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MEMORANDUM

JULY 24, 1997

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

FROM: DIVISION OF ELECTRIC & GAS (GOAD, KUMMER, DRAPER, DUDLEY, GING)
DIVISION OF AUDITING & FINANCIAL ANALYSIS (MERTA, NORIEGA, STALLCUP)
DIVISION OF LEGAL SERVICES (PAUGH)

RE: DOCKET NO. 970171-EU - TAMPA ELECTRIC COMPANY - DETERMINATION OF APPROPRIATE COST ALLOCATION AND REGULATORY TREATMENT OF TOTAL REVENUES ASSOCIATED WITH WHOLESALE SALES TO FLORIDA MUNICIPAL POWER AGENCY AND CITY OF LAKELAND BY TAMPA ELECTRIC COMPANY.

AGENDA: AUGUST 5, 1997 - REGULAR AGENDA - POST HEARING DECISION - PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\EAG\WP\970171EU.RCM

CASE BACKGROUND

In late 1996, Tampa Electric Company (TECO) entered into long term wholesale sales agreements with the Florida Municipal Power Agency (FMPA) and the City of Lakeland (Lakeland). The purpose of this docket is to establish the retail regulatory treatment of the costs and revenues associated with these sales.

Service for the FMPA contract began on December 16, 1996 and is scheduled to continue through March 15, 2001. The original contracted base capacity was 35 MW in 1997 and was scheduled to increase to 80 MW on December 16, 1999. FMPA has since requested additional amounts of capacity and is now scheduled to receive 50 MW in 1997 increasing up to 150 MW in December 1999. Capacity is available to FMPA any time generating resources from either Big Bend 2 or 3, or Gannon 5 or 6 are available. Upon mutual consent of FMPA and TECO, supplemental capacity may be provided and will be served at an equivalent priority as original contracted capacity.

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TECO began providing service to Lakeland on November 4, 1996 for 10 MW of firm peaking capacity. Service is scheduled through September 2006. Capacity will be delivered at the same priority as TECO's firm native load customers. In addition, at TECO's discretion, it will supply up to 10 MW of supplemental service.

As a result of these sales an issue was raised at the February 1997 fuel hearing; that being, how should the non-fuel revenues associated with TECO's wholesale sales to FMPA and Lakeland be treated for cost recovery purposes. (Order No. PSC-97-0180-PHO-EI) In order to allow the parties to submit testimony the Commission established docket 970171-EU.

Historically the Commission has separated, from the retail jurisdiction, the revenues and costs for long-term sales, greater than one year, that commit production capacity to a wholesale customer. On occasion long-term sales have been retained in the retail jurisdiction as non-separated sales. However, non-separated sales are usually non-firm wholesale sales, such as Broker sales. To compensate the retail customers for bearing the costs, the revenues from non-separated sales are returned through recovery clauses to the retail customers. Utilities are allowed to retain, "below-the-line", a 20% share of the profits on Broker sales. (EXH 1, Order No. PSC-97-0262-FOF-EI)

TAMPA ELECTRIC COMPANY'S PROPOSAL

The costs and revenues for long-term wholesale sales similar to the Lakeland and FMPA sales were removed from retail rates in TECO's last rate case. TECO proposes, in this case, however, that the wholesale sales to FMPA and Lakeland not be separated and that the costs associated with the sales remain in the retail jurisdiction. TECO proposes to credit back the revenues received from the sales to the retail customers in the following order and manner:

> Recovery clause treatment. Regardless of the total revenues received TECO proposes to credit the Fuel and Purchased Power Cost Recovery Clause (Fuel Clause) with system incremental fuel and the Environmental Cost Recovery Clause (ECRC) with the incremental SO_2 allowance cost. If revenues do not cover these two costs, TECO will make up the difference from its operating revenues.
>
> Operating Revenue treatment. Variable operation and maintenance (O&M) is to be included in TECO's operating revenues. The Variable O&M amount will be determined by multiplying the total MWh's by an annual O&M rate.

Transmission revenue received in accordance with TECO's Open Access Tariff filed with FERC is to be added to operating revenues.

Sharing. Any remaining revenues produced by these sales is to be split 50/50 with 50% to be credited to the Fuel Clause and as an incentive to TECO, 50% to be added to operating revenues. TECO has guaranteed to credit a minimum of $2.0 million to the Fuel Clause in lieu of the anticipated lifetime stream of revenues. The $2.0 million is to be credited within two fuel clause periods (starting as soon as possible).

RECENT COMMISSION DECISIONS ON WHOLESALE SALES

During the March fuel hearings in Docket No. 960001-EI, the Office of Public Counsel (OPC) asked the Commission to establish a generic policy statement on whether a utility could recover any revenue shortfall arising from the difference between the actual fuel revenues the utility receives from a wholesale sale and system average fuel costs, where wholesale revenues were less than system average cost. The issue was deferred to the August 1996, fuel hearings to allow all parties the opportunity to present testimony. After considering Staff's recommendation at the February 4, 1997 Agenda Conference, the Commission issued Order No. PSC-97-0262-FOF-EI establishing the policy to be applied to the treatment of fuel for new separable wholesale sales. This new policy requires the utility to credit its Fuel Clause with an amount equal to the system average fuel cost for separable sales, regardless of the actual fuel revenues received. However, the Commission will consider alternatives to this treatment, provided the utility can demonstrate that the sales provide net benefits to its retail ratepayers.

The purpose of TECO's petition in this docket is to demonstrate that both the treatment of fuel and base rate revenues associated with the sales to Lakeland and FMPA conveys a net benefit to TECO's retail rate payers.

DISCUSSION OF ISSUES

ISSUE 1: Does the off-system sale agreement to the Florida Municipal Power Agency provide net benefits to Tampa Electric Company's general body of rate payers?

PRIMARY STAFF RECOMMENDATION: There are no net benefits because the Stipulation approved in Order PSC-96-1300-S-EI requires capital costs and revenues of these sales to be separated. The net benefits cited by TECO in this docket are derived solely from crediting non-fuel revenues from the sales to retail operating revenues. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: Yes, if the stipulation does not apply, provided that TECO's projection of incremental costs and revenues are realized over the period of the contract, and the revenues are credited as described in Alternative Staff's Recommendation on Issues 2 and 3. (GOAD)

POSITION OF PARTIES

TECO: Yes. The net benefits from the FMPA sale are projected to be $9.0 million Net Present Value. The total revenue from this sale are projected to be $77.2 million Net Present Value and the total costs associated with this sale are projected to be $68.2 million Net Present Value.

FIPUG: No. Retail ratepayers will suffer a $69.1 million loss if they are compelled to pay the carrying costs on assets exclusively dedicated to wholesale sales. Further, even if captive retail customers had first call on the assets, TECO has reversed the traditional 80/20 sharing concept by giving 80% to TECO.

OPC: No. Tampa Electric did not prove benefits would exceed: (1) the $3.5 million of lost gains on economy sales; (2) the lower fuel costs from reporting the FMPA and Lakeland sales at average cost pursuant to Order No. PSC 97-0262-FOF-EI; or (3) refunds required to be made under the stipulations.

PRIMARY STAFF ANALYSIS: The need to address net benefits arises from Order No. PSC-97-0262-FOF-EI, "Final Order Addressing Treatment of Fuel Revenues Received from Wholesale Sales in the Fuel and Capacity Cost Recovery Clauses." (EXH 1) This Order allows for crediting less than average fuel revenues for wholesale sales if net benefits can be shown. Primary Staff maintains that the "net benefits" TECO describes arise only from crediting non-fuel revenues to retail operating revenues. (TR 91) If capital and

O&M costs and revenues are separated as required by the Stipulation entered into by TECO and the two parties to this docket in settlement of Docket 960409-EI, the benefits TECO relies upon to justify different treatment of fuel disappear. TECO's reliance on this order to justify any treatment of non-fuel revenues and costs is in error.

Order PSC-96-1300-S-EI, entered in Docket No. 960409-EI, Prudence Review to determine the Regulatory Treatment of Tampa Electric Company's Polk Unit specifically addresses the treatment of TECO's wholesale sales. The order approving the Stipulation signed by TECO, the OPC, and the FIPUG, clearly lays out the treatment of wholesale sales:

> **F. The separation procedure to be used to separate capital and O&M which was approved in the Company's last rate case, Docket No. 920324-EI, shall continue to be used to separate any current and future wholesale sales from the retail jurisdiction. (Stipulation, p.8; Order No. PSC-96-1300-S-EI)** (emphasis added)

In its 1992 rate case, TECO sought to retain certain long-term firm wholesale sales as non-separated. In Order No. PSC-93-0165-FOF-EI,(EXH 1) the Commission explicitly rejected TECO's request that those costs remain in retail jurisdiction:

> We do not believe it is fair or appropriate for non-retail customers to be buying firm capacity, particularly when the non-retail customers have first call for the capacity, at a rate which is not compensatory or cost-based which means the retail customers are responsible for part of the revenue requirement for the plant serving the non retail customers. (Order p.13)

The language on separations was integral to the Stipulation in the Polk case. In its brief, OPC states "The parties to the Second Stipulation reasonably expected that future wholesale sales would lead to higher reported retail earnings and an increased likelihood of further refunds under the sharing

arrangement embodied in both the First and Second Stipulations." (OPC BR 9) TECO Witness Ramil agreed with FIPUG's representation that the removal of $71 million dollars in rate base costs clearly has a more positive benefit on retail earnings than crediting $10 million to operating revenue. (TR 94) FIPUG goes on to point out "The language in paragraph 15 clearly states that no change in the terms of the Stipulation (including the treatment of wholesale sales described in paragraph 5F) may be made without the mutual consent of the parties to the Stipulation. Clearly there is no such mutual agreement in this case." (FIPUG BR 4)

In order to justify its request, TECO attempted to differentiate between the sales at issue in this docket and those considered in the rate case. In his testimony, TECO Witness Ramil stated that the most significant difference between the FMPA and Lakeland sales compared to previously separated sales is the condition of the wholesale market. (TR 37) Another difference in these sales cited by TECO Witness Ramil was the option to purchase supplemental energy under both contracts. (TR 38)

Staff agrees with OPC Witness Larkin that there does not appear to be any material difference between the type of sales considered in the rate case and the firm portion of the sales at issue in this docket to FMPA and Lakeland in terms of length or capacity commitment. (TR 441) On cross-examination, TECO Witness Ramil agreed with the interpretation of the FMPA contract as a long-term firm sale with base load characteristics. (TR 66, 182) He also testified that FMPA has first call on the capacity upon which the contract is based. (TR 78) TECO Witness Branick added that, "...Lakeland has the same service priority as Tampa Electric's firm native load customers." (TR 310)

Staff also believes TECO's assertion that the inclusion of supplemental sales is a difference without a distinction. (TR 38) The ability to purchase supplemental energy does not change the fact that the firm portion of the contract is for a period exceeding one year and requires a commitment of capacity. (TR 309)

Staff believes there is no basis for distinguishing these sales from the wholesale sales separated in the rate case. By TECO's own statement, their proposed treatment of fuel has no effect on retail ratepayers. (TR 43) If non-fuel revenues and cost are separated pursuant to the Stipulation in Docket 960409-EI, there can be no net benefits.

