IN THE SUPREME COURT OF FLOIRDA



GULF POWER COMPANY,

Appellant,

vs.

FLORIDA PUBLIC SERVICE COMMISSION,

Appellee.

Case No.: 66,632

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INITIAL BRIEF OF APPELLANT

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## PRELIMINARY STATEMENT

Appellant, Gulf Power Company will be referred to as "Gulf Power", "Gulf" or "the Company." Appellee, Florida Public Service Commission, will be referred to as "Public Service Commission" or "the Commission". Southern Company Services will be referred to as "SCS", "Southern Services, or "the Services."

References to the record will be designated "R _____," the transcript of the final hearing held on August 23, 1984, "T _____," and the Appendix to this brief, "Appendix ____."

## STATEMENT OF CASE

In early April of 1981, Gulf Power Company requested a meeting with the Commission Staff to discuss commencing an accrual for recovery of reclamation and closure costs which were expected to be incurred upon closure of the Maxine Mine in June of 1984. The meeting took place on April 8, 1981. Gulf Power commenced the accrual on March 1, 1981. Discussions with the Commission Staff preliminary to the May 1982 fuel adjustment hearings indicated that the Commission intended to take up the subject of the Maxine Mine closure and reclamation accrual during the course of those hearings. By letter dated April 30, 1982, counsel for Gulf Power requested that the subject of the Maxine Mine closure be considered at a separate hearing. Tr 48. The request was granted by Order No. 10783, which provided as follows:

> ORDERED by the Florida Public Service Commission that the question of the prudency of purchases by Gulf Power Company from Alabama By-Product Corporation's Maxine Mine shall be considered at a hearing separate from the true-up hearings set for May, 1982. It is further
>
> ORDERED that any delay in considering the issue of prudency shall not be to the prejudice of the Commission's power to act and any decision at such later time shall be as though entered in conjunction with the true-up hearings.

By notice dated August 31, 1982, the Commission set a final hearing for September 22, 1982. On September 9, 1982, Gulf Power Company filed its motion for continuance based upon the anticipated unavailability of its key witness, J. Gibson

Lanier. By order dated September 16, 1982, Order No. 11171, Gulf Power's motion for a continuance was granted. By notice dated October 29, 1982, the hearing was rescheduled for December 13, 1982. On December 13, 1982, the Commission issued Order No. 11408 continuing the hearing to January 17, 1983, and clarifying the scope of the hearing. In that order, the Commission held that the issues to be addressed in the hearing were:

> (a) Whether the prices paid by Gulf Power Company for Maxine Mine coal during the period January 1, 1981 through September 30, 1982, were reasonable and prudently incurred, and, if not, what amount should be disallowed for that period;

The hearings were later rescheduled and held on September 15 and 16, were reconvened on September 28, and were concluded on September 29, 1983. The Commission's order requiring refund was issued on June 22, 1984, with the order becoming final on July 6, 1984. (Order No. 13452, Appendix A) R 146. Gulf filed its motion for reconsideration on July 23, 1984. R 171. The Public Counsel also filed a motion for reconsideration on August 6, 1984. R 202. The Commission's order denying the motions for reconsideration was issued on February 15, 1985. Order No 14089, R 229. Gulf filed its appeal of the Commission's decision on February 28, 1985. R 231.

## STATEMENT OF FACTS

In 1949, the four operating companies of the Southern Electric System conducted an in-depth review of fuel alternatives. Based on this review, a decision was made for the operating companies to rely on coal as their primary generating fuel source. Shortly thereafter, Gulf Power began construction of the first pulverized coal-fired generating unit in Florida at the Scholz Plant. The first unit (40MW) began commercial operation in early 1953, and the second unit was completed shortly thereafter. A reliable coal supply was sought. Since the demands of the Scholz Plant alone were too small to justify the development of an economically sized, dedicated mine, and the Scholz Plant was originally jointly owned by Alabama Power, Georgia Power, and Gulf Power, a mine contract involving all three companies was sought. Tr 684-685.

On August 19, 1952, the Maxine Mine contract was entered into by Gulf, Alabama, and Georgia, as purchasers, and Alabama By-Product Corporation (hereinafter ABC), as the operator. (Ex. 3, Sch. 1) The contract was viewed as offering Gulf a high quality washed coal product, multiple transportation modes (barge, rail, and truck), attractive transportation costs to Gulf's service area, supply and demand diversity from multiple operating company participation, and association with a strong and stable coal mining operator. Tr 685-686.

From the early 1950's through the early 1960's the Maxine contract provided Gulf with a reliable, low cost source of quality coal. On several occasions, the contract term was extended. In 1963, Gulf Power Company was afforded the opportunity to enter into arrangements for the purchase of natural gas from United Gas Company and coal from Pittsburg and Midway Coal Company (P & M) at a lower delivered cost per million BTU than it was currently paying for the delivered Maxine coal. Negotiations were entered into between the three operating companies involved in the Maxine contract and Southern Company Services, Inc. (SCS). On December 31, 1963, an agreement was executed which ultimately reallocated the output of coal from Maxine America Mine to Alabama Power. The original contract had allocated production 33-1/3% to each operating company. The contract reallocating production also provided that any "excess" of cost to Alabama Power as a result of its taking all of the output of Maxine Mine, as compared to possible other competing sources of coal, was to be shared by Georgia Power Company and Gulf Power Company. Tr 690-691. (Ex. 3, Sch. 11) It is estimated that during the period this reallocation amendment was in effect, Gulf Power Company saved its customers well over one million dollars. Tr 715. (Ex. 3, Sch. 26)

In late 1968, due primarily to an underground mine fire in the DeKovan Mine of P & M, Gulf's major coal supplier, Gulf developed a critical coal situation. It was estimated that the DeKovan Mine would be able to resume operation after a delay of two or three years. Gulf therefore began seeking an immediate source of substitute coal.

Upon determining the need, Southern Company Services, Inc. and Gulf Power Company conducted a study of possible alternative sources of coal. This analysis indicated that Maxine Mine offered a supply of coal which had the advantage of being immediately available, was competitive with alternative sources on a "cost per ton" basis, and was more than competitive on a cost per million BTU basis due to the unusually high quality and heat content of the Maxine coal. For these reasons, Gulf decided to purchase an appropriate amount of Maxine coal to substitute for the anticipated temporary loss of the DeKovan coal.

The DeKovan Mine did not resume production. The owners of the DeKovan Mine declared a "force majeure", terminating the contract. Gulf disagreed, deeming the failure to resume production the result of the contract price being less than the cost of production. Gulf sued P & M, and ultimately recovered a settlement of $1.6 million, which was passed on to Gulf's customers.

The loss of the DeKovan production dictated that Gulf find a permanent substitute source of coal beyond 1972. Gulf decided to reinstate its one-third share of the Maxine production. This decision was based on the fact that Maxine coal was economical, especially when considered in terms of cost per million BTU and the demonstrated immediate availability and reliability of the source of supply. Tr 691-694. During this period of time, Gulf's problems with the DeKovan and Peabody coal had led to critical shortages on Gulf's coal stockpile. (Ex. 3, Sch. 28) In a meeting on December 27, 1973, Mr. E. L. Addison of Gulf Power informed to Peabody Coal Company of Gulf's critical shortage and sought Peabody's continued effort to correct the serious problems with production in the Eagle No. 2 Mine. At this point, Gulf was in the worst condition of all Florida utilities from a fuel reserve standpoint. (Ex. 3, Sch. 34) ABC had demonstrated for the past twenty years that it could provide the much needed economy and reliability for the past twenty years, and offered an immediate source of coal to allay the critical shortages on Gulf's coal stockpile.

