**FLORIDA PUBLIC SERVICE COMMISSION**

**Fletcher Building**

**101 East Gaines Street**

**Tallahassee, Florida 32399-0850**

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

**August 19, 1993**

**TO: DIRECTOR, DIVISION OF RECORDS & REPORTING**

**FROM: DIVISION OF ELECTRIC & GAS [BASS, BREMAN, SHEA, TAYLOR, WHEELER]**

**DIVISION OF LEGAL SERVICES [CANZANO]**

**DIVISION OF RESEARCH & REGULATORY REVIEW [ADAMS, HARLOW]**

**DIVISION OF AUDITING & FINANCIAL ANALYSIS [MAUREY, MEEKS, ROMIG, HICKS, MERTA, STALLCUP, MCNULTY]**

**RE: DOCKET NO. 930613-EI - GULF POWER COMPANY - PETITION TO ESTABLISH AN ENVIRONMENTAL COST RECOVERY CLAUSE PURSUANT TO SECTION 366.825, FLORIDA STATUTES, BY GULF POWER COMPANY**

**AGENDA: AUGUST 31, 1993 - CONTROVERSIAL AGENDA - PROPOSED AGENCY ACTION - PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\EAG\WP\930613.RCM**

**STAFF ANALYSIS TO BE FILED ON 8/24/93**

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**CASE BACKGROUND**

On June 22, 1993 Gulf Power Company (Gulf) filed a petition to establish an environmental cost recovery (ECR) clause pursuant to Section 366.8255, Florida Statutes. Gulf requested that its petition be considered during the fuel adjustment hearings scheduled for August 18-19, 1993. Gulf also requested it be allowed to implement initial ECR factors concurrently with new fuel cost recovery factors that will become effective October 1, 1993. The Commission has scheduled hearings to consider Gulf's petition on December 8-9, 1993. Because Gulf wants to begin recovering environmental costs on October 1, 1993, the company has filed a motion for authorization to implement ECR factors pending the hearing and decision schedule. That motion is the subject of this recommendation.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should the Commission schedule proceedings so that the Commission may address the merits of Gulf's petition in this docket through hearings and a decision by the Commission prior to the end of calendar year 1993?

**RECOMMENDATION:** Since the Commission has already scheduled this docket for Commission decision prior to the end of the year, this issue is moot.

**STAFF ANALYSIS:** As reflected on the attached CASR, the issues raised in this docket will be considered at a hearing on December 8-9, 1993 and at the Commission's agenda conference on December 21, 1993. (See Attachment A)

**ISSUE 2:** Should the Commission authorize Gulf to collect revenues through the implementation of the proposed environmental cost recovery factors beginning with cycle 1 meter readings scheduled for September 29, 1993?

**RECOMMENDATION:** No. The Commission should not authorize Gulf to collect revenues through ECR factors for environmental costs that have not been demonstrated to be necessary or prudent.

**STAFF ANALYSIS:** Gulf's request to begin recovery of incurred and projected environmental compliance costs on October 1, 1993 should be denied because of the following reasons:

1. Gulf's request for early recovery does not comply with the statute. Section 366.8255, Florida Statutes, clearly requires a finding of prudence before cost recovery can occur. According to the statute, if the environmental costs are found to be necessary and prudent, then and only then may they be included in an environmental cost recovery factor. Gulf's request is premature.

2. It appears that a significant amount of the environmental costs Gulf seeks to recover through the environmental cost recovery factor does not conform to the intent of Section 366.8255, Florida Statutes. Gulf has requested recovery of costs associated with projects included in its last rate case, thus using the environmental cost recovery factor as a base rate true-up mechanism. Staff believes that Section 366.8255, F.S., was enacted to address only new project costs not included in the company's last rate case.

3. Gulf has allocated its environmental costs primarily based on demand. Staff believes that a significant portion of Gulf's environmental costs should be allocated on the basis of energy. An example is the cost of complying with the Clean Air Act Amendments of 1990 which are primarily driven by the amount of fuel burned. If Gulf is required to reallocate its environmental costs as a result of the December 8 hearings, bills for some classes of customers would go up while bills for other classes of customers would go down.

Each of these concerns is addressed in further detail in the following discussion.

Section 366.8255, Florida Statutes, was signed into law on April 13, 1993. This section states, in part,

(2) An electric utility may submit to the commission a petition describing the utility's proposed environmental compliance activities and projected environmental compliance costs in addition to any Clean-Air-Act-compliance activities and costs shown in a utility's filing under s. 166.825. If approved, the commission shall allow recovery of the utility's prudently incurred environmental compliance costs...

