State of Florida

Public Service Commission

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

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

DATE: October 17, 2007

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Slemkewicz, Bulecza-Banks, Draper, Kyle, Lester, Maurey, Sickel, Springer)
Office of the General Counsel (Brown)

RE: Docket No. 070290-EI – Petition to increase base rates to recover full revenue requirements of Hines Unit 2 and Unit 4 power plants pursuant to Order PSC-05-0945-S-EI, by Progress Energy Florida, Inc.

AGENDA: 10/23/07 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Argenziano

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\070290.RCM.DOC
Attachments not available on line

Case Background

On April 30, 2007, Progress Energy Florida, Inc. (PEF or Company) filed a petition to increase its base rates to recover the $52.4 million revenue requirements associated with Hines Unit 4 and to transfer the recovery of the $36.3 million revenue requirements for Hines Unit 2 from the fuel clause to base rates. The increase in base rates would become effective with the commercial in-service date of Hines Unit 4. PEF anticipates that Hines Unit 4 will begin commercial operations on December 1, 2007. Base rates would be increased by 7.45 percent.

In its petition, PEF has requested the following:

● Base rate increase of $36.3 million for the Hines Unit 2 revenue requirements currently recovered through the fuel clause.

● True-up procedure for the Hines Unit 2 revenue requirement currently being recovered through the fuel clause.

● Base rate increase of $52.4 million for the Hines Unit 4 and related transmission facilities revenue requirement.

● Recovery of the costs in excess of the need determination for the Hines Unit 4 ($18.5 million) and the related transmission facilities ($22.1 million).

● Base rate increase effective date coinciding with the first billing cycle after the commercial in-service date of Hines Unit 4 (12/01/07 anticipated date).

PEF has filed its petition pursuant to Paragraph 12 of the rate case Stipulation and Settlement Agreement (Stipulation) approved by Order No. PSC-05-0945-S-EI.[1] Paragraph 12 of the Stipulation states the following:

> 12. a. Beginning on the commercial in-service date of Hines Unit 4, for which the Commission has previously granted a need determination in Order PSC-04-1168-FOF-El,[2] PEF will further increase its base rates to recover the full revenue requirements of (a) the installed cost of Hines Unit 4 subject to the limitations of Rule 25-22.082(15), F.A.C., and (b) the unit's non-fuel operating expenses. The revenue requirements of the unit will be calculated using an 11.75% ROE and the capital structure as set forth in the test year 2006 MFR Schedule D-la filed by PEF in Docket No. 050078-El. Such base rate increase shall be established by the application of a uniform percentage increase to the demand and energy charges of the Company's base rates including delivery voltage credits, demand credits, power factor adjustment and premium distribution service, and using billing determinants as filed by PEF in Docket No. 050078-El, and set forth in Exhibit I, Attachment C to this Agreement. Beginning on the commercial in-service date of Hines Unit 4, such amounts shall be added to the revenue sharing threshold and cap set forth in Section 6 of this Agreement.
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> b. Effective on the Implementation Date of this Agreement and until the commercial in-service date of Hines Unit 4 (the "Fuel Clause Recovery Period"), PEF will recover annually through the fuel cost recovery clause the 2006 full revenue requirements of the installed cost of Hines Unit 2, excluding the unit's non-fuel O&M expenses. During the Fuel Clause Recovery Period, the

[1]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.
[2]Order No. PSC-04-1168-FOF-El, issued November 23, 2004, in Docket No. 040817-EI, In re: Petition for determination of need for Hines 4 power plant in Polk County by Progress Energy Florida, Inc.

> installed cost of Hines Unit 2 and corresponding depreciation accounts will be excluded from rate base for surveillance reporting purposes. Upon the commercial in-service date of Hines Unit 4, PEF will transfer the recovery of Hines Unit 2's 2006 full revenue requirements, excluding the unit's non-fuel O&M expenses, from the fuel cost recovery clause to base rates by decreasing PEF's fuel charges and increasing its base rates accordingly. The calculation of Hines Unit 2's revenue requirements for base rate recovery purposes will be calculated using an 11.75% ROE and the capital structure as set forth in the test year 2006 MFR Schedule D-la filed by PEF in Docket No. 050078-El. Such base rate increase shall be established by the application of a uniform percentage increase to the demand and energy charges of the Company's base rates including voltage credits, demand credits, power factor adjustment and premium distribution service, and using billing determinants as filed by PEF in Docket No. 050078-E1, and as included in Exhibit 1, Attachment C to this Agreement. Beginning on the commercial in-service date of Hines Unit 4, such amounts shall be added to the revenue sharing threshold and cap set forth in Section 6 of this Agreement.

The recovery of the Hines Unit 2 investment through the fuel clause was previously authorized in Order No. PSC-02-0655-AS-EI.[3] Paragraph 9 of the stipulation approved in that order states the following:

> 9. Beginning with the in-service date of Hines Unit 2 through December 31, 2005, FPC will be allowed to recover through the fuel cost recovery clause a return on average investment and straight-line depreciation expense (but no other non-fuel expense) for Hines Unit 2, to the extent such costs do not exceed the unit's cumulative fuel savings over the recovery period. All costs associated with Hines Unit 2, including those described in this section, are subject to Commission review for prudence and reasonableness as a condition for recovery through the fuel cost recovery clause. The investment for Hines Unit 2 upon which a return is recovered under this section will be excluded from rate base for surveillance reporting purposes during the recovery period.

The consideration of staff's recommendation, dated September 27, 2007, was deferred at the October 9, 2007, Agenda Conference. On October 12, 2007, a Joint Motion for Approval of Stipulation and Settlement Agreement (Agreement) was filed. The joint movants[4] agreed that the jurisdictional revenue requirements for Hines Unit 2 and Hines Unit 4 were $36,339,546 and $52,354,000, respectively. The joint movants also agreed that the base rate increase would be

[3]Order No. PSC-02-0655-AS-EI, issued May 14, 2002, in Docket No. 000824-EI, <u>In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light</u>, and in Docket No. 020001-EI, <u>In re: Fuel and purchased power cost recovery clause with generating performance incentive factor</u>.

[4]The joint movants to the Agreement are Progress Energy Florida, Inc., Office of the Public Counsel, AARP, Florida Industrial Powers User Group, White Springs Agricultural Chemicals, Inc., and the Florida Retail Federation. The joint movants are those that signed the Stipulation and Settlement Agreement approved in Order No. PSC-05-0945-S-EI except for the Attorney General of the State of Florida, Sugarmill Woods Civic Association, Inc., Buddy L. Hansen, and the Commercial Group.

effective with the first billing cycle in January 2008. In addition, PEF would be allowed to retain one half ($1,458,020) of the Hines Unit 2 revenue requirements for December 2007 currently being recovered through the fuel cost recovery clause.

This recommendation addresses the Agreement resolving the issues related to the base rate increase associated with the revenue requirements for Hines Unit 2, Hines Unit 4, and the related transmission facilities. The Commission has jurisdiction over this matter pursuant to Sections 366.05 and 366.06, Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission approve the proposed Stipulation and Settlement Agreement?

Recommendation: Yes, the Commission should approve the proposed Stipulation and Settlement Agreement. In addition, starting with the first billing cycle in December 2007, PEF should include bill inserts to notify its customers of the proposed base rate increase. (Slemkewicz, Sickel, Draper, Lester, Springer)

Staff Analysis: The joint movants have proffered the proposed Stipulation and Settlement Agreement (Attachment A) as a complete resolution of all matters pending in this docket. The major elements contained in the Settlement Agreement are as follows:

- Jurisdictional base rate revenue requirement for Hines Unit 2 is $36,339,546 (Paragraph 2)
- Jurisdictional base rate revenue requirement for Hines Unit 4 is $52,354,000 (Paragraph 2)
- Base rate increase effective with the first billing cycle in January 2008 (Paragraph 3)
- Recovery of one half ($1,458,020) of the installed cost of Hines Unit 2 through the fuel cost recovery clause for the month of December 2007 (Paragraph 4)

There is also an attachment to the Agreement that shows the proposed rates and charges. Although most of the paragraphs are self-explanatory, staff believes that several of the paragraphs merit comment. These are as follows:

Paragraph 2: The joint movants have agreed that the requested jurisdictional base rate revenue increases of $36,339,546 (Hines Unit 2) and $52,354,000 (Hines Unit 4) are the appropriate revenue requirements to be placed into effect. Although not explicitly stated, the agreed upon revenue requirements include the $41 million of costs in excess of the need determination for Hines Unit 4 and the related transmission facilities. Staff has reviewed the revenue requirement calculations for Hines Unit 2 (Attachment B) and Hines Unit 4 (Attachment C). The proposed base rate revenue increases are the appropriate amounts. Staff also has reviewed the Hines Unit 4 cost overruns and determined that the additional costs were necessary and reasonable.

Paragraph 3: In its petition, PEF had proposed that the base rate increase would become effective with the first billing cycle of December 2007. Per the Agreement, the proposed base rate increase will become effective with the first billing cycle in January 2008. Staff has reviewed the calculation of the rates and charges attached to the Agreement. This paragraph also provides that revised tariff sheets will be filed within 45 days of the approval of the Agreement.

Paragraph 4: In its petition, PEF had proposed that the base rate increase would become effective with the first billing cycle of December 2007. In addition, PEF would immediately cease any further recovery of the revenue requirements of the installed cost of Hines Unit 2 through the fuel cost recovery clause. However, the Agreement provides that the base rate increase will not become effective until the first billing cycle of January 2008. The Agreement allows PEF to recover one half ($1,458,020) of the installed cost of Hines Unit 2 through the fuel cost recovery clause for the month of December 2007. The actual recovery of the $1,458,020 will not occur until 2009 as part of PEF's 2007 final true-up.

Staff has reviewed the terms of the Agreement. The proposed jurisdictional base rate revenue increases of $36,339,546 (Hines Unit 2) and $52,354,000 (Hines Unit 4) are calculated in compliance with the provisions of the Stipulation approved in Order No. PSC-05-0945-S-EI. Although it is not specifically stated, the Agreement resolves any potential dispute concerning the $41 million of costs in excess of those approved in the need determination for Hines Unit 4 and the related transmission facilities. In addition, the Agreement resolves any potential dispute concerning the effective date for the implementation of the revised tariffs. The Agreement also provides that revised tariff sheets will be filed within 45 days of the approval of the Agreement. Staff recommends that the Commission should approve the Agreement.

Beginning with the first billing cycle in December 2007, PEF should include bill inserts in customers' bills providing notification of the base rate increase. For residential customers, PEF should also state the impact on the 1,000 kwh residential bill. PEF should provide staff with a copy of the bill insert for staff review. PEF's current 1,000 kwh residential bill is $110.34. The base rate increase adds $2.73 to the 1,000 kwh residential bill. However, PEF's projected decrease in 2008 fuel costs will more than offset the base rate increase. PEF projects that the 1,000 kwh residential bill will decrease to $108.11 starting in January 2008.

Issue 2: Should this docket be closed?

Recommendation: Yes. If the Commission approves the Stipulation and Settlement Agreement and no protest is filed within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. If a protest is timely filed, the revised rates should remain in effect, with revenues held subject to refund pending resolution of the protest. (Brown)

Staff Analysis: If the Commission approves the Stipulation and Settlement Agreement and no protest is filed within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. If a protest is timely filed, the revised rates should remain in effect, with revenues held subject to refund pending resolution of the protest.