State of Florida

Public Service Commission

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

DATE: October 1, 2007

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Lester, Ballinger, Draper, Kyle, Maurey, McNulty, Slemkewicz, Springer)
Office of the General Counsel (Bennett, Young)

RE: Docket No. 070052-EI – Petition by Progress Energy Florida, Inc. to recover costs of Crystal River Unit 3 Uprate through fuel clause.

AGENDA: 10/09/07 – Regular Agenda – Posthearing Decision – Participation is Limited to Commissioners and Staff

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Carter

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070052\070052.RCM.DOC

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Case Background

The Commission granted Progress Energy Florida, Inc.'s (PEF's) petition for determination of need for expansion of PEF's nuclear power plant located at the Crystal River Unit 3 (CR3) in Docket No. 060642-EI, by Order No. PSC-07-0119-FOF-EI, issued February 8, 2007. In its petition for determination of need, PEF requested that the Commission grant PEF recovery of the costs associated with the proposed expansion through the fuel and purchased power cost recovery clause (the fuel clause). By Order No. PSC-06-1059-PCO-EI, the Commission bifurcated the original petition, and this docket was opened to address the appropriate method of cost recovery. AARP, FRF, FIPUG, White Springs, and OPC were granted intervention in this proceeding.

On September 22, 2006, PEF filed testimony seeking fuel clause recovery of all three phases of its nuclear power plant expansion. PEF stated that the three phases will be implemented over the next four years, and the estimated cost was $381.8 million. The first phase involves a series of engineering analyses resulting in modifications to plant instrumentation. This first phase is termed by PEF as Measurement Uncertainty Recapture (MUR). Phase 1 is expected to achieve an uprate of 12MW and will be completed in 2007. The second phase involves a turbine and electrical generator replacement and will be completed in 2009, with an expected uprate of 28MW. The third phase will include improvement to the reactor core to allow PEF to utilize enriched uranium. Phase 3 will also include upgrades to its transmission system and to its point of discharge cooling system. Phase 3 has an expected uprate of 140 MW.

A hearing was held in this docket on August 7 and 8, 2007, on PEF's requested method of cost recovery and related matters at which time testimony was taken and exhibits were entered into the record. Briefs were filed by parties on August 28, 2007.

This recommendation addresses the issues that were the subject of the August hearing. The Commission has jurisdiction pursuant to Sections 366.04, 366.041, 366.05, and 366.06 Florida Statutes.

Executive Summary

The CR3 Uprate Project will increase the capacity of PEF's CR3 nuclear unit by 180 MW, from 900 MW to 1,080 MW. The uprate will make CR3 the largest single generating unit in the state. PEF plans to accomplish the project in three phases, set forth in the table below:

<table>
<tr><th colspan="5">THE CR3 UPRATE PROJECT</th></tr>
<tr><th></th><th>Description</th><th>Estimated Cost</th><th>Megawatt Gain</th><th>In-Service Date</th></tr>
<tr><td>Phase 1</td><td>Measurement Uncertainty Recapture (MUR) – instrumentation modifications for improved accuracy.</td><td>$6 million</td><td>12 MW</td><td>End of 2007</td></tr>
<tr><td>Phase 2</td><td>Balance of Plant – turbine and electrical generator replacement</td><td>$150 million</td><td>28 MW</td><td>End of 2009</td></tr>
<tr><td>Phase 3 -1</td><td>Reactor Core/Fuel -</td><td>$94 million</td><td rowspan="4">140 MW</td><td rowspan="4">End of 2011</td></tr>
<tr><td>Phase 3 -2</td><td>Transmission – upgrades to transmission system due to CR3 becoming the state's largest generating unit.</td><td>$89 million</td></tr>
<tr><td>Phase 3 -3</td><td>Point of Discharge (POD) – additional cooling for additional capacity.</td><td>$43 million</td></tr>
<tr><td>Phase 3 -4</td><td>Other</td><td></td></tr>
<tr><td colspan="2">TOTAL</td><td>$382 million</td><td>180 MW</td><td></td></tr>
</table>

PEF estimates the project will cost $381.8 million. Citing an exception to base rate recovery found in Order No. 14546, PEF seeks cost recovery of the uprate – return on investment, depreciation, and taxes - through the fuel clause.

OPC, AARP, and FRF oppose cost recovery through the fuel or capacity clause. However, if the Commission allows recovery through the fuel clause, OPC, AARP, and FRF recommend that the recovery period should be the useful lives of the improvements, expected to last through 2036, and the return on investment should be no greater than the cost of debt. FIPUG and White Springs also oppose clause recovery. However, if the Commission allows clause recovery, FIPUG and White Springs recommend that the recovery period should be based on useful lives of the assets. FIPUG recommends that the capacity clause is the appropriate clause if the Commission grants clause recovery. FIPUG recommends a return no greater than

the return on U.S. Treasury notes, and White Springs recommends a return no greater than the cost of debt.

Staff is presenting Primary and Alternative recommendations for Issue 1, with the specific difference being whether or not to include the costs of MUR in base rates or the fuel clause. Primary staff recommends that the measurement uncertainty recapture costs be recovered through the fuel clause because customers will receive immediate benefit from MUR and its cost is in line with other capital projects recovered through the fuel clause pursuant to Order No. 14546. PEF will have time to evaluate whether to file a base rate proceeding to recover the costs of Phases 2 and 3.

Alternative staff, however, recommends recovery of all phases through base rates because PEF has time to evaluate whether to seek cost recovery of most of the uprate costs through a base rate proceeding. Phase 1 costs are small and would not significantly impact PEF's earnings. Thus, alternative staff recommends the Commission deny PEF fuel clause recovery for all phases of the project, but primary staff recommends fuel clause recovery limited to Phase 1 costs (Issue 1A). Alternative staff does not believe Order No. 14546 is binding – the order clearly states case by case review. Alternative staff notes the CR3 Uprate Project costs are not volatile or fossil fuel-related. Therefore, alternative staff believes the uprate costs should be recovered in base rates.

If the Commission denies PEF's request for clause recovery in Issue 1, Issue 2 through 7 are moot. Issue 2 addresses which clause, fuel or capacity, is appropriate for the CR3 Uprate Project costs. Issue 3 addresses the appropriate cost recovery (depreciation and amortization) period. Issue 4 addresses ratemaking adjustments and Issue 5 addresses rate of return. Issue 6 addresses jurisdictional separation and Issue 7 addresses reporting requirements.

Issue 1 includes subparts 1A, 1B, 1C1, 1C2, 1C3, and 1C4. Issue 1 is designed to allow the Commission to vote on each subpart of Issue 1. Staff's recommendation and parties' positions follow each subpart. The in-depth staff analysis of Issue 1 is included at the conclusion of the entire issue – page 12- (after subpart IC4) to avoid repetition.

Discussion of Issues

NOTE: Issue 1 has been broken into 6 parts. The issues, recommendations, and parties positions appear on pages 6 through 11. Staff's overall analysis starts on page 12.

Issue 1A: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: Phase 1 of PEF's CR3 Uprate Project?

Recommendation: The Commission should allow the costs of Phase 1 – the MUR costs – to be recovered through the fuel clause. (Lester, Maurey, McNulty)

Alternative Recommendation: The Commission should not allow Phase 1 costs for clause recovery. (Trapp)

Positions of the Parties

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the costs associated with Phase 1, consistent with PEF's position on Issue 3 below, should therefore be granted. Order No. 14546 does not contain an "earnings test" so it is irrelevant whether PEF could absorb these costs in base rates without affecting its rate of return.

OPC: Recovery of the MUR portion of the CR3 Uprate Project is inappropriate through the fuel clause under Item number 10. The MUR project costs are non-volatile, non-fuel related costs which belong in base rates. Further, base rates are designed to absorb increases in investment costs between base rate proceedings. The MUR would have only a de minimus impact on PEF's earnings.

AARP: No. AARP adopts the position of the Office of Public counsel on this issue.

FIPUG: No. The Commission has allowed utilities to avoid base rate cases when relatively small non fuel base rate expenditures are rapidly off set by fuel savings. That criterion doesn't apply to PEF's MUR obsolete instrumentation replacement. There is no base rate case to avoid. In 2005 after good faith negotiations in which consumers agreed to allow an automatic base rate increase in 2008 for Hines #2 & #4, PEF promised that it wouldn't file another base rate case for 4 years. This request to collect for a non fuel base rate expenditure through the fuel clause breaches PEF's promise.

WHITE SPRINGS: No. The measurement uncertainty recapture ("MUR") replacement of obsolete and inaccurate instrumentation has become a commonplace nuclear plant upgrade over the past decade. PEF's revised plan to perform the MUR upgrade in 2007, rather than 2009 as originally filed, does not change the fact that this is a base rate expenditure that should be subsumed among the on-going capital investments in its system that the Commission expected PEF to make as part of the 2005 rate stipulation, and no special allowance is warranted for fuel cost recovery.

FRF: No. Recovery of Phase 1 portion of the CR3 Uprate Project is inappropriate through the fuel clause because these costs are non-volatile, non-fuel related costs that belong in base rates.

Issue 1B: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: Phase 2 of PEF's CR3 Uprate Project

Recommendation: The Commission should not allow clause recovery for Phase 2 costs. Because of the magnitude of the investment and because of the time the plant expansion is expected to go into commercial service, this request is more appropriately considered in a base rate proceeding. (Lester, Maurey, McNulty)

Positions of the Parties

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the costs associated with Phase 2, consistent with PEF's position to Issue 3 below, should therefore be granted. Order No. 14546 does not contain an "earnings test" so it is irrelevant whether PEF could absorb these costs in base rates without affecting its rate of return.

OPC: Recovery of the Phase 2 of the CR3 Uprate Project is inappropriate through the fuel clause under Item number 10. The Phase 2 project consists of generation plant costs which belong in base rates. PEF has the opportunity to seek an increase in base rates if one is needed. Granting PEF's request would expose customers to double recovery of uprate costs.

AARP: No. AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: No. In 2005 PEF said it needed to build Hines 5 & 6 for reliability to meet sales growth. Today it predicts even greater sales growth, but has cancelled the Hines 5 & 6. It partially replaces these units with over 500 MW of new purchased power and the CR#3 uprate. Under its present plan it seeks guaranteed cost recovery rate increases to pay for these investments in capacity while it retains the increased base revenue from sales growth. PEF's seeks to shift investment risk from its holding company to Florida customers.

WHITE SPRINGS: No. PEF's 2005 and 2006 resource plans called for additional natural gas and coal –fired generation to be built to meet expected sales growth. The utility's current TYSP effectively replaces the planned coal unit with the CR3 Uprate and additional power purchases. As the CR3 Uprate represents a planned baseload capacity addition, it should be treated for rate purposes like similar base load generation additions (as rate base additions in its next base rate case). Guaranteed cost recovery of the capital costs and return on the uprate investment rate is unwarranted, is inconsistent with the 2005 base rate stipulation, and is not contemplated by the limited exception created in Order No. 14546.

FRF: No. Recovery of the Phase 2 costs of the CR3 Uprate Project is inappropriate through the fuel clause because these costs are generation plant costs that belong in base rates.

Issue 1C1: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: Phase 3 of PEF's CR3 Uprate Project, including: Nuclear Core Modifications, Secondary Systems, and Other Project-related Plant Additions/Modifications ?

Recommendation: The Commission should not allow Phase 3 costs for clause recovery. Because of the magnitude of the investment and because of the time the plant expansion is expected to go into commercial service, this request is more appropriately considered in a base rate proceeding. (Lester, Maurey, McNulty)

Positions of the Parties

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the Nuclear Core Modifications, Secondary Systems, and Other Project-related Plant Additions/Modifications costs, consistent with PEF's position to Issue 3 below, should be granted. The Commission did not limit the types of costs that could be recovered pursuant to Order No. 14546, as long as the straightforward test was met.

OPC: Recovery of the Phase 3 of the CR3 Uprate Project is inappropriate through the fuel clause under Item number 10. The Phase 3 project costs generation plant costs which belong in base rates. PEF has the opportunity to seek an increase in base rates if one is needed. Granting PEF's request would expose customers to double recovery of uprate costs.

AARP: No. AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: No. CR#3 is 30 years old. The investment in the nuclear plant has been fully returned to the utility through a depreciation charge included in base rates. Customers are still paying that charge plus a return on the investment in CR#3 and taxes on that return. In 2006 the cash flow from base revenues provided sufficient cash flow to pay a dividend to the holding company, all taxes, operating expenses and 116% of the costs of current construction. Whether PEF needs a rate increase to pay for these uprate modifications or whether the increase is to enhance profit remains unanswered.

WHITE SPRINGS: No for the reasons stated with respect to the Phase 2 investment. Further, piece-meal rate decisions on major modifications or upgrades to CR3 should be avoided. PEF is free to file for a change in base rates to accommodate the Phase 3 uprate investments before the new investments are slated to enter commercial operation.

FRF: No. Recovery of the Phase 3 costs of the CR3 Uprate Project is inappropriate through the fuel clause because these costs are generation plant costs that belong in base rates.

Issue 1C2: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: The "point of discharge" cooling solution?

Recommendation: The Commission should not allow PEF to recover the point of discharge costs through a recovery clause. Because of the magnitude of the investment and because of the time the plant expansion is expected to go into commercial service, this request is more appropriately considered in a base rate proceeding. (Lester, Maurey, McNulty)

Positions of the Parties

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the "point of discharge" cooling solution costs, consistent with PEF's position to Issue 3 below, should be granted. In addition, the cooling solution changes must be made as a direct result of the increased MW output of CR3.

