



Public Service Commission

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

DATE: October 12, 1999
TO: All Interested Persons
FROM: Mary Anne Helton, Associate General Counsel
RE: Docket No. 980643-EI - Amendments to cost allocation procedures for investor-owned utilities

Staff has reviewed the transcript from the August 24, 1999, workshop as well as the post-workshop comments. Based on the discussion and comments, staff made the attached changes to Rules 25-6.135, 25-6.1351, and 25-6.0436.

The most significant changes are as follows: Staff followed FPC's suggested wording for the definitions of "regulated" and "nonregulated." Staff incorporated much of FPL's suggested changes to paragraph (3)(c). In addition, staff added a prevailing price valuation requirement to paragraph (3)(c). This requirement mimics the FCC requirement set out in 47 CFR Ch. I Subpart B § 32.27(c)-(d). Staff struck the competitive bidding requirement in paragraph (3)(c). Staff also struck the mapping requirement in paragraph (3)(e). Finally, staff struck the external audit requirement from subsection (6).

Any additional comments or language suggestions concerning the attached draft rules must be filed with the Division of Records and Reporting by Wednesday, November 3, 1999. After staff reviews these additional comments and makes any appropriate changes to the rule, Craig Hewitt will send out a data request from which he will prepare the Statement of Estimated Regulatory Costs. Once the SERC is prepared, staff will bring the amendments to the Commission and recommend their proposal. You may contact the Division of Records and Reporting at (850) 413-6770 to learn how to obtain a copy of staff's recommendation. All interested persons will be allowed to address the Commission concerning staff's recommended draft at the agenda conference during which the Commission takes up the matter.

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A current schedule of events will be posted on the Commission's web site, which is http://www2.scri.net/psc/psc\_toc.html. From the Commission's home page, click on electric, then dockets, then 980643-EI, and then events list.

Please call me at (850) 413-6096 or Jay Revell at (850) 413-6425 if you have any questions.

cc: All Staff Assigned
Division of Records and Reporting

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

1 25-6.1351 Cost Allocation and Affiliate Transactions

2 ~~Diversification Reports.~~

3 (1) Purpose. The purpose of this rule is to establish cost  
4 allocation requirements to ensure proper accounting for affiliate  
5 transactions and utility nonregulated activities so that these  
6 transactions and activities are not subsidized by utility  
7 ratepayers. This rule is not applicable to affiliate  
8 transactions for purchase of fuel and related transportation  
9 services which are subject to Commission review and approval in  
10 cost recovery proceedings.

11 ~~(1) Each investor owned electric utility shall file~~  
12 ~~information on its affiliates and affiliated transactions on~~  
13 ~~Commission Form PSC/AFA 16 (12/94) which is incorporated into~~  
14 ~~this rule by reference. Form PSC/AFA 16, entitled "Analysis of~~  
15 ~~Diversification Activities", may be obtained from the~~  
16 ~~Commission's Division of Auditing and Financial Analysis.~~

17 (2) Definitions

18 (a) Affiliate -- Any entity that directly or indirectly  
19 through one or more intermediaries, controls, is controlled by,  
20 or is under common control with a the utility. As used herein,  
21 "control" means the possession, directly or indirectly, of the  
22 power to direct or cause the direction of the management and  
23 policies of a company, whether such power is exercised through  
24 one or more intermediary companies, or alone, or in conjunction  
25 with, or pursuant to an agreement, and whether such power is

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1 established through a majority or minority ownership or voting of  
2 securities, common directors, officers or stockholders, voting  
3 trusts, holding trusts, associated companies, contracts or any  
4 other direct or indirect means. Ownership of ~~five~~ 5 percent or  
5 more of the voting securities of an entity shall be conclusively  
6 deemed to constitute the control thereof.

7 (b) Affiliated Transaction -- Any transaction in which both  
8 a utility and an affiliate thereof are each participants, except  
9 other than transactions related solely to the filing of  
10 consolidated tax returns.

11 (c) Cost Allocation Manual (CAM) - The manual that sets out  
12 a utility's cost allocation policies and related procedures.

13 (d) Direct Costs - Costs that can be specifically  
14 identified with a particular service or product.

15 (e) Fully Allocated Costs - The sum of direct costs plus a  
16 fair and reasonable share of indirect costs.

17 (f) Indirect Costs - Costs, including all overheads, that  
18 cannot be identified with a particular service or product.

19 (g) Nonregulated - Refers to services or products that are  
20 not subject to price regulation by the Commission or not included  
21 for ratemaking purposes and not reported in surveillance.

