5-14

IN THE SUPREME COURT OF FLORIDA

MONSANTO COMPANY,	)	
Appellant,	)	CASE NO. 73,689
v.	)	PSC DOCKET NO. 880001-EI
MICHAEL McK. WILSON, et al.,	)	
Appellee.	)	

On Appeal from the Florida Public Service Commission

INITIAL BRIEF OF APPELLANT MONSANTO COMPANY

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PRELIMINARY STATEMENT

In the case below, there were three Industrial Intervenors. Only Monsanto Company has taken this appeal. Throughout the brief, the Appellant, Monsanto Company, is referred to as Monsanto or Intervenor.

The Appellee, Florida Public Service Commission, is referred to as the Commission. Gulf Power Company is referred to as Gulf Power. Southern Company is referred to as Southern. Because Southern acted as Gulf Power's agent in some of the transactions discussed herein, the two entities are sometimes referred *to* as Gulf Power/Southern.

The record on appeal is denoted "R-Vol. ___, p. ___." Exhibits are denoted "R-Vol. ___, Exh. ___." References to the transcript are designated "Tr-Vol. ___, p. ___." References to the Appendix are designated "A., p. ___."

STATEMENT OF THE CASE

This case began as part of the Commission's ongoing fuel cost recovery proceeding. In that proceeding, regulated electric utilities petition for authority to collect the fuel expenses incurred to provide retail electric service from retail customers through the fuel cost recovery clause component of their authorized rate structures. The Commission compares 6-month projections of expenses with actual expenditures; reviews the reasonableness and prudence of the amounts for which approval is requested; and determines which portion should be approved for recovery and which amounts should be disallowed.

In January 1987, Gulf Power filed a petition seeking approval of, inter alia, the recovery of a portion of the cost of buying out two expensive coal contracts with vendors who had previously supplied the coal burned in Gulf Power's Plant Daniel. Gulf Power proposed to collect the cost of the buyout from wholesale and retail customers who bought Plant Daniel energy on a cents/kWh basis. (In other words, the more Plant Daniel energy bought by a customer, the larger the share of coal buyout costs that customer would pay). Monsanto raised and preserved for hearing the issue of the manner in which expensive Plant Daniel energy had been allocated between retail and wholesale jurisdictions over time.

Later, in a Prehearing Statement, Monsanto asserted that, during the period August 1985-1987, Gulf Power had improperly charged retail customers for quantities of expensive Plant

Daniel energy by flowing through the clause the cost of a concession to wholesale customers in the form of the new rate schedule (Schedule R), and that the practice had resulted in unreasonably high retail fuel costs and an overallocation of the Plant Daniel coal buyout costs.

Following extensive discovery, a prehearing conference was held on February 3, 1988. R-Vol. 11, pp. 1-65. A prehearing order was entered on February 16, 1988. Order No. 18867; R-Vol. I, pp. 22-79.

A hearing was held before the Commission on February 22-24, 1988. As a result of the hearing, the Commission issued Order No. 19042 on March 25, 1988. R-Vol. I, pp. 80-112; A., pp. 1-12. The Commission found in Order No. 19042 that Schedule R had not caused Gulf Power's retail ratepayers to bear inappropriate fuel charges because Plant Daniel was operated on the basis of "economic dispatch" and because off-system sales attributable to Schedule R benefited Gulf Power's ratepayers through lowered fuel costs.

On April 7, 1988, Monsanto filed a motion for reconsideration. R-Vol. I, pp. 123-126. Gulf Power responded on April 26, 1988. R-Vol. I, pp. 131-137.

On September 8, 1988, Monsanto filed a Request for Official Notice of an opinion of the Federal Energy Regulatory Commission. R-Vol. I, pp. 138-172. Gulf responded on September 19, 1988.

On January 9, 1989, the Commission entered Order No. 20568. R-Vol. I, pp. 173-177; A., pp. 13-17. This order granted the request for official no-Lice.

More importantly, in Order No. 20568, the Commission receded from the finding of Tact relating to Gulf Power's claim that Schedule R led to fuel savings, on which it had partially based its approval of the amounts collected by Gulf Power. The Commission stated:

> The Industrial Intervenors have pointed to no new evidence or misinterpretation of the evidence produced at trial that counters the rationale that economic dispatch does credit the ratepayer with the appropriate amount of fuel costs even though those costs may have been higher in the questioned period. The second misinterpretation Of the evidence complained of by the Industrial Intervenors concerned the finding that the offering of Schedule R actually lowered fuel costs due to increased MW sales. Upon a more detailed review of the record, we are now convinced that the evidence presented at the hearing is simply incapable of supporting that factual finding. However, we do not believe that the failure of the record to support that factual finding nullifies our decision in this case.

R-Vol. I, pp. 175-176. Based on the sole remaining finding--that related to the "economic dispatch" rationale--the Commission denied reconsideration.

On February 8, 1989, Monsanto filed its Notice of Appeal of Order Nos. 19042 and 20568. R-Vol. I, pp. 178-180.

STATEMENT OF THE FACTS

Gulf Power is an electric utility which serves retail customers in the northern panhandle of Florida. It is a "public utility" within the meaning of Section 366.02, Florida Statutes (1987). The rates and service it provides to retail customers are regulated by the Commission.

Gulf Power is also one of four subsidiary operating companies comprising the Southern power pool. (The others are Georgia Power Company, Mississippi Power Company, and Alabama Power Company). While Gulf Power has direct responsibility for service to its Florida jurisdictional customers, its generating/transmission system is pooled with those of its sister companies, and the combined resources are operated as a single integrated system. See description in Gulf Power Co. v. Florida Public Service Commission, 453 So.2d 799, 801 (Fla. 1984).

Gulf Power enters into three types of energy sales. The first is sales to customers in its geographical service area. Of these sales, 95% are to retail ratepayers and are regulated by the Commission. Tr-Vol. III, p. 378. The Commission determines the level of investment devoted to and "used and useful" in providing service to retail customers; the reasonable, prudent expenses necessarily incurred to provide service to retail customers; and fixes the fair rates to be charged for that service. Sections 366.041 and 366.06, Florida Statutes (1957). The rate structure approved by the Commission includes a "fuel cost recovery clause," through

which the Commission allows Gulf Power to collect from retail customers the cost of fuel burned to serve those customers.

Another category of sales is "intercompany transactions." These are purchases and sales of energy among the four operating companies comprising the Southern power pool. The terms and conditions governing such transactions are set forth in an Intercompany Interexchange Contract, which is subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). See R-Vol. VI, Exh. 12.

The final category of transactions consists of sales by Southern (as Gulf Power's agent) to utilities outside Gulf Power's service area (other than the member operating companies). These are called "off-system" sales. Like other wholesale transactions, these sales are regulated by the FERC.

Under the Florida regulatory scheme, Gulf Power's primary responsibility is to its retail customers. Its statutory obligation is to efficiently and economically plan, build, and operate a system that will meet the needs of its Florida ratepayers. Through a variety of off-system transactions--short-term and long-term--Gulf Power (through its parent and agent Southern) may attempt to market capacity and/or energy not needed to serve its retail customers.

When the Commission determines that a particular asset or facility is <u>not</u> needed to serve retail customers, it excludes ("disallows") the. costs associated with the asset from the revenue requirements borne by retail rates. The off-system sale of the excluded capacity then has the effect of

preventing the utility's shareholders from having to absorb the costs associated with owning the facility which are not reflected in customers' rates. See Order No. 11498 at p. 76, Docket No. 820150-EU.