In order to prevent the expiration of the Maxine contract in mid-1974, an option to extend had to be exercised on or before January 1, 1974. The formal extension provision provided as follows:

> If this agreement is not cancelled or terminated by buyer prior to the expiration of the term hereof, and if the recoverable coal has not been or prior thereto been worked out, then the buyer shall have the right or option, upon six (6) months' notice to seller prior to the expiration of such term, <u>to renew or extend this agreement as to all of its terms and conditions for a further period of ten (10) years or until the recoverable coal is earlier mined or worked out.</u>

(Ex. 3, Sch. 5) Tr 723. (Emphasis added)

In early 1972, Alabama, Gulf and Georgia, in conjunction with Southern Company Services, began the formal process of considering an extension of the Maxine America Agreement. In a series of correspondence, telephone conversations, and meetings between and among the operating companies and Southern Company Services, the wisdom of exercising the extension was discussed. As stated above, one of Gulf's primary concern was obtaining a reliable, economical source of coal. In addition to the devastating effect of the default by P & M under the DeKovan Agreement, and Gulf's Crist Unit 7 coming on line in 1973, Gulf was continuing to experience considerable difficulties under its long-term agreements with Island Creek Coal Company and Peabody Coal Company. Its coal inventory remained dangerously low. Tr 725 (Ex. 3, Sch. 33, 34 & 35; Ex. 5, Sch. 16)

Southern Company Services recommended that Gulf exercise its option to extend the Maxine contract. This was done on the basis of comparisons of delivered cost of alternative sources meeting Gulf's requirement from a quantity and quality standpoint; the state of the coal market from a supply standpoint; the existing environmental uncertainties; and Gulf's then existing coal supply program and inventory levels. It was determined that Maxine offered a reliable, cost effective, flexible (from a transportation standpoint), high quality (wash), and large quantity source of supply. Tr 722, 962-963.

In deciding whether to accept the recommendation of Southern Company Services, one of Gulf's primary concerns was production. The America Seam, which had been the subject of the 1952 contract, lay under the Pratt Seam, which as of the time of the 1972-1974 negotiations had been unmined. By agreement dated September 8, 1970, Alabama Power Company was given an option to have ABC mine the Pratt Seam. (Ex. 5, Sch. 15A) By letter dated May 22, 1972, Mr. William G. Lalor, Jr., of Southern Company Services, Inc., transmitted to Gulf Power Company the estimated production schedule for the America and Pratt Seams from 1972 through 1996. (Ex. 5, Sch. 15B) This production schedule indicated a gap in the America Seam production between

1980 and 1986. The reason for the anticipated gap in production was the necessity to leave pillars of coal in the America Seam in order to support mining of the Pratt Seam above. Concerned about the gap in production, Gulf, in a series of correspondence and conversations, raised the question of how the gap could or should be dealt with under the Maxine America Agreement, particularly as it related to the rights and obligations between Gulf and Alabama under an extension. Tr 648-650. Gulf's concern was that it recover its share of the Maxine coal in regular annual quantities without interruption from development of the Pratt Seam. Receipt of its share of America Seam production from the Pratt Seam was advantageous to Gulf in that the Pratt coal offered a higher BTU content, lower ash, and lower sulfur content than the America Seam coal. (Ex. 5, Sch. 16)

It is clear from the correspondence that Gulf anticipated receiving its share of the America Seam coal, through both the America Seam and Pratt Seam, at the 1972 rate of production. At this rate of production, Gulf would have received its full share of the America Seam coal between 1977 and 1979. This was the sole basis for the several references to 3-to-5 year extensions in the correspondence. Tr 725-726, 802-803.

By letters dated May 17, 1972 and October 25, 1972, George Layman of Gulf Power notified Southern Company Services of Gulf's concurrence in the recommendation of Southern Company Services fuel department that the Maxine contract be extended for total recovery and a share of the output. (Ex. 5, Sch. 16, Sch. 17) By letter dated December 19, 1973, W. H. Haynes, Jr., of Southern Services, Inc., requested that Gulf Power Company and Alabama Power Company once again express concurrence in the extension prior to the exercise deadline of January 1, 1974. (Sch. 5, Ex. 17C) By letter dated December 27, 1973, from George Layman to Mr. Haynes, Gulf Power expressed its concurrence in the exercise of the option. (Ex. 5, Sch. 18A) By letter dated December 28, 1973, the option was exercised to extend the agreement for a period of ten (10) years from June 30, 1974 or until the recoverable coal was earlier mined or worked out. (Ex. 3, Sch. 40; Ex. 5, Sch. 17E) Tr 727.

An amendment exercising the buyers' option to extend the Maxine America agreement and amending the agreement in other areas was forwarded to Gulf Power Company on July 18, 1974 for execution. (Ex. 3, Sch. 43) On July 22, 1974, John Howard of Gulf Power wrote Southern Company Services, inquiring about the amendment and its failure to address Gulf's obligation after it had received its proportionate share of the America Seam reserves. (Ex. 5, Sch. 22) Gulf had agreed to the basic terms of the extension and deliveries thereunder, but was concerned about the agreement between it and Alabama Power regarding Gulf's receiving its proportionate share of the America Seam reserves out of the Pratt Seam. Thereafter, the production schedule changed drastically, additional reserves were added, and the depletion of America Seam reserves slowed so that America production was contemplated on a continuous basis beyond June 30, 1984, one of the termination dates specified in the extension of the Maxine America Agreement. In other words, there was no longer projected to be a gap in production between 1980 and 1986, the basis of Gulf's prior concern regarding its ability to receive its share of the Maxine production on a continuous basis. Tr 728-729, 802-803, 878. (Ex. 3, Sch. 44, 45, 46 & 47)

In late 1973, the coal market, as well as all energy markets erupted, primarily as a result of the Arab oil embargo. The national UMWA strike also affected the coal market. In 1974 the average cost of Maxine FOB mine was $14.35/ton. In 1975 it was $18.72/ton. This price, for both years, was considerably lower than alternate fuel sources. During this period it is estimated that Gulf Power Company saved its customers approximately $8,130,429.00, with its participation in the Maxine contract. Tr 730. (Ex. 3, Sch. 48 and 49)

During 1973, Maxine Mine produced approximately 1,223,000 tons at a cost of approximately $10.34/ton. Over the twenty years prior to 1974, it had produced a total of approximately 25,810,614 tons of high quality coal at an average price of approximately $5.83/ton. Tr 695-696. In 1974, both production and production costs at Maxine again seemed relatively stable. Mine production and mine labor productivity began to decline in 1975. During that year, Maxine America produced 942,736 tons at an approximate cost of $18.72/ton. In 1976, the decline continued and the mine produced only 751,518 tons at an approximate cost of $22.09/ton. It was during this period that Gulf Power and Southern Company Services became concerned about the future economic viability of Maxine Mine.

Southern Company Services personnel immediately began discussions with ABC's operating personnel, who assured the Services that the trend was short-term and due to local conditions being encountered which were expected to improve.

Southern Company Services received ABC's mining plans and projections in May of 1977, and after a thorough analysis of the projections became convinced that the plans and budget as submitted were unworkable. The mining plans and budget were rejected. ABC submitted revised projections and budgets in October of 1977. Southern Company Services again advised Alabama Power Company and Gulf Power Company that it could not recommend approval of the budget.

In November of 1977, Services' employees met once again with ABC management to discuss the future of Maxine Mine. ABC personnel were requested to develop cost projections for Maxine Mine through termination of the America Seam operations and for an interim period while new mining plans and capital budgets were being developed. Numerous meetings were held to discuss the problems with each of the operating companies, as well as with ABC. In the course of those meetings, the Services recommended, in view of the diversity of opinions as to the continued economic viability of Maxine Mine, that an independent mining consulting firm be retained to conduct a separate study. Gates Engineering Company of Beckley, West Virginia, was selected to conduct the study. The initial Gates' report was received in September, 1978, with the final supplement and revision being received in May of 1979. (Ex. 3, Sch. 19)

Shortly before receipt of the final Gates' study, in April of 1979, the Services received from ABC an "addendum" to their mining plan, a plan which would provide for phase down and ultimate phase out of Maxine Mine by June 30, 1984. Tr 701-702.

For the most part, the Gates' study confirmed the conclusions previously reached by Southern Company Services and its operating companies, i.e., that there appeared to be no economically viable alternative to the closure of Maxine Mine, at a date to be determined by economic evaluation of the various alternatives available. These alternatives included immediate giving of 12-months' closure notice to ABC (an alternative that ABC disputed); closure on June 30, 1984; or, if possible, to negotiate an immediate closure. The operating companies instructed the Services to meet with officials of ABC to advise them of the company's position and to explore any alternatives which might be offered by ABC which could result in lowering the cost of coal to the operating companies.

On May 10, 1979, representatives of Southern Company Services met with officials of ABC, advising them of the necessity of closure of Maxine Mine if a viable alternative to lower the cost of coal could not be found. ABC was requested to advise of any viable alternative or in the absence of such, to provide its best estimates of closure costs under each scenario, i.e., immediate closure, closure beginning after twelve months' notice, and closure on June 30, 1984.

