BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for approval of Agreement for Purpose of Ensuring Compliance with Ozone Ambient Air Quality Standards between Gulf Power Company and Florida Department of Environmental Protection pursuant to Section 366.8255(1)(d)7, F.S., for purposes of cost recovery of related expenditures and expenses through environmental cost recovery clause.	DOCKET NO. 020943-EI ORDER NO. PSC-02-1396-PAA-EI ISSUED: October 9, 2002

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
MICHAEL A. PALECKI
RUDOLPH "RUDY" BRADLEY

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING COST RECOVERY OF OZONE REDUCTION ACTIVITIES
THROUGH THE ENVIRONMENTAL COST RECOVERY CLAUSE

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose substantial interests are substantially affected files a petition for a formal proceeding pursuant to Rule 25-22.029, Florida Administrative Code.

On August 28, 2002, Gulf Power Company ("Gulf" or "Company") entered into an agreement with the Florida Department of Environmental Protection ("DEP") for the purpose of ensuring compliance with new air quality standards for ozone ("Agreement"),

a copy of which is incorporated herein. The specific standard at issue is the eight hour ozone ambient air quality standard, which becomes effective in 2004/2005. DEP does not expect Escambia and Santa Rosa Counties to be in compliance with this standard unless emissions of ozone-forming compounds are reduced significantly in the Pensacola area.

On August 30, 2002, Gulf petitioned to recover the costs of implementing the Agreement through the Environmental Cost Recovery Clause ("ECRC"). Section 366.8255, Florida Statutes, the ECRC, gives us the authority to review and decide whether a utility's environmental compliance costs are recoverable through an environmental cost recovery factor.

To recover environmental compliance costs through the ECRC, an electric utility must file a petition describing the utility's proposed environmental compliance activities and projected environmental compliance costs. Section 366.8255(2), Florida Statutes. Environmental compliance costs are defined as costs incurred in complying with environmental laws or regulations. Section 366.8255(1)(d), Florida Statutes. If the petition is approved, the Commission allows recovery of prudently incurred environmental compliance costs. Id.

Section 366.8255(1)(d) of the ECRC was amended during the 2002 legislative session, such that the definition of environmental compliance costs was expanded to include:

> Costs or expenses incurred by an electric utility pursuant to an agreement entered into on or after the effective date of this act and prior to October 1, 2002, between the electric utility and the Florida Department of Environmental Protection or the United States Environmental Protection Agency for the exclusive purpose of ensuring compliance with ozone ambient air quality standards by an electric generating facility owned by the electric utility.

Section 366.8255(1)(d)7, Florida Statutes. The amendment was signed into law by the Governor on May 23, 2002. The Agreement was executed under authority of this new legislation.

This Order is organized into four sections. Section A addresses the contents of the Agreement. Section B addresses the relief Gulf requests in its Petition. Section C addresses depreciation. Section D is our conclusion.

A. The Agreement

The Agreement requires Gulf to undertake various activities at the Crist Plant in order to reduce overall plant-wide air emissions of nitrogen oxides (NOx) to 0.2 lbs/mmbtu. NOx are precursors of ozone. These activities include:

1. Retirement of Crist Unit 1 (24 MW) within 120 days of receiving a Final Order from the Commission;

2. Retirement of Crist Units 2 and 3 (59 MW total) on or before May 1, 2006;

3. Relocation of the precipitator at Crist Unit 7;

4. Installation of selective catalytic reduction (SCR) technology on Crist Unit 7 by May 1, 2005;

5. Completion of an engineering feasibility study addressing NOx reduction technologies on Crist Units 4, 5, and/or 6 to achieve the 0.2 lbs/mmbtu emission limit by May 1, 2005; and,

6. Implementation of emission reduction activities on Crist Units 4, 5, and/or 6 by May 1, 2006. However, if it is determined that the best way to meet the 0.2 lbs/mmbtu emission limit is through the installation of SCR on Crist Unit 6 then the implementation date will be December 31, 2007.

Gulf will obtain written concurrence from DEP that the activities Gulf proposes to implement are reasonable and necessary to achieve the emission limit, before implementing the other NOx reduction activities supported by the engineering feasibility study.