Gulf Power owns half of Plant Daniel, a coal-fired generating facility located in Mississippi. Tr-Vol. III, pp. 345-346, 370. Plant Daniel is Gulf Power's most recently added increment of generating capacity. Gulf Power sought to include its Plant Daniel investment in the "rate base" borne by retail rates in Docket No. 820150-EU. However, in Order No. 11498, the Commission refused to allow all of the investment in the plant to be included. In a subsequent rate case--Gulf Power's last completed rate case--only 50% of Gulf Power's investment in Plant Daniel was reflected in rates fixed by the Cornmission for service to retail ratepayers.

Similar experiences occurred elsewhere. During the late 1970's and early 1980's, the Southern operating companies overbuilt generating capacity. Faced with an overabundance ("excess") of generating capacity, needed neither for retail nor intercompany transactions, Southern (as agent for Gulf Power and the other operating companies), sought to market the excess capacity (and associated energy) to off-system utilities. Tr-Vol. III, p. 345. It succeeded.

In the early 1980s, Southern entered off-system contracts called Unit Power Sales ("UPS") agreements with Florida Power and Light Company ("FPL"), Jacksonville Electric Authority ("JEA"), and Gulf States Utilities ("GSU"). Tr-Vol. III, pp.

345-346. Under the UPS concept, the capacity of specific generating units was contractually dedicated to the buying utilities. Tr-Vol. IV, p. 480. In return, the utilities agreed to pay rates ("capacity charges") designed to enable Southern to recover all of the fixed costs of owning the dedicated units plus a 16% return on the equity investments in those units. Tr-Vol. IV, p. 492.

For the UPS buyers, having the contract entitlements was much like owning the dedicated unit. Tr-Vol. IV, p. 480. The buyer paid for the specific carrying costs of the particular unit and was entitled to schedule the delivery to its system of energy out of that unit in amounts commensurate with the limits of its contracted and dedicated capacity.

In addition to the rates designed to pay for the fixed costs of owning the unit (depreciation, taxes, return on equity), the buying utility also committed to schedule and pay for minimum quantities of <u>energy</u> generated by the dedicated UPS unit. The contractual obligation which is most pertinent to the issue before the Court concerned the commitment to schedule and purchase a minimum quantity of UPS unit energy annually.

Section 3.5 of the UPS agreement with FPL,[1/] for example, states:

1/ The terms and conditions of the several UP, contracts are virtually identical. Tr-Vol. 111, p. 357.

> 3.5 <u>Minimum Energy Scheduling</u>: FPL agrees to schedule energy from each unit made available under Article 11 in excess of a fifty percent (50%) output factor on an annual basis. FPL agrees to use its best efforts, consistent with Prudent Utility Practices, to make the energy scheduled from each unit pursuant to Section 3.4 such that during any year the total energy scheduled from each unit is more than one-half the total hourly capacity made available from that unit under Article II for such year, as adjusted pursuant to Section 3.3 above.[2/]

Gulf Power's Plant Daniel, only 50% of which is reflected in Gulf Power's retail rate base, Tr-Vol. 111, pp. 370-371, was designated as a UPS unit in the UPS contracts. The amount of Plant Daniel capacity sold to the buying utilities scaled upward over a number of years. Initially, the amount was only 47% of the unit; in 1983 and 1984, however, the amount mushroomed to about 85%; and remained at approximately that level during 1986 and continuing through January 1989. The revenues paid by the buying utilities for the dedicated Plant Daniel capacity correspondingly increased. Throughout this period, retail ratepayers continued to bear the cost of 50% of Gulf Power's investment in Plant Daniel through the rates they

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2/ The UPS contracts require the purchasing utility to schedule energy from each unit made available in excess of a fifty percent (50%) "output factor'' on an annual basis. Assume that a purchasing utility was entitled to schedule 100,000 kilowatts of a designated UPS unit. Assume further that, during a particular twelve-month period, that unit operated for 8,040 hours. This means that, during the twelve-month period, the unit was capable of producing 804 million kilowatt hours of energy (100,000 kilowatts x 8,040 hours). Under this provision, the UPS customer would be obligated to schedule and purchase, at a minimum, in excess of 50% of the unit's output, or 402 million kilowatt hours based on the above example.

paid. As a result, from 1985 forward Gulf Power's combined retail rates and UPS capacity charges covered about 120%-135% of its investment in Plant Daniel. In addition, the 16% rate of return on equity provided by the UPS capacity charges was more lucrative than the return which had been established by the Commission for retail purposes. Tr-Vol. IV, p. 492.

Like other utilities, Gulf Power/Southern operates the units on its system, including Plant Daniel, on the basis of "economic dispatch." That is, the unit which costs the least to operate is the first to be used; the other generators are committed ("dispatched") in the ascending order of relative operating costs as more capacity is needed to meet rising system demand. Tr-Vol. 111, p. 368. The units are automatically committed to meet the aggregate of overall system conditions. Tr-Vol. IV, p. 531; R-Vol. VI, Exh. 14, Answer to Interrogatory 1; A., pp. 18-19.

The process of determining the responsibility of the retail customers for the energy generated by Plant Daniel in a particular period of time is a separate, after-the-fact determination. Tr-Vol. III, pp. 368-369; R-Vol. VI, Exh. 14, Answer to interrogatory 1; A., pp. 18-19. it is a process of elimination. The total Plant Daniel generation for the period is known. The billing program first assigns to the UPS customers and any other off-system customers the cost of the Plant Daniel energy they scheduled (ordered for delivery) in the period. The same is done for intercompany transactions.

The <u>remainder</u>, which was bought neither by off-system customers nor by other members of the pool, is then allocated and charged to the retail customers. Tr-Vol. III, pp. 369-370. The process is summarized by:

RETAINED ENERGY = MET GENERATION - ALL ENERGY SOLD

R-Vol. VI, Exh. 15, Intervenors' Third Set of Interrogatories, Item 52(b); A., p. 22.

During the period 1983-1987, Plant Daniel was fueled by very expensive western sources of coal, which placed Plant Daniel's operating costs among the highest on Gulf Power's system. Tr-Vol. IV, p. 489; R-Vol. VI, Exh. 22, Schedule 7.

The decision of the UPS buyers to enter the UPS contracts was based in part upon the then attractive relative economics between coal-fired Southern generating costs and the cost of oil-fired generation on their own systems. In the 1985 time frame, oil costs began to trend downward, and the economics of the UPS energy transactions were no longer as favorable. Tr-Vol. III, pp. 346, 391. To mollify its unhappy UPS customers (thereby securing the capacity charges and the 16% return on equity afforded by the contracts), Gulf Power/Southern unilaterally altered the annual energy purchase requirement to which the UPS buying utilities had contractually committed. The instrument of the modification was a new wholesale rate schedule, termed Schedule R (for "replacement"). Tr-Vol. III, p. 347. Through Schedule R, Gulf Power/Southern provided the UPS customers access to generating sources on Southern's

system which were significantly cheaper than the energy out of the dedicated units which they had contracted to buy--and allowed the UPS customers to count the cheaper Schedule R energy toward the annual minimum energy requirement of the UPS contract. Tr-Vol. III, p. 400; Vol. IV, p. 482; R-Vol. VI, Exh. 13.

With Schedule R in place, Gulf Power/Southern continued to operate its system on the basis of economic dispatch.

The UPS customers continued to buy energy from Gulf Power/Southern. They naturally substituted the new, cheaper "Schedule R" energy for the more expensive Plant Daniel energy whenever possible. R-Vol. VI, Exh. 15, Intervenors' Third Set of Interrogatories, Item 43(c); A., p. 20.

Gulf Power continued to bill for Plant Daniel's generated energy as before. First, the amount of energy scheduled by and delivered to off-system customers, such as the UPS buyers, was allocated and charged to those wholesale customers.

