



TAMPA ELECTRIC

October 18, 1999

Ms. Denise N. Vandiver  
Bureau Chief - Auditing Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

**Re: Docket No. 990007-EI; Audit Report;  
ECRC - Nine Months Ended December 31, 1998  
Audit Control No. 99-042-2-1**

Dear Ms Vandiver:

Enclosed is Tampa Electric Company's response to your document request dated July 16, 1999, regarding the audit of Environmental Cost Recovery - Nine Months Ended December 31, 1999.

If you have any questions, please call me at (813) 228-1752.

Sincerely,

Angela L. Llewellyn  
Administrator, Regulatory Coordination  
Tampa Electric Company

Enclosure

cc: J. D. Beasley

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**SUBJECT: CAPITALIZED PAYROLL**

**AUDITORS OPINION:**

The payroll costs included in the ECRC plant investment is already being recaptured through base rates. Since no new positions have been created, no unanticipated incremental payroll costs have been incurred. Any increases in payroll costs since 1995 would consist mostly of normal, recurring charges such cost of living merit increases, and promotions. These increases are anticipated and fall under rate base umbrella.

To include these payroll costs in the ECRC as expenses or plant investment would allow the Company to receive double recovery of same. Therefore staff believes that an adjustment should be made to remove the capitalized payroll, totaling \$1,167,009, which is referenced above.

**RESPONSE:**

Tampa Electric disagrees with the auditor's opinion that payroll costs in ECRC plant investment are already being recaptured through base rates, because all environmental capital spending is incremental to the capital spending projected in the rate case. Double recovery would only occur if capital dollars being spent for environmental compliance were included in the capital dollars included in revenue requirement done for base rate calculations.

The audit opinion focuses on unanticipated incremental payroll costs. It is more appropriate to focus on total unanticipated costs. Rate case capital projections anticipated the activities necessary to provide ongoing electric service. The foundation of the ECRC statute is that new environmental regulations create unanticipated costs, which are recoverable through the clause.

This new spending has to be evaluated on a total basis. A simple example is provided here to address this point:

At the time of the rate case, capital needed for ongoing service was \$150, comprised of:

Internal Labor	30
Subcontracted Labor	20
Other	<u>100</u>
Total	150

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An environmental project required to be done and has the following expenditures:

Internal Labor	5
Subcontracted Labor	0
Other	<u>10</u>
Total	15

At that point, if the company makes no new hires, capital spending would occur like this:

	Ongoing	New	Total
Internal Labor	25	5	30
Subcontracted Labor	25	0	25
Other	<u>100</u>	<u>10</u>	<u>110</u>
Total	150	15	165

The need for subcontracted labor would go up to \$25 due to the shift of revenue resources to the new environmental project. As a result of the new requirement, the company would spend \$15 more than the amount provided for in rates. Any adjustment to deny a specific component of capital cost would constitute a disallowance of environmental spending. In the example, to deny \$5 of labor and recover \$10 through ECRC would result in recovery of \$160 (\$150 in rates + \$10 in ECRC) instead of the full \$165 the company was required to spend.

Payroll disallowance could also send the wrong message to utilities that environmental projects should only be done with subcontracted labor. This could potentially reduce the expertise applied to these projects as well as potentially drive up the costs of the projects recovered dollar-for-dollar through the ECRC clause. That is clearly not the intention of the statute or the Commission's implementation of the ECRC.

The company believes that any adjustment to remove capitalized payroll would inappropriately deny recovery of prudent environmental compliance cost and, thus, an adjustment should not be made.

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**SUBJECT: COMPUTATION OF DEPRECIATION - Gannon and Big Bend CEM**

**AUDITORS OPINION:**

Section 366.8255, Florida Statutes states, "An adjustment for the level of costs currently being recovered through base rates or other rate-adjustment clauses must be included in the filing." Further, in a Commission sponsored workshop, staff concluded that "...The present practice in the ECRC is to look at the rate case test year to see if a capital project with the same function as a newly proposed project was included in setting base rates...If a project with the same function as a new project proposed for ECRC recovery were included in the last rate case test year, the company is allowed to recover the incremental cost of the new project upon certain conditions. Since the company's last rate case, there must have been either a new environmental compliance requirement...which necessitated the new project for which recovery is being sought through the ECRC..."

The ECRC should not be used to recover the full depreciation expense of the above listed projects when a portion of these project costs are included in rate base. Therefore, an adjustment should be made to reduce depreciation expense and accumulated depreciation as follows:

	<b>Reduce Depreciation Expense <u>4/1-12/31/98</u></b>	<b>Reduce Depreciation Expense Captured in Prior Periods</b>	<b>Reduce Accumulated Depreciation at 12/31/98</b>
<b>Big Bend CEM addition</b>	(\$ 4,612)	(\$22,080)	(\$26,692)
<b>Gannon Ignition</b>	<u>( 7,782)</u>	<u>( 2,161)</u>	<u>( 9,943)</u>
	<u><b>(\$12,394)</b></u>	<u><b>(\$24,241)</b></u>	<u><b>(\$36,635)</b></u>

**RESPONSE:**

Tampa Electric believes that it is necessary to clarify a basic difference between the two referenced capitalized projects. The Gannon Ignition Oil Tank project included in the 1998 ECRC filing (Docket No. 980007) was an upgrade to the original tank project included in Tampa Electric's 1993 rate base. In contrast, the Big Bend CEM project included in the 1996 ECRC filing (Docket No. 960688) was a replacement of the original CEM project included in Tampa Electric's 1993 rate base. As such, the appropriate computation of average net investment and depreciation expenses for these two projects must be addressed differently.