ALTERNATIVE STAFF ANALYSIS: TECO estimated net benefits based on an assumption of the regulatory treatment for the revenues received. (TR 42-43; EXH 10) Staff agrees that a method of accounting for the revenues from the sales must be determined before you can estimate net benefits. Treatment of the revenues is addressed in Issues 2 and 3. Staff's recommendation in this Issue is premised on the acceptance of the treatment of revenues as discussed in Alternative Staff's Recommendation on Issues 2 and 3.

TECO has based its proposal on the assessment that net benefits are realized from making sales to FMPA and Lakeland. The determination of net benefits is a subjective one. TECO has argued that as long as the incremental costs incurred to make additional sales are recovered then net benefits are realized. (TR 36, 224) TECO's argument has to be qualified. In a competitive market where all customers are "incremental" and there are no "captive" customers to support the company's full investment, a company would not consider net benefits unless average total costs are covered. (TR 273) However, TECO operates in a monopolistic market where it has exclusive rights to serve all the end use customers in its service territory. These customers fully support TECO's fixed investment. In theory, if no additional sales were made, specifically wholesale sales, TECO would still recover its total cost (fixed and variable). Further, if additional sales are made that recover more than the incremental costs incurred to make the sales a contribution to fixed cost will be made.

TECO has defined incremental costs to be: fuel, SO_2 allowances, variable O&M, and fixed plant and investment (generation and transmission). (TR 314-317) Unless new facilities are required to serve additional sales, total fixed generation and transmission costs do not increase. (TR 229) However, TECO's assessment that the sale to FMPA provides net benefits to the rate payers, requires not only a definition of incremental costs, but also a projection of those incremental costs and revenues.

To determine the incremental cost of making the FMPA sale, TECO performed two production simulation analyses runs. A simulation run without either the Lakeland or FMPA sale (Base) and one including the FMPA sale. (TR 314) The differences in projected expenses, before and after the production run including the FMPA sale, for fuel and SO_2 allowance costs were used as the incremental cost forecast for each component. (TR 314-315, 325-326) Variable O&M cost was estimated by using the 1997 O&M rate paid to qualifying facilities (QF) as part of the as-available cogeneration payments. The 1997 O&M rate was escalated by 3% annually through 2006. (TR 316)

TECO did not account for any capacity costs for the FMPA sale because its next capacity addition is estimated to be in 2003 and the FMPA sale is scheduled to terminate in March 2001. (TR 317) Revenues were estimated by multiplying the contract demand and estimated energy by the established contract rates.

The following table is a summary of TECO's projections of the revenues and costs for the FMPA sale. (EXH 10)

Cost Benefit of the FMPA Wholesale Sale ($000) Cumulative Present Value	
Total Revenue	$77,240.00
Incremental Costs	
Fuel	$63,581.00
SO_2 Allowances	$586.00
Variable O&M	$4,096.00
Transmission	$0.00
Expansion	$0.00
Total Costs	$68,236.00
Revenues - Costs	$9,004.00

Reliability Concerns

TECO's forecasts appear to be reasonable. However, staff is concerned that TECO did not account for any capacity costs in its projection of incremental costs. TECO's 1997 Ten Year Site-Plan (TYSP), filed with the Commission on April 1, 1997, does not project generating capacity expansion until 2003, two years after the FMPA sale expires. Based on that expansion plan, TECO did not include capacity costs in the incremental cost calculations for the FMPA sale. (TR 317) However, TECO's reserve margins and ability to provide reliable service to retail ratepayers may be affected by the sale.

Pursuant to Rule 25-6.035, Florida Administrative Code, TECO monitors a 15% firm winter peak reserve margin. In addition, TECO follows a 1% expected unserved energy (EUE) guideline. (TR 499) Prior to 1997, TECO used a 20% reserve margin and a loss of load probability criteria. (EXH 15, TR 499) Table IV-2 of TECO's 1997 TYSP shows a projected reserve margin after maintenance of 17%

for 2000-01. (EXH 15) However, the 1997 TYSP projections did not include the current amounts of capacity committed to FMPA and Lakeland. (EXH 15) With the current amounts of contracted capacity included in TECO's projections of firm winter peak demand, the 2000-01 projected reserve margin dropped below the 15% criterion to 14%. (EXH 15)

TECO Witness Ramil's rebuttal testimony states, "The addition of these sales does not cause Tampa Electric to fall short of meeting these criteria. Thus, while the total level of reserves are reduced by the addition of these sales, the minimum reserve criteria have not been violated and are not affected." (TR 483) TECO's response to staff's interrogatory No. 12 clearly states that the 2003 projected expansion, as identified in TECO's 1997 TYSP, was based on the 15% reserve margin criterion. (EXH 15) This apparent conflict in TECO's responses leads staff to believe that TECO may accelerate its planned expansion as a result of its projected reserve margin dropping below 15%. It should also be noted that no supplemental capacity is considered for either sale in the 14% reserve margin projection. If TECO were to provide supplemental capacity during 2000-01, its reserve margin would be further reduced, increasing the need to build additional capacity. The same would be true for any new long-term firm sales similar to the FMPA sale.

It may be appropriate to not include expansion costs as a result of the 14% reserve margin. However, if TECO does need to expand its generation resources, prior to the expiration of either the FMPA or Lakeland sales, any net benefits achieved will likely be eliminated because actual incremental costs would then include plant and investment not previously included in the cost vs. revenues projections. It may be appropriate to impute revenues equal to costs of expansion if TECO builds new capacity prior to the expiration of the FMPA sale

Cost Projections

TECO has projected that the revenues received from the sale to FMPA will exceed incremental costs by $9.0 million. (EXH 10) Fuel cost makes up the largest share of the incremental costs, about $64.0 million or 82% of the total. (EXH 10) If fuel costs increase approximately 14% and all other costs remain the same, costs would meet or exceed the revenues received, creating a burden on TECO's retail ratepayers. To mitigate potential harm to retail customers by fluctuations in costs, TECO proposes to credit actual incremental fuel and SO_2 allowance costs regardless of revenues received. (TR 92; TECO BR 4-5) Staff agrees that crediting actuals will prevent the retail ratepayers from being monetarily affected

in the short run. However, in order to meet this commitment, TECO has proposed to reduce operating revenues by any amount of shortfall between actual fuel and SO_2 allowances costs and revenues received. (TR 92) Any reduction in operating revenues to make fuel whole reduces the potential for any possible refund to ratepayers under the provisions of Order Nos. PSC-96-1300-S-EI and PSC-96-0670-S-EI. In order for the "guarantee" of fuel revenues to have any meaning, staff believes it is necessary to require TECO to make up any shortfall between costs and revenues from "below-the-line." This will be addressed in Issue 3.

Summary

Based on TECO's projections, as shown in the above table, revenues are expected to exceed incremental costs, thus producing net benefits. However staff is concerned that in the event TECO's cost projections are incorrect, the rate payers may be harmed. Staff believes that this chance can be eliminated by requiring TECO to make up any shortfalls between costs and revenues when crediting fuel and SO_2 costs from "below-the-line." Also, if generation expansion is required before the FMPA sale expires, revenues in an amount equal to the costs of the expansion caused by the FMPA sale should be imputed, from "below-the-line", to operating revenues. With these two protections TECO's retail rate payers will be indifferent at worst.

ISSUE 2: How should the non-fuel revenues and costs associated with Tampa Electric Company's wholesale schedule D sales to the Florida Municipal Power Agency be treated for retail regulatory purposes?

PRIMARY STAFF RECOMMENDATION: The Stipulation entered into by the parties to Docket No. 960409-EI requires that the capital and O&M costs be separated at average embedded cost, consistent with the methodology used in TECO's 1992 rate case. This treatment should be applied retroactively since the inception of the sale in December 1996. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: Because the impact on ratepayers depends on the treatment of revenues, alternative staff recommends the following regulatory treatment for the non-fuel costs and revenues:

- Retain all costs associated with the FMPA sale in the retail jurisdiction.
- Incremental SO_2 allowance revenues should be credited back through the Environmental Cost Recovery Clause.
- Transmission revenues should be credited to the Capacity Cost Recovery Clause.
- O&M revenues should be included in operating revenues.
- All remaining revenues should be credited to the Capacity Cost Recovery Clause.
- If additional plant capacity is added prior to the end of the FMPA sale, revenues equal to the FMPA sale's cost contribution of the new plant should be imputed to operating revenues from "below-the-line."

Any decision reached by the Commission should be applied retroactively since the inception of the sale in December 1996. (GOAD, DUDLEY)

POSITION OF PARTIES

TECO: The Commission should approve the treatment of fuel and non-fuel revenues and costs as proposed by Tampa Electric and

described in detail in the testimony of Mr. Ramil and Ms. Branick. Tampa Electric's proposed treatment guarantees significant benefits to retail customers. The other parties' suggested treatment would deny those benefits.

Tampa Electric proposes the following regulatory treatment for this sale:

- These sales should not be separated and should remain in the retail jurisdiction.
- The Fuel and Purchased Power Cost Recovery Clause should be credited with an amount equal to system incremental fuel cost, eliminating any fuel clause impact associated with making this sale.
- The Environmental Cost Recovery Clause should be credited with an amount equal to incremental costs for SO_2 allowances.
- Revenues associated with variable operating and maintenance costs should be credited above the line to operating revenues.
- Transmission revenues should be credited to the company's operating revenues above the line.
- The remaining sale proceeds should be divided 50/50, with 50% credited through the Fuel Clause and 50% credited to operating revenues. ($1.5 million guaranteed, regardless of actual contract revenues.)

FIPUG: The non-fuel revenues and costs should be separated for regulatory purposes. If revenues are not separated, they should be flowed back to retail ratepayers based on system average fuel costs.