Next, the amount of Plant Daniel energy, if any, which had been ordered by other Southern operating companies through intercompany transactions was identified and charged to those entities.

Then the remainder of Plant Daniel energy was allocated to Gulf Power's territorial customers. Tr-Vol. III, p. 374-376. Ninety-five percent of the "territorial" generation consists of retail requirements. Tr-Vol. 111, p. 378. That corresponding quantity of expensive Plant Daniel energy was incorporated in the cost of fuel which was flowed through the

retail fuel cost recovery clause and collected from Gulf Power's jurisdictional retail customers.

The overall level of operation of Plant Daniel (in economic dispatch) over time did not vary materially following the advent of Schedule R from its pre-Schedule R levels. Tr-Vol. IV, p. 485.

However, the division between jurisdictions of the responsibility for paying for Plant Daniel energy changed dramatically after Schedule R was implemented. Post-R, the UPS customers, who were availing themselves of much cheaper Schedule R energy and counting those purchases toward their original UPS minimum annual obligations, scheduled (and were therefore charged for) far less Plant Daniel energy than before. The other Southern operating companies, who like the UPS customers did not find the price of Plant Daniel energy attractive, did not purchase the Plant Daniel energy which the UPS buyers had disdained.

The retail customers, who under the billing formula are charged for whatever Plant Daniel energy is not bought by others, suddenly were being charged for a radically increased share of expensive Plant Daniel energy. The increase was as dramatic a change as the shift of the UPS customers away from Plant Daniel energy.

Although the concession of Schedule R safeguarded the capacity charges (with 16% return on equity) being received under the UPS contracts, Gulf Power's shareholders paid none of the cost associated with relenting on the contract

minimums. Tr-Vol. III, pp. 410, 494. Instead, the fuel costs that the UPS customers were able to avoid by substituting Schedule R energy were channeled directly to retail ratepayers via the operation of the "residuum" feature of the after-the-fact billing formula and were recovered from the ratepayers through the retail fuel cost recovery charge.

In 1986, Gulf Power bought out the expensive western contracts for Plant Daniel coal. It petitioned the Commission for authority to recover the costs of the buyout through the fuel cost recovery clause. It proposed to allocate the cost of the buyout between retail and wholesale customers on the basis of relative consumption, meaning that a greater responsibility for Plant Daniel generation would translate into a larger share of the buyout cost.

Monsanto did not raise an objection to the coal buyout per se. However, based on indications of past anomalous allocations of Plant Daniel energy to the retail customers, it raised the issue of the appropriate amounts of Plant Daniel energy and buyout costs which should be borne by retail customers during the 1985-1987 time frame.

At hearing, Monsanto demanded that the Commission disallow that portion of 1985-1987 Plant Daniel fuel expense associated with the flow-through of the Schedule R concession. Monsanto argued that such amounts did not constitute costs reasonably and necessarily incurred to provide service to retail customers; instead, Gulf Power was requiring retail ratepayers to subsidize a concession made to

wholesale customers who were contractually obligated to purchase the expensive energy. Monsanto argued that Gulf Power was improperly flowing nonjurisdictional UPS costs through the fuel recovery clause to its jurisdictional retail customers for the purpose of protecting its wholesale rate of return. Monsanto asserted that the increased allocation of Plant Daniel energy had the additional effect of placing an unfairly high share of the Plant Daniel coal buyout costs on the retail customers.

The Commission refused to require a refund. Its decision was based on the single finding that, because Gulf Power's generators are committed on the basis of economic dispatch, the amounts of Plant Daniel energy charged to retail customers were not unreasonable.

SUMMARY OF ARGUMENT

In past rate cases, the Commission has assiduously reviewed Gulf Power's filings to assure that the wholesale investment and expenses associated with Gulf Power's ownership of Plant Daniel were filtered out of the revenue requirements borne by Gulf Power's retail ratepayers. This Court upheld the Commission in a case involving Gulf Power's challenge of such an adjustment in Gulf Power Co. v. Florida Public Service Commission, 453 So.2d 799 (Fla. 1984). In the instant case, involving a similar issue in a fuel cost recovery proceeding, the Commission was less vigilant.

Fuel cost recovery proceedings involve the same standards governing right to recovery and burden of proof as do base rate cases. It was incumbent upon Gulf Power to demonstrate that the anomalously high 1985-1987 allocation of expensive Plant Daniel energy to retail ratepayers occasioned by a contractual concession to wholesale customers constituted expenses reasonable in amount and necessarily incurred to provide service to retail customers.

The Commission's finding that the reasonableness of the expense is justified by the manner in which the generating units are committed (economic dispatch) to meet system needs is not supported by competent substantial evidence. The evidence of record instead overwhelmingly establishes that the allocation of Plant Daniel energy between retail and wholesale customers is accomplished and explained--not by the method of dispatch--but by a separate, after-the-fact, backward-looking

billing methodology that simply assigns to retail ratepayers all Plant Daniel generation that was not specifically sold to others. The evidence establishes that the method of economic dispatch and the total Plant Daniel generation remained the same over time. With the concession which relieved wholesale customers of their obligation to purchase Plant Daniel energy in place, and cheaper sources of energy newly available, the wholesale customers smartly bought less of the expensive Plant Daniel energy. Gulf Power used the billing program to automatically charge the retail customers for dramatically more of the expensive Plant Daniel energy than they had used when the wholesale customers were fulfilling their original obligation to purchase Plant Daniel energy. Shareholders absorbed none of the cost of the concession.

The extra expense associated with the concession must be disallowed because it represents nonjurisdictional wholesale costs. To allow recovery would be to require retail ratepayers to subsidize Gulf Power's wholesale rate of return. Since stockholders, not ratepayers, were at risk in the event the wholesale contracts unraveled, the cost to cement the wholesale relationship and safeguard the lucrative wholesale contractual rewards should be borne by the stockholders. Costs incurred for that purpose do not meet the standard of costs reasonably and prudently incurred to provide retail service.

The evidence of record establishes both the necessity of a disallowance and the mechanism for accomplishing it. The Commission's order should be reversed. The Commission should be directed to order Gulf Power to make refunds to those customers who experienced overallocations of Plant Daniel energy during 1985-1987.

I.

ARGUMENT

THE FLORIDA PUBLIC SERVICE COMMISSION'S REFUSAL TO DISALLOW FROM RECOVERY, THROUGH THE RETAIL FUEL COST RECOVERY CLAUSE, THE COST OF EXPENSIVE ENERGY WHICH GULF POWER UNILATERALLY EXCUSED WHOLESALE UTILITY BUYERS FROM PURCHASING IS NOT SUPPORTED BY COMPETENT SUBSTANTIAL EVIDENCE.

A. **The Standard of Review.**

This Court's review of the Commission's Order is governed by section 120.68, Florida Statutes (1987). Section 120.68(10) addresses agency determinations which depend on findings of fact:

> The court shall . . . set aside agency action or remand the case to the agency if it finds that the agency's action depends on any finding of fact that is not supported by competent substantial evidence in the record.

The Commission's Order, which holds that Gulf Power is entitled to recover a disputed cost from ratepayers, must be supported by competent substantial evidence of record.

This Court defined competent substantial evidence in DeGroot v. Sheffield, 95 So.2d 912, 916 (Fla. 1957). Substantial and competent evidence is:

> [S]uch evidence as will establish a substantial basis of fact from which the fact at issue can reasonably be inferred . . . . [S]uch relevant evidence as a reasonable mind would accept as adequate to support a conclusion. Citations omitted.

