State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: December 7, 2006

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Lester)
Office of the General Counsel (Bennett)

RE: Docket No. 060658-EI – Petition on behalf of Citizens of the State of Florida to require Progress Energy Florida, Inc. to refund customers $143 million.

AGENDA: 12/19/06 – Regular Agenda – Motion to Dismiss – Oral Argument Requested – Participation at Commission's Discretion

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Tew

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060658.RCM.DOC

Case Background

In the 2006 annual fuel cost recovery docket, Docket No. 060001-EI, the Office of Public Counsel (OPC) filed a petition on August 10, 2006 asking that the Commission require Progress Energy Florida (PEF) to refund $143 million to Florida ratepayers for purchases of higher costing coal for Crystal River Units 4 and 5. Upon request of OPC and consent by PEF, the matter was spun out of the fuel docket and now is scheduled for a separate proceeding.

OPC, in its fifty-nine page petition and attachments, alleges that from 1996-2005, PEF failed to utilize the most economical sources of coal for ratepayers in its Crystal River Units 4 and 5. OPC alleges that PEF failed to act prudently in incurring the fuel charges and costs of

SO_2 allowances. Because of PEF's alleged imprudent actions, OPC argues, PEF's customers are entitled to a refund of $143 million dollars.

PEF filed a Motion to Dismiss on August 30, 2006, and, at the same time, requested oral argument. On September 13, 2006, OPC filed a response to the Motion to Dismiss and a response to PEF's request for oral argument. AARP filed a joinder on September 27, 2006. This Commission has jurisdiction pursuant to Sections 366.03, 366.04, 366.05, 366.06 and 366.07, Florida Statutes.

Discussion of Issues

Issue 1: Should PEF's Request for Oral Argument be granted?

Recommendation: Yes, oral argument should be granted. Staff believes that, although PEF's motion and OPC and AARP's responses are clear and fully discuss the case law, there is a large volume of information provided and legal argument may be helpful to understanding each party's position. However, if the Commission believes that oral argument would not be helpful, it has the discretion to deny the request. If the Commission grants oral argument, each party should be limited to five minutes. (Bennett)

Staff Analysis: By separate motion, PEF seeks oral argument on its motion to dismiss. Rule 25-22.058, Florida Administrative Code, provides that the Commission, at its discretion, may grant a request for oral argument. The Commission has traditionally granted oral argument upon a finding that oral argument would aid the Commission in its understanding and disposition of the underlying motion. PEF's motion and OPC's and AARP's responses are well-articulated but each cite numerous cases. Oral argument may be helpful to the Commission in understanding the underlying motions. Staff believes oral argument may aid the Commission in its decision on the motion. Therefore, staff recommends that the Commission grant PEF's request for oral argument. Staff also recommends that if the Commission decides to hear oral argument, argument should be limited to five minutes per party.

Rule 25-22.058, Florida Administrative Code, allows the Commission the discretion to hear oral argument. If the Commission believes that the motion and responses are clear on their face and that oral argument would not be helpful, it has the discretion to deny the motion.

Issue 2: Should the Commission grant PEF's Motion to Dismiss OPC's Petition to recover $143 million in allegedly imprudent expenditures for coal purchased between the years 1996 and 2005?

Recommendation: No, the Motion to Dismiss should be denied. The Commission should hear OPC's Petition in a full evidentiary proceeding and determine the prudence of PEF's actions based on the evidence and testimony adduced at the hearing.

Staff analysis:

Standard of Review

A motion to dismiss raises as a question of law the sufficiency of the facts alleged in a petition to state a cause of action. See Varnes v. Dawkins, 624 So. 2d 349, 350 (Fla.1st DCA 1993). The standard to be applied in disposing of a motion to dismiss is whether, with all factual allegations in the petition taken as true and construed in the light most favorable to the petitioner, the petition states a cause of action upon which relief may be granted. See id. at 350. In determining the sufficiency of the petition, the Commission should confine itself to the petition and documents incorporated therein, and the grounds asserted in the motion to dismiss. See Flye v. Jeffords, 106 So. 2d 229 (Fla. 1st DA 1958), overruled on other grounds, 153 So. 2d 759, 765 (Fla. 1st DCA 1963), and Rule 1.130, Florida Rules of Civil Procedure.