At this meeting, the officials of ABC indicated that they would not agree to immediate closure and advised Southern

Company Services that, in their opinion, the right to close the mine on twelve months' notice was no longer a legally effective contract provision. They did agree to evaluate any possible alternatives and advise Southern Company Services. One of the alternatives which had been discussed was the possible utilization of the Maxine coal in ABC's own coking operations. Following the meeting, ABC advised Southern Company Services officials that there was no possibility of utilization of the Maxine coal in their own coking operations. Further, there was no sale for the coal in ABC's own markets, and ABC had no production at low cost which would be available for blending in order to reduce the cost of Maxine coal. Tr 702-703.

Throughout the negotiations with ABC, Southern Company Services fuel procurement department had been analysizing the Gates' study and performing an analysis of their own regarding alternative coals and the economic viability of the various scenarios for closure. Tr 703. (Ex. 5, Schs. TF-HA3, TF-HA4) One of these studies was the "Woodfin Report", which was concluded on December 21, 1979. (Ex. 5, Sch. TF-HA4) This report concluded that of the various scenarios, the most economically viable was to accept ABC's proposal to close the mine in June of 1984. Mr. Woodfin also suggested the possibility of Gulf Power electing to terminate its obligations under the ABC contract by negotiating a settlement payment to Alabama Power for Gulf's financial responsibilities under the contract.

Well before this recommendation in the Woodfin Study, Gulf had contacted Southern Company Services, on several occasions, regarding Southern Company Services Fuel Department exploring means of relieving Gulf from the Maxine contract. Tr 1043-1055. (Ex. 5, Sch. TJF 6, 7, & 8) Pursuant to Gulf's request, Mr. Ludwig, of Southern Company Services, did attempt to negotiate a settlement with Alabama Power Company which would relieve Gulf of its share of the Maxine output. Tr 739, 854. (Ex. 3, Schs. 53 & 54) These negotiations were unsuccessful.

By letter dated January 14, 1980, J. Gibson Lanier, of Southern Company Services, advised Mr. Gilchrist of Gulf Power Company of the results of the several studies which had been conducted. In this letter, Southern Company Services recommended that a proposal be submitted to ABC to provide for continuation of the Maxine America and Pratt Operations until June 30, 1984. This recommendation was concurred in by Gulf Power and the offer conveyed to ABC. (Ex. 5, Sch. TJF-13) ABC did not immediately accept the proposal of Southern Company Services, and negotiations continued throughout 1980. Finally, in 1981, an agreement was reached regarding closure of both the America and Pratt Seams. In March of 1981, immediately following the agreement with ABC as to the closure date for Maxine, Southern Company Services recommended to Gulf Power an accrual for the cost of closure and abandonment. In April of 1981, representatives of Gulf Power Company met with Mr. Foxx of the Commission Staff to discuss the accrual. The Commission Staff's investigation of the Maxine accrual, closure costs, and the cost of Maxine coal followed. Tr 739-741.

## SUMMARY OF ARGUMENT

In the proceedings below, the Commission has deemed management decisions made in the years 1972-1979 by the fuel procurement personnel of Gulf Power relating to the extension and administration of the Maxine Mine contract to be imprudent. In essence, the Commission has, using 20/20 hindsight, substituted its judgment for that of Gulf's management. The Commission's decision as to both the extension and the administration of the contract is unsupported by competent substantial evidence. Rather, the evidence, though understandably fragmented due to the passage of time, discloses in its totality a full and complete review of alternative fuel choices and a conscience effort on the part of Gulf's management to act in the ratepayers' best interest.

The Commission's review has focused solely on the issue of the price of alternative coals while ignoring the tremendous importance of quality and reliability. The Commission has also ignored the benefits of long-term fuel contracts and would, by its decision, force utilities into the tremendous uncertainties of short term contracts or the spot coal market. This can only harm the ratepayers. It has deemed events resulting in lower coal prices as "chance" while those resulting in higher prices are deemed "imprudent." Finally, it has determined that Gulf should have cancelled the contract when it had no legal right to do so. Had Gulf breached the contract, the resulting damages would have far exceeded the "penalty" imposed herein.

Having deemed Gulf's management imprudent, the Commission then uses a methodology which it admits has "imperfections" to determine a "market price" at which Gulf could allegedly have bought coal were it not for the Maxine contract. The difference between the market price and the Maxine price is Gulf's "penalty." Neither the "market price" methodology selected by the Commission, to impose a penalty of $2,575,540 nor the eight to ten others supported by its witnesses with widely varying results, have any support in statistical theory. Moreover, even after all the witnesses testified that any methodology used to calculate a penalty must allow for error, the Commission did not do so.

In assessing its penalty, the Commission has taken fuel purchases approved in fuel adjustment hearings between July, 1980 and October, 1981 and retroactively adjusted them. This action constitutes retroactive ratemaking prohibited by law and violates the doctrine of res judicata. This position is supported by the dissent from the Commission order by Chairman Gunter.

For the convenience of the Court, the following table summarizes the "penalty" amounts associated with the various positions of the parties:

MAXINE MINE PENALTY

| PERIOD | NO ALLOWANCE FOR ERROR | ALLOWANCE FOR ERROR |
|---|---|---|
| July '80 - Sept. '82 | $2,575,540 | $1,284,521 |
| Jan. '81 - Sept. '82 | $ 869,524 | $ 314,836 |
| Oct. '81 - Sept. '82 | $ 476,997 | $ 74,772 |
| No Liability | - 0 - | - 0 - |

## ARGUMENT

### I. GULF'S DECISION TO EXERCISE ITS OPTION TO EXTEND THE MAXINE CONTRACT BEYOND JUNE 30, 1974 FOR TEN (10) YEARS OR UNTIL THE RECOVERABLE COAL HAD BEEN MINED, WHICHEVER OCCURRED FIRST, WAS PRUDENT AND IN THE BEST INTEREST OF GULF'S RATEPAYERS.

In Order No. 13452 (Appendix A), the Commission goes to great lengths to emphasize that it does not "intend to become involved in the actual management of a utility." It also emphasized that it did not seek to "retroactively apply new policies to Gulf's prior actions" and has "recognized that a utility cannot foresee the future." (Order No. 13452, p.10) To the contrary, the Commission's actions in this matter involve nothing short of the substitution of the Commission's judgment for that of utility management and the use of 20/20 hindsight to judge their actions. The Commission's decision is based upon what its own staff members admitted was fragmented information relating to events that occurred from three to fifteen years prior to the hearings. Tr 142-143. The information is justifiably fragmented, yet it sustains Gulf's position that its actions with regard to the Maxine contract have been "prudent".

The standard of "prudency" has never been adequately defined by the Commission. Although the Commission stated in its order that it had not sought to retroactively apply new policies to Gulf's prior actions, the standards by which the Commission judged Gulf's actions in this matter were those standards which resulted from the Commission's generic investigation into fuel procurement resulting in Order No.

12645. (Appendix B) This generic investigation was commenced well after the initiation of the Maxine investigation, and the standards resulting therefrom were applied to Gulf by the Commission in its decision in the proceedings below. See, Florida Power Corp. v. Pub. Serv. Comm'n, 456 So.2d 451 (Fla. 1984)

If the prudency of Gulf's decision to extend the Maxine contract was going to be reviewed by the Commission, it should have been reviewed shortly after the option was exercised. Tr 696, 721, 810, 995-999, 1015-1017. The one individual testifying at the hearing who was involved in the decision making process stated catergorically that had a prudency review been made within an appropriate time, a decision not to extend the contract would have been deemed by the Commission to have been clearly "imprudent". Tr 696. Despite the passage of time, the unavailability of key personnel involved in the decision making process and what is understandably an incomplete record of the numerous correspondence and conversations which led up to the extension, the record shows that the decision by Gulf Power to exercise its option to extend the Maxine contract was prudently made.

The Commission's findings relating to Gulf's decision to extend the Maxine contract focus on Gulf's own assessment of the value of the Maxine contract over the twenty years prior to 1972 and the preliminary decision in 1972 to exercise the option to extend for ten years. The Commission criticizes Gulf's determination of the value of the Maxine contract over the twenty year period prior to the decision to extend the contract. (Order No. 13452 pp. 3-4) It further finds that Gulf made the decision to extend in 1972 based on inadequate information. (Order No. 13452 pp. 4-5) Neither of these findings are supported in the record. The Commission's conclusions as to both the historical value of the Maxine contract and the decision to extend are based solely on its assessment of the price of alternative sources.