Gulf explains that the focus of the Agreement is to limit emissions of NOx to 0.2 lbs/mmbtu, as opposed to identifying

specific technologies to achieve that result. By committing to the emissions limit, Gulf was able to conduct additional research into the most cost effective method of attaining that limit.

Once the feasibility study is completed Gulf will submit another petition which describes the study's results and the technology that Gulf selects to meet the emissions limit. Gulf explains that this petition will allow the Commission and interested parties to review the selected compliance options to ensure that there is agreement on the most cost effective technologies to use. Gulf's filing can of course be contested. This process is consistent with our current practice.

In addition to identifying the six NOx reduction activities listed above, the Agreement allows Gulf to retain all NOx reduction credit and trading rights, should state or federal law establish NOx trading for Florida. Also, Gulf will not be subject to New Source Review due to the power plant modifications required by the Agreement.

In paragraph 9 of the Agreement, the signatories address our role. The Agreement is based on an assumption that we will approve the activities in the Agreement and an Order will become final within 90 days of the execution date of the Agreement, November 26, 2002. The compliance dates are subject to change if a Final Order is not rendered by November 26, 2002. The Agreement expires on its own terms if a Final Order is not rendered within 120 days of execution of the Agreement, December 26, 2002, unless extended by the signatories within 30 days thereafter.

On September 16, 2002, Gulf provided estimates of the plant-in-service amounts, in-service dates, and associated O&M expenses as listed below. The estimated investment amounts include the cost of the engineering feasibility study.

Estimated Costs for Crist Plant Modifications (Dollars in Thousands)			
Required Additions Include A, B, and either C or D	Plant-In-Service Amounts	In-Service Date	Annual O&M Amounts
A) Crist Unit 7 Precipitator	$26,582	May 2004	n/a
B) Crist Unit 7 SCR	$79,405	May 2005	$2,802
C) Non SCR technology on Crist Units 4, 5, 6	$12,429	Dec 2005	$1,030
D) Crist Unit 6 SCR	$71,806	Dec 2007	$2,505

We find that the Agreement satisfies the requirements of Section 366.8255(1)(d)7, Florida Statutes. The Agreement was entered on August 28, 2002, which is between May 23, 2002, and October 1, 2002, as required. The DEP, at Section III of the Agreement, has determined that the Agreement is needed for purposes of continued compliance with the eight hour ambient air standards for ozone in the Pensacola Florida Metropolitan Planning Area. The six activities are therefore environmental compliance costs.

In addition, we find that Gulf has satisfied the requirements of Section 366.8255(2), Florida Statutes, for each of the six activities, and we therefore approve recovery of prudently incurred costs for all six activities.

B. Gulf's Petition

In its Petition, the relief requested by Gulf is for approval of the Agreement and "the costs associated therewith" for recovery through the ECRC. Both of these requests are problematic. The former is problematic because we does no have authority to approve such an agreement. The latter is problematic because the ECRC is very specific as to the types of costs eligible, and the phrase used in Gulf's Petition is very broad. Consequently, there is a possibility that giving such broad approval now might result in recovery of costs in the future that do not meet the requirements of the statute. In addition, the Agreement does not specifically identify each of the activities for which Gulf seeks recovery. The

six activities listed above were identified by Gulf in response to an informal data request.

Because the relief requested cannot be granted, it is necessary to specify the type of relief that can be granted. Instead of approving the agreement, we find that Gulf is bound by the Agreement to : 1) to reach the 0.2 lbs/mmbtu NOx emission limit within the specified time; and, 2) complete the six activities listed above within the specified time. With respect to the relief requested for costs, we grant approval for recovery of the costs prudently incurred to complete the six activities listed in the preceding section.

C. Depreciation

Gulf requests that we decide how to handle depreciation of Crist Units 1, 2, and 3. These units are currently scheduled to be retired in 2011, but because of the Agreement these units will be retired earlier. Gulf proposed two methods of handling the depreciation of Crist Units 1, 2, and 3.

