

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by Tampa
Electric Company for approval of
cost recovery for a new
environmental program, the Big
Bend Units 1 & 2 Flue Gas
Desulfurization System.

DOCKET NO. 980693-EI
ORDER NO. PSC-99-0075-FOF-EI
ISSUED: January 11, 1999

The following Commissioners participated in the disposition of
this matter:

JULIA L. JOHNSON, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.

APPEARANCES:

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ORDER APPROVING TAMPA ELECTRIC COMPANY'S PETITION FOR COST
RECOVERY FOR BIG BEND UNITS 1 & 2 FLUE GAS DESULFURIZATION SYSTEM

BY THE COMMISSION:

CASE BACKGROUND

Pursuant to Section 366.8255, Florida Statutes, on May 15, 1998, Tampa Electric Company (TECO) filed a Petition for Approval of Cost Recovery for a New Environmental Program, the Big Bend Units 1 & 2 Flue Gas Desulfurization System. This matter was set for hearing.

On June 2, 1998, Florida Industrial Power Users Group (FIPUG) petitioned to intervene and filed its response to TECO's petition for approval of cost recovery. On June 10, 1998, the Commission granted FIPUG's petition to intervene in Order No. PSC-98-0806-PCO-EI. On July 23, 1998, FIPUG filed its motion to dismiss. On July 29, 1998, the Office of Public Counsel (OPC) filed both its notice of intervention and suggestion that the Commission dismiss TECO's petition. The Commission acknowledged OPC's intervention on August 3, 1998, in Order No. PSC-98-1047-PCO-EI. On August 14, 1998, the Legal Environmental Assistance Foundation (LEAF) petitioned to intervene and filed its motion to dismiss. A prehearing in this docket was held on August 21, 1998. The Commission granted LEAF's petition to intervene on August 28, 1998, in Order No. PSC-98-1168-PCO-EI. All intervening parties' motions and the suggestion to dismiss were denied in Order No. PSC-98-1260-PCO-EI, issued September 22, 1998.

A hearing in this matter was held September 2, 1998. The parties filed post hearing briefs and statements of issues and positions. Having considered the evidence, the arguments of the parties and our staff's recommendation, we now enter our final order.

POST HEARING MOTION

On October 12, 1998, FIPUG filed a Motion to Reopen the Record citing to Rule 25-22.037, Florida Administrative Code, which has now been superseded by Rule 28-106.204, Florida Administrative Code. On October 19, 1998, TECO filed its Memorandum in Opposition to FIPUG's Motion to Reopen the Record.

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In its motion, FIPUG contends that TECO presented two witnesses in Docket No. 980007-EI, Karen Zwolak and Gregory Nelson, who gave testimony concerning TECO's NO_x and SO₂ compliance. FIPUG asserts that these witnesses testified as to the appropriateness of granting TECO "some \$1.6 million to defray a small part of the costs for CAAA compliance, including SO₂ and NO_x removal." FIPUG further states in its Motion that:

This [the Zwolak and Nelson testimony] demonstrates that there is a significant investment in NO_x removal already in place and from this testimony the Commission may be able to ascertain the full impact of CAAA compliance. TECO does have a plan in place and under construction to comply with CAAA. TECO has simply failed to divulge this comprehensive plan to the Commission and to the parties in this case. The Commission should consider this in making its decision in this case.

TECO's Memorandum in Opposition to FIPUG's Motion to Reopen the Record states that:

FIPUG's Motion to Reopen the Record appears to be premised on the same erroneous point FIPUG raised in its failed Motion to Dismiss Tampa Electric's Petition in this proceeding -- that a utility must present an overall environmental compliance plan as a prerequisite to seeking approval of cost recovery for a particular environmental compliance activity under Section 366.8255, Fla. Stat. That argument was specifically rejected by this Commission in its Order Denying Motions to Dismiss in this proceeding.

TECO asserts that even if a plan including NO_x emission control were required under Section 366.8255, Florida Statutes, which TECO claims is not required, TECO maintains that it provided ample evidence of its NO_x compliance activities on the record in this docket. In responding to questions posed by FIPUG's counsel, TECO asserts that its Witness Black amply described the company's proposed NO_x compliance activities such as combustion modifications and classification equipment replacement, including costs of such activities. TECO asserts that Mr. Black's descriptions and estimates of these activities are located in the transcript at pages 62-64 and 67.

There are three reasons why FIPUG's Motion to Reopen the Record should not be granted. These reasons are as follows: (1)

the Motion to Reopen the Record makes the same arguments concerning the applicability of Section 366.825, Florida Statutes, versus the applicability of Section 366.8255, Florida Statutes, as were made in the Motions to Dismiss which we denied in Order No. PSC-98-1260-PCO-EI, issued September 22, 1998; (2) the issue of No_x compliance, if it is relevant, was adequately addressed on the record of this proceeding; and, (3) as a party to this proceeding, FIPUG had reasonable opportunity to offer evidence on the issue of No_x compliance. These reasons are addressed below.

The Question of Which Statute Controls the Case

FIPUG's contentions in its motion appear to be based upon the belief, stated in FIPUG's Motion to Dismiss, filed July 23, 1998, that a proceeding under Section 366.8255, Florida Statutes, requires TECO to file a comprehensive CAAA compliance plan outlining all proposed CAAA compliance projects for which TECO would seek cost recovery under the Environmental Cost Recovery Clause. Specifically, in the Motion to Dismiss, FIPUG argued:

Rather than providing the Commission with its Compliance Plan well ahead of the necessary implementation date in compliance with §366.825 so that appropriate analysis and study could be done, TECO has essentially come in at the "11th hour" seeking cost recovery of a compliance plan that has not been reviewed, much less approved, pursuant to §366.825 and for which no rate impact information has been provided. Having failed to timely file under §366.825, TECO may not seek recovery for Clean Air Act compliance costs under §366.8255.

