BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition by Progress Energy Florida, Inc. for approval to recover modular cooling tower costs through environmental cost recovery clause.	DOCKET NO. 060162-EI ORDER NO. PSC-07-0345-PHO-EI ISSUED: April 25, 2007

Pursuant to Notice and in accordance with Rule 28-106.209, Florida Administrative Code (F.A.C.), a Prehearing Conference was held on April 23, 2007 in Tallahassee, Florida, before Commissioner Matthew M. Carter, II, as Prehearing Officer.

APPEARANCES:

GARY V. PERKO, ESQUIRE and CAROLYN S. RAEPPLE, ESQUIRE, Hopping Green & Sams, P.A., Post Office Box 6526, Tallahassee, FL 32314, and R. ALEXANDER GLENN, ESQUIRE, Deputy General Counsel, Progress Energy Services Company, LLC., 100 Central Avenue, Suite 1D, St. Petersburg, FL 33701-3324
On behalf of Progress Energy Florida, Inc.

JOSEPH A. McGLOTHLIN, ESQUIRE, Associate Public Counsel, Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, Room 812, Tallahassee, FL 32399-1400
On behalf of Office of Public Counsel.

MARTHA C. BROWN, ESQUIRE, and LISA C. BENNETT, ESQUIRE, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850
On behalf of the Florida Public Service Commission (Staff).

PREHEARING ORDER

I. CASE BACKGROUND

On February 24, 2006, Progress Energy Florida, Inc. (PEF) filed a petition for approval to recover the costs of its modular cooling tower project through the Fuel and Purchased Power Cost Recovery Clause (the Fuel Clause). PEF implemented this project on June 9, 2006, to comply with wastewater discharge standards required by the Florida Department of Environmental Protection (FDEP). On July 13, 2006, after discussions with our staff, PEF filed an amended petition to recover the costs of the project through the Environmental Cost Recovery Clause (ECRC) rather than the Fuel Clause. Thereafter, at its August 29, 2006, Agenda Conference, the Commission heard comments from several parties, including the Office of

Public Counsel, who objected to the proposal of PEF to pass the costs of the cooling towers project through either the ECRC or the Fuel Clause, instead of recovering them through base rate revenues. After deliberation, the Commission decided to schedule this matter directly for a formal administrative hearing. As stated in the Order setting the matter for hearing, the broad issue to be considered is whether PEF's cooling tower project is eligible for recovery of the costs associated with the project either through the ECRC or the Fuel Clause.

II. CONDUCT OF PROCEEDINGS

Pursuant to Rule 28-106.211, F.A.C., this Prehearing Order is issued to prevent delay and to promote the just, speedy, and inexpensive determination of all aspects of this case.

III. JURISDICTION

This Commission is vested with jurisdiction over the subject matter by the provisions of Chapter 366, F.S. This hearing will be governed by said Chapter and Chapters 25-6, 25-22, and 28-106, F.A.C., as well as any other applicable provisions of law.

IV. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION

Information for which proprietary confidential business information status is requested pursuant to Section 366.093, F.S., and Rule 25-22.006, F.A.C., shall be treated by the Commission as confidential. The information shall be exempt from Section 119.07(1), F.S., pending a formal ruling on such request by the Commission or pending return of the information to the person providing the information. If no determination of confidentiality has been made and the information has not been made a part of the evidentiary record in this proceeding, it shall be returned to the person providing the information. If a determination of confidentiality has been made and the information was not entered into the record of this proceeding, it shall be returned to the person providing the information within the time period set forth in Section 366.093, F.S. The Commission may determine that continued possession of the information is necessary for the Commission to conduct its business.

It is the long-standing policy of this Commission that all Commission hearings be open to the public at all times. The Commission also recognizes its obligation pursuant to Section 366.093, F.S., to protect proprietary confidential business information from disclosure outside the proceeding. Therefore, any party wishing to use any proprietary confidential business information, as that term is defined in Section 366.093, F.S., at the hearing shall adhere to the following:

(1) When confidential information is used in the hearing, parties must have copies for the Commissioners, necessary staff, and the court reporter, in red envelopes clearly marked with the nature of the contents and with the confidential information highlighted. Any party wishing to examine the confidential material that is not subject to an order granting confidentiality shall be provided a copy in

the same fashion as provided to the Commissioners, subject to execution of any appropriate protective agreement with the owner of the material.