22 (h) Prevailing Price Valuation - The occurrence of sales of  
23 a particular asset or service to third parties encompassing more  
24 than 50 percent of the total quantity of the product or service  
25 sold by the entity. The 50 percent threshold is applied on an

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1 asset-by-asset and service-by-service basis, rather than on a  
2 product line or service line basis.

3 (i) Regulated - Refers to services or products that are  
4 subject to price regulation by the Commission or included for  
5 ratemaking purposes and reported in surveillance.

6 (j) Subsidize - The act of regulated utility operations  
7 paying more than their fair and reasonable share of costs  
8 associated with affiliate transactions and utility nonregulated  
9 activities.

10 (3) Non-Tariffed Affiliate Transactions

11 (a) The purpose of subsection (3) is to establish  
12 requirements for non-tariffed affiliate transactions impacting  
13 regulated activities.

14 (b) A utility must charge an affiliate the higher of fully  
15 allocated costs or market for all non-tariffed services and  
16 products purchased by the affiliate from the utility. Except, a  
17 utility may charge an affiliate less than fully allocated costs  
18 if the charge is above incremental cost and equivalent to market  
19 prices. If a utility charges less than fully allocated costs,  
20 the utility must maintain documentation to support and justify  
21 doing so would benefit regulated operations.

22 (c) When a utility purchases services and products from an  
23 affiliate and applies the cost to regulated operations, the  
24 utility shall apportion to regulated operations the lesser of  
25 fully allocated costs or market price. Except, a utility may

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1 apportion to regulated operations more than fully allocated costs  
2 if the charge is less than or equal to the market price. If a  
3 utility apportions to regulated operations more than fully  
4 allocated costs, the utility must maintain documentation to  
5 support and justify doing so would benefit regulated operations  
6 and would be based on prevailing price valuation.

7 (d) When an asset used in regulated operations is  
8 transferred from a utility to a nonregulated affiliate, the  
9 utility must charge the affiliate the greater of market or net  
10 book value. When an asset to be used in regulated operations is  
11 transferred from a nonregulated affiliate to a utility, the  
12 utility must record the asset at the lower of market or net book  
13 value. An independent appraiser must verify the market value of  
14 a transferred asset with a net book value greater than  
15 \$1,000,000.

16 (e) Each affiliate involved in affiliate transactions must  
17 maintain all underlying data concerning the affiliate transaction  
18 for at least three years after the affiliate transaction is  
19 complete. This paragraph does not relieve a regulated affiliate  
20 from maintaining records under otherwise applicable record  
21 retention requirements.

22 (4) Cost Allocation Principles

23 (a) Utility accounting records must show whether each  
24 transaction involves a product or service that is regulated or  
25 nonregulated.

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1       (b) Direct costs shall be assigned to each service and  
2 product provided by the utility.

3       (c) Indirect costs shall be distributed on a fully  
4 allocated cost basis. Except, a utility may distribute indirect  
5 costs on an incremental or market basis if the utility can  
6 demonstrate that its ratepayers will benefit. If a utility  
7 distributes indirect costs on less than a fully allocated basis,  
8 the utility must maintain documentation to support doing so.

9       (d) Each utility must maintain a listing of revenues and  
10 expenses for all non-tariffed products and services.

11       (5) Reporting Requirements. Each utility shall file  
12 information concerning its affiliates, affiliate transactions,  
13 and nonregulated activities on Form PSC/AFA 19 (xx/xx) which is  
14 incorporated by reference into this rule. Form PSC/AFA 19,  
15 entitled "Annual Report of Major Electric Utilities," may be  
16 obtained from the Commission's Division of Auditing and Financial  
17 Analysis.

18       (6) Cost Allocation Manual. Each utility involved in  
19 affiliate transactions or in nonregulated activities must  
20 maintain a Cost Allocation Manual (CAM). The CAM must be  
21 organized and indexed so that the information contained therein  
22 can be easily accessed.

23       ~~(3) Within 45 days of coming under the jurisdiction of the~~  
24 ~~Commission, each investor owned electric utility shall file~~  
25 ~~Schedules 1, 7, and 8 of Form PSC/AFA 16 with the Division of~~

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1 ~~Auditing and Financial Analysis.~~

2 ~~(4) Each investor owned electric utility shall file~~  
3 ~~Schedules 1  6 of Form PSC/AFA 16 as an attachment to its~~  
4 ~~annual report.~~

5 ~~(5) Each investor owned electric utility shall keep a~~  
6 ~~detailed backup report of the summary report to facilitate~~  
7 ~~auditing and analysis. Each investor owned electric utility shall~~  
8 ~~maintain a clear audit trail from the summary report through the~~  
9 ~~general ledger to the source documents supporting the~~  
10 ~~transaction.~~

11 Specific Authority 366.05(1), 350.127(2) FS.

12 Law Implemented 350.115, 366.04(2)(a), (f), 366.05(1), (2), and  
13 (9), 366.093(1) FS.

14 History--New 12-27-94, Amended \_\_\_\_\_.

15  
16 25-6.135 Annual Reports.