From the similarity of the arguments presented in FIPUG's Motion to Dismiss and its subsequent Motion to Reopen the Record, we believe that FIPUG is attempting to "back into" the same arguments it made in its Motion to Dismiss. The arguments of FIPUG and OPC centered around the appropriateness of TECO's filing under Section 366.8255, Florida Statutes. Both FIPUG and OPC argued that TECO should have filed under Section 366.825, Florida Statutes. We found that a filing under Section 366.8255, Florida Statutes, was sufficient in deciding to deny the suggestion and motions to dismiss.

In this docket, TECO appropriately filed for prudence determination and eligibility for future cost recovery of its proposed Flue Gas Desulfurization (FGD) system under Section 366.8255, Florida Statutes. Therefore, a "comprehensive plan" as

intimated in FIPUG's Motion to Reopen the Record is not required or contemplated under Section 366.8255, Florida Statutes. This issue has already been rejected by the Commission and need not be revisited here.

The Issue of NO_x Compliance

We believe that NO_x compliance is not an issue in this filing for a prudence determination of a specific environmental compliance activity to reduce SO₂ emissions under Section 366.8255, Florida Statutes. Even if it were an issue, as FIPUG's Motion to Reopen the Record asserts, this question has been addressed in the record. TECO witness Black stated at the hearing:

The technologies that we utilize for NO_x control are totally separate from those that we are employing for SO₂ control. And because of the fact that no single technology that we're aware of can deal with both of those issues, we're treating them as totally unrelated. And the approach that we're taking on our NO_x compliance has no effect on the options that we would select with respect to our SO₂ compliance. And even if you look at the cost of the SCR case and compare that to other options for dealing with NO_x and SO₂ in a combined nature, that still is by far the most cost-effective solution.

Witness Black again addressed NO_x in his testimony before the Commission in answering a question posed by FIPUG:

Q: Would you give a description of the proposed action and alternative actions considered by Tampa Electric to comply with the nitrogen oxide emission rates required by the Clean Air Act?

A: Yes, sir. We currently are in negotiations with the Environmental Protection Agency with respect to the nitrous oxide emission limits for the Tampa Electric boilers The emission limits that were set, we are moving towards those limits by making combustion modification to the units which involve the replacement of the classification equipment, which allows us to better balance the fuel flow to the boilers, which allows us to reduce the amount of excess oxygen that is required for the combustion process and that reduction of the excess oxygen provides a benefit in reducing the NO_x work

. . . . To the extent that we are not successful with our combustion modifications, the next level of NO_x compliance would be the installation of a selective catalytic reduction clean-up technology on the tail end of one of our large boilers So, we're taking a staged approach for our NO_x compliance. We are looking at least cost alternative first, and we want to verify that either is or is not totally acceptable. If it's not, then we move to the next control technology to achieve the limits The current estimate for the combustion modification cost is in the order of \$8- to \$10 million of capital cost. If we have to move beyond that, the installation, the capital cost associated with a SCR on one of our large boilers we estimate to be in the order of \$20 million.

Witness Black went on to give TECO's current NO_x emissions and the amount of reduction necessary to bring TECO into compliance and the cost of such reduction. Thus there is no need to include additional testimony as to NO_x compliance, because the record appears to already be sufficient and the parties have had a reasonable opportunity to develop the record.

FIPUG's Reasonable Opportunity to Offer Evidence

FIPUG was granted party status June 10, 1998, by Order No. 98-0806-PCO-EI. FIPUG filed direct testimony on July 27, 1998. FIPUG participated in and propounded discovery. FIPUG had an opportunity to cross-examine witnesses at the hearing held September 2, 1998. We believe that, given these opportunities to participate in the hearing process and to develop the record through discovery and cross-examination, FIPUG has been given a full and fair opportunity to present any evidence it might have deemed relevant. Further, we believe that it is now too late for FIPUG to attempt to revisit the record with additional testimony the subject matter of which could have been addressed during the discovery and hearing process.

Conclusion

The Florida Industrial Power Users Group's Motion to Reopen the Record appears to be predicated upon the theory that Section 366.825, Florida Statutes, controls this case. This theory was specifically rejected in Order No. PSC-98-1260-PCO-EI, issued September 22, 1998. In addition, FIPUG, as a party to this proceeding, had a reasonable opportunity to offer evidence on the issue of NO_x compliance. Further, the issue of NO_x compliance, if

it is relevant, was adequately addressed on the record of this proceeding. FIPUG's Motion to Reopen the Record is, therefore, denied.

DECISION

I. Commission Authority

Section 366.8255, Florida Statutes, gives this Commission express authority to review and either approve or reject a 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 Clean Air Act compliance activities and costs shown in a utility's filing under s. 366.825.

We have considerable authority and responsibility for the planning, development, maintenance, and coordination of Florida's energy grid. Section 366.04(5), Florida Statutes, states that:

- (5) The commission shall further have jurisdiction over the planning, development, and maintenance of a coordinated electric power grid throughout Florida to assure an adequate and reliable source of energy for operational and emergency purposes in Florida and the avoidance of further uneconomic duplication of generation, transmission, and distribution facilities.

We have considered the factors set out in both Section 366.8255 and 366.04(5), Florida Statutes, concerning our authority to review and determine the prudence of an expense incurred by a utility in complying with environmental regulations.

In determining the prudence of the proposed FGD system, we followed the criteria established in Order No. PSC-94-0044-FOF-EI, issued January 12, 1994, in Docket No. 930613-EI. These criteria were developed to implement the intent of the environmental cost recovery statute. These criteria are enumerated at pages six and seven of the Order as follows:

Upon petition, we shall allow the recovery of costs associated with an environmental compliance activity through the environmental cost recovery factor if:

1. such costs were prudently incurred after April 13, 1993;
2. the activity is legally required to comply with a governmentally imposed environmental regulation enacted, became effective, or whose effect was triggered after the company's last test year upon which rates are based; and,
3. such costs are not recovered through some other cost recovery mechanism or through base rates.