PEF's Motion

Progress Energy Florida's Motion to dismiss is based on two grounds. First, PEF alleges that OPC's request for relief requires the Commission to engage in improper hindsight review of PEF's coal procurement policies. Secondly, PEF alleges that the Commission only has authority to set rates on a prospective basis. By granting OPC's petition, PEF claims that the Commission would engage in retroactive ratemaking, which, PEF charges, violates the Commission's limited statutory authority. PEF, in support of its motion, presents Florida case law and prior Commission decisions for the Commission's consideration.

OPC's Response

In response to PEF's motion to dismiss, OPC argues that the standard of review for a motion to dismiss is that the Commission must deem all of its allegations in the pleadings as true and the Commission must consider those facts in a light most favorable to OPC. According to OPC, the Commission cannot dismiss OPC's complaint unless PEF establishes that there is no set of facts whatsoever in support of its claim. The facts, according to OPC, are that PEF purposely built Crystal River Units 4 and 5 to have the flexibility to burn a 50/50 mixture of bituminous coal (from Appalachian coal mines) and sub-bituminous coal (from western coal mines) and PEF so stated that to regulators. OPC states that from the commencement of operation in 1982 for CR4 and 1984 for CR5, there has not been a mixture of coal burned at the two units. The petition alleges that, while the delivery price of western (sub-bituminous) coal originally was unfavorable, cheaper sub-bituminous coal became available during the early 1990's and PEF knew or should have known about it. According to OPC, PEF, by authoring changes to its environmental permits, unilaterally abandoned its rights under environmental

permits to burn the 50/50 mixture of coal. OPC alleges that PEF subsequently tried to justify its decision to buy more expensive coal by citing the permit limitations it had previously abandoned. Additionally OPC claims that PEF requested permission of environmental regulators to burn synfuel produced by its affiliates, even when less expensive coal was available to it. OPC concludes that based on the prices PEF paid for bituminous coal and synfuel provided by a sister company, as compared to the lower market price of delivered sub-bituminous coal that was known to be available at the time of the purchases during the period of 1996-2005, PEF paid substantially more for coal than a prudent utility should have. OPC alleges that the utility knew or should have known that less expensive coal was available to it and did not take advantage of the lower priced coal. In its legal analysis, OPC cites Florida case law and prior Commission decisions in support of its position that the Commission proceed to an evidentiary hearing on OPC's petition. In addition, OPC in its Response to the Motion to Dismiss, analyzed the applicability of several of the cases and Commission decisions which PEF used in support of its Motion to Dismiss.

Analysis

Staff has reviewed all the court cases, statutes, and Commission decisions cited by both PEF and OPC, and has performed additional research. The two cases most relevant to the Commissions determination here are Gulf Power Company v. Florida Public Service Commission, 487 So. 2d 1036 (Fla 1986), which is attached, and Richter v. Florida Power Corp., 366 So. 2d 798 (Fla 2d DCA 1979). In Gulf, the Florida Supreme Court affirmed an order of the Commission that required Gulf Power to refund $2,200,000 to its customers for imprudently entering into and then failing to terminate a coal contact. The issues presented for the Court's review were whether there was competent substantial evidence to support the Commission's findings of managerial imprudence, whether the calculation for the amount of the refund was proper, and whether the refund order constituted retroactive ratemaking and was, therefore, prohibited. Gulf at 1037.