The DeGroot definition was cited with approval in Duval Utility Co. v. Florida Public Service Commission, 380 So.2d 1028 (Fla. 1980), when this Court reversed a Commission order for lack of competent substantial evidence.

This Court has not hesitated to reverse Commission orders when the record reveals a lack of competent substantial evidence. ~~See~~, ~~i.e.~~, State v. Hawkins, 364 So.2d 723 (Fla. 1978) (no competent substantial evidence to support accounting method for contributions-in-aid-of-construction); Citizens of Florida v. Hawkins, 356 So.2d 254 (Fla. 1978) (subsidiary method of calculating tax effect not supported by competent substantial evidence); City of Plant City v. Mayo, 337 So.2d 966 (Fla. 1976) (order regarding new policy on franchise fees reversed due to lack of competent substantial evidence).

A review of the record in this case demonstrates that the Commission's refusal to disallow Gulf Power's excessive fuel costs is not supported by competent substantial evidence and therefore must be reversed. Section 120.68(10) gives this Court the authority to set aside agency action if such action is not based on competent substantial evidence. See also, Section 120.68(13)(a)1.

B. Gulf Power Can Only Recover Fuel Expenses Which Were Reasonably and Prudently Incurred.

The general standard which governs whether a utility may recover expenses from ratepayers is whether the expenses incurred were reasonable, prudent, and necessary in order to

provide service to ratepayers. This regulatory principle is expressed in A. Priest, Principles of Public Utility Regulation, at 51 (1969). With regard to operating expenses, the author notes that such expenses may be excluded from recovery:

> (1) if the questioned outlays represent "inefficiency" or "improvidence," or (2) managerial discretion has been abused, or (3) the action taken has been "arbitrary," or "inimical to the public interest," or (4) there has been "economic waste," or (5) such outlays were not legitimate operating expenses because they were "in excess of just and reasonable charges."

The well-established principle that only prudent and reasonable expenses may be recovered flows from the precept that a utility may not impose unnecessary costs on its consumers. Cities Service Gas Co. v. Federal Power Commission, 424 F.2d 411 (10th Cir. 1969), cert. denied, 400 U.S. 801 (1970). Obviously, any costs which are not prudent and reasonable in relation to the provision of service are unnecessary. Regulated utilities must operate with all reasonable economies. El Paso Natural Gas Co. v. Federal Power Commission, 281 F.2d 567 (5th Cir. 1960), cert. denied, 366 U.S. 912 (1961).

The principle of reasonable and prudent costs has often been discussed by this Court. In Gulf Power Co. v. Florida Public Service Commission, 453 So.2d 799 (Fla. 1984), this Court discussed reasonable and prudent costs in relation to what may be included in rate base for rate setting purposes. In Gulf Power, this Court affirmed the Commission's finding

that only fuel stock reasonably and prudent y included in Gu Power's fuel inventory should be included in rate base and excluded almost $9 million of fuel inventory from rate base. The Court stated:

> This Court has held that the rate base upon which a utility should be afforded an opportunity to earn a return is not every dollar of investment made but only that investment in assets devoted to public service at the time rate base is quantified. United Telephone Co. v. Mayo; Keystone Water Co. v. Bevis, 278 So.2d 606 (Fla. 1973). Order no. 11498 allows Gulf an opportunity to earn a return on every dollar of investment in assets committed to provide service to its customers and allows it to include a 23% reserve margin.

Id. at 806.

In Gulf Power's 1981 rate case, Docket No. 810136-EU, the Commission applied the standard of prudence to Gulf Power's investment in Plant Daniel. In Order No. 10557, the Commission found that Gulf Power had failed to prudently identify and respond to changes in load growth in the 1970's. This failure resulted in excess capacity, in the form of Plant Daniel, on Gulf Power's system. Even after accounting for off-system sales, this imprudence would have necessitated a $3 million contribution from ratepayers toward Plant Daniel's revenue requirements.

The Commission held:

> We believe that prudent management would have led Gulf to begin a concerted effort to develop accurate forecasting methods much earlier than mid-1980. More significantly for the purposes of this

> case, more accurate forecasting at an earlier point in time would have signalled to Gulf's system planners the need to develop greater sales of capacity off the system, and would have provided the lead time required for measures designed to prevent Gulf's ratepayers from paying for excess capacity. Because of our finding that Gulf failed to use prudent measures in developing its load forecasts, we are adjusting net operating income by $3,099,000 so that the ratepayers will not be called upon to bear the shortfall in the revenue requirements associated with Plant Daniel in the 1981 test period.

Id at 23.

The general standard of recovery discussed above specifically applies to the requests of utilities to recover fuel costs from ratepayers through the fuel cost recovery clause. In Order No. 9273, Docket No. 74680-CI, the Commission made several changes to the then existing fuel adjustment clause. In that Order, a Staff witness explained that:

> [T]he companies would be required to explain the reasonableness of their fuel purchases at the hearing during which projected amounts would be compared to actual results.

Id. at 8.

The Commission held:

> We recognize that the companies' projections will inevitably differ from actual results, and agree that a true-up mechanism, designed to conform the projected estimates to actual figures, is necessary to realize the objective of eliminating overrecoveries and under-recoveries of fuel costs. We will

> continue, however, to audit and evaluate the performance of the companies, and to approve for inclusion into the clause only prudently and necessarily incurred fuel expense. Accordingly, we will conduct in the second month following a projection period a public hearing for the purpose of ascertaining the differences between projected and actual costs. At that time, the reasonableness of the companies' expenditures during the preceding projection period will also be examined.

Id. at 14. Emphasis added.

This Court has applied the prudent and reasonable cost standard to recovery under the fuel adjustment clause in several cases. In Gulf Power Co. v. Florida Public Service Commission, 487 So.2d 1036 (Fla. 1986), this Court affirmed the Commission's order which required Gulf Power to refund $2 million to ratepayers. In that case, Gulf Power entered into an imprudent contract to purchase coal from Maxine Mine. The contract resulted in Gulf Power paying excessive prices for coal and then passing that cost along to the ratepayers via the fuel cost recovery clause. This Court affirmed the disallowance of the excessive fuel costs and the refund.

In In re: Investigation of fuel cost recovery clause of electric utilities, Docket No. 810001-EU, the Commission disallowed $3.5 million of fuel expense claimed by Florida Power Corporation in a fuel adjustment proceeding. In this case, Florida Power's Crystal River No. 3 nuclear power plant was shut down and remained out of service for 167 days. As a

result, Florida Power had to switch to more expensive fossil fuel generation and incurred much higher fuel expenses.

The Commission held:

> Florida Power Corporation must bear responsibility for seven days of the outage of Crystal River No. 3 which is the subject of this proceeding, and . . . the sum of $3,524,715 of its incurred fuel expense must be excluded from recovery as imprudently and unreasonably incurred.

Order No. 9950, p. 5. In Florida Power Corporation v. Cresse, 413 So.2d 1187 (Fla. 1982), this Court affirmed the Commission's disallowance of the excessive fuel costs.

Gulf Power has recognized that only reasonable and prudent expenses may be recovered through the fuel adjustment clause. In its Petition requesting recovery in this case, Gulf alleged:

> Amounts spent for fuel by the Company [Gulf Power] are reasonable and prudent, and the Company makes every effort to secure the most favorable price for all of the fuel it purchases and for its purchased power.

R-Vol. I, p. 2.

C. The Commission Has the Authority to Review Past Fuel Adjustment Charges.

This Court has recognized that the Commission has the authority to review the prudence of past fuel adjustment charges:

> Fuel adjustment charges are authorized to compensate for utilities' fluctuating fuel expenses. The fuel adjustment proceeding is a continuous proceeding and operates to a utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the commission of the jurisdiction and power to review the prudence of these costs.