OPC: The stipulations require that the FMPA and Lakeland sales be separated in the same manner as was used in the company's last rate case. The firm portion of these long-term schedule D sales must be fully separated, and 100% of non-fuel revenues for the supplemental portion must be flowed back.

PRIMARY STAFF ANALYSIS: As discussed in Issue 1, the Stipulation signed by TECO and two of the parties to this docket clearly specifies the treatment of non-fuel revenues for all current and future firm long term wholesale sales.

In the past, the Commission has required TECO to separate from the retail jurisdiction, costs associated with long-term wholesale sales. (TR 456) The sales were separated at TECO's average embedded cost which included fixed plant. (TR 456-457) This was done even recognizing that the sales revenues were less than average embedded cost. (EXH 1, Order No. PSC-93-0165-FOF-EI) In general, wholesale sales may be non-separated or separated. The classification of wholesale sales is determined by the characteristics of the sale, such as the commitment of capacity and the duration of the sale.

Separated sales are generally defined as firm sales lasting longer than one year which involve the dedication of capacity. Because the committed capacity is no longer available for use by retail customers, the non-fuel costs (production plant and operating expenses) are removed from retail rates and earnings calculations. If the contracts are in place at the time base rates are set, retail rates do not include any of the costs associated with such sales. If such contracts are entered into between rate cases, the revenue requirement used to determine ROE in monthly surveillance reports is reduced to account for costs associated with the sales. In exchange for assigning cost responsibility to the company's shareholders, the Commission allows the utility's shareholders to retain all non-fuel revenues received from the sale. (EXH 1, Order No. PSC-97-0262-FOF-EI)

Order PSC-96-1300-S-EI, entered in Docket No. 960409-EI, Prudence Review to determine the Regulatory Treatment of Tampa Electric Company's Polk Unit specifically addresses the treatment of capital and O&M costs of TECO's wholesale sales. The order approving the Stipulation signed by TECO, OPC, and FIPUG explicitly lays out the treatment of wholesale sales:

> **F. The separation procedure to be used to separate capital and O&M which was approved in the Company's last rate case, Docket No. 920324-EI, shall continue to be used to separate any current and future wholesale sales from the retail jurisdiction. (Stipulation, p.8, Order No. PSC-96-1300-S-EI)** (emphasis added)

In its 1992 rate case, TECO sought to retain certain long term firm wholesale sales as non-separated. In Order No. PSC-93-

0165-FOF-EI, the Commission explicitly rejected TECO's request that those costs remain in retail jurisdiction:

> We do not believe it is fair or appropriate for nonretail customers to be buying firm capacity, particularly when the nonretail customers have first call for the capacity, at a rate which is not compensatory or cost-based which means the retail customers are responsible for part of the revenue requirement for the plant serving the non retail customers. (Order p.13)

Stipulation

The language cited above on the treatment of wholesale sales was integral to the Stipulation approved in the Polk docket. OPC points out that Mr. Ramil signed both the letters of commitment for these sales after the Stipulation had been signed and therefore must surely have been aware of the restrictions in the Stipulation as it applied to the treatment of future wholesale sales. (OPC Brief p. 10) Yet there was no regulatory-out clause allowing for termination of the contract if TECO receive unfavorable regulatory treatment of these sales. (TR 85) TECO admits that it is bound to serve the loads so contracted, even if the FPSC treatment is unfavorable for retail regulatory purposes. (TR 67)

The long term wholesale sales separated in the rate case order are described as Schedule D sales (EXH 1, Order PSC-93-0165-FOF-EI, p. 13) Witness Ramil agreed with FIPUG that the sale to FMPA was considered a Schedule D sale. (TR 68) Witness Ramil contends that the Commission should take wholesale market conditions into account in determining the treatment of wholesale sales. (TR 70) Ramil also points out that some Schedule D sales are not separated, but that the percentage of these sales is small and that the total revenues from these sales equal to the costs is flowed directly back to the ratepayers through recovery clauses, keeping the ratepayers unharmed. (TR 74) TECO admits the sales at issue in this docket are not cost compensatory on a fully embedded cost basis. (TR 74-5) The Stipulation language cited above does not include any exceptions for market conditions to the treatment prescribed in the rate case order. In its Briefs, FIPUG and OPC both maintain that TECO's requested treatment violates the

requirements of the Stipulation. (FIPUG BR 4, OPC BR 12)

Difference in sales

TECO attempted to differentiate the sales at issue in this docket from the wholesale sales it was ordered to remove from rate base in its 1992 rate case. However, the primary reason it gave for this difference was not related to the length of the contract or the capacity commitment of the sales or any term or condition of the contract itself, but simply that the wholesale market has changed since 1992. (TR 37) TECO Witness Ramil stated that the revenues from the FMPA sale would not cover the fully allocated embedded costs associated with that sale and that if TECO's stockholders were forced to absorb the difference between the actual revenues received and the system average cost, it would be sufficient disincentive to prevent any future sales. (TR 97)

Staff agrees with OPC Witness Larkin that there does not appear to be any material difference between the type of sales considered in the rate case, Docket No. 920324-EI, and the sales at issue in this docket to FMPA and Lakeland. (TR 441) On cross-examination, TECO Witness Ramil agreed with the interpretation of the FMPA contract as a long term firm sale with base load characteristics. (TR 66, 182) He also testified that FMPA has first call on the capacity upon which the contract is based. (TR 78) TECO Witness Branick added that, "...Lakeland has the same service priority as Tampa Electric's firm native load customers." (TR 310) The Commission expressly addressed the non-cost compensatory aspect of the wholesale sales in the 1993 rate case order and appeared to use that as a justification **for** separation rather than an argument against it. (EXH 1, Order PSC-93-0165-FOF-EI, p. 13) Additionally, TECO Witness Ramil stated that another Schedule D contract, with Reedy Creek Improvement District, entered into subsequent to the 1992 rate case, was treated according the treatment prescribed in the rate case which was later echoed in the Stipulation. (TR 68) TECO did not seek any decision or ruling from the Commission on this matter but simply separated out the costs on surveillance reports as directed by the rate case order. (TR 69)

Another difference in these sales cited by Mr. Ramil was the option to purchase supplemental energy under both contracts. (TR 38) Staff believes this is a difference without a distinction. The ability to purchase supplemental energy does not change the fact that the firm portion of the contract is for a period

exceeding one year and requires a commitment of capacity. (TR 309)

TECO also argued that its proposal had no downside for retail ratepayers because the cost of the plant used to make these sales is already in base rates and all revenues are being retained "above-the-line." (TR 52,71,76) Therefore, the retail ratepayers are better off with some revenue than none and that the contract sales provide more revenue that is available through Broker sales. (TR 153-154) Even if one accepts the statement that capacity costs are sunk costs and should not be included in any incremental calculation of benefits (TR 258), TECO has proposed to credit the majority of non-fuel dollars received from these sales through operating revenues. As a result of this treatment, the only benefit retail customers will see from these revenues is in a possible, but far from certain, future refund under the Polk Stipulation or the reduction or postponement of a rate increase. (TR 164, 177)

Incentives

On cross-examination, TECO Witness Ramil agreed that TECO should not need an incentive for sales already completed, stating that the incentive TECO seeks is not for these sales but a precedent for future sales. (TR 162) FIPUG Witness Pollock pointed out that there is tremendous pressure on regulated utilities today to shift cost from the competitive markets to captive customers and that care must be taken by regulatory bodies to protect captive customers. (TR 213) If the treatment proposed by TECO is approved, staff agrees with OPC Witness Larkin that other utilities will also likely seek similar treatment for their off-system sales. (TR 439) As utilities compete for wholesale sales without being held accountable for the total cost of those sales, the possibility exists for significant costs to be shifted from wholesale markets to retail ratepayers. Additionally, Witness Ramil admitted that even with incentives available in the past, TECO had failed to meet the goals set as a condition of receiving those incentives. (TR 172-174) Primary Staff maintains that TECO as a regulated utility has an obligation under the historical regulatory compact to maximize the revenues from plant recovered through base rates and should not need any extra incentive to do so. (TR 96,469)

Broker sales

The comparison with Broker sales is also less than compelling. Unlike the FMPA and Lakeland sales, Broker sales are short-term and require no capacity commitment. Such sales are truly "opportunity" sales and are subject to market forces on a much more immediate basis than long-term contract sales. A utility can assess its immediate needs and determine if it has capacity available for the next hour or the next day. (TR 77) That is far more flexible than a long-term contract which obligates the utility to serve wholesale load even at the expense of higher prices to its retail customers.

TECO also repeatedly reminded the Commission that it could have simply made broker sales and kept 20% of the profit. (TR 155,163,171) Primary Staff believes TECO made a business decision to negotiate these sales without any guarantees of regulatory treatment. (TR 67, 179) TECO appears to have made a conscious choice to lock in firm sales rather than live with the more uncertain opportunity sales on the Broker. If, as TECO maintains, the wholesale market is increasingly competitive, it is logical to assume that TECO's Broker opportunities may also decline as more sellers enter the market. Therefore, it was in TECO's best interest from a competitive standpoint to lock in customers now, whether or not retail ratepayers realized any real benefits from the transaction.

Fair treatment

TECO made much of its reliance on "fair treatment" by this Commission. (TR 95) However, both of the sales at issue in this docket were entered into after the Stipulation in Docket No. 960409-EI was signed. The FMPA Letter of Commitment was entered into approximately one month later and the Letter of Commitment for the Lakeland sale was signed some seven months after TECO signed the Stipulation agreeing to the specified treatment of wholesale sales. (EXH 10, p 10, 32) TECO agreed to the terms of both the FMPA and Lakeland contracts and sought FERC approval of the contracts without any guarantee of regulatory treatment on the retail side. (TR 67) Staff believes that "fair" should be defined as the treatment TECO freely agreed to in Docket No. 960409-EI. If TECO did not believe the treatment spelled out in the Stipulation was fair, it should not have agreed to it in the Stipulation.

Lastly, Primary Staff believes TECO was in error to rely on Order No. PSC-97-0262-FOF-EI as the basis for requesting retention of non-fuel costs and revenues. This Order was issued in a Fuel and Capacity Cost Recovery docket, 970001-EI. The language in the order addresses only the treatment of fuel revenues. Even if net benefits could have been shown, to imply that Order allowed any specific treatment of the non-fuel costs misinterprets the language and intent of that order.

ALTERNATIVE STAFF ANALYSIS: TECO has proposed not to separate the costs of the FMPA sale, but instead leave the costs in the retail jurisdiction. (TECO BR 4, Section III) In the event the Commission decides that the Stipulation entered into by TECO and approved in Order No. PSC-96-1300-S-EI requires that the FMPA sale be separated the discussion in this issue is moot.

