to be completed in excess of one year is completed in one year or less;
2. AFUDC may not be accrued retroactively if a project expected to be completed in one year or less is

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- subsequently suspended for six months, or is not ready for service after one year;
3. When a project is completed and ready for service, it shall be immediately transferred to the appropriate plant account(s) or Account 106, Completed Construction Not Classified, and may no longer accrue AFUDC;
 4. Where a work order covers the construction of more than one property unit, the AFUDC accrual shall cease on the costs related to each unit when that unit reaches an in-service status;
 5. When the construction activities for an ongoing project are expected to be suspended for a period exceeding six (6) months, the utility shall notify the Commission of the suspension and the reason(s) for the suspension, and shall submit a proposed accounting treatment for the suspended project; and
 6. When the construction activities for a suspended project are resumed, the previously accumulated costs of the project may no accrue AFUDC if such costs have been included in rate base for ratemaking purposes. However, the accrual of AFUDC may be resumed when the previously accumulated

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costs are no longer included in rate base for ratemaking purposes.

(e) Subaccounts. Account 107, Construction Work in Progress, and Account 120.1, Nuclear Fuel in Process of Refinement, Conversion, Enrichment and Fabrication, shall be subdivided so as to segregate the cost of construction projects that are eligible for AFUDC from the cost of construction projects that are ineligible for AFUDC.

(f) Prior to the commencement of construction on a project, a utility may file a petition to seek approval to include an individual project in rate base that would otherwise qualify for AFUDC treatment per Section (1)(a).

(g) Prior to the commencement of construction on a project, a utility with less than \$100,000,000 gross plant in service (the sum of the total balance in Account 101 - Electric Plant in Service, and Account 106 - Completed Construction Not Classified) may file a petition to seek approval to accrue AFUDC on an individual project that exceeds a gross cost of \$250,000 that would not otherwise qualify for AFUDC treatment per Section (1)(a).

(h) On a prospective basis, the Commission, upon its own motion, may determine that it is in the best interests of the ratepayers to exclude an amount of CWIP from a utility's rate base that does not qualify for AFUDC treatment per Section (1)(a) and to allow the utility to accrue AFUDC on that excluded amount.

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(2) The applicable AFUDC rate shall be determined as follows:

(a) The most recent 13-month average embedded cost of capital, except as noted below, shall be derived using all sources of capital and adjusted using adjustments consistent with those used by the Commission in the utility's ~~Company's~~ last rate case.

(b) The cost rates for the components in the capital structure shall be the midpoint of the last allowed return on common equity, the most recent 13-month average cost of short term debt and customer deposits and a zero cost rate for deferred taxes and all investment tax credits. The cost of long term debt and preferred stock shall be based on end of period cost. The annual percentage rate shall be calculated to two decimal places.

~~(c) The treatment by the Commission of all investment tax credits at a zero cost rate shall be contingent upon a ruling from the Internal Revenue Service that such treatment will not, for companies elected to be treated under s. 46(f) (2) of the Internal Revenue Code, result in the forfeiture of the tax credits. Pending receipt of such a ruling, each utility shall continue to use the weighted overall cost of capital calculated in a manner consistent with the final IRS Regulation Section 1.46-6 published May 22, 1986, as the cost of the utility's 4% and 10% investment tax credits.~~

~~(d) Any such ruling request must be submitted to the Commission by December 15, 1987. The AFUEC cost rate for the~~

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~~investment tax credit for any company which fails to submit its own letter ruling request to the IRS shall be governed by the first letter ruling issued by the IRS in response to a request submitted pursuant to subsection 2(c) of this rule.~~

(3) Discounted monthly AFUDC rate. A discounted monthly AFUDC rate, calculated to six decimal places, shall be employed to insure that the annual AFUDC charged does not exceed authorized levels.

(a) The formula used to discount the annual AFUDC rate to reflect monthly compounding is as follows:

$$M = \left\{ (1 + \frac{A}{100})^{1/12} - 1 \right\} \times 100$$

100

Where:

M = discounted monthly AFUDC rate

A = Annual AFUDC rate

(b) The monthly AFUDC rate, carried out to six decimal places, shall be applied to the average monthly balance of eligible CWIP and NFIP that is not included in rate base.

(4) The following schedules shall be filed with each petition for a change in AFUDC rate:

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(a) Schedule A. A schedule showing the capital structure, cost rates and weighted average cost of capital that are the basis for the AFUDC rate in subsection (2).

(b) Schedule B. A schedule showing capital structure adjustments including the unadjusted capital structure, reconciling adjustments and adjusted capital structure that are the basis for the AFUDC rate in subsection (2).

(c) Schedule C. A schedule showing the calculation of the monthly AFUDC rate using the methodology set out in this Rule.