II. Alternatives to the FGD System

The resolution of this issue centers on whether or not TECO was prudent in its planning process. If there is evidence that TECO ignored relevant facts, ignored reasonable options, or made unreasonable assumptions in its planning process, then TECO did not adequately explore all reasonable alternatives for compliance with the Clean Air Act Amendments of 1990 (CAAA).

According to Witness Black, TECO's lengthy decision-making process may cause TECO to incur slightly higher costs for fuel and SO₂ allowances during the first part of the year 2000. However, we conclude that these increased costs are not sufficient to change the ultimate cost-effectiveness of the scrubber option for TECO. Therefore, we believe that the record supports the conclusion that TECO has been reasonable in its evaluations of alternatives to comply with CAAA requirements.

A. TECO's Timeline of CAAA Reviews

The CAAA of 1990, requires specific reductions in SO₂ and NO_x air emissions at fossil fuel-fired power plants. All compliance alternatives available to TECO are composed of one or more of the following five basic options: purchased power, fuel switching, environmental dispatch, retrofit existing power plants with pollution control equipment, and displacement of coal-fired generation with new natural gas-fired generation. These five basic options in many various combinations have been considered and evaluated by TECO since passage of the CAAA. According to Witnesses Black and Hernandez, TECO's evaluation of the options included consideration of fuel prices, fuel quality, the specific design of the generating unit, operational and efficiency characteristics, as well as potential infrastructure additions such as natural gas laterals and coal yard improvements. However,

different evaluations were made at various stages of the decision process.

According to Witness Hernandez, in August of 1992, TECO concluded that blending coals was the most cost-effective option for the Phase I requirements which the CAAA placed specifically on Big Bend Units 1, 2, and 3. We believe that this was a reasonable choice because there simply was no evidence that any other alternative would have been more cost-effective. According to Witness Hernandez, too many unknowns existed in 1992 with respect to the CAAA.

According to Witnesses Black and Hernandez, TECO's 1994 CAAA compliance plan evaluation was a milestone study with long-term implications. Witnesses Black and Hernandez stated that this study concentrated on SO₂ requirements principally because SO₂ emission limits for Big Bend Units 1, 2, and 3 were listed in the CAAA and were to be met by 1995. However, the 1994 study also addressed flexibility to respond to future developments in the CAAA. Witness Hernandez testified that although the Environmental Protection Agency (EPA) had set SO₂ limits for the first phase of the CAAA for Big Bend Units 1-3, it had not set applicable NO_x limits for those units at the time of the study. Witness Hernandez testified that, instead, EPA was studying what was reasonable and economical for utility boilers with the design characteristics of Big Bend Units 1-3. Witness Hernandez further testified that the EPA was to promulgate NO_x limits for boilers of this type by January 1997 to take effect at the beginning of Phase II. Witness Hernandez stated that because of this, TECO continued to separately study options for compliance with CAAA Phase II limits for both NO_x and SO₂.

The conclusion drawn by TECO from the 1994 review was that the deferral of investment in a scrubber retrofit project was cost-effective as long as allowances could be purchased at a reasonable price and were competitive with the price spread between lower and higher sulfur coals. However, according to Witness Hernandez, uncertainty existed which required TECO to continue to monitor the newly formed SO₂ Allowance Market, EPA's drafting of the NO_x rules, pending air toxic studies, and the potential for CO₂ legislation.

According to Witnesses Hernandez and Black, in 1995, TECO determined that it was economic to use its Big Bend Unit 4 scrubber to also scrub the Big Bend Unit 3 flue gas. Witness Black stated that this finding was largely based on ongoing research and development (R&D) efforts at TECO's Big Bend Unit 4 scrubber. The project became known as the "Big Bend Unit 3 Flue Gas

Desulfurization Integration" project. In May 1996 TECO petitioned for cost recovery for this CAAA compliance activity which was granted in Order PSC-96-1048-FOF-EI, issued August 14, 1996.

According to Witness Black, another screening analysis of SO₂ compliance options began in late 1996. This analysis is the basis for various exhibits attached to Mr. Hernandez' prefiled testimony which was entered into the record of this proceeding as Hearing Exhibit 12. Mr. Hernandez clarified that the 1996 cost figures in were in 1996 dollars because that is when the evaluations were done. According to Witnesses Black and Hernandez, the 1996 evaluation built on the 1994 review and lessons learned with the R&D project on the Big Bend Unit 4 scrubber. A review of the tables and figures within Mr. Hernandez' prefiled testimony reveals four different scrubber options. The first page of Hearing Exhibit 8 shows that only scrubber projects were under investigation as of January 1997. According to TECO Witnesses Black and Hernandez, by this time, TECO had made a determination on the means of compliance with SO₂ requirements of the CAAA. The cost-effectiveness of the FGD option was determined based upon TECO's current compliance actions: fuel switching and allowance purchases. The alternative of fuel switching (also called fuel blending) was labeled the base case throughout the remaining planning process. Upon consideration, we believe that this approach provides a reasonable measure of the expected change in costs for compliance alternatives from the current alternative.

A 1997 snapshot of TECO's dialogue with EPA regarding NO_x limits and retrofit costs on various units is contained in Hearing Exhibit 10. The potential cost impact for NO_x compliance shown exceeds an estimated \$100,000,000 in capital costs if selective catalytic reduction (SCR) technology is required on six TECO units. However, according to Witness Black, TECO has undertaken efforts before EPA for different and less restrictive NO_x limits. If successful, Witness Black maintains that TECO will have reduced the NO_x compliance cost to be between \$8 and \$30 million. However, we note Mr. Black's uncertainty that TECO's current NO_x compliance approach will meet the existing limits under the CAAA.

In late 1997, according to Witness Black, TECO obtained several estimates for the Big Bend Units 1 & 2 scrubber from Sargent & Lundy. A September estimate for a similar FGD quoted an amount of \$80 million, according to Witness Black. Witness Black testified that TECO then requested a detailed estimate of the major portions of the project. The detailed estimate was transmitted on October 3, 1997, and, according to Witness Black, formed the basis

of the cost estimates in TECO's final review, the presentation to management, and the cost estimates presented in Mr. Black's prefiled testimony.