The sale to FMPA is a long term firm sale. (TR 66) As stated in Primary Staff's analysis, long term firm sales are traditionally separated from the retail jurisdiction. In its post-hearing briefs, TECO states "separation of wholesale sales at average embedded cost is inappropriate at this time given the competitive conditions which prevail in the Florida market for wholesale power." (TECO BR 8, Section IV) In his direct testimony, TECO Witness Ramil states:

> The market price today is well below Tampa Electric's average embedded cost, but in many cases above the Company's incremental costs. [] However, under current market conditions, if the Commission were to separate the FMPA and Lakeland sales at system average cost, or through some other means impute system average cost to these sales, the resulting disincentive for Tampa to make these or other new sales would be absolute. The company would not engage in such transactions where a shareholder loss is guaranteed. (TR 50)

In order to remove any disincentive for making these and any future sales, Staff Witness Wheeler acknowledged in his testimony that "it may be appropriate to allow retention of these sales in the retail jurisdiction..." (TR 464)

Staff believes that retail customers are entitled to full compensation for the use of plant which they are supporting.

Investor Owned Electric Utilities have the obligation to build sufficient plant to provide adequate and reliable service to its firm retail customers. (TR 461) Economies of scale in power plant design often dictate that more capacity than immediately required by retail customers be built. Even though retail customers may not fully utilize all of the available capacity, the cost of plants and facilities determined to be used and useful to the retail customers are included in retail rates, resulting in excess capacity paid for but not used by retail customers.

The Commission has long recognized that utilities have an implicit responsibility to maximize the use of any excess capacity until it is needed by retail customers. (TR 461) Electric utilities have accomplished this by making off-system (wholesale) sales. Long-term wholesale sales most often require that a portion of available capacity be dedicated to these wholesale sales which reduces the amount of plant capacity which could be used to serve the needs of retail ratepayers. Based on the premise that retail rates were set using average embedded cost, costs associated with any long-term wholesale sales which committed capacity were separated from the retail jurisdiction at average embedded cost, so that the full cost burden was removed from retail customers. (TR 457; EXH 1, Order No. PSC-97-0262-FOF-EI) However, a number of factors must now be considered.

Staff accepts TECO's argument that the wholesale market has become increasingly competitive. (TR 38) Recent Federal Energy Regulatory Commission (FERC) Orders have encouraged and in some cases mandated the removal of barriers to competing power suppliers at the wholesale level. (TR 38) Non-utility generators are now able to take advantage of newer technology and are not burdened with years of regulatory obligations. In addition, TECO's embedded cost significantly increased with the addition of Polk Unit One in 1996. (TR 459) Given these two points, staff acknowledges that market prices are likely below TECO's average embedded cost. Considering that separating average embedded costs associated with the FMPA sale from the retail jurisdiction would cause a loss by TECO's shareholders and create a disincentive for making similar sales in the future. In order to remove any disincentive, staff believes that it would be appropriate to allow TECO to retain the costs in the retail jurisdiction, in other words not separate. This decision is caveated with the understanding that revenues received from the sale will exceed incremental costs, as discussed in Issue 1 and that the Commission decides that the Stipulation approved in Order No. PSC-96-1300-PSC-S-EI does not require this sale to be separated. If the Commission decides that these sales must be separated per the Stipulation, this issue is moot.

For non-separated sales, it has been Commission policy to return all revenues from the sales to retail ratepayers. (TR 465) By allowing costs associated with this wholesale sale to remain in the retail jurisdiction, supported by retail customers, it is prudent and consistent with past Commission policy to return all the revenues received from the sale to the retail customers. (EXH 1, Order No. PSC-97-0262-FOF-EI) Staff Witness Wheeler stated, "If it is determined that it is appropriate to allow TECO to retain these sales within the retail jurisdiction, it is my belief that all of the revenues from these sales be returned immediately to the ratepayers through adjustment clause mechanisms." (TR 466) Staff concurs with Staff Witness Wheeler, as such, staff proposes that revenues be returned in the following manner:

(1) Incremental SO_2 allowance revenues should be credited back through the Environmental Cost Recovery Clause.

(2) Transmission revenues should be credited to the Capacity Cost Recovery Clause.

(3) O&M revenues should be included in operating revenues.

(4) All remaining revenues should be credited to the Capacity Cost Recovery Clause.

(5) Impute revenues if capacity additions are required during the life of the contract.

SO_2 Allowances

By increasing their usage to accommodate the additional loading requirements of the FMPA wholesale sales, TECO's generating units will emit additional tonnages of sulfur dioxide. Sulfur dioxide (SO_2) emissions are directly related to the sulfur content of the fuels being consumed to produce electricity. To prevent any affect on existing customers, TECO has proposed to credit its ECRC with all incremental SO_2 allowance costs incurred as a result of making the FMPA sale based on "current market conditions." (TR 320-322, 324, 391) The ECRC is the current mechanism for recovering environmental compliance expenditures not currently recovered through base rates. Staff agrees with the necessity of this credit because absent some form of offset, TECO's remaining customers would be denied the full benefit of zero-cost based allowances granted to TECO by the EPA each year.

TECO has proposed to determine the "current market" cost of SO_2 allowances based on information from brokers and various publications. (TR 391-392) Staff agrees that combining information from sources such as Clean Air Compliance Review's industry survey price, also known as EATX[1], and Cantor Fitzgerald's Market Price Index would serve as reasonable surrogates for SO_2 allowance replacement costs. These and other sources of information have the advantage of being publicly available and appear to be free from undue influence by any one specific transaction. Furthermore, TECO remains aware of this type of information as it is continuously seeking the least-cost method of compliance. Staff further suggests that TECO not be precluded from proposing sources of SO_2 allowance market information other than those identified above which could be used to calculate an average SO_2 allowance replacement cost.

With respect to the proper accounting treatment, the incremental SO_2 allowance costs along with the quantity of SO_2 allowances retired during each period should be documented and identified as a separate line item within TECO's ECRC filings. In addition, TECO should provide documentation supporting its SO_2 allowance replacement cost calculations which will be subject to audit during TECO ECRC proceedings.

Staff notes that the EPA Allowance Auction Clearing price would also provide an acceptable "market-based" SO_2 allowance price. By April of each year, the EPA holds an SO_2 allowance auction. The results, including a clearing price, are posted and do not change until the next year's auction. Though the clearing price gives a good annual indication of trends in SO_2 allowance prices, it would not reflect the conditions that might exist should TECO be required to offset SO_2 emissions resulting from the FMPA sales. Therefore, staff believes the combined EATX and Energy Ventures price-proxy discussed above would be more representative of on-going market conditions.

Transmission Revenues

TECO has proposed that transmission revenues received in accordance with its Open Access Tariff should be included in operating revenues. TECO argued in the Prehearing Order that,

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[1] The Emission Allowance Trading Index (EATX) is a survey-based price which is published each month in "Clean Air Compliance Review", a Fieldston publication.

> Pursuant to Federal Energy Regulatory Commission Order 888 and 889, the Company is required to charge itself for the use of its transmission system the same as it would charge a third party user. Tampa Electric must credit the transmission revenues associated with the wholesale sales to FMPA and Lakeland to operating revenues. (Order No. PSC-97-0653-PHO-EU)

Staff agrees that TECO must charge itself the same for transmission service the same as it would a third party and also that it must separately account for these costs. (TR 462) Staff does not agree that these costs must be credited to operating revenues.

Transmission expense is considered a fixed expense because once the facilities are built there is no significant variable expense associated with transmitting power through the lines. This fixed expense is included in retail base rates and fully supported by retail customers. (TR 197, 401) TECO Witness Ramil agreed that the sale to FMPA creates no additional transmission expense. (TR 166) The sale only requires transmission capacity which retail customers are fully supporting. (TR 197, 461) By crediting transmission revenues to operating revenues the likelihood of the **transmission costs currently being paid by retail customers** of ever being completely returned is slim to none. (emphasis added) If the transmission revenues are credited to the Capacity Clause, the customers who are currently paying for the facilities being used by FMPA would be assured of being compensated immediately and in full. (TR 402, 465) It is appropriate to credit the revenues through the Capacity Clause, because transmission costs are allocated using the same method as the Capacity Clause uses to recover capacity costs. (TR 466) The Capacity Clause would merely serve as a vehicle to return transmission costs already paid by retail customers and should not be construed as a way to recover future transmission expense.

O&M Revenues

Along with transmission revenues, TECO has proposed to include revenues equal to incremental O&M expenses in operating revenues. (TR 40) However, O&M expense is much different than transmission expense. Both are included in the calculation of base rates (EXH 1, Order Nos. 15451 and PSC-93-0165-FOF-EI), but unlike transmission expense, O&M is truly a variable expense. (TR 166, 314) When energy output is increased, so are O&M expenses. (TR 316) At the time of a rate case O&M is estimated based on projected energy sales. (EXH 1, Order Nos. 15451 and PSC-93-0165-

FOF-EI) In the event O&M expenses are more than estimations, the company foregoes recovery of the difference by way of reduced earnings. Staff acknowledges that the FMPA sale increases O&M expense which is not included in base rates but is included as an increased expense for surveillance purposes. In order to offset this increase and to hold earnings steady it is prudent to increase operating revenues by an equal amount. TECO has proposed to use the variable O&M rate used to pay cogenerators for as-available energy purchases. (TR 321) This rate is derived from TECO's Commission-approved cogeneration tariff. (TR 321) Although this may not match exactly the incremental O&M incurred, staff believes it is an adequate proxy. Therefore, staff concurs with TECO's proposed determination and treatment of incremental O&M expenses. Staff recommends that if the Commission modifies the cogeneration O&M rate methodology, any change should be reflected in this crediting mechanism.

