BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Clarification) DOCKET NO. 920041-EI
a Guidance on Appropriate Market) ORDER NO. PSC-92-1048-FOF-EI
Based Pricing Methodology for) ISSUED: 09/23/92
Coal Purchased from Gatliff Coal)
Company by Tampa Electric Company)
_____)

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
SUSAN F. CLARK
J. TERRY DEASON
BETTY EASLEY
LUIS J. LAUREDO

ORDER ON PETITION FOR CLARIFICATION AND GUIDANCE

BY THE COMMISSION:

Background

In 1988, in Tampa Electric's "cost plus" docket, the Commission approved the implementation of a market-based pricing and benchmark methodology to measure the appropriateness of Tampa Electric's coal purchases from its affiliate, Gatliff Coal Company. (Order No. 20298, Docket No. 870001-EI-A). In that docket the we approved a stipulation between Tampa Electric and the Office of Public Counsel that established an initial market price for coal purchased from Gatliff. The stipulation then provided that for purposes of regulatory review in the fuel docket, a benchmark would be calculated by escalating or de-escalating the initial market price by the annual percentage change in Bureau of Mines District 8 data for Coal Shipments, as reported on FERC Form 423 for the weighted average price per million BTU of contract transactions that meet Tampa Electric's Gannon Station coal specifications. All spot transactions included in the FERC data were intended to be excluded from the benchmark calculation. For purposes of recovery through the fuel adjustment clause, Tampa Electric was required to justify the costs for Gatliff Coal that exceeded the market-based benchmark calculation.

On January 10, 1992, Tampa Electric Company (Tampa Electric) filed a petition for clarification and guidance on the market based pricing methodology for recovery of the cost of coal that it purchases from its affiliate, Gatliff Coal Company. Tampa Electric's Petition for Clarification and Guidance sought our review of the appropriate method to calculate the index on which market pricing of the cost of coal from Tampa Electric's affiliate is based.

The Office of Public Counsel and Florida Industrial Power Users Group intervened in the case. On January 30, 1992, Public Counsel filed a motion to dismiss Tampa Electric's petition that we denied on May 6, 1992 in Order No. PSC-92-0304-FOF-EI. A prehearing conference was held on May 28, 1992, and a hearing was held on June 9-10, 1992.

At the request of Gatliff Coal Company, Lawrence Metzroth of Research Data International (RDI), a consultant for Gatliff, conducted an analysis of the benchmark procedure and the database (Bureau of Mines District 8 contract shipments reported on FERC Form 423) used to calculate the benchmark. RDI provided Mr. Metzroth's analysis to Tampa Electric; and that analysis, its results, and its relation to our original Order No. 20298 were the focus of the hearing on Tampa Electric's petition.

Mr. Metzroth recommended that certain categories of contract transactions presently included in the BOM data should be excluded for purposes of calculating the benchmark, because they were erroneously included in earlier implementations of the benchmark procedure and they were not representative of the same type of coal contract as Tampa Electric's Gatliff contract.

The issues addressed below explore the validity of the current method of determining the market based pricing index, the validity of Tampa Electric's proposals to modify that index, and the effect of those proposals on Order No. 20298 and the stipulation approved therein.

Decision

The first issue the parties addressed in this case was whether the FERC Form 423 data currently being used to calculate the market-based index contains errors that make the data unsuitable to measure changes in the market price of coal. Tampa Electric asserted that errors contained in the Form 423 data did make it unsuitable to measure changes in the market. We find, to the contrary, that even though the FERC Form 423 data does contain errors, the errors do not make the data unsuitable to measure changes in the market price of coal.

Tampa Electric's witness Metzroth estimated that his firm, RDI, enters approximately 1,600 Forms 423 per month into its computer database. He further estimated that data from Bureau of Mines District 8 represents approximately 25% of these 1,600 forms, or 400 forms a month. Mr. Metzroth testified that, in his experience with the FERC data, he has encountered a combination of

errors of approximately 5% on an annual average. This combination consists of errors made when FERC personnel enter the data in their computerized database, and errors made when individuals at the utility fuel offices fill out the forms. Based on Mr. Metzroth's estimation of a 5% error rate, data on approximately 20 forms filed each month may contain errors.