17       (1) Each investor-owned electric utility shall file annual  
18 reports with the Commission on Commission Form PSC/AFA 19 (~~xx/xx~~  
19 ~~12/94~~) which is incorporated by reference into this rule. Form  
20 PSC/AFA 19, entitled "Annual Report of Major Electric Utilities",  
21 may be obtained from the Commission's Division of Auditing and  
22 Financial Analysis. These reports shall be verified by a  
23 responsible accounting officer of the utility making the report  
24 and shall be due on or before April 30 for the preceding calendar  
25 year. A utility may file a written request for an extension of

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1 time with the Division of Auditing and Financial Analysis no  
2 later than April 30. One extension of 31 days will be granted  
3 upon request. A request for a longer extension must be  
4 accompanied by a statement of good cause and shall specify the  
5 date by which the report will be filed.

6 (2) The utility shall also file with the original and each  
7 copy of the annual report form, or separately within 30 days, a  
8 letter or report, signed by an independent certified public  
9 accountant, attesting to the conformity in all material respects  
10 of the schedules and their applicable notes listed on the general  
11 information page of Form PSC/AFA 19 with the Commission's  
12 applicable uniform system of accounts and published accounting  
13 releases.

14 Specific Authority 366.05(1), 350.127(2) FS.

15 Law Implemented 350.115, 366.04(2)(f), 366.05(1), (2)(a) FS.

16 History--New 12-27-94, amended \_\_\_\_\_.

17  
18  
19 25-6.0436 Depreciation.

20 (1) For the purposes of this part, the following definitions  
21 shall apply:

22 (a) Category or Category of Depreciable Plant -- A grouping  
23 of plant for which a depreciation rate is prescribed. At a  
24 minimum it should include each plant account prescribed in Rule  
25 25-6.014(1), F.A.C.

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1 (b) Embedded Vintage -- A vintage of plant in service as of  
2 the date of study or implementation of proposed rates.

3 (c) Mortality Data -- Historical data by study category  
4 showing plant balances, additions, adjustments and retirements,  
5 used in analyses for life indications or calculations of realized  
6 life. Preferably, this is aged data in accord with the  
7 following:

- 8 1. The number of plant items or equivalent units (usually  
9 expressed in dollars) added each calendar year.
- 10 2. The number of plant items retired (usually expressed in  
11 dollars) each year and the distribution by years of  
12 placing of such retirements.
- 13 3. The net increase or decrease resulting from purchases,  
14 sales or adjustments and the distribution by years of  
15 placing of such amounts.
- 16 4. The number that remains in service (usually expressed  
17 in dollars) at the end of each year and the  
18 distribution by years of placing of such amounts.

19 (d) Net Book Value - The book cost of an asset or group of  
20 assets minus the accumulated depreciation or amortization reserve  
21 associated with those assets.

22 (e)~~(d)~~ Remaining Life Method -- The method of calculating a  
23 depreciation rate based on the unrecovered plant balance, less  
24 average future net salvage and the average remaining life. The  
25 formula for calculating a Remaining Life Rate (RLR) is:

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1             $RLR = \frac{100\% - \text{Reserve } \% - \text{Average Future Net Salvage } \%}{\text{Average Remaining Life in Years}}$

2  
3  
4            (f) Reserve (Accumulated Depreciation) - The amount of  
5 depreciation/amortization expense, salvage, cost of removal,  
6 adjustments, transfers, and reclassifications accumulated to  
7 date.

8            (g)(e) Reserve Data -- Historical data by study category  
9 showing reserve balances, debits and credits such as booked  
10 depreciation, expense, salvage and cost of removal and  
11 adjustments to the reserve utilized in monitoring reserve  
12 activity and position.

13            (h)(f) Reserve Deficiency -- An inadequacy in the reserve of  
14 a category as evidenced by a comparison of that reserve indicated  
15 as necessary under current projections of life and salvage with  
16 that reserve historically accrued. The latter figure may be  
17 available from the utility's records or may require retrospective  
18 calculation.

19            (i)(g) Reserve Surplus -- An excess in the reserve of a  
20 category as evidenced by a comparison of that reserve indicated  
21 as necessary under current projections of life and salvage with  
22 that reserve historically accrued. The latter figure may be  
23 available from the utility's records or may require retrospective  
24 calculation.

