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**Subject:** e-filing (Dkt. 070052-EI)  
**Attachments:** 070052.Prehearing statement.sversion.doc

**ORIGINAL**

## Electronic Filing

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## b. Docket No. 070052-EI

In re: Petition by Progress Energy Florida, Inc. to recover costs of Crystal River Unit 3 uprate through fuel clause.

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

## d. There are a total of 12 pages.

## e. The document attached for electronic filing is the Prehearing Statement of the Office of Public Counsel.

(See attached file: 070052.Prehearing statement.sversion.doc)

Thank you for your attention and cooperation to this request.

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**DOCUMENT NO. DATE**  
0572507 07/09/07  
**FPSC - COMMISSION CLERK**

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition by Progress Energy )  
Florida, Inc. to recover costs of )  
Crystal River Unit 3 uprate through )  
fuel clause )  
\_\_\_\_\_ )

DOCKET NO. 070052-EI

Filed: July 9, 2007

ORIGINAL

**PREHEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL**

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-07-0390-PCO-EI, issued May 2, 2007, and Order No. PSC-07-0466-PCO-EI, issued May 23, 2007, hereby submit this Prehearing Statement.

**APPEARANCES:**

JOSEPH A. MCGLOTHLIN, Esquire  
Associate Public Counsel

PATRICIA A. CHRISTENSEN, Esquire  
Associate Public Counsel

Office of Public Counsel  
c/o The Florida Legislature  
111 West Madison Street, Room 812  
Tallahassee, Florida 32399-1400  
On behalf of the Citizens of the State of Florida.

**1. WITNESSES:**

Citizens prefiled testimony by the following witnesses:

**Patricia W. Merchant:** In her testimony, Ms. Merchant outlines the proper roles of and relationships between base rates and special cost recovery clauses. She demonstrates that allowing a utility to flow a base rate-related cost through a cost recovery clause can result in an unwarranted, back door increase in customer's bills. Because utilities have an incentive to flow base rate-related costs through a cost recovery clause, thereby increasing earnings at the expense of customers, the Commission should vigilantly enforce the eligibility criteria of the clause. Ms. Merchant testifies that the CR3 uprate costs are not eligible for the fuel cost recovery clause.

DOCUMENT NUMBER-DATE

05725 JUL-95

FPSC-COMMISSION CLERK

Permitting PEF to collect the CR3 uprate costs through the fuel clause would enable PEF to circumvent the review of the utility's total reasonable and necessary revenue requirements and would lead to unfair and unreasonable rates and charges.

**Daniel J. Lawton:** Mr. Lawton addresses fundamental ratemaking principles from his perspective as an economist. He also points out that, because the fuel cost recovery clause has a true-up feature, there is virtually no risk of non-recovery; to allow PEF to apply its proposed 13.5% pretax rate of return to the uprate investment would be to overstate PEF's capital costs and would result in unfair and unreasonable rates.. Further, PEF's proposed truncated recovery periods would deny customers the benefits of cost-free capital in the form of deferred taxes. This denial of deferred tax benefits over the appropriate time period results in revenue requirements higher than would be the case if PEF were to put the uprate assets in rate base and recover the costs through base rates over their useful lives.

## **2. EXHIBITS:**

Witness for Citizens prefiled the following exhibits:

### **Patricia W. Merchant:**

(PWM-1) Resume

### **Daniel J. Lawton:**

(DJL-1) Resume and Case Listing

(DJL-2) Deferred Tax Impact

(DJL-3) Net Savings at 7.5% ROR

(DLJ-4) Cash Flow Comparison

(DLJ-5) PEF's Proposed Timing

## **3. STATEMENT OF BASIC POSITION**

As it reviews PEF's request for authority to flow some \$381 million (PEF's early estimate) of nuclear generating plant costs and associated capital items through the fuel cost recovery clause, the Commission must keep the larger regulatory and ratemaking picture in focus. The principal tool that the Commission employs in the economic regulation of electric utilities is the base rate mechanism. Base rates are the culmination of an all-encompassing analysis of the utility's overall financial and operating condition. Base rate proceedings are therefore the Commission's principal means of accomplishing a holistic, rather than piecemeal, approach to regulation.