Throughout the proceeding, the Commission ignored the numerous other advantages which the Maxine contract offered, and focused solely on those relatively infrequent periods of time during the life of the contract in which the price was above that which the Commission determined to be "alternative sources." No consideration was given to the fact that the Maxine contract offered Gulf a high quality washed coal product, multiple transportation modes (barge, rail, and truck), and attractive transportation costs to Gulf's service area, supply and demand diversity from multiple operating company participation, and association with a strong and stable coal mining operator. Tr 685-686.

Focusing solely on price, the Commission takes issue with Gulf's assessment that the contract was a good one and was of tremendous benefit to the ratepayers of Gulf. The Commission does recognize that in the years 1964 through 1969 Gulf was able to purchase alternative fuels at a lower cost, reducing its Maxine requirements. In exchange for Alabama taking Gulf's share of the Maxine coal during this period, Gulf was required to pay excess cost payments. The Commission is correct that Gulf entered into the amendment to the Maxine contract and agreed to make the excess payments in order to secure other coal and natural gas at a lesser cost than the price of Maxine coal. Contrary to the Commission's assertion, this does not lead to the conclusion that the coal price of Maxine was out of line with the "market price" and would remain so. To experienced coal procurement personnel, the agreements meant that the Maxine contract afforded much more flexibility than would a similar long-term contract between a supplier and Gulf Power only. It is widely recognized in the industry that during the term of a long-term contract there will be periods when the price is above, as well as periods when it is below, the price of other available sources. Under most contracts, however, it would have been impossible for Gulf Power to have taken advantage of the opportunity to save its customers well over $1 million. Tr 713-715. (Ex. 3, Sch. 26)

The events leading up to Gulf's decision to extend commenced in 1969, Gulf developed a critical coal shortage, due primarily to an underground mine fire in the DeKovan Mine of P & M, Gulf's major coal supplier. Gulf needed an immediate source of substitute coal. An analysis performed by Gulf and Southern Company Services concluded that Maxine Mine offered a supply which had the advantage of being immediately available, was competitive with alternative sources on a "cost per ton" basis, and was more than competitive on a cost per million basis due to the unusually high quality and high BTU content of the Maxine coal. It had also proven to be an extremely reliable source over the past years. This conclusion was borne out in that Maxine did provide a reliable and economical source of substitute coal over the next four years. Tr 690-692.

The Commission, at page 4 of Order No. 13452, criticizes the analysis and determines that the selection of Maxine was not the prudent option because, except for the excess cost payments, Paradise Mine coal purchased from P & M would have been less expensive for the period 1970-1974. (Order No. 13452, pp. 3, 4) Again, the Commission ignores the other enumerated advantages of Maxine coal stated in the analysis, without a similar analysis of the Paradise coal. Moreover, it ignores the fact that the primary source of Gulf's reliability problem had been its relation to P & M and that P & M's failure to resume production out of the DeKovan Mine had resulted in a lawsuit. The settlement of this lawsuit resulted in a $1.6 million benefit to Gulf's customers.

In its order, the Commission finds that Gulf's decision to extend the Maxine contract was made in July of 1972, although Gulf's primary justification for doing so rests upon events that occurred after July, 1982. (Order No. 13452, p. 4) This is nothing more than an attempt by the Commission to hide behind its own retrospective judgment of Gulf's actions by attempting to accuse Gulf of the same thing. The record is devoid of any support for this finding.

An assessment was performed in 1972 by Southern Company Services which indicated that the Maxine extension offered the most viable alternative for Gulf's coal supply. It would have been imprudent on the part of Gulf Power to wait until just prior to the notification date to begin consideration of the extension. Gulf's indications in 1972 of its concurrence in the recommendation of Southern Company Services were by no means cast in stone. Gulf Power continued to evaluate its alternatives, and the facts are that everything which occurred between July of 1972 and the actual exercise of the extension on December 28, 1973, re-inforced the viability of the Maxine extension. Gulf's concurrence in the recommendation in July of 1972 was based on the facts as they existed at the time.

The facts in 1972 were that Gulf had lost its primary source of supply, i.e., the DeKovan production. In addition to the devastating effect of this default and the need to supply Gulf's Crist Unit 7, coming on line in 1973, Gulf was experiencing considerable difficulties under its long-term agreements with Island Creek Coal Company and Peabody Coal Company. Tr 725 (Ex. 3, Schs. 33, 34 & 35) Peabody Coal Company had requested reducing the total yearly quantity to 2,500,000 tons, a 500,000 ton reduction. Island Creek Coal Company was projecting greatly decreased tonnage from its Hamilton Mine. Tr 725 (Ex. 5, Sch. 16) Gulf's inventory situation became so critical that Mr. Ludwig recommended to Gulf that they file with the Federal Energy Regulatory Commission a fuel emergency report (Form 237-A).

Again, the Commission has ignored the importance of a reliable source of coal and focused solely on price. P & M, Island Creek and Peabody are all relatively well known and reputable coal suppliers. Yet, Gulf's experience with these companies during the relevant period had been less than good. In marked contrast, over the twenty years prior to 1972, ABC Maxine had produced a total of approximately 25,810,614 tons of high quality coal at an average price of approximately $5.84/ton. Over the history of the mine the production had remained stable or increased.

Another factor impacting Gulf's decision to exercise the option was the environmental considerations. See, Ex. 5, Schs. 16 & 17. In January of 1972, the State of Florida adopted its air implementation plan. The plan was approved by the Environmental Protection Agency in May of 1972. In order to avoid the use of much more expensive compliance coal, Gulf adopted a strategy of utilizing the relatively low sulfur Maxine coal in a blend with its higher sulfur coals. Thus, from 1972 until after the July 1977 amendments to the Clean Air Act and the 1978 revisions of the Florida Emissions Standards, the Maxine coal helped to enable Gulf to meet these environmental limitations to the benefit of Gulf's ratepayers. Tr 728.

All of the above contradicts the Commission's assertions that the majority of justifications given by Gulf's witnesses for the prudence of the 1974 extension involve facts occurring after July, 1972. (Order No. 13452, p. 4) (Emphasis supplied by Commission) Every indication which Gulf had as of July, 1972, pointed to the wisdom of the extension of the Maxine contract. Gulf's ultimate decision to extend, made on December

28, 1973, was based on the prior assessment as well as numerous events, including the oil embargo which occurred in the interim. All of the elements leading to the initial assessment that an extension was the best interest of Gulf's ratepayers continued to prevail in the time period from July of 1972 to December of 1973. For example, as of December 1973, Gulf's fuel reserves were the lowest of all Florida utilities. (Ex. 3, Sch. 34) The oil embargo only exacerbated the problems with reliability of supply and cost.

The Commission in its order, found that, "historically, Maxine had not been a low cost alternative for Gulf (a fact that Southern Services recognized)" and that "the 1972 recommendation by Southern Services did not specify any other advantage to be obtained by Gulf's further participation in Maxine." The Commission concluded that Gulf had "acted upon insufficient information in agreeing to participate in an extension of the Maxine Mine contract." Order No. 13452, p. 4. This finding by the Commission is simply unsupported by the evidence. The reference to the Southern Company Services extension is as follows:

> The Maxine production has provided over the years an exceptionally stable fuel supply in regard to both quantity and quality, and <u>while the delivered cost of this coal has not proved economical to one or more of the buyer parties from time to time, and may not be at this time, it has remained one of Alabama's prime fuels over the economic life</u>. (Emphasis supplied by Commission)

The statement by the Commission regarding the failure of Southern Services to specify any other advantage to be obtained by Gulf's further participation in Maxine and its emphasis only on the last half of the above quoted reference to the analysis, serves only to point out the "tunnel-vision" which the Commission is exercising in its review of fuel contracts. The Commission totally ignores the reference and recommendation relating to exceptional stability of the fuel supply in regard to both quantity and quality from the Maxine Mine. As evidenced by all of the above, these elements were of tremendous importance to Gulf Power at the time. Cheap coal does the ratepayer absolutely no good if it is unavailable when needed. Stability, quantity, and quality are all factors which have recognized benefits to the ratepayer and substantial economic value. These values of the Maxine contract were uncontradicted in the evidence, but ignored by the Commission.