(5) No utility may charge or change its AFUDC rate without prior Commission approval. The new AFUDC rate shall be effective the month following the end of the 12-month period used to establish that rate and may not be retroactively applied to a previous fiscal year unless authorized by the Commission.

(6) Each utility charging AFUDC shall include in its ~~June and December Earnings Rate of Return Surveillance Reports~~ to the Commission Schedules A and B identified in subsection (4) of this Rule, as well as disclosure of the AFUDC rate it is currently charging.

(7) The Commission may, on its own motion, initiate a proceeding to revise a utility's AFUDC rate.

(8) The provisions of this rule are effective January 1, 1996 and shall be implemented by all electric utilities no later than January 1, 1999, or the utility's next rate proceeding, whichever

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ATTACHMENT B

~~occurs first. Paragraphs (a) and (b) of subsection (1) shall not be effective for any utility until it implements final rates in a general rate case initiated after the effective date of this Rule. The foregoing notwithstanding, those provisions will become effective for all utilities no later than January 1, 1989.~~

Specific Authority: 350.127(2), 366.05(1), P.S.

Law Implemented: 350.115, 366.04(2)(a), 366.06(1), P.S.

History: New 8/11/86, Amended 11/13/86, 12/7/87, _____.

CODING: Words underlined are additions; words in ~~struck through~~ type are deletions from existing law.

M E M O R A N D U M

March 29, 1996

TO: DIVISION OF APPEALS (BELLAK)
FROM: DIVISION OF RESEARCH AND REGULATORY REVIEW (HENITT) *CBH P D DMH*
SUBJECT: REVISED ECONOMIC IMPACT STATEMENT; PROPOSED REVISIONS TO RULE 25-6.0141, FAC, ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

SUMMARY OF THE RULE

Currently Rule 25-6.0141, FAC, Allowance for Funds Used During Construction (AFUDC), describes the criteria for determining whether a project could be included in construction work in progress (CWIP) or nuclear fuel in process (NFIP) and qualified for accrual of AFUDC. These criteria include a minimum project cost (\$25,000) and a construction period in excess of one year.

The proposed amendments would change the cost criterium from a minimum dollar amount of \$25,000 to projects which exceed 0.5% (Primary Recommendation) of the sum in Account 101--Electric Plant in Service, and Account 106--Completed Construction not Classified; or, projects which exceed a gross addition to plant of \$15,000,000 (Alternative Recommendation). Also, projects under a lease agreement would be excluded from accruing AFUDC.

The purpose of the amendments is to increase the cost threshold of a project which will qualify for accrual of AFUDC so that projects will only qualify if there will be a significant financial impact on the company. The rule also clarifies that a utility may seek approval to include a project in rate base that would otherwise qualify for AFUDC accrual.

Under current Rule 25-6.0141(2)(c) and (d), FAC, the Commission's treatment of investment tax credits (ITC) at a zero cost rate is contingent upon an IRS ruling under Section 46(f)(2) of the Internal Revenue Code. All ITC ruling requests were to have been sent to the Commission by December 15, 1987. Since that deadline for submission has passed, the proposed amendment would delete the outdated information from the rule, and thus comply with efforts to eliminate unnecessary or obsolete rules.

Also, prior to the commencement of construction on a project, a utility would be able file a petition to seek approval to include the project in rate

base that would otherwise qualify for AFUDC treatment under Section (1)(a).

In the Alternative Recommendation a utility with less than \$100,000,000 gross plant in service would be able file a petition to seek approval to include the project in rate base that would not otherwise qualify for AFUDC treatment under Section (1)(a). The petition would have to be filed prior to the commencement of construction on a project that exceeds a gross cost of \$250,000.

The Primary Recommendation proposes that each utility shall include in its Forecasted Surveillance Report a schedule of projects that commence during that forecasted period which would equal or exceed a gross cost of \$10,000,000. Also required would be some minimum information about the project.

Finally, the proposed amendment states that the provisions of the rule are effective January 1, 1996, and allows a grace period for implementing the provisions by January 1, 1999, or the Company's next rate proceeding, whichever occurs first.

DIRECT COSTS TO THE AGENCY AND OTHER STATE OR LOCAL GOVERNMENT ENTITIES

The proposed amendment allows a utility to file a petition to seek approval to include a project in rate base that would otherwise qualify for AFUDC treatment. Commission staff would evaluate those petitions on a case-by-case basis. The proposed amendment is not expected to significantly increase workload for Commission staff since such petitions are expected to be rare. There should be no additional direct costs to other state or local governmental entities since the changes apply only to Investor-Owned Utilities.