Residual Revenues

Once all incremental costs, as defined by TECO, are accounted for (system incremental fuel, incremental SO_2 allowances, transmission, and O&M), TECO has proposed to split any remaining revenues 50/50; 50% credited to the Fuel Clause and 50% added to operating revenues. (TR 40, 322) During the hearing, this portion of TECO's proposal was viewed as an incentive to encourage TECO to make off-system sales. (TR 155-159, 162)

TECO repeatedly reminded the Commission that it was foregoing a 20% sharing of the profit on broker sales which it contends could have been made instead of the long-term sale to FMPA. (TR 155, 163, 171) Staff believes that the record shows TECO made a conscious business decision to trade uncertain broker sales for certain firm contract commitment. (TR 492) In response to a cross-examination question asking, "...would you agree that we don't need to incent you into entering into the existing contract because you already did" TECO Witness Ramil agreed. (TR 162)

Staff continues to maintain that TECO has the obligation to maximize the use of excess capacity to keep retail rates as low as possible, vis-a-vis the "Regulatory Compact." (TR 96, 461) Staff agrees with Witnesses Pollock and Wheeler that TECO's shareholders have incentives such as affiliated company profits and maintaining low rates. (EXH 6; TR 209-10, 461)

In fact, TECO Witness Ramil stated that under TECO's proposal, "its incentive is limited to an improved chance to earn its allowed rate of return." (TR 488) During TECO's last rate case the Commission set rates that it felt were adequate to allow TECO

to earn a fair return. Section 366.07, Florida Statutes, grants any Florida public utility the ability to petition the Commission for a modification of its rates if it feels they are insufficient. TECO stipulated in Order Nos. PSC-96-1300-S-EI and PSC-96-0670-S-EI that it would not ask to increase rates prior to January 2000, foregoing its right granted in Section 366.07, Florida Statutes. TECO was fully aware of its allowed rates and in good faith entered into the agreements not to increase rates above the current level prior to January 2000. It appears to staff that TECO's proposal to retain 50% of any residual revenues in operating revenues is an attempt to unconventionally support ROE and circumvent its agreement set forth in the above orders.

Staff believes that by retaining the costs of the FMPA sale in the retail jurisdiction the potential disincentive to TECO is removed. (TR 460) In the absence of any disincentives to making wholesale sales, public electric utilities have inherent incentives to actively pursue new wholesale sales. Staff concurs with Staff Witness Wheeler that, "...it is entirely inappropriate to provide any further incentive to make these sales." (TR 460)

TECO's argument that net benefits are realized from this sale merits the appropriateness of crediting all revenues above costs to the Capacity Clause. In theory net benefits are a contribution to fixed cost, which as stated previously is supported through the retail customers base rates. (TR 197, 461) Staff believes it is appropriate to credit the net benefits in the manner fixed costs are allocated. The Capacity Clause allocates cost in a manner most similar to the allocation of fixed costs at the time of a rate case. Therefore, staff recommends that all revenues, after all incremental costs have been accounted for, be credited to the Capacity Clause.

If the Commission feels that TECO will not respond to its implicit obligations and that it must be further incented to meet these obligations, staff proposes splitting any remaining revenues 80/20: 80% being credited to the Capacity Clause and 20% used to increase the depreciation expense of Polk Unit One. This treatment is consistent with the regulatory treatment of the Oil-Backout Clause. (EXH 5)

Capacity Cost Adjustment

TECO's proposal is premised on the assertion that net benefits will be realized by its retail ratepayers. In order to make the assertion of net benefits, TECO attempted to demonstrate that revenues exceeded incremental costs, including expansion costs. TECO Witness Bohi stated that, "capital costs are commonly

fixed costs, but within a very long time frame where expansion plans are being considered, these costs are variable....The time period of relevance for my testimony is determined by the length of the time needed to complete the wholesale power transactions with FMPA and Lakeland." (TR 228) TECO Witness Bohi goes on to say that TECO's capacity requirements are the same whether the sale to FMPA is made or not, making all capacity costs fixed. (TR 229)

TECO Witnesses Branick and Ramil have stated that TECO's planned expansion is unaffected by the FMPA sale. (TR 100, 317, 483) Because TECO does not intend to build additional capacity prior to the end of the FMPA sale, no costs were considered and thus regulatory treatment for this component has not been addressed. TECO Witness Bohi's testimony implies that if the FMPA sale contributed towards the need for expansion, the costs associated with expansion would become a variable expense. (TR 229) The conclusion could be drawn from TECO Witness Bohi's testimony that if TECO expands prior to the end of the FMPA sale any benefits realized by the ratepayers may be eliminated.

In 2000-01, TECO's reserve margin is projected to be 14%, the scheduled amount of capacity is 150 MW. (EXH 15; TR 309) As discussed in Issue 1, TECO maintains a reserve margin criterion of 15%. During the hearing, TECO Witness Ramil claimed that since TECO's criterion was only violated near the end of the FMPA sale he felt that "this risk is well worth the taking". TECO Witness Ramil went on to say that "It's almost no risk to get the benefits," (TR 502) implying that TECO is willing to take the risk.

With reference to TECO's obligation to serve FMPA, TECO Witness Ramil stated that the FMPA and Lakeland sales are opportunity sales and implied that TECO may be able to cancel its contract for these sales if they are not advantageous to TECO. (TR 85-88, 181, 182)

Staff believes that if TECO is faced with the need for expansion, as a result of the FMPA sale, and chooses to do so instead of canceling the sale, that TECO's stockholders should be responsible for expansion costs associated with the sale and not the retail rate payers. TECO Witness Ramil acknowledged that TECO was willing to take the risk. (TR 502) Staff believes that risk to be increased cost due to expansion. Staff recommends that revenues equal to an allocable amount of costs for the FMPA sale relative to a new plant be imputed to operating revenues from "below-the-line". The costs should be determined by multiplying the total capital cost of expansion by the percentage demand the FMPA sale is relative to the size of expansion. By requiring that the retail ratepayers be made whole in this manner, the retail rate payers

will not feel the affect of adding a new plant which was necessitated not by retail load but by off-system "opportunity sales".

Summary

Staff's recommendation differs from TECO's proposal in three respects. First, staff recommends that transmission revenues be credited to the Capacity Clause as opposed to operating revenues. Second, staff recommends that any residual revenues be credited to the Capacity Clause. Third, if expansion occurs prior to the expiration of the FMPA sale, staff recommends that revenues be imputed to operating revenues from "below-the-line". TECO has not accounted for expansion costs. Staff believes that the regulatory treatment, as just stated, will remove any disincentive and compensate TECO's retail customers for excess capacity that they are paying for.

Implementation of the Commission's Decision

All parties in the February 1997 fuel hearing stipulated to Issue 26 in Order PSC-97-0180-PHO-EI. Issue 26 addressed the treatment for cost recovery purposes for the non-fuel revenues associated with the FMPA and Lakeland sales. The stipulated position states

> This issue will be considered in a separate docket (Docket No. 970171-EU) in order to afford the parties an opportunity to submit testimony, with the understanding that when this issue is ultimately resolved, Tampa Electric's surveillance reporting results will be adjusted to the extent necessary to reflect the treatment ultimately approved, going back to the time when Tampa Electric began receiving revenues under the wholesale contracts in question.

Any decision reached by the Commission, whether it be to implement primary staff's recommendation, alternative staff's recommendation or some other proposal, should be applied from the inception of the sales going forward.

ISSUE 3: How should the fuel revenues and costs associated with Tampa Electric Company's wholesale Schedule D sales to the Florida Municipal Power Agency be treated for retail regulatory purposes?

PRIMARY STAFF RECOMMENDATION: The Stipulation approved in Docket No. 960409-EI requires TECO to separate the non-fuel revenues and costs for these wholesale sales. Therefore, as discussed in Primary Staff Analysis of Issue 1, there can be no net benefits. In accordance with Order No. PSC-97-0262-FOF-EI, average system fuel costs should be credited to the Fuel Clause. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: TECO should credit its Fuel Clause with an amount equal to the system incremental fuel cost resulting from the FMPA sales. The system incremental fuel cost should be determined using TECO's as-available energy cogeneration fuel expense methodology based on the actual MW block size for the FMPA sales during each hour. In addition, TECO should be required to make up any revenue shortfalls throughout the term of the FMPA sale by crediting its Fuel Clause using "below-the-line" operating revenues. (DUDLEY)

POSITION OF PARTIES

TECO: See Tampa Electric's position on Issue 2.

FIPUG: Because the revenues are less than system average for this transaction, system average revenues should be credited to the retail jurisdiction. The power company and its related coal, transportation and exempt wholesale generating companies, which are the primary beneficiaries of the sales, should pay the difference between incremental and average cost.

OPC: Fuel costs for FMPA and Lakeland are included in the weighted-average inventory cost of fuel on Line 1 of Schedule A1. They should be deducted on a weighted-average inventory basis on Line 16 pursuant to Order No. PSC-97-0262-FOF-EI.

PRIMARY STAFF ANALYSIS: Under Order No. PSC-97-0262-FOF-EI, in the absence of a showing of net benefits to the retail ratepayers, fuel revenues from separated wholesale sales must be credited to the Fuel Clause at average cost. In its testimony, TECO stated that the retail customers will be unaffected by their proposal of crediting incremental fuel, so there are no net benefits associated with the fuel portion of the sale. (TR 43) TECO further admits that the net benefits shown in its petition are derived from crediting the non-fuel revenues to the retail accounts. (TR 91) Primary Staff maintains that TECO does not have the option of

retaining any non-fuel benefits on the retail side under the Stipulation approved in Order No. PSC-96-1300-S-EI as discussed in Issue 2. Therefore, there can be no net benefits to justify crediting fuel costs at anything other than system average.

In addition, as discussed in Alternative Staff Analysis on Issue 1, concerns remain about the forecasts of costs associated with these sales. Even TECO's guarantee of $2 million simply takes from one pocket of the ratepayer and puts it in another pocket. It does not increase total revenue on the retail side or put TECO's stockholders at any additional risk. Therefore, the company has failed to show any net benefits of the sales.

ALTERNATIVE STAFF ANALYSIS: TECO has contracted to provide firm power to both FMPA and Lakeland through 2001 and 2006, respectively. These sales are long-term firm wholesale sales which this Commission has traditionally separated from the retail jurisdiction at the utility's average system embedded cost. In Order No. PSC-97-0262-FOF-EI, issued March 11, 1997, in Docket No. 970001-EI, the Commission agreed to deviate from its traditional accounting treatment for these types of sales in situations where it could be demonstrated that the sales provided net benefits to the utility's retail ratepayers.

The Primary recommendation in this issue suggests that there can be no benefits to TECO's retail ratepayers once the FMPA sale is separated, as required by the Stipulation, since crediting incremental fuel only makes the Fuel Clause whole. All benefits purported by TECO are derived from the non-fuel revenues. (TR 91) However, as recognized by OPC in its brief, the parties to the Stipulation "reasonably expected that future wholesale sales would lead to higher reported retail earnings and an increased likelihood of further refunds under the sharing arrangement embodied in both the First and Second Stipulations." (OPC BR 9) Therefore, it appears that by separating the sales, an overall benefit can be expected. Although, by allowing these sales to remain in the retail jurisdiction as proposed in the Alternative Staff Recommendation of Issue 2, benefits to TECO's retail ratepayers would be more certain.