Gulf Power Co. v. Florida Public Service Commission, 487 So.2d 1036, 1037 (Fla. 1986). The Court may review past fuel adjustment charges and order a refund as to any amounts imprudently incurred.

D. Gulf Power Has the Burden to Prove That the Costs It Seeks to Recover Were Reasonably and Prudently Incurred.

Gulf Power has the burden of proof to demonstrate that the costs it seeks to recover from retail ratepayers through the fuel cost recovery clause are reasonable and prudent. In Florida Power Corporation v. Cresse, supra, this Court addressed the issue of which party has the burden of proof on the issue of the reasonableness of operating expenses, such as fuel costs.

In Florida Power Corporation, the utility argued that legitimately incurred operating expenses are presumptively reasonable and that the mere proof that such costs were incurred satisfies the utility's burden of proof. Then, according to the utility, the burden shifts to the Commission to prove that the costs were imprudently or unnecessarily incurred.

This Court explicitedly rejected Florida Power's burden of proof argument and stated:

> We do not agree [with Florida Power]. The language in PSC Order No. 9273, issued March 7, 1980, which adopted, among other things, the true-up mechanism here under consideration, provides or indicates several times that the burden of justifying fuel cost adjustments is on the utilities.

Id. at 1190.

This Court went on to hold:

> The requirement that utilities demonstrate the reasonableness of their fuel costs is not improper or unusual. "Burden of proof in a commission proceeding is always on a utility seeking a rate change, and upon other parties seeking to change established rates." WELCH, CASES AND TEXT ON PUBLIC UTILITY REGULATION, 638 (Revised Edition 1968). . . . The data provided showed that FPC's fuel costs were significantly higher due to an incident the responsibility for which was in dispute. It was up to the utility, under those conditions, to show that the excess costs incurred were reasonable and were not the fault of management.

Id. at 1191.

Similarly, in this case, Gulf Power was required to demonstrate that the anomalously high allocation of expensive Plant Daniel fuel costs to retail customers represented

expenses reasonably and prudently incurred to provide retail service. It failed to meet its burden.[3]

E. The Regulatory Framework Requires the Separation of Jurisdictional and Nonjurisdictional Costs.

The Commission regulates the retail costs, rates and services of public utilities within the state. Sections 366.02, 366.03. 366.041, 366.06, Florida Statutes (1987). Such costs and expenses are termed "jurisdictional" because they are related to the provision of services which come under the Commission's statutory purview.

The capital costs, operating expenses, and rates associated with the provision of capacity and energy to wholesale customers are regulated by FERC. 16 U.S.C.' § 824(b)(1). Such costs and expenses are "nonjurisdictional" with respect to the requirements legitimately placed on retail customers through rates and charges fixed by the Commission.

Thus, as a corollary to the "reasonable, prudent and necessary" standard, an appropriate exclusion of all costs and expenses associated with nonjurisdictional transactions must be made so that retail ratepayers pay only for those costs and expenses related to the provision of service ~~to them~~.

3/ Although the burden of proof as on G lf Power to justify the reasonableness of the Plant Daniel fuel expense placed upon retail cus-toners during 1985-1987, it did not at any time prior to Monsanto's discovery activities mention or refer to Schedule R in any pleading or testimony before the Commission. Tr-Vol. III, p. 436.

The Commission has clearly recognized and emphasized this regulatory differentiation in previous orders addressing Plant Daniel and Gulf Power's UPS sales. In Gulf Power's 1932 rate case, Docket No. 820150-EU, Gulf Power sought a rate increase of approximately $37 million. In discussing the appropriate adjustments to be made due to Plant Daniel's unused capacity (see discussion of Gulf Power's 1931 rate case, pp. 22-23, supra), the Commission discussed the same UPS contracts which are involved in this case.

The Commission was careful to ensure that retail ratepayers did not subsidize wholesale customers:

> Because the UPS contract is a wholesale transaction, it is regulated by the FERC. Our sole concern is whether Gulf has properly allocated -- all of the investment, operating costs, and revenues associated with UPS out of the retail jurisdiction.

Order No. 11493, p. 19. Emphasis added.

The Commission also discussed wholesale intercompany sales among the Southern companies as they related to Plant Daniel's excess capacity. The Commission stated:

> [W]e must assure ourselves that this sale of capacity does not require the retail ratepayers to subsidize the purchasers of that capacity.

Id. at 21. The Commission found that the 186 MW of Plant Daniel which would be sold to the Southern pool would have to be supported by almost $20 million in annual revenue requirements. After crediting all income against the revenue

requirements, a shortfall remained. The Commission noted that Gulf Power:

> would have the retail ratepayers support the revenue requirements of the 186 MW in the amount of $5,391,931, despite the fact that the 186 MW is above and beyond the capacity necessary to maintain an adequate reserve margin for Gulf.

Id. at 21-22. The Commission reduced Gulf Power's "revenue deficiency" by $5,391,931 to avoid retail subsidization of wholesale customers.

On appeal, this Court affirmed the Commisson's order. Gulf Power Co. v. Florida Public Service Commission, 453 So.2d 799 (Fla. 1984). This Court held that the reduction had:

> the net effect of excluding from rate base that portion of Plant Daniel determined to be nonused and useful bv present customers. See § 366.06, Fla. Stat. (1981).
>
> . . . .
>
> It is . . . an adjustment to rate base to exclude capacity which is not currently serving customers.

Id. at 806. Stated another way, the exclusion of a portion of Plant Daniel from rate base was necessary to prevent jurisdictional retail ratepayers from paying for nonjurisdictional costs.

The concept of the separation and exclusion of nonjurisdictional costs from retail costs and expenses has been consistently recognized and applied by other jurisdictions. See, i.e., Cities Service Gas Co. v. Federal Power Commission,

424 F.2d 411 (10th Cir. 1969), cert. denied, 400 U.S. 801 (1970) (nonjurisdictional gas costs disallowed and refund ordered); Sierra Pacific Power Co. v. Public Serv-ice Commission of Nevada, 634 P.2d 1206 (Nev. 1981) (ratepayers should not bear total increase in fuel costs when energy produced by fuel was sold to other utilities); Re Georgia Power Co., 29 PUR 4th 253 (1979) (rate increase denied for failure to present sufficient evidence as to the separation of retail and wholesale components).

In this case, the above regulatory standards have been violated.

F. **The Capacity and Energy Which the UPS Buyers Contracted to Purchase Represented Nonjurisdictional Wholesale costs.**

Confronted with the Commission's determination that Gulf Power had justified only a portion of the costs of Plant Daniel for inclusion in the base rates of retail customers, Gulf Power's recourse was to market the capacity (and related energy) to off-system, nonjurisdictional customers.

The capacity charges, which were a feature of the UPS contracts, were a way to avoid having shareholders absorb that portion of the costs of owning Plant Daniel that were not built into Gulf Power's retail customers' rates. Tr-Vol. IV, p. 506. (Over time, as the amount of Plant Daniel capacity sold to UPS buyers increased to 85% of the total and retail rates continued to support 50%, the UPS capacity charges also

became a bonanza for Gulf Power). Tr-Vol. IV, p. 492. The capacity charges were designed to recover from the wholesale buyers all of the fixed costs of owning the capacity and to provide Gulf Power a 16% return on its related equity investment. Even if the UPS buyers purchased 'little energy, the "take-or-pay" nature of the capacity charge assured Gulf Power that its fixed costs would be recovered. Tr-Vol. IV, p. 492.

The UPS customers also committed to buy minimum quantities of energy from the capacity of the dedicated units. Like the capacity charges, the minimum energy obligations represented a nonjurisdictional wholesale transaction.