COSTS AND BENEFITS TO THOSE PARTIES DIRECTLY AFFECTED BY THE RULE

The proposed amendments would result in more stringent eligibility requirements, allowing fewer construction projects to be eligible to accrue AFUDC. This should reduce administrative costs associated with the determination and calculation of eligible AFUDC expenses. There would be some slight additional costs associated with providing information on the Forecasted Surveillance Report about planned projects that exceed \$10,000,000.

The increased threshold for AFUDC would impact rate base by not allowing the inclusion of construction interest in rate base as frequently. Rate base would not be as large with the proposed amendment, because less accrued interest will ultimately be included. Less accrued AFUDC interest in rate base will

result in less depreciation for those projects which will impact net income. Less AFUDC interest in rate base will also result in less AFUDC earnings. With the higher threshold, projects that are not eligible to accrue AFUDC will be included in CWIP; and, for surveillance purposes, included in rate base during the construction period. AFUDC projects are not included in rate base until the construction project is completed.

Projects not eligible to accrue AFUDC during construction can be included in rate base for surveillance purposes, resulting in a lower achieved rate of return during the construction period than if the project were excluded from rate base. For those projects which are eligible to accrue AFUDC, the project costs plus the accrued interest are included in rate base once the construction period is over. In this instance, the achieved rate of return is also lowered, but only after construction is completed.

A company's future earnings on rate base will be impacted by the timing of a project's inclusion in rate base and whether the project cost includes accrued AFUDC. Gulf Power Company (Gulf) indicated that the company will have to "absorb the carrying costs of these projects prior to their in-service dates, and could result in significant harm." Tampa Electric Company (TECO) expressed concern that even if a project is included in rate base, the company will not recover the associated revenue requirement until it has another rate change. However, in order to prepare for competition, the electric companies are not currently requesting rate increases. Data requests were sent to the affected investor-owned electric utilities (IOUs) with both the Primary Rule and Alternative Rule proposals. The Primary Rule contains a 0.5% threshold level of the sum total in the Electric Plant in Service--Account 101 and Completed Construction not Classified--Account 106, above which projects would be allowed to accrue AFUDC. The Alternative Rule proposal contains a fixed amount of \$15,000,000 for the threshold level before a project would be allowed to accrue AFUDC.

Florida Power and Light (FPL) favors reducing the amount of AFUDC capitalized and states that the proposed primary rule changes "are appropriate and will streamline the accounting and budgeting process and reduce costs to FPL's customers." But, FPL thinks that the previously proposed percentage threshold of 1% would be better. The most significant cost to FPL would be the impact on shareholders that would result from the proposed rule changes because reducing the amount of AFUDC capitalized would reduce FPL's earnings (net

income). Under the current AFUDC rule and 1995 construction projects, FPL has \$14,825,000 capitalized, with \$12,389,000 earnings. With a \$15,000,000 threshold, AFUDC capitalized would be \$9,149,000 and \$7,646,000 earnings. With a 0.5% threshold, AFUDC capitalized would be \$8,806,000 and \$7,359,000 earnings.

Reducing the amount of AFUDC capitalized would reduce both the potential for stranded investment from future construction and the upward pressure on future revenue requirements. That is, higher capitalization of AFUDC increases potential earnings but increases the risk of not being able to compete in the future. FPL does not expect any increases in administrative costs from the proposed changes. However, if the alternative rule is adopted, FPL's potential cost to petition the Commission to include a project in rate base would increase because more projects would qualify for AFUDC.

Florida Public Utilities Company and TECO do not expect an increase in administrative costs from the proposed rule amendments. TECO indicated that a \$15,000,000 threshold would be a more reasonable compromise. Gulf does not expect additional operating and management costs. However, Gulf indicated that it would have a reduction in AFUDC earnings with the increase in threshold from \$25,000 to 0.5% of the relevant accounts. It stated that the 0.5% threshold would be inappropriate and if the rule has to be changed, it should be a uniform fixed dollar amount (\$10,000,000). One \$10,000,000 project in CWIP for one year would result in \$727,000 of AFUDC for Gulf and would affect its return on average common equity (based on the current approved rate) by approximately 15 basis points. Gulf indicated, however, that it is not sure any change is required at this time.

Florida Power Corporation (FPC) does not expect any significant change in costs to result from the adoption of the proposed rule revision, unless it is determined that separate books must be maintained for Florida Public Service Commission (retail) and the Federal Regulatory Commission (wholesale) jurisdictions. However, FPC estimated that if the proposed rule revisions of 0.5% or \$15,000,000 thresholds were implemented, the Company would have recorded a \$2.8 million reduction of AFUDC (based on 1995 activity).

The proposed amendments to the language regarding investment tax credits do not benefit or cost the utilities since the companies have not been required to request an IRS ruling since 1987.