The fact that market prices for alternative coals to Maxine rose rapdily during the first few years after the extension was in the Commission's eyes "fortuitous." The Commission also determined that the "embargo caused Gulf's initial decision to reap a chance benefit for its ratepayers." (Order No. 13452, pp. 5, 11) It is a simplistic and inequitable approach to use 20/20 hindsight to dismiss periods of good contract performance as "chance events" while determining other periods when "chance events" result in poorer contract performance to have been caused by imprudent management.

The cost of Maxine coal did compare favorably with other long-term coal prices in the period just prior and in the next few years after the exercise of the option. The oil embargo was a critical part of the Company's actual decision to extend the contract and was one of many factors resulting in the escalation of coal prices in the latter part of 1973. Tr 696, 818. (Ex. 3, Sch. 34) A cost comparison between Maxine coal and other coals, including the price levels of other long-term contracts made by the other operating companies of the Southern Electric System during the period indicates that the Maxine coal was an economical source during this period. Tr 730. (Ex. 3, Schs. 48 & 49) If Gulf Power is to be penalized for "excess prices" during the 1980-1982 time period, it should be likewise rewarded for having saved its customers approximately $8 million during the 1974-1975 period. (Ex. 3, Sch. 48) Tr 1288.

The post-embargo period was marked by spot prices of coal rising to levels which have not been exceeded since. Many of the less reliable suppliers diverted their coal from their contract customers into the more lucrative spot market. Long-term contracts were difficult to acquire. Had a utility depended on the spot market for the bulk of its requirements, or had the misfortune to have a contract expire during the last quarter of 1973 or during 1974-75, it would have been very difficult to obtain sufficient coal for its needs for almost any price. Tr 1249-1250.

The Commission is saying that had it been making decisions for Gulf during this period it would have gone through a formal bidding process before exercising the option. Again, this is application of the new rules to events which occurred some fourteen years prior to implementation of the rules. See

Order No. 12645 (Appendix B) The decision to extend the contract was a difficult one, made with a full analysis of all factors. Gulf did look at alternative sources of coals in deciding to extend the Maxine contract and determining that the Maxine deal was the best available. Tr 910-911. Had Gulf not exercised its option, and been forced to pay the high coal prices associated with the post-embargo period, the decision to terminate the operations in Maxine Mine in mid-1974 would clearly have been considered imprudent. Tr 696.

The Commission's assertions regarding Gulf's intent in exercising the extension are likewise without foundation. The Commission finds that Gulf intended to extend the contract for only a three to five year period. Order No. 13452, p.5. The contract provided for only two possible extension periods: (1) ten years or (2) until the recoverable coal was earlier worked out. Tr 723. Nothing in the record indicates that Gulf felt that it had any right other than as provided for in the contract. The numerous references in the correspondence cited by the Commission to three or five year option periods are all clearly based upon the production schedules which indicated that the recoverable coal would be worked out within the three to five year period. (Exs. TF-15B, TF-16A, TF-17, TF-17B, TF-22 & TF-22A) The uncontradicted testimony, which the Commission ignores, supports the fact that Gulf knew and understood the clear terms of the contract, but expected that the recoverable coal would be worked out within the three to five year time period. Tr 722-730.

Gulf Power's actions with regard to the extension of the Maxine contract were prudent under any reasonable definition of that term. For the Commission to take what it admits is "fragmented" information and apply its own judgment to decisions made from ten to twelve years prior to the Commission's investigation constitutes the epitome of 20/20 hindsight and retroactive management by the Commission. See, Florida Power Corp. v. Fla. Pub. Serv. Com'n., 456 So.2d 451 (Fla. 1984) The evidence is that the recommendation of Southern Company Services to exercise the option and Gulf's ultimate decision to accept the recommendation were made with the best interest of Gulf's ratepayers in mind. Tr 722. These decisions were prudent.

## II. GULF'S ADMINISTRATION OF THE CONTRACT SINCE THE EXERCISE OF THE EXTENSION HAS BEEN PRUDENT AND IN THE BEST INTEREST OF GULF'S RATEPAYERS.

The evidence shows that at the first indication of problems with the future economic viability of Maxine Mine, Gulf Power and Southern Company Services did everything legally and practically possible to alleviate the problems. The Company could understand criticism had it simply done nothing and allowed the cost of Maxine coal to be passed on to the ratepayers through the fuel adjustment clause. It is extremely difficult to understand, however, how the Commission can criticize and deem "imprudent," a concerted effort on the part of management of Gulf Power and Southern Company Services to remedy the problems associated with the cost and production of

Maxine coal.

Incredibly, the Commission determines that information available to Gulf in the 1974-1975 time frame would have triggered violent reaction on Gulf's part with resulting negotiations for a "market out" clause with ABC or Alabama, shortening the contract term. (Order No. 13452, p. 6) To the contrary, the information as related above, indicated that the extension was the wise and prudent course.

Throughout the proceeding, the Commission Staff threw around the term "market out" clause as if it were the common practice during the period in question. Presumably, the "market out" clause would have allowed Gulf to terminate the contract with either ABC or have Alabama assume its obligations if and when the price of Maxine coal became too high. The all too obvious fact is that a "market out" clause turns a long-term contract into a short-term contract. Moreover, both the Commission's experts, Mr. Foxx and Mr. Hill had to look long and hard in the 1982-83 time frame in order to find relatively few contracts with "market out" provisions. Tr 1158-1162. Such provisions were not common in the coal industry during the 1973-77 time frame and remain the exception rather than the rule. This is yet another example of application of the 1983 rules to 1973.

A "market out" provision must work both ways. If the price of coal on the spot market becomes too high, the supplier must have available to it the option of terminating the contract and selling its coal in the spot market. This removes any assurances that the utility has of a steady and reliable source of coal. Contrary to the Commission's findings, a "market out" provision is not in the best interest of Gulf or any other utility's ratepayers. A "market out" provision as the Commission would have had Gulf seek from Alabama or ABC most likely would have had allowed Alabama or ABC to terminate its supplies during the 1974-76 time frame in which the price of other coals far exceeded the cost of Maxine. The effect of the Commission's decision regarding "market out" provisions in this and the generic docket will likely have a devastating effect on the ratepayers of Florida. Tr 716, 977-978.

The fact is that there was little evidence indicating that Gulf or Southern should be concerned about the future economic viability of Maxine Mine until 1976. This concern was first raised following the decline in mine production and mine labor productivity during 1975. In 1976, the decline continued. This trend and the concerns of Gulf and Southern Company Service were thoroughly discussed with ABC operating personnel. ABC assured Gulf Power and Southern Company Services, that, in its judgment, the trend was short-term and was a result of local conditions being encountered which were expected to improve. Tr 699-700.

The events which occurred between 1977 and 1981 evidenced a dedication on the part of Gulf Power Company and Southern Company Services personnel to take every practical step possible to alleviate the production and price problems with the Maxine Mine. These actions need not be recounted in detail here. The Commission's account in its Order No. 13452 at pages 7 and 8 evidences the activities of Gulf and Southern Company Services personnel. The fact that Gulf and Southern acted pursuant to the recommendations of the various studies performed, rather than as the Commission would have reacted, or the fact that it did not take steps to terminate where legally impossible to do so, in no way detracts from the efforts of Gulf and Southern to act in the best interest of Gulf's ratepayers.

Gulf's brief to the Commission at pages 15-19 and 36-46 details the numerous studies, meetings, and efforts on the part of Gulf and Southern Company Services to increase production and reduce prices at Maxine. R 47. What the record reflects is that the management of Gulf Power and Southern Company Services reacted timely and with diligence to the problems associated with the Maxine contract.

The Commission finds fault with Gulf's action in two regards. First, that Gulf did not give notice on or before June 30, 1979, of termination of the contract. Second, that there is "no evidence of record to show that Gulf actually sought to have the contract terminated or that it sought to determine whether termination was a possible option." The Commission ignores the fact that neither Gulf, Alabama or Southern had the legal right to terminate the contract based on the high cost of the coal. Likewise, the Commission ignores the abundance of evidence showing that Gulf actively sought alternatives to relieve it from its obligation under the Maxine contract.