The May 1998 review contained in Mr. Hernandez' testimony is a composite summary of various efforts over time. Currently, according to Mr. Hernandez, there are only two viable alternatives under consideration by TECO, the FGD stand-alone system for Big Bend Units 1 & 2 and fuel blending. The proposed FGD is expected to be less expensive than the use of lower sulfur coals paired with participation in the SO₂ allowance market because the difference between high and low sulfur coal prices is expected to increase. As detailed in the section of this Order entitled, Reasonableness of TECO's Fuel Price Forecast, the forecasted coal prices are reasonable expectations, and none of the parties disputed the trends in coal prices.

OPC's concerns appear to be directed by a sense of insufficiency in TECO's testimony. OPC highlighted two concerns with respect to planning, evaluations, and alternatives. The first is that, according to Witness Black, TECO could have scheduled the scrubber to come on line earlier. The second pertains to the fuel price forecasts used by TECO. OPC believes that a ten-year fuel price forecast is not sufficient to make a decision, and fuel price forecasts specific to each generating unit have not been provided.

Similar to OPC's concerns, FIPUG states that it does not believe TECO provided sufficient information to determine the prudence of the proposed FGD system. FIPUG believes that TECO's filing falls short of the information required by law and that TECO has given itself insufficient time for full consideration of the facts.

Upon consideration of the evidence, we believe that all facts showing what TECO knew or could have reasonably known at the time are contained in the record. The ultimate installed costs and all other incidental costs for compliance with the CAAA are not relevant in the review of TECO's 1996/1997 decision to install an FGD system on Big Bend Units 1 & 2. Whether or not TECO has been prudent in its selection of a compliance option can be determined from the record in this case.

LEAF's primary concern is that TECO prematurely eliminated all natural gas options for purposes of compliance with CAAA requirements. One alternative to CAAA compliance which TECO's 1996-1998 reviews did not address was building a new natural gas-

fired combined cycle facility. Such a facility would reduce TECO's system NO_x and SO₂ emissions if it could economically displace TECO's coal-fired generation. This compliance alternative did not appear in any review or study after it was determined to not be cost-effective in the 1994 study.

An exhibit provided by TECO Witness Hernandez demonstrates the degree to which a new natural gas facility would or would not be cost-effective for TECO in place of the coal-fired FGD alternative. Based on this and all other evidence in the record, we are persuaded that a new natural gas-fired unit is not cost-effective and not competitive with the FGD alternative for purposes of CAAA SO₂ compliance.

Based on the foregoing analysis, we find that TECO has adequately explored alternatives to the construction of a Flue Gas Desulfurization (FGD) system on Big Bend Units 1 and 2. The in-service date of the FGD system and its effect on both fuel and allowance savings should be monitored in the ongoing fuel adjustment and environmental cost recovery dockets.

III. Reasonableness of TECO's Fuel Price Forecast

Witness Black testified that TECO annually develops a fuel price forecast to support its planning process. Witness Black stated that TECO used the same forecast in its evaluation of the cost-effectiveness of the FGD system that it used in its 1998 Ten-Year Site Plan (TYSP). According to Witness Black, when developing its fuel price forecast, TECO compared historical fuel prices with future fuel prices as projected by several consultants and government agencies such as U.S. Energy Information Administration, American Gas Association, Cambridge Energy Research Associates, Resource Data International, and Energy Ventures Analysis. Furthermore, according to Witness Black, TECO also reviewed several industry publications to monitor historical price trends. We note that none of the parties questioned the validity or reliability of the sources used by TECO in its analysis of fuel prices. In fact, these sources are the same ones used for TECO's fuel price forecasts for its prior TYSP filings with the Commission. We have consistently determined these filings to be reasonable for planning purposes. We believe that TECO has taken reasonable steps to monitor current trends and future expectations of fuel prices.

As discussed in detail in Section VI of this Order entitled Most Cost-Effective Alternative for SO₂ Compliance, the cost-effectiveness of the FGD system is highly dependent on the

forecasted price differential between low-sulfur and high-sulfur coal. Witnesses Black and Hernandez stated that TECO compared its forecast of low-sulfur and high-sulfur coal prices at the mine to similar forecasts by Resource Data International (RDI) and Energy Ventures Analysis (EVA) and found that its forecasted price differential was less than either RDI or EVA. Also, these witnesses demonstrated that TECO's coal price forecasts escalated at a slower rate than the two independent forecasts. Based upon these two characteristics, Witnesses Black and Hernandez asserted that TECO considered its forecasts to be a conservative projection of future coal prices. We agree.

As discussed by Witness Hernandez, the difference between coal and natural gas prices, when converted to dollars per equivalent barrel of one percent sulfur #6 residual oil, diverges over the forecasted period. The record contains no further explanation to support this divergence. However, we believe that for the purpose of determining whether an FGD system is the most cost-effective alternative for CAAA Phase II SO₂ compliance, the fuel price forecast used by TECO appears to be reasonable.

According to OPC, TECO has not filed sufficient testimony with respect to detailed fuel price forecast information. Both Witness Black and Witness Hernandez depicted forecasted prices for low-sulfur coal from Eastern Kentucky and high-sulfur coal from Western Kentucky in graph form in Hearing Exhibits two and twelve. These forecasts from TECO, according to Witness Black, as well as forecasts from two independent sources, RDI and EVA, represent mine prices only, not delivered prices. However, given that the two coal sources are located in fairly close proximity, we believe that it is reasonable to assume that transportation costs to TECO would be similar from either delivery origin.

OPC infers that there is no forecast within the record that projects fuel prices beyond ten years into the future. We disagree. TECO provided coal and natural gas price forecasts, either explicitly or implicitly, in several documents submitted by Witness Hernandez as late-filed deposition exhibits. These exhibits were made part of the record in this proceeding as Hearing Exhibit 14. In Late-Filed Deposition Exhibit 1, Witness Hernandez explicitly provided 27-year coal and natural gas price forecasts to compare the cost effectiveness of the FGD system to a natural gas-fired combined cycle unit. In Late-Filed Deposition Exhibit 6, Witness Hernandez implicitly provided 27-year coal price forecasts. In Late-Filed Deposition Exhibit 8, Witness Hernandez implicitly

provided 27-year price forecasts for several fuels to calculate annual system fuel costs.