This excerpt from the statute clearly states that if the Commission approves a utility's petition then recovery of prudently incurred environmental compliance costs will be allowed. Gulf has requested that it be allowed to implement its proposed environmental cost recovery (ECR) factors prior to a scheduled hearing and to the Commission's decision on the merits of its petition. Gulf is asking the Commission to require the company's ratepayers to pay for environmental costs that the company has not demonstrated to be reasonable, necessary or prudent.

Further, it appears that certain costs for which Gulf seeks recovery do not comply with the intent of the statute. Staff believes the intent of Section 366.8255, Florida Statutes, is to allow a utility to recover environmental costs associated with an action which has not been considered in another proceeding. Staff does not believe the statute was intended to create a base rate true-up mechanism to recover costs associated with a change in forecasts. Although discovery is incomplete at this time, it appears that Gulf's petition anticipates that the environmental cost recovery clause will provide a base rate true-up mechanism. The interpretation and implementation of Section 366.8255, Florida Statutes, represents one of the policy issues that needs to be addressed by this Commission prior to allowing Gulf to recover environmental costs.

Staff believes that the Commission's resolution of policy issues and its decision on the necessity and prudence of incurred and projected environmental costs prior to recovery of these costs complies with the statute, represents good regulatory practice, and is requisite to allowing the company to recover these costs from its ratepayers. The Commission's decision to allow Gulf to recover environmental costs should be based on substantial and competent evidence that should be presented during Gulf's scheduled hearing. Until the Commission makes its decision, Gulf should not be allowed to recover environmental costs from its ratepayers.

Staff's concerns regarding the appropriateness of Gulf's proposed cost allocation methodology is discussed in the Staff Analysis of Issue 5.

After Gulf's hearing on its petition, if the Commission determines that the company should be allowed to begin recovering revenues associated with environmental costs, the company could implement environmental cost recovery factors on January 1, 1994. Implementing a cost recovery factor on this date represents only a three-month delay in the collection of revenues. Staff does not believe this delay in implementation would have a significant negative impact on the utility's ratepayers through the interest provisions of the true-up mechanism. The delay would ensure that the ratepayers are paying for environmental costs that the Commission has determined to be necessary and prudent and in compliance with the new law.

**ISSUE 3:** If the Commission allows Gulf to begin collecting revenues for environmental costs, for what period of time should the factor be in effect?

**RECOMMENDATION:** The environmental cost recovery factor should be in effect through March 31, 1994.

**STAFF ANALYSIS:** An stated in Issue 2, staff does not recommend cost recovery until after a hearing has been held. If the Commission does allow recovery before the scheduled hearing, Gulf has requested approval to implement an environmental cost recovery factor for the period October 1993 through September 1994. The company proposes to establish an annual factor that would be reviewed each August with any resulting changes to be effective from October through September.

Staff believes the establishment of an annual factor is inappropriate at this time. Staff believes the environmental cost recovery clause should run concurrently with the fuel cost recovery clause which is currently on a six-month time period. This is the first time the Commission and the electric utilities have dealt with many of the environmental costs that may ultimately be recovered through this clause. Limiting recovery and projections of environmental costs to six-month periods would lessen the possibility of excessive over- and underrecoveries which may result from cost projections further into the future.

Regardless of when the Commission determines Gulf should begin recovering the revenue associated with environmental costs, staff recommends that the environmental cost recovery factor should be in effect through March 31, 1994.

**ISSUE 4:** If the Commission allows Gulf to begin collecting revenues for environmental costs, should those collections be subject to refund and true-up?

**RECOMMENDATION:** Yes. Any revenue collected by Gulf for environmental costs should be subject to refund and true-up.

**STAFF ANALYSIS:** Gulf has requested that it be allowed to implement its proposed ECR factor, subject to true-up. The company contends that the true-up mechanism provides a reasonable and adequate means of addressing the differences, if any, between revenue requirements for its environmental activities and the revenue requirements approved by the Commission.

Staff agrees that if the company is allowed to implement proposed ECR factors, those factors will be subject to true-up. However, staff does not agree that a true-up mechanism alone is an adequate means of addressing any adjustments resulting from differences in projected and approved revenue requirements. Any costs allowed to be recovered prior to being found to be prudent after a public hearing should also be subject to refund with interest. The Commission has traditionally used the true-up mechanism in cost recovery clauses to adjust for differences in projected and actual costs for items previously approved for recovery by the utility. However, when a utility has requested recovery of projected costs associated with new projects, the Commission allowed those costs to be recovered subject to refund pending further discovery and review of the specific projects by staff and other parties. As recently as February 1993, the Commission allowed Florida Power and Light Company and Florida Power Corporation to recover, subject to refund, projected costs associated with the decontamination and decommissioning of Department of Energy uranium enrichment plants. The Commission determined that additional time was needed to more fully address the appropriateness of the recovery of those costs through the fuel adjustment cost recovery clause.