OPC: Since the "point of discharge" solution is necessitated by the Phase 3 increases in generation and Phase 3 is inappropriate for fuel clause recovery, the POD should not be through the fuel clause under Item number 10.

AARP: No. AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: No. OPC points out that these future costs are estimated to be large. They are uncertain; they are not volatile; they are not fuel-related; they are neither new nor innovative. The additional capacity to be provided by the cooling tower improvement is needed by PEF to meet its projected peak demands and to maintain the required reserve margins. The expenditures do not meet the essential requirements of Order No. 14546. There is no rational reason to lock in entitlement to guaranteed cost recovery before the plans are complete, the money has been invested and prudency determined.

WHITE SPRINGS: No. PEF estimates that its POD investment will be large ($43 million) but it offered no actual analysis or studies of the issue, discussions with the DEP or other credible assessments to justify its request that such costs be recovered through the fuel clause. The utility bears the burden of proving the proposed investments are necessary, reasonable and prudent. PEF, however, provides only an assumed proxy that does not satisfy its burden of proof. At a minimum, the Commission should withhold any decision on rate recovery for the proposed POD investment until PEF provides specific plans, DEP permit authorization and a Board approved capital budget.

FRF: No. Recovery of the "point of discharge" costs is inappropriate and should be rejected because these costs are associated with the Phase 3 increases in generation, which are themselves inappropriate for fuel clause recovery.

Issue 1C3: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: Transmission upgrades associated with the CR3 Uprate Project?

Recommendation: The Commission should not allow PEF to recover the transmission upgrades costs through a recovery clause. Because of the magnitude of the investment and because of the time the plant expansion is expected to go into commercial service, this request is more appropriately considered in a base rate proceeding. (Lester, Maurey, McNulty)

Positions of the Parties

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the transmission upgrades, consistent with PEF's position to Issue 3, should be granted. The Commission did not limit the types of costs that could be recovered pursuant to Order No. 14546. Also, the transmission upgrades must be made as a direct result of the increased MW output of CR3.

OPC: Since the transmission upgrades associated with the CR3 project are due to safety and reliability issues and are not associated with any fuel saving, recovery is inappropriate through the fuel clause under Item number 10.

AARP: No. AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: No. The Commission Staff review of 2006 ten year site plans filed under the requirements of §186.801 *Florida Statutes* and Commission Rule 25-22.07 found problems with the North Florida transmission line near the Georgia boundary where PEF imports power under its purchased power contracts. This case proposes to spend $83 million to upgrade that particular line on the grounds that if CR#3 has a forced outage other utilities must fill the power gap. The line is 100 miles north of CR#3. This non fuel cost expenditure is unnecessary. Demand side management cures the perceived problem at no cost to PEF.

WHITE SPRINGS: No. Any transmission upgrade changes power flows and many system variables must be considered. PEF's transmission proposal has not been developed yet. The Commission should require a complete review of PEF's transmission investments as part of its TSYP review and consider rate recovery of such added investments in base rate cases. PEF's unsubstantiated assumption that a $83 million upgrade to a transmission line located 100 miles north of CR3 for Florida reliability purposes does not qualify for fuel clause recovery.

FRF: No. The costs of transmission upgrades associated with the CR3 Uprate Project are due to safety and reliability issues and are not associated with any fuel saving, and therefore, recovery of those costs is inappropriate through the fuel clause.

<u>Issue 1C4</u>: Should the Commission authorize clause recovery of the prudent and reasonable costs of the following: Other costs associated with Phase 3 of the CR3 Uprate Project?

<u>Recommendation</u>: The Commission should not allow PEF to recover other costs associated with Phase 3 of the CR3 Uprate Project through a recovery clause. Because of the magnitude of the investment and because of the time the plant expansion is expected to go into commercial service, this request is more appropriately considered in a base rate proceeding. (Lester, Maurey, McNulty)

<u>Positions of the Parties</u>

PEF: Yes, the CR3 Uprate costs (1) are not recognized or anticipated in the cost levels used to determine PEF's current base rates and (2) the costs generate fuel savings for customers. Thus the project satisfies the requirements of Order No. 14546. Recovery through the fuel clause for all the CR3 Uprate costs, including the other costs for Phase 3, consistent with PEF's position to Issue 3 below, should be granted. The Commission did not limit the types of costs that could be recovered pursuant to Order No. 14546, as long as the straightforward test was met.

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

AARP: No. AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: No all of these costs are typical base rate charges.

WHITE SPRINGS: No. All of these uprate costs are typical base rate charges and should be recovered through the base rate process.

FRF: No. PEF has failed to justify recovery of any portion of the costs of Phase 3 of the CR3 Uprate Project in the fuel clause.

<u>Overall Staff Analysis for Issue 1</u>:

<u>INTRODUCTION</u>

The CR3 Uprate Project is possible due to technological advances and reactor core modifications that would allow for more highly enriched fuel. (TR 36, 42) PEF plans to accomplish the uprate in three phases. The uprate will increase MW capacity at CR3 by 180 MW.

Phase 1 involves MUR, which is modifying instrumentation to improve accuracy in measuring the secondary heat balance, thereby allowing an increase in rated thermal power. The MUR phase will increase power capacity by 12 MW and will cost approximately $6 million. (TR 35, 46, 65, 86) PEF expects MUR to be approved by the NRC and implemented during the planned October 2007 refueling outage. (TR 67)

Phase 2 involves turbine and electrical generator replacement, will increase capacity by 28 MW, and will cost approximately $150 million. PEF plans to accomplish this phase during the planned 2009 refueling outage. (TR 47, 71)

PEF plans to accomplish Phase 3 during the planned 2011 refueling outage. This is the extended power uprate phase and will provide the remaining megawatts of capacity to reach the full 180 MW for the uprate. CR3's current capacity is approximately 900 MW. After the uprate, the capacity will be approximately 1,080 MW, making CR3 the largest single generating unit in Florida. (TR 41, 43-44, 47, 56) The uprate project is based on the assumption that the NRC will grant CR3 license extension, from 2016 to 2036. (TR 44)

PEF estimates the cost of the uprate to be $381.8 million. Approximately $250 million is for the uprate itself, $89 million for transmission system upgrades, and $43 million for Point of Discharge (POD) to address cooling issues. (TR 41; 227) PEF has begun ordering equipment and materials and incurred costs for the uprate in 2006. (TR 48; 229)

PEF witness Waters testifies that the CR3 Uprate Project will produce fuel savings in excess of $2.6 billion in nominal terms over the remaining life of CR3. (TR 138–139) The Company expects these fuel savings to provide net present value savings in excess of project costs of approximately $320 million to PEF's retail customers. (Waters TR 143; Portuondo 230) PEF witness Portuondo testifies that the costs of the CR3 Uprate Project meet the criteria under the item number 10 exception of Order No. 14546 for recovery through the fuel clause, and approval of the Company's petition in the instant case would be consistent with past Commission orders approving similar requests. (TR 240–241, 559) For these reasons, PEF requests that the Commission determine the costs of the CR3 Uprate Project are appropriate for recovery through the fuel clause. (TR 559)

PEF proposes to recover all uprate costs through the fuel clause to the extent costs do not exceed cumulative savings. PEF proposes to begin recovering Phase 1 costs in 2008 and plans to submit these costs in the upcoming fuel hearings – Docket No. 070001-EI. (TR 230-231). PEF argues that item number 10 of Order No. 14546 and several subsequent Commission orders are precedent to Commission approval of PEF's petition for cost recovery of the nuclear power plant

expansion through the fuel clause. PEF seeks to recover the cost of the CR3 Uprate Project through the fuel clause based on the application of item number 10 of Order No. 14546. (TR 227)

OPC, AARP, FIPUG, White Springs, and FRF (intervenors) intervened in this docket. While the intervenors support PEF's construction of a cost effective nuclear plant uprate, each has filed a brief in this proceeding opposing Commission approval of PEF's proposed method of recovery of the costs of all phases of the project. (OPC BR at 7–9, AARP BR at 1–3, FIPUG BR at 21, White Springs BR at 8–9, FRF BR at 1) The intervenors believe the uprate costs are base rate items and, as such, the Commission should not allow PEF to recover the costs through the fuel clause.

For Issue 1 and all its parts, staff analyzed each of the arguments for and against clause recovery for the CR3 Uprate Project. Following this analysis, staff presents primary and alternative recommendations.

ORDER NO. 14546 AND SUBSEQUENT COMMISSION ORDERS AS PRECEDENT

Central to the controversy in this docket is the correct interpretation of Order No. 14546 as it applies to PEF's petition. To fully understand the Commission's intent to include certain base rate costs in the fuel clause, Order No. 14546 must be read as a whole, and accordingly is appended as Attachment 1. Staff will highlight below relevant portions of Order No. 14546 in its discussion of the intent of the order as applied to the current request by PEF.

In 1985, the Commission instructed parties and staff to "provide information necessary for the Commission to be able to consider at the August 1985 fuel adjustment hearing whether the utilities were passing appropriate fixed and variable costs associated with fuel receipts through their fuel adjustment clauses."[1] Order No. 14546 was the result of a stipulation between OPC, FPL, TECO, Gulf, and FPC (predecessor to PEF) after a workshop exploring the issue. This policy consisted of two essential points which address the Commission's application of the fuel adjustment clauses:

> 1. When similar circumstances exist, the Commission should attempt to treat, for cost recovery purposes, specific types of fossil fuel-related expenses in a uniform manner among the various electric utilities. At times, however, it may be appropriate to treat similar types of expenses in dissimilar ways.
>
> 2. Prudently incurred fossil fuel-related expenses which are subject to volatile changes should be recovered through an electric utility's fuel adjustment clause. The volatility of fossil fuel-related costs may be due to a number of factors including, but not necessarily limited to: price, quantity, number of deliveries, and distance. Except as noted below, these volatile fossil fuel-related charges are incurred by the utility for goods obtained or services provided prior to the delivery of fuel to the electric utility's dedicated storage facilities. (Dedicated storage facilities mean storage facilities which are used solely to serve the

[1] Order No. 14546, p. 1

> affected electric utility.) All other fossil fuel-related costs should be recovered through base rates.[2]

The Commission then discussed the parties' specific applications of the Commission articulated policy. For instance, the parties discussed "invoiced fuel charges." The invoiced fuel charges should include all price revisions and adjustments relating to volume and quality of fuel. After discussing several specific applications of the policy, the parties then agreed that the Commission policy on fuel clause recovery should be flexible enough to cover some items that would normally go through base rates. This fuel clause exception to base rate recovery was discussed as follows:

> In addition to stipulating to the foregoing applications of policy, the parties also recommended to the Commission that the policy it adopts be flexible enough to allow for recovery through fuel adjustment clauses of expenses normally recovered through base rates when utilities are in a position to take advantage of a cost-effective transaction, the costs of which were not recognized or anticipated in the level of costs used to establish the utility's base rates. One example raised was the cost of an unanticipated short-term lease of a terminal to allow a utility to receive a shipment of low cost oil. The parties suggest that this flexibility is appropriate to encourage utilities to take advantage of short-term opportunities not reasonably anticipated or projected for base rate recovery. In these instances, we will require that the affected utility shall bring the matter before the Commission at the first available fuel adjustment hearing and request cost recovery through the fuel adjustment clause on a case by case basis. The Commission shall rule on the appropriate method of cost recovery based upon the merits of each individual case.[3]

The Commission, in its findings in Order No. 14546, approved the stipulation of the parties and adopted them as its own. The stipulated provisions (including the fuel clause exception to base rate recovery), were found by the Commission to be an appropriate extension of the policy established by Order No. 6357.[4] As a result of the policy determinations, the

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[2] Order No. 14546, p. 2

[3] Order No. 14546, p. 3

[4] In Order No. 6357, the Commission discussed the purpose of the fuel adjustment clause as follows: "A fuel adjustment clause is intended to compensate for day-to-day fluctuations in the cost of fuel which cannot be anticipated in the base rates. It should be constructed and applied so as to reimburse the utility for the increase in the cost of fuel as related to generation. It also operates so as to pass on to the customer any savings realized by the utility from decreased cost of fuel. (Order No. 2515-A, dated April 24, 1959). . . It should be emphasized that a utility does not make a profit on its fuel costs. . . . The charge reflected on a customer's bill each month is designed only to provide for the recovery of fuel costs experienced by the utility in generating the customer's power. Conversely, it can and has resulted in a credit to the customer's bill when the price falls below the base cost of fuel. While some may question the propriety of allowing fuel costs to be recovered through an automatic adjustment clause, recent events underscore the basic reasons why such is done for this particular cost item as opposed to others. First, electric utilities rely largely upon fossil fuels to generate power; only Florida Power and Light Company now has a nuclear unit on the line and in service. Thus, their dependency on purchasing large quantities of fossil fuels will continue to exist for many years. Presently, fuel costs represent a substantial portion of operating costs; in some instances, fuel costs alone comprise more than half of a company's total operating costs. Any fluctuation, then, in fuel costs will have a significant impact on a company's earnings and can work to the detriment of the ratepayer or

Commission made two lists. One list included charges properly considered in the computation of the average inventory price of fuel. The other list contained items that were more appropriately considered in the determination of base rates. It should be noted that each item on either list was a shortened reference to the detailed description of the types of costs the Commission discussed earlier in the order.[5]