(2) Counsel and witnesses are cautioned to avoid verbalizing confidential information in such a way that would compromise confidentiality. Therefore, confidential information should be presented by written exhibit when reasonably possible.

At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the proffering party. If a confidential exhibit has been admitted into evidence, the copy provided to the court reporter shall be retained in the Office of Commission Clerk's confidential files. If such material is admitted into the evidentiary record at hearing and is not otherwise subject to a request for confidential classification filed with the Commission, the source of the information must file a request for confidential classification of the information within 21 days of the conclusion of the hearing, as set forth in Rule 25-22.006(8)(b), F.A.C., if continued confidentiality of the information is to be maintained.

V. PREFILED TESTIMONY AND EXHIBITS; WITNESSES

The parties have stipulated to admission of the prefiled testimony and exhibits of all witnesses, as well as Staff's Composite Exhibit 1, consisting of PEF's Responses to Staff's interrogatories and production of document requests. The parties have waived cross-examination. The parties have agreed to file posthearing briefs on the stipulated record, after short opening statements at the hearing.

VI. ORDER OF WITNESSES

As a result of discussions at the prehearing conference, each witness whose name is followed by an asterisk (*) may be excused from this hearing if no Commissioner assigned to this case seeks to cross-examine the particular witness. Parties shall be notified as to whether any such witness shall be required to be present at the hearing. The testimony of excused witnesses will be inserted into the record as though read, and all exhibits submitted with those witnesses' testimony, as shown in Section IX of this Prehearing Order, shall be identified and admitted into the record.

Witness	Proffered By	Issues #
Direct		
*Javier Portuondo	PEF	1, 2
*Thomas Lawery	PEF	1, 2

Witness	Proffered By	Issues #
*Thomas Hewson[1]	OPC	1, 2
*Patricia W. Merchant	OPC	1, 2
Rebuttal		
*Javier Portuondo	PEF	1, 2

VII. BASIC POSITIONS

PEF: PEF should recover costs of the Modular Cooling Tower Project (Project) either through the Environmental Cost Recovery Clause (ECRC) or the Fuel and Purchase Power Cost Recovery Clause (Fuel Clause). The purpose of the Project is to provide additional cooling water capacity necessary to comply with the thermal discharge limitation in the state wastewater discharge permit for the Crystal River Plant. The need for the additional cooling water capacity was triggered by unusually high inlet water temperatures during the summer of 2005. The Crystal River permit does not mandate a particular method to meet the thermal limitation, but the permit legally requires PEF to remain in compliance. Due to the increased cooling water intake temperatures, PEF has two options to maintain compliance: de-rate, and thus decrease the availability of its baseload capacity; or add additional cooling capacity. The Project provides additional cooling capacity and restores plant capacity to its baseline level and thereby avoids higher alternate fuel or purchase power costs being borne by ratepayers. Although PEF has the option to de-rate its plants to comply with the permit, the Project is the most cost-effective and beneficial compliance option for PEF's ratepayers.

The costs of the Project meet the criteria for recovery under both the ECRC, as interpreted in orders of this Commission, as well as the criteria for recovery through the Fuel Clause set forth in Commission Order No. 14546 and applied in subsequent Commission Orders. The costs for the modular cooling tower project were not anticipated at the time PEF's base rates were established/approved and therefore are not recovered in base rates. Subject to prudence review and true-up in the annual cost recovery proceedings, Project costs should be included in the annual cost recover factors in accordance with prior Commission practice and precedent.

[1] Mr Hewson prepared and submitted prefiled testimony on behalf of OPC. The parties and staff have reached a stipulation under which, if the stipulation is approved, prefiled testimony will be entered into the record without the necessity of appearances at the hearing. In the event the stipulation is not approved and the matter proceeds to hearing, Mr. Hewson's testimony will be adopted by John Stamberg.