The number of errors contained in the FERC Form 423 database would be significant if the results of the benchmark index calculation were substantially affected as a result of the inclusion of the errors. When Mr. Metzroth was asked if he had tabulated the effect of those errors, Mr. Metzroth responded that he had not done a detailed statistical analysis to determine the effect of the errors in the database.

Staff witness Shea acknowledged that, in his experience, the FERC Form 423 data does contain some inaccuracies. However, Mr. Shea testified that because the index calculation methodology specified in Order No. 20298, which uses the FERC Form 423 data, selects such a large number of transactions in each year, the impact of any inaccuracies in the data will be minimized. Mr. Shea further testified that since the methodology calculates an average price, errors will tend to counteract one another. When asked if the errors could result in an index that is beneficial to the utility in terms of resulting in a higher benchmark, Mr. Metzroth responded that he believed that that was possible.

Tampa Electric has proposed using a database, COALDAT, that Mr. Metzroth's company produces. Tampa Electric believes this database to be superior because it contains information from FERC Forms 423, PURPA Forms 580, MSHA Forms 7000-2, and information gleaned from RDI's telephone conversations with utility employees.

While data from additional sources might be useful to correct or verify the FERC Form 423 data, the additional information must be available on a timely basis. This is not the case with PURPA Form 580, which Mr. Metzroth relied upon for coal contract information, such as coal quality standards. The PURPA Form 580 is filed in July or August once every two years. Information for the years 1990 and 1991, for example, will be included in the PURPA Form 580 to be filed in July or August of 1992. Likewise, the 1992 and 1993 data will not be filed until 1994. The information we would need to verify the accuracy of the FERC Form 423 data would not be available to us until after we were called upon to make a determination of the appropriate benchmark price.

Tampa Electric's witness Wood testified that the benchmark methodology does not provide an exact market proxy, but it is reasonable. Mr. Wood agreed that the purpose of the benchmark methodology was never to make it exact, but to make it reasonable and fair. Mr. Shea's testimony supports this conclusion. Responding to a question whether the intent of Order 20298 was to be exact and what was the intent of the 5% zone of reasonableness, Mr. Shea said, "In fact, we added 5% just because the benchmark itself is just an indicator of market movement and it is not exact. And so the parties stipulated to a 5% increase above that to acknowledge the fact that there's no way we can be exact in determining what the market is."

The FERC Form 423 does contain errors. As Mr. Metzroth stated, "Data entry and form compilation is a human activity and humans err, and somebody can come in and have a bad morning and there will be a series of errors." In response to a question from Public Counsel, however, Mr. Metzroth admitted he had performed no analysis at all of the type or extent of errors that might be contained in any FERC diskettes that have been used by Tampa Electric Company in prior fuel cost recovery proceedings. As Public Counsel correctly argues, errors would only be relevant if they affected the weighted-average cents per mmbtu.

Furthermore, the purpose of the benchmark methodology is to measure what a given product or service would cost if purchased in the competitive market. The coal market is declining and the index, based on FERC Form 423 data, accurately reflects the declining market conditions. The evidence shows that, although the FERC Form 423 data does contain errors, the errors do not make the data unsuitable to measure changes in the market price of coal.

In this proceeding, Public Counsel asked us to consider whether the FERC Form 423 data, after adjusting for term and quality using information contained in the Forms 423, contains errors that parties to the stipulation could not have discovered with due diligence and which make the FERC Form 423 data unsuitable to measure changes in the market price of coal. The question of whether Tampa Electric Company exercised due diligence in discovering errors in the FERC Form 423 data is not relevant. As we have explained above any errors contained in the data do not make it unsuitable to measure changes in the market price of coal.