According to Order No. PSC-97-0262-FOF-EI, absent a showing of overall benefits to its retail ratepayers from a separable wholesale sale, a utility must credit average system fuel revenues through its Fuel Clause. However, it is only by chance that the true fuel cost impact of a separable wholesale sale would equal that of system average. In fact, the ratepayers could be harmed by the requirement to credit average system fuel costs if

the incremental cost of making a sale exceeds the system average.

In TECO's case, incremental cost is less than system average. (TR 367-368, 370-371) Thus, TECO's retail ratepayers would be overcompensated for fuel costs credited at system average. Conceptually, the average cost of fuel shouldered by the utility's retail ratepayers must remain unaffected as a result of wholesale sales. Or as stated by OPC in its brief, "The intent is to have retail customer rates only support retail operations." (OPC BR 7) In order to achieve this result, staff believes that TECO's system fuel cost should be credited with the true cost of providing the power. Doing so will reduce the total fuel expense as if the sale had not occurred.

As explained in Issue 1, TECO currently projects that the total revenues received from the FMPA sale will exceed the incremental cost incurred to make the sale. Hence, TECO maintains that the sale provides net benefits. Although, net benefits can only be demonstrated once a regulatory accounting treatment is prescribed. Currently, TECO is crediting only the actual fuel revenues received from FMPA to its Fuel Clause, which are less than the incremental fuel costs. (TR 361, 392; EXH 10) However, TECO has proposed to credit its Fuel Clause with the system incremental fuel cost as a result of making the sale. (TR 39, 324, 361, 390) This cost will be determined on an hourly basis, deterministically, in the same manner as TECO calculates the as-available energy rate for cogenerators. (EXH 14) Specifically, TECO determines the fuel cost impact to its system with and without the benefit of the QF power. (TR 385) TECO originally proposed to use the cogeneration as-available energy rate as reflected in the A-Schedules as a revenue proxy for the FMPA sale's incremental fuel cost. (TR 333-334) This rate determines the avoided decremental dispatch cost, ($/MWh), after including all purchases and all sales, retail and wholesale, except economy. The rate is then multiplied with the block size of the of the hourly as-available energy being purchased.

At the hearing, TECO Witness Branick stated that TECO was currently purchasing 8 to 15 MW of as-available QF power. (TR 383) Since the QF block size is not expected to equal the size of the FMPA sale, using that rate would overstate the actual incremental fuel expense. (TR 384; EXH 14) Therefore, TECO has proposed to make an additional calculation using the cogeneration as-available energy methodology and the actual block size of the sale to determine the true incremental fuel expense incurred. (EXH 14) Staff agrees that TECO's proposal should provide a more accurate determination of the hourly fuel expense incurred as a result of selling power to FMPA. However, Exhibit 14 lacks the details of

how TECO will actually implement its proposal. TECO should determine the hourly fuel cost impact, recognizing the cost of as-available energy and emergency purchases as well as the effect of prior committed sales. In this manner, TECO will credit its Fuel Clause with the true incremental cost to its system. This cost includes both the actual dispatch cost incurred plus its cost of QF, economy, and emergency purchases which, if occurring, displaces all or a portion of the wholesale load. Absent this type of credit basis, TECO's Fuel Clause will not reflect the true impact of serving FMPA.

In its brief, FIPUG asserts that if TECO only credits its Fuel Clause with "incremental" fuel cost, retail ratepayers will be required to make up the cost of transporting that fuel and any associated fuel handling charges. (FIPUG BR 11, 12) This is not the case. Pursuant to Commission Order No. 14546, issued July 8, 1985, O&M expenses at generating plants or storage facilities, including unloading and fuel handling costs, are considered in the computation of base rates. These expenses are not recovered through the Fuel Clause. In addition, the dispatch cost, $/MWh that is currently used to price as-available energy from cogenerators and what will be used to determine the incremental fuel cost impact of the FMPA sales is based on the delivered price, including transportation, of fuel required for the next increment of generation.

Throughout the course of the hearing, several parties indicated concerns that TECO's ratepayers would not be made whole in the event incremental fuel expense exceeded the fuel revenues received from the FMPA sale. (TR 92) In response to those concerns, TECO has proposed to credit its Fuel Clause during any such revenue shortfall in an amount equal to the difference between the revenues received and the actual incremental fuel expense. (TR 319) However, TECO proposes to credit the Fuel Clause using operating revenues from "above-the-line". (TR 92-93)

The record suggests that TECO's proposal will not benefit the ratepayer. Although the Fuel Clause will be trued-up, retail operating revenues will be reduced, resulting in a decrease to TECO's ROE, which further results in reducing the likelihood of any potential for sharing under the current stipulations. (TR 92) In addition, if TECO were to use operating revenues from "above-the-line" after the stipulation period, the likelihood of TECO needing to increase customer rates in a rate proceeding would increase. Therefore, staff recommends that TECO be required to make up any revenue shortfalls throughout the term of the FMPA sale by crediting its Fuel Clause using "below-the-line" operating revenues.

ISSUE 4: Does the off-system sale agreement to the City of Lakeland provide net benefits to Tampa Electric Company's general body of rate payers?

PRIMARY STAFF RECOMMENDATION: There are no net benefits because the Stipulation approved in Order PSC-96-1300-S-EI requires capital costs and revenues of these sales to be separated and the net benefits cited by TECO in this docket are derived solely from crediting non-fuel revenues from the sales to retail operating revenues. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: Yes, if the stipulation does not apply, provided TECO's projection of incremental costs and revenues are realized over the period of the contract, and the revenues are credited as described in Alternative Staff's Recommendation on Issues 5 and 6. (GOAD, DUDLEY)

POSITION OF PARTIES

TECO: Yes. The net benefits from the sale to Lakeland are projected to be $0.9 million net present value. Total revenues from this sale are projected to be $4.2 million net present value and the total costs associated with this sale are projected to be $3.3 million net present value.

FIPUG: No. Retail ratepayers will suffer a $69.1 million loss if they are compelled to pay the carrying costs on assets exclusively dedicated to wholesale sales. Further, even if captive retail customers had first call on the assets, TECO has reversed the traditional 80/20 sharing concept by giving 80% to TECO.

OPC: No. Tampa Electric did not prove benefits would exceed: (1) the $3.5 million of lost gains on economy sales; (2) the lower fuel costs from reporting the FMPA and Lakeland sales at average cost pursuant to Order No. PSC-97-0262-FOF-EI; or (3) refunds required to be made under the stipulations.

PRIMARY STAFF ANALYSIS: The Stipulation in Docket 960409-EI requires the separation of non fuel costs and revenues, therefore there are no net benefits. See Primary Staff Analysis on Issue 1.

ALTERNATIVE STAFF ANALYSIS: Assuming the treatment of revenues described in Alternate Staff analysis in Issue 2, there are net benefits. See issue 1.

ISSUE 5: How should the non-fuel revenues and costs associated with Tampa Electric Company's wholesale schedule D sales to the City of Lakeland be treated for retail regulatory purposes?

PRIMARY STAFF RECOMMENDATION: The Stipulation entered into by the parties to Docket No. 960409-EI requires that the capital and O&M costs be separated at average embedded cost, consistent with the methodology used in TECO's 1992 rate case. This treatment should be applied retroactively since the inception of the sale in November 1996. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: Because the impact on ratepayers depends on the treatment of revenues, staff recommends the following regulatory treatment for the non-fuel costs and revenues:

- Retain all costs associated with the Lakeland sale in the retail jurisdiction.
- Incremental SO_2 allowance revenues should be credited back through the Environmental Cost Recovery Clause.
- Transmission revenues should be credited to the Capacity Cost Recovery Clause.
- O&M revenues should be included in operating revenues.
- All remaining revenues should be credited to the Capacity Cost Recovery Clause.

Any decision reached by the Commission should be applied retroactively since the inception of the sale in November 1996. (GOAD, DUDLEY)

TECO: The Commission should approve the treatment of fuel and non-fuel revenues and costs as proposed by Tampa Electric and described in detail in the testimony of Mr. Ramil and Ms. Branick. Tampa Electric's proposed treatment guarantees significant benefits to retail customers. The other parties' suggested treatment would deny those benefits.

Tampa Electric proposes the following regulatory treatment for this sale:

- These sales should not be separated and should remain in the retail jurisdiction.

- The Fuel and Purchased Power Cost Recovery Clause should be credited with an amount equal to system incremental fuel cost, eliminating any fuel clause impact associated with making this sale.
- The Environmental Cost Recovery Clause should be credited with an amount equal to incremental costs for SO_2 allowances.
- Revenues associated with variable operating and maintenance costs should be credited above the line to operating revenues.
- Transmission revenues should be credited to the company's operating revenues above the line.
- The remaining sale proceeds should be divided 50/50, with 50% credited through the Fuel Clause and 50% credited to operating revenues.

FIPUG: The non-fuel revenues and costs should be separated for regulatory purposes. If revenues are not separated, they should be flowed back to retail ratepayers based on system average fuel cost.

OPC: The stipulations require that the FMPA and Lakeland sales be separated in the same manner as was used in the company's last rate case. The firm portion of these long-term schedule D sales must be fully separated, and 100% of non-fuel revenues for the supplemental portion must be flowed back.

PRIMARY STAFF ANALYSIS: As discussed in Issue 2, staff believes the treatment of non-fuel revenues is prescribed by the Stipulation entered into by TECO in settlement of the Polk Prudence review. All the arguments cited in consideration of the FMPA sale are equally applicable for the Lakeland sale.

ALTERNATIVE STAFF ANALYSIS: Staff recommends the same regulatory treatment for the Lakeland sale as that of the FMPA addressed in Issue 2, with the exception of expansion costs.

TECO projected possible expansion costs as a result of the sale to Lakeland. (TR 318) TECO did not however consider these costs for regulatory treatment. (EXH 10) As stated in Issue 2, staff prefers that TECO increase operating revenues, from "below-the-line", an amount attributable to the Lakeland sale's contribution. However, staff recognizes that the scheduled term of the sale to Lakeland is through September 2006, and that two new

plants are scheduled to be added during that period. (TR 317-318) Staff also realizes that the characteristics of the scheduled demand for each sale is significantly different. The sale to Lakeland is a 10 MW peaking sale. (TR 310) The sale to FMPA is a base load sale of substantially more capacity. (TR 309) It is unlikely that a 10 MW peaking sale by itself would cause TECO to accelerate the addition of a new plant prior to what it would have built otherwise. In fact, 10 MW represents only about 0.33% of TECO's firm winter reserve margin in 1997 and 0.28% in 2006. (EXH 15) Given the magnitude of the sale relative to TECO's projected available capacity through 2006, staff does not believe the sale to Lakeland will contribute to TECO's generation expansion such that the projected net benefits will be affected.

