SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: SB 2798

SPONSOR: Senator Argenziano

SUBJECT: Air Quality

DATE: March 17, 2004 REVISED: _____ _____ _____ _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Branning	Kiger	NR	Favorable
2.			CU	
3.			AGG	
4.			AP	
5.				
6.				

I. Summary:

This bill allows certain electric utilities to recover certain costs related to certain air pollution control equipment through their rates charged to retail customers. Creates the Air Quality Improvement Act and provides limitations for certain air emissions from certain units at investor-owned public utilities.

This bill amends s. 366.8255, F.S.; and creates s. 366.8252 and s. 403.0874, F.S.

II. Present Situation:

The Clean Air Act was first adopted in 1970 with significant amendments added in 1977 and the last amendments were signed into law on November 15, 1990. The 1990 amendments were adopted after nearly a decade of contentious debate and contain a total of 11 titles (7 major titles.) Those titles include:

- Title I — Nonattainment Areas
- Title II — Mobile Source Controls
- Title III — Toxic Air Pollution
- Title IV — Acid Rain
- Title V — Air Operation Permits
- Title VI — Ozone Depletion (CFCs)
- Title VII — Enforcement
- Titles VIII-XI — Miscellaneous Provisions

States were given the primary responsibility for implementing these amendments. Legislatures were required to revise and enact certain air pollution programs.

Under the Clean Air Act Amendments of 1990, the U.S. Environmental Protection Agency (EPA) has established limits for the amount of a pollutant that can be in the air anywhere in the United States. The law allows individual states to have stronger pollution controls, but may not have less stringent controls than those set by the EPA.

States are required to develop state implementation plans (SIP) that explain how each state will implement it responsibilities under the Clean Air Act. The SIP must be periodically updated to ensure attainment and maintenance of national ambient air quality standards throughout Florida. In developing the state implementation plan, the public is involved through hearings and opportunities to comment. The EPA must approve each state's SIP and if the plan is unacceptable, the EPA can assume the authority over enforcing the Clean Air Act in that state. The 1990 Clean Air Act Amendments enabled the EPA to directly fine violators.

Chapter 366, F.S., provides that the Public Service Commission (PSC) has primary regulatory jurisdiction over electric utilities. Pursuant to s. 366.04, F.S., the PSC fully regulates the investor-owned utilities (IOU), with limited rate structure jurisdiction over the rural electric cooperatives and municipally owned electric utilities.

Rate regulation has historically been cost based. Utilities are allowed to charge rates that recover the actual cost of producing and delivering electricity plus a fair return on investment. The PSC has established numerous procedures to ensure that electric rates are fair. The ratemaking and rate review methods currently in use by the PSC include:

- A full revenue requirements rate case. All costs and expenses are justified by the utility and recurring operating expenses and prudent expenses are included in the net operating income. A fair rate of return on investment is determined based on prevailing market conditions.
- Surveillance reports. Such reports are filed monthly by each IOU with the PSC that show current and year to date accounting and financial data. The information is used to ensure that the rates being charged remain reasonable.
- Recovery clauses. Annual evidentiary hearings are conducted by the PSC to consider charges passed through to ratepayers. This method pertains only to the IOUs. There are four separate cost recover clauses available to utilities. These are:

  -Fuel and Purchased Power
  -Purchased Capacity
  -Environmental
  -Energy Conservation

In 1993, the Legislature created s. 366.8255, F.S., to address environmental cost recovery through environmental compliance cost recovery factors that are separate and apart from the utility's base rates.[1] Section 366.8255(1)(d), F.S., provides that environmental compliance costs

[1] Section 7, ch. 93-35, Laws of Florida

include all costs or expenses incurred by an electric utility in complying with environmental laws or regulations, including but not limited to the following:

- Inservice capital investments, including the electric utility's last authorized rate of return on equity thereon;
- Operation and maintenance expenses;
- Fuel procurement costs;
- Purchased power costs;
- Emission allowance costs;
- Direct taxes on environmental equipment; and
- Costs or expenses prudently incurred by an electric utility pursuant to an agreement entered into on or after the effective date of this act (ch. 2002-276) and prior to October 1, 2002, between the electric utility and the Florida Department of Environmental Protection or the U.S. Environmental Protection Agency for the exclusive purpose of ensuring compliance with ozone ambient air quality standards by an electrical generating facility owned by the electric utility.