The next issue we considered in this proceeding was whether the FERC Form 423 data, as adjusted for term and quality using information contained in the Forms 423, provide a reasonable standard to measure changes in the market price of coal. The evidence presented to us at this hearing clearly shows that the

data does provide a reasonable standard to measure changes in the market price of coal.

The Federal Energy Regulatory Commission (FERC) requires that electric utilities file a monthly report (Form 423) by plant of the availability, cost and quality of fossil fuels purchased. This report contains various information, such as type of purchase (contract, spot, etc.), type of fuel, source of fuel, quantity of fuel received, quality of coal, and delivered price in cents per million Btu.

When the FERC Form 423 data is adjusted for term (type of purchase) and quality as specified in the stipulation approved in Order No. 20298, the remaining data represents a pool of data reflecting transactions that have occurred in a competitive coal market. As Mr. Shea testified, the market price of coal has been declining in recent years, and the index calculated using FERC Form 423 has tracked this decline. As we stated in Order No. 20298 we wish to gauge the reasonableness of Tampa Electric's Gatliff fuel costs by measuring them against a competitive market standard. FERC Form 423 data, as adjusted for term and quality, provides such a standard.

The next issue we considered in this case was whether the FERC Form 423 database of contract deliveries from Bureau of Mines District 8 that meet the coal quality specifications of Order No. 20298 contain contracts that have been erroneously included for purposes of calculating the market-based index.

Tampa Electric Company proposed that the FERC Form 423 database does include certain spot coal transactions that should have been excluded, and excludes certain contract coal transactions that should have been included. Tampa Electric Company stated that the method proposed by Mr. Metzroth for calculating a market-based index aggregates transactions to an annual level, thereby enabling the Commission to ensure that all deliveries under non-conforming contracts are excluded and all deliveries under contracts that meet or exceed the Gannon Station specifications are included in the index calculation. Public Counsel stated that Tampa Electric did not offer evidence of even one contract that was erroneously included in development of the benchmark, or in subsequent applications in fuel cost recovery proceedings.

Staff Witness Shea testified about the method previously employed by Staff and Tampa Electric to calculate the market-based index used to establish the benchmark price. The first step in this method is to select individual monthly transactions from the FERC Form 423 database that are designated as contract transactions

and that meet the quality specifications as contained in Order No. 20298. Basically, this step selects all contract coal deliveries, on a monthly basis, from B.O.M. District 8 that meet or exceed the Gatliff coal quality. The next step of the procedure is to calculate the weighted average delivered price for each year of all coal transactions that meet this criteria. These annual prices are then used to create an index to escalate the stipulated 1987 market price of $39.44 per ton. The benchmark is calculated by increasing this market price by 5%.

The question arose at the hearing whether the index was being skewed by including or excluding individual deliveries that either meet or do not meet quality criteria. Under the current method of calculating the index, an individual delivery could be excluded if it did not meet the quality criteria even if deliveries aggregated on an annual basis met the quality criteria. Conversely, an individual delivery could be included in the index calculation if it met the quality criteria, when aggregated annual deliveries did not meet quality specifications.

Mr. Shea contended that it did not matter whether transactions that meet the quality criteria were selected on a shipment basis or an annual basis. He asserted that each of the transactions, regardless of what the contract states, is a transaction on the open market. In addition, the index is not tracking absolute prices but instead the change in price from year-to-year.

During the hearing, there was substantial testimony offered on the intent and interpretation of the stipulation and Order No. 20298 with respect to whether quality criteria should be applied to individual shipments or to annual totals. The Order states:

> For purposes of regulatory review, this base price will be escalated or de-escalated by the annual percentage change in BOM District 8 Data for Coal Shipments as reported on Form 423 for the weighted average price per million BTU of contract transactions (excluding all spot transactions), which meet Tampa Electric's Gannon Station specifications for heat content, sulfur content, ash content, and content and pounds sulfur dioxide per million BTU." (p. 14)

This sentence of the Order would lead one to believe that it was anticipated that individual shipments classified as contract transactions on FERC Form 423 would be screened for quality criteria.