The Gulf case is dispositive of both issues presented by PEF in its motion to dismiss. The Court considered both the appropriateness of the Commission's review of prior decisions and whether a refund for prior imprudent actions constituted retroactive ratemaking. The Commission's decision dealt with certain actions of Gulf that had occurred over a period of several years prior to the Commission's order finding the actions imprudent. The Court recited the underlying facts utilized by the Commission in reaching its decision and affirmed that Gulf had acted imprudently over the years by renewing the contract and by failing to terminate the contract when prices rose to excessive levels. In holding that the Commission properly conducted its prudence review of Gulf's prior managerial decisions, the court stated:

> Contrary to Gulf's contentions, the commission sought to evaluate Gulf's managerial decisions *under the conditions and times they were made.* Witnesses testified that these actions were imprudent, and this testimony was adequately predicated on pertinent factual data. Likewise, the method of determining the effects of these imprudent decisions on its rate payers was an acceptable method and with sufficient supporting data to sustain the amount ordered to be returned to the customers.

Id. (emphasis supplied).

As held in the Gulf case, this Commission may review the actions of the utility to determine if Progress management's decisions regarding fuel procurement were prudent under the conditions and time they were made. The difference between a prudence review and a hindsight review is distinguishable. Hindsight, as stated by PEF in its motion to dismiss "makes a different course of action look preferable." Richter v. Florida Power Corp., 366 So. 2d 798, 800 (Fla 2d DCA 1979). It involves applying facts, as we know them today, to decisions made in the past. But this Commission can consider decisions made in the past, by applying facts that were available to the company at the time of its management decision, just as the prior Commission did in its decision regarding Gulf. Based on the Richter and Gulf decisions, PEF's motion to dismiss should fail.

The Supreme Court also addressed the issue of whether review of prior decisions constitutes prohibited retroactive ratemaking. Justice McDonald opined:

> Nor do we find that the order constitutes prohibited retroactive ratemaking fuel adjustment. Fuel adjustment charges are authorized to compensate for utilities' fluctuating fuel expenses. The fuel adjustment proceeding is a continuous proceeding and operates to a utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the commission of the jurisdiction and power to review the prudence of these costs. The order was predicated on adjustments for 1980, 1981 and 1982. We find them to be permissible.

Gulf at 1037.

The Supreme Court did not limit the Commission's ability to review expenditures of and require refunds from a utility under the facts presented to it in Gulf. As stated before, the Commission actually looked at the prudence of a 1974 contract, and subsequent decisions to renew it and failures to terminate the contract. The fuel adjustment hearing allows for a continuing review of the prudence of actions of a utility. OPC's petition includes factual allegations of PEF's imprudence in its expenditures and is seeking a refund from the utility for imprudent decisions, just as in Gulf. Like the Gulf decision, the Commission will not be engaging in retroactive ratemaking by considering the evidence submitted by OPC and PEF. The motion to dismiss must also fail as to the issue of retroactive ratemaking.

Conclusion

OPC's petition sets forth sufficient factual allegations which, when taken in the light most favorable to OPC, state a cause of action which is not subject to dismissal. An evidentiary hearing is the most appropriate mechanism for the Commission to determine whether to grant OPC's request to order PEF to refund of $143 million to ratepayers. In ruling against the utility's motion to dismiss, the Commission is not determining whether PEF's management's decisions were imprudent. Rather the Commission will weigh the facts and the law in judging the prudence of management decisions during the course of the evidentiary proceeding. Likewise, if the Commission were to grant any refund to the ratepayers, it would only be done

after a full and complete evidentiary proceeding. PEF will not be denied its due process of law by being required to present its case to this Commission.

Issue 3: Should this docket be closed?

Recommendation: No. If the Commission accepts staff's recommendation, this docket should not be closed until after an evidentiary hearing has been held and final order issued. (Bennett)

Staff Analysis: If the Commission accepts staff's recommendation in Issue 2, this docket should remain open pending final order of the Commission after an evidentiary hearing.