Further, s. 366.8255(2), F.S., states that:

> (a)n electric utility may submit to the commission a petition describing the utility's proposed environmental compliance activities and projected environmental compliance costs in addition to any Clean Air Act compliance activities and costs shown in a utility's filing under s. 366.825. If approved, the commission shall allow recovery of the utility's prudently incurred environmental compliance costs, including the costs incurred in compliance with the Clean Air Act, and any amendments thereto or any change in the application or enforcement thereof, through an environmental compliance cost-recovery factor that is separate and apart from the utility's base rates. An adjustment for the level of costs currently being recovered through base rates or other rate-adjustment clauses must be included in the filing.

Finally, s. 366.8255(5), F.S., provides that

(r)ecovery of environmental compliance costs under this section does not preclude inclusion of such costs in base rates in subsequent rate proceedings, if that inclusion is necessary and appropriate; however, any costs recovered in base rates may not also be recovered in the environmental cost-recovery clause.

Air pollution is associated with increased health risks associated with cardiovascular disease, asthma and other respiratory ailments. Those risks are lessened in areas which are in attainment of ambient air quality standards. Florida is currently only one of two states east of the Mississippi River that is in attainment with all health-based national ambient air quality standards. As a result, Florida has not had to implement a mandatory vehicle inspection program or require costly reformulated gasoline as other non-attainment states have had to do.

III. Effect of Proposed Changes:

Section 1. Section 366.8255, F.S., relating to environmental cost recovery, is amended to revise the definition of "environmental laws or regulations" to include voluntary agreements for air quality improvement programs entered into with the Department of Environmental Protection (DEP) prior to December 31, 2011, that apply to electric utilities and are designed to protect or improve the environment. Further, the definition of "environmental compliance costs" is revised to include costs or expenses the commission determines are prudently incurred by an electric utility for the addition of air pollution control equipment for purposes of attaining or maintaining compliance status with ambient air quality standards or reducing emissions of hazardous air pollutants or visibility-impairing pollutants. In order to seek recovery of such costs and expenses, an electric utility must enter into an agreement with the DEP prior to December 31, 2011, for the expeditious installation of this pollution control equipment.

An electric utility may submit to the Public Service Commission (PSC) a petition describing the utility's proposed environmental compliance activities and projected environmental compliance costs in addition to any Clean Air Act and Air Quality Improvement Act compliance activities and costs shown in a utility's filing under ss. 366.825 and 366.8252, F.S., and may include a proposal for nontraditional recovery of any such costs and the reasons supporting approval of the proposal.

Section 2. This section creates s. 366.8252, F.S., to provide for Air Quality Improvement Act compliance, definitions, plans and conditions. The Air Quality Improvement Act, s. 403.0874, F.S., is created by section 3 of this bill.

Section 366.8252, F.S., would provide that each public utility subject to the air emission limitations of the Air Quality Improvement Act may petition the PSC for approval to recover the costs of a plan to achieve compliance with the act. Such petition shall be filed with the PSC on or before September 1 of the year prior to the calendar year for which requested cost recovery is to commence. The request must include:

- The number and identity of affected generating units.
- A description of the compliance plan submitted by the public utility to the DEP for certification pursuant to s. 403.0874(7), F.S.
- The estimated effects of the compliance plan on the public utility's requirements for construction and operation of proposed or alternative generating facilities.
- The public utility's proposed schedule for implementation of compliance activities.
- The estimated costs, including capital investment and operating expenses, that the public utility will incur to implement its compliance plan.
- A description of any changes in the public utility's future sources of fuel as a result of the compliance plan and the estimated effects of any such changes on the public utility's fuel costs.

The PSC shall review the costs submitted to determine whether such estimated costs are reasonable. If it determines the costs are reasonable, the PSC shall approve the costs for recovery from the utility's retail customers in accordance with the provisions of s. 366.8255, F.S., subject to certain additional regulatory conditions. The PSC shall render its decision on a plan filed by a

public utility within 8 months after the date of filing. Notwithstanding the date of the PSC's decision, recovery of the public utility's estimated costs shall be allowed commencing with the beginning of the calendar year requested in the utility's petition and shall be made subject to refund if the PSC has not rendered its decision prior to such time. Approval by the PSC shall establish that the public utility's estimated costs to implement the plan are recoverable, subject to true-up based on a subsequent determination of the utility's reasonable actual costs.

