ORIGINAL

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October 9, 1998

VIA HAND DELIVERY

Blanca S. Bayo, Director
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Re: Docket No. 980693-EI

Dear Ms. Bayo:

Enclosed for filing and distribution are the original and fifteen copies of the Florida Industrial Power Users Group's Post-Hearing Reply Brief in the above docket.

Please acknowledge receipt of the above on the extra copy enclosed herein and return it to me. Thank you for your assistance.

Sincerely,

Vicki Gordon Kaufman

VGK/pw
Encls.

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11159 OCT-9 98

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by Tampa Electric Company for Approval of Cost Recovery for a New Environmental Program, the Big Bend Units 1 and 2 Flue Gas Desulfurization System.	)))))	Docket No. 980693-EI Filed: October 9, 1998

THE FLORIDA INDUSTRIAL POWER USERS GROUP'S

POST-HEARING REPLY BRIEF

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11159 OCT-9

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PRELIMINARY STATEMENT

One of the complexities of the Environmental Cost Recovery Clause (ECRC) is that it, like all other cost recovery clauses, enables the utility to keep a separate set of books for a specified endeavor. This reply brief will respond to some of the points in TECo's initial brief that shed additional light on how this dual accounting method disadvantages current consumers. Much of the argument posed in TECo's initial brief is based upon evidence outside the record, but FIPUG will not fuss about that herein.

SUMMARY OF ARGUMENT

When the TECo petition and its initial explanatory brief are dissected, the examiner finds that there are three distinct requests for Commission action:

1. That the FGD plan for removing sulphur dioxide from the atmosphere after coal is burned in TECo's boilers be approved;

2. That TECo be allowed to add $7.2 million to the construction cost of its FGD by booking an AFUDC rate which includes a return on equity at the top of its authorized range; and

3. That the Commission authorize TECo to use the Environmental Cost Recovery Clause after the plant is built without further proof that the current clause is appropriate.

FIPUG responds to these requests by saying:

1. The law does not require TECo to submit its plan in advance of construction, but if it does, it must submit a complete plan in a timely fashion so that alternatives can be rationally explored. The plan submitted was too little and too late.

2. It is inappropriate to book AFUDC in this case because there is already sufficient CWIP in the rate base to cover the FGD construction carrying costs. Whether TECo is allowed to book AFUDC is discretionary with the Commission. Even if there were no CWIP, AFUDC should be disallowed in this case because the AFUDC rate embedded in the rule would result in an arbitrage profit to the utility.

3. Heretofore, the ECRC clause has primarily been used to recover current expenses. The present clause should not be used when the environmental compliance

plan chosen entails the construction of a major facility that has a useful life of 25 years or more. In addition, the present clause does not fairly apportion the environmental cure cost between retail and wholesale customers.

This case is not an emergency; no one is harmed by postponing a decision until all the facts are known.

ARGUMENT

ISSUE 1

Has TECo adequately explored alternative solutions?

Burning coal emits sulphur dioxide (SO2), nitrous oxide (NOx) and other pollutants into the atmosphere. TECo has undoubtedly fully analyzed the manner by which it will comply with the CAAA without burning less coal or reducing sales, but failed to share this information in its petition, testimony or brief.

The smoking gun surfaced this week in the testimony of TECo witnesses Greg Nelson and Karen Zwolak filed in Docket No. 980007-EG. These witnesses ask the Commission to grant authorization for TECo to collect $1.6 million from consumers in 1999 to pay a small part the operating and carrying costs for the investments to be made for SO2, NOx removal and other CAAA compliance costs. Under separate cover FIPUG, will request the Commission to open the record in this case to receive this newly discovered evidence. The testimony of TECo's own witnesses shows that TECo has a complete plan in place and under construction. Why then does this petition only deal with SO2?

TECo's theory must be that it will pain consumers less if the cost needle is inserted in a series of jabs rather than all at once. This dynamic jab approach is forbidden by law when CAAA plan preapproval is sought as TECo has done in this case. FIPUG will not reiterate the arguments previously presented by the Intervenors on this point by motion, in argument and brief, except to point out once again that § 366.825, *Florida Statutes*, dealing with preapproval of CAAA compliance plans and

§ 366.8255 dealing with cost recovery for CAAA plans require the Commission to consider the whole plan to see if it is in the public interest rather than dealing with the issue in a piecemeal fashion. Section 366.825(3) states:

> The commission shall review a plan to implement the Clean Air Act compliance submitted by public utilities pursuant to this section in order to determine whether such plans, the costs necessarily incurred in implementing such plans, and any effect on rates resulting from such implementation are in the public interest.