This is consistent with the testimony of Ms. Payne, who testified that it was discussed during negotiations on the stipulation whether or not the market price would be adjusted quarterly, semi-annually, with every fuel adjustment proceeding, on an annual basis calendar year or an annual basis fiscal year. She further stated it was her understanding that the actual transactions to be compiled were to be the shipments on a quality basis. If the market price was adjusted on any basis other than annually, individual shipments would have to be the basis for applying quality criteria, because annual data would not be available. Ms. Payne recalled that the parties decided the adjustment to market price would be done on an annual basis because the FERC data could be obtained once a year. She contended that was the whole basis for the annual change provision.

Mr. Metzroth, in his rebuttal testimony, asserts that the benchmark described in Order No. 20298 specifically provides for an adjustment by the annual change for coal shipments of contract transactions. Mr. Metzroth fails to include the phrase included in parentheses immediately following contract transactions, "excluding all spot transactions." The term "contract transactions" was used to differentiate the type of shipments reported on FERC Form 423, spot or contract.

Mr. Shea produced Late-Filed Exhibit No. 9 that demonstrates the market-based index and benchmark calculations based on a contract annual average quality method. Exhibit 9 shows a recalculated benchmark of $41.06 for 1988, $40.15 for 1989 and $39.80 for 1990. When compared to the actual benchmark used in previous fuel adjustment hearings, the benchmark prices would have been higher in 1988 by 44 cents, in 1989 by 23 cents and in 1990 by 51 cents.

Tampa Electric contends that this 51 cents difference in 1990 is significant for a large volume long-term contract. Assuming 1990 deliveries from Gatliff to Tampa Electric of 2.1 million tons, and assuming those tons were priced at the original benchmark price of $39.29, the total cost to Tampa Electric would be $82.509 million. Based on a new benchmark price of $39.80, the cost to Tampa Electric would have been $83.58 million. The difference between the total cost to Tampa Electric based on the two benchmarks is $1.071 million, or approximately 1% of the total cost to Tampa Electric.

We do not consider this to be a significant enough difference overall to require a change in the present benchmark methodology, but the figures do indicate that it would be beneficial to analyze the data on a contract annual average quality basis as a "sanity

check". If in any given year the benchmark calculation would be significantly different by each method, our staff or the company or other interested parties could bring that difference to our attention and explains the reasons for it during the fuel adjustment proceedings.

Tampa Electric's witness Mr. Metzroth contended that previous benchmark calculations have included as contract transactions certain transactions he considers to be spot transactions. He testified that "spot" contract is defined by FERC as any agreement of less than one year's duration. He stated that based upon industry practice, he would also consider any coal contract, regardless of its stated duration, that involves shipment of less than 100,000 tons per year to be a spot contract.

Neither the stipulation nor the order approving the stipulation state that transactions made under contract must be at least a specified annual tonnage to be considered a contract transaction. If the shipment is designated "C" on the Form 423, it is considered to be a contract transaction. Likewise, if the shipment is designated "S" on the form, it is considered to be a spot transaction. Mr. Metzroth offers no other basis for his minimum 100,000 annual tonnage other than his opinion of the industry standard, and this "industry standard" is not reflected in the FERC's definition of what is considered a spot or a contract transaction. In addition, Mr. Shea testified that it is not appropriate to eliminate contracts based on calendar year tonnage, because all transactions, regardless of tonnage, reflect the market price determined by the competitive market.

For these reasons we hold that the method that has previously been used in fuel adjustment proceedings to select transactions for inclusion in the market-based index calculation is appropriate and complies with the intent and interpretation of Order No. 20298.

The next issue we considered in this docket was whether Tampa Electric's proposed calculation of the market-based index is consistent with the original provisions and intent of the stipulation and Order No. 20298. We do not believe that it is.