OPC: Not all costs are eligible for cost recovery clauses. Accordingly, when assessing PEF's request for permission to collect the costs of the modular cooling tower project through either the Environmental Cost Recovery Clause or the Fuel Cost Recovery Clause, the Commission must take into account the impact that including ineligible costs in a cost recovery clause would have on customers. That subject in turn requires consideration of the proper roles of base rates and cost recovery clauses in ensuring the rates that customers pay are fair and reasonable. In establishing base rates to be effective in the period following a rate case, the Commission analyzes a typical "test year," and fashions rates to recover the utility's prudent and reasonable test year expenses plus a fair return on investment. However, during the period in which rates are effective, all of the information and projections regarding investment, revenues, and costs that the Commission incorporated into the designing of rates will change over time. Costs included in the test year may no longer be incurred. New costs, not contemplated at the time rates were designed, will arise. Some customers will leave the system; others will be added. Consumption patterns will change. Revenues will vary and, in a growth state like Florida, likely will increase. An overall increase in costs—including costs unknown at the time rates were set—may be offset by an increase in revenues. In this ongoing milieu, the adequacy of base rates over time is measured by the ability of the utility to earn a fair rate of return on investment after paying its prudent and reasonable expenses, and that adequacy can be determined only by a review of the utility's overall condition. If base rates are inadequate, the utility has the ability to request an increase in base rates. If the return is excessive, the Commission can adjust base rates downward. In either scenario, the Commission can review the totality of the Company's operations and take shifting relationships among customers, investment, revenues, and expenses into account when again fixing rates for the future.

Cost recovery clauses are a departure from traditional ratemaking. In the case of the fuel cost recovery clause, the Commission decided to allow the utilities to collect volatile fuel costs separate and apart from base rates. In the case of the environmental cost recovery clause, the Legislature directed the Commission to enable the utilities to recover certain environmental costs through a clause. However, each of these cost recovery mechanisms has eligibility criteria that the requesting utility must meet. As a matter of policy, the Commission should enforce those eligibility criteria strictly. The ability to gauge the cost in the context of the dynamics of the factors affecting the utility's overall financial condition is absent if and when a utility asks the Commission to focus on a single cost and allow it to pass the cost through a cost recovery clause. Importantly, to allow a utility to roll an ineligible cost through a cost recovery clause imposes an unwarranted rate increase on customers. If the Commission permits a utility to roll an ineligible cost through a cost recovery clause instead of absorbing it in base rates, the customers' bills will increase. By contrast, if the utility absorbs the cost in base rate earnings, as traditional and appropriate ratemaking would require, the customers' bills do not change. This is the context in which the Commission must consider PEF's proposal

to roll the costs of modular cooling towers through either the fuel cost recovery clause or the environmental cost recovery clause.

The costs of the modular cooling system project do not meet the eligibility conditions of either clause mechanism. The requirement predates PEF's most recent rate case. The utility attempts to overcome this fact by portraying the increase in temperature of intake water as "triggering" the effect of the environmental requirement. The argument does not hold cooling water. An increase in the level of expenses necessary to comply with a constant, unchanging, continuously effective operating requirement dating to 1988 is not a "triggering event" within the meaning of the Commission's order. It is, instead, merely a fluctuation in the O&M associated with meeting a constantly existing, unchanging environmental condition of operation.

Nor are the costs of the modular cooling towers of the type that the Commission should allow the utility to collect through the fuel cost recovery clause. PEF has an obligation to maintain its generating units in a manner that will enable it to serve customers at lowest reasonable cost. The costs of the modular cooling towers are necessary to enable PEF's existing units to operate at full capacity when they are the most economical resources available to serve customers. The inability to operate base load units at full capacity imposes unnecessarily high costs that the utility needs to eliminate to provide service efficiently. Therefore, the elimination of these unwarranted costs, imposed by uneconomic operations, cannot be viewed as "savings" in the sense intended by the Commission in the order permitting section base rate-related costs to be passed through the clause. The costs therefore represent basic operating needs, as opposed to an opportunity to enhance fuel supply costs, and the Commission should expect PEF to incur them and recover them in the usual manner-i.e., through base rates.

STAFF: Staff's positions are preliminary and based on materials filed by the parties and on discovery. The preliminary positions are offered to assist the parties in preparing for the hearing. Staff's final positions will be based upon all the evidence in the record and may differ from the preliminary positions.

VIII. ISSUES AND POSITIONS

ISSUE 1: What is the appropriate mechanism to recover the prudently incurred costs of Progress Energy's temporary cooling tower project?

(A) Should PEF recover costs for the Crystal River Units 1 and 2 cooling tower project through the Environmental Cost Recovery Clause?