Once set, a utility's base rates are designed to function without change in an environment of fluctuating costs and revenues as long as the utility earns a return that falls within a reasonable range. This means the utility uses earnings generated by base rates to defray and recover any increases in costs, just as it enjoys the enhanced earnings it derives from any decreases in other costs and/or increases in revenues, as long as the overall relationship between costs and revenues results in a reasonable return on the utility's investment. If and when the relationship between all costs and all revenues no longer yields a fair return, the utility's recourse is to request an increase in base rates.

Allowing a utility to bypass the base rate process and instead pass a new, base rate-related cost through the fuel cost recovery clause would have the inequitable effect of increasing a customer's total bill, even though an overall review may well indicate that no increase in base rate is justified due to the decline in other costs or an increase in revenues. The Commission must therefore protect customers by strictly enforcing the eligibility criteria of the fuel cost recovery clause.

While in Order No. 14546 the Commission indicated that it would consider, on a case-by-case basis, requests to authorize passing "base rate"-related costs through the fuel cost recovery mechanism when the costs would achieve fuel savings, the illustration it provided in that order demonstrates the limited scope of its intent. While the Commission's policy on this matter has evolved, and over time it has allowed utilities to pass costs through the clause in a number of circumstances, recently the Commission has begun to recalibrate that policy in a manner that better protects customers' interests. It should continue the process of refining and formulating its policy to protect customers from PEF's overreaching requests in this docket. The request that initiated this case is "over the top" in terms of its effort to disadvantage customers in order to skew benefits toward the requesting utility. The fact that PEF has an ample opportunity to submit a base rate case prior to expending the vast majority of amounts on the project obviates the need to depart from normal ratemaking to provide an "incentive," and so distinguishes this case from the reasoning that underlay the limited departure from the base rate mechanism contemplated in Order No. 14546.

Further, PEF's proposed short capital recovery periods—which PEF did not disclose in its petition or testimony—would require customers to bear all of the costs of the project without receiving meaningful fuel savings until at least 2016, thereby creating severe intergenerational inequities between the customers who would pay for the project immediately and those who may, at some point in the future, receive the benefits. Typically, the accelerated depreciation a utility employs for tax purposes gives rise to the collection of revenues earmarked for taxes that actually won't be paid until later. In turn, customers benefit in this process when the utility uses those funds as "cost-free capital" in the base rate process. In this case, PEF has uniquely proposed capital recovery periods that are even shorter than the lives it can use for tax purposes, meaning that under PEF's proposal customers would forgo the benefits of deferred taxes on a net present value basis.

In addition, because the fuel cost recovery clause incorporates a true-up mechanism, there is little risk that the utility will not collect amounts the Commission authorizes it to pass through the clause. PEF proposes to add a return of 11.75% (after taxes) on its capital expenditures.

This return is well above the risk-free rate, better represented by the cost of debt, overstates PEF's related capital costs, and so would result in rates and charges to consumers that are unreasonably and unjustifiably high. For all of these reasons, the Commission should deny PEF's request and instruct PEF to recover the investment in the uprate project through base rates in the normal fashion.

#### **4. STATEMENT OF FACTUAL ISSUES AND POSITIONS**

**ISSUE 1: Should the Commission authorize clause recovery in lieu of base rate recovery of the prudent and reasonable costs of the following:**

##### **A. Phase 1 of PEF's CR3 Uprate Project?**

**CITIZENS:** No. Phase I of the CR3 nuclear uprate is related to plant instrumentation and associated calculations to allow measurement uncertainty recovery (MUR) which is scheduled to be constructed in 2007. According to PEF, the MUR is expected to add 12 thermal megawatts (MWe) for a cost of \$6.5 million. The MUR instrumentation and associated costs are plant and represent an investment in plant by PEF.

The costs of the MUR phase are not volatile, and are not fuel-related in the sense that would meet the criteria of the fuel cost recovery clause. PEF's proposal to collect the costs in a single year, which PEF did not disclose in its petition or testimony, is patently unreasonable. Because the true-up mechanism renders the fuel cost recover clause risk-free, PEF's proposed rate of return on its Phase 1 investment associated with its fuel clause proposal would overstate its capital costs and result in unreasonably high rates and charges.