The Commission Staff asserted throughout the proceedings, which assertion the Commission apparently adopted, that Gulf and Southern had the unilateral right to give one-year notice of termination of the contract based on the fact that the price of coal under the contract was significantly higher than what the Commission deemed to be the "current market price". The contention of the Commission is premised on the assumption, which Gulf Power Company asserts is not only wrong, but absurd, that the existence and availability of lower coal prices from other producers constituted sufficient "good cause" for termination of the agreement under the cancellation provisions found in Section 2a of the Maxine contract. Tr 126-127, 310, 342. Included in this assumption is the fact that ABC would not have contested the cancellation and that cancellation would have resulted in no legal cause. Tr 389. The relevant part of Section 2a of the agreement provides as follows:

> The Buyer shall have the right upon twelve months' notice in writing by Buyer to Seller of its intention so to do to cancel and terminate this agreement at any time after ten (10) years from June 30, 1954, in the manner hereinafter set out, but <u>Buyer agrees nevertheless that it will not exercise its said right so as to cancel or terminate this agreement arbitrarily or without good cause</u>. (Emphasis added)

This conclusion on the part of the Commission and Staff as to the Company's ability to terminate the contract ignores rudimentary contract law concepts. It is fundamental that "a contracting party may not repudiate his promises solely because he later becomes dissatisfied with his bargain." <u>Beer Nuts, Inc. v. King Nut Company</u>, 477 F.2d 326, 328 (6th Cir. 1973). A purchase contract, fair when entered into, does not thereafter become unconscionable and therefore legally or justifiably breached because the price paid by a buyer has become significantly higher than the purchase price which can be subsequently obtained from other sellers. See, Bennett v. Behring Corp., 466 F.Supp 689, 698 (S.D. Fla. 1979).

The courts recognize that, "the entire law of contracts, as well as the commercial value of contractual arrangements, would be substantially undermined if parties could back out of their contractual undertakings" on the basis that because of changes in the market, the contract may evolve into what the buyer may regard as a bad or unreasonable bargain that consequently causes him hardship. Accordingly, under these circumstances, the courts will neither rescind a contract nor will they uphold a breach of the contract as justifiable, or for good cause, merely because the market situation changes and a better price is available elsewhere. See, Steinhardt v. Rudolph, 422 So.2d. 884 (Fla. 3d DCA 1982); Bennett, 466 F.Supp. at 698-699; See also, Rutland Marble v. Ripley, 10 Wall 399, 77 US 339, 356, 19 L.Ed. 955 (1870).

Had Gulf Power Company terminated and cancelled the agreement with ABC claiming that it had "good cause" for termination because of lower prices then Gulf Power Company would have exposed itself to liability for breach of contract and damages as well as associated litigation costs. These damages, along with incidental damages and the cost of substitute coal, even at the Commission's "market price", would have far exceeded any premium paid by Gulf for the Maxine coal. Sections 672.708(1), 672.710, Fla. Stat.; Sections 7-2-708(1), 7-2-710, Ala. Code.

At no time did Gulf Power and Southern Company Services feel that they had the legal right to terminate under the "good cause" provision. However, contrary to the Commission's findings Gulf and Southern did assert this right to cancel in their negotiations with ABC. This was done in an effort to obtain some concessions from ABC. Tr 797-798, 825. Written opinions from counsel confirmed what Southern Company Services had been told all along, i.e., that "high price" did not constitute "good cause". Tr 343-359, 734-375, 825, 888, 913. (Ex. 3, Schs. 52,53)

Had the operating companies and Southern Company Services exercised the termination provision, litigation was a virtual certainty. It would have been costly and time consuming. The economic studies did not include an estimate of these costs. Tr 1123, 1183. Instead of wasting their time in costly litigation, the personnel of Southern Company Services and Gulf Power continued their efforts, pursuant to the economic studies, to find the most cost effective solution to the problems of price and productivity.

The Commission's second finding of fault with regard to Gulf's administration of the Maxine extension was what the Commission asserts is an absence of evidence indicating that Gulf "actually sought to have the contract terminated or that it sought to determine whether termination was a possible option."

(Order No. 13452, p. 7) To the contrary, the Commission Staff's own witness' exhibit evidences a series of correspondence and memorandum indicating Gulf's manifestation of its concerns regarding the contract and attempts to have the contract terminated. (Ex. 5, Schs. TJF-6, TJF-7, TJF-8, & TFJ-9) From the first indication of problems with the Maxine contract, Gulf Power fuel procurement personnel were active in seeking to have Southern Company Services explore means of relieving Gulf from the Maxine contract, including notifying ABC of the necessity of immediate closure of the mine. Tr 701-704. Southern Services did in fact explore every possible avenue of doing so. Among the alternatives was a suggested solution contained in the Woodfin Study, i.e., Gulf's attempting to terminate its obligations under the ABC contract by negotiating a settlement payment to Alabama Power for Gulf's financial responsibilities under the contract. The effort was made, but was unsuccessful. Tr 739, 854. (Ex. 3, Schs. 53 & 54) Gulf and Southern Company Services fuel procurement personnel made every effort to relieve Gulf from its obligation under the Maxine contract. The fact that they were unsuccessful in doing so in no way justifies a finding of imprudence.

Gulf is not requesting that this Court reweigh the evidence. We are requesting that the Court review the record to determine whether the Commission's decision herein is supported by competent substantial evidence. Gulf believes that the Court will find that the management of Gulf Power and Southern Company Services reacted timely and diligently to the problems associated with the Maxine Mine. Studies were conducted, meetings were held, and a conscious effort was made to arrive at the decision most economically beneficial to the ratepayers of Gulf Power. Nothing in the record supports the Commission's conclusion that Gulf's management acted imprudently. Again, the Commission's decision constitutes a substitution of its wisdom for that of the management of Gulf Power. We would respectfully submit that throughout the extension period every effort was made to minimize the impact of Maxine coal on Gulf's ratepayers, and that such efforts were "prudent" under any reasonable definition.

## III. THE COMMISSION'S "MARKET PRICE ANALYSIS" AND FAILURE TO ALLOW FOR A "MARGIN OF ERROR" ARE UNSUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE, ARE ARBITRARY AND CAPRICIOUS, AND CONSTITUTE A DEPARTURE FROM THE ESSENTIAL REQUIREMENTS OF THE LAW.

In its order, the Commission determined that the cost of Maxine fuel recovered through the fuel adjustment charge between July, 1980 and September, 1982, should be retroactively adjusted by that amount which the price of Maxine coal exceeded the "market price." The amount of the refund -- i.e., Gulf's "penalty" -- is the difference between the Maxine price and the "market price." The Commission recognized the fact that "use of a market price comparison involves imperfections." Nevertheless the Commission concluded that the "market price analysis" was appropriate in this case and adopted it for the imposition of a penalty. (Order No. 13452, p. 12)

At pages 10 through 13 of the Commission's order, it discusses the various methodologies derived by the Staff's witness and the Staff's consultant to determine "market price." The Commission's own analysis evidences the wide variations in the results and the statistically unacceptable averaging method to derive a "market price." The Commission's consultant's own comparison of the various methodologies is even more revealing. In Exhibit 6, Schedule 3, the consultant compared three of his methodologies with three of those used by the Commission Staff's witness, Mr. Foxx. The results are that in 1982, the difference between the high and low estimate of the "penalty" is some 83%. In 1981, the difference is 40.1%, and in 1980, the difference is 34.4%. It is not difficult to ascertain why these "experts" willingly admitted that there is no accepted methodology for determining "market price." Tr 441-444, 1185-1186.

In Table 3, at page 14 of Order No. 13452, the Commission seeks to support the validity of the methodology selected by it by comparing the various methodologies of its witnesses. This table in fact emphasizes the inherent inaccuracy of the process of estimating a fair market price. The figures shown on this table are arrived at by making several independent estimates of the market price using various methodologies and averaging these estimates. Because the averaging process tends toward a central estimate, the multiple averaging employed by the Commission's witnesses should produce nearly identical results. Tr 1193, 1261-1266. The fact that there is as much as 5.92% error between the estimates of the two witnesses, even after the compound averaging, suggests a high level of error in the data and estimating process. Despite this, no provision is made in the Commission's finding for the likely error or the degree of confidence which can be placed on these estimates of the average market price.