Both OPC and FIPUG expressed concern that TECO has not indicated its present and potential future sources of fuel as required by Section 366.825, Florida Statutes. However, as stated in Order No. PSC-98-1260-PCO-EI, TECO has brought this petition before the Commission under Section 366.8255, Florida Statutes. Under this statute, TECO is not required to identify its present and potential future sources of fuel. However, in Hearing Exhibit 8, which has been made a part of the record in this proceeding, TECO provided its fuel source assumptions for Big Bend Units 1-4 and Gannon Units 1-6 under each of four different Phase II SO₂ compliance scenarios.

As previously discussed, we find TECO's fuel price forecast to be reasonable for planning purposes regardless of the compliance alternative ultimately selected.

IV. Reasonableness of the Economic and Financial Assumptions

We find that the economic and financial assumptions used by TECO in its selection of the FGD system for its CAAA Phase II Compliance plan are reasonable. We reviewed all of the base case and FGD case assumptions underpinning the company's selection process. These include the discount rate, capitalization ratios, inflationary rates, and income tax rate assumptions.

Witness Hernandez stated that TECO used a 9.55 percent discount rate in arriving at the purported savings resulting from the choice of the FGD compliance option based on a cumulative present worth revenue requirements (CPWRR) analysis. This rate, according to Witness Hernandez, represents TECO's estimate of its after-tax weighted average cost of capital, determined annually by evaluating financial market trends. Based on the evidence presented in this case, we believe that TECO's after-tax weighted average cost of capital is a reasonable discount rate, which can be used to evaluate the financial viability of capital projects such as this FGD proposal. Thus, we find that 9.55 percent is a reasonable rate to assess the cost-effectiveness of the various compliance options.

A detailed review of TECO's capitalization ratios, including the debt, preferred, and common equity ratios, as well as TECO's cost rates for each of these components, is outside the scope of this proceeding. Although we believe that the discount rate

obtained from these inputs is reasonable for this limited compliance purpose, we do not believe that the cost of capital assumed here is necessarily appropriate for other rate-making or regulatory purposes.

TECO's inflationary assumptions, 2.8 percent for production and 3.0 percent for non-production scenarios, are consistent with long-term projections found in national publications such as Blue Chip Economic Indicators and Data Resources, Inc. (DRI). We believe that these are reasonable and reliable sources. In addition, the state, federal, and effective income tax rates are consistent with available data for these inputs and are adequate assumptions.

OPC, FIPUG and LEAF neither supported alternative assumptions for any of these components nor sponsored witnesses that addressed these issues. OPC's and FIPUG's disagreement with the AFUDC assumption is discussed in Section VII of this Order entitled Accrual of Allowance for Funds Used During Construction.

Based upon the evidence, we find that the economic and financial assumptions used by TECO in its selection of a CAAA Phase II Compliance plan are reasonable and sufficient for planning purposes.

V. Reasonableness of Environmental Compliance Costs for Regulated Pollutants

According to Witnesses Black and Hernandez, TECO considered the environmental compliance costs for other regulated pollutants besides SO₂ in its selection of the proposed FGD system. Witness Black indicated that the cost impact for both NO_x and SO₂ compliance were specifically quantified for a ten-year period in TECO's January 1997, review of SO₂ compliance strategies. Witness Hernandez testified that in TECO's May 1998 CAAA Phase II compliance evaluation, NO_x related costs were explained to have no effect on the selection of the FGD alternative as the most cost-effective. In responding to an hypothetical question, Witness Black reinforced that opinion. He suggested that it is appropriate to evaluate individual projects that reduce one type of emission as long as the other emissions would be addressed the same regardless of the project chosen to address the one type of emission. He also suggested that solutions that address all emissions at one time are rare.

Costs were not quantified, however, with respect to each pollutant. As is evident in the record, regulations for many pollutants are not yet finalized. For instance, although the rules limiting particulate matter to less than 2.5 microns in size were passed in 1997, Witness Black projects that it could take until 2005 before specific actions are required to bring areas determined to be in non-attainment into compliance. Witness Black further stated that TECO does not even expect a decision about which geographic areas are in noncompliance for this rule until sometime between 2002 and 2005.

Witness Black noted that the potential for CO₂ regulations was noted as a strategic consideration in TECO's January 1998, review. According to Witness Hernandez, in TECO's 1994 milestone study, the negative implications of potential Congressional legislation setting CO₂ limits were discussed as well as the increase in CO₂ emissions resulting from installation of a FGD system. Witness Black asserted in his testimony that increased CO₂ emissions are still expected to result from the addition of the FGD system but that the increase would be somewhat offset by a small reduction in CO₂ emissions at the Gannon station. However, specific CO₂ emissions limits currently do not exist.

FIPUG's contentions on this issue reargue the same concerns addressed in that Section II of this Order entitled Alternatives to the FGD System. Those arguments focus on the sufficiency of TECO's filings and planning process. We agree with FIPUG that a detailed NO_x removal plan was not included in TECO's filing; however, we do not believe that a detailed NO_x removal plan is necessary to determine whether TECO's proposed Phase II SO₂ compliance alternative is cost-effective. According to Witness Hernandez, the costs of TECO's chosen NO_x compliance strategy do not impact the selection of its SO₂ compliance alternative.

LEAF asserts that TECO is likely to be subject to numerous environmental compliance costs and that TECO did not reasonably consider all of them in its analysis. There is no evidence or testimony which shows that TECO failed to take into account some environmental requirement which would have resulted in a lower cost compliance alternative than the proposed FGD system.

The purpose of this issue was to determine whether or not TECO's cost estimates for the FGD project included costs for compliance with all applicable environmental regulations. We note that no additional cost items were identified. In fact, the AFUDC

amount was the only line item in the project cost estimate that was questioned.

