

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Innovation, Industry, and Technology

BILL: CS/SB 796

INTRODUCER: Innovation, Industry, and Technology Committee and Senator Gruters and others

SUBJECT: Public Utility Storm Protection Plans

DATE: March 19, 2019 **REVISED:** _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wiehle</u>	<u>Imhof</u>	<u>IT</u>	<u>Fav/CS</u>
2.	<u>Price</u>	<u>Miller</u>	<u>IS</u>	<u>Pre-Meeting</u>
3.	_____	_____	<u>AP</u>	_____

I. Summary:

CS/SB 796 creates a recovery clause¹ for storm protection costs instead of recovering these costs through base rates, as is done now; provides for recovery of a return on capital costs (profit) through the clause; and potentially requires the Public Service Commission (PSC or commission) to approve cost recovery without consideration of the actual costs. The bill makes specific legislative findings that it is in the public interest to promote storm protection activities that will reduce restoration costs and outage times and increase reliability.

The bill applies to only public utilities, which are the investor-owned utilities (IOUs): Florida Power and Light, Duke Energy Florida, Gulf Power Company, Tampa Electric Company, and the Florida Public Utilities Corporation. Initially, the bill builds on PSC rule, requiring that, as part of the storm hardening plan required by the rule, each IOU must submit to the commission for review and approval a transmission and distribution storm protection plan that covers 30 years.

The commission must approve or modify the proposed plan, as appropriate, within 6 months after the IOU initially submits the plan. In reviewing the plan, the commission must give due consideration to:

- Whether the plan enhances reliability, strengthens infrastructure, and reduces restoration costs and outage times in a prudent, practical, and cost-efficient manner.
- Whether transmission and distribution storm protection of electric infrastructure is feasible, reasonable, or practical in certain areas of the public utility’s service territory, including, but not limited to, flood zones and rural areas.

¹ Most of an investor-owned utility’s costs and profits are recovered through base rates, the per-kilowatt-hour charges on a customer’s bill. Recovery clause charges are additional charges, usually in separate line item charges on the bill. A recovery clause is typically used to make an annual recovery of costs that are difficult to plan for, are a simple pass-through of actual costs, do not include capital costs or a return on those capital costs, and for which regulatory lag in recovering such costs would be problematic.

Each public utility must submit an updated transmission and distribution storm protection plan at least every three years after commission approval of its most recent plan. The commission must approve or modify the plan using the same considerations as applied to the original plan.

The bill creates a storm protection cost recovery clause and requires the commission to conduct an annual proceeding to allow a public utility to justify and recover transmission and distribution storm protection plan costs through the cost recovery clause. Action taken by a public utility for storm protection of transmission and distribution facilities pursuant to a commission-approved plan is deemed prudent, but a party may challenge the commission's determination of prudence.

The annual cost recovery through the storm protection cost recovery clause must be stated separately from the public utility's base rates. If a capital expenditure cost is recoverable through the recovery clause, the IOU may recover annual depreciation and a return on capital.

The bill requires the commission to adopt rules to implement and administer its provisions.

The bill takes effect July 1, 2019.

II. Present Situation:

Electric Utilities and the Public Service Commission

Chapter 366, F.S., provides for regulation of electric utilities in Florida. Section 366.02, F.S., provides definitions for these purposes.

- "Commission" means the Florida Public Service Commission.
- "Electric utility" means any municipal electric utility, investor-owned electric utility, or rural electric cooperative which owns, maintains, or operates an electric generation, transmission, or distribution system within the state.
- "Public utility" means every person, corporation, partnership, association, or other legal entity and their lessees, trustees, or receivers supplying electricity ... to or for the public within this state; but the term "public utility" does not include either a cooperative now or hereafter organized and existing under the Rural Electric Cooperative Law of the state; a municipality or any agency thereof;

The commission has grid reliability authority over all Florida electric utilities.² It has full economic regulation authority over the public utilities, including setting rates, and ensuring service quality standards.³ The public utilities are the investor-owned utilities: Florida Power and Light, Duke Energy Florida, Gulf Power Company, Tampa Electric Company, and the Florida Public Utilities Corporation.