An earlier section of the law sets out the minimum information that must be submitted for plan analysis. Without having the minimum information in hand, no determination can be made to see if alternatives have been fairly evaluated. Nelson's testimony provides another piece and runs the rate increase to consumers in 2001 to over $22 million if TECo gets its way. We see that environmental cost recovery for coal burning utilities is not a penny ante business. It is a big WAZOO.

TECo's review of alternative approaches must not be just to preserve the coal business for its affiliated mining and transportation company as LEAF suggests might be the case with this petition. It must come forward at some time and expose its total plan so that the Commission can see all pieces of the puzzle when it makes its review to determine if the rate impact on consumers is in the public interest. When the total cost is exposed, alternatives, such as, a gas plant which LEAF suggests eliminates the SO2 and NOx problem by eliminating their source, may be a better approach.

The rate impact on retail consumers might be ameliorated as FIPUG suggests by having the wholesale customers pay a share of the clean-up cost that is proportional to the coal burned to meet their demand. If TECo is able to compete for

this business by using lower cost coal, the Commission should ensure that the retail customers don't pick up part of the coal cost as well as all of the generating plant capital cost so that TECo can beat its competitors in the wholesale market.

Concentrating only on the SO2 compliance cost, as TECo has done in this case, avoids a fair presentation. No one flying from Tallahassee to Los Angeles would look only at the cost to fly to Denver with the idea of buying a second ticket for the remainder of the flight while ignoring the cost of a single ticket from Tallahassee to Los Angeles. Why should the Commission be asked to do something similar in this case?

ISSUE 6

Should the Commission approve TECO's request to accrue allowance for funds used during construction (AFUDC)for the proposed FGD system on Big Bend Units 1 and 2?

In its initial brief, TECo seeks to justify the opportunity to earn AFUDC on the scrubber project, by attempting to rebut the OPC/FIPUG illustration that there is already sufficient CWIP in the rate base to cover the project. Even if TECo were to win that argument it does nothing to justify AFUDC. Nevertheless, it loses the CWIP argument. Exhibit No. 13, Schedule 2, page 1, refutes the unsupported assertion in the TECo brief that there is no CWIP in the rate base. That exhibit, prepared by a TECo representative in the normal course of business and submitted to the Commission under oath, acknowledges that in 1998 the company has $21 million of unidentified CWIP in rate base. This CWIP is in addition to the $506 million cost of the new Polk Power Plant that has been added to the rate base since the last general rate

case. TECo is already earning a return on this amount. Blanket approval of AFUDC for the scrubber project would violate the portion of the rule that prohibits recovery of AFUDC on top of CWIP.

Exhibit No. 13 shows there is sufficient CWIP to cover the first year's construction. The project will be completed in the second year.

Rule 25-6.0141(1)(c)4, *Florida Administrative Code*, requires Commission preapproval of AFUDC for "portions of projects providing service during the construction period." The new smoke stack and scrubber will be a portion of Big Bend Units 1 and 2. These are generators presently providing service. Presumably, preapproval does not come just because a utility asks. The rule must contemplate that TECo will justify the propriety of booking AFUDC. In this case, the need is unjustifiable.

It is with understandable trepidation that the uninitiated venture into the arcane dominion of the Financial Accounting Standards Board, the birth place of AFUDC. But the explanation provided by the accounting standards for this concept is clear and understandable even to the ordinary mind. The standards are created by this arm of the American Institute of Certified Public Accountants for the purpose of providing a uniform and accurate method of financial accounting.

There are two pertinent standards to this case: FAS 34, Capitalization of interest cost and FAS 71, Accounting for the Effects of Certain Types of Regulation. The first standard relates to the way unregulated businesses currently report interest attributable to long-term construction projects that will be in service later. The second

standard, FAS 71, deals with the reporting criteria for regulated companies for similar long term construction projects. The distinguishing characteristic of the twc standards is explained in the board's summary of FAS 71:

> If rates are based on the allowable costs that include an allowance for the cost of funds used during construction (consisting of an equity component and a debt component), the company should capitalize and increase net income by the amount used for rate-making purposes--instead of capitalizing interest in accordance with FASB Statement No. 34, Capitalization of Interest Cost.

