

State of Florida



# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

**DATE:** December 4, 2008

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Slemkewicz) *JS*  
Office of Strategic Analysis & Governmental Affairs (Sickel) *gsh*  
Office of the General Counsel (Brown) *MCB JSB*

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*RT*  
*HA*

**RE:** Docket No. 070432-EI – Petition for authority to use deferral accounting and for creation of a regulatory asset for prudently incurred preconstruction costs associated with development of clean coal project, by Florida Power & Light Company.

**AGENDA:** 12/16/08 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Skop

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\070432.RCM.DOC

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### Case Background

On February 1, 2007, Florida Power & Light Company (FPL or Company) filed a petition in Docket No. 070098-EI<sup>1</sup> for a determination of need for the proposed Glades Power Park (GPP) Units 1 and 2 electrical power plants in Glades County, pursuant to Section 403.519, Florida Statutes (F.S.), and Rule 25-22.080, Florida Administrative Code (F.A.C.). FPL proposed two ultra-supercritical pulverized coal (USCPC) generating units, each having summer net capacities of approximately 980 megawatts (MW) for a combined net capacity of 1,960 MW, with proposed in-service dates of 2013 and 2014. The proposed location of the units was a 4,900-acre site located west of Lake Okeechobee, approximately four miles northeast of the town

<sup>1</sup> Docket No. 070098-EI, In re: Petition for determination of need for Glades Power Park Units 1 and 2 electrical power plants in Glades County, by Florida Power & Light Company.

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of Moore Haven in an unincorporated area of Glades County. A formal administrative hearing was held on April 16-17, 25-26, and 30, 2007. At the June 5, 2007, Agenda Conference, the Commission denied FPL's petition for a determination of need for the USCPC generating units at the GPP site,<sup>2</sup> stating:

FPL has failed to demonstrate that the proposed plants are the most cost-effective alternative available, taking into account the fixed costs that would be added to base rates for the construction of the plants, the uncertainty associated with future natural gas and coal prices, and the uncertainty associated with currently emerging energy policy decisions at the state and federal level.

On July 17, 2007, FPL filed a petition for authority to use deferral accounting and for the creation of a regulatory asset for its incurred preconstruction costs associated with the development of the clean coal project at the GPP. In its petition, the Company requested that it be authorized to defer \$34.5 million of preconstruction costs as a regulatory asset. FPL is not requesting any revision of its existing base rates. Instead, FPL is requesting that the regulatory asset be deferred and amortized over a five-year period beginning when new rates are implemented. Based on its test year notification letter filed November 17, 2008, it is anticipated that new rates would become effective on January 1, 2010.<sup>3</sup>

The Commission staff conducted an audit of the cost components included in the \$34.5 million of preconstruction costs for the GPP project. The audit report was filed January 22, 2008.

The Commission has jurisdiction over this matter pursuant to Chapter 366, F. S., including Sections 366.04, 366.05, and 366.06, F. S.

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<sup>2</sup> Order No. PSC-07-0557-FOF-EI, issued July 2, 2007, in Docket No. 070098-EI, In re: Petition for determination of need for Glades Power Park Units 1 and 2 electrical power plants in Glades County, by Florida Power & Light Company.

<sup>3</sup> Docket No. 080677-EI, In re: Application for increase in rates by Florida Power & Light Company.

### Discussion of Issues

**Issue 1:** Should the Commission grant FPL's petition to use deferral accounting and establish a regulatory asset for the Glades Power Park preconstruction costs?

**Recommendation:** Yes, the Commission should grant FPL's petition to use deferral accounting and establish a regulatory asset in Account 182.2, Unrecovered Plant and Regulatory Costs, for a portion of the Glades Power Park preconstruction costs. (Slemkewicz)

**Staff Analysis:** FPL has requested that it be allowed to defer \$34.5 million of GPP preconstruction costs as a regulatory asset. The regulatory asset would be amortized over a five-year period beginning when base rates are re-set. Without such an approval, FPL would be required to record the entire \$34.5 million as a current expense. FPL is not requesting any revision of its existing base rates with this petition.

A regulatory asset involves a cost incurred by a regulated utility that would normally be expensed currently but for an action by the regulator or legislature to defer the cost as an asset to the balance sheet. This allows the utility to amortize the regulatory asset over a period greater than one year instead of treating it as an expense in a single year.<sup>4</sup> For example, unamortized rate case expense in the water and wastewater industry is a regulatory asset. Normally, the costs of a rate case would be expensed when they are incurred. However, Section 367.0816, F.S., requires that water and wastewater utilities amortize rate case expense over a four year period, thus creating a regulatory asset.