Hurricane-Related Costs

Until recently, the subject of electric utility costs associated with a hurricane meant the costs of post-hurricane repair of the electric grid, the system of transmission and distribution lines and associated infrastructure. Then after the 2004-2005 hurricane seasons, there was an emphasis on

² Sections 366.04(2)(c) and 366.05(8), F.S.

³ Section 366.04(1), F.S.

storm hardening and the resulting costs. The IOUs now incur, and recover from their ratepayers (their customers), two types of costs associated with hurricanes and storms: after-the-fact repair costs and pre-storm hardening costs.⁴

Storm hardening and cost recovery are governed by PSC rule.⁵ The rule applies to all IOUs and is intended:

- To ensure safe, adequate, and reliable electric transmission and distribution service for both operational and emergency purposes;
- To require the cost-effective strengthening of critical electric infrastructure to increase the ability of transmission and distribution facilities to withstand extreme weather conditions; and
- To reduce restoration costs and outage times associated with extreme weather conditions.

Under the rule, each IOU filed an initial plan for the PSC's review and approval, after which each utility's plan must be updated every three years. In a proceeding to approve a utility's plan, the commission is to consider whether the utility's plan meets the desired objectives of enhancing reliability and reducing restoration costs and outage times in a prudent, practical, and cost-effective manner to the affected parties.

The rule requires each utility storm-hardening plan to contain a detailed description of the construction standards, policies, practices, and procedures to be employed to enhance the reliability of overhead and underground electrical transmission and distribution facilities. Each filing must, at a minimum, address the extent to which the utility's storm hardening plan:

- Complies with a specified national safety code;
- Adopts specified extreme wind loading standards;
- Is designed to mitigate damage to underground and supporting overhead transmission and distribution facilities due to flooding and storm surges; and
- Provides for the placement of new and replacement distribution facilities to facilitate safe and efficient access for installation and maintenance.

Each storm hardening plan must explain the systematic approach the utility will follow to achieve the desired objectives of enhancing reliability and reducing restoration costs and outage times associated with extreme weather events. The explanation of the deployment strategy must include, but is not limited to, the following:

- A description of the facilities affected, including technical design specifications, construction standards, and construction methodologies employed;
- The communities and areas within the utility's service area where the electric infrastructure improvements are to be made;
- The extent to which the electric infrastructure improvements involve joint-use facilities on which third-party attachments exist;
- An estimate of the costs and benefits to the utility of making the improvements, including the effect on reducing storm restoration costs and customer outages; and

⁴ Florida Public Service Commission, *Review of Florida's Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 5 (July 2018).

⁵ Fla. Admin. Code R. 25-6.0342 (2007).

- An estimate of the costs and benefits to third-party attachers affected by the electric infrastructure improvements, including the effect on reducing storm restoration costs and customer outages realized by the third-party attachers.

Approval of an IOU's storm-hardening plan does not guarantee the IOU the recovery of all costs incurred to implement the plan. After the IOU takes steps to implement the plan, the IOU must seek cost recovery during its next general rate case proceeding, where the PSC reviews the costs and determines whether they were prudently incurred before adding the approved costs to the IOU's base rates.⁶ This helps to protect the IOU's ratepayers.

Each IOU has a rate-case settlement in place with a provision freezing the IOU's base rates and they can't get an increase to recover these costs until the settlement expires and they initiate another rate case.

Recovery Clauses

The vast majority of an IOU's general costs of providing service, including the IOU's profit, or allowed range of rates of return, is recovered through base rates. Base rates are set in a rate case, where all of an IOU's projected costs of doing business are reviewed and individual costs or categories of costs can be reviewed separately for a determination of accuracy and prudence. All approved costs are added together, an allowed range of rates of return is set, and a "revenue requirement" is established, the total revenue necessary to recover all these costs and the profit. The rates for different customer classes are then set that will provide recovery of this revenue requirement. The process protects the interests of both the IOU and its ratepayers.