The process of estimating the market price of coal has no foundation in scientific, statistical, or economic theory. The Commission's witnesses derive several estimates of market price from different data sources and methodologies. In each of these approaches, the several estimates are then combined indiscriminately into a final average price estimate. The final estimate thus results from an arbitrary weighting of the individual estimates, without regard to the source of the data, the level of data accuracy, or credibility of the data. There is no generally accepted analytical basis for ignoring these attributes in the data, and combining the resulting estimates in a manner that weighs the significance of fundamentally different estimates in an arbitrary way. Tr 1193, 1261-1266.

Incredibly, the Commission determines that there is "validity to all the methods," then selects one without any allowance for error. The method selected was the delivered price analysis. Contrary to the Commission's assertion, Gulf's witness did not testify that a delivered price analysis is appropriate for calculation of a penalty. The Gulf witness did not condone, nor agree with, the delivered price analysis for either estimating an accurate price or calculating a "penalty." Tr 1254-1258. As Gulf's witnesses repeatedly testified, the only appropriate comparison to the price of Maxine coal would be a comparison of market prices of coal delivered to Gulf Power since that comparison only properly represents the purchasing situation under which fuel decisions are made. In other words, the only valid economic comparison is between long-term contracts of equal vintage, which would have been negotiated under similar market conditions with similar expectations of future supply and price trends.

The Commission's analysis goes far beyond these limitations and is fraught with error. The samples used by the Commission represent contracts of various lengths (as short as one year), different volumes and purchasing terms, as well as with different negotiating environment and history from the Maxine contract. Tr 1094-1104. The samples include coals from geographic areas which are not comparable in sorting or distribution patterns to the mine and generating plants in question. The transportation estimates are unreliable. Tr 1256-1258. See also, Gulf Commission Brief at pages 56-68. R 47.

Perhaps the most revealing aspect of the Commission's decision in this entire matter is its refusal to allow for a margin for error even after acknowledging the imperfections in the calculation of a "market price." There exists absolutely no support in the record for the Commission's failure to allow for a margin for error in its assessment of a penalty. To the contrary all the witnesses supported the allowance of a margin for error. The Staff, in the testimony of Mr. Foxx, suggested an arbitrary range of 20% above the average estimate to adjust for likely estimation error. Contrary to the Commission's assertion, the range of error was suggested by Mr. Foxx not due to error in the FOB mine analysis but due to variations inherent in all of the various methodologies used by the Commission Staff and its consultant. Tr 1254. The Commission's consultant recognized the inherent error in the estimating process through the introduction of his Exhibit 6-A and 6-B. He testified, "I would hope --- and I am sure the Commission will allow some tolerance for error in these numbers." Tr 1203. Mr. Hill further testified as follows:

> Q Should Gulf Power (or any utility) be expected to have any contract at or below an estimate of fair market price?
>
> A I do not believe so. These are estimates and subject to some error. Also there are important factors other than price in coal supply arrangements; some leeway should be given to allow for these variables.
>
> Q Do you think Mr. Foxx's proposal to allow 20% over the estimated market price as a margin for error (or neutral zone) is reasonable?
>
> A Yes. Although if enough data are available, the use of a limit based on some given number of standard deviations above the mean of the sample of estimates might even be better.

Tr 1175-1176.

The Commission rejects the "allowance for error" by holding that it might be correct to allow a margin for error in the determination of prudence but not in the calculation of a penalty. The Commission has correctly segregated the issues of price and prudency, but has erroneously associated the concept of a range above average market price with the concept of prudency. The purpose of a range above the average price is to provide a fair and logical adjustment for (1) the errors in estimating the average market price and (2) the realistic likelihood that any "prudent or imprudent" contract could be above average. To estimate an average market price without any allowance for error in the calculation of a penalty neglects the fact that (1) there was a high likelihood the Maxine price would exceed the average market value without regard for prudence and (2) one-half of the contract prices sampled also exceeded this average market price. No evidence whatsoever was presented supporting the distinction made by the Commission in declining to allow for a margin for error in the calculation of the penalty. The fact is that there is a zero percent chance that the "market price" used by the Commission actually represents the true average market price. The Commission, in electing to use an estimate of average market price, ignores the evidence and opinions presented by all the witnesses to this proceeding. This constitutes error. At the very least, the Commission was required to produce competent evidence supporting its position. Florida Bridge Co. v. Bevis, 363 So.2d 799 (Fla. 1978); General Dev. Util., Inc. v. Hawkins, 357 So.2d 408 (Fla. 1978).

As the Commission's consultant recognized, in order to be statistically sound, the use of a limit based on some given number of standard deviation above the mean of the sample of estimates is the more statistically sound method of measuring both prudency and a "penalty." Tr 1176. The probability is zero that a single numerical estimate (a so-called "point estimate") is exactly correct. Some indication of likely range must be given in order to have any chance of including the true average price. Using this more statistically sound methodology, the Maxine price on a cents per million BTU basis falls within a normal distribution for the estimated price of comparable coals on a delivered basis. Under acceptable statistical theory, to be inconsistent with normal distribution of prices, a sample price must deviate more than three (3) standard deviations from the mean. In each of the years, 1981-1983, Maxine price is within two standard deviations and for 1982, the price is approximately one standard deviation from the mean. The conclusion is that the Maxine price is well within the expected distribution of prices about the average. Ex. 4-B (Appendix C) Exhibit 4-B also reveals a great deal about the use of the 20% margin for error. The Maxine price falls under the mean plus 20% for each year considered. Using accepted statistical analysis, and the preferred cents per million BTU comparison, no penalty is justified. Application of the minimum 20% margin for error for the period of July 1980 through September 1982 reduces the penalty amount from $2,575,540 to $1,284,521. (Order No. 13452, p. 12) Application of the 20% margin to the period of October 1981 through September 1982, which Chairman Gunter found in his dissent to be the applicable period, reduces the penalty from $476,997 to $74,772. (Order No. 13452, p. 23)

## IV. THE COMMISSION'S REQUIREMENT OF A REFUND OF FUEL PURCHASES PRIOR TO OCTOBER 1, 1981, CONSTITUTES ILLEGAL, RETROACTIVE RATEMAKING, AND VIOLATES THE DOCTRINE OF RES JUDICATA.

In its order, the Commission penalized Gulf Power for fuel purchases made from the ABC Maxine Mine from July 1980 through September 1982. It is the position of Gulf Power Company, as supported by Chairman Gunter in his dissent, that the majority's decision to order a refund of purchases prior to October 1, 1981, constitutes retroactive ratemaking. This action on the part of the Commission also violates the doctrine of res judicata.

Fuel adjustment hearings are adjudicatory proceedings conducted pursuant to Chapter 120, Florida Statutes. Specifically, they are proceedings determining substantial interest and are therefore conducted pursuant to Section 120.57, Florida Statutes, and the Commission rules promulgated pursuant thereto. The fuel adjustment charge hearings conducted by the Commission constitute ratemaking. No distinctions are to be drawn between the fuel adjustment charge considerations and the ratemaking procedures set forth in Chapter 366, Florida Statutes. 1974 Op Att'y Gen. Fla. 074-288 (September 20, 1974); 1974 Op Att'y Gen. Fla. 074-309 (October 9, 1974) (Appendix D)

As ratemaking procedures conducted pursuant to Section 120.57, Florida Statutes, the prudency of the fuel purchases made by the respective companies is in issue. Were the prudency of the purchases not in issue, the fuel adjustment charges would be little more than the arbitrary mechanical adjustment which the Attorney General determined to be prohibited in Opinion No. 074-309. In Opinion No. 074-288, the Attorney General determined that although for a period of fourteen years an automatic fuel adjustment clause had been in effect, without a hearing the Commission could not retroactively adjust the amounts permitted to be recovered by the companies thereunder. The fuel adjustment charges may be imposed only prospectively. Utility ratemaking is prospective only, not retroactive. The Public Service Commission is prohibited from retroactive ratemaking. Southern Bell Telephone & Telegraph Co. v. Florida Public Service Commission, 453 So.2d 780 (Fla. 1984) Gulf Power Co. v. Bevis, 289 So.2d 401, (Fla. 1974) Westwood Lake, Inc. v. Dade County, 264 So.2d 7 (Fla. 1972); City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968).

