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

DATE: November 17, 2009

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (A. Roberts, Draper, Kummer)
Office of the General Counsel (Jaeger) JSB for RRJ

RE: Docket No. 090173-EI – Request to revise underground residential differential rates by Gulf Power Company.

AGENDA: 12/01/09 – Regular Agenda – Tariff Filing – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: 12/01/09 (8-Month Effective Date)

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\090173.RCM.DOC

Case Background

Rule 25-6.078, Florida Administrative Code (F.A.C), defines investor-owned utilities' (IOU) responsibilities for filing updated underground residential distribution (URD) tariffs for new subdivisions. This rule requires IOUs to file updated URD charges for Commission approval at least every three years, or sooner if a utility's underground cost differential for the standard low-density subdivision varies from the last approved charge by 10 percent or more. The rule requires IOUs to file on or before October 15 each year a schedule showing the increase or decrease in the differential for the standard low-density subdivision.

On October 15, 2008, Gulf Power Company (Gulf) notified the Commission, pursuant to Rule 25-6.078, F.A.C., that its underground cost differential for the standard low-density

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subdivision varies from the last approved differential by 39 percent. Gulf's current URD charges were approved in 2007.[1]

To comply with the 10 percent filing requirement of the rule, Gulf filed on April 1, 2009, a petition for Commission approval of revisions to its Underground Residential Distribution (URD) tariff, and their associated charges. The URD tariffs apply to new residential developments and represent the additional costs Gulf incurs to provide underground distribution service in place of overhead service. By Order No. PSC-09-0350-PCO-EI, issued on May 22, 2009, the Commission suspended Gulf's proposed tariffs. On June 17 and July 24, 2009, Gulf filed responses to staff's data requests. On October 1, 2009, Gulf filed revisions to its petition that included certain minor corrections.

In Docket No. 060172-EU, the Commission amended Rule 25-6.078, F.A.C., to require that the differences in net present value (NPV) of operational costs, including average historical storm restoration costs over the life of the facilities, between underground and overhead systems, be taken into consideration in determining the URD differential.[2] Prior to the rule revision, URD charges were based on initial installation costs only and did not include the costs of maintenance or storm restoration activities over time. The rule revision was intended to capture longer term costs and benefits of undergrounding. Gulf's current URD tariffs were calculated based on the prior rule. This petition incorporates the requirements of amended Rule 25-6.078, F.A.C., for the first time for Gulf, and includes the differences in operational and storm restoration costs between underground and overhead facilities.

This recommendation address Gulf's revised URD tariffs and the associated charges. The Commission has jurisdiction over this matter pursuant to Sections 366.03, 366.04, 366.05, and 366.06, Florida Statutes.

[1] Order No. PCS-07-0836-TRF-EI, issued October 16, 2007, Docket No. 070242-EI, In re: Request for revisions to underground residential differential, by Gulf Power Company.

[2] Order No. PSC-07-0043-FOF-EU, issued January 16, 2007, Docket No. 060172-EU, In re: Proposed rules governing placement of new electric distribution facilities underground, and conversion of existing overhead distribution facilities to underground facilities, to address effects of extreme weather.

Discussion of Issues

Issue 1: Should the Commission approve Gulf's revised Underground Residential Distribution (URD) tariffs and their associated charges?

Recommendation: Yes. (A. Roberts, Draper)

Staff Analysis: The URD charges represent the additional costs Gulf incurs to provide underground distribution service in place of overhead service, and are calculated as differentials between the cost of underground and overhead service. Costs for underground service have historically been higher than for standard overhead construction. The URD differential is paid by the customer (usually a developer) as a contribution-in-aid-of construction (CIAC). The URD tariffs provide standard charges for certain types of underground service, and apply to new residential developments such as subdivisions and townhouses.

Gulf's URD charges are developed based on two model subdivisions: (1) a 210-lot low density subdivision with a density of one or more, but less than six, dwelling per units per acre; and (2) a 176-lot high density subdivision with a density of six or more dwelling units per acre. All four of the largest investor-owned electric utilities use the same standardized model subdivisions to develop their URD charges.

As stated in Rule 25-6.078(1). F.A.C., the URD differential is developed by estimating the cost per lot of both underground service and overhead service. The differential is based on the utility's standard engineering and design practices. The difference between these numbers is the per-lot charge that customers must pay when requesting underground service in lieu of standard overhead service. The cost of both underground and overhead service include the material and labor costs to provide primary, secondary, and service distribution lines, and transformers. The costs to provide overhead service also includes poles. The cost to provide underground service also includes the cost of trenching and backfilling. The utilities are required to use current cost data.