There are, however, some exceptions where costs are recovered through a recovery clause, an additional charge usually in separate line item charge on the bill. The primary recovery clause is the fuel-cost recovery clause charge. Fuel costs can vary, sometimes significantly, from year to year and are recovered through the fuel-cost recovery clause. A recovery clause is used when the costs at issue are volatile, unusual, or short-term and are therefore difficult to plan for, and when regulatory lag in recovering such costs would be problematic. Recovery clause proceedings are typically conducted on an annual basis and provide only for a pass-through of actual costs. As capital expenditures are typically made based on long-term plans, recovery clauses typically do not include capital costs or a return on those capital costs. An IOU cannot use a recovery clause to recover capital expenses and a rate of return on those expenses when there is an existing, applicable rate-settlement agreement containing a rate freeze.⁷

Undergrounding Lines

The construction of underground electrical distribution systems is more expensive than overhead systems, and the ratepayers served by the underground line are responsible for the difference in the costs between underground and overhead. The costs and benefits of storm hardening are

⁶ Florida Public Service Commission, *Review of Florida's Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 12 (July 2018).

⁷ See, e.g., *Citizens of the State v. Graham*, 213 So. 3d 703, 715-717 (Fla. 2017).

factored into the cost difference calculation for new construction or conversion to underground facilities.⁸

The data collected after Hurricane Irma showed that underground lines suffered minimal outages during storms. It should be noted that while underground facilities fared particularly well during Hurricane Irma, they still are susceptible to damage caused by uprooted trees and flooding, and these repairs typically take longer to complete.⁹

In response to data requests from PSC staff, the three largest IOUs¹⁰ stated that approximately 40 percent of all distribution lines are underground and that the majority of recent underground projects were for new construction, rather than the conversion of overhead to underground. Since 2006, the installed underground facilities have increased by approximately 5,300 miles for the IOUs. The total amount of installed underground facilities during the past five years was approximately 2,200 miles for an average rate of 440 miles/year.¹¹

In an effort to further the deployment of underground facilities, Duke Energy Florida and Florida Power and Light have initiated targeted undergrounding programs that: began in 2018, focused on historically poor performing lateral circuits¹² to replace several hundred miles of overhead lines, and were funded through current base rates. Duke Energy Florida's pilot program is scheduled over a period of ten years and Florida Power and Light's for three years. The goal for each program is to test different construction techniques and identify impediments to converting these targeted overhead facilities to underground.¹³

III. Effect of Proposed Changes:

The bill creates s. 366.96, F.S., to require a recovery clause for storm protection costs, provide for recovery of a return on capital costs (profit) through the clause, and potentially require commission approval of recovery without consideration of the cost.

The bill makes legislative findings that it is in the public interest to promote storm protection activities that will reduce restoration costs and outage times and increase reliability. It creates the following definitions.

- “Transmission and distribution storm protection plan” or “plan” means a plan for the overhead hardening of electric transmission and distribution facilities, undergrounding of electric distribution facilities, and increased vegetation management.
- “Transmission and distribution storm protection plan costs” means the reasonable and prudent costs to implement an approved transmission and distribution storm protection plan.

⁸ Florida Public Service Commission, *Review of Florida's Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 12 (July 2018).

⁹ *Id.*, 30.

¹⁰ Florida Power and Light, Duke Energy Florida, and Tampa Electric Company.

¹¹ Florida Public Service Commission, *Review of Florida's Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 11-12 (July 2018).

¹² An IOU's distribution grid consists of feeder and lateral circuits. Feeders run outward from substations and can serve thousands of customers. Laterals branch out from feeders and are the final portion of the electric delivery system, serving smaller numbers of customers and typically associated with residential areas. Florida Public Service Commission, *Review of Florida's Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 9-10 (July 2018).

¹³ *Id.*, 12.

- “Vegetation management” means the actions a public utility takes to prevent or curtail vegetation from interfering with public utility infrastructure. The term includes the mowing of vegetation, application of herbicides, trimming of trees, and removal of trees or brush near and around electric transmission and distribution facilities.

The bill requires each public utility to file for commission review, as part of its storm hardening plan required by the commission under s. 366.04(2)(c), F.S., a transmission and distribution storm protection plan that covers 30 years. The commission must approve or modify the plan within 6 months after the public utility files the plan with the commission. In doing so, the commission must give due consideration to whether:

- The plan enhances reliability, strengthens infrastructure, and reduces restoration costs and outage times in a prudent, practical and cost-efficient manner. The plan should prioritize areas in order to generate the highest impact on system resiliency and efficiency and should focus on areas with large numbers of customers, high frequency outages, and lengthy outages.
- Storm protection of transmission and distribution infrastructure is feasible, reasonable, or practical in certain areas of the utility’s service territory, including in flood zones and rural areas.