PEF argues that number 10 on the list[6] is the Commission's policy regarding the fuel clause exception to base rate cost recovery. (PEF BR at 1-3, 4, 13-16) Staff does not agree that number 10 on the list constitutes the entirety of the Commission's policy on the exception. PEF argues that the CR3 project falls squarely within the parameters of a "two part test" that it argues was established by item number 10 of Order No. 14546. PEF concludes that if it meets those two prongs of the test it identified, then the Commission should approve the project. (PEF BR at 5) PEF argues that any other facts considered by the Commission impermissibly "adds" to this two prong test and is an impermissible expansion of the Commission's generic policy established by Order No. 14546. (PEF BR at 2-3) According to PEF, if the project meets these two prongs, all that is left for the Commission to do is review the project's costs on a case by case basis. (PEF BR at 14-15)

OPC witness Merchant testifies that Order No. 14546 was designed to address a situation in which a utility that initiated a cost-saving measure would have no ability to have the costs of the activity reflected in base rates in a timely manner. (TR 399) OPC witness Lawton testifies that most of the uprate costs could be recovered in base rates, that the costs are not the type of volatile fossil fuel costs contemplated by Order No. 14546, and that some of the costs are not associated with fuel savings. (TR 455-456) Witness Lawton testifies that Order No. 14546 clearly states that requests such as PEF's will be reviewed on a case-by-case basis. (TR 457)

PEF witness Portuondo disagrees with witnesses Merchant and Lawton regarding the appropriate interpretation of Order No. 14546 in general and item number 10 in particular. Witness Portuondo testifies that Order No. 14546 "is a policy of general applicability, which has the force of a rule, because it applies prospectively to all utilities." (TR 567–568) As a "policy of general applicability," he contends, the Commission should apply item number 10 of Order No. 14546 uniformly and consistently to all utilities. (TR 568) In addition, witness Portuondo testifies that the reference to the recovery of costs under item number 10 of Order No. 14546 on

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the utility depending on the direction of the movement unless some means exists to recoup those increased costs or refund those savings as quickly as possible. Rate cases are time consuming and expensive, and do not lend themselves to these objectives. Second, fuel costs are a highly volatile cost item unlike other costs of the utilities, such as wages and maintenance. When the volatility factor is coupled with the magnitude of fuel costs, one can readily conclude that the fuel adjustment clause is both a necessary and proper regulatory tool to insure that both the customer and the utility receive the benefits of responsive recognition to changes in the cost of generating electricity. We do not have the slightest doubt that a type of recovery clause should be retained by the utilities in order to accomplish this goal." Order No. 6357, issued November 26, 1974, in Docket No. 74680-CI, <u>In re: General investigation of fuel adjustment clauses of electric companies</u>.

[5] For instance, the discussion of invoiced fuel charges appears on the approved fuel clause recovery lists as items 1, 2 and 3. The fuel clause exception appears on the list as item number 10.

[6] "10. Fossil fuel-related costs normally recovered through base rates but which were not recognized or anticipated in the cost levels used to determine current base rates and which, if expended, will result in fuel savings to customers. Recovery of such costs should be made on a case by case basis after Commission approval." Order No. 14546 p. 4.

a "case-by-case" basis does not mean what the intervenor witnesses say it means. (TR 568) Rather than convey the discretion the Commission reserved for itself to review company proposals submitted for recovery through the fuel clause under item number 10, witness Portuondo testifies the term "case-by-case" was included in item number 10 to differentiate the costs under item number 10 from the costs under items 1 through 9 of Order No. 14546. Pursuant to PEF's construction, the term "case-by-case" limits the Commission to determining whether the two prerequisite conditions it argues are listed in item number 10, have been met. (TR 569)

Staff disagrees with PEF's interpretation of Order 14546. The meaning of the order cannot be discerned from simply looking to number 10 on a list contained in the order. As noted above, the entirety of the order should be viewed to garner the intent of the Commission in promulgating the order. Staff agrees with PEF that the costs associated with the proposed CR3 Uprate Project were not anticipated and included in current base rates and, if completed, the project would generate fuel savings for customers. (TR 227) However, given the express language above, staff does not agree with PEF's narrow interpretation of the term "case-by-case" with respect to item number 10 on the list contained in Order No. 14546. (TR 568–569) Witness Portuondo acknowledges that number 10 is an exception to the general rule for recovery of certain costs not normally eligible for recovery through the fuel clause. (TR 561) By definition, before an exception to a general practice can be granted a decision maker must engage in some form of review to determine if the requested exception is warranted. (TR 500, 504–506) It is staff's opinion that the unambiguous meaning of the passage on page 3 of Order No. 14546 quoted above demonstrates that the Commission intended to review such special requests under item number 10 on a "case-by-case" basis and that the Commission reserved the right to rule on the appropriate method of cost recovery based upon "the merits of each individual case."[7]

In its brief and testimony, PEF relied on prior Commission Order No. PSC-96-1172-FOF-EI as precedent for PEF's request.[8] In Order No. PSC-96-1172-FOF-EI, the Commission approved Florida Power & Light Company's (FPL) request to recover the costs of its uprate project at Turkey Point Units 3 and 4 (TP 3&4) through the fuel clause. FPL's uprate resulted in a 31 MW increase in nuclear capacity at each unit at a total cost of approximately $10 million. (TR 240-241) Per Order No. PSC-96-1172-FOF-EI, FPL was permitted to recover the cost of its uprate project through the fuel clause over a two year period and was allowed to earn a return on average investment at its then current weighted average cost of capital. (TR 573) Based on this precedent, witness Portuondo contends that PEF is requesting treatment for its uprate project costs consistent with how other project costs were treated by the Commission under the item number 10 exception of Order No. 14546. (TR 574)

OPC witness Merchant acknowledges the Commission has allowed some non-fuel related costs to be recovered through the fuel clause on a case-by-case basis, including the FPL TP 3&4 uprate project. (TR 404–405) However, she notes two distinctions between the FPL uprate and PEF's uprate in the instant docket. First, she contends the investment in the FPL uprate was "de

[7] Order No. 14546, p.3.
[8] Order No. PSC-96-1172-FOF-EI, issued September 19, 1996, in Docket No. 960001-EI, In re: Fuel and Purchased Power Cost Recovery Clause and Generating Performance Incentive Factor, p. 9.

minimus" relative to FPL's total fuel expense. (TR 430–431) The second distinction she draws is that FPL customers saw lower bills immediately. Witness Merchant notes that PEF's customers will not see meaningful savings for at least eight years after the completion of the first phase. (TR 404–405)

OPC witness Lawton also agrees the Commission has allowed certain base rate costs to be recovered through the fuel clause. However, he disagrees with the Company's position that the Commission must approve PEF's request in the instant docket because of its decision regarding the FPL TP 3&4 request. (TR 468) He testifies that the facts and circumstances of PEF's request do not fit the item number 10 exception of Order No. 14546. (TR 488) Moreover, because of the case-by-case standard set forth in Order No. 14546, witness Lawton contends item number 10 affords companies an exception for recovery of certain costs not normally eligible for recovery through the fuel clause, not a blanket acceptance of any project with fuel savings for recovery through the fuel clause. (TR 468)

In response to OPC witness Merchant, PEF witness Portuondo testifies there is no requirement in item number 10 under Order No. 14546 that fuel savings must outweigh the costs by a certain percentage or by some nominal amount. (TR 580) He states the only requirement is that projected fuel savings exceed the costs. In response to witness Lawton, witness Portuondo testifies Order No. 14546 imposes no ceiling on the amount of project costs that may be passed through the fuel clause. (TR 581) Again, he states that the only requirement is that the projected fuel savings exceed the costs. Witness Portuondo also disagrees with both witnesses Merchant and Lawton that PEF customers will not receive savings until 2016. (TR 403, 487) He testifies PEF customers will receive fuel savings beginning in year one and continuing for every year throughout the projected 20-year period. (TR 581)

Staff does not agree with PEF that the Commission is necessarily bound by its approval of previous applications for recovery under Order No. 14546. (TR 415, 468) As noted in the passage on page 2 of Order No. 14546 quoted above, while it is preferable to treat recovery of similar costs in a uniform manner, there may be circumstances where it is appropriate to treat similar types of expenses in dissimilar ways. (TR 422) If it is permissible to treat recovery of similar types of expenses differently, then it is certainly permissible to treat dissimilar expenses differently. (TR 430–431) PEF witness Roderick testifies that not all uprates are the same. (TR 54–55; EXH 17) Witness Portuondo acknowledges that at least one other nuclear plant uprate performed in Florida has been recovered through base rates. (TR 596–597) Witness Merchant testifies that at least one other application for cost recovery under the fuel clause exception to base rate recovery found in Order No. 14546 has been denied.[9] (TR 435) For all of these reasons, staff believes the Commission's decision must be based on the evidence in the record in this docket, not on the decisions in other cases where the facts of the case were different. The facts of PEF's request should dictate the results.

Moreover, staff believes there are sufficient differences between prior Order No. 14546 exception requests and PEF's current request to support ruling on the merits in this record and still be consistent with past precedent. For instance, the facts of the Turkey Point Uprate

[9] Order No. PSC-05-1252-FOF-EI, issued December 23, 2005, in Docket No. 050001-EI, In Re: Fuel and Purchased Power Recovery Clause with Generating Performance Incentive Factor.

decision can be distinguished from PEF's request. In the Turkey Point Uprate Order, the Commission allowed FPL to recover costs of the uprate through the fuel clause because the costs were not included in base rates and because the uprate generated fuel savings. PEF witness Portuondo states the only difference between the Turkey Point Uprate and the matter at hand is the magnitude of the costs and savings. (TR 241) The record shows there is a substantial difference in the costs and savings between the two cases, and staff believes this substantial difference makes the cases distinguishable. As OPC witnesses Merchant and Lawton testifies, the FPL uprate was small - $10 million – as compared to the CR3 Uprate Project costs of $381.2 million. Both witnesses Merchant and Lawton note that the FPL uprate created net savings immediately. (Merchant TR 404, 423, 430-431; Lawton TR 468; 511-512) PEF's customers will not see any reduction in the fuel factor until after the costs of the project have been fully recovered. (TR 324, 404-405, 477) As discussed in more detail below, PEF's request is not a short-term opportunity. Rather, there is opportunity for PEF to seek a base rate case, if appropriate.

A comprehensive review[10] of the Commission's orders applying the base rate exception found in Order No. 14546 exemplifies the Commission's application of this case-by-case review. Of the sixteen dockets referencing the exception found in Order No. 14546, eight were presented to the Commission as a stipulation for approval. One request was denied. The highest dollar amount approved by the Commission was $72 million for the proposed conversion of FPL's Manatee Units to burn orimulsion. In that order, the Commission required depreciation over the used and useful life of the plant and required customer bills to reflect a true decrease for savings.[11] In 2001, the Commission allowed incremental security costs (a base rate item) to be recovered through the fuel clause exception to base rate recovery because of "recent national security concerns."[12] The Commission's reasoning in the 2001 Order makes it clear that each request must be considered on its own merits and the Commission must decide on a case-by-case basis whether recovery should be through base rates or through the fuel clause. (See Attachment 1.)

CR3 UPRATE COST RECOVERY IN A BASE RATE PROCEEDING

Not only are there substantial differences between the magnitude of the costs and savings for PEF's request and prior approved exceptions, but the timing of the request is substantially different. OPC witnesses Merchant and Lawton state that the uprate costs are base rate costs that can be recovered in a rate case. They note that Phases 2 and 3 will enter service at the end of 2009 and 2011, respectively, and that PEF's current rate settlement agreement expires at the end of 2009. Witnesses Merchant and Lawton also note that Phase 1 costs are small. They believe PEF can absorb the Phase 1 MUR costs without having a significant impact on earnings. (TR 400, 411-412; TR 455-456, 468-469) Witness Merchant also notes that utilities that have entered

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[10] See Attachment 2 for a comprehensive list of orders referencing the fuel clause exception to base rate recovery permitted by Order No. 14546.

[11] Order No. PSC-94-1106-FOF-EI, issued September 7, 1994, in Docket No. 940391-EI, In re: Petition for approval to recover Orimulsion project costs through an oil-backout cost recovery factor by Florida Power and Light Company, p. 3.

[12] Order No. PSC-01-2516-FOF-EI, issued December 26, 2001, in Docket No. 010001-EI, In re: Fuel and Purchased power cost recovery clause and generating performance incentive factor, p.3.

base rate settlements have an incentive to attempt to recover project costs through clauses. (TR 405-406)

In response, PEF witness Portuondo states intervenors have introduced a new requirement for item number 10 of Order No. 14546. He elaborates as follows:

> The Commission did not require the utility to show that project costs were not recoverable in *future* base rates to obtain recovery of the project costs through the Fuel Clause under Item number 10 of Order No. 14546. Instead the Commission required the utility to demonstrate that the project costs were not recognized or anticipated in *current* base rates. The intent was to protect against possible double recovery not to eliminate regulatory lag.
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> * * *
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> A requirement that a utility demonstrate that project costs cannot be recovered in future base rates, again, defeats the purpose of the Commission policy established in Item number 10 of Order No. 14546. And, again, in more than 20 years of applying its policy under Item number 10 of Order No. 14546, the Commission has never required the utility to show that the project costs cannot be recovered in future base rates to obtain recovery of those costs through the Fuel Clause.