Gulf is requesting recovery of costs associated with new projects that have not been reviewed by this Commission or any other party. Until the Commission has had the opportunity to review those projects and determine the appropriate manner for recovery of those costs, any revenues collected by Gulf through the ECR factors should be collected subject to refund and true-up.

**ISSUE 5:** If the Commission allows Gulf to begin collecting revenues for environmental costs beginning with the cycle 1 meter readings scheduled for September 29, 1993, how should those costs be allocated to the various rate classes?

**RECOMMENDATION:** Staff has significant concerns regarding the manner in which Gulf has proposed to allocate environmental compliance costs among the rate classes. Staff believes that these important decisions regarding cost allocation should be fully addressed at the hearing scheduled for December 8-9, 1993. If Gulf is allowed to begin collecting environmental costs beginning September 29, 1993, staff believes that, at a minimum, all compliance costs relating to the Clean Air Act should be re-allocated on an energy basis.

**STAFF ANALYSIS:** Staff disagrees with the manner in which environmental costs are allocated by Gulf in its proposed Environmental Cost Recovery Mechanism. Gulf proposes to allocate most of its environmental costs based on 12 CP and 1/13th method, which was the Commission-approved method used to allocate production costs in Gulf's last rate case. This method allocates approximately 92 percent of costs based on each class's contribution to the twelve monthly system peak demand hours. The remaining 8 percent of the costs, the 1/13th portion, is allocated on an energy basis. A demand allocator assigns more costs to those classes with lower load factors, such as residential and general service - non-demand, than would an energy allocator. Although staff is still conducting discovery for the December 8 hearings, it appears that many of Gulf's environmental costs should be allocated on the basis of energy. For example, the compliance costs incurred to comply with the Clean Air Act Amendments of 1990 are directly related to the amount of SO2 and NOx emissions from Gulf's plants. The amount of SO2 and NOx emissions are clearly related to the rate and quantity of fuel burned at the plant to produce kilowatt hours, not kilowatt demand.

The proper allocation of costs is an issue to be discussed at the December 8 hearing. Staff is concerned that if Gulf is allowed to recover its environmental costs subject to review and refund based on a predominately demand allocation at this time, costs may have to be reallocated pending the final resolution of the allocation issue at the December 8 hearings. Even if all of Gulf's proposed environmental costs are found to be prudent and recoverable pursuant to the cost recovery statute, customers would have to be rebilled, with some classes receiving refunds and some classes receiving additional costs, should the Commission not agree with Gulf's 12 CP and 1/13th allocation method.

As is stated in Issue 2, staff is recommending that Gulf's petition for early recovery be denied at this time. If, however, the Commission decides to allow Gulf to recover its environmental costs subject to review and refund in the December hearings, staff would recommend that, at a minimum, the environmental costs associated with Gulf's compliance with the Clean Air Act Amendments of 1990 be allocated on an energy basis.

**ISSUE 6:** Should the Commission provide that the time for requesting a Section 120.57 hearing be 14 days from the issuance of the notice of proposed agency action?

**RECOMMENDATION:** Yes, in order to decide the issue prior to the beginning of the requested recovery date of October 1, 1993.

**STAFF ANALYSIS:** Ordinarily after agenda conference, the Commission issues a written notice of proposed agency action and permits a substantially affected person 21 days after the date of the issuance of the notice in which to file a request for a Section 120.57 hearing. Rule 25-22.029(2) provides in part that

(f)or good cause shown, the Commission may provide that the time for requesting a 120.57 hearing shall be 14 days from issuance of the notice.

In this instance, we have a motion by Gulf requesting recovery subject to true-up of its environmental compliance costs beginning October 1, 1993. Should the Commission's decision be protested by any person whose substantial interests are affected, a hearing date could be established and the contested issues resolved prior to October 1, 1993, if the Commission allows a 14-day protest period. Staff recommends that if this issue is approved, the notice of proposed agency action should be issued no later than September 3, 1993. The protest period should end no later than 14 days after the issuance of the notice of proposed agency action. If anyone whose substantial interests may be affected requests a Section 120.57 hearing, staff recommends that the hearing be set for September 28, 1993, following the agenda conference.

**ISSUE 7:** Should this docket be closed?

**RECOMMENDATION:** No.

**STAFF ANALYSIS:** Hearings are scheduled for December 8-9, 1993 to more fully address the issues in this docket.