Each public utility must submit an updated transmission and distribution storm protection plan at least every three years after commission approval of its most recent plan. The commission must approve or modify the plan using the same considerations as applied to the original plan.

The bill requires the commission to conduct an annual proceeding to allow a public utility to justify and recover transmission and distribution storm protection plan costs through a storm protection cost recovery clause. Action taken by a public utility for storm protection of transmission and distribution facilities pursuant to a commission-approved plan is deemed prudent, but a party may challenge the commission’s determination of prudence.

The annual transmission and distribution storm protection plan costs that are recoverable through the storm protection cost recovery clause must be stated separately from the public utility’s base rates and must be allocated to customer classes pursuant to the rate design most recently approved by the commission. If a capital expenditure cost is recoverable through a storm protection cost recovery clause, the public utility may recover the annual depreciation on such cost, calculated at the public utility’s current approved depreciation rates. The IOU may also recover a return on the depreciated balance of the costs calculated at the public utility’s weighted average cost of capital using the return on equity last approved by the commission in a rate case or settlement order.

The bill requires the commission to adopt rules to implement and administer its provisions.

The bill takes effect July 1, 2019.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

Each IOU may have to wait until its currently applicable rate settlement agreement expires to use the storm protection cost recovery clause provisions of the bill. Both the federal and State constitutions prohibit passage or implementation of a law impairing the obligation of contracts.¹⁴ A settlement agreement is a contract, and this prohibition would be applicable. The question, then, is whether the State's "significant and legitimate public purpose" outweighs the intrusion into the parties' bargain.¹⁵ Allowing an IOU to recover capital expenses and a rate of return despite a rate freeze provision in a settlement agreement may violate the constitution's prohibition against impairment of contract.

V. Fiscal Impact Statement:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

Public utilities will incur unknown costs to develop and implement the transmission and distribution storm protection plans, which will be passed on to their customers. Customers will get the benefits of the energy grid improvements, but these benefits cannot be quantified with any certainty because they depend on many variables, such as what improvements are made and the details of future storms and outages.

¹⁴ U.S. CONST. art. I, s. 10 and FLA. CONST. art. I, s.10.

¹⁵ See, e.g., *Searcy, Denney, Scarola, Barnhart & Shipley, Etc., et al. v. State of Florida*, 209 So. 3d 1181 (Fla. 2017), 1192

C. Government Sector Impact:

The PSC will incur costs to adopt the required rules and to hold hearings to develop the disaster preparation and energy grid improvement plans. There will be additional costs to continue to monitor and periodically modify the plans. These costs have not yet been estimated.

These proceedings will also involve the Office of Public Counsel,¹⁶ which will also incur costs.

VI. Technical Deficiencies:

Lines 58-62 and 66-71 define “transmission and distribution storm protection plan” to include the costs of “increased vegetation management” and define “vegetation management” in a broadly inclusive manner. Existing storm hardening plans include vegetation management¹⁷ and the resulting costs are included in existing base rate charges,¹⁸ so it is unclear how future vegetation management costs would be recovered. Even if the phrase “increased vegetation management” limits clause recovery in some way, it may be difficult to separate a base line of vegetation management activities and costs from increased activities and costs, particularly as time passes.

VII. Related Issues:

In their analysis on the bill, the Public Service Commission staff raised several concerns.¹⁹

The Prudence Standard

The PSC’s longstanding practice for determining prudence is “consideration of what a reasonable utility manager would have done, in light of the conditions and circumstances which were known, or should have been known, at the time the decision was made.” This standard results in assessing the utility’s actions and decisions that give rise to the costs incurred. If an action or decision was prudent then the resulting costs were prudently incurred and recoverable from customers. However, if an action or decision was not prudent, then the resulting costs were not prudently incurred and are not recoverable from customers.

The bill states “[a]ll actions taken in implementing the storm protection plan are considered prudent, but a party may challenge the prudence of the costs associated with such actions.”²⁰ The standard of review for determining prudence as expressed in the language of the bill may not be consistent with the PSC’s longstanding practice. With a presumption that all utility actions are prudent, it is unclear how a party can challenge the prudence of costs associated with those actions.

