FLORIDA PUBLIC SERVICE COMMISSION
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MEMORANDUM

JANUARY 23, 1997

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF ELECTRIC & GAS (BERG) WBB CS
DIVISION OF LEGAL SERVICES (JOHNSON) VDJ RVE RG JDJ

RE: DOCKET NO. 970001-EI - FUEL AND PURCHASED POWER COST RECOVERY CLAUSE WITH GENERATING PERFORMANCE INCENTIVE FACTOR.

AGENDA: 2/4/97 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\EAG\WP\970001.RCM

CASE BACKGROUND

The Office of Public Counsel (OPC) raised the issue of the appropriate recovery of fuel costs associated with wholesale sales during the March 1996 fuel hearings, PSC Docket No, 960001-EI. OPC asked that the Commission issue a generic policy statement on whether a utility could recover any revenue shortfall that existed between the fuel revenues a utility actually received from a wholesale sale when those revenues were less than system average fuel costs. The issue was deferred until the August 1996 fuel hearing. Parties were provided an opportunity to present testimony in support of their individual positions. At the hearing, the Commission choose not to make a bench decision and requested that the parties provide posthearing statements and that staff submit a recommendation to the Commission for its consideration at a future agenda conference.

DISCUSSION OF ISSUES

ISSUE 1: Should an electric utility be permitted to include, for retail cost recovery purposes, fuel cost of generation at any time its units exceed, on a cents-per kilowatt-hour basis, the average fuel cost of total generation (wholesale plus retail) out of those same units?

RECOMMENDATION: Yes, for non-separated sales and no, for separated sales. For existing and prospective non-separated sales, the actual total revenues received from the sale should be credited to the fuel adjustment clause. Companies should still retain the

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Commission approved 20 percent shareholder incentive on Broker sales. Prospectively, for sales that are subject to a jurisdictional separation factor, average system fuel revenues should be credited to the fuel adjustment clause regardless of the actual amount of fuel revenues the utility receives from the sale. Utilities should be afforded the opportunity, however, to demonstrate that incremental fuel pricing for each new separable sale is beneficial to the retail ratepayer on a case-by-case basis during the Commission's ongoing fuel adjustment hearings.

POSITION OF PARTIES:

FPC: For non-separated wholesale sales, incremental fuel costs may be included if all non-fuel revenues are also included. For separated sales, fuel costs should be assigned consistent with the assignment of fixed costs. Most importantly, the Commission should provide guidance so that all utilities may compete for wholesale sales under the same rules.

TECO: While this issue, as stated, is easily misunderstood, Tampa Electric believes that wholesale sales at incremental costs are appropriate so long as there are overall system benefits. Existing review procedures are adequate to ensure that this condition is met. No problem has been identified and no additional Commission processes are needed.

GULF: Yes. The Commission should follow a policy which looks at the total net benefits to the retail customer with regard to off-system sales. This policy permits utilities to continue making off-system sales which benefit the retail customers.

OPC: No. A utility's decision to offer wholesale customers less-than-average fuel costs on longer term sales(i.e., other than economy sales transactions) out of a single or multiple generating units should not cause the fuel cost responsibility of the retail jurisdiction to be greater than the average.

FIPUG: No. The average fuel cost of the generating units from which a sale is made should be used for fuel cost recovery purposes unless it is demonstrated that the actual cost is less for the time period the electricity is sold.

FPL: No position.

FPUC: No position.

STAFF ANALYSIS: At the outset, it is important to understand the significance of a wholesale sale that is subject to a jurisdictional separation factor (a "separated sale") and a wholesale sale that is not subject to a jurisdictional separation factor (a "non-separated sale"). These terms are important because

a different regulatory treatment exists for the costs and revenues associated with each type of sale.

Non-separated sales: The Commission historically treated sales that are non-firm or less than one year in duration as non-separated sales (TR 164). An example of non-separated sale is a Florida Energy Broker sale (TR 154). Broker sales are typically made as the opportunity presents itself, and there are no long term capacity commitments undertaken to provide energy. Non-separable sales are not assigned cost responsibility through a separation process. This is because the sales are often times sporadic in nature. Because there is not a separation process, the retail ratepayer supports all of the investment that is used to make the sale. In exchange for supporting the investment, the retail ratepayer receives all of the revenues, both fuel and non-fuel, that the sale generates (TR 164). The revenues are credited back to the retail ratepayer through the fuel and capacity adjustment clauses. For Broker sales, the utilities' shareholders receive 20 percent of the profit associated with the sale.

For purposes of non-separated sales, staff recommends that the Commission not modify its existing policy. This policy allows a utility to credit back to the retail ratepayer the actual total revenues it receives from a sale. The actual revenues that a utility receives for non-separable sales are typically based on incremental costs (TR 154). As discussed during the hearing, this policy has generated over $800 million in retail benefits to date through the Florida Energy Broker alone (TR 225). All parties appear to agree, at a minimum, that the Commission should not preclude utilities from this opportunity (TR 154,224,320).

Separated sales: The Commission has traditionally allowed a sale to be separated if it is a long term firm sale, greater than one year, that commits production capacity to an individual wholesale customer (TR 159). The example that was explored during the hearing involved Tampa Electric's Big Bend Station sales. In this example, witness Ramil testified that these wholesale customers have a priority claim on the Big Bend Station capacity that is greater than the retail ratepayers claim on that same capacity (TR 262-264). In essence, a sale is separated to remove from the retail jurisdiction's cost responsibility the production plant and operating expenses associated with the sale (TR 168). A separated sale can be either: 1) an all or partial requirements sale made from system resources; 2) a unit power sale; or 3) a multiple generating unit sale.