In addition, the cost estimates are supported by an independent source. Witness Black testified that TECO's in-service estimates are greater than those of Sargent & Lundy by \$9,730,280 excluding AFUDC. Therefore, we believe that it is not likely that TECO ignored or failed to show any significant costs which could have resulted in the proposed project becoming uneconomic.

At this time, TECO appears to have reasonably considered the environmental compliance costs for all regulated air, water and land pollutants in its selection of the proposed FGD system on Big Bend Units 1 and 2 for SO₂ compliance purposes.

VI. Most Cost-Effective Alternative For SO₂ Compliance

Many factors must be considered to conclude that the FGD system is the most cost-effective alternative. One thing that must be established is whether TECO began its analysis by exploring all alternatives available for compliance with the SO₂ requirements of Phase II of the CAAA. As discussed in Section II of this Order entitled Alternatives to the FGD System, we believe that the record shows that TECO has adequately explored compliance alternatives. By eliminating alternatives that were either not viable or uneconomic, TECO narrowed the options for further screening to arrive at the most cost-effective alternative.

In order to determine which compliance option was the most cost-effective, Witness Hernandez testified that TECO performed a cumulative present worth revenue requirement analysis. The outcome of this analysis is, of course, dependent on the reasonableness of the assumptions within. Therefore, we reviewed TECO's fuel price forecasts, its economic and financial assumptions, its planning assumptions, and its demand and energy forecasts. Although some of TECO's assumptions and forecasts have been addressed above, we will revisit them briefly in the following discussion of TECO's key assumptions and forecasts used in its decision-making process which led to selection of the proposed FGD system on Big Bend Units 1 & 2.

A. Fuel Forecast

As discussed in Section III of this Order entitled Reasonableness of TECO's Fuel Price Forecast, we believe the fuel

price forecast used by TECO in its selection of a CAAA Phase II compliance plan is reasonable.

B. Economic and Financial Assumptions

In Section IV of this Order entitled Reasonableness of the Economic and Financial Assumptions, we concluded that the record shows that the economic and financial assumptions used by TECO in its selection of a CAAA Phase II compliance plan are reasonable and sufficient for planning purposes.

C. Planning Assumptions

In addition to the assumptions and forecasts addressed in previous sections, we reviewed several key planning assumptions used by TECO in its analysis of the cost-effectiveness of its Phase II compliance plan. According to Witness Hernandez, forecasts of net and purchased cogeneration, and wholesale interchange used in the cost-effectiveness analysis were taken from TECO's 1998 Ten-Year Site Plan. Witness Hernandez also stated that the forecast of demand side management used in the cost-effectiveness analysis was taken from TECO's 1998 Ten-Year Site Plan. We find TECO's use of data from its Ten-Year Site Plan is reasonable for use in analyzing the cost-effectiveness of its Phase II compliance options.

We also examined the methodology and assumptions of the demand and energy forecasts used by TECO for its selection of a CAAA Phase II compliance plan and found these to be reasonable for planning purposes.

These forecasts are also based upon the Company's 1998 Ten-Year Site Plan (TYSP), filed on April 1, 1998, according to Witness Hernandez. However, TECO submitted a Revised TYSP in August 1998. We evaluated the new demand and energy forecasts in order to test how they might affect the overall viability of the FGD compliance plan.

When asked forecasting questions based upon the original TYSP filing, specifically about a comparison between the historical data and the base case forecast of TECO's summer net firm demand, TECO Witness Hernandez stated that residential utilization, measured as load per customer or KW per customer, is slightly increasing despite TECO's best conservation efforts. In addition to this, Witness Hernandez stated that an increasing customer base has yielded higher summer peak projections. Subsequent to this deposition, TECO filed the Revised TYSP, and we reviewed the

revised summer net firm demand data. Witness Hernandez explained that the base case forecast showed more of an increase in summer net firm demand, thus making the FGD compliance option an even more appealing alternative.

We note that TECO's 1998 winter net firm demand base case forecast is consistent with forecasts filed for purposes of the Commission's reviews of electric utility TYSPs. According to Witness Hernandez, TECO's latest winter peak demand base case projection shows that historical growth rates continue to exceed the projected growth rates by approximately one percent per year.

TECO's projection for net energy for load (NEL) is also consistent with previous forecasts. TECO's NEL is based upon firm energy commitments. At one time, the forecast was growing at a slower rate than recent historical trends. However, the gap has since narrowed, and the forecasts are closer to resembling historical trends.

At hearing, Witness Hernandez was questioned about the Revised TYSP NEL forecast, specifically about whether it included sufficient energy to operate the proposed FGD system. Mr. Hernandez compared the Revised TYSP to the original TYSP and stated that:

in all years except for perhaps the first year, 1998, that the combined net energy for load is, in fact, higher than the net energy for load that was the basis for the final cost effectiveness study. . . . there's sufficient energy projected in terms of system requirements, and, therefore, the FGD option is, in fact, just a little bit more cost effective.

Mr. Hernandez also stated that given TECO's current projected energy requirements, there is about a 2.2 to 2.5 percent retail energy growth on the system, and that there must be SO₂ compliance by the year 2000. When FIPUG asked Witness Hernandez how construction for the purposes of compliance would affect demand. Mr. Hernandez replied that:

relative to compliance, most of the compliance issues are associated with energy, not peak demand or capacity. . . . But specifically for environmental compliance, the energy forecast is probably the more relevant piece of the forecast.

We agree with TECO that for the purposes of this review, the energy forecast is the critical component that leads to the determination of the most viable compliance alternative.

Based upon the information discussed above, we find that TECO's demand and energy forecasts are reasonable for the selection of a compliance option.

D. Environmental Compliance Costs for Other Pollutants

Another important aspect to consider in determining cost-effectiveness is whether TECO reasonably considered the environmental compliance costs for all regulated pollutants in its analysis. In Section V of this Order entitled Reasonableness of Environmental Compliance Costs for Regulated Pollutants, we determined that TECO had considered compliance costs for other regulated pollutants in its selection of the FGD system as the most cost-effective alternative.