As recounted by Chairman Gunter in his dissent, Gulf Power Company, in April of 1981, requested a meeting with the Commission Staff to discuss commencing an accrual for recovery of reclamation and closure costs which were expected to be incurred upon closure of the Maxine Mine in June of 1984. In a meeting with the Commission Staff just prior to the May 1982 fuel adjustment hearings, the Staff indicated that the Commission intended to take up the subject of the Maxine Mine closure and reclamation accrual during the course of those hearings. Counsel for Gulf Power then requested that the subject of the Maxine closure be considered at a separate hearing. This request was granted by the Commission in Order No. 10783 which provided in pertinent part as follows:

> "Ordered by the Florida Public Service Commission that the question of the prudency of purchases by Gulf Power Company from Alabama By-Product Corporation's Maxine Mine shall be considered at a hearing separate from the true-up hearings set for May, 1982. It is further
>
> Ordered that any delay in considering the issue of prudency shall not be to the prejudice of the Commission's power to act and any decision at such later time <u>shall be as though entered in conjunction with the true-up hearings.</u> (Emphasis supplied)

At issue at the May true-up hearings was the prudency of costs incurred during the period October 1981 through March 30, 1982. All costs of Maxine Mine coal incurred prior to October 1, 1981 had been approved at previous fuel adjustment hearings. The Commission is precluded under the doctrine of retroactive ratemaking from ordering a refund of any costs incurred prior to October 1, 1981. Absent a finding of illegality, negligence or fraud, any attempt to require a refund of fuel expenses prior to October 1, 1981, constitutes retroactive ratemaking. (Order No. 13452, p. 23) <u>Ritcher v. Florida Power Corp.</u>, 366 So.2d 798 (Fla. 2d DCA 1979); 1974 Op Att'y Gen. Fla. 074-288 (September 20, 1974); 1974 Op Att'y Gen. Fla. 074-309 (October 9, 1974) (Appendix D)

In every petition filed by Gulf Power Company for the period June 1980 through September 1982, Gulf alleged that the amounts spent for fuel by the Company were reasonable and prudent and that the Company had made every effort to secure the most favorable price for all of the fuel it purchases and for its purchased power. Gulf Power Company made the prudency of its fuel purchases an issue in each and every fuel adjustment hearing conducted during the relevant period. In each of the orders resulting from these petitions, the Commission has approved a specific fuel factor and has approved estimated true-up amounts subject to final true-up and determination of the reasonableness and prudency of such expenditures at the true-up hearings. See, e.g., Order No. 10289, Docket No. 810001-EU, issued 9/14/81 p.9 (Appendix E).

It has consistently been the position of the parties subject to the fuel adjustment that final consideration of the prudency of fuel purchases during a prescribed period is made at the true-up hearings. The companies have consistently taken the position that absent fraud, mistake or inadvertence, jurisdiction lapses at the time the true-up is proved. Until this matter arose, the Commission and Staff acted consistently with this position. If the prudency of particular fuel purchases by a utility were thought suspect by the Commission or its Staff, those particular revenues were simply approved subject to refund. See, e.g., Order No. 10093, Docket No. 810001, issued 6/19/81 p. 9 (Appendix F). This allowed the Company the opportunity to recover the fuel costs, but with the knowledge that the purchases made subject to refund were under the continuing jurisdiction of the Commission.

Under the majority's decision herein, "a utility remains uncertain as to whether the Commission will ultimately determine its expenditures to be prudent." (Order No. 13452, p. 18) In other words, a utility is at the Commission's mercy as to whether or not its fuel expenditures will ever be determined to be prudent and not subject to refund. There is no finality whatsoever. Under the Commission's decision, on a thirty year contract, the Commission could penalize a company for any portion of that period which the Commission deemed the fuel purchases to have been imprudent. The Commission's position herein constitutes retroactive ratemaking and violates the doctrine of res judicata.

Essential to all systems of justice is the notion of finality. This notion is embodied in the doctrine of res judicata. Public policy and the interest of litigants alike require that there be an end to litigation, which without the doctrine, would be endless. Hay v. Salisbury, 109 So. 617 (1926); Universal Constr. Co. v. Ft. Lauderdale, 68 So.2d 366 (Fla. 1953). The conclusiveness of a prior judication extends not only to matters which were actually determined, but also to all matters which could properly have been determined in the prior action, whether or not they were in fact, considered. Hay, 109 So. 617; Tilton v. Horton, 137 So. 80 (Fla. 1931). See also, Copeland v. Mayo, 87 So.2d 501 (Fla. 1956); Warriner v. Fink, 62 So.2d 913 (Fla. 1953). The doctrine of res judicata applies to administrative adjudicatory proceedings. Farrell v. Amica Mutual Ins. Co., 361 So.2d 408 (Fla. 1978) Peoples Gas System, Inc. v. Mason, 187 So.2d 335 (Fla. 1966); See also, State, etc. v. Professional Firefighters, etc., 366 So.2d 1276 (1st DCA 1979).

Again, as recognized by Chairman Gunter in his dissent, the Commission's Order No. 10783, provided that the prudency of the Maxine Mine purchases would be determined "as though entered in conjunction with the true-up hearings." At issue in these true-up hearings was the prudency of costs incurred during the period October 1, 1981 through March 30, 1982. All fuel purchases of Gulf Power Company prior to October 1, 1981, were approved by this Commission in prior orders. Consideration of fuel purchases prior to October 1, 1981 is in direct violation of the doctrine of res judicata and the prohibition against retroactive ratemaking. Assessing the penalty commencing October 1, 1981, and accepting the Commission's methodology, results in a total penalty of $476,997. See Order No. 13452, p. 23. The BTU adjustment made by the Commission is likewise barred under the doctrines of retroactive ratemaking and res judicata. As recognized by Commissioner Gunter in his dissent, the BTU adjustment should be reduced to $20,238.

It should also be noted that the Commission's order herein violates its own prior order "limiting the scope of the proceedings." Pursuant to statutory and constitutional requirement, the Commission issued Order No. 11408, dated December 13, 1978. See, Hollywood Jaycees v. State, Department of Revenue, 306, So.2d 109 (Fla. 1974); Deel Motors, Inc. v. Department of Commence, 252 So.2d 389 (Fla. 1st DCA 1971). Therein the Commission ordered the following:

> 1. The issues to be addressed in the hearing will include (a) whether the prices paid by Gulf Power Company for Maxine Mine coal during the period January 1, 1981 through

September 30, 1982 were reasonable and prudently incurred, and if not, what amount should be disallowed for that period; (Emphasis added)

Thus, by its own order, the Commission's review is limited to the period from January 1, 1981 through September 1982. Limiting the scope of the review to this period, and accepting the Commission's methodology, the total penalty is $869,524 . With the 20% margin for error, the penalty is $314,836.

Finally, at page 17 of Order No. 13452, the Commission determines that interest should be paid on the penalty amounts. Pre-judgment interest is not recoverable on unliquidated claims. Chicago Ins. Co. v. Argonaut Ins. Co., 451 So.2d 876 (Fla. 4th DCA 1984); Honeywell, Inc. v. Trend Coin Co. 449 So.2d 876 (Fla. 3d DCA 1984). An amount due is deemed to be unliquidated "when the amount of damages cannot be computed except on conflicting evidence, inferences and interpretations." Federal Deposit Ins. Corp. v. Carre, 436 So.2d 230 (Fla. 2d DCA 1983), petition for review denied, 444 So.2d 416 (Fla. 1984). Although concluding that the use of a "market price comparison involves imperfections," the Commission is apparently of the opinion that its "market price analysis" is accurate enough to make the penalty amount "liquidated." As indicated in Section III, the calculation of a market price and penalty amount is anything but exact. Under no sense of the term can the penalties imposed herein be deemed to be "liquidated."

## CONCLUSION

The Commission's order requiring retroactive adjustment of fuel expenditures previously approved by the Commission is unsupported by competent substantial evidence, constitutes the application of 20/20 hindsight to managment decisions, and violates established principles of law regarding retroactive ratemaking and res judicata. The order should be reversed.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished to Steve Fogel, Room 4, The Holland Building, Tallahassee, Florida 32304; William S. Bilenky, 101 East Gaines Street, Tallahassee, Florida 32301; Paul Sexton, 101 East Gaines Street, Tallhaassee, Florida 32301; and Prentice P. Pruitt, 3264 Rue De Lafitte, Tallahassee, Florida 32312 by U. S. Mail this 8th day of May, 1985.

G. EDISON HOLLAND, JR.