Tampa Electric proposed two alternative methods for calculating the market-based index; the year-to-year method, and the 5-year term method. Tampa Electric contends that either method is consistent with and properly implements Order No. 20298 and the stipulation approved therein.

Year-to-Year Alternative

In the year-to-year method, Mr. Metzroth proposes to aggregate shipments made under contract on an annual basis before screening for quality criteria. As we stated before, we do not consider this method to be appropriate. Quality screening on an annual shipment basis is not consistent with the intent and provisions of Order No. 20298. The final step of the Mr. Metzroth's year-to-year method is to eliminate any contract transactions which were not in effect for any two-year period, 1987-1988, 1988-1989, and 1989-1990. Mr. Metzroth then proposes to calculate the percent change between each 2-year period as representative of market conditions during each period. Mr. Metzroth's screening process using this method reduced the number of contract transactions from 591 to 37 in the 1987-1988 period, 40 in the 1988-1989 period, and 36 in the 1989-1990 period.

Order No. 20298 states that the initial coal benchmark will be adjusted by the annual percentage change in a large number of contract coal transactions. The order further states that the Commission is confident that the changes indicated by this large group of contracts will adequately reflect changes in the "market." (Order No. 20298, pp. 14-15) It is clear that we intended to include a large group of contract transactions, rather than eliminating approximately 90% of them. The elimination of a large group of contract transactions and the use of a small group as indicative of the "market" is contrary to the intent of the order.

As Public Counsel points out, each of the paired years used in this methodology stand in isolation, unaffected by new contracts entering or old contracts leaving the market between years. The cents per mmbtu will vary within paired years only because of changed btu content or escalation provisions within the contracts themselves. Mr. Metzroth's year-to-year approach ignores changes in the market altogether, and it produces benchmark prices that are increasing during a period of time when the coal market is declining. This approach is obviously not indicative of the current competitive coal market.

Five Year Term Alternative

Using this alternative, Mr. Metzroth again began with transactions aggregated on an annual basis prior to screening for quality criteria. He then eliminated, for the entire period 1987 to 1990, those contracts that did not meet the specified quality criteria in any one year (1987, 1988, 1989, or 1990). Mr. Metzroth then sorted the remaining contracts to remove any that were not in effect during the entire period from November 1, 1988 through

December 31, 1993. Mr. Metzroth's remaining database consists of 19 contracts that he believes meet the basic benchmark stipulation criteria - quality and term. Mr. Metzroth stated that he made this calculation primarily because he thought that it met the vintage and term language in the order, but when asked if the language at the bottom of page 14 of the Order said contracts had to be the same vintage, Mr. Metzroth stated, "It doesn't refer to exactly the same vintage, no. I interpreted it that way."

Mr. Metzroth's remaining 19 contracts are ones that had deliveries in each year 1987 to 1990 and were in effect from November 1, 1988 until at least the end of 1993. It is unclear from the record how deliveries in 1987 were made under a contract entered into after November 1, 1988. It is also unclear how Mr. Metzroth determined that the remaining 19 contracts were in effect until the end of 1993.

Once again, Mr. Metzroth has reduced a large group of 591 contracts to a small group of 19 contracts. This group of contracts would be totally unaffected by changes in the market place, other than the elimination of contracts. Mr. Metzroth admits that he does not recommend this method because sample size continues to decline over time.

Like the year-to-year method, this method produces a benchmark that has increased every year since 1988. This is not indicative of a declining coal market, and Mr. Metzroth admits that the stipulation says, "measure the movement of the market and raise or lower the index on the basis of movement in the market." We find that this method to calculate the market-based index is not consistent with the original provisions and intent of the stipulation and Order No. 20298, either.

We will not approve Tampa Electric's proposed calculation of the market-based index, and we will not modify the manner in which the market-based index is calculated. The record in this proceeding shows us that the present method of calculating the market-based index is not broken, and there is no reason to fix it.