25            (j)(h) Salvage Data -- Historical data by study category

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1 showing bookings of retirements, gross salvage and cost of  
2 removal used in analysis of trends in gross salvage and cost of  
3 removal or for calculations of realized salvage.

4 ~~(k)~~~~(i)~~ Theoretical Reserve or Prospective Theoretical  
5 Reserve -- A calculated reserve based on components of the  
6 proposed rate using the formula:

7  
8 Theoretical Reserve = Book Investment - Future Accruals - Future  
9 Net Salvage

10  
11 ~~(l)~~~~(j)~~ Vintage -- The year of placement of a group of plant  
12 items or investment under study.

13 ~~(m)~~~~(k)~~ Whole Life Method -- The method of calculating a  
14 depreciation rate based on the Whole Life (Average Service Life)  
15 and the Average Net Salvage. Both life and salvage components  
16 are the estimated or calculated composite of realized experience  
17 and expected activity. The formula is:

18  
19 Whole Life Rate = 
$$\frac{100\% - \text{Average Net Salvage } \%}{\text{Average Service Life in Years}}$$

20  
21  
22 (2) (a) No utility shall ~~may~~ change any existing depreciation  
23 rate or initiate any new depreciation rate without prior  
24 Commission approval.

25 (b) No utility shall ~~may~~ reallocate accumulated depreciation

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1 reserves among any primary accounts and sub-accounts without  
2 prior Commission approval.

3 (c) When plant investment is booked as a transfer from a  
4 regulated utility depreciable account to another or from a  
5 regulated company to an affiliate, an appropriate reserve amount  
6 shall also be booked as a transfer. When plant investment is  
7 sold from one regulated utility to an affiliate, an appropriate  
8 associated reserve amount shall also be determined to calculate  
9 the net book value of the utility investment being sold.

10 Appropriate methods for determining the appropriate reserve  
11 amount associated with plant transferred or sold are as follows:

- 12 1. Where vintage reserves are not maintained,  
13 synthesization using the currently prescribed curve  
14 shape may be required. The same reserve percent  
15 associated with the original placement vintage of the  
16 related investment shall then be used in determining  
17 the appropriate amount of reserve to transfer.
- 18 2. Where the original placement vintage of the investment  
19 being transferred is unknown, the reserve percent  
20 applicable to the account in which the investment being  
21 transferred resides may be assumed as appropriate for  
22 determining the reserve amount to transfer.
- 23 3. Where the age of the investment being transferred is  
24 known and a history of the prescribed depreciation  
25 rates is known, a reserve can be determined by

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1           multiplying the age times the investment times the  
2           applicable depreciation rate(s).

3           4.   The Commission shall consider any additional methods  
4           submitted by the utilities for determining the  
5           appropriate reserve amounts to transfer.

6           (3) (a) Each utility shall maintain depreciation rates and  
7 accumulated depreciation reserves in accounts or subaccounts as  
8 prescribed by Rule 25-6.014(1), F.A.C. Utilities may maintain  
9 further sub-categorization.

10           (b) Upon establishing a new account or subaccount  
11 classification, each utility shall request Commission approval of  
12 a depreciation rate for the new plant category.

13           (4) A utility filing a depreciation study, regardless if a  
14 change in rates is being requested or not, shall submit to the  
15 Commission Clerk's office fifteen copies of the information  
16 required by paragraphs (6) (a) through (6) (f) and (6) (h) of this  
17 rule and at least three copies of the information required by  
18 paragraph (6) (g).

19           (5) Upon Commission approval by order establishing an  
20 effective date, the utility shall ~~may~~ reflect on its books and  
21 records the implementation of the proposed rates, subject to  
22 adjustment when final depreciation rates are approved.

23           (6) A depreciation study shall include:

24           (a) A comparison of current and proposed depreciation rates  
25 and components for each category of depreciable plant. Current

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1 rates shall be identified as to the effective date and proposed  
2 rates as to the proposed effective date.

3 (b) A comparison of annual depreciation expense as of the  
4 proposed effective date, resulting from current rates with those  
5 produced by the proposed rates for each category of depreciable  
6 plant. The plant balances may involve estimates. Submitted data  
7 including plant and reserve balances or company planning  
8 involving estimates shall be brought to the effective date of the  
9 proposed rates.

10 (c) Each recovery and amortization schedule currently in  
11 effect should be included with any new filing showing total  
12 amount amortized, effective date, length of schedule, annual  
13 amount amortized and reason for the schedule.

14 (d) A comparison of the accumulated book reserve to the  
15 prospective theoretical reserve based on proposed rates and  
16 components for each category of depreciable plant to which  
17 depreciation rates are to be applied.