The following table shows Gulf's current and proposed URD differentials:

Table 1

	Current URD differential per lot	Proposed URD differential per lot	Percent Change
210-lot low density	$507	$312	-38%
176-lot high density	$397	$213	-46%

The above per-lot charges apply if Gulf supplies and installs all equipment and materials. Gulf's URD tariff also provides for reduced URD charges if the customer chooses to supply and/or install the primary and secondary trench and duct system.

The calculation of Gulf's proposed URD charges includes the following steps. First, Gulf revised the charges to reflect actual 2008 labor and material costs. This is how the traditional installed cost of the underground project has been calculated. Second, in addition to the initial installation costs, Gulf's proposed URD charges now incorporate the differences in net present value of operational costs between underground and overhead systems, including average historical storm restoration costs over the life of the facilities.

The effect of each of the calculations on the URD differential is shown in the table below and addressed separately below.

Table 2

Line		210-lot low density subdivision	176-lot high density subdivision
A.	Current URD differential per lot	$507	$397
B.	Impact of updated material and labor costs	($33)	($42)
C.	Impact of operational costs differential	($162)	($142)
D	Proposed URD charge per lot – rounded (A+B+C)	$312	$213
E.	Net difference (A-D)	($195)	($184)

Updated material and labor costs

While both overhead and underground material costs increased, overhead material costs increased by a larger percentage, resulting in a decrease in the URD differential as shown in line B of Table 2. The larger increase in overhead material costs is a result of Gulf's implementation of its storm hardening plan. The revised overhead construction standard requires increased anchoring, span guy upgrades, and increased pole sizes. Gulf stated that the use of the stronger construction is now the standard for Gulf's new and rebuilt distribution systems.

In addition to the revised overhead constructions standards, Gulf stated its material costs for overhead and underground construction have risen due to supply and demand. Mergers and acquisitions of manufacturers and suppliers have limited the available supplier base to only a few suppliers to provide products. In addition, Gulf stated that the change in the world economy has resulted in companies selling products abroad at higher prices than what they receive in the United States, therefore limiting the available supply. Gulf also noted the rise in prices for core steel, copper, aluminum, and other raw materials used in the manufacturing process have risen, and manufacturers' transportation costs have increased because of higher fuel and equipment costs.

Both overhead and underground labor costs increased by approximately the same percentage, resulting in minor impacts to the differential. Most overhead labor is performed by Gulf employees. Gulf's overhead labor rates increased due to a travel and headquarter time allocation labor adder of 19 percent, which Gulf added to its labor costs in 2008 in order to capture all costs included in the actual work. In addition, contract rates between Gulf and Asplundh, Gulf's tree trimming contractor, increased from 2007 to 2008. Underground labor is typically done by contract crews, whose rates have also increased.

Finally, Gulf's tariff includes charges that apply when an applicant requests a three-phase lift station for sewage in a new residential subdivision. Gulf proposed to update those charges to reflect current material costs.

<u>Calculation of operational cost difference</u>

Subsection (4) of Rule 25-6.078, F.A.C., prescribes that the differences in net present value (NPV) of operational costs, including storm restoration costs, over the life of the facilities, between underground and overhead systems, be included in the URD charge. Operational costs include operations & maintenance (O&M) costs and capital costs. Gulf's analysis of its historical 2007 operational costs shows that the overhead facilities are more expensive to operate and maintain than the equivalent underground facilities, resulting in a decrease in the differential for both subdivision models. That decrease can be seen in line C of Table 2. Gulf states that in accordance with the requirement of Rule 25-6.078, F.A.C., Gulf began implementing new record keeping and accounting measures to separately identify operational costs for underground and overhead facilities, including storm related costs. Gulf used actual 2007 data to identify its overhead and underground operational costs, including storm restoration expenses.

To account for overhead and underground operational costs in the URD charge, Gulf determined its overhead and underground 2007 distribution plant in service costs and the operational expenses associated with that investment. Gulf then escalated the operational expenses at 2.2 percent to adjust for inflation over a period of 32 years, which represents the expected life of the plant. To calculate the NPV of the operational costs, Gulf used the after tax weighted average cost of capital of 7.76 percent. Gulf then calculated operational cost multipliers for overhead and underground subdivisions, which are based on the NPV of operational expenses as a percentage of the investment. The resulting overhead lines operating cost multiplier is 0.75117, and underground lines operating multiplier is 0.49136. The multipliers are applied to the overhead and underground labor and material costs for each subdivision.

<u>Conclusion</u>. After reviewing the proposed charges and accompanying work papers submitted by Gulf, staff believes the proposed URD charges are reasonable and should be approved.

Issue 2: Should this docket be closed?

Recommendation: Yes. If Issue 1 is approved, the tariffs should become effective on December 1, 2009. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order. (Jaeger)

Staff Analysis: If Issue 1 is approved, the tariffs should become effective on December 1, 2009. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order.