(TR 566)

Witness Portuondo acknowledges that base rate cases can be timed to match increases in costs and assets. He also acknowledges that new power plants and re-powerings should not be recovered through the fuel clause. (TR 260-261)

Staff disagrees with PEF's assertion that the Commission should not consider the timing of a request for recovery. The Commission in Order No. 14546 referred to the timing of a fuel savings opportunity as an aspect to be considered in a request for exception to base rate recovery. In discussing the need for flexibility the Commission agreed that "it was appropriate to encourage utilities to take advantage of short-term opportunities not reasonably anticipated or projected for base rate recovery." Id. 3. It is staff's opinion then, that timing is something the Commission may consider when deciding whether to grant an exception to base rate recovery under Order No. 14546. If a project is planned for commercial service at a point several years in advance, and if the costs of the project are such that a base rate proceeding is not cost prohibitive, then using the recognized regulatory method of base rate recovery is preferred over the use of this exception.

PEF has taken the position that looking at the timing of placing the plant in service is inappropriate because of Order No. 14546. PEF argues that this is an additional requirement to a test that PEF asserts was established in that order. (PEF BR at 18-19) As set forth above, staff disagrees with PEF that there is only a two part test established by Order No. 14546. The order allows the Commission to look at each request for exception to base rate recovery on the merits of the case. In the matter at hand, staff believes the timing of the plant in service is an important point for the Commission to consider. It is staff's opinion that base rate recovery of generating

plants should be the norm and exceptions to base rate recovery should be considered on their individual merits. Staff agrees with OPC witnesses Merchant and Lawton that the purpose of base rates is to give the Commission the ability to review all aspects of a utility's costs to ensure that the utility's rates are fair, just, and reasonable. If the timing and magnitude of capital expenses are such that a thorough review of the project can be conducted, then base rates are the better cost recovery method.

As explained in the proceeding, both base rates and special clauses have their functions. OPC witness Merchant explained:

> Base rates are designed to generate revenues that reflect a variety of costs, are intended to function between revenue requirement cases without changing whereas cost recovery clauses focus on specific costs and design a rate element or rate factor to track changes in those costs outside the revenue requirements environment. (TR 393)

But base rate recovery is, according to OPC, the principal rate recovery mechanism. (TR 391) According to OPC witness Merchant, base rates are rates that are set after an examination of a utility's overall revenue requirement and is done in a setting that allows the Commission to consider the entire operation of the utility. (TR 391) There are special cost recovery clauses designed for certain circumstances and the clauses and base rates are designed to work together to provide for fair, just, and reasonable rates. (TR 391)

OPC argues that allowing an exception to base rate recovery for the CR3 Uprate Project is inconsistent with ratemaking standards. (TR 464) According to OPC witness Lawton, recovery under a fuel adjustment mechanism guarantees the utility 100% of its costs and its authorized return. (TR 465) This recovery mechanism is in opposition to regulatory ratemaking principals that allow a utility the opportunity to earn a fair rate of return. (TR 392; TR 465) According to OPC witness Merchant:

> Another side effect of allowing base rate incremental expenses for capital costs in a clause is that offsetting decreases in expenses might not be disclosed by the utility. So at the very time that a company is requesting recovery of a new expense through the fuel clause, there can easily be expenses that might be decreasing or going away which could substantially offset or eliminate any need of the requested increase in its entirety. This illustrates the danger of reviewing a cost in isolation of the bigger picture. Special cost recovery mechanisms have their places, but are not intended to replace the base rate process, in which the Commission reviews the utility's overall operation. For this reason, the Commission should be ever vigilant for claims that new or unusual costs belong in a cost recovery clause as opposed to base rates. (TR 396)

The vast majority of the project costs will not be recovered until 2009 and later when the project goes into commercial service. (TR 468-469) The stipulation will have expired (see discussion below) and if PEF deems it appropriate, it will have sufficient time to seek base rate recovery of the project costs. Staff believes the facts and

circumstances of the CR3 Uprate Project request do not warrant granting PEF an exception to base rate recovery.

UNCERTAINTY OF COST ESTIMATES

Intervenors argue that significant portions of the CR3 Uprate Project costs are uncertain and, therefore, should not be considered for clause recovery. OPC witness Lawton notes that the cost estimates have not been refined. He further notes that PEF has not identified a preferred solution to the POD issue (regarding additional cooling) so the cost estimates are uncertain. (TR 458, 482-483, 517)

PEF witness Roderick acknowledges that the transmission study for the transmission system upgrade has not been done and that an optimal solution to the POD issue has not been identified. (TR 41, 44, 48-49, 73, 76, 91) He also acknowledges that the cost estimates for the uprate are based on engineering work that has not been completed. (TR 70-76)

Witness Roderick states that the cost estimates are based on accepted engineering and utility industry practice. (TR 57-58) The estimates are for the base case, not the high or low case. (TR 59) Witness Roderick also states the costs of the uprate project are reasonable and prudent because the company will conduct competitive bids and will benchmark costs to power uprates performed at other plants owned by Progress Energy. (TR 50-51)

PEF witness Portuondo agrees that project costs are preliminary but notes that the Commission will have an opportunity to review the actual cost and savings in fuel clause proceedings. (TR 248-249, 266, 275, 286, 314-315, 582) According to witness Portuondo, the cost and savings estimates are based on generally accepted estimating methodology. (TR 582) PEF is not willing to absorb cost overruns or agree to a ceiling for costs. (TR 262, 286)

Staff agrees that, if the Commission allows the uprate costs to be recovered in the fuel clause, the Commission will be able to review the costs in fuel clause proceedings. Further, PEF had to employ cost estimates to make its proposal. However, staff notes that the cost estimates for the transmission upgrade and the POD solution (which will be implemented in 2011) are preliminary and uncertain. While these costs can be reviewed in future fuel proceedings, in this particular case, because PEF has the opportunity to seek base rate recovery, and because the estimates may be firmer for the base rate proceeding, recovery through a base rate proceeding is more appropriate for these project costs. In staff's opinion, the uncertainty of the cost estimates are an additional factor to support the Commission's decision to consider this project in a base rate proceeding.

FUEL COST VOLATILITY

OPC witnesses Merchant and Lawton note that fuel costs are volatile and this is the reason for fuel clauses – the company can recover volatile costs without having to file a rate case. The OPC witnesses further note that the uprate costs are not volatile and should not be recovered through the fuel clause. (Merchant TR 394, 398, 404; Lawton 456, 460) In response, PEF witness Portuondo states that this argument would be a new requirement for Order No. 14546. Item 10 of the order allows recovery of costs "normally recovered through base rates."

Since base rate costs are not volatile, no base rate costs could be recovered through the fuel clause if volatility becomes a requirement for the fuel clause exception to base rate recovery. According to witness Portuondo, the policy the Commission established under Order No. 14546 would be rendered meaningless. (TR 560-561)

Base rate costs generally are not volatile. Staff believes that the fuel clause exception to base rate recovery allows some base rate costs to flow through the fuel clause. The decision to flow a base rate cost through the fuel clause is based on the merits of the individual project. One fact the Commission may consider in determining whether to grant an exception to base rate recovery is whether the project would save customers money by allowing the utility to lower otherwise volatile fossil fuel costs.

CR3 UPRATE IS NOT FOSSIL FUEL-RELATED

PEF witness Portuondo states that Order No. 14546 was not limited only to costs associated with fossil fuel. He notes that the Commission allowed FPL to recover through the fuel clause costs associated with uprates of its Turkey Point nuclear units. According to witness Portuondo, costs that create savings by reducing the use of fossil fuel qualifies for cost recovery through the fuel clause. He further notes that the Commission has allowed incremental security costs at nuclear plants to be passed through the fuel clause. (TR 238, 240-242)

In contrast, witness Merchant states the CR3 Uprate Project costs are not fossil fuel-related. She agrees that the FPL uprate was not fossil fuel-related but notes that Order No. 14546 addresses fuel-related costs whereas the CR3 costs are associated with base load generating plant. She agrees that the savings from the FPL uprate were created by low-cost nuclear fuel replacing high-cost nuclear fuel. (TR 404, 425-427)

Staff believes that the aim of the exception found in Order No. 14546 is to encourage utilities to reduce the costs of fossil fuel. This can be accomplished in a number of ways, as evidenced by the list of cases approving exceptions to base rate recovery. In the past, the Commission has allowed an exception to base rate recovery for security costs for a nuclear plant and for a smaller, less costly expansion of a nuclear plant. Each project was decided on its own merits. PEF's petition should also be decided on its own merits.

TRANSMISSION UPGRADES NOT RELATED TO FUEL SAVINGS

OPC witness Lawton also asserts that the transmission upgrades are not related to fuel savings but instead related to the need for reliability. (483-484) Witness Roderick notes the uprate will make CR3 the largest plant in the state. The transmission upgrade is necessary to get replacement power in case of a sudden outage at CR3. (91-93) PEF witness Roderick states: "The only reason for PEF to incur these transmission costs is if CR3 becomes the largest single generation unit on the Florida gird, and that occurs only as a result of the CR3 Uprate." (TR 56)

Clearly, the uprate will affect cooling and transmission requirements. Staff agrees with witness Roderick that the transmission upgrade costs are directly linked to the uprate. However, the transmission upgrades are part of Phase 3, and as noted above, staff is of the opinion the

magnitude and timing of all costs associated with Phase 3 should be recovered through base rates.

EARNINGS TEST

PEF asserts that OPC is asking the Commission to conduct an earning test as part of its evaluation of PEF's petition. OPC witness Merchant states that utilities have a financial incentive to seek cost recovery through the clauses and avoid absorbing costs through base rates. (TR 396) Witness Merchant further states that, once base rates are set, costs and revenues vary but, if the company is earning within its authorized ROE, then it is recovering its costs. (392, 395-396) OPC witness Lawton notes that, if PEF absorbed the Phase 1 costs, its earnings would not be significantly impacted. (TR 458-459, 468)

In response, PEF witness Portuondo states that Order No. 14546 does not have an earnings test requirement and, historically, the Commission has not applied one. Witness Portuondo states that requiring an earnings test would start a base rate review and remove the incentive the order was intended to create. He notes that an earnings test would be a new requirement for applying Item number 10. (TR 563-565, 573)

In the implementing order for the Environmental Cost Recovery Clause, the Commission considered a similar earnings test argument proposed by OPC and stated "regulatory philosophy indicates that OPC is theoretically correct . . . ." (See Order No. PSC-94-0044-FOF-EI at pp. 6 &7.) The Commission did not apply an earnings test in the environmental clause because that clause, unlike the fuel clause, is established by statute which precluded an earnings test.

Witness Merchant notes that the exception in Order No. 14546 provides an incentive for utilities to invest in projects they might not otherwise invest in to obtain fuel savings. (TR 404) Staff notes that Order No. 14546 requires a decision based on the merits of each case. The order allows flexibility. (TR 238) Staff believes this provision appropriately allows the Commission the flexibility to consider each individual project. Accordingly, the Commission should preserve its ability to look at all facts of a project, and if appropriate, require base rate recovery. On the other hand, a strict requirement that all petitions for fuel clause exception to base rate recovery must meet an earnings test is too restrictive and would eliminate the incentive for utilities to seek projects that generate fuel savings.

2005 STIPULATION

In addition to the various reasons discussed elsewhere in this recommendation for why the Commission should deny PEF's request in this docket, AARP, FIPUG, and White Springs also allege that PEF's petition violates the Stipulation it entered into with the Intervenors. (AARP at BR 7–8, FIPUG at BR 6–7, White Springs BR at 8–9) On September 1, 2005, all parties to this instant proceeding filed a joint motion for approval of a Stipulation and Settlement Agreement (Stipulation) to resolve all matters raised in Docket No. 050078-EI. (TR 345–346) The Commission rendered its vote on the stipulation on September 7, 2005. Pursuant to Order

No. PSC-05-0945-S-EI,[13] the Stipulation became effective with the first billing cycle in January 2006 and will continue through the last billing cycle in December 2009. However, PEF may, at its sole option, extend the term of the Stipulation through the last billing cycle of June 2010 upon written notice to the parties to the Stipulation and to the Commission on or before March 1, 2009. (TR 345–346)

FIPUG witness Pollack testifies that all components of the CR3 Uprate Project are similar in nature to costs PEF is currently recovering through base rates. (TR 352) By requesting recovery of the CR3 Uprate Project through the fuel clause, he contends PEF is attempting to circumvent the specific provision of the Stipulation that states PEF will not petition for recovery through clauses of any costs that are of a type that have been historically, or are presently, recovered through base rates. (TR 352)

PEF argues that its petition does not violate the Stipulation. Witness Portuondo testifies that the Stipulation was not intended to preclude fuel clause recovery of costs that properly qualify for such recovery. He notes that paragraph 14 of the Stipulation specifically contemplates a return on equity for costs recovered through clauses. (TR 584) Witness Portuondo also disagrees that the Stipulation prohibits recovery through the fuel clause of costs incurred under the item number 10 exception of Order No. 14546. He notes that Order No. 14546 is never referenced in the Stipulation. (TR 584) Witness Portuondo contends that since Order No. 14546 had been in existence for 20 years at the time the Stipulation was signed, the intervenors were certainly aware of its implications. Had the intervenors intended to explicitly prohibit the recovery of costs under the item number 10 exception of Order No. 14546, they could and should have said so in the Stipulation. (TR 584) Lastly, witness Portuondo testifies the Company's proposal in the instant case cannot be considered a surcharge. Since PEF's proposal is to recover project costs only to the extent of fuel savings in any given year, customer bills will decrease or remain the same as they would have been without the project. (TR 584)