Statement of Financial Accounting Standards 71 (SFAS 71) allows regulated companies to defer costs and create regulatory assets if it is likely that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. To create a regulatory asset or liability, a regulated company must have the approval of its regulator. Additional qualification requirements are stated in Section 9 of SFAS 71:

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
  - a) It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
  - b) Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred costs rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred costs.

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<sup>4</sup> Order No. PSC-95-1230-FOF-EI, issued October 3, 1995, in Docket No. 950270-EI, In re: Petition for approval of accounting treatment for funds expended on Lake Tarpon-Kathleen transmission line by Florida Power Corporation.

Per the Uniform System of Accounts, Account 183, Preliminary Survey and Investigation Charges, has been established to record certain costs incurred for the purposes of determining the feasibility of contemplated projects. If construction does not result, the charges can be made to the appropriate operating expense accounts or to Account 426.5, Other Deductions. The Commission may also authorize that the costs be recorded in Account 182.2, Unrecovered Plant and Regulatory Costs, and be amortized over a specific period.

In staff's opinion, FPL should be authorized to use deferral accounting and establish a regulatory asset for a portion of the GPP costs claimed as preconstruction costs. The deferral and amortization of these costs would allow FPL the opportunity to recover them in current and future periods. As discussed in Issue 2, however, staff does not believe that all of the \$34.5 million designated as preconstruction costs should be deferred as a regulatory asset and be amortized over future periods.

**Issue 2:** What is the appropriate amount of Glades Power Park preconstruction costs to be deferred as a regulatory asset?

**Recommendation:** The appropriate amount of Glades Power Park preconstruction costs to be deferred as a regulatory asset is \$34,090,145. In addition, the \$71,016 of lobbying expenditures should be recorded as an expense in Account 426.4, Expenditures for Certain Civic, Political and Related Activities. (Sickel, Slemkewicz)

**Staff Analysis:** FPL seeks to recover \$34.5 million<sup>5</sup> in costs related to activities associated with the Company's integrated resource planning for additions to generation and the analysis of possibilities involved with the decision to construct a plant at the GPP site. The requested recovery includes the following categories of costs:

	<u>Requested</u>	<u>Actual<sup>5</sup></u>
Major Equipment Contract Termination Costs	\$17,500,000	\$17,236,800
Land and Right of Way Options Payments	1,700,000	1,684,275
Site Certification and Permitting Costs	7,600,000	7,646,308
Preliminary Engineering and Project Management Costs	5,300,000	5,289,159
Engineering, Procurement, and Construction Contract Termination Costs	<u>2,400,000</u>	<u>2,430,934</u>
Total	<u>\$34,500,000</u>	<u>\$34,287,476</u>

Work done by FPL in 2005 indicated that the earliest possible time for including solid fuel in the generation fleet was 2012. That possibility required an uninterrupted workflow from early planning through material specification to equipment procurement and installation. When the GPP site appeared to be a possibility, work proceeded to meet the 2012 in-service date and a need determination was filed on February 1, 2007. In its request for a determination of need, FPL had estimated costs of approximately \$3.5 billion (2013) and \$2.244 billion (2014) for the GPP Units 1 and 2 in successive years.<sup>6</sup> The process of estimation was complex. It necessarily included fuel specifics as to chemistry and transport, as well as construction of a plant that would be much larger and more technologically complex than the combined cycle plants of recent vintage.

Staff performed an audit as the first step to review whether FPL's \$34.5 million deferral request was strictly associated with the costs for the GPP. In the review and analysis of the audit findings, staff considered the underlying requirements for estimating costs that would be associated with a plant such as the GPP project. The following staff analysis will provide a general description of the activities associated with each of the major categories of the amount requested for recovery, and the reasons for any recommended adjustments.

#### Major Equipment Contract Termination Costs

To file a need determination, the utility typically includes information obtained from vendors relating to costs and timing for delivery or installation. Vendors informed FPL of the unprecedented limitations on the supply of large forgings and other major components. The world-wide supply capability is so limited that already established queues will determine what

<sup>5</sup> \$34,287,476 actual as of August 22, 2007, per FPL's response to Staff Interrogatory No. 1.

<sup>6</sup> Docket No. 070098-EI, In re: Petition for determination of need for Glades Power Park Units 1 and 2 electrical power plants in Glades County, by Florida Power & Light Company.

orders will be filled for years to come. The vendors of the boiler, the turbine generator, as well as the feed water and material handling systems, would have no availability by the time the need determination was granted or denied, and the magnitude of delay would be multiple years rather than a few months or seasons.