One method is to revise the depreciation rates to reflect the retirements of all three units on or before December 31, 2006. In this case, Gulf has proposed that the incremental increase in depreciation expense and carrying costs on net investment be recovered in the ECRC factors for 2003-2005. The second method is to depreciate the units in accordance with the current schedule, in which case no incremental amounts would flow through the ECRC.

The last comprehensive depreciation and dismantlement review for Gulf was filed May 29, 2001. On February 22, 2002, a Stipulation for Settlement of Depreciation Related Issues (Stipulation) was filed by OPC, FIPUG, FEA, and Gulf. We approved the Stipulation on February 25, 2002, at Gulf's rate case hearing in Docket No. 010949-EI. New depreciation rates and dismantlement provisions approved by the Stipulation became effective January 1, 2002. Current base rates and depreciation rates reflect a December 31, 2011, retirement date for Crist Units 1, 2, and 3.

Gulf represents that the estimated December 31, 2002, net book value of Crist Units 1, 2 and 3 is $2,918,253 ($11,394,866 investment less $8,476,613 reserve). The annual carrying costs on

the net investment in base rates is approximately $336,913; annual depreciation expenses based on a currently approved 3.9% depreciation rate are approximately $444,400. If the depreciation schedule is revised, Gulf proposes to credit the ECRC with the annual carrying costs on net investment as well as credit the ECRC with the annual depreciation expenses. The resulting amount to be recovered through the ECRC is net of recovery provided by base rates.

Pursuant to Rule 25-6.0436(8)(a), Florida Administrative Code, electric utilities are required to file comprehensive depreciation studies at least once every four years from the submission date of the previously filed study unless we require otherwise. Thus, utilities may request new depreciation rates on a more frequent basis than four years. It is a basic tenet of the theory behind depreciation that the depreciation schedule match the service life of the asset. For this reason we find that the depreciation schedule be revised for Crist 1, 2, and 3 to reflect retirements on or before December 31, 2006.

The shift in retirement dates required by the Agreement necessitates a reassessment of the appropriate recovery schedule of the net unrecovered assets associated with the entire Crist Plant. For this reason we find that Gulf must submit a depreciation study for the entire Crist Plant within 90 days of the issuance of the Consummating Order in this docket. The depreciation study will be assigned to a new docket.

D. Conclusion

For the reasons provided above, we find that the Agreement satisfies the requirements of Section 366.8255(1)(d)(7), Florida Statutes, and that the six activities described in Section A satisfy the requirements of Section 366.8255(2), Florida Statutes, and we therefore approve recovery of prudently incurred costs for all six activities.

ECRC implementation issues such as base rates adjustments can be addressed at the annual November hearings in the ECRC docket.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Gulf Power Company's Agreement with the Florida Department of Environmental Protection, executed on August 28, 2002, satisfies the requirements of Section 366.8255(1)(d)(7), Florida Statutes. It is further

ORDERED that the six activities described in Section A of this Order are environmental compliance costs, and that the prudently incurred costs of the six activities shall be recovered through the environmental cost recovery clause. It is further

ORDERED that Gulf shall file a petition describing the results of the feasibility study and the specific activities Gulf selects to address NOx emission reductions on Crist Units 4, 5, and 6. The petition shall provide sufficient detail to allow us and interested parties to assess the cost effectiveness of all options considered. It is further

ORDERED that the depreciation schedule for Crist Units 1, 2, and 3 shall be revised to reflect the actual retirement dates, and that the incremental costs associated with the new retirement schedule be recovered through the clause, and that Gulf submit a new depreciation study within 90 days of the issuance of the Consummating Order in this docket. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 9th Day of October, 2002.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

(S E A L)

MKS

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on October 30, 2002.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

Appendix A

AGREEMENT FOR THE PURPOSE OF ENSURING COMPLIANCE WITH OZONE AMBIENT AIR QUALITY STANDARDS

This agreement is entered into by the Florida Department of Environmental Protection (DEP) and Gulf Power Company (GULF), for the exclusive purposes as follows: (a) ensuring that GULF's electrical generating facility located within the Pensacola, Florida Metropolitan Planning Area (PFMPA) supports the Area's compliance with the eight hour ozone ambient air quality standard and (b) authorizing related cost recovery pursuant to Section 366.8255(1)(d) of the Florida Statutes as amended by the Florida Legislature in its 2002 session and signed into law by the Governor of the State of Florida.