Further, base rates are the normal and traditional method for utility to recover its investment in plant. Base rates are designed to allow the utility the opportunity to recover all of its prudent operating costs and a reasonable rate of return on its investment in utility plant. Ratemaking principles contemplate that costs and revenues will fluctuate over time from those used in setting the base rates. The revenue requirements of Phase 1 are only \$1.05 million annually. This amount is not a material change. It clearly is the type of fluctuation that base rates are designed to accommodate between base rate proceedings. Even under the Company's inappropriate cost recovery request for the MUR (where \$6.45 million of the investment is recovered in one year – 2008) the total 2008-2009 MUR-related revenue requirement would be \$8.67 million. If the utility were to recover the \$8.67 million through base rates, the utility's return on equity would only change from 10.90% to 10.50% based on PEF's recent return reports. Allowing PEF to flow these costs through the clause would result in an unwarranted, "back door" base rate increase, because customers' bills would increase by the amount of the MUR-related costs, even though the MUR project

would not justify a base rate increase. Thus, it is inappropriate for the MUR project to be recovered through the clause.

### **B. Phase 2 of PEF's CR3 Uprate Project?**

**CITIZENS:** No. Phase II of the CR3 uprate project involves replacement of the turbine line components to take advantage of greater steam efficiencies in the turbines and electrical generator. This phase is expected to be placed in service with the 2009 CR3 refueling outage and will add an estimated 28 MWe at a preliminary cost estimate of \$88 million. Again, the turbine line replacements are plant investment made by the utility which are normally and traditionally recovered through base rates. Phase 2 consists of investment in nuclear generating plant. The costs are not volatile and are not fuel-related in the sense that would qualify them for inclusion in the fuel cost recovery.

In addition, Order No. 14546, which PEF attempts to invoke, was intended to provide an incentive to expend monies in circumstances in which the utility had no ability to process a base rate proceeding in time to build the costs into base rates. PEF projects that it will place Phase 2 into service during 2009. This is important because the utility has the opportunity and capability of returning to the Commission for base rate relief, if and when, it determines that such base rate relief is necessary. Thus, the cost of Phase II can be captured appropriately through a base rate proceeding that could occur in the 2009 time frame without the utility incurring the potential loss of return in the interim. This fact obviates the need for an "incentive" in the form of a departure from fundamental ratemaking, and distinguishes PEF's situation from that addressed in Order No. 14546.

PEF's proposed means of recovery lopsidedly skews benefits to the utility and its shareholders, at the expense of customers. PEF would create severe intergenerational inequities among customers by recovering 100% of costs over at least ten years before future customers realize any benefits. Also, by artificially shortening recovery periods, PEF would require customers to forgo the net present value benefits of cost-free capital in the form of deferred taxes. Granting PEF's proposal would overcharge customers, because its proposed return on investment is overstated in light of the risk-free nature of the fuel cost recovery mechanism.

### **C. Phase 3 of PEF's CR3 Uprate Project, including:**

1. Nuclear Core Modifications, Secondary Systems, and Other Project-related Plant Additions/Modifications?

**CITIZENS:** No. Phase III of the CR3 project will increase the power or thermal MWe produced in the reactor core by making plant modifications to allow for use of

more highly enriched uranium. Phase 3 is expected to add 140 MWe to be placed into service by 2011 at an estimated cost of \$199 million. These components of Phase 3 consist of investments in nuclear generating plant. Like those of earlier phases, the costs are not volatile and are not fuel-related in the sense that would qualify them for clause recovery.

In addition, Order No. 14546, which PEF attempts to invoke, was intended to provide an incentive to expend monies in circumstances in which the utility had no ability to process a base rate proceeding in time to build the costs into base rates. That is not the case here. PEF can submit and process a base rate proceeding prior to the time it begins to incur the costs following the refueling outage of 2011. There is no occasion or need for an “incentive” in the form of a departure from the base rate process. This fact distinguishes PEF’s situation from that addressed in Order No. 14546.

PEF’s proposed means of recovery lopsidedly skews benefits to the utility and its shareholders, at the expense of customers. PEF would create severe intergenerational inequities among customers by recovering 100% of costs over at least ten years before future customers realize any benefits. Also, by artificially shortening recovery periods, PEF would require customers to forgo the net present value benefits of cost-free capital in the form of deferred taxes. Granting PEF’s proposal would overcharge customers, because its proposed return on investment is overstated in light of the risk-free nature of the fuel cost recovery mechanism.