18 (e) A general narrative describing the service environment  
19 of the applicant company and the factors, e.g., growth,  
20 technology, physical conditions, necessitating a revision in  
21 rates.

22 (f) An explanation and justification for each study category  
23 of depreciable plant defining the specific factors that justify  
24 the life and salvage components and rates being proposed. Each  
25 explanation and justification shall include substantiating

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1 factors utilized by the utility in the design of depreciation  
2 rates for the specific category, e.g., company planning, growth,  
3 technology, physical conditions, trends. The explanation and  
4 justification shall discuss any proposed transfers of reserve  
5 between categories or accounts intended to correct deficient or  
6 surplus reserve balances. It should also state any statistical  
7 or mathematical methods of analysis or calculation used in design  
8 of the category rate.

9 (g) The filing shall contain all calculations, analysis and  
10 numerical basic data used in the design of the depreciation rate  
11 for each category of depreciable plant. Numerical data shall  
12 include plant activity (gross additions, adjustments,  
13 retirements, and plant balance at end of year) as well as reserve  
14 activity (retirements, accruals for depreciation expense,  
15 salvage, cost of removal, adjustments, or transfers and  
16 reclassifications and reserve balance at end of year) for each  
17 year of activity from the date of the last submitted study to the  
18 date of the present study. To the degree possible, data  
19 involving retirements should be aged.

20 (h) The mortality and salvage data used by the company in  
21 the depreciation rate design must agree with activity booked by  
22 the utility. Unusual transactions not included in life or  
23 salvage studies, e.g., sales or extraordinary retirements, must  
24 be specifically enumerated and explained.

25 (7) (a) Utilities shall provide calculations of depreciation

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1 rates using both the whole life method and the remaining life  
2 method. The use of these methods is required for all depreciable  
3 categories. Utilities may submit additional studies or methods  
4 for consideration by the Commission.

5 (b) The possibility of corrective reserve transfers shall be  
6 investigated by the Commission prior to changing depreciation  
7 rates.

8 (8) (a) Each company shall file a study for each category of  
9 depreciable property for Commission review at least once every  
10 four years from the submission date of the previous study unless  
11 otherwise required by the Commission.

12 (b) A utility proposing an effective date of the beginning  
13 of its fiscal year shall submit its depreciation study no later  
14 than the mid-point of that fiscal year.

15 (c) A utility proposing an effective date coinciding with  
16 the expected date of additional revenues initiated through a rate  
17 case proceeding shall submit its depreciation study no later than  
18 the filing date of its Minimum Filing Requirements.

19 (9) As part of the filing of the annual report pursuant to  
20 Rule 25-6.014(3), F.A.C., each utility shall include an annual  
21 status report. The report shall include booked plant activity  
22 (plant balance at the beginning of the year, additions,  
23 adjustments, transfers, reclassifications, retirements and plant  
24 balance at year end) and reserve activity (reserve balance at the  
25 beginning of the year, retirements, accruals, salvage, cost of

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1 removal, adjustments, transfers, reclassifications and reserve  
2 balance at end of year) for each category of investment for which  
3 a depreciation rate, amortization, or capital recovery schedule  
4 has been approved. The report shall indicate for each category  
5 that:

6 (a) There has been no change of plans or utility experience  
7 requiring a revision of rates, amortization or capital recovery  
8 schedules; or

9 (b) There has been a change requiring a revision of rates,  
10 amortization or capital recovery schedules.

11 (10) For any category where current conditions indicate a  
12 need for revision of depreciation rates, amortization or capital  
13 recovery schedules and no revision is sought, the report shall  
14 explain why no revision is requested.

15 ~~(10)~~(a) Prior to the date of retirement of major  
16 installations, the Commission shall ~~may~~ approve capital recovery  
17 schedules to correct associated calculated deficiencies where a  
18 utility demonstrates that (1) replacement of an installation or  
19 group of installations is prudent and (2) the associated  
20 investment will not be recovered by the time of retirement  
21 through the normal depreciation process.

22 (b) The Commission shall ~~may~~ approve a special capital  
23 recovery schedule when an installation is designed for a specific  
24 purpose or for a limited duration.

25 (c) Associated plant and reserve activity, balances and the

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1 annual capital recovery schedule expense must be maintained as  
2 subsidiary records.

3 Specific Authority 350.127(2), 366.05(1) FS.

4 Law Implemented 350.115, 366.04(2)(f), 366.06(1) FS.

5 History--New 11-11-82, 1-6-85, Formerly 25-6.436, Amended  
6 4-27-88, 12-12-91,                     .

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