Neither staff nor the Commission were parties to the Stipulation. Staff has no way of knowing what was in the minds of the parties at the time they crafted and signed the Stipulation. All we have to go by is the Stipulation itself and the testimony of the parties in this record. The pertinent passage of the Stipulation that PEF relies on is:

> Effective on the Implementation Date, PEF will not have an authorized return on equity for the purpose of addressing earnings levels, and the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels. However, for purposes other than reporting or assessing earnings, such as cost recovery clauses and Allowance for Funds Used During Construction ("AFUDC"), PEF will use 11.75% as its authorized return on equity percentage in such cost recovery clauses. Commencing with the Implementation Date the applicable annual AFUDC rate will be 8.848%.[14]

[13] Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

[14] Order No. PSC-05-0945-S-EI, pp. 21-22. (emphasis added)

PEF is correct that the Stipulation specifically allows for the Company to earn its weighted average cost of capital, including a return on equity of 11.75%, on investments eligible for recovery of AFUDC or through cost recovery clauses. (TR 584) PEF is also correct that the Stipulation is silent with respect to Order No. 14546. (TR 584) However, PEF's final argument regarding whether its proposal constitutes a surcharge is not as persuasive. While PEF is technically correct that PEF's customer bills will not increase under its proposal, the intervenors are also correct that if the costs of the project are recovered through the fuel clause when base rate revenues are adequate to cover some or all of the costs and provide a fair return, then PEF's customers total bills will be too high. (TR 401, 467–468)

The intervenors also have a legitimate argument regarding the provision of the Stipulation prohibiting costs traditionally or presently recovered through base rates being recovered through clauses. The pertinent passage from the Stipulation is:

> During the term of this Agreement, except as otherwise provided for in this Agreement, or except for unforeseen extraordinary costs imposed by government agencies related to safety or matters of national security, PEF will not petition for any new surcharges, on an interim or permanent basis, to recover costs that are of a type that traditionally and historically would be, or are presently, recovered through base rates.[15]

Certainly the fuel clause is not a "new" surcharge. In addition, if the charges passed through the fuel clause are limited to the amount of savings in a given period, there is no net increase in the customer's bill on an absolute basis. However, 180 MW of new generating capacity is exactly the type of cost that traditionally has been, and presently is, recovered through base rates. And if costs that should be recovered through base rates are instead permitted to be recovered through the fuel clause, it could be construed as a rate increase. (TR 395, 424-425)

Primary Staff Conclusion:

Based on the above analysis, primary staff recommends that the Commission approve PEF's request for recovery of Phase 1 costs of the CR3 Uprate Project through the fuel clause. Phase 1 addresses the MUR portion of the uprate project. The MUR project is being installed during the 2007 refueling outage and will increase the capacity of CR3 by 12 MW at a cost of approximately $6 million. Witness Portuondo testifies that the savings associated with the MUR project are more than enough to recover the costs in the first year. As a result, PEF will be able to pass along savings to its customers through lower fuel charges in the first year of the investment's commercial operation (2008) and the full savings from this incremental project in subsequent years of its expected life. Thus, primary staff believes the Phase 1 investment is of such a magnitude of costs and the timing of the recovery is such that the Commission should approve this portion of the project as an exception to base rate recovery as provided by Order No. 14546. Primary staff also believes the MUR project conforms with the intent of the fuel clause exception to base rate recovery found in Order No. 14546 to encourage utilities to invest money to save fuel costs they might not otherwise invest without the ability to reflect those costs in rates. In addition, as demonstrated in the two tables below, primary staff believes the MUR

[15] Order No. PSC-05-0945-S-EI, pp. 12–13. (emphasis added)

project is similar in nature to the other projects the Commission has previously approved under the exception provided by Order No. 14546.

CR3 UPRATE COMPARED TO

PRIOR APPLICATIONS OF ORDER NO. 14546

Company	Order No.	Date	Project Description	Project Cost	Amortization Period
FPL	PSC-96-1172-FOF-EI	7/96	Thermal Uprate of T.P. units 3 & 4, 31 MW gain per unit	$10.0 million	2-years
FPC	PSC-97-0359-FOF-EI	3/97	Conversion of peaking units	$7.5 million	5-years
FPC	PSC-96-0353-FOF-EI	3/96	Conversion of CT units P8 and P10	$2.6 million	5-years
FPC	PSC-95-1089-FOF-EI	9/95	Conversion of CT units P7 and P9	$2.5 million	5-years
FPC	PSC-98-0412-FOF-EI	3/98	Conversion of Suwannee 3 to natural gas	$2.45 million	5-years
PEF			CR3 Uprate (Phase 1 - MUR)	$6.0 million	1-year
PEF			CR3 Uprate (Entire Project)	$381.8 million	10-years

CR3 UPRATE PROPOSAL

Year	Items Installed	Estimated Cost	Capacity (MW)
2007	MUR	$6 million	12
2009	Balance of Plant	$150 million	28
2011	Reactor core/fuel	$94 million	140
2011	Transmission	$89 million	0
2011	Point of Discharge	$43 million	0
	Total	$382 million	180

However, primary staff draws a distinction between the Phase 1 costs and the costs for Phases 2 and 3. As shown in the tables above, Phases 2 and 3 are significant capital expenditures both in terms of the amount of investment and the proposed 10 year payback period. In addition to the fuel savings expected to be generated, Phases 2 and 3 will also add to the available capacity for PEF to meet its load requirements. However, these projects are not expected to

come into commercial service until the end of 2009 and 2011, respectively. As discussed PREVIOUSLY in this recommendation, the fuel clause exception to base rate recovery under Order No. 14546 was intended to encourage utilities to take advantage of short-term opportunities not reasonably anticipated or projected for base rate recovery. While Phase 1 meets this criteria, Phases 2 and 3 do not. Because the current Stipulation will end in 2009, PEF will have an opportunity to petition for a base rate case prior to the commercial in-service dates of Phases 2 and 3 if the Company deems such recovery necessary to maintain a fair return. Finally, PEF witness Roderick testifies that the POD and transmission investments would not be undertaken absent the Phase 3 investment. Because the POD and transmission investments of the CR3 Uprate Project are "but for" Phase 3 investments, and primary staff recommends against recovery of Phase 3 through the fuel clause for the reasons discussed above, it follows that these projects should not be recovered through the fuel clause either.

Alternative Staff Conclusion: Alternative staff recommends that the Commission should not allow any of the costs of the CR3 Uprate Project to be passed through the fuel clause. Alternative staff notes the CR3 Uprate Project costs are base rate items and that PEF has adequate time to plan for the regulatory treatment of those items. Specifically, in the last year of its rate settlement agreement, PEF can consider whether to seek a base rate proceeding that would address the CR3 Uprate Project costs. The $6 million cost associated with Phase 1 can be absorbed by the Company without significant impact on earnings as a normal cost of doing business. The CR3 Uprate Project costs do not qualify as a short-term opportunity to lower fuel costs as contemplated by Order No. 14546. Instead, the costs derive from capacity increases at a base load unit.

Generally, in addition to the reliability benefits, all new plant additions provide some level of fuel savings associated with more efficient operation. PEF's argument that the CR3 Uprate Project should be included in the fuel clause is spurious. MUR costs are instrumentation costs, not fuel costs. Further, these costs are not volatile fuel costs. Therefore, the costs should be recovered in base rates, not through the fuel clause. When considering petitions for exceptions to base rate recovery under item number 10 of the previously mentioned list, the Commission should be very frugal in its inclusion of non-fuel costs in the fuel 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?

Recommendation: If the Commission finds that clause recovery is appropriate for a portion or all the CR3 Uprate Project, then the costs should be recovered through the fuel clause since the uprate is projected to generate fuel savings. If the Commission denies PEF's petition, then this issue is moot. (Draper)

Positions of the Parties

PEF: The recovery of PEF's costs for the uprate should be through the same clause in which savings will materialize, so that no particular class of customer is harmed or benefited by the allocation. Allocation of fuel savings will be through the fuel clause, so the costs must be allocated the same way.

OPC: No position.

AARP: No recovery should be authorized by the Commission, but approved revenues, if any, should be recovered through the fuel clause recovery clause since the claimed benefits of the project, namely of fuel savings, will be realized through the fuel clause.

FIPUG: No. The non fuel costs at issue are properly classified as demand related. It would result in cost shifting because demand-related costs would be recovered on a kWh basis. Some opine that high load factor customers will receive greater fuel savings because they have more off peak consumption, but PEF uses average costs not real time costs to assess its fuel factor. Grocery stores and large industry will not receive benefits commensurate with the price they pay.

WHITE SPRINGS: No. The uprate investments at issue are properly classified as demand related. Every effort should be made to align the recovery of these costs, in terms of timing, allocation and rate design with the normal function and classification of these plant additions. Recovering demand related costs though kwh charges, as PEF proposes, produces a basic mis-alignment of cost recovery and cost causation that the Commission should avoid.

FRF: The Commission should not authorize clause recovery of the CR3 Uprate Project. If it does, the FRF takes no position on whether any allowed capital costs should be recovered through the Fuel Cost Recovery Clause or the Capacity Cost Recovery Clause.

Staff Analysis: At issue is whether any CR3 Uprate Project costs the Commission approves should be recovered through the fuel or the capacity clause. This decision does not change the total dollars PEF recovers from its ratepayers, but it does affect how the dollars are recovered from the various rate classes, such as residential or commercial.

PEF states that the recovery of the PEF uprate costs should be recovered through the same clause in which the savings will materialize, so that no particular class of customer is harmed or benefited by the allocation. (PEF BR at 38) The purpose of the CR3 Uprate Project is to reduce fuel costs to customers by displacing energy from higher cost fossil fuel with lower cost nuclear fuel. (TR 229) PEF maintains that the CR3 project generates substantial fuel savings for PEF's customers. (TR 229). The fuel clause allocates costs and savings on an energy

basis. (TR 324). The capacity clause, however, allocates costs on a demand basis. (TR 324) In general, a demand allocation assigns more responsibility to the residential class, therefore, if the CR3 Uprate Project costs are being recovered through the capacity clause, then the residential class would see a larger assignment of the costs than if the costs were recovered through the fuel clause. (TR 324-325)

FIPUG's primary position is that PEF should not be allowed to recover the CR3 Uprate project costs through a clause. However, if the Commission allows clause recovery, it is FIPUG's position that the uprate costs should be recovered through the capacity clause. (FIPUG BR at 18) FIPUG witness Pollock contends that nuclear base rate costs are allocated to customers classes on a demand basis. (TR 357) Witness Pollock further states that demand allocation factors (used to assign costs to the different rate classes) are not the same as energy allocation factors. (TR 357)

As discussed in Issue 1, primary staff recommends approval of Phase 1 of PEF's CR3 Uprate Project because it results in immediate fuel savings and therefore lower fuel charges. Staff agrees with PEF that the uprate costs should be recovered through the same clause in which the savings will materialize so that all customer classes are treated equally. Staff also notes that the costs of all the projects the Commission has previously approved under the exception provided by Order No. 14546 (see discussion under primary staff conclusion) were recovered through the fuel clause. Staff therefore recommends that if the Commission finds that clause recovery is appropriate for a portion or all the CR3 Uprate Project costs, then the costs should be recovered through the fuel clause since the uprate is projected to generate fuel savings. If the Commission denies PEF's petition, then this issue is moot.

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

Recommendation: If the Commission finds that clause recovery is appropriate for Phase 1 of the CR3 Uprate Project, the capital recovery period should be one year. If the Commission finds that clause recovery is appropriate for the remaining phases of the CR3 Uprate Project, the capital recovery period should be equal to the tax depreciation lives of the assets. If the Commission denies PEF's petition, then this issue is moot. (Kyle, Slemkewicz)

Positions of the Parties

PEF: Consistent with past Commission precedent and policy, PEF should be authorized to recover through the fuel adjustment clause the amortization of capital costs and a return on capital at their current pretax weighted average cost of capital (WACC) of the project amortized over a period for which the demonstrated fuel savings exceed the amortization and pretax WACC return of the project.

OPC: To accomplish a fair matching of the costs of the uprate project and the benefits to be derived, the recovery period should coincide with the useful lives, expected to last through 2036. Each year in which the uprate is operational, customers would pay a pro rata share of the costs of the project and receive the fuel savings associated with the project. By contrast, PEF's proposal would create severe intergenerational inequities to enable the utility to recoup its investment before meaningful fuel savings reach customers' bills. There is no justification for an approach so skewed to favor PEF at customers' expense.

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: The useful life of the rate base additions, 36 years for the power plant 40 years for the transmission lines.

WHITE SPRINGS: The Commission should base capital recovery of the assets based on the expected useful life of the rate base additions.

FRF: Agree with OPC that the recovery period should coincide with the useful lives of Uprate Project components, expected to last through 2036. In contrast, PEF's proposal would unfairly impose severe intergenerational inequities on PEF's customers to enable PEF to recoup its investment before its customers realize meaningful fuel savings.