Further, there is no certainty as to the overall proposed savings of the CR3 project (PEF’s basis for fuel clause recovery), because savings values estimated further out into the future are less reliable. The near term planning horizon (2007-2015) when projected values are probably more accurate, customers receive no net savings, rather they are assigned a net loss associated with the proposed uprate. Under the utility’s proposal to recover the CR3 cost through the fuel clause, it is not until 2016 that the proposal provides a net savings in nominal dollars for customers. What is certain from the utility’s proposal is that the utility will recover its costs on an accelerated basis - as compared to traditional ratemaking - while customers will be forced to wait for savings than may not come at the proposed level.

## **2. The “point of discharge” cooling solution?**

CITIZENS: No. The point of discharge (POD) costs associated with the increased capacity of Phase III of the CR3 project is estimated at \$51 million. Essentially, according to the utility’s analysis, the 140 MWe increase associated with Phase III will increase the temperature and the proposed POD facilities are necessary to reduce the incremental temperature increase to the temperature level prior to the uprate. The cost estimates are extremely preliminary and may change

significantly, especially since the utility has yet to determine the most cost effective option to accomplish the goal of reducing the temperature. This component of Phase 3 consists of investment in nuclear generation plant. The costs are not volatile and are not fuel-related in the sense that would satisfy the criteria of the fuel cost recovery clause.

Order No. 14546, which PEF attempts to invoke, was intended to provide an incentive to the utilities to undertake measures for which the utility had no ability to process a base rate proceeding in time to build the costs into base rates. Here, PEF can submit and process a base rate proceeding prior to the time it begins to incur the costs following the refueling outage of 2011. Accordingly, there is no need for an incentive. This fact differentiates PEF's situation from that addressed in Order No. 14546.

PEF's proposed means of recovery severely skews benefits to the utility and its shareholders, to the detriment of customers. PEF would create severe intergenerational inequities among customers by recovering 100% of costs over at least ten years before future customers realize any benefits. Also, by artificially shortening recovery periods, PEF would require customers to forgo the net present value benefits of cost-free capital in the form of deferred taxes. Granting PEF's proposal would overcharge customers, because PEF's proposed return on investment is overstated in light of the risk-free nature of the fuel cost recovery mechanism.

### **3. Transmission upgrades associated with the CR3 Uprate Project?**

**CITIZENS:** No. The transmission projects necessary to accommodate the increased capacity of CR3 are estimated at \$104 million. The transmission upgrades are necessitated by the fact that the uprate will cause CR3 to become the largest single generator in Florida. The utility must have the capability to respond to the loss of that single largest unit to maintain the stability of the grid. PEF hopes to have the transmission upgrades piggyback its rationale for including the generating plant in the clause, because there is even less justification for including investments in transmission facilities in the fuel cost recovery clause than there is for including investments in nuclear generating plant. Transmission facilities clearly are related to the capacity of the system, not to fuel.

Further, the costs are not volatile. They are not fuel-related within the meaning of the criteria of the fuel cost recovery clause.

Importantly, Order No. 14546, on which PEF attempts to rely, was intended to provide an incentive to spend money on measures in circumstances in which the utility had no ability to process a base rate proceeding in time to build the related costs into base rates. The order is inapplicable to this case, because PEF can submit and process a base rate proceeding prior to the time it begins to



incur the costs following the refueling outage of 2011. In short, there is no need for an “incentive,” and no reason to depart from fundamental ratemaking.

In addition, PEF’s proposed means of recovery unfairly skews benefits to the utility and its shareholders, at the expense of customers. PEF would create severe intergenerational inequities among customers by recovering 100% of costs over at least ten years before future customers realize any benefits. By truncating recovery periods, PEF would require customers to forgo the benefits of cost-free capital in the form of deferred taxes. Granting PEF’s proposal would overcharge customers, because PEF’s proposed return on investment is overstated in light of the risk-free nature of the fuel cost recovery mechanism.

#### **4. Other costs associated with phase 3 of the CR3 Uprate Project?**

CITIZENS: PEF has demonstrated no justification for including any portion of the costs of Phase 3 of the uprate project in the fuel cost recovery clause.

**ISSUE 2:** **If the Commission authorizes clause recovery of the CR3 Uprate Project, which cost recovery clause, fuel or capacity, is appropriate for capitalized costs attributable to the uprate?**

CITIZENS: No position.