Plant Daniel was one of the units designated in the UPS contracts. The capacity of Plant Daniel was dedicated--in specific increments over time--to the needs of the UPS wholesale customers. These wholesale buyers had a corresponding contractual obligation to purchase minimum amounts of energy from Plant Daniel annually. All of these contractual obligations were nonjurisdictional with respect to matters regulated by the Commission.

G. <u>The Evidence of Record Overwhelmingly Demonstrates the Prejudicial Impact of Schedule R on Retail Ratepayers.</u>

It is important to point out that the evidence establishing the relative responsibilities for Plant Daniel energy by retail and UPS customers before and after Schedule R is <u>uncontroverted</u>. Through discovery, Monsanto obtained information from Gulf Power concerning the price and

disposition of Plant Daniel energy over time. That information, consisting of Gulf Power's own numbers, was received in evidence in composite Exhibits 14 and 15. R-Vol. VI, Exh. 14 and 15; see especially Exh. 15, Item 46. It formed the basis for the comparisons and calculations provided by Jeffry Pollock, Monsanto's expert witness. The record of pertinent transactions is clear.

In August 1985, Gulf Power/Southern introduced Schedule R, which made generation sources cheaper than the UPS units available to the UPS buyers. The result was predictable. From August 1985 through June 1987, the UPS customers bought roughly 20,200,000 megawatt hours of newly available "R" energy, which was considerably more than the total of approximately 17,600,000 megawatt hours of UPS energy they bought during the same period. R-Vol. VI, Exh. 15, Intervenors' Third Set of Interrogatories, Item 43(c); A., p. 20. The reason is clear; the cost of the Schedule R energy ranged from 2.1 to 2.4 cents/kWh, while the corresponding cost of UPS base energy was from 3 cents/kWh to 3.8 cents/kWh during that time. Tr-Vol. IV, p. 483.[4/] As a result of this substitution, the consumption by UPS customers of UPS energy would have been significantly below their minimum annual

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4/ Under the terms of the UPS contracts, UPS buyers, on occasion, could purchase energy other than that from the designated units. Historically, these purchases represented a small fraction of total UPS sales. Tr-Vol. III, pp. 416, 418. The alternatives provided by the contract were also more expensive than the new Schedule R energy. Tr-Vol. IV, p. 483.

obligation levels in 1986 and 1987 but for their ability to count the Schedule R purchases toward that minimum. R-Vol. VI, Exh. 15, Intervenors' Third Set of Interrogatories, items 43(a) and 43(c); A., p. 20.

Using the data obtained from Gulf Power pertaining to Plant Daniel energy, Monsanto witness Jeffry Pollock demonstrated that the change in the UPS customers' usage was accompanied by a concomitant change in the amount of Plant Daniel energy "retained" by Gulf Power for its retail customers. He compared the percentages of the capacity and energy of Plant Daniel retained by Gulf Power for territorial customers[5/] before and after Schedule R was implemented:

Description	Plant Daniel Retained By Territorial Customers	
	Capacity	Energy
Before Schedule R	46%	42%
After Schedule R Was Implemented	20%	45%

The swing is graphically demonstrated by Mr. Pollock's calculation of the implic-it capacty factors[6/] attributable to the portions of Plant Daniel capacity devoted to retail and UPS customers, respectively.

5/ Of "territorial sales," 95% are made to retail customers.

6/ "Capacity factor" is a calculation that measures how extensively capacity is utilized over time. It compares the amount of energy actually generated with the amount of energy that could have been generated if the capacity had been fully utilized. Therefore, the maximum capacity factor is 100%.

Comparison of Plant Daniel Capacity Factors

Description	Total Plant	Retained by Territorial Ratepayers	UPS Customers
Before Schedule R	44%	38%	39%
After Schedule R	47%	107%	20%

Tr-Vol. IV, p. 486.

Like the relative consumption data, these calculations were not disputed. They show that, on an overall basis, the utilization of Plant Daniel did not change materially after Schedule R was implemented. Prior to Schedule R, the levels of utilization by UPS and territorial customers of their respective portions of Plant Daniel capacity were virtually identical. After Schedule R was implemented, the level *of* usage by UPS customers of the Plant Daniel capacity they had purchased plummeted, while that of territorial customers simultaneously soared.

The explanation of how the retail ratepayers came to be charged for the Plant Daniel energy not purchased by the UPS customers is also fully established by the evidence of record in Gulf Power's own description of its billing methodology. In a response to an interrogatory, Gulf Power summarized the billing mechanism used to determine the responsibility of retail customers for "retained" Plant Daniel energy as:

RETAINED ENERGY = NET GENERATION - ALL ENERGY SOLD

R-Vol. VI, Exh. 15, Intervenors' Third Set of Interrogatories, Item 52(b); A., p. 23.

Gulf Power's witness, Lane Gilchrist, confirmed the mechanics of the billing program during his cross-examination. Tr-Vol. 111, pp. 368-370.

The evidence clearly establishes that, with the advent of Schedule R, UPS customers took less Plant Daniel energy, with the result that retail customers were charged for more. Fuel costs which prior to Schedule R had been the responsibility of wholesale customers were passed through the retail fuel cost recovery clause, causing retail customers' bills to be higher than they would have been had the UPS customers been held to their minimum annual purchases of Plant Daniel energy (or had the cost of the concession been absorbed by stockholders).

Having demonstrated the "tilt" of expensive energy toward retail customers caused by Schedule R and the "residual" nature of the retail customers' allocation under Gulf Power's billing methodology, Wonsanto demanded that Gulf Power be required to refund the cost of the Schedule R concession which had been collected from retail ratepayers. Monsanto asserted that Gulf Power had improperly passed wholesale, nonjurisdictional costs through the retail rate structure, thereby requiring retail customers to subsidize a contractual concession designed to protect the shareholders' wholesale rate of return.

The Commission made no adjustment. It based its decision on a single finding: Because Gulf's units are on economic dispatch, said the Commission, the fuel costs were not

unreasonable, even if the costs for the period were higher. R-Vol. I, pp. 175-176.

The Commission's decision is not based on competent substantial evidence; instead, it flies in the face of the evidence. Gulf Power's repeated references to "economic dispatch" at hearing were an exercise in obfuscation, not justification. "Economic dispatch" refers to the commitment of units to meet system requirements in the ascending order of costs at the time capacity is required. Gulf Power's own answers to interrogatories acknowledged (indeed, delineated) the distinction between the computerized dispatch process, which is used to economically call on units to meet system aggregate conditions, and the separate billing mechanism, which later determines the portion of Plant Daniel energy which is charged to retail customers:

> All generating units on the Southern electric system, including Plant Daniel, are committed to the line based on the results of daily unit commitment computer program which is used to evaluate the economics of serving the aggregate of the territorial load and off-system sales. The UPS units are potential resources in ~~this~~ aggregate commitment evaluation. They are not committed to the line based solely on anticipated UPS sales.
>
> . . . .
>
> The amount of energy from Plant Daniel retained for Gulf's retail customers is a function of the UPS customers schedule from Plant Daniel and the amount of energy allocated from Plant Daniel to serve other off-system sales. The actual billing allocation of Plant Daniel energy is determined "after-~~the~~-~~fact~~" by the Billing Redispatch program on an hourly basis.

> The amount of the UPS schedule from each Daniel unit (base energy) is subtracted from the actual net generation of the unit.

R-Vol. VI, Exh. 14, Answer to Interrogatory 1. Footnote omitted. Emphasis added. A., pp. 15-19.