REASONABLE ALTERNATIVE METHODS

Reasonable alternative methods are proposed with the primary and alternative rule recommendations.

Gulf expressed concern over the administrative costs of having to calculate the balance of "Electric Plant in Service/Completed Construction not Classified" each month. The company suggests that, since an eligible project's criteria would require a calculation of the Electric Plant balance, the criteria should be based on prior year-end balances. This would save the administrative costs of making the calculation on a monthly basis.

TECO makes a suggestion regarding the concern that an increase in rate base will not be recovered with an appropriate return. The company suggests that the:

. . . implementation of the new calculation method should be required at the time of each company's next price change. This would ensure that each utility will be able to adequately recover the expenditures required to maintain and expand the system that provides reliable electric service to all ratepayers.

FPC proposes that Nuclear Fuel eligible for AFUDC should be qualified in a separate manner than the proposed amendment. FPC asserts that if the cost of a batch of Nuclear Fuel equals or exceeds the percent threshold of the balance in Account 120.3--Nuclear Fuel Assemblies in Reactor, at the time the batch procurement commences, it should be eligible to accrue AFUDC. FPL believes that if Construction Work In Progress (CWIP) and Nuclear Fuel in Process (NFIP) will not accrue AFUDC, then their balances should be included in the rate base.

FPC proposes that two accounts be excluded from the calculation of eligibility requirements threshold: Electric Plant in Service and Completed Construction not Classified. The company asserts that these two accounts be excluded since the functions represented by the accounts normally do not accrue AFUDC. Furthermore, FPC proposed:

. . . that the capitalization structure cost rate calculations for short term debt and customer deposits be consistent with the methodology utilized for Surveillance reporting, with the exception that investment tax credits (ITC's) be eliminated. ITC's are not a source of financing new construction. Also, the reporting of the AFUDC rate should be included once a year (December) in Surveillance reporting.

However, staff maintains that ITCs should not be eliminated. A utility will have other pre-existing sources of capital such as debt or stock issued years ago. Pre-existing sources of capital are not used to finance current construction; and

ITC is no different from other pre-existing sources of capital that are not being used to finance current construction. Therefore, ITC should neither be treated differently nor eliminated. FPC also objects to the reinstatement of the provision requiring a construction period in excess of one year for a project to be eligible to accrue AFUDC.

Finally, FPL proposes that projects currently under construction should be grandfathered and continue to accrue AFUDC even though they would not otherwise be eligible under the proposed rule. FPL added, however, that if the Commission determines to grandfather projects currently under construction, it should not make the grandfathering mandatory.

IMPACT ON SMALL BUSINESSES

No direct impact on small businesses is foreseen as Gulf, FPUC, TECO, FPC, and FPL are not small business as defined in Section 288.703(1), Florida Statutes (1991).

IMPACT ON COMPETITION

FPL believes the proposed amendment would generate a competitive benefit for the company. If the proposed amendment is adopted, the amount of AFUDC capitalized by FPL would be reduced. This reduction in the amount of AFUDC capitalized, plus the compounding thereof, could improve FPL's ability to compete in the future and reduce the potential for stranded investment from future construction. But, the company stated that CWIP and NFIP no longer eligible for AFUDC must be included in rate base for all regulatory purposes so that adequate provision is made to recover the carrying costs of these investments.

TECO has determined that the proposed rule changes could affect the company's ability to compete in the energy market. If interchange sales are impacted by transmission tariffs and those tariffs are cost based, then differences in the way costs are capitalized could lead to pricing differences which could affect competition. TECO believes that if a percentage threshold rather than a specific dollar threshold is used to accrue AFUDC, then larger utilities would have to accrue less capital costs to build transmission facilities. Thus, it would create an uneven marketplace for transmission.

FPC believes strongly that a specific dollar limit for AFUDC eligibility does not have an equal impact on all the Florida electric utilities and favors

the percentage method as it is more equitable and has no significant effect on the company's ability to compete. But, a specific dollar threshold amount would put the larger utilities at a competitive disadvantage.

Gulf believes that the alternative threshold of \$10,000,000 is far superior to the primary proposal for competitive reasons. Florida Public Utilities does not expect the proposed rule amendments to impact its ability to compete.

IMPACT ON EMPLOYMENT

Gulf, FPUC, TECO, FPC, and FPL indicated they do not expect the proposed rule amendment to affect the level of employment in their companies.

METHODOLOGY

Data requests were sent to the Investor-Owned Electric Utilities to collect additional economic information. Discussions were held with technical and legal staff. Related rules and statutes were examined and referenced. Standard microeconomic analysis was used to determine the estimated impact.

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