ISSUE 6: How should the fuel revenues and costs associated with Tampa Electric Company's wholesale schedule D sales to the City of Lakeland be treated for retail regulatory purposes?

PRIMARY STAFF RECOMMENDATION: The Stipulation approved in Docket No. 960409-EI requires TECO to separate the non-fuel revenues and costs for these wholesale sales. Therefore, as discussed in Primary Staff Analysis of Issue 1, there can be no net benefits. In accordance with Order No. PSC-97-0262-FOF-EI, average system fuel costs should be credited to the Fuel Clause. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: TECO should credit its Fuel and Purchased Power Cost Recovery Clause with an amount equal to the system incremental fuel cost resulting from the Lakeland sales. The system incremental fuel cost should be determined using TECO's as-available cogeneration fuel expense methodology based on the actual MW block size for the Lakeland sales during each hour. In addition, TECO should be required to make up any revenue shortfalls throughout the term of the FMPA sale by crediting its Fuel Clause using "below-the-line" operating revenues. (DUDLEY)

POSITION OF PARTIES

TECO: See Tampa Electric's position on Issue 5.

FIPUG: Because the revenues are less than system average for this transaction, system average revenues should be credited to the retail jurisdiction. The power company and its related coal, transportation and exempt wholesale generating companies, which are the primary beneficiaries of the sales, should pay the difference between incremental and average cost.

OPC: Fuel costs for FMPA and Lakeland are included in the weighted average inventory cost of fuel on Line 1 of Schedule A1. They should be deducted on a weighted average inventory basis on Line 16 pursuant to Order No. PSC-97-0262-FOF-EI.

PRIMARY STAFF ANALYSIS: Fuel revenues should be credited to the Fuel and Capacity Cost Recovery Clause as average cost. See Issue 3.

ALTERNATIVE STAFF ANALYSIS: Staff recommends that fuel revenues and costs associated with the Lakeland sales be treated consistent with the discussion in Issue 3. More specifically, TECO should credit its Fuel Clause with an amount equal to the system incremental fuel cost resulting from the Lakeland sales. The system incremental fuel cost should be determined using TECO's as-

available cogeneration fuel expense methodology based on the actual MW block size for the Lakeland sale during each hour. In addition, staff recommends that TECO should be required to make up any revenue shortfalls throughout the term of the Lakeland sale by crediting its Fuel Clause using "below-the-line" operating revenues.

ISSUE 7: How should the transmission revenues and costs associated with Tampa Electric Company's wholesale sales to the Florida Municipal Power Agency and the City of Lakeland be treated for retail regulatory purposes?

PRIMARY STAFF RECOMMENDATION: Pursuant to the Stipulation in Docket No. 960409-EI, transmission costs and revenues, like other non-fuel revenue would accrue to the wholesale side. (KUMMER)

ALTERNATIVE STAFF RECOMMENDATION: TECO should credit all transmission revenues to the Capacity Cost Recovery Clause. Transmission revenues should be based on TECO's FERC approved tariff rates. (GOAD, DUDLEY)

POSITION OF PARTIES

TECO: These transmission revenues should be credited to Tampa Electric's operating revenues, consistent with the Commission's traditional practice of crediting transmission revenues against Tampa Electric's retail cost of service during base rate cases. These revenues will offset transmission revenue requirements in future rate proceedings.

The FERC, under Order 888, has required utilities such as Tampa Electric to charge themselves for transmission just as they would charge a third party user of the system. The Commission has traditionally treated third party transmission revenue as a credit to retail revenue requirements in the next rate proceeding as Tampa Electric has proposed in this instance. Under these circumstances, the Commission's traditional treatment of third party transmission revenue should apply.

FIPUG: If the wholesale sales are not separated, retail customers are entitled to receive all the benefits derived from the use of the transmission facilities for which they are paying the entire cost. Such benefits should be used to reduce TECO's retail rates. Otherwise, retail customers would be subsidizing TECO's wholesale activities.

OPC: Since all transmission costs are included in base rates, the only way to effect a jurisdictional separation consistent with the last case is to flow all transmission revenues back to the retail customers through the fuel clause.

PRIMARY STAFF ANALYSIS: Following the argument made in Primary Staff Analysis on Issues 2 and 5, transmission costs and revenues would be separated at system average costs. Like generation,

transmission costs associated with serving these sales are currently captured in retail base rates and should be removed at system average costs as prescribed in Docket No. 920324-EI. Similarly, the revenues associated with transmission received from the wholesale sales would accrue to the wholesale jurisdiction.

ALTERNATIVE STAFF ANALYSIS: Consistent with issues 2 and 5, staff recommends that all transmission revenues be credited to the Capacity Clause. During a rate proceeding, transmission costs are allocated to each of the rate classes based on that classes's contribution to the utility's coincident peak. This is the same method in which capacity costs, or demand costs, are allocated to each of the rate classes through the Capacity Cost Recovery Clause in between rate proceedings.

ISSUE 8: Will the Commission's treatment of the City of Lakeland and Florida Municipal Power Agency wholesale sales have an impact on Tampa Electric Company's refund obligation under the stipulation in Docket No. 950379-EI, Order No. PSC 96-0670-S-EI, approved by the Commission?

RECOMMENDATION: TECO's obligation to refund per the above referenced Order will not be changed by the Commission's treatment of these sales. However, the amount of the refund could be impacted. If the sales are separated, the amount of the potential refund could be increased. On a non-separated basis and if the revenues are higher than the expenses of the sales, the amount of the potential refund could be increased. On a non-separated basis and if the expenses are higher than the revenues, the amount of the potential refund could be decreased. (MERTA)

POSITIONS OF PARTIES:

TECO: No. As per the above referenced Order, Tampa Electric's commitment to refunds to the retail ratepayers remains unchanged under this proposal. In fact, Commission approval of the regulatory treatment proposed by Tampa Electric for these sales may produce greater refunds than would otherwise occur.

FIPUG: Yes. If these transactions are not jurisdictionally separated, TECO's earnings will be artificially depressed and the potential for a refund will be reduced.

OPC: No. Tampa Electric is bound by the stipulations and the orders approving them. The Commission cannot impair the refunds which would result from treating the FMPA and Lakeland sales in a manner consistent with the stipulations.

STAFF ANALYSIS: The Commission's treatment of the Lakeland and FMPA sales will have no impact on TECO's obligation to make the refund under the stipulation approved in Order No. PSC-96-0670-S-EI. However, these sales may impact the amount of the potential refund.

If the Lakeland and FMPA sales are separated per the primary recommendation, the amount of the potential refund could be increased. An increase could result because jurisdictional expenses and jurisdictional rate base will be reduced without any reduction in jurisdictional revenues. Therefore, TECO's earned return on equity could be increased and result in a greater potential refund.

The following analysis assumes that the revenues from the sales are greater than the expenses per Alternative Staff's position in Issue 1. If this is not the case, the potential refund amount could be decreased because TECO will credit revenues equal to incremental fuel and SO2 costs to the clauses and these revenues will be removed from operating revenues thus reducing net operating income. (TR 92)

In Issues 2 through 7, Alternative Staff recommends that the revenues and costs for SO2 allowances, transmission costs, and fuel be credited through cost recovery clauses. This treatment will have no effect on the potential refund amount because the revenues and expenses are removed from net operating income when they are flowed through the clauses. In addition, O&M-related revenues would be included in operating revenues and would offset the incremental O&M expenses included in operating expenses. Therefore, the amount of the potential refund would be unaffected by this treatment.

TECO's position in Issues 2 through 7 could increase the potential refund amount. TECO proposes to credit the clauses with fuel and SO_2 costs equal to actual system incremental cost regardless of the revenues actually collected from the sales. Revenues associated with O&M costs are credited above the line. These items will have no effect on the refund since the related O&M expenses are included in net operating income and the fuel and SO_2 will be flowed through the clause. TECO proposes to credit the transmission revenues to operating revenues above the line. This could increase any refund because, according to TECO, there are no offsetting incremental transmission expenses. (TR 166) The Company's proposal to divide the remaining sale proceeds 50/50, with 50% credited through the Fuel Clause and 50% credited to operating revenues could also increase the potential refund. The credit to operating revenues would increase net operating income and thereby increase the potential refund amount.

FIPUG's primary position in Issues 2 through 7 could increase a potential refund since they propose to separate the non-fuel revenues and costs. This separation would remove the revenues and expenses to the wholesale jurisdiction and jurisdictional net operating income would not be effected. However, rate base would be reduced thereby reducing the revenue requirement and increasing the refund amount.

FIPUG's alternative position in Issues 2 and 6 could decrease a potential refund. In these issues, FIPUG proposes that revenues should be flowed back to retail ratepayers through the clauses based on system average fuel costs. This treatment would

decrease any refund since the revenues to cover the difference between incremental and average fuel costs would be removed from operating revenues thereby decreasing net operating income and any potential refund. In Issue 7, FIPUG proposes that the transmission revenues be credited through the appropriate clause. This would not effect the amount of a refund, but it could lower the retail fuel charges since there are no incremental transmission expenses.

OPC's position in Issues 2 and 7 could increase a potential refund since they propose to fully separate the sales in the same manner as was used in the company's last rate case. This treatment removes the revenues and expenses from jurisdictional net income and reduces rate base, thereby reducing the revenue requirement and increasing the potential refund amount. In issue 7, OPC proposes that the transmission revenues be credited through the fuel clause. This would not effect the amount of a refund but it could lower the retail fuel charges since there are no incremental transmission expenses.

ISSUE 9: Would the Commission exceed its jurisdiction if it were to allow Tampa Electric Company to earn a return through retail rates for its wholesale sales to the Florida Municipal Power Agency and to the City of Lakeland?

RECOMMENDATION: No. The Florida Public Service Commission has jurisdiction to regulate the returns earned by public utilities through retail rates. (PAUGH)

POSITIONS OF PARTIES:

TECO: OPC's assertion that this Commission lacks authority to adopt Tampa Electric's proposed regulatory treatment of the FMPA and Lakeland sales on the grounds of federal preemption has no basis in law. The cases cited by OPC in the prehearing statement in support of its position on this issue are inapposite.