As Mr. Gilchrist acknowledged, the process of sorting out which customers pay for which generation source is a separate, backward-looking endeavor that first accounts for specific sales to others, then charges the remainder to jurisdictional customers. It is important to bear in mind that Gulf Power's system was operated on the basis of economic dispatch before and after Schedule R was implemented. Like the overall capacity factor (level of usage) of Plant Daniel, economic dispatch was a constant. It cannot explain or justify the shift in the assigned responsibility of expensive Plant Daniel energy between jurisdictions. As the evidence clearly establishes, that explanation lies in the ability of UPS customers to substitute Schedule R energy for UPS energy and in the action of Gulf Power in steering Plant Daniel energy not sold to others through the retail fuel cost recovery clause.

Gulf Power's faulty economic dispatch argument is: If units are operated in economic dispatch, then customers receive the most economical energy available at any point in time. That reasoning leaves out an important consideration: the obligation of UPS customers to schedule and purchase a minimum share of the Plant Daniel energy that was forgiven by Gulf Power/Southern.

This point can be illustrated with an analogy. A car dealer assigns to his parts manager the job of buying tires at the best prices. There are two available suppliers: Prestige Tire Company, which sells at $100/tire, and Ajax Tires, which sells at $25/tire. Ajax contracts to supply a minimum of 500 tires per month. However, midway into the term of the contract, Ajax becomes dissatisfied with its low mark-up and announces it will no longer supply tires. The manager says, "Oh, okay," and moves all his requirements to Prestige, the single remaining supplier. When the dealer complains about the high cost of tires, the manager can claim, "I'm buying the most economical tires available"--but will he keep his job? But for his willingness to forego the obligation of Ajax to supply tires, the "most economical tires available" would have cost less. Similarly, "but for" the concession to wholesale customers through Schedule R, the fuel costs charged to retail customers following economic dispatch would have been lower.

Even Gulf Power's witness, Lane Gilchrist, was repeatedly careful not to ascribe the full brunt of the Plant Daniel allocation to the procedure of economic dispatch:

> Q And the amount of Daniel energy that is retained for Gulf's territorial customers consists of the difference between the total amount generated and the amount which the redispatch program identifies as having been bought by the UPS customers, other off-system customers, and intercompany transactions, is that correct?
>
> A Yeah, based on economic dispatch.

> Q So the amount retained for territorial customers, 95% of whom are the retail customers, is a function of what is sold to others, is that correct?
>
> A No, not necessarily. It may be needed by the territorial customers in that particular hour.
>
> Q But the amount that is billed to them is a function of the total generation and those components which are identified as having been purchased by those other customers?
>
> A Yes. But part of it may have been needed by them.

Tr-Vol. III, pp. 369-370. Emphasis added.

> Q And would you agree that we demonstrated through use of your response to Interrogatory 1, and the examples on the easel, that any amount of Daniel generation not sold to UPS customers, other off-system customers or intercompany transactions, the residual of the [sic] is retained and billed to territorial customers?
>
> A No. You are implying that it was more expensive or [sic] them, and my point I made in making the presentation was that it may not be, it may have been the most economic energy on certain hours for them.
>
> Q I don't think that's the question, Mr. Gilchrist. The question is we established that any amount of Daniel generation not sold to and billed to UPS customers, other off-system customers and intercompany transactions, the residual is the amount that is billed to the territorial customers, is that correct?
>
> A Yes.
>
> Q So that regardless of what happens to other transactions there is

always somebody paying for the amount of generation from Daniel?

A Yes.

Tr-Vol. III, p. 409. Emphasis added.

One of Gulf Power's own exhibits belies its "economic dispatch" argument. In Exhibit 11, Section 5, Gulf Power purported to show that the negative impact of Schedule R was offset by fuel savings. R-Vol. VI, Exh. 11. The Commission ultimately rejected the fuel savings rationale, for good reason. It is pertinent to note, however, that the basic premise of the exhibit is that to the extent Schedule R sales displace UPS purchases of Plant Daniel energy, a Plant Daniel "deficit" is created, resulting in a "negative impact" of Schedule R. In a lengthy preamble full of caveats, Gulf Power quarreled with the amount of the penalty which resulted from the parameters and assumptions of the study; it also attempted to demonstrate within the exhibit that the penalty would be offset by fuel savings. Gulf Power did not, however, claim that economic dispatch justified the reasonableness of the amount of Plant Daniel energy which would have to be absorbed by others. Gulf Power did not argue that economic dispatch would preclude the deficit from becoming an additional cost to others caused by Schedule R in the analysis, even though the same document that acknowledged the existence of the "negative cost impact" observed that the energy in question would be provided to the system through economic dispatch:

> The *negative impact* of being able to schedule Replacement energy is determined to be the total *additional Base energy*[7] *required* multiplied by the difference in the Base energy rate and the Schedule R energy rate. . . .
>
> It is very important to note that energy generated out of Daniel *under economic dispatch* which, absent R, would have been sold as base, may be utilized by Gulf's retail or wholesale customers, sold to the Southern System pool, or sold off-system under one of a number of off-system sales contracts.[8]

Tr-Vol. VI, Exh. 11, Section 5, pp. 31, 33-34. Emphasis and footnotes added.

Gulf Power witness William Howell unwittingly placed the coup de grace on the economic dispatch argument when trying to make a different point. In emphasizing the importance of maintaining off-system UPS sales, he acknowledged the very relationship which establishes the subsidy to which Monsanto objects:

> Q What happens to the territorial customers' portion of Plant Daniel energy when off-system sales decline?
>
> A *The territorial customer will receive a higher portion of Daniel energy*

7/ "Base energy" here is Plant Daniel energy.

8/ Early in the case, Gulf Power tried to assert that the Plant Daniel energy not purchased by UPS customers could be sold to a number of other customers. During the case, Monsanto exacted through discovery the information which proved what happened to that Plant Daniel energy during 1985-1987. As established by Gulf Power's own numbers and Mr. Pollock's testimony, it was "retained" and charged to retail customers. Tr-Vol. VI, Exhibit 15, Item 46.

> since this is a Gulf-owned resource which was originally obtained to satisfy territorial customer requirements.

Tr-Vol. IV, p. 626. Emphasis added.

In other words, Mr. Howell acknowledged that it is the fact of lower off-system sales--not economic dispatch--which causes retail customers to experience a higher allocation of Plant Daniel energy under Gulf Power's billing mechanism. Schedule R was a concession which led to lower Plant Daniel off-system sales (a "decline"). As Mr. Howell and the interrogatory exhibits establish, the impact of that concession was to steer more Plant Daniel energy to territorial (virtually all of whom are retail) customers.

The Court cannot conclude that the Commission's order was based on competent substantial evidence when Gulf Power's own evidence disproves the assertion upon which the Commission based its finding.

H. Stockholders Should Bear the Costs of the Schedule R Concession.

Gulf Power argued that the concession of Schedule R was necessary to prevent the UPS customers from abrogating their contracts and halting the payment of capacity charges (through which Gulf Power recovered the cost of much of its investment in Plant Daniel). It is clear that the cost of that concession was channeled through the retail fuel cost recovery clause and borne by retail customers. Gulf Power's witness

Lane Gilchrist acknowledged that its stockholders did not absorb any of the cost of the concession:

> Q The stockholders were not called upon to absorb any cost of the concession provided to UPS customers through Schedule R?
>
> A Not directly at the time. That was the result.

Tr-Vol. III, p. 410.

Gulf Power's witness also acknowledged that different types of concessions could have been structured in a way that would have sent the costs of the concession to the stockholders' bottom line instead of the retail customers' bills. Tr-Vol. III, p. 408.