PEF: PEF should recover costs of the Project either through the ECRC or the Fuel Clause. The Project meets the criteria for recovery under the ECRC, Section 366.8225, F.S., as interpreted in Order No. 94-0440-FOF-EI. The need for the

Project was triggered by the unusually high inlet water temperatures during the summer of 2005 which required PEF to de-rate the Crystal River units in order to comply with the permit limit for the temperature of cooling water discharged from the plant. Project costs are being prudently incurred after April 13, 1993. The activity is legally required to comply with a governmentally imposed environmental regulation whose effect was triggered by the unanticipated high inlet water temperatures after PEF's last ratemaking proceeding. The costs are not being recovered through some other cost recovery mechanism or base rates.

OPC: No. these costs do not qualify as ECRC costs pursuant to the Commission's policy defined in Order No. PSC-94-0044-FOF-EI. To qualify costs for recovery through the ECRC, a utility must demonstrate that the costs were prudently incurred after April 13, 1993, the activity is legally required to comply with a government-imposed environmental regulation that was enacted or became effective, or whose effect was triggered after the company's last test year upon which rates are based, and the costs are not recovered through some other cost recovery mechanism or through base rates. The cooling towers are intended to help PEF comply with a requirement that predated the passage of the ECRC statute and the company's last rate case. Accordingly, the effect of the requirement was not "triggered" after PEF's last rate case. The "triggering event" language in the Commission's policy refers to changes in regulatory requirements, not operating conditions. The "triggering event" provision would be applicable, for instance, in a regulation that was enacted in 2003 but imposed requirements that take effect in 2009 and require money to be spent in 2008 to comply with the 2009 criterion. Thus, the costs do not satisfy the Commission's eligibility criteria and are ineligible for the ECRC.

This result does not mistreat PEF, as it will recover the costs, as it recovers all costs other than those that qualify for the exceptional treatment of a specific recovery mechanism, through base rate earnings. The effect will be negligible-- the stand-alone impact on the company's earned rate of return during the first, high-cost year is less than 9/10 of 1%--and may be offset by growth in revenues or declines in other costs.

STAFF: No position at this time.

(B) Should PEF recover costs for the Crystal River Units 1 and 2 cooling tower project through current base rates?

PEF: No. As explained in PEF's positions to Issues 1(A) and (C), the costs for the Project meet the criteria for recovery through the ECRC and through the Fuel Clause under the flexible policy established in Commission Order No. 14546 and applied in subsequent orders. The costs for the Project were not anticipated at the time PEF's base rates were established/approved and therefore are not recovered in base rates.

OPC: Yes. The costs are of the type that are properly considered operation and/or maintenance costs. They do not satisfy the eligibility criteria of separate cost recovery mechanisms. To include them in the cost recovery clause notwithstanding their ineligibility would impose an unwarranted rate increase on customers. Accordingly, they should be recovered in base rate revenues. To require PEF to collect the costs through base rate revenues is appropriate, because this specific increase in O&M is but one of a myriad of changing costs, revenues, investments, and other dynamics that affect earnings during the period following the conclusion of a rate case. The impact of the costs on rate of return is negligible, and may be offset by declines in other costs and/or increases in revenues in any event.

STAFF: No position at this time.

(C) Should PEF recover costs for the Crystal River Units 1 and 2 cooling tower project through the Fuel Cost Recovery Clause?

PEF: PEF should recover costs of the Project either through the ECRC or the Fuel Clause. The Project meets the criteria for recovery of unanticipated fuel-related costs set forth in Order No. 14546 and applied in subsequent orders. Specifically, the Project will result in fuel savings and Project costs were not recognized or anticipated in the cost levels used to determine current base rates. Accordingly, under the policy established in Order No. 14546, recovery of reasonably and prudently incurred costs for the Project is appropriate through the Fuel Clause. Because the Project was necessitated by unanticipated climatic conditions that are beyond PEF's control, contrary to OPC's argument, the Project is not they type of operation and maintenance costs (including costs incurred during planned or unplanned outages) which are recognized and anticipated when base rates are determined.