WHEREAS:

I. GULF owns and operates the Crist Plant electrical generating facility in Escambia County, Florida. This plant generates electricity for the consuming public through the combustion of fossil fuel. The combustion of fossil fuels produces some of the precursor compounds that contribute to the formation of ozone in the ambient air.

II. Under the authority of the Clean Air Act, the U. S. Environmental Protection Agency (EPA) promulgated regulations dealing with air quality, including ambient air quality standards designed to protect human health and welfare. One such regulation places a limit on the amount of ozone that is considered to be acceptable in the ambient air during any 8-hour period (Ozone Standard).

III. Based upon the best available information, including ambient air quality monitoring data, DEP does not expect Escambia and Santa Rosa Counties to be in compliance with the Ozone Standard in 2004/2005 unless significant reductions of emissions of ozone precursor compounds are achieved in the Pensacola, Florida Metropolitan Planning Area.

IV. In its 2002 session, the Florida legislature adopted amendments to section 366.8255(1)(d) of the Florida Statutes to provide that an electric utility may seek recovery of costs and expenses prudently incurred pursuant to a voluntary agreement with DEP or EPA, for the purpose of ensuring compliance with ozone ambient air quality standards.

V. Representatives of DEP and GULF have met and arrived at a mutual agreement in furtherance of the purposes of Section 366.8255(1)(d)7 of the Florida Statutes as amended during the 2002 Florida legislative session.

VI. DEP and GULF concur that installation of Selective Catalytic Reduction (SCR) controls at Crist Unit #7 as well as the implementation of other NOx reduction

technologies on one or more of the other three coal-fired generating units at Plant Crist will be needed as part of a community wide effort to reduce ozone precursor compounds in the Pensacola Metropolitan Planning Area. Due to structural interference and performance concerns for the new SCR, a new Unit #7 precipitator will also be constructed at a new location and the SCR will be completed one year later in the location of the old Unit #7 precipitator.

VII. It is anticipated that the implementation of this agreement will result in an approximately 61% reduction [9,188 tons] in annual NOx emissions from the GULF Crist Plant based upon 1999 baseline data.

NOW THEREFORE, in consideration of the premises and the mutual agreements contained herein, and intending to be legally bound, the DEP and GULF hereby agree as follows:

1. By May 1, 2005, GULF, after obtaining necessary permits and approvals, will install and begin and continue operating an SCR system at Crist Unit #7 whenever the Crist Unit #7 is online. The SCR system is designed to achieve no less than an 85% reduction in the quantity of nitrogen oxides as measured at the SCR unit inlet (SCR Project). The SCR Project includes the installation of a new precipitator necessary to structurally accommodate installation of the SCR. See Exhibit "A" for proposed project schedule.

2. In addition to the Crist Unit #7 SCR Project, and in order to achieve an overall plant wide Btu weighted average of 0.2 lbs/mmbtu NOx emission rate as further specified in paragraph 3 below, Gulf agrees to conduct engineering studies on the feasibility of other NOx reduction technologies on one or more of the remaining three coal-fired units at Plant Crist. Such studies and related unit specific demonstration projects may include (but are not limited to) SCR, Selective Non-Catalytic Reduction (SNCR) technology, Over-Fired Air (OFA) technology, natural gas reburn technology, selective use of biomass fuel, etc. Gulf further agrees to complete these studies by May 1, 2005. In the event GULF identifies an SCR project for Crist Unit #6 as the NOx reduction technology, GULF will implement, begin and continue operating the SCR on Crist Unit #6 as described in paragraph 3 below by December 31, 2007. In the event GULF identifies a NOx reduction technology other than SCR on Crist Unit #6, GULF will select and implement one or more NOx reduction technologies on one or more of the three other Plant Crist coal-fired units by May 1, 2006. GULF will obtain written concurrence from DEP, before implementing such NOx reduction technology or technologies, that the use thereof is reasonable and necessary to achieve the overall plantwide emission rate of 0.2 lbs/mmbtu specified in paragraph 3 below.