The PSC shall establish certain regulatory conditions in conjunction with the approval of cost recovery for a public utility's compliance plan.

- If requested by the public utility in its petition, the PSC shall authorize recovery of the public utility's total costs to implement the compliance plan on a levelized basis over a period not to exceed 7 years beginning with the year in which cost recovery commences. The utility may, in any year during such cost recovery period, increase or decrease such levelized recovery amount to the extent of any net over-recovery or under-recovery in the aggregate for its combined adjustment clauses, provided that the utility's estimated costs to implement the compliance plan are fully recovered by the conclusion of the cost recovery period. Any over-recovery or under-recovery of actual costs shall be trued up in the year following the conclusion of the cost recovery period. Costs to implement the compliance plan that are incurred beyond the recovery period shall be recovered through applicable adjustment clauses in accordance with the PSC's normal practice and procedure.

- If cost recovery is implemented, the base rates and related rate schedules of the public utility in effect on the effective date of this section shall remain unchanged and frozen during the initial 5 years of the recovery period, and the depreciation rates and any annual adjustments to depreciation expenses and reserves allowed in an approved rate settlement agreement in effect on the effective date of this section remain in effect and capped during the recovery period. This is subject to certain specified conditions.

- During the cost recovery period, the public utility shall not be allowed to:
    1. Recover, through the capacity cost recovery mechanism of the fuel and purchased power adjustment clause, its annual revenue requirements associated with any generating unit subject to the Florida Electrical Power Plant Siting Act that is placed in service by the utility during such period.
    2. Suspend up to 100 percent of the annual accruals to its reserves for the dismantlement and decommissioning of generating facilities without limiting the utility's right to recover through future accruals or otherwise the reasonable and prudent costs of such dismantlement and decommissioning.
    3. Accelerate the amortization of regulatory assets previously approved by the PSC.

- Notwithstanding the foregoing base rate and adjustment clause freeze, the PSC may take certain specified actions consistent with the public interest, which shall not be construed to impair the continued effectiveness of the regulatory conditions stated in this section.

- The Legislature finds that the regulatory conditions established in this bill provide the necessary and appropriate recognition of the obligations imposed on a public utility by

the Air Quality Improvement Act, and that such conditions are therefore in the public interest. However, in the event circumstances arise which demonstrate that there will be a substantial harm to the public interest, the PCS may take the necessary action to prevent or mitigate such harm.

Section 3. Section 403.0874, F.S., creates the Air Quality Improvement Act. The terms "electric utility steam generating unit" and "investor-owned public utility" are defined.

Investor-owned public utilities would be required under this act to significantly reduce their annual emissions of nitrogen oxides (NOx) and sulfur dioxide (SO_2) in calendar year 2010 and any calendar year thereafter. Specifically:

- An investor-owned public utility that on the effective date of this act owns or operates coal-fired electric utility steam generating units for which the collective emissions of NOx from all such coal-fired generating units were between 32,000 tons and 36,000 tons in calendar year 2002, as reported in the U.S. Environmental Protection Agency (EPA) clean air markets program database, shall not collectively emit from all such coal-fired generating units more than 17,000 tons of nitrogen oxide in calendar year 2010 or any calendar year thereafter.

- An investor-owned public utility that on the effective date of this act owns or operates coal-fired electric utility steam generating units for which the collective emissions of SO_2 from all such coal-fired generating units were between 96,000 tons and 100,000 tons in calendar year 2002, as reported in the EPA clean air markets program database, shall not collectively emit from all such coal-fired generating units more than 50,000 tons of sulfur dioxide in calendar year 2010 or any calendar year thereafter.

- An investor-owned public utility that on the effective date of this act owns or operates residual oil and natural gas-fired or residual oil-fired electric utility steam generating units for which the collective emissions of NOx from all such oil and gas-fired or oil-fired generating