OPC: No. The modular cooling tower costs are not fossil-fuel related and are well-removed from the fuel process. Secondly, Paragraph 10 in Order 14546 was meant to encourage utilities to spend money that they might not otherwise choose to spend to save fuel costs. When the utility cannot operate base load units at full capacity, costs borne by customers are increased above the norm. Measures designed to return base load units to normal, economic operations are not "savings" as contemplated by the Commission in Paragraph 10. These costs are necessary to enable PEF to generate units at full capacity when they are the most economical resources available to serve customers. They therefore differ from an opportunity to lower fuel costs. OPC believes the Commission did not contemplate that such operation and maintenance costs would be flowed through the fuel cost recovery clause. Further, if one accepts PEF's fuel savings argument, then by extension all costs incurred in planned or unplanned outages of any lower-fuel cost plant would qualify for the fuel clause—an absurd proposition. These types of costs are properly considered operation and/or maintenance costs. They belong in base rates.

STAFF: No position at this time.

ISSUE 2: How should the Commission's decision on Issue 1 be implemented?

PEF: Subject to prudence review and true-up in the annual cost recovery proceedings, Project costs should be included in the annual cost recover factors in accordance with prior Commission practice and precedent.

OPC: The estimated 2006 costs included in the ECRC clause should be removed in the 2007 ECRC docket true-up process with interest added. The 2006 actual costs incurred and any 2007 and other future costs associated with this project should be recorded as regular O&M expenses, to be absorbed in base rate revenues.

STAFF: No position at this time.

IX. EXHIBIT LIST

Witness	Proffered By	I.D. No.	Description
Direct			
Javier Portuondo	PEF	JP-1	Schedule C-6 of MFRs filed in Docket No. 050078-EI
		JP-2	Schedule B-8 of MFRs filed in Docket No. 050078-EI
Thomas Lawery	PEF	TL-1	Comparison of Cooling Water Intake Temperatures and POD derates
		TL-2	Industrial Wastewater Facility Permit No. FL0000159
		TL-3	Cooling Water Inlet Temperatures and unit loads from 5/1/06 through 7/31/06
Thomas A. Hewson Jr.	OPC	TAH-1	Resume of Thomas A. Hewson Jr.

Witness	Proffered By	I.D. No.	Description
Patricia W. Merchant		PWM-1	Resume of Patricia W. Merchant
		PWM- 2	PEF Earnings Analysis Adjusted for Inclusion of Modular Cooling Towers in Base Rates
Rebuttal			
Javier Portuondo	PEF	JP-3	Florida Department of Environmental Protection Rule 62-761(1998)

The parties have stipulated that all prefiled exhibits, as well as staff's composite exhibit 1 can be admitted into the record without objection.

X. PROPOSED STIPULATIONS

The parties have stipulated to admission of the prefiled testimony and exhibits of all witnesses, as well as Staff's Composite Exhibit 1, consisting of PEF's Responses to Staff's interrogatories and production of document requests. The parties have waived cross-examination. The parties have agreed to file posthearing briefs on the stipulated record, after short opening statements at the hearing.

XI. PENDING MOTIONS

There are no pending motions at this time.

XII. PENDING CONFIDENTIALITY MATTERS

There are no pending confidentiality matters at this time.

XIII. POST-HEARING PROCEDURES

Each party shall file a post-hearing statement of issues and positions. A summary of each position of no more than 100 words, set off with asterisks, shall be included in that statement. If a party's position has not changed since the issuance of this Prehearing Order, the post-hearing statement may simply restate the prehearing position; however, if the prehearing position is longer than 100 words, it must be reduced to no more than 100 words. If a party fails to file a post-hearing statement, that party shall have waived all issues and may be dismissed from the proceeding.

Pursuant to Rule 28-106.215, F.A.C., a party's proposed findings of fact and conclusions of law, if any, statement of issues and positions, and brief, shall together total no more than 40 pages and shall be filed at the same time.

XIV. RULINGS

Opening statements shall not exceed ten minutes per party.

It is therefore,

ORDERED by Commissioner Matthew M. Carter, II, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth above unless modified by the Commission.

By ORDER of Commissioner Matthew M. Carter II, as Prehearing Officer, this 25th day of April, 2007.

MATTHEW M. CARTER II
Commissioner and Prehearing Officer

(SEAL)

MCB

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.

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.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, 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 wastewater utility. A motion for reconsideration shall be filed with the Office of Commission Clerk, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.