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Sent: Wednesday, April 11, 2007 3:35 PM
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Subject: e-filing (Dkt. 060162-EI)
Attachments: 060162.phs.sversion.doc

ORIGINAL

Electronic Filing

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b. Docket No. 060162-EI

In re: Petition by Progress Energy Florida, Inc. for approval to recovery modular cooling tower costs through environmental cost recovery clause.

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 8 pages.

e. The document attached for electronic filing is Citizens' Prehearing Statement.

(See attached file: 060162.phs.sversion)

Thank you for your attention and cooperation to this request.

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4/11/2007

DOCUMENT NUMBER-DATE
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In re: Petition by Progress Energy Florida,)
 Inc. for approval to recover modular)
 cooling tower costs through environmental)
 cost recovery clause.)
 _____)

DOCKET NO. 060162-EI

Filed: April 11, 2007

CITIZENS' PREHEARING STATEMENT

The Citizens of the State of Florida, through the Office of Public Counsel, pursuant to the Orders Establishing Procedure in this docket, Order No. PSC-06-0990-PCO-EI, issued November 29, 2006, and Order No. PSC-07-0138-PCO-EI, issued February 19, 2007, hereby submit this Prehearing Statement.

I. WITNESSES:

Citizens will call the following witnesses:

DIRECT:

John B. Stamberg (adopting the prefiled testimony of **Thomas A. Hewson, Jr.**)¹. — Mr. Stamberg will testify that the modular cooling tower project does not qualify for inclusion in the ECRC because it is not “a government imposed environmental regulation that was enacted or became effective, or whose effect was triggered after the company’s last test year upon which rates are based.” He will testify that the cooling towers are intended to help PEF comply with a requirement that predated the passage of the ECRC statute and the company’s last rate case, and has been effective continuously since that time. The “triggering event” language in the Commission’s policy refers to changes in regulatory requirements, not changes in operating conditions.

Patricia W. Merchant — Ms. Merchant will testify regarding the proper roles of base rates and cost recovery clauses in designing fair and reasonable rates. She will testify that the role of base rates is not to recover only those costs included in MFRs, but to provide an adequate rate of return after all costs, including those that arise after the rate case, are

¹ The prefiled testimony was originally submitted by Mr. Hewson. Due to a scheduling conflict, Mr. Stamberg, who is employed by the same firm and worked with Mr. Hewson to analyze PEF’s request, will adopt and sponsor the prefiled testimony at the hearing.

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included; to allow a utility to place an ineligible cost in a cost recovery clause instead of absorbing it in base rates is to place an unwarranted “back door” rate increase on customers.

Based on Mr. Stamberg’s analysis, she will testify that the modular cooling tower costs are not properly included in the costs recovered through the environmental cost recovery clause.

Ms. Merchant will testify that the modular cooling tower costs are not fossil-fuel related and are well-removed from the fuel process. Paragraph 10 in Order 14546 was meant to encourage utilities to spend money that they might not otherwise choose to spend to save fuel costs; measures addressing a fundamental operational need do not fall within the category of costs contemplated by the Commission’s order.

Ms. Merchant will testify that including the modular cooling tower costs in the fuel clause would violate the intent of the 2005 rate case settlement approved by the Commission in Docket No. 050078-EI. PEF agreed not to petition for approval of any new surcharges to recover costs that are of a type that traditionally and historically would be, or are presently, recovered through base rates. These costs traditionally and historically would belong in base rates and as such are not appropriate to be recovered in either the ECRC or fuel clause.

II. EXHIBITS

Through their witnesses, Citizens will sponsor the following exhibits:

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|--------|--|
| TAH-1 | Resume of Thomas A. Hewson Jr. |
| PWM-1 | Resume of Patricia W. Merchant |
| PWM- 2 | PEF Earnings Analysis Adjusted for Inclusion of Modular Cooling Towers in Base Rates |

III. STATEMENT OF GENERAL POSITION

Not all costs are eligible for cost recovery clauses. Accordingly, when assessing PEF’s request for permission to collect the costs of the modular cooling tower project through either the Environmental Cost Recovery Clause or the Fuel Cost Recovery Clause, the Commission must take into account the impact that including ineligible costs in a cost recovery clause would have on customers. That subject in turn requires consideration of the proper roles of base rates and cost recovery clauses in ensuring the rates that customers pay are fair and reasonable. In establishing base rates to be effective in the period following a rate case, the Commission analyzes a typical “test year,” and fashions rates to recover the utility’s prudent and reasonable test year expenses plus a fair return on investment. However, during the period in which rates are effective, all of the information and projections regarding

investment, revenues, and costs that the Commission incorporated into the designing of rates will change over time. Costs included in the test year may no longer be incurred. New costs, unanticipated at the time rates were designed, will arise. Some customers will leave the system; others will be added. Consumption patterns will change. Revenues will vary and, in a growth state like Florida, likely will increase. An overall increase in costs—including costs unknown at the time rates were set—may be offset by an increase in revenues. In this ongoing milieu, the adequacy of base rates over time is measured by the ability of the utility to earn a fair rate of return on investment after paying its prudent and reasonable expenses, and that adequacy can be determined only by a review of the utility's overall condition. If base rates are inadequate, the utility has the ability to request an increase in base rates. If the return is excessive, the Commission can adjust base rates downward. In either scenario, the Commission can review the totality of the Company's operations and take shifting relationships among customers, investment, revenues, and expenses into account when again fixing rates for the future.

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

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

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

IV. ISSUES AND POSITIONS

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

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

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

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

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

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

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

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

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

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

Stipulated Issues

Citizens are not aware of any stipulated issues at this time.

Pending Motions

Citizens have no pending motions at this time.

Pending Requests or Claims for Confidentiality

Citizens have no pending requests or claims for confidentiality.

Notice of Intent to Use Confidential Documents at Hearing

Citizens do not have any confidential documents that we wish to use at hearing at this time but reserve the right to supplement this list at a later time.

Objections to Qualifications of Witnesses as Experts

Citizens have no objections to the qualifications of PEF's witnesses.

Requirements of Order Establishing Procedure

Citizens believe that they have complied with the requirements of the order establishing procedure.

s/ Joseph A. McGlothlin
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DOCKET NO. 060162-EI
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of foregoing Citizens' Prehearing Statement has been furnished by electronic mail and U.S. Mail on this 11th day of April, 2007, to the following:

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