¹⁶ The Office of Public Counsel represents utility customers in PSC proceedings (s. 350.0611, F.S.).

¹⁷ Florida Public Service Commission, *Review of Florida’s Electric Utility Hurricane Preparedness and Restoration Actions 2018*, 5 (July 2018).

¹⁸ *Id.*, 12.

¹⁹ 2019 Agency Legislative Bill Analysis issued by the PSC for SB 796, dated March 4, 2019 (on file with Senate Committee on Innovation, Industry, and Technology).

²⁰ While the language quoted has changed in the committee substitute, it appears the concern should continue.

Approval of a Storm Protection Plan versus a Storm Hardening Plan

Currently, commission approval of storm hardening plans do not constitute a finding that costs to implement the plan are prudently incurred. The bill does not appear to require changes to the commission's current review of storm hardening plans or the method of cost recovery for their implementation. The activities and costs incurred for storm hardening remain a consideration during rate cases.

However, the commission must address storm protection plans differently because implementation of the storm protection plan activities and associated costs will become subject to an annual clause. Commission orders on storm protection plans may need to address in detail each activity, level of activity, management oversight, and other similar aspects in addition to the specific factors set forth in the bill.

Separating Storm Protection Plan Cost Recovery from Base Rate Revenues

According to the commission, revenues from base rates are currently addressing the utility's costs for targeted undergrounding and all storm hardening activities. Utility activities and costs fluctuate year-to-year based in part on the utility's management decisions and external factors such as extreme weather events. Year-to-year fluctuation of costs that are addressed by base rate revenues is normal.

The commission indicated that the intent of the bill appears to promote an incremental increase of the same types of activities and costs that are already described by the existing storm hardening plans. However, there is no direct mechanism to measure or establish exactly what level of activities and associated costs are included in current base rates because fluctuations are normal. Consequently, there could be tension in assessing the level of activity and ultimately the costs that may qualify for recovery through the clause.

Administrative Timeline

The commission indicated that allowing only six months for the commission to complete its review of a public utility's transmission and distribution storm protection plans, hold hearings, and make a determination of approval or modification is aggressive. The bill language is unclear whether the six month period includes the additional time after commission vote that may be necessary for issuance of a final order. It is unlikely that six months is reasonably sufficient for an intervening party to perform a rigorous review assessing the factors required by the bill and validating that the costs identified by the utility are not included in base rates. In March 2016, all five public utilities filed storm hardening plans and the PSC voted on the plans in December, reflecting an administrative timeline of nine months.

Return on the Depreciated Balance versus Return on Undepreciated Balance

The bill describes costs that can be recovered through the clause. The costs include "a return on the depreciated balance." However, this is a departure from current accounting practice. Current accounting practice is to allow a utility to earn a return on the undepreciated balance. The

undepreciated balance is the utility's remaining investment that has not been recovered. The depreciated balance is the sum of the annual amounts that the utility collects as depreciation expense through commission established rates.

VIII. Statutes Affected:

This bill creates section of the Florida Statutes.

IX. Additional Information:

- A. **Committee Substitute – Statement of Substantial Changes:**
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Innovation, Industry, and Technology on March 6, 2019:

The committee substitute:

- Requires each transmission and distribution storm protection plan to cover 30 years of planned improvements;
- Provides each plan should prioritize areas in order to generate the highest impact on system resiliency and efficiency and should focus on areas with large numbers of customers, high frequency outages, and lengthy outages;
- Deletes from the bill all provisions relating to federal corporate income tax benefits;
- Deletes from the bill the restriction on undergrounding (burying) of lines to no more than four percent of a utility's lateral distribution lines per year;
- Deletes from the bill the reference to ch. 120, F.S., in the provisions on Public Service Commission approval of a plan;
- Revises the provisions on updates plans to require that they address at least a 30-year period, require that the Public Service Commission approve or modify each updated plan, and require that it do so using the criteria used for approving or modifying the original plan; and
- Deletes the definitions of the terms commission and public utility, as those terms are already defined within ch. 366, F.S.

- B. **Amendments:**

None.