487 So. 2d 1036, *; 1986 Fla. LEXIS 1799, **;
11 Fla. L. Weekly 114

LEXSEE 487 SO. 2D 1036

GULF POWER COMPANY, Appellant, v. FLORIDA PUBLIC SERVICE COMMISSION, Appellee

No. 66,632

Supreme Court of Florida

487 So. 2d 1036; 1986 Fla. LEXIS 1799; 11 Fla. L. Weekly 114

March 20, 1986

SUBSEQUENT HISTORY: [**1]

Rehearing Denied May 29, 1986.

PRIOR HISTORY: An Appeal from the Public Service Commission.

COUNSEL:

G. Edison Holland, Jr. of Beggs and Lane, Pensacola, Florida, for Appellant.

William S. Bilenky, General Counsel, and Paul Sexton, Associate General Counsel, Florida Public Service Commission, Tallahassee, Florida, for Appellee.

Jack Shreve, Public Counsel and Stephen Fogel, Associate Public Counsel, Office of the Public Counsel, for Citizens of the State of Florida, Intervenor.

JUDGES:

McDonald, J. Adkins, Overton, Ehrlich, Shaw and Barkett, JJ., concur. Boyd, C.J., dissents.

OPINION BY:

McDONALD

OPINION:

[*1036] Gulf Power Company appeals from an adverse ruling by the Public Service Commission ordering Gulf to refund $2,200,000 to its rate payers. The commission predicated the order on its findings that managerial imprudence caused Gulf to [*1037] pay excessive fuel costs in the purchase of coal.

The issues presented are whether there is competent substantial evidence to support the commission's findings of managerial imprudence, whether the calculation for the amount of the refund is proper, and whether the refund order constitutes retroactive ratemaking and is therefore prohibited. [**2] We affirm the order of the commission.

In 1952 Gulf Power, Alabama Power Company, and Georgia Power Company contracted with Alabama By-Products Corporation to purchase coal removed from the Maxine Mine. A contract rewrite in 1954 extended the contract to 1974. Several agreements among the three purchasers allocated the output from Maxine Mine, and, under those agreements, Gulf took no coal from that mine from 1964-69, instead making excess cost payments to Alabama Power. In 1969 Gulf lost its alternate coal supplier and reactivated its Maxine Mine deliveries. ABC proposed extending the mining of Maxine in 1972, and Gulf agreed to extend its contract through 1977. This was a cost-plus type of contract. A subsequent amendment extended the contract through 1984, when the mine would be shut down. By 1978 Maxine coal was Gulf's highest cost fuel, and by 1980 the price Gulf paid for Maxine coal was the highest of comparable coals purchased by utilities throughout the country. In 1981 Gulf asked the PSC staff for a meeting to discuss an accounting mechanism to accrue the estimated cost of closing down and reclaiming Maxine Mine. The staff recommended that the issue be brought [**3] before the PSC which, after holding hearings, determined that Gulf had acted imprudently by renewing the contract and by failing to terminate its contract when prices rose to excessive levels.

Contrary to Gulf's contentions, the commission sought to evaluate Gulf's managerial decisions under the conditions and times they were made. Witnesses testified that these actions were imprudent, and this testimony was adequately predicated on pertinent factual data. Likewise, the method of determining the effects of these imprudent decisions on its rate payers was an acceptable method and with sufficient supporting data to sustain the amount ordered to be returned to the customers.

Nor do we find that the order constitutes prohibited retroactive ratemaking fuel adjustment. Fuel adjustment charges are authorized to compensate for utilities' fluctuating fuel expenses. The fuel adjustment proceeding is a continuous proceeding and operates to a

utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the commission of the jurisdiction and power to review the prudence of these costs. The order [**4] was predicated on adjustments for 1980, 1981, and 1982. We find them to be permissible.

The order of the Public Service Commission is affirmed.

It is so ordered.

ADKINS, OVERTON, EHRLICH, SHAW and BARKETT, JJ., Concur.

BOYD, C.J., Dissents.