In analyzing the issues comprising the relevant sections of this Order, analyzing TECO's planning assumptions and energy and demand forecasts we found no errors of fact nor any necessary adjustments to TECO's forecasts. After applying all of these assumptions and forecasts to the analysis, Witness Hernandez stated that the CPWRR was calculated by summing the incremental system fuel and purchased power expense, the incremental capital and O&M expense, and the other incremental costs of the compliance options. Then, Witness Hernandez explained, the alternative with the lowest incremental cost, or in this case, the highest incremental savings, over the fuel blending base case scenario, was chosen from the compliance alternatives.

Due in large part to the forecasted price differential between low-sulfur and high-sulfur coal, Witness Hernandez stated that the FGD system was selected as the most cost-effective alternative for compliance with the SO₂ requirements of Phase II of the CAAA. As the differential between low-sulfur and high-sulfur coal becomes larger, the FGD system generally becomes more cost-effective. In Section III of this Order entitled Reasonableness of TECO's Fuel Price Forecast, we agreed that TECO used a conservative projection of future coal prices. If TECO's conservative expectations of coal prices are accurate, then the fuel savings are expected to exceed the FGD system's capital costs. According to Witness Hernandez, the fuel savings realized by the FGD system during the first five years of operation almost offset the entire capital costs of the FGD system. However, if the future proves that coal prices are

more closely reflected by RDI's and EVA's forecasts, then TECO's ratepayers may realize greater savings than anticipated by TECO.

Both OPC and FIPUG state that TECO has not provided sufficient evidence that the forecasted price differential between low-sulfur coal and high-sulfur coal is large enough to overcome the high capital requirements of the FGD system. However, we disagree because both Witnesses Black and Hernandez demonstrated on the record that the FGD system's cost-effectiveness is due to projected fuel savings that will more than offset the capital and O&M on a CPWRR basis.

Based on the preceding discussion, we find that TECO has adequately demonstrated that its proposed FGD system on Big Bend Units 1 & 2 is the most cost-effective alternative available for SO₂ compliance purposes.

VII. Accrual of Allowance for Funds Used During Construction

In its petition filed May 15, 1998, TECO requested that it be allowed to recover the investment and costs associated with the construction of Flue Gas Desulfurization (FGD) equipment to be installed to meet environmental compliance requirements. TECO mentioned that the approximate \$90 million cost of the FGD included the accrual of AFUDC. The petition, however, does not contain any request for the waiver or modification of Rule 25-6.0141, Florida Administrative Code, entitled "Allowance For Funds Used During Construction." Although TECO Witness Hernandez' prefiled testimony contained a request for confirmation that the FGD project qualified for AFUDC accrual under the definition of eligible projects in the AFUDC rule, there was no mention of other rule provisions that might have to be waived or modified if the total project were to be eligible for AFUDC.

In order to be eligible for the accrual of AFUDC under Section (1)(a) of Rule 25-6.0141, Florida Administrative Code, a project must exceed a dollar limitation and a one-year construction period. The FGD project meets both of these criteria. However, a further provision of the rule, Section (1)(b), states that projects, or portions thereof, are ineligible for AFUDC unless the projects exceed the level of CWIP allowed in rate base in the utility's last rate case. Based on this criterion, a portion of the FGD project would not be eligible for AFUDC. During cross-examination, Witness Hernandez stated that he had not read the entire rule and had focused on Section (1)(a) regarding eligible projects.

In TECO's last rate case, Docket No. 920324-EI, \$36,171,000 of construction work in progress (CWIP) eligible for AFUDC was included in rate base. As stated in Order No. PSC-93-0664-FOF-EI, issued April 28, 1993:

From January 1, 1994 until ordered to modify or cease, the \$36,171,000, which is earning a return from this proceeding, shall offset CWIP balances that accrue AFUDC.

According to Hearing Exhibit 13, which was entered in to the record of this proceeding, TECO's 1998 Forecasted Earnings Surveillance Report, the projected average total balance of CWIP is \$21,255,000. This total CWIP is not segregated between the short-term amount, included in rate base because it is not eligible for AFUDC, and the long-term amount included that would otherwise be eligible for AFUDC. In the last rate case, those amounts were \$18,793,000 and \$36,171,000, respectively.

In our opinion, TECO has not demonstrated any extenuating circumstances for deviating from the provisions of the AFUDC rule. The environmental nature of the project and its recovery mechanism through a cost recovery clause, have no bearing on the issue at hand. Therefore, we find that AFUDC shall be accrued in accordance with Rule 25-6.0141, Florida Administrative Code, which allows the accrual of AFUDC only on CWIP that exceeds the amount included in rate base in the TECO's last rate case. We will review the calculation of AFUDC when TECO seeks to recover the costs through the ECRC.

VIII. Approval of Petition for Cost Recovery of a FGD System on Big Bend Units 1 & 2

Upon cross examination at the hearing, Witness Hernandez clearly identified TECO's requests in this docket with the following statement:

We're seeking, really, the three things; that this is the most cost-effective alternative for our ratepayers; that the environmental cost recovery clause is, in fact, the appropriate cost recovery mechanism; and then to get an acknowledgment that we would like to defer the accrual of AFUDC, and that would also be a cost item when we go for cost recovery about this time next year. We are not seeking cost recovery at this time.

We will respond to each of the three requests listed in Mr. Hernandez' statement. First, we find that the FGD is the most cost-effective alternative for compliance with the SO₂ requirements of Phase II of the CAAA (see that portion of this Order entitled Most Cost-Effective Alternative for SO₂ Compliance). Second, we find that the FGD project qualifies for recovery through the ECRC as discussed in more detail below. We note, however, that there are means for cost recovery of the FGD system other than the ECRC. Obviously, base rates are also an appropriate cost recovery mechanism. Third, we addressed TECO's request to accrue AFUDC in Section VII of this Order entitled Accrual of Allowance for Funds Used During Construction. In Section VII, we found that AFUDC should be accrued only to the extent that it complies with the criteria set forth in Rule 25-6.0141, Florida Administrative Code, especially Section (1)(b)(1), concerning the level of CWIP included in rate base in the last rate case.