FAS 71 Summary.

In the current financial reporting period, the unregulated business does not reduce current earnings by interest expense paid in the current year if interest is attributable to money borrowed to finance a project that will be in service after the current year. Accountants conclude that while it is proper for an unregulated company to postpone reporting a current out-of-pocket cost, it is not proper to show a current profit on equity. In an unregulated competitive enterprise, there is no guarantee of profit.

The regulated business offsets this type of interest with AFUDC, but unlike the unregulated business, AFUDC also imputes earnings to the equity component of capital structure. It can only report this these additional earnings however:

> If regulation provides assurance that incurred costs will be recovered in the future, this Statement [FAS 71] requires companies to capitalize those costs.

FAS 71.09(b).

When these straightforward explanations are considered, we see that what is really happening in this case is that TECo is seeking assurance in advance from the Commission that not only out-of-pocket interest costs, but also a return on equity can be added to hard construction costs to elevate its prospective rate base for ECRC compliance by $7.2 million. (Exhibit No. 2). If the AFUDC rate is chosen, the soft cost addition will include the return on equity allowed in 1993 even though the capital structure and cost of capital of the company has changed dramatically.

The question is, should the Commission give this assurance? The AFUDC rate established by the rule deals with construction projects that are encompassed in base rates. The theory is that you cannot pinpoint the exact funds that were used for the construction project so the cost of the composite capital structure is chosen. ECRC costs are kept in a separate set of books independent of base rates according to TECo. It claims entitlement to a full profit on these costs even though earnings may be capped in the base case or the utility may be earning in excess of its authorized return when the assets go into service. The AFUDC theory designed for base rate application should not be blindly applied to a guaranteed cost recovery mechanism.

The applicable AFUDC rate established by Rule 25-6.0141(2) assumes that a construction project is funded from the composite sources of capital delineated in the utility's capital structure. While it might be appropriate to use the current AFUDC rate for additions to rate base, it is not appropriate for a major capital addition to be amortized through a cost recovery clause.

In this case, we can pinpoint some funds that are available for the construction. The availability of these funds militates against using the AFUDC rate. TECo is already earning its full return on CWIP as shown above, so there is no need to add an AFUDC windfall. Even if CWIP did not disqualify using the AFUDC rate, there are other specific sources of funds available for this project that should be examined before rubber stamping the "applicable" AFUDC rate as it is defined in 25-6.0141(2).

TECo's current AFUDC rate is 7.79%. This is higher than the 5.94% interest the company is using to fund the project according to a July 31, press release, acknowledged by Mr. Hernandez (Tr. 197); it is higher than the 5.46% customers are paying for the privilege of having TECo hold excess profits it collected from them in 1995 and 1996 (Order No. PSC-98-0802-FOF-EI); it is higher than commercial paper rates which would be prudent to use for this short-term construction project.

Why should the Commission assure TECo that it can earn a higher rate than the costs it will actually incur to complete the FGD construction? If the prudency determination is postponed until the assets are in place, does a current assurance of AFUDC recovery undermine a fair review of prudency when the issue arises? Of course it does. Does deferral of the AFUDC decision commit the Commission one way or the other on the AFUDC question? Of course it does not. Under the circumstances, no decision should be made at this time. No harm is done by waiting until the facts are in.

ISSUE 7

Probably the greatest failing in TECo's case arises out of the method glowingly reported as the crown jewel in TECo's initial brief where it said:

> The BB 1 and 2 stand alone option demonstrate the greatest relative benefit to ratepayers. As noted above the BB1 and 2 FGD option yields a net system present worth revenue requirement savings to ratepayers of $18 million over the first 10 years, $80 million over the first 20 years and $95 million over the first 25 years of operation as compared to the base case scenario . . . (Page 9)

The intergenerational equity problem:

What the brief doesn't say but the quote clearly exposes, is the fact that the cumulative net worth revenue requirements ("CPWRR") method used to justify the FGD investment is an intergenerational subsidy program. The savings will go to customers who don't have to pay for the investment that makes the savings possible. The quoted language shows that the savings occur after today's customers have paid off TECo's investment. It occurs then only if TECo's estimates of future fuel costs are accurate. We can't check the accuracy of these estimates because TECo does not supply them.