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Tampa Electric agrees with the auditor's opinion that part of the costs associated with the Gannon Ignition Oil Tank upgrade are in the Company's base rates and, therefore, are being recovered through current rates. Tampa Electric adjusted the Gannon Ignition Oil Tank upgrade project's accumulated depreciation by \$9,943 for depreciation expense captured through December 31, 1998. Additionally, the company made an adjustment to the ECRC schedules in its October 1, 1999 filing to ensure that no depreciation expense associated with rate base items are recovered through the ECRC in the current period or any future periods.

The auditor's opinion on the Big Bend CEM addresses a generic issue the Commission will be deciding in the upcoming proceeding. The issue centers on how to recover costs when an existing asset is replaced by a new asset required by new environmental regulation.

In the course of analyzing this issue, discussing it with staff and preparing responses to interrogatories on the subject, Tampa Electric has concluded that there is a logical recovery method for this situation. This method asks two basic questions: (1) Was the original asset a prudent investment properly recoverable through base rates? (2) Is the new asset a prudent investment required to comply with new environmental regulation? If the answer to each question is yes, then no disallowance or netting is appropriate.

Since the original CEM equipment was required for the certification of Big Bend Unit 4, it was a prudent expense allowable for recovery and approved by the FPSC in the 1992 rate case. However, this investment was not made any less prudent as a result of Tampa Electric's compliance with the new Clean Air Act Amendments (CAAA) requirements. As such, Tampa Electric believes that it is appropriate to continue recovery of the old equipment through base rates.

The new CAAA requirements impose new operating parameters for the company that did not exist at the time the existing Big Bend equipment was put in service. The costs incurred by the company in meeting the standards imposed by the new environmental requirements are incremental costs. Were it not for this new requirement, the company would not make the expenditure to replace the existing equipment. Therefore, the company should recover the entire in-service capital cost of the new CEM through the ECRC.

Since the company originally netted the original BB4 CEM cost due to uncertainty on treatment, we will agree to continue netting for recovery purposes. However, we believe full recovery of prior capital expenditures is appropriate based on the discussion above.

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In conclusion, Tampa Electric agrees to make the auditor's adjustments and has recognized this in its ECRC filing made October 1, 1999, but believes the Commission should establish a full recovery policy on a going forward basis.

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**SUBJECT: GYPSUM SALES IN ECRC**

**AUDITORS OPINION:**

Limestone and DBA use has increased significantly over the past years and as such, a corresponding increase in cost has occurred. In order to recover this increased cost, the Company has allocated a portion of the limestone and DBA cost to the ECRC filing.

The production of gypsum, a direct result of a chemical reaction between SO<sub>2</sub>, limestone and DBA, has also increased. However, the Company does not allocate a portion of the gypsum sales to the ECRC filing nor does the Company allocate O&M expenses related to the sale of gypsum.

Audit staff believes that a matching of costs and revenues in the ECRC filing, would be more appropriate that the one-side inclusion of consumable costs only. Staff is therefore suggesting inclusion of specific O&M expenses, allocated sales expenses and allocated gypsum sales revenues in the ECRC true-up.

Audit staff also believes that specific O&M charges should be allocated to ECRC. The charges that would be allocated would be only that portion of increased costs which is directly attributable to increased gypsum production and which is not being currently recovered through base rates. An arbitrary allocation of O&M costs would allow for double recovery of these costs. Those non-payroll O&M expenses suggested by the Company as directly attributable to gypsum production include electricity, tangible property tax of Big Bend #3 FGD integration system, and a portion of the depreciation resulting from increased "wear and tear" of the FGD system at BB #3.

**RESPONSE:**

Tampa Electric agrees with the auditor's statements that gypsum revenue is excluded from ECRC filings. However, the company does not agree with the audit opinion on the allocation of gypsum revenue or specific O & M charges to the ECRC.

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The Commission has already addressed this issue. In Order No. PSC-97-1047-FOF-EI the Commission agreed with the company that "Revenues generated from the sale of gypsum, as well as the corresponding O & M costs of the scrubbing process, have historically been included in the calculation of Tampa Electric Company's base rates. Provided these costs (with the exception of consumables) associated with the scrubbing process are not recovered through the ECRC, the corresponding revenues likewise should not be recovered through the ECRC."

Based on the Commission's previous decision, the suggested allocation should not be made.