**ISSUE 3:** **If the Commission authorizes clause recovery of the CR3 Uprate Project, what capital recovery periods should the Commission prescribe for the assets?**

CITIZENS: Whether PEF recovers the costs of the uprate through base rates or through the clause, the recovery periods should correspond to the useful lives of the assets—here, through the year 2036. This will fairly and equitably match the costs and benefits of the assets. To allow PEF to artificially shorten the recovery period would result in severe, unfair discrepancies between those customers who bear the costs of the project and those who later would receive fuel savings.

**ISSUE 4:** **Based on the recovery periods prescribed for the CR3 Uprate Project assets, what ratemaking adjustments, if any, are necessary?**

CITIZENS: Whether PEF recovers the costs of the uprate through base rates or through the clause, the Commission should reset the recovery periods to correspond with the expected useful lives. If it allows PEF to use the artificially accelerated lives that the utility proposes, the Commission should make those ratemaking adjustments needed to compensate customers for the loss of the net present value benefits of deferred taxes that they would receive with the application of the standard useful life concept.

**ISSUE 5: If the Commission authorizes PEF clause recovery of the CR3 Uprate Project, what return on investment should the Commission authorize PEF to include?**

CITIZENS: If the Commission denies PEF's proposal, as Citizens urge, this issue will become moot. PEF's proposal to earn 11.75% on its investment in assets flowing through the clause overstates its costs, because the proposed return contemplates the risk of non-recovery associated with base rate treatment, whereas the clause is virtually risk-free as a result of the true-up process. If the Commission were to grant PEF's request for clause treatment, it should authorize a return no greater than the cost of debt. (Citizens recognize that the existing settlement agreement addresses the return on capital items that the Commission permits PEF to flow through clause items during the term of the agreement.)

**ISSUE 6: If the Commission authorizes clause recovery of the CR3 Uprate Project, how should the costs associated with the project be allocated between wholesale and retail jurisdictions for rate recovery purposes?**

CITIZENS: If the Commission denies PEF's proposal, as Citizens urge, this issue will become moot. Whether PEF recovers the costs of the uprate through base rates or the fuel cost recovery clause, retail customers should pay for only the portion of the unit that is devoted to retail service. At this point, Citizens have not addressed the specific methodology for accomplishing the appropriate allocation.

**ISSUE 7: If the Commission authorizes clause recovery of the CR3 Uprate Project, what reports, if any, should PEF be required to file with the Commission?**

CITIZENS: If the Commission denies PEF's proposal, as Citizens urge, this issue will become moot. Alternatively, PEF must be required to file a report that clearly identifies the timing and level of all claimed costs incurred along with the corresponding timing and level of cost recovery. Further, PEF must demonstrate the prudence of its expenditures for all investments that would normally have been given base rate treatment and would have been subject to standard prudence review in a base rate case.

**ISSUE 8: Should this docket be closed?**

CITIZENS: The docket should be closed if the Commission denies PEF's petition, as Citizens urge the Commission to do. If the Commission authorizes PEF to collect any of the uprate-related costs through the clause, it should close the docket only if all related issues of updated estimates, prudence of actual expenditures, and implementation are preserved and can be raised in other dockets.

5. **STIPULATED ISSUES:**

None.

6. **PENDING MOTIONS:**

None.

7. **STATEMENT OF PARTY'S PENDING REQUESTS OR CLAIMS FOR CONFIDENTIALITY:**

Citizens have no pending requests for claims for confidentiality.

8. **OBJECTIONS TO QUALIFICATIONS OF WITNESSES AS AN EXPERT:**

Citizens do not expect to challenge the qualifications of any witness who has submitted direct testimony. Rebuttal testimony has not yet been filed.

9. **STATEMENT OF COMPLIANCE WITH ORDER ESTABLISHING PROCEDURE:**

There are no requirements of the Order Establishing Procedure with which the Office of Public Counsel cannot comply.

Dated this 9<sup>th</sup> day of July, 2007.

Charles J. Beck  
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s/ Joseph A. McGlothlin  
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**DOCKET NO. 070052-EI**  
**CERTIFICATE OF SERVICE**

**I, HEREBY CERTIFY** that a true and correct copy of the **PREHEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL** has been furnished by electronic mail and U.S. Mail on this 9<sup>th</sup> day of June, 2007, to the following:

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