In Public Utilities Commission of Rhode Island V. Attleboro Steam & Electric Co., 273 U.S. 83 (1927), the Court held that no individual state may regulate a wholesale sale of electric power in interstate commence. It was this decision which led the Congress to enact the Federal Power Act in order to prevent such transactions from being left unregulated. In Federal Power Commission V. Southern California Edison Co., 376 U.S. 205 (1964), the Court clarified the extent of FERC jurisdiction under the Federal Power Act over wholesale power sales by further defining what constituted "interstate Commerce" within the meaning of the Federal Power Act. These cases do not suggest that this Commission lacks the power to determine how the FMPA and Lakeland sales should be treated for retail rate making purposes.

FIPUG: The Commission has jurisdiction to, and should, prohibit TECO from requiring retail customers to pay a return on a plant dedicated to wholesale sales.

OPC: Yes. The Commission has no authority to allow revenues and costs from sales for resale under FERC's jurisdiction to affect reported earnings from retail operations or the refunds due under the stipulations, which are based on reported retail earnings levels.

STAFF ANALYSIS: The jurisdiction issue was raised and extensively discussed by the Office of Public Counsel in its post-hearing Brief. TECO and FIPUG provided only summary arguments in their post-hearing briefs affirming Commission jurisdiction. Subsequent

to the parties filing of post-hearing briefs, TECO filed a Motion For Leave to File a Supplemental Brief on Issue 9, accompanied by the Supplemental Brief. The Prehearing Officer denied TECO's Motion and the Supplemental Brief has not been considered in this recommendation.

In its Brief, TECO argued that the cases cited by OPC as authority for preemption do not apply to the instant proceedings. In its Brief, FIPUG argued that the Commission does have jurisdiction over the manner in which TECO's wholesale sales impact retail customers. OPC's extensive argument considered three primary points: (1) based on established federal case law, the Commission has required jurisdictional separation because to do otherwise would permit the retail jurisdiction to subsidize the wholesale jurisdiction;(2) the Commission is preempted from allowing wholesale sales in the retail jurisdiction by federal law; and (3) permitting the wholesale sales in the retail jurisdiction would violate the 'filed rate' doctrine. Staff agrees with TECO and FIPUG for the reasons set forth in their briefs as well as for the following reasons. First, the Commission's jurisdiction to regulate the returns earned by public utilities is well established by statute and supported by the cases. Second, contrary to the assertions set forth in OPC's Brief regarding Commission policy to separate wholesale sales, there are several types of wholesale sales which are currently retained in the retail jurisdiction. Finally, the issues in these proceedings involve the treatment of revenues from wholesale sales, not the rates charged for those sales. As such, the Commission is not preempted by federal law nor is there a violation of the filed rate doctrine.

The Florida Public Service Commission's jurisdiction to regulate the returns earned by public utilities is established by statute. Section 366.01, Florida Statutes, enunciates the general jurisdiction of the Commission: "The regulation of public utilities as defined herein...shall be deemed to be an exercise of the police power of the state for the protection of the public welfare and all the provisions hereof shall be liberally construed for the accomplishment of that purpose." Section 366.041(1)establishes the Commission's specific jurisdiction over returns earned by public utilities.

> In fixing the just, reasonable, and compensatory rates, charges, fares, tolls, or rentals to be observed and

> charged for service within the state by any and all public utilities under its jurisdiction, the commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered, the cost of providing such service and the value of such service to the public...provided that no public utility shall be denied a reasonable rate of return upon its rate base in any order entered pursuant to such proceedings.

The Commissions's plenary jurisdiction over the returns earned by public utilities is well supported by the case law. In Gulf Power Company v. Wilson, 597 So. 2d 270 (Fla. 1992), the Commission's authority and broad discretion over returns earned by utilities is clearly enunciated:

> It is well established that all a regulated public utility is entitled to is "an opportunity to earn a fair or reasonable rate of return on its invested capital". What constitutes a fair rate of return for a utility depends upon the facts and circumstances of each utility, and this Court has expressly recognized that the Commission must be allowed broad discretion in setting a utility's appropriate rate of return. (citations omitted)

579 So. 2d 270, 273.

The Gulf Power decision is indicative of the deference the Supreme Court of Florida grants to the Public Service Commission with respect to the Commission's authority to fix fair, just and reasonable rates and a reasonable return on investment. "This Court has consistently recognized the broad legislative grant of authority which these statutes confer and the considerable license the Commission enjoys as a result of this delegation." Citizens of the State v. Public Service Commission, 425 So. 2d 534, 540 (Fla. 1982).

The specific question of a public utility's earning a return through retail rates from wholesale sales has not been addressed by Florida's courts. However, the Supreme Court has approved the Commissions's treatment of the profits (returns) of economy energy sales in the retail jurisdiction. Citizens of the State v. Public Service Commission, 464 So. 2d 1194 (Fla. 1985). Economy energy sales are wholesale sales of electricity. The treatment proposed by the Commission was that the selling utilities be allowed to retain 20% of the economy sales profits for their shareholders and that the remaining 80% be credited to ratepayers through the fuel and purchased power cost recovery clauses. In affirming the Commission's orders, the Court stated:

> As we have repeatedly stated, we will not reweigh or reevaluate the evidence presented to the commission, but will examine the record only to determine whether the order complained of meets the essential requirements of law and whether the agency had available to it competent substantial evidence to support its findings. We find that the commission clearly had substantial competent evidence to support its order. (citations omitted)

Id.

Public Counsel was the appellant in the economy sale profits litigation. A review of the Public Counsel's extensive brief filed with the Supreme Court in that case reveals that the issue of the Commissions's jurisdiction to allow a return from wholesale sales was not raised at that time.

Public Counsel's arguments in the instant case may be summarized as follows: (1) the Commission has long required jurisdictional separation; (2) the Commission is preempted from allowing the wholesale sales to be included in retail jurisdiction by the Federal Power Act; and (3) permitting the wholesale sales in the retail jurisdiction would indirectly infringe on the FMPA and Lakeland rates established by the Federal Energy Regulatory Commission. Each of the arguments is addressed in turn.

Public Counsel's first contention that the Commission has required jurisdictional separations since 1967, does not fully represent Commission decisions or policy on the subject. The 1967 decision upon which the assertion is based does not affirmatively require jurisdictional separations. In a case of apparently first impression for the Commission, the Commission struggled with the interpretation of the then-current federal case law on the subject. Many of the cases cited in that order are recounted in Public Counsel's brief in this docket. The decision, which ultimately required separation was permissive, not mandatory.

> From the various cases we have discussed herein, we must conclude that where two services are conducted by the same public utility--one regulated and the other unregulated-it is proper, *although it may not be essential*, for the ratemaking body to make a segregation or separation of the investments, revenues and expenses assignable to the different services. This, we believe, is the preferable practice in order that the regulatory agency may be sure that the rates over which it has jurisdiction are fair and reasonable, and that the customers of the regulated service are not subsidizing the customers of the unregulated service.

In Re: General Investigation Of The Rates, Charges, And Earnings Of Florida Power Corporation, As Well As A Review And Re-evaluation Of The Rate-making Practices, Policies, And Philosophies Under Which Said Public Utility Operates And Prices Its Service, For The Purpose Of Making Whatever Adjustments, If Any, May Be Appropriate And In The Public Interest. Docket No. 7767-EU, Order No. 4139, March 19, 1967, pg. 61. Subsequent Commission practice permits a variety of wholesale sales in the retail jurisdiction. As stated above, wholesale economy energy sales are jurisdictional sales. Likewise, Schedule A and B, short term, emergency wholesale sales are in the retail jurisdiction. In addition, Schedule J negotiated non-firm wholesale sales are also in the retail jurisdiction.

Public Counsel's argument that the Commission is preempted from allowing the wholesale sales to be included in retail jurisdiction by the Federal Power Act is not supported by

the evidence presented in this docket or the federal legislation pertaining thereto. The Federal Power Act, 16 U.S.C. 791a et seq. specifically reserves retail jurisdiction for the states:

> **(a) Federal regulation of transmission and sale of electric energy.** It is hereby declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation...and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

16 U.S.C. § 824(a).

What is expressly preempted by the Federal Power Act is wholesale ratemaking by the states. The FMPA and Lakeland wholesale transactions were approved by the Federal Energy Regulatory Commission (FERC). The reasonableness of the wholesale rates TECO is charging its wholesale customers is not an issue in this docket. In addition, there is no evidence in the record of these proceedings to indicate that the rates approved by FERC and charged by TECO for the wholesale electricity will be affected by the decision of the Commission. The sole issue before the Commission is the retail treatment of the *costs and revenues* generated by the sales. No aspect of the instant proceedings encroached upon the express Federal rate jurisdiction.

As stated, the Commission's decision regarding the treatment of wholesale revenues in this docket is not expressly preempted by the Federal Power Act. Likewise, there is no evidence to support a finding of implied preemption. Preemption may be implied where a scheme of federal regulation is so pervasive that enforcement of state laws on the same subject is precluded. In addition, preemption may be implied where federal law conflicts

with state law so as to render compliance with both impossible. United Distribution Companies v. Federal Energy Regulatory Commission, 88 F. 3d 1105, 1109 (D.C. Cir. 1996) *quoting* Pacific Gas & Electric Co. v. State Energy Resources Conservation and Development Commission, 461 U.S. 109, 203-04 (1983). Neither type of implied preemption appear to be at work in the instant proceedings. The decision of this Commission regarding the treatment of the revenues of the FMPA and Lakeland sales will be enforceable under state law. In addition, TECO will be able to comply with FERC's wholesale rate decision concomitantly with its compliance with the FPSC's revenue decision.

Public Counsel's third argument, the "filed rate" doctrine, is not applicable. The filed rate doctrine requires that interstate power rates established through Federal Energy Regulatory Commission be given full and binding effect by state utilities commissions in setting intrastate rates. Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986). The rates set by FERC for the FMPA and Lakeland sales are not an issue in this proceeding. Additionally, there is no evidence in the record suggesting any impact on the FMPA and Lakeland rates resulting from the Commission's treatment of the revenues generated by the sales.

In sum, staff recommends that the Commission has jurisdiction to allow Tampa Electric Company to earn a return through retail rates for its wholesale sales to the Florida Municipal Power Agency and the City of Lakeland. The Commission's jurisdiction arises from Florida Statutes Chapter 366 and is not preempted by the Federal Power Act.

ISSUE 10: Should this docket be closed?

RECOMMENDATION: Yes. This docket should be closed.

STAFF ANALYSIS: The Commission's decision will resolve all the issues in this docket and therefore the docket should be closed.