Staff Analysis: As discussed in Issue 1, primary staff recommends approval of Phase 1 of PEF's CR3 Uprate Project because it results in immediate fuel savings and is consistent with the Commission's approval of FPL's request to recover costs associated with the thermal power uprate of Turkey Point Units 3 and 4. PEF has stated that it expects to recover the Phase 1 costs in the first year of MUR commercial operation in 2008 because fuel savings are projected to exceed the MUR costs. (TR 615) Further, PEF has proposed to recover the CR3 project costs of each successive phase through amortization to the extent that there are demonstrated fuel savings to cover the costs. (TR 584) PEF witness Portuondo estimates that the costs of Phases 2 and 3 are expected to be recovered within ten years because fuel savings are expected to exceed project costs by the end of that period. (TR 616)

OPC witness Merchant raises several challenges to PEF's proposed plan to recover costs. She states that customers would receive minimal, if any, savings until PEF had recovered all of its investment. (TR 407) Witness Merchant also refers to Section 22A of the Uniform System of Accounts (USOA) general instructions, which requires that "utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of the property over the service life of the property." (TR 408) She notes that PEF has estimated that the useful life of all the property included in the CR3 Uprate Project will be at least 25 years, and that the tax depreciation lives PEF has used in its own analysis are 15 years for nuclear property and 20 years for the POD and transmission plant. (TR 408) Witness Merchant points out that the USOA account, through which PEF proposes to amortize the costs of this project is, by its title (Amortization of Limited-term Electric Plant), intended only for short-term projects. (TR 409-410) Finally, witness Merchant objects to the abbreviated recovery period proposed by PEF on the basis that it creates an intergenerational inequity whereby current customers will pay for costs which will benefit customers up to 25 years in the future. (TR 410)

OPC witness Lawton also objects to PEF's proposed cost recovery periods. (TR 470-474) Witness Lawton states that selection of a recovery period less than the tax depreciation lives of the assets will deny customers the benefit of deferred income taxes during the early years of the project. (TR 475-476) He states that his analysis indicates that the loss of these deferred taxes would result in a net present value (NPV) increase of $3.9 million in additional revenue requirements. (TR 476)

PEF witness Portuondo notes that the Commission has the discretion to modify or waive the application of USOA requirements. (TR 576) In its brief, PEF also cites examples of the Commission allowing recovery periods which coincide with demonstrated fuel savings. (BR at 27) Staff notes, however, that the projects cited involve much smaller dollar amounts and shorter time periods than is the case in Phases 2 and 3 of the CR3 Uprate Project.

Staff believes that it is reasonable to allow PEF to recover the costs of the MUR over a one year period because the relatively small dollar value of the investment is comparable to the cost of projects in which the Commission has previously granted a rapid recovery. Further, the short time period involved in Phase 1 increases the likelihood that the savings projections will be accurate.

With respect to Phases 2 and 3, staff finds the arguments of OPC's witnesses that there should be a closer matching of value to useful life persuasive. Because of the substantially larger dollar amounts involved in Phases 2 and 3 of the project, and because the longer time periods involved reduce the predictive value of the savings estimates, staff believes that it is unreasonable to allow a cost recovery method which may be as short as ten years. Staff believes that an appropriate decision is to allow PEF to recover its costs for Phase 2 and 3 over the tax depreciation lives of the respective assets. The tax depreciation lives of the nuclear assets are 15 years for the nuclear assets and the tax depreciation life of the POD and transmission assets is 20 years. Staff notes that this approach is neutral with respect to deferred taxes. While no deferred tax liability will be created (a benefit to rate payers if the depreciation life is longer than the tax life), no deferred tax asset will be created either (a cost to rate payers if the depreciation life is shorter than the tax life). (TR 623-624; EXH 24)

Staff's recommended approach balances the interests of the Company and its customers and is also consistent with past Commission precedent in a prior application for the fuel clause exception to base rate recovery under Order No. 14546.[16] Although FPL filed its petition requesting approval to recover the costs of its Orimulsion project through an oil back-out cost recovery factor, in Order No. PSC-94-1106-FOF-EI[17] the Commission authorized FPL to recover its investment through the fuel clause under the item number 10 exception of Order No. 14546. In approving FPL's request for recovery of the $72 million cost of the Orimulsion project, the Commission applied two conditions. First, the Commission found that the investment would be depreciated "over the used and useful life of the conversion components added to Plant Manatee," and FPL was authorized to depreciate the investment over 20 years.[18] The second condition addressed the treatment of fuel savings, and FPL was limited to applying only half of the actual savings from the conversion of Manatee Units 1 and 2 to burn Orimulsion as accelerated depreciation.[19]

For the reasons stated above, staff recommends that if the Commission finds that clause recovery is appropriate for Phase 1 of the CR3 Uprate Project, the capital recovery period should be one year. Further, staff recommends that if the Commission finds that clause recovery is appropriate for the remaining phases of the CR3 Uprate Project, the capital recovery period should be equal to the tax depreciation lives of the assets, specifically 15 years for the nuclear assets and 20 years for the POD and transmission assets.

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[16] Order No. PSC-94-1106-FOF-EI, issued September 7, 1994, in Docket No. 940391-EI, In re: Petition for approval to recover Orimulsion project costs through an oil-backout cost recovery factor by Florida Power and Light Company

[17] Id. p. 3.

[18] Order No. PSC-94-1106-FOF-EI, p. 6.

[19] Order No. PSC-94-1106-FOF-EI, p. 3.

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

Recommendation: If the recovery periods recommended in Issue 3 are approved, no ratemaking adjustments are necessary. If the Commission denies PEF's petition, then this issue is moot. (Kyle, Slemkewicz)

Positions of the Parties

PEF: No rate making adjustments are necessary. Consistent with Commission treatment in past petitions of this nature, PEF proposes fuel clause recovery of the amortization of capital investment and the return on that capital investment at the pretax weighted average cost of capital last authorized by the commission. As such these investment costs would not be included in the calculation of base rates during the period over which recovery is occurring through the fuel clause.

OPC: Whether PEF recovers the costs of the uprate through base rates or through the clause, the Commission should set 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.

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: Agree with OPC.

WHITE SPRINGS: Agrees with OPC.

FRF: No adjustments to PEF's current rates are appropriate. Agree with OPC that, regardless of base rate or fuel clause recovery, the Commission should set cost recovery periods to correspond with expected useful lives, and that otherwise, PEF's customers must be compensated for any lost NPV benefits of deferred taxes.

Staff Analysis: In its brief, OPC states that if "artificially accelerated" depreciation rates are allowed for all or part of the CR3 Uprate Project assets, the Commission should make ratemaking adjustments to compensate customers for the loss of deferred tax benefits which would result from using the "standard useful life concept." (BR at 34) OPC witness Lawton states that he has calculated that customers would pay an additional Net Present Value (NPV) of $3.9 million dollars in revenue requirement as a result of using PEF's proposed recovery method. (TR 476) OPC witness Lawton arrived at this amount from a table he constructed using a combination of PEF projected figures and "corrected" amounts which he calculated. (EXH 12) Staff notes that witness Lawton's calculations are based upon projections to the year 2036, despite his own observation that "values estimated further out into the future are less reliable." (TR 480) Further, OPC does not propose any specific adjustment to compensate customers for the loss of the benefit of deferred taxes other than, by implication, that PEF be required to recover the cost of project assets over their useful lives.

As noted in Issue 3, staff has recommended that if the Commission authorizes clause recovery of the CR3 Uprate Project, PEF should be allowed to recover the costs of Phase 1 in one year and the costs of Phases 2 and 3 over the tax depreciation lives of the assets. This compromise would diminish the impact of the loss of deferred tax benefits to customers. In the absence of any specific proposed adjustment to compensate customers, staff believes that any remaining deferred tax distortions are minimal and that no adjustments are necessary.

Based on the above, staff recommends that if the recovery periods recommended in Issue 3 are approved, no ratemaking adjustments are necessary.

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?

Recommendation: PEF should be allowed to earn a return on average investment at its current weighted average cost of capital. If the Commission denies PEF's petition, then this issue is moot. (Springer)

Positions of the Parties

PEF: Consistent with the Commission's past decisions that have allowed recovery of capital costs through the fuel clause pursuant to Order No. 14546, PEF proposes to recover a return on investment of its current pretax weighted average cost of capital.

OPC: 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.)

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: Evidence in the record discloses that under its proposal PEF will receive a 13.19% after tax return on equity. This is a before income tax return of over 20%. These are income taxes that the utility conglomerate may not have to pay. Because the recovery is guaranteed and all risk is eliminated and because the return is recalculated every year the return should be no greater than the return on US Treasury notes. The risk guaranteed by two million customers is substantially the same as "risk free" treasury investments.

WHITE SPRINGS: Agrees with OPC.

FRF: The Commission should not authorize clause recovery of the CR3 Uprate Project. The FRF agrees with OPC that, if the Commission were to grant PEF's request for clause treatment, it should authorize a return no greater than PEF's cost of debt.

Staff Analysis: It is PEF's position that it be allowed to earn its current pretax weighted average cost of capital, including its last authorized rate of return on common equity. Pursuant to the Stipulation approved by the Commission in Order No. PSC-05-0945-S-EI,[20] this rate is 11.75%. (TR 325-326) Witness Portuondo states that PEF's settlement agreement with the intervenors contemplated a return on equity for costs recovered through clauses at exactly the rate that PEF requests in its petition. (TR 584) Additionally, witness Portuondo states that consistent with past Commission precedent and policy, PEF should be authorized to recover through the fuel clause the amortization of capital costs and a return on capital at their current pretax weighted average

[20] Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In Re: Petition for rate increase by Progress Energy Florida, Inc.

cost of capital of the uprate project. (TR 591-592) It is PEF's contention that its request in this case be treated the same way every utility has been treated with respect to projects approved for recovery under the item number 10 exception of Order No. 14546 over the past 20 years. (TR 14-15)

It is OPC's, AARP's, White Springs' and FRF's position that the Commission should deny PEF's proposal making this issue moot. (TR 405-406) OPC Witness Merchant states PEF will have the opportunity to include the uprate cost in a base rate proceeding, which will give the Commission the opportunity to review the Company's operations and earnings at that time. (TR 416) OPC Witness Lawton states that there is no basis for including a risk-adjusted equity return of 11.75% when all the risk has been removed by the fuel clause recovery true-up mechanism. (TR 477) However, if the Commission were to grant PEF's request for clause treatment, he states that the Commission should authorize a return no greater than PEF's cost of debt. (TR 539-540)

FIPUG's position is that PEF's proposed method of cost recovery is wrong and should be denied. (TR 341) Evidence in the record discloses that under its proposal PEF will receive a 13.19% after tax return on equity. (TR 457) Witness Pollack testifies that since the recovery is guaranteed and because the return is trued-up every year, all risk is eliminated and the return should be no greater than the return on US Treasury bonds. (TR 351)

From staff's perspective, each time the Commission approves recovery of utility expenses or capital costs through a cost recovery clause, the overall volatility of the utility's earnings before interest and taxes (EBIT) is reduced. This has the effect of reducing business risk. (TR 457, 489) This reduced risk should result in a lower average cost of capital (required rate of return) over the long run. (TR 507-508) While it can be disputed that currently authorized ROEs may not reflect the reduced risk resulting from the guaranteed recovery of prudently incurred capital costs through the fuel clause, ROEs set prospectively should reflect this reduced risk.

PEF's request for recovery utilizing its current pretax weighted average cost of capital is consistent with the Commission's approval of cost recovery for prior projects under the item number 10 exception of Order No. 14546. (TR 573-576) Based on the record in this proceeding, staff recommends that PEF be allowed to earn its current weighted average cost of capital, including its currently authorized ROE of 11.75%, on capital investment costs that the Commission deems to be prudent and eligible for recovery through the fuel clause.

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?

Recommendation: To the extent any wholesale customers share in the costs of the upgrade, PEF should reduce the costs allocated to the retail jurisdiction accordingly. If the Commission denies PEF's petition, then this issue is moot. (Draper)

Positions of the Parties

PEF: To the extent that the joint owners of CR3 agree to pay for a portion of the costs associated with the CR3 Uprate Project, PEF will reduce its cost recovery request accordingly. Likewise, the net fuel savings benefits will be allocated proportionately among the joint owners, depending on the percentage of costs each owner bears.

OPC: 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.

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: In accordance with the projected wholesale sales shown in the filed ten year site plans, approximately 12% to 15% are made to the wholesale market. In addition if there are any co owners of the CR # 3 these owners should make the appropriate contribution.

WHITE SPRINGS: Agrees with FIPUG.

FRF: The Commission should not authorize clause recovery of the CR3 Uprate Project. If the Commission does so, the FRF agrees with OPC that retail customers should pay for only the portion of the unit that is devoted to retail service.

Staff Analysis: This issue deals with the allocation of the CR3 Uprate Project costs between the wholesale and retail jurisdictions. PEF owns approximately 90 percent of the CR3 plant, with Seminole and several cities also owning a share. Seminole and the cities are co-owners or equity owners in the power plant and part of the wholesale jurisdiction. (TR 328) PEF Witness Portuondo testifies that PEF's retail customers will get the full benefits of the 180-megawatt increase if the co-owners do not come to the table and support the project. (TR 328) Witness Portuondo further testifies that in the exhibit that PEF proposes to attach to its testimony each year in the fuel docket (see Issue 7), the calculation of the allocation between retail and wholesale will be shown. At that time the Commission will be able to review PEF's allocation of the CR3 Uprate Project between the wholesale and retail jurisdiction.