While the Commission's order is not based upon Gulf Power's claim that Schedule R protected ratepayers by insuring the continued flow of UPS capacity charges, a consideration of who was truly at risk reinforces Monsanto's point that the costs of the wholesale concession were not reasonably incurred to provide service to retail customers.

Gulf Power asserted that, absent Schedule R, retail ratepayers would have been forced to pay for capacity abandoned by the UPS customers. First, that is speculation, on top of speculation, on top of more speculation. It assumes the UPS customers would have abrogated binding agreements; further, that efforts to enforce the agreements would have failed; and further still, that a subsequent attempt to

incorporate the investment into retail rates would have been successful.

The essential facts are that (a) happy or not, the wholesale customers had a binding contractual obligation to take Plant Daniel energy;[9] and, even more fundamentally, (b) assuming the contracts could have been abrogated, it was the stockholders, not Gulf Power's retail ratepayers, who were enjoying the benefits of the wholesale contracts and who wanted to minimize the risk of losing those benefits. Gulf

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9/ When Gulf Power was trying to characterize the capacity charges as being at risk, the following exchange took place between Commissioner Wilson and Mr. Gilchrist:

> Q (Mr. Holland) If the economics of that entitlement, in other words, if it became uneconomical for them to purchase that energy out of the unit power sales units or alternate or supplemental energy became uneconomical, would there have been an incentive for them to continue to make the capacity payments?
>
> A In my opinion it would have been seriously threatened.
>
> COMMISSIONER WILSON: Would they have been bound to make those capacity payments?
>
> WITNESS GILCHRIST: Would they -- the question is, would they --
>
> COMMISSIONER WILSON: Would they be obligated?
>
> WITNESS GILCHRIST: If they weren't buying any energy? (Pause) In my opinion they would be.
>
> Q (By Mr. Holland) The terms of the UPS agreement require them to make the capacity payments, do they not?
>
> A Yes.

Power's argument proceeded from the assumption that whatever costs are not paid by others must be paid by ratepayers. That is wrong. Instead, ratepayers bear only costs necessarily and prudently incurred to serve them; any additional costs which cannot be collected from off-system sales must be absorbed by shareholders. Tr-Vol. IV, p. 505.

The shareholders would have been particularly at risk in this instance. The UPS contracts were providing 85% of Plant Daniel's fixed costs. Ratepayers were already bearing 50%; assuming that Gulf Power could have somehow justified placing more of the burden on ratepayers, it by definition could not have exceeded an additional 50% of the plant. Had the UPS contracts been abrogated, shareholders would have lost significantly even if Gulf Power had been spectacularly successful in a retail rate case. By providing Schedule R, Gulf Power was trying to enhance the continued enjoyment of a windfall overrecovery of the costs of its investment in Plant Daniel. For these reasons, Gulf Power's attempt Lo insulate itself from risk at the expense of its retail customers is particularly inappropriate.

I. The Record Contains the Evidence Weeded to Quantify the Adjustment Necessary to Prevent Retail Ratepayers from Subsidizing the Concession to Wholesale Contract Customers.

The record clearly demonstrates that the allocation of Plant Daniel energy costs has been "tilted" to the detriment of jurisdictional ratepayers. The record further demonstrates

that the economic dispatch of Gulf Power's generators does not explain or justify the inappropriate allocation. The Commission's refusal to disallow the cost of the concession cannot be sustained. The remaining issue is the manner in which the excess costs charged to retail ratepayers should be quantified, and Gulf Power's abuse of the retail fuel cost recovery clause rectified.

There are two parts of the overcharge related to the excess Plant Daniel energy. The first relates to the inappropriate allocation of buyout costs. The second is the differential in fuel cost between the expensive Plant Daniel energy and that which it supplanted.

Monsanto witness Jeffry Pollock supplied both the data and the methodology needed to make the appropriate adjustments. Based on data supplied by Gulf Power, Mr. Pollock observed that prior to Schedule R, retail ratepayers used a percentage of Plant Daniel energy which, on average, closely paralleled the percentage of Plant Daniel capacity retained for them. Tr-Vol. IV, p. 488. Schedule R and the residual feature of the billing mechanism severely distorted that relationship. Mr. Pollock calculated the amount of excess Plant Daniel energy which should be adjusted out of the fuel cost recovery formula during the period in question to restore the relationship between the percentages of capacity and energy retained for retail customers to their normal pre-Schedule R levels. Tr-Vol. IV, pp. 488-490; R-Vol. VI, Exh. 21, Schedule 6. (Gulf Power disagreed with the need for or

propriety of this methodology, but did not question Mr. Pollock's mathematical calculation).

Having identified the amount of Plant Daniel generation which should be properly associated with retail consumption for the period, calculating the proper amount of coal buyout costs attributable to that adjusted consumption figure became a straightforward matter. Mr. Pollock determined that Gulf Power had overcharged the retail customers for their share of coal buyout costs by $1.7 million. Tr-Vol. IV, p. 488. The Commission should be directed to order Gulf Power to refund that amount to the customers who overpaid in the 1985-1987 time frame.

The same determination of excess Plant Daniel generation enters into a determination of the fuel cost overcharge that should be refunded. Mr. Pollock demonstrated that the cost of the generation sources which would have served the retail customers absent Gulf Power's skewed allocation can be reasonably estimated. He provided two proxies--one more conservative than the other--which he used to calculate the amount of fuel cost which should be disallowed and refunded to those customers who paid them in 1985-1987. If Gulf Power's average cost of purchased power for the period is used as a proxy, the refund amount is $10.6 million; if instead its cost of economy energy sold is used, the refund amount is $3.9 million. Tr-Vol. IV, pp. 488-490; R-Vol. VI, Exh. 21, Schedules 7, 8. The Court should direct the Commission to

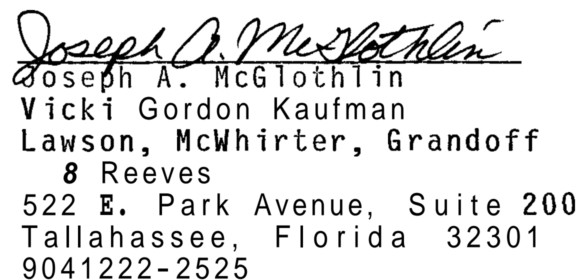
determine the appropriate measure of a refund of excessive fuel costs based on the record.[10]

10/ The refund would be a return of the excessive fuel costs borne by retail customers during August 1985-1987 to the customers (including Monsanto) who were overcharged at the time; in other words, a correction to the bills for the period, based upon consumption during the period.

Monsanto's challenge is limited to this time frame. After different fuel sources replaced the western contracts, the differential in cost between Plant Daniel generation and other sources on the system narrowed.

CQNCLUSION

Over time, both the Commission and this Court have been involved in the process of assuring that Gulf Power's retail ratepayers are not required to subsidize wholesale transactions involving Plant Daniel. In this case, the evidence clearly establishes that Gulf Power unilaterally relented on the responsibility of its wholesale UPS customers to purchase expensive Plant Daniel energy for the purpose of shoring up a lucrative wholesale contract. Gulf Power then adeptly sidestepped the cost *of* that concession and improperly required retail ratepayers to absorb **it.** The Commission's determination that the higher costs were appropriate and reasonable in light of the system's use of "economic dispatch" is not supported by competent substantial evidence. Based on the evidence, the Court must set aside the Commission's decision. The Court should direct the Commission to order Gulf Power Company to refund the excess fuel and coal buyout costs to those customers--including Monsanto--who paid for an excessive allocation of Plant Daniel energy during the period August 1985-1987.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Initial Brief of Appellant, Monsanto Company, has been furnished by U.S. Mail to the following parties of records, this 19th day of April, 1989.

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