CPWRR is used by most businesses contemplating a major capital investment. It shows the internal rate of return of the proposed investment to the business. This return is then compared to alternative solutions to see if the project should go forward. CPWRR is not a method that should be employed in the Commission's task of setting current rates. The Commission has historically tried to match rate payment to costs incurred or benefits received. The classic example is income tax

normalization. This ratemaking concept allows TECo to charge current customers for income taxes that it doesn't have to currently pay so that a deferred tax fund will be available to ease the burden on future customers. It looks nice that deferred taxes are a no cost or low cost component of the rate base, but customers get no benefit from this fact until there is a general rate case. The CWIP and AFUDC concepts discussed above are other examples of rate normalization used to avoid intergenerational inequity. Unfortunately, it appears that current customers are always getting the rate shaft to protect some infinite league of future customers who never seem to come over the regulatory horizon.

Mr. Hernandez' Exhibit No. 12 (TLH-1), at bates-stamped page 135, attached as an appendix to this brief, shows the pay now, save later cost benefit curve that justifies a major current capital investment based on future undisclosed fuel cost savings if they materialize. It also shows how current customers will pay to subsidize the future savings whether they materialize or not.

Heretofore, as TECo points out in its brief, the ECRC clause has been used to reimburse utilities principally for their current expenses with only modest capital costs involved. This case heralds a new era of cost recovery based on major capital expenditures. The Commission needs to re-examine the collection procedure before acting in this case. Before approval of cost recovery, the clause needs to be reformed to deal with economy wholesale sales. Before approval of cost recovery, the clause needs to be reformed to deal with intergenerational inequity.

The Base Rate Problem:

There is another very compelling reason why cost recovery should not be authorized at this time. No consideration has been given to base rates, even though both § 366.825 and § 366.8255, *Florida Statutes*, require that attention to be given to this subject. Furthermore, there is no compelling reason why the Commission should attempt to speculate on year 2001 earnings this far in advance. At page 13 of its initial brief, the articulate draftsman says:

> Tampa Electric will only be permitted to earn within its authorized rate of return on equity pursuant to the terms of the rate Stipulation. In any event after the Stipulation period ends, this Commission retains the *very effective* continuing surveillance program to monitor earnings. . . . Therefore, there should not be a concern that the Company may overearn on its retail rate base now or in the future.

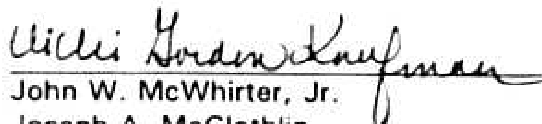
(Emphasis supplied).

Commissioner Clark highlighted the problem of relying on the surveillance report at page 214 of the transcript. It is a timing problem. It would be improper to rely upon a single surveillance report to conclude that there are overearnings. It takes months and usually years to reach the conclusion that overearnings exist. After that, rates cannot be adjusted until after a full general rate case, taking many months. § 366.07, *Florida Statutes.* The rate adjustment can only be prospective. The regulatory delay creates an overearnings hiatus. The cost recovery mechanism needs to be reformed to avoid a serious OW (overearnings windfall) when the cost recovery needle is inserted.

CONCLUSION

TECo's presentation is based on hopes and promises. The statutory ECRC is a guaranteed cost recovery mechanism. If guarantees are wanted, they should also be given. If TECo wants early cost recovery approval before all the facts are known put a hook in the cost recovery. Extend the base rate earnings cap and link the cost recovery entitlement to promised fuel savings. Allow cost recovery to be imposed only when the savings materialize. This way the risk of inaccurate savings estimates are shared by the utility and its customers not borne by customers alone.

Cost recovery should not be approved until the mechanism is reformed to deal with the new focus on capital investment to achieve environmental compliance.