Once a utility enters into a wholesale transaction that is to be separated, the retail cost responsibility is adjusted in the following ways: 1) through a reduction in actual retail base rate revenue requirements at the time of the utility's next base rate case and (2) through continued monthly surveillance reporting,

which, in the event a utility is over earning, generates additional funds subject to Commission disposition and (3) through credits to the fuel adjustment clause (TR 182,284). In exchange for assigning cost responsibility to the company's shareholders, the Commission allows the utility's shareholders to keep all of the non-fuel revenues that it receives from the sale (TR 282).

In Florida, the Commission has generally employed a uniform cost allocation methodology between the wholesale and retail markets for separable sales. As witness Wieland points out, if there is a system of uniform cost allocation between the wholesale and retail jurisdictions it is difficult to say that one group of customers is being priced unfairly (TR 172). Historically, the Commission has assigned costs to both jurisdictions using an average embedded cost methodology for production plant and operating expenses, and has required fuel credits equal to average system fuel costs (TR 172). This process protects the retail market from subsidizing the competitive wholesale market.

As discussed by Tampa Electric, the Commission has allowed some deviation from the average fuel costing methodology for separated sales, (i.e. allowed a utility to credit incremental fuel revenues even if those revenues were less than average system fuel costs) on a case-by-case basis (TR 246). The Commission allowed Tampa Electric to make the price concession because it resulted in increased wholesale sales to Florida Power and Light from Big Bend unit 4. However, whenever a utility credits anything less than average system fuel costs to the fuel adjustment clause for its separated wholesale sales, the retail ratepayers bear an increased (i.e. above average) fuel cost responsibility from what it otherwise would be if the sale were made and revenues credited back at average fuel costs (TR 265-270). As witness Wieland points out, there is an increased possibility of gaming the system when the fuel prices are discounted and the discount is automatically passed through to the retail ratepayer, while the other non-fuel revenues go to the utility's shareholders immediately (TR 192). This problem is heightened by the fact that the retail ratepayer's cost responsibility is only reduced 1) at the time of a utility's next base rate case or(2) when a utility is over earning, and the continued monthly surveillance adjustments generate additional funds subject to Commission disposition (TR 182, 284). If neither of the two criteria are present, the additional non-fuel revenues flow directly to the company's shareholders.

The issue at hand requires the Commission to decide whether a utility should be allowed to credit back to the fuel adjustment clause anything less than average system fuel costs for separable sales, even if the actual fuel revenues it receives are less than average system fuel costs (TR 160, 174). Staff recommends that, as a generic policy, the Commission should continue its

existing policy of uniform cost allocation between the wholesale and retail markets for all prospective separable sales. This policy would require that the Commission impute revenues in the fuel adjustment clause in the event the actual fuel revenues a utility receives from a separable sale are less than average system fuel costs. This policy will protect the retail ratepayer from automatic increases in fuel cost responsibility.

Under staff's recommendation, the utility's shareholders would, in effect, be required to pay for any shortfall associated with fuel revenues if the actual fuel revenues it collects are less than the average system fuel costs being imputed. There is a significant amount of discussion in the record regarding the idea that a utility might be hesitant to enter into a separable sale, even if that sale provides net benefits to the retail ratepayer, because the imputation process has the effect of reducing shareholder earnings (TR 239, 297). This idea was coupled with the fact that the wholesale market has become increasingly competitive and it is difficult for a utility to collect the average embedded revenues that this Commission imputes (TR 153). As such, some discounting of the fuel costs might be necessary to achieve overall benefits for the retail ratepayers. To remedy this problem, Gulf and TECO suggest that the Commission should adopt a generic policy that recognizes the overall net benefits a separable sale provides the retail ratepayer (TR 281). This approach would compare the potentially negative impacts associated with crediting incremental fuel revenues to the fuel adjustment clause to the positive benefits associated with the benefits to retail ratepayers of selling capacity (TR 284).

The Commission has a long history of providing utilities with the flexibility needed to maximize retail benefits. The Commission has also, however, required that a utility demonstrate that the actions of management are indeed beneficial to the retail ratepayers (TR 230). Staff believes that the Commission should, as it has in the past, continue to allow for case-by-case deviations from average costing when a new sale provides demonstrable net benefits to the retail ratepayer. Therefore, staff's recommendation is twofold: (1) A utility should be required to credit average system fuel revenues through the fuel adjustment clause until (2) it has demonstrated that each new sale does in fact provide overall benefits to the retail ratepayers.

All parties appear to agree that the Commission should not preclude deviations from average system fuel cost allocation for longer term sales when there are net benefits to the retail ratepayer. The areas of concern, however, is what should the net benefit demonstration entail. Staff is sympathetic to the concerns raised by Witness Ramil with a potentially burdensome review and the danger of such a review becoming an opportunity for increased

litigation. (TR 303-304). It is the Commission's responsibility, however, to ensure that the activities taking place in the wholesale market do not adversely affect the retail market (TR 170). Therefore, staff further recommends that in its review of petitions for recovery of fuel cost differentials, the Commission should only determine whether a sale is beneficial to the retail ratepayers. Such a limited review would not require the Commission to determine which sales are made but would focus on the actions of each utility and the subsequent impact on that utility's retail ratepayers.

In summary, staff recommends the following cost recovery policy:

<u>Non-separable sales</u> - (Firm sales less than one year or non-firm sales)

- Total revenues credited to fuel and capacity cost recovery clauses. However, the 20 percent shareholder incentive for Broker sales still applies.

<u>Separable sales</u> - (Firm sales greater than one year duration)

- Average system fuel costs credited to fuel cost recovery clause. Some deviation may be permissible after the utility demonstrates that doing so generates net benefits to the retail ratepayers on a case-by-case basis.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: No.

STAFF ANALYSIS: The fuel and purchased power cost recovery clause is an on-going clause and should remain open.