That is not to say that we could not modify the manner in which the benchmark is calculated if circumstances warranted such a modification. We are not precluded by any legal doctrine from considering Tampa Electric's petition, from reviewing the correctness and effectiveness of its market-based pricing method, or from modifying that method if we determine that it is in the public interest to do so. To the contrary, we are required to review and modify our rate decisions, on a prospective basis, by virtue of our continuing duty to regulate the rates and service of

electric utilities. If we determine that the rates charged by a utility are not fair, just and reasonable, either to the company or to its ratepayers, we have the obligation to fix them. This continuing obligation applies to rates for fuel cost recovery as well as to other forms of rates, and it applies perhaps most crucially to experimental rates.

Ratemaking is an ongoing, legislative function intended to be responsive to changing economic conditions. As the First District Court of Appeal recently stated in its order affirming the Commission's authority to correct, on a going forward basis, "an incorrect assumption" in a five-year-old rate order that had operated to the detriment of the utility's ratepayers:

> Peoples Gas Systems, Inc. v. Mason, 187 So.2d 335, 339 (Fla. 1966), and Austin Tupler Trucking, Inc. v. Hawkins, 377 So.2d 679 (Fla. 1979), recognize an exception to the doctrine of administrative finality where there is a demonstrated public interest. Unlike the issues raised in those cases (authority to approve territorial agreements and the dormancy of transportation certificate), the issue of prospective rate-making is never truly capable of finality.
> Sunshine Utilities v. Florida Public Service Commission, 577 So.2d 663 (Fla. 1st DCA 1991).

See also Reedy Creek Utilities v. Florida Public Service Commission, 418 So.2d 249 (Fla. 1982), and Richter v. Florida Power Corporation, 366 So.2d 798 (Fla. 2d DCA 1979).

We cannot modify our prior rate orders capriciously, without sufficient demonstration that the public interest requires the modification; but where the demonstration has been adequately made, we not only have the authority to make the appropriate modifications, we have the obligation to make them. Tampa Electric has not adequately demonstrated in this case that a modification to Order No. 20298's market pricing index is necessary; but if Tampa Electric had adequately shown the need for a change, we would certainly have the authority to make it, in spite of the fact that the original rate setting order was based upon a stipulation between the parties.

When a stipulation on a matter within our jurisdiction is entered into by the parties and approved by the Commission, the stipulation is subsumed by our order approving it. The stipulation has no legal significance apart from the order itself. See Public Service Commission v. Fuller, 551 So.2d 1210, 1212 (Fla. 1989), where the Supreme Court found that a territorial agreement between

two utilities; " has no existence apart from the PSC order approving it and . . . the territorial agreement merged with and became part of Florida Public Service Commission Order No. 4285".

A stipulation in a ratemaking proceeding before the Florida Public Service Commission can not be carved in stone. That is not to say that parties' stipulations should be ignored or treated lightly. But where the public interest requires that we modify an order or any part of an order that adopted a stipulation, we would have the obligation to do so. It is therefore

ORDERED, for the reasons set forth above, that no modifications shall be made to the implementation of the market-based pricing and benchmark methodology established in Order No. 20298 to measure the appropriateness of Tampa Electric's coal purchases from its affiliate, Gatliff Coal Company. It is further

ORDERED that this docket be closed.

By ORDER of the Florida Public Service Commission this 23rd day of September, 1992.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

MCB:bmi

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, 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 or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida

Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Civil Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.

M E M O R A N D U M

September 22, 1992

TO : DIVISION OF RECORDS AND REPORTING

FROM : DIVISION OF LEGAL SERVICES (BROWN) MCB

RE : DOCKET NO. 920041-EI

PSC-92-1048-FOF-EI

Attached please find an **ORDER ON PETITION FOR CLARIFICATION AND GUIDANCE** in the above referenced docket which is ready to be issued.

MCB:bmi
Attachment

920041z.mcb