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?

Recommendation: If the Commission authorizes clause recovery of the cost of the CR3 Uprate Project, the Commission should require PEF to provide an exhibit to its testimony for the annual fuel clause hearing that will show the calculation of fuel savings, the costs of the project, and the allocation between retail and wholesale. This reporting should occur regardless of which clause, fuel or capacity, the Commission might authorize for cost recovery. (See Issue 2.) If the Commission denies PEF's petition, then this issue is moot. (Lester)

Positions of the Parties

PEF: Consistent with PEF's past practice associated with the Commission's approval of past requests, the Company will attach an exhibit to its testimony each year in the fuel clause, which will show the calculation of fuel savings and costs of the project.

OPC: 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 nave been given base rate treatment and would have been subject to standard prudence review in a base rate case.

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: In the cost recovery dockets the Commission must analyze over $11 billion in cost recovery items every year with only about 90 days study. No serious consideration can be given to the prudency of confidential capital expenditures by one utility without even the opportunity for reasonable discovery before intervenor testimony must be filed. The capital expenditures should be filed with the Commission staff at least nine months before recovery is sought.

WHITE SPRINGS: Agrees with FIPUG.

FRF: If the Commission authorizes clause recovery, then the Commission should, in order to evaluate the prudence of PEF's expenditures for these base-rate type items, require PEF to file reports at least annually that include complete information on all already-expended costs and all projected capital and fuel costs of the Project.

Staff Analysis: PEF witness Portuondo agrees that, if the Commission authorizes clause recovery of the CR3 Uprate Project, the company will attach an exhibit to its testimony each year in the fuel clause which will show the calculation of fuel savings and costs for the project. (TR 326) He also acknowledges that the Commission can review the actual savings and costs incurred to determine if the costs are prudent and reasonable. (TR 266, 275, 286, 314-325, 582) He further acknowledges Commission auditors review the costs of projects recovered through the fuel clause. (TR 326)

Staff believes that, if the Commission allows the CR3 Uprate Project for clause recovery, the reporting of actual costs and savings each year in testimony in the annual fuel clause

proceeding is appropriate. Staff notes that the costs will be audited and can be reviewed for reasonableness.

Issue 8: Should this docket be closed?

Recommendation: The docket should be closed after the time for filing an appeal has run. (Bennett, Young)

Positions of the Parties

PEF: Yes, this docket should be closed.

OPC: 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.

AARP: AARP adopts the position of the Office of Public Counsel on this issue.

FIPUG: Yes.

WHITE SPRINGS: Yes.

FRF: Yes.

Staff Analysis: The docket should be closed 32 days after issuance of the order, to allow the time for filing an appeal to run.

ACRONYMS AND ABBREVIATIONS

AARP – AARP

AFUDC – Allowance for funds used during construction

CR3 – Crystal River Unit 3, PEF’s nuclear unit

EBIT – Earnings before interest and taxes

FPL – Florida Power & Light Company

FIPUG – Florida Industrial Power Users Group

FRF – Florida Retail Federation

MUR – Measurement Uncertainty Recapture

MW – Megawatt

NPV – Net present value

NRC – Nuclear Regulatory Commission

OPC – Office of Public Counsel

PEF – Progress Energy Florida

POD – Point of Discharge

ROE – Return on equity

TP 3 & 4 – FPL’s Turkey Point nuclear units 3 & 4

USOA – Uniform System of Accounts

In re: Cost Recovery Methods for Fuel-Related Expenses
DOCKET NO. 850001-EI-B; ORDER NO. 14546
Florida Public Service Commission
1985 Fla. PUC LEXIS 531
85 FPSC 67
July 8, 1985

PANEL:
The following Commissioners participated in the disposition of this matter: JOHN R. MARKS, Chairman; JOSEPH P. CRESSE, GERALD L. GUNTER

OPINION: NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING COST RECOVERY METHODS FOR FUEL-RELATED EXPENSES
BY THE COMMISSION:
Background
As a result of issues raised by Staff in the February, 1985 fuel adjustment hearing, this docket was created to consider the proper means of recovery of fossil fuel-related expenses. In Order No. 14222, the final order establishing the April-September, 1985 Fuel and Purchased Power Cost Recovery Factors, we instructed Staff, the four investor owned electric utilities and any other interested parties to provide information necessary for the Commission to be able to consider at the August, 1985 fuel adjustment hearing whether the utilities were passing appropriate fixed and variable costs associated with fuel receipts through their fuel adjustment clauses.
Pursuant to the Commission's directive, a workshop concerning the cost recovery methods of fossil fuel-related expenses was noticed for and held on May 2, 1985. As a result of the information exchanged at that workshop and subsequent discussions, the parties to the proceeding, which include Staff, the Office of Public Counsel, Florida Power and Light Company (FPL), Florida Power Corporation (FPC), Gulf Power Company (Gulf), and Tampa Electric Company (TECO), identified the fossil fuel-related costs currently being recovered through the utilities' fuel adjustment clauses and agreed to a policy addressing the appropriate prospective means of recovering such fossil fuel-related expenses. The Florida Industrial Power Users Group (FIPUG) has not intervened in this proceeding but was informed of the parties' stipulation and stated that they took no position.
On June 21, 1985, the parties submitted to the Commission a stipulation evidencing their agreement. Attached to the stipulation was a draft Notice of Proposed Agency Action which the parties requested be adopted in the disposition of this proceeding. The draft Notice of Proposed Agency Action was endorsed by Staff's recommendation of June 20, 1985. In the stipulation the parties identified the fossil fuel-related costs currently being incurred and how each of the utilities are treating those expenses for cost recovery. A copy of that information is attached as Appendix A. As can be seen on Appendix A, each of the utilities do not incur all of the same types of fossil fuel-related expenses, and even in instances where the same types of expenses are incurred, utilities may recover them differently.
In addition to identifying fossil fuel-related costs and their current means of recovery, the parties reached an agreement in their stipulation as to whether these cots should be

recovered prospectively through base rates or through fuel adjustment clauses. The agreement regarding specific costs reflects a broader policy consensus for the recovery of fossil fuel-related costs. The policy agreed to among the parties and recommended to the Commission consisted of two essential points which appear to reflect the Commission's practical application of fuel adjustment clauses:

1. When similar circumstances exist, the Commission should attempt to treat, for cost recovery purposes, specific types of fossil fuel-related expenses in a uniform manner among the various electric utilities. At times, however, it may be appropriate to treat similar types of expenses in dissimilar ways.
2. Prudently incurred fossil fuel-related expenses which are subject to volatile changes should be recovered through an electric utility's fuel adjustment clause. The volatility of fossil fuel-related costs may be due to a number of factors including, but not necessarily limited to: price, quantity, number of deliveries, and distance. Except as noted below, these volatile fossil fuel-related charges are incurred by the utility for goods obtained or services provided prior to the delivery of fuel to the electric utility's dedicated storage facilities. (Dedicated storage facilities mean storage facilities which are used solely to serve the affected electric utility.) All other fossil fuel-related costs should be recovered through base rates.

In the specific application of this policy, the parties recommended the following treatment of fossil fuel-related charges:

Invoiced Fuel Charges. The invoiced cost of fuel is dependent upon market conditions and the quantity of fuel purchased. The invoiced cost of fuel should be considered to include all price revisions and adjustments relating to the volume and/or quality of fuel delivered. This component of a utility's fossil fuel-related expenses is the most volatile in nature and is most appropriately recovered through the fuel adjustment clause.

Transportation Charges. The costs associated with moving fuel to fuel storage locations and terminals dedicated to the supply of a utility's generating facility are subject to significant changes due to fluctuations in distances, deliveries, volume and price. Consequently, such costs should be recovered through fuel adjustment clauses. However, transportation charges for moving fuel between dedicated storage facilities and generating plant sites appear to be more stable and predictable, due in part to many of these costs occurring under longer-term arrangements. Therefore, these transportation costs are more appropriately recovered through base rates.

Taxes and Purchasing Agents' Commissions. These charges vary with each transaction and are affected by both price and volume. These costs are most appropriately recovered through fuel adjustment clauses.

Port Charges. These charges include dockage, the fee paid to a port facility for the use of a pier, wharfage, the fee paid to a port facility for the right to receive products through a port facility, harbormaster fees, pilot fees and charges for assist tugs. These fees, which are transportation costs, are incurred prior to delivery to the utility's dedicated inventory storages facilities and vary with the number and volume of deliveries and are more properly recovered through fuel adjustment clauses.

Inspection Fees. Volume and quality inspection charges are often incurred several times in bringing fuel to a utility's generating plant sites. The charges for these inspections, which are critical to assuring that the utilities receive the proper amount of fuel consistent with contract specifications, vary with the number and size of deliveries and are essential to the determination of whether there should be adjustments to the invoice price of fuel. These charges are incurred prior to and during delivery to the utility and are

appropriate for recovery through the fuel adjustment clauses.

O&M Expenses at Plants, Storage Facilities and Terminals. These costs are relatively fixed and do not tend to fluctuate significantly even with changes in the number and sizes of Deliveries. As these costs are closely akin to other O&M expenses, they are more properly recovered through base rates. These expenses include unloading and handling costs at storage facilities and generating plants.

Additives. Several of the utilities blend additives with their fuel prior to burning or inject additives directly into boiler firing chambers along with fuel being burned. The price of these additives is subject to swings, and of course, the amount of additives is related to the volume and type of fuel burned. Therefore, the costs of these types of additives should be recovered through fuel adjustment clauses. Fuel additives neither blended with fuel prior to its burning nor injected into the boiler firing chamber along with fuel will be recovered through base rates.

Fuel Procurement Administrative Charges. Each of the utilities have staffs responsible for fuel procurement, and the costs associated with fuel procurement and administration do not bear a significant relationship to the volume or price of fuel purchases. These costs are relatively fixed and are not volatile; they are more appropriately recovered through base rates.

Inventory Adjustments. From time to time adjustments are made to the volume and/or value of fuel inventory maintained for system generation. Most frequently, these adjustments relate to coal inventory and result from survey evaluations of coal sites maintained at the generating facilities. Differences between the survey results and per book volumes result due to the inaccuracy inherent in the measuring devices utilized. Coal inventory adjustments shall continue to be afforded the accounting treatment specified in the Florida Public Service Commission Staff Advisory Bulletin No. 3 dated April 9, 1982. From time to time adjustments to the volume and/or value of inventory may result from Commission decisions. The impact of these adjustments are appropriately recognized in the computation of the fuel cost recovery factors.

In addition to stipulating to the foregoing applications of policy, the parties also recommended to the Commission that the policy it adopts be flexible enough to allow for recovery through fuel adjustment clauses of expenses normally recovered through base rates when utilities are in a position to take advantage of a cost-effective transaction, the costs of which were not recognized or anticipated in the level of costs used to establish the utility's base rates. One example raised was the cost of an unanticipated short-term lease of a terminal to allow a utility to receive a shipment of low cost oil. The parties suggest that this flexibility is appropriate to encourage utilities to take advantage of short-term opportunities not reasonably anticipated or projected for base rate recovery. In these instances, we will require that the affected utility shall bring the matter before the Commission at the first available fuel adjustment hearing and request cost recovery through the fuel adjustment clause on a case by case basis. The Commission shall rule on the appropriate method of cost recovery based upon the merits of each individual case.

Finally, the parties recognize that the Commission, during its most recent fuel adjustment hearing, voted to determine in a single proceeding which items of fossil fuel-related costs should be transferred from fuel adjustment recovery to base rate recovery and to effect such changes at one time. While recognizing that this was the vote of the Commission, Public Counsel disagrees with such approach.

Commission's Findings

Having considered the stipulation of all the parties in this proceeding and recognizing the need for a further elaboration upon how fossil fuel-related costs should be treated for purposes of cost recovery, the Commission approves the stipulation of the parties and adopts the provisions therein, as its own. We find the policy outlined and specified in the stipulation to be an appropriate extension of the prior determinations regarding fuel costs to be recovered through fuel clauses made by the Commission in Order No. 6357.

In that earlier decision the Commission found that "the delivered cost of fuel to the generating plant site be used in determining a utility's fuel adjustment charge." That language has given rise to the recovery through the fuel adjustment clauses of unloading expenses, terminal operating expenses for terminals removed from plant sites, and transportation costs for moving oil from terminals to plant sites. While we recognize that the recovery of such costs through fuel clauses is consistent with the language in Order No. 6357, we feel further refinement is necessary since it is clear that these costs are not volatile.

Another expense which has come to be passed through the utilities' fuel clauses as a part of the cost of fuel is the cost of additives which are not added to fuel prior to burn or to boilers during burn. These additives are added after fuel is burned, generally to improve emissions control. We find that the cost of these "non-fuel additives" is more appropriately recovered through base rates.

As a result of our determinations in this proceeding, prospectively, the following charges are properly considered in the computation of the average inventory price of fuel used in the development of fuel expense in the utilities' fuel cost recovery clauses:

1. The invoice price of fuel.
2. Any revisions to the invoice price.
3. Any quality and/or quantity adjustments to the invoice price.
4. Transportation costs to the utility system, including detention or demurrage.
5. Federal and state taxes and purchasing agents' commissions.
6. Port charges.
7. All quantity and/or quality inspections performed by independent inspectors.
8. All additives blended with fuel prior to burning or injected into the boiler firing chamber along with fuel.
9. Inventory adjustments due to volume and/or price adjustments.
10. Fossil fuel-related costs normally recovered through base rates but which were not recognized or anticipated in the cost levels used to determine current base rates and which, if expended, will result in fuel savings to customers. Recovery of such costs should be made on a case by case basis after Commission approval.

