



Public Service Commission

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

DATE: May 11, 1999
 TO: Chairman Joe A. Garcia
 Commissioner Susan F. Clark
 Commissioner J. Terry Deason
 Commissioner E. Leon Jacobs
 Commissioner Julia L. Johnson
 FROM: Tim Devlin, Director, Division of Auditing and Financial Analysis *TD*
 RE: Docket No. 990000-~~990000~~ EI, Petition for authority to increase annual storm fund accrual by Florida Power & Light Company

990000

At the June 16, 1998 Agenda Conference, you requested that staff evaluate Florida Power & Light Company's (FPL or the Company) accounting for nuclear rebates and the risk exposure of including retroactive assessments in the storm damage reserve and fund. Further, in response to Order No. PSC-98-0953-FOF-EI, issued July 14, 1998, FPL filed a study addressing the feasibility of establishing a trust fund for the storm damage reserve and fund and a methodology for separating Transmission, Distribution and Other assets covered by the reserve and fund. The study and methodology were received in February 1999. Following is a discussion and analysis of those four items.

Nuclear Electric Insurance Limited (NEIL)

According to FPL, there is not a nuclear premium rebate; the NEIL pays, under certain circumstances, what it characterizes as "income distributions" to its members. For 1994 through 1998, FPL received \$90,756,888 in distributions for nuclear property and \$4,256,819 in refunds for nuclear liability insurance. In 1998, the total nuclear property premium was \$9,750,177 and the distribution was \$26,522,288; the total nuclear liability premium was \$1,367,292 while the refund was \$1,047,710. FPL records both the NEIL premiums and any distributions in Account 924, Property Insurance. The Company stated that the income distributions are recorded in accordance with Order No. 7843, in Docket No. 760727-EU, issued June 16, 1977, ("Nuclear Insurance" at pp 10-11), which directs FPL "to continue to credit refunds to operating expense".

At the agenda, it was suggested that the income distributions could be used to increase the reserve and fund. In response to informal requests, the Company asserts that this alternative would create cross-subsidy issues. There are several groups of FPL customers who, under current accounting treatment, do not pay for NEIL insurance premiums nor benefit from Neil distributions. For instance, FPL has wholesale power contracts that sell power only from fossil units, excluding nuclear function expenses such as NEIL premium payments; FPL also has customers which receive transmission service and do not pay NEIL premiums. If NEIL distributions were used to fund the reserve rather than as a credit against NEIL premiums in the nuclear function, then these customers would benefit to the extent the increase in the reserve and fund is used to offset any non-nuclear costs for which they would have otherwise been charged.

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A similar cross-subsidy exists in instances where wholesale customers pay rates covering nuclear function but not distribution function expenses.

If the Commission deems it appropriate, the accounting for NEIL income distributions can be changed by Commission Order. As stated below, FPL will file a study by December 31, 2002; accounting for distributions can be an issue in that proceeding.

In response to staff's request to estimate its risk exposure for NEIL retroactive premium assessments, FPL stated:

In answering the question, FPL wishes to make it clear that FPL has not yet quantified or estimated its risk exposure for NEIL retroactive premium assessments. FPL will address this risk, as well as all other potential risks relating to items which are allowed to be charged to the storm and property insurance reserve and fund, in a study addressing the reasonableness of the reserve and accrual to be filed by December 31, 2002, in accordance with Order PSC-98-0953-FOF-EI. . .

In informal requests, FPL quantified its maximum share of any NEIL premium assessment per policy year. The Company's present maximum retroactive premium assessment from NEIL is \$53.8 million (including taxes) for nuclear property exposures and its maximum retroactive premium assessment under the Price-Anderson Act is \$374 million per incident at any nuclear utility reactor in the United States payable at a rate of \$55 million per year, per incident, for up to 9 years for nuclear liability exposures (for people and businesses damaged by nuclear incidents).

In the above mentioned order, the Commission recognized that, "The best information available suggests that the probability of such an [NEIL retroactive] assessment is low. . ." Although such assessments are possible, none have occurred, either for FPL or for any other U.S. nuclear operator. Further, because of the excellent loss history, NEIL's financial condition has improved dramatically making a retroactive premium call much less likely. This issue will be addressed in FPL's next study.

Storm Damage Reserve Trust Fund

Order No. PSC-98-0953-FOF-EI also required FPL to file a study addressing the feasibility of establishing a trust fund for the storm damage reserve. According to the Company, it has been studying and analyzing this issue and will continue to search for a "tax efficient trust type structure or entity" to hold the assets in the storm damage reserve. In its study, FPL provided several income tax considerations in support of its position for not creating a trust. The most compelling consideration was that a trust's income is taxed at the maximum federal rate of 39.6%, whereas the earnings for the storm damage reserve are taxed as part of FPL's taxable income at the 35% federal rate.

An external trust fund would be managed by a trustee independent of the company. The trust fund would be managed and funds would be released according to the trust agreement. Therefore, the trust agreement could be structured to agree with the Commission order, and this would provide assurance that the funds are used for the intended purpose. However, staff believes that the current funding method provides adequate assurance and outweighs the higher administrative cost and the higher federal tax that would be incurred by placing the assets in a trust.

In summary, staff does not believe that trusts are a viable vehicle for holding the assets of storm damage reserves because of the higher maximum federal income tax rate and the administrative costs of trusts.

Separating Storm Damage Reserve

In response to the Commission's order, FPL proposed a methodology to separate the storm fund into Transmission, Distribution and Other. The methodology would be to develop a study to determine the then estimated annual average loss for each category and subdivide the fund based on the percentage each category's estimated annual loss bears to the total of all average annual losses.

The Company requested EQE International, Inc. (EQE) to provide a study showing the expected annual losses in Transmission and Distribution (T&D) assets from hurricane peril; non-T&D assets from hurricane peril; nuclear retrospective premium assessments; and nuclear losses larger than the insured limits (\$2.75 billion per plant) provided by FPL's insurance program. The results of EQE's study is as follows:

	<u>Expected Loss</u>	<u>Annual Ratio</u>
Transmission Assets	\$ 7.2	15.0%
Distribution Assets	35.0	72.6%
Non-T&D hurricane	5.0	10.4%
Nuclear retro premiums	.5	1.0%
Uninsured nuclear risk	<u>.5</u>	<u>1.0%</u>
	\$48.2	100.0%

Staff needs to study the methodology further before making a recommendation on its acceptance. We expect FPL to update its analysis in its next study. Accounting separation does not appear necessary at this time.

I hope this adequately addresses your concerns. If you need further information, please let me know.

TJD/NM:slc

c: Bill Talbott
Mary A. Bane
Blanca Bayo (docket file copy) ✓