FIPUG argues that existing rates are sufficient to address the additional expense of the FGD. FIPUG asserts that allowing recovery through the ECRC mechanism would create double recovery. While we agree with this analysis to the extent that it correctly applies regulatory theory, Section 366.8255, Florida Statutes, does not appear to allow this degree of discretion by the Commission in this instance.

OPC argues that allowing TECO to accrue AFUDC on:

construction balances below the \$36,171,000 CWIP-in-rate-base threshold would violate sound regulatory policy. It would require customers to pay twice for carrying charges on the company's construction projects.

We note, however, that our actions with regard to the accrual of AFUDC are governed not only by the applicable rule, but also by prior Commission precedent. The following excerpt from Order No. PSC-94-0044-FOF-EI, issued January 12, 1994, in Docket No. 930613-EI, addresses sufficiency of earnings to address proposed environmental compliance costs:

Public Counsel argued that if a utility is earning within its allowed return on equity range, it is already being compensated for all environmental expenses, and it should not be allowed to recover any costs through the environmental cost recovery clause. Public Counsel maintains that it does not matter whether the environmental activity was included in the test year of

the utility's last rate case. The utility should only be allowed to recover costs through the clause if the utility is under-earning and if the environmental expenses are the cause of the under-earning. OPC argued that to allow any recovery through the clause if the utility is not under-earning would amount to double recovery.

Although regulatory philosophy indicates that OPC is theoretically correct, we must consider the legislation establishing the environmental cost recovery clause. The statute contains a non-exclusive list of the types of expenses which should be recoverable through the clause. (Section 366.8255(1)(d), Florida Statutes). The enumerated expenses are:

1. In-service capital investments, including the utility's last authorized rate of return on equity;
2. Operation and maintenance expenses;
3. Fuel procurement costs;
4. Purchased power costs;
5. Emission allowance costs; and,
6. Direct taxes on environmental equipment.

The statute also states in Section 366.8255(2), Florida Statutes, that

(a)n adjustment for the level of costs currently being recovered through base rates or other rate-adjustment clauses must be included in the filing.

Finally, the statute provides that

(r)ecovery of environmental compliance costs under this section does not preclude inclusion of such costs in base rates in subsequent rate proceedings, if that inclusion is necessary and appropriate; however, any costs recovered in base rates may not also be recovered in the environmental cost-recovery clause. (Section 366.8255(5), Florida Statutes).

Thus, we find that the legislature clearly intended the recovery of investment carrying costs and O&M

expenses through the environmental cost recovery clause. For this reason, Public Counsel's argument must be rejected.

Accordingly, we find that if the utility is currently earning a fair rate of return that it should be able to recover, upon petition, prudently incurred environmental compliance costs through the ECRC if such costs were incurred after the effective date of the environmental compliance cost legislation and if such costs are not being recovered through any other cost recovery mechanism.

The proposed FGD is a significant new expense which is subsequent to TECO's last rate case. Therefore, base rates were not set to specifically include all expenses of the proposed FGD system on Big Bend Units 1 & 2.

The Commission is required under Section 366.8255, Florida Statutes, to allow recovery of prudently incurred costs for environmental compliance only when they are not being recovered elsewhere. Whether or not base rates are sufficient to address these expenses today, the proposed FGD system clearly qualifies for recovery through the ECRC. Because the costs of this activity are not clearly being recovered in base rates, this project qualifies for recovery under the ECRC.

According to Witness Hernandez, TECO plans to file for cost recovery in 1999. Therefore, specific cost recovery issues will probably be addressed in the 1999 hearing in the ongoing docket in which the Commission sets ECRC factors. The Commission's decision in the present docket in no way predetermines the amounts to be recovered through the ECRC for the FGD system on Big Bend Units 1 & 2. The prudence of costs will be determined after they become actual costs, and final disposition of the costs incurred will be subject to audit.

We find that the proposed FGD project qualifies for recovery through the ECRC; however, the amount of costs to be recovered will be determined in subsequent rate-setting proceedings.

Based upon the foregoing, it is therefore

ORDERED by the Florida Public Service Commission that Florida Industrial Power Users Group's Motion to Reopen the Record is hereby denied. It is further

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ORDERED that TECO has adequately explored alternatives to the construction of a Flue Gas Desulfurization system on Big Bend Units 1 & 2. It is further

ORDERED that the fuel price forecasts used by TECO in its selection of a CAAA Phase II Compliance plan are reasonable. It is further

ORDERED that the economic and financial assumptions used by TECO in its selection of a CAAA Phase II Compliance plan are reasonable and sufficient for planning purposes. It is further

ORDERED that TECO reasonably considered the environmental compliance costs for all regulated air, water and land pollutants in its selection of the proposed FGD system on Big Bend Units 1 and 2 for sulfur dioxide (SO₂) compliance purposes. It is further

ORDERED that TECO has demonstrated that its proposed FGD system on Big Bend 1 and 2 for SO₂ compliance purposes is the most cost-effective alternative available. It is further

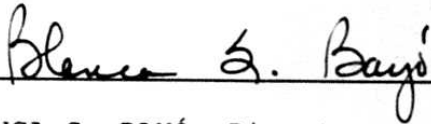
ORDERED that TECO shall only accrue allowance for funds used during construction (AFUDC) for the proposed FGD system on Big Bend Units 1 and 2 to the extent that it complies with the criteria set forth in Rule 25-6.0141, Florida Administrative Code. It is further

ORDERED that TECO's petition for cost recovery of a FGD system on Big Bend Units 1 and 2 through the Environmental Cost Recovery Clause (ECRC) is granted. It is further

ORDERED that this docket should be closed after the time for filing an appeal has run.

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By ORDER of the Florida Public Service Commission this 11th
day of January, 1999.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

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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 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, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, 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 and/or wastewater 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 Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.