3. GULF will make necessary changes identified and within the timeframes set forth in paragraph 2 above, that will allow it to limit the overall 30 day average NOx emission rate at the Crist Plant to 0.2 lbs./mmbtu year-round except for periods in which Crist Unit #7 is offline. The emission rate shall be calculated pursuant to the formula set forth in Exhibit "B" to this agreement. While Crist Unit #7 is online, this 0.2 lbs./mmbtu will be achieved by utilizing the SCR system on Crist Unit #7 [discussed in paragraph 1 above] and the controls identified pursuant to paragraph 2 above. During such time as Crist Unit #7 may be offline between May 1 and September 15, GULF agrees to operate any NOx reduction technology or technologies DEP may have determined to be reasonable and necessary at other Plant Crist coal-fired units, pursuant to paragraph 2 above, unless prevented from doing so by circumstances beyond its reasonable control.

4. In addition to the NOx emission rate reduction strategies implemented pursuant to paragraphs 1 through 3 above, as a further part of this agreement to support the PFMPA's compliance with the eight hour ozone ambient air quality standard, GULF agrees to retire Crist Unit #1 within 120 days of receiving a final order from the Florida Public Service Commission as provided in paragraph 8 below. In addition, GULF further agrees to retire Crist Unit #2 and Crist Unit #3 on or before May 1, 2006.

5. In the event state or federal law changes to require a change in NOx emissions or the PFMPA is declared non-attainment for ozone, any reduction requirements would be in accordance with all applicable state and federal requirements. In addition, although Florida currently has no state statute providing for NOx trading or credits, GULF shall be entitled to retain all NOx reduction credits and trading rights that may be authorized by Florida law in the future.

6. In the event the FPSC issues a final order authorizing GULF to recover costs incurred pursuant to this agreement, by July 5, 2004, GULF will submit a Title V renewal application to the Department's Bureau of Air Regulation, 2600 Blair Stone Rd, MS 5500, Tallahassee, FL 32399 to incorporate the control technologies contained in this agreement as well as the NOx emission rate as described in paragraphs 1 through 3 above. DEP concurs that the changes envisioned by this agreement will not constitute "modifications" that trigger New Source Review.

7. DEP concurs that the steps and changes described in paragraphs 1 through 4 above are prudent for purposes of (a) ensuring that GULF's electrical generating facility located within the PFMPA supports the Area's compliance with the eight hour ozone ambient air quality standard and (b) authorizing

related cost recovery pursuant to Section 366.8255(1)(d) of the Florida Statutes as amended by the Florida Legislature in its 2002 session and signed into law by the Governor of the State of Florida.

8. This agreement is based upon the assumption that an order from the Florida Public Service Commission (FPSC) authorizing GULF to recover the costs incurred pursuant to this agreement through the Environmental Cost Recovery Clause is rendered final (final order) within 90 days of the execution of the agreement. A final order is one that is no longer subject to review or appeal by a court of competent jurisdiction. If a final order is not rendered within 90 days of the date of execution of this agreement, the parties concur that the dates and schedules herein are subject to revision solely by mutual agreement, in order to allow GULF to move forward with the activities described in paragraphs 1-4 above pending a final order by the FPSC. Gulf will exercise good faith in seeking approval of such cost recovery from the FPSC in a timely manner. DEP will support the efforts of GULF before the FPSC and in any subsequent review or appeal. If a final order is not rendered within 120 days of execution of this agreement, the entire agreement shall automatically become null and void unless extended by mutual written agreement of the parties within 30 days thereafter.

9. This agreement shall bind the parties hereto and those whom they represent and may be modified only in writing with the consent of both parties.

10. This agreement is entered into and effective on the date of the last signature of the parties below.

FLORIDA DEPARTMENT OF ENVIRONMENTAL PROTECTION

By: David B. Struhs

David B. Struhs
Secretary

Date: August 28, 2002

GULF POWER COMPANY

By: Thomas A. Fanning

Thomas A. Fanning
President and Chief Executive Officer

Date: August 28, 2002