It is not the Commission's intent to require the restatement of the average cost of fossil fuel inventory computed prior to the revision of rates necessitated by this Order.

The following types of fossil fuel-related costs are more appropriately considered in the computation of base rates:

1. Operations and maintenance expenses at generating plants or system storage facilities. This includes unloading and fuel handling costs at the generating plant or storage facility.
2. Transportation charges between dedicated storage facilities and generating plants.
3. Fuel procurement administrative functions.
4. Fuel additives neither blended with fuel prior to burning nor injected into the boiler firing chamber along with fuel.

While it is the Commission's intent in this Order to establish comprehensive guidelines for the treatment of fossil fuel-related costs, it is recognized that certain unanticipated costs may have been overlooked. If any utility incurs or will incur a fossil fuel-related cost which is not addressed in this order and the

utility seeks to recover such cost through its fuel adjustment clause, the utility should present testimony justifying such recovery in an appropriate fuel adjustment hearing.

Consistent with the determinations previously made herein, the Commission finds that the base rates and fuel and purchased power cost recovery factors for the following investor owned electric utilities in this state will require revisions. Tampa Electric Company is currently recovering unloading expenses through its fuel clause which should be recovered through base rates. Similarly, Florida Power & Light Company and Florida Power Corporation are recovering expenses of terminal operations and of transportation of fuel between terminals and plant sites through their fuel adjustment clauses which should be recovered through their base rates. Gulf Power Company is recovering the cost of a contract tugboat used to shift coal barges at a plant site through its fuel clause which expense is more appropriately recovered through its base rates. It is the Commission's intent that any revisions to fuel and purchased power cost recovery factors and base rates only reflect a change in the means of recovery of these items. So that the Commission can be assured of the accuracy and fairness of these necessary rate changes, they will be considered during the course of the August 1985 fuel adjustment hearings and become effective for billings on or after October 1, 1985.

Therefore, the stipulation of the parties to this proceeding is accepted, and it is,

ORDERED by the Florida Public Service Commission that the findings of fact and conclusions of law herein be and the same are hereby approved in every respect. It is further

ORDERED that the fuel and fossil fuel-related expenses discussed herein shall be treated in the fashion approved in the computation of fuel and purchased power cost recovery factors. It is further

ORDERED that the revisions to base rates being charged by Florida Power Corporation, Florida Power & Light Company, Gulf Power Company and Tampa Electric Company necessary to implement the determinations in this proceeding shall be considered at the August, 1985 fuel adjustment hearings and shall become effective for billings made on and after October 1, 1985. It is further

ORDERED that the action proposed herein is preliminary in nature and will not become effective or final, except as provided by Florida Administrative Code Rule 25-22.29. It is further

ORDERED that any person adversely affected by the action proposed herein may file a petition for a formal proceeding, as provided by Florida Administrative Code Rule 25-22.29. Said petition must be received by the Commission Clerk on or before July 29, 1985, in the form provided by Florida Administrative Code Rule 25-22.36(7) (a) and (f). It is further

ORDERED that in the absence of such a petition, this order shall become effective on July 30, 1985 as provided by Florida Administrative Code Rule 25-22.29(6). It is further

ORDERED that if this order becomes final and effective on July 30, 1985, any party adversely affected may request judicial review by the Florida Supreme Court by the filing of a notice of appeal with the Commission clerk and the filing of a copy of the notice and the filing fee with the Supreme Court. This filing must be completed within 30 days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

By Order of the Florida Public Service Commission, this 8th day of July, 1985.

APPENDIX A
FUEL COST RECOVERY COMPARISON

Expense Item	TECO Recovery Method	FPLL Recovery Method	FPC Recovery Method	GULF Recovery Method
01. Purchase Price of Fuel	FAC	FAC	FAC	FAC
02. Quality / Quantity Adj.	FAC	FAC	FAC	FAC
03. Retroactive Price Adj.	FAC	FAC	FAC	FAC
04. Transp. to Plant or Term.	FAC	FAC	FAC	FAC
05. Unloading Expenses	FAC-->BR	BR	BR	FAC-->BR
06. Labor (Rail Car Maint.)				FAC
07. Ad Valorem Taxes (Rail Car)				FAC
08. Rail Car Depreciation				FAC
09. Stores (Spare Parts)				FAC
10. Terminal Operating Expenses		FAC-->BR	FAC-->BR	
11. Transp. from Term. to Plant		FAC-->BR	FAC-->BR	
12. Handling Costs at Plant	BR	BR	BR	BR
13(a). Volume Insp's -- In-House		BR	BR	
13(b). Volume Insp's – Outside		FAC	BR-->FAC	
14(a). Quality Insp's -- In-House	BR	BR	BR	BR
14(b). Qual. Insp's – Outside	BR-->FAC	FAC	BR-->FAC	BR-->FAC
15. Limestone	FAC			
16. Limestone Freight	FAC			
17. Fuel Additives	FAC	FAC	FAC	FAC
18. Non-fuel Additives	FAC-->BR	BR	BR	
19. Detention / Demurrage	FAC	FAC		FAC
20. Inventory Adjustments	FAC	FAC	FAC	FAC
21. Wharfage / Dockage	FAC	FAC		FAC
22. Tug / Pilot Fees	FAC	FAC		FAC
23. Port Charges	FAC	FAC		FAC
24. EPA Charges	FAC			
25. Lost Coal	FAC			FAC
26. Fuel Administration	BR	BR	BR	BR
27. Outside Services	BR	BR	BR	BR
28. Admin. & General	BR	BR	BR	BR
29. Residuals	BR		BR	BR

LEGEND: FAC-->BR = To be removed from Fuel Adj. and put in Base Rates

BR-->FAC = To be removed from Base Rates and put in Fuel Adj.
FAC = Fuel Adjustment Clause

BR = Base Rates
= Category does not exist.

Docket No. Order No.	Project	Reasons for approval	Recovery Period	Recovery Amount	Savings
930001-EI PSC-93-1331-FOF-EI	Martin gas pipeline lateral	Commission has the flexibility to review fossil fuel related costs on a case-by-case basis to determine whether those costs are appropriate for recovery through the fuel clause. Martin gas pipeline lateral has reduced costs, or at the very minimum, not resulted in any increased costs, and the decision was made with the ratepayers' interest in mind, which is to minimize cost. Recognizing the unique facts and circumstances regarding FPL's decision to construct the lateral, to alleviate regulatory lag, and to encourage utilities to take actions to reduce fuel costs to customers, we find that it is appropriate in this case to recover the depreciation and return on investment in the Martin gas pipeline lateral through the fuel recovery clause until FPL's next rate case.	N/A	N/A	N/A
940391-EI PSC-94-1106-FOF-EI	Conversion by FPL of Manatee units to burn orimulsion	By party stipulation and subject to conditions, Commission allowed fuel clause recovery pursuant to Order 14546 of conversion of Manatee Units 1 and 2 to burn orimulsion. *The project was never commenced.*	Used and useful life of assets	$72,000,000	
951096-EI PSC-95-1299-NOR-EI	Oil Backout Rule	Was repealed because if a utility justifies a project that will result in fuel savings to its ratepayers, those oil backout costs will generally be recoverable through the fuel clause on a case-by-case basis.	N/A	N/A	N/A
950001 PSC-95-1089-FOF-EI	FPL's recovery of rail cars	By stipulation, Commission granted rail cars. Unanticipated fuel-related costs not included in the computation of base rates when economically beneficial to a utility's ratepayers, the cost of purchasing or leasing rail cars. FPL projects that the $24,024,000 cost will save ratepayers more than $24 million above the cost of the cars. The purchase enabled FPL to obtain favorable transportation rate savings from railroad companies.	15 years	$24,024,000	$48,024,000
	FPC conversion of Intercession City combustion turbine units P7 and P9 to burn natural gas.	By stipulation. Order No. 14546 . . . allows a utility to recover fossil-fuel related costs that result in fuel savings, even if those costs were not previously addressed in determining base rates.	5 years	$20,000,000	$2,500,000
950001-EI PSC-95-0450-FOF-EI	FPL modifications to Cape Canaveral Units 1 and 2, Fort Myers Unit 2, Riviera Units 3 and 4, and Sanford Units 3, 4, and 5 to use a more economic grade of residual fuel oil	FPL stated costs would be $2,754,502. In approving the fuel clause exception to base rates for these conversions, Commission quoted from Order 14546. We recognized that certain unanticipated costs may be appropriate for recovery through the fuel clause. Order 14546 allows fuel related expenditures that are not being recovered through a utility's base rates. . . . "While it is the Commission's intent in this order to establish comprehensive guidelines for the treatment of fossil fuel related costs, it is recognized that certain unanticipated costs may have been overlooked. If any utility incurs, or will incur, a fossil fuel related cost which was not addressed in this order and the utility seeks to recover such cost through its fuel adjustment clause, the utility should present testimony		$2,754,502	$80,000,000

Docket No. Order No.	Project	Reasons for approval	Recovery Period	Recovery Amount	Savings
		justifying such recovery in an appropriate fuel adjustment hearing." We have allowed in the past, when those expenditures result in significant savings to the utility ratepayers.			
960001-EI PSC-96-1172-FOF-EI	FPL's uprate of Turkey Point Units 3 and 4	The savings are due to the difference between low cost nuclear fuel replacing higher cost fossil fuel. Order No. 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	2 years	$10,000,000	$198,000,000
960001-EI PSC-96-0353-FOF-EI	FPC conversion of Intercession city P8 and P10 turbine units to burn natural gas.	By stipulation. Order 14546 allows a utility to recover fossil-fuel related costs that result in fuel savings, even if those costs were not previously addressed in determining base rates.	5 years	$2,600,000	$16,000,000
970001-EI PSC-97-1045-FOF-EI	FPC's conversion of Debary Unit 9 to burn natural gas	Order 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	5 years	$734,000	$2,100,000
970001-EI PSC-97-0359-FOF-EI	FPC conversion of Debary 7, Bartow 3 and 4, Suwannee 1 to burn natural gas	By stipulation. Order 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	5 years	$7,500,000	$22,000,000
970001-EI PSC-97-0359-FOF-EI	FPL's investment on rail cars	By stipulation. Recover the depreciation expense and return on investment for rail cars purchased to deliver coal to the Scherer Plant. Pursuant to Order 14546 unanticipated fuel-related costs not included in the computation of base rates may be considered for recovery through a utility's fuel clause. When economically beneficial to a utility's ratepayers, the cost of purchasing or leasing rail cars is considered to be a fuel-related expense that should be recovered through the fuel clause.			
970001-EI PSC-97-0359-FOF-EI	FPL's modifications to generating plants and fuel storage facilities to use low gravity fuel oil.	By stipulation. These modifications will allow FPL to operate these plants and using a heavier more economic grade of residual fuel oil. Order 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	3 years	$2,000,000	$19,000,000
980001-EI PSC-98-0412-FOF-EI	FPC's conversion of Suwannee 3 to burn natural gas.	Order 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	5 years	$2,450,000	$3,250,000
980001-EI PSC-98-1715-FOF-EI	FPC's conversion of Debary 8 to burn natural gas	Order 14546 allows a utility to recover fossil-fuel related costs which result in fuel savings when those costs were not previously addressed in determining base rates.	5 years	$1,800,000	$3,400,000
010001-EI PSC-01-2516-FOF-EI		By stipulation. Parties restated that regulatory treatment of capital costs that are expected to reduce long-term fuel costs is the treatment prescribed in Order 14546 where we listed the types of costs that are recoverable through the Fuel Cost Recover Clause. . . . Parties also stipulated that the appropriate rate of return on the unamortized balance of capital projects with an in-service date on or after Jan 1, 2002, is the utility's cost of capital based on the midpoint of its authorized return on equity.	N/A	N/A	N/A

Docket No. Order No.	Project	Reasons for approval	Recovery Period	Recovery Amount	Savings
		We approve these stipulations as reasonable.			
010001-EI PSC-01-2516-FOF-EI	Incremental Power Plant Security Costs request by FPL	We find that recovery of this incremental cost through the fuel clause is appropriate in this instance because there is a nexus between protection of FPL's nuclear generation facilities and the fuel cost savings that result from the continued operation of those facilities. Further, we believe that this type of cost is a potentially volatile cost, making it appropriate for recovery through the fuel clause. . . . In addition, we find that recovery of this cost through the fuel clause provides a good match between the timing of the incurrence and recovery of the cost. . . . We believe that approving recovery of this incremental power plant security cost through the fuel clause send s and appropriate message to Florida's investor-owned electric utilities that we encourage them to protect their generation assets in extraordinary, emergency conditions as currently exist.	N/A	N/A	N/A
050001-EI PSC-05-1252-FOF-EI	FPL sleeving project at St. Lucie No. 2	By Order 14546 we set forth certain criteria for establishing the types of expenses that are eligible for recovery through the fuel clause. In particular, a utility must show that a cost will not be recognized or is not anticipated to be recovered in current base rates. We believe that FPL knew about the potential to sleeve the tubes when it filed its minimum filing requirements for its most recent rate case.			