In an effort to meet the in-service date, FPL proceeded to negotiate primary supplier contracts for major equipment items. Approximately \$17.5 million of its requested deferral is associated with the supplier contracts. By the nature of the installation, intensive design work must be done before material can be ordered for fabrication. For example, staff reviewed confidential documents including the heat balance for the reheat turbine. These confidential documents are summary sheets which show the results of many intricate calculations, and, in turn, the summary information must be completed before calculations can be made to specify piping, valves, and multiple elements that are critical to the machine that is planned. The compensation for such "preliminary" work is always included in contract arrangements, as it was in this case. Staff recognizes efforts by the utility to effect cost control, and has not identified any missed opportunities.

#### Land and Right of Way Options Payments

Similarly, the \$1.7 million for the purchase of land rights options included a committed price for land parcels to be purchased, if FPL exercised a purchase option. The options provided FPL with a known cost for the needed parcels, but at a cost lower than the cost for an outright purchase. It would not have been prudent to "plan" for a generation site and file a need determination without having determined the availability and cost of land. The purchase of options was prudent, as compared to outright ownership of land that would be unusable by FPL for the foreseeable future.

#### Site Certification and Permitting Costs

This category includes costs of \$7,646,308 associated with preliminary assessments of fuel chemistry needed to develop the environmental compliance plan for proposed plants to utilize solid fuel at the GPP site. Evaluation of various possibilities and contingencies involved with permitting and transportation, with the associated projections of impact on costs, would be included in this work. Both fuels and waste materials could require permits. The work product includes development and provision of the information necessary for environmental permits to be filed if a determination of need is granted.

#### Preliminary Engineering and Project Management Costs

This category includes the costs for the professional design and management functions to successfully manage the interface between FPL and the contractors that would provide equipment, construction, or technical services for the GPP project. Preliminary evaluation and estimated costs for transmission additions are also included. The work done by the preliminary engineering and project management functions provided the cost estimates amounting to \$5.744 billion that appeared in the FPL request for need determination for the GPP.<sup>7</sup>

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<sup>7</sup> Docket No. 070098-EI, In re: Petition for determination of need for Glades Power Park Units 1 and 2 electrical power plants in Glades County, by Florida Power & Light Company.

Engineering, Procurement, and Construction Contract Termination Costs

This category includes some preliminary work at the specific site, such as the geological evaluation of the site designated for construction. It also includes the evaluation of construction requirements including necessary methods, time, and materials.

In summary, the land and right of way option payments (\$1.7 million), site certification and permitting costs (\$7.6 million), major equipment contract termination costs (\$17.5 million), preliminary engineering and project management costs (\$5.3 million), and engineering, procurement and construction contract termination costs (\$2.4 million) are reasonable and prudent except for the following adjustments for employee relocation costs and lobbying costs.

Per Audit Finding No. 2, relocation costs of \$126,315 were incurred for the recruiting and hiring of two technically credentialed persons to provide oversight in the construction of the GPP. Documents provided by the Company show that these persons held the titles, "Director - Construction" and "Manager - Construction." The employees in these two positions would be expected to provide vital expertise during the planning and construction associated with the GPP project. The relocation expenses paid by FPL for those individuals go back as far as December 2005, and apparently both of those persons were working for FPL by April 2006. The audit work papers include GPP contract documents signed in early 2007 by one of those individuals. Also, the Company has advised that one individual was allocated 80 percent to the GPP project. Both persons have continued to be employed by FPL as the Company moves forward to assess possibilities for meeting growth needs in the next decade.

Beyond the information recounted above, FPL did not provide any details regarding the assignments or work performed by the two persons. The requested recovery of the moving costs and payroll costs is based on FPL's plan to utilize these employees in critical job assignments that would have developed during the construction of the GPP, but the utilization of these employees has changed. Since FPL is necessarily engaged in development of a new plan for meeting the demand for generation, the moving and payroll costs are not uniquely associated with the historic efforts to build the GPP. Even prior to the vote denying the need for the GPP on June 5, 2007, these individuals would likely have been responsible for management of a variety of technical issues requiring a high level of expertise, but not directly associated with the GPP project. The information provided is not sufficient to quantify what fraction of the moving costs and payroll to date might credibly be associated with the GPP project. Therefore, the requested regulatory asset should be reduced by \$126,315 in employee relocation costs.

Per Audit Finding No. 3, FPL spent \$1,552,270 for lobbying, community outreach and public relation costs for the GPP project. Included in this amount is \$71,016 that has been specifically identified as lobbying. Account 426.4, Expenditures for Certain Civic, Political and Related Activities, is defined as follows in the Uniform System of Accounts:

This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances

before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

Account 426.4 is not an operating expense account. It is classified as a "below-the-line" expense account and is not included in the determination of net operating income for ratemaking purposes. In other words, these types of expenditures (lobbying) are not recoverable from the ratepayers and are, therefore, paid for by the shareholders. Although FPL has every right to lobby on its own behalf, it is staff's opinion that lobbying costs should not be considered as recoverable from the ratepayers and should be recorded "below-the-line." Therefore, the requested regulatory asset should be reduced by \$71,016.

Based on the two adjustments previously discussed, staff recommends that the appropriate amount of the regulatory asset should be \$34,090,145, calculated as follows:

Total Regulatory Asset <sup>8</sup>	<u>\$34,287,476</u>
Lobbying Costs	(71,016)
Employee Relocation Costs	<u>(126,315)</u>
Total Adjustments	<u>(197,331)</u>
Staff Adjusted Regulatory Asset	<u>\$34,090,145</u>

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<sup>8</sup> \$34,287,476 actual as of August 22, 2007, per FPL response to Staff Interrogatory No. 1.



**Issue 3:** What is the appropriate amortization period and beginning date for the amortization of the Glades Power Park preconstruction costs regulatory asset?

**Recommendation:** The appropriate amortization period is five years beginning January 1, 2008. (Slemkewicz)

**Staff Analysis:** In its petition, FPL has requested a five-year amortization period beginning the next time that base rates are re-set. FPL's present base rates have been in effect since January 1, 2006, pursuant to Order No. PSC-05-0902-S-EI.<sup>9</sup> That order approved the stipulation and settlement agreement that governs FPL's base rates until December 31, 2009, or until new base rates and charges become effective by order of the Commission. On November 17, 2008, FPL filed a test year notification letter stating that it intends to file for a base rate increase in March 2009.<sup>10</sup> Any base rate increase approved in that proceeding could not become effective before January 1, 2010.

Based on FPL's requested accounting treatment, the amortization of the regulatory asset would not begin until new base rates become effective. Until that time, the entire regulatory asset would earn a return by virtue of including the asset in rate base for earnings surveillance purposes. As previously discussed, the event giving rise to FPL's request occurred on June 5, 2007, the date when the determination of need was denied.

In a similar case involving Progress Energy Florida, Inc.<sup>11</sup> (PEF) regarding the cancellation of a transmission line project,<sup>12</sup> the Commission stated, "We believe that the commencement of the amortization period should closely follow the timing of FPC's decision to cancel the project." In that case, PEF's decision to cancel the project was made in October 1994. Because the Commission's determination of the appropriate accounting treatment was not made until late in 1995, the amortization period was ordered to begin on January 1, 1995. The use of the January 1, 1995, commencement date avoided the possibility of PEF having to restate its prior year's financial statements if the amortization had been ordered to begin in 1994.

In staff's opinion, the same principle should be applied to FPL in this docket. The event giving rise to the cancellation occurred on June 5, 2007. All other things being equal, staff would normally recommend that date as the appropriate starting point for the amortization period. However, the timing of the cancellation event and the Commission's decision is very similar to that in the case cited for PEF. Therefore, staff recommends that January 1, 2008, is the appropriate date at which the amortization of any authorized regulatory asset should begin. This closely follows the cancellation decision while also avoiding the possibility of FPL restating its prior year's financial statements. Staff also believes, and recommends, that five years is a reasonable amortization period for the regulatory asset. It should be noted that customer rates are not affected at this time.

<sup>9</sup> Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050045-EI, In re: Petition for rate increase by Florida Power & Light Company.

<sup>10</sup> Docket No. 080677-EI, In re: Application for increase in rates by Florida Power & Light Company.

<sup>11</sup> Then known as Florida Power Corporation (FPC)

<sup>12</sup> Order No. PSC-95-1230-FOF-EI, issued October 3, 1995, in Docket No. 950270-EI, In re: Petition for approval of accounting treatment for funds expended on Lake Tarpon-Kathleen transmission line by Florida Power Corporation.

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**Issue 4:** Should this docket be closed?

**Recommendation:** If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (Brown)

**Staff Analysis:** At the conclusion of the protest period, if no protest is filed this docket should be closed upon the issuance of a consummating order.