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APPENDIX

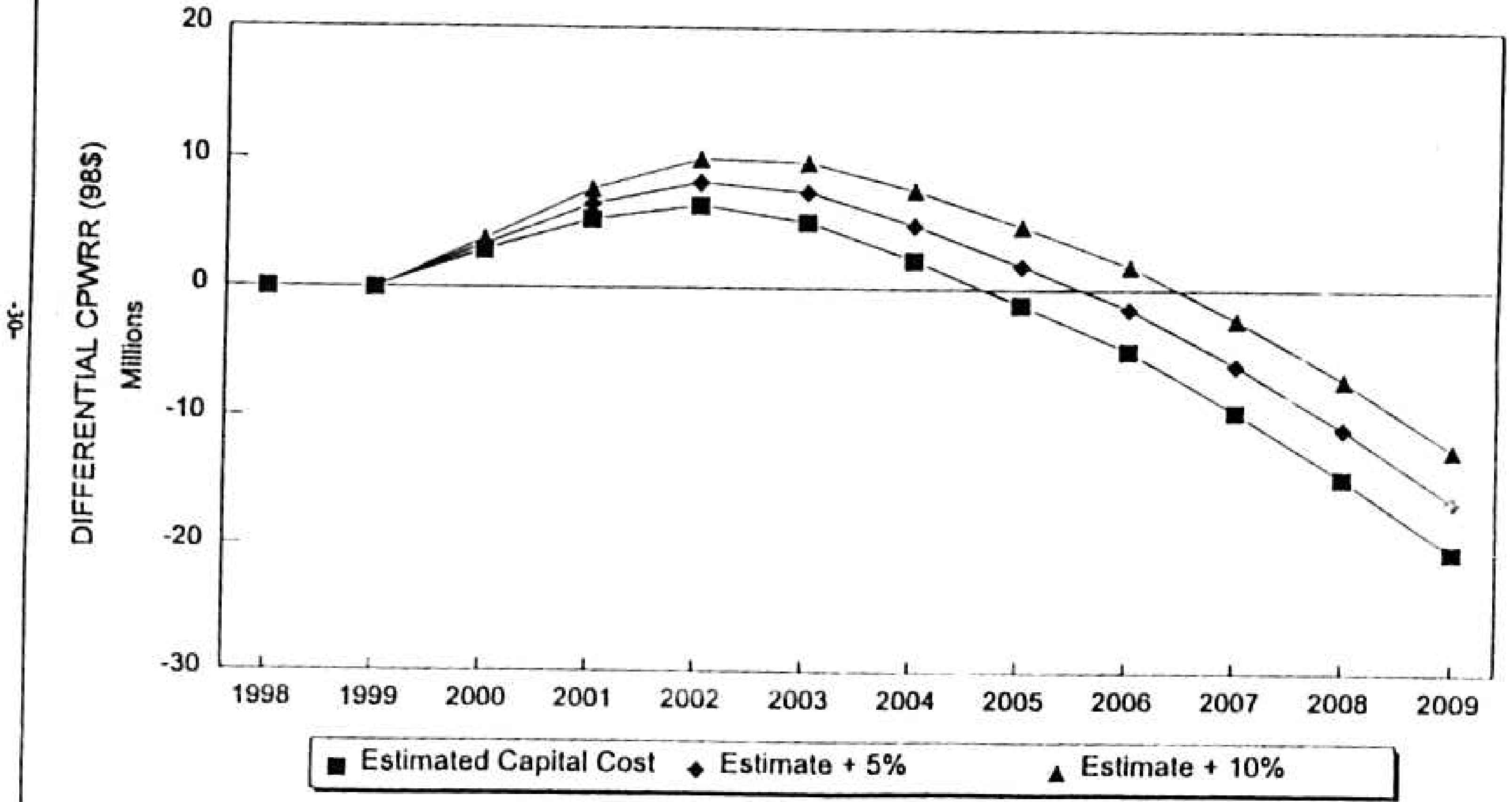
FIGURE 3-1
BB1&2 FGD CAPITAL COST SENSITIVITY
DIFFERENTIAL VS. BASE CASE
DIFFERENTIAL CPWRR (98$)
Millions
20
10
0
-10
-20
-30
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
Estimated Capital Cost
Estimate + 5%
Estimate + 10%

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of **FIPUG's** foregoing **Post-Hearing Reply Brief** was furnished by hand delivery (*) or U.S. Mail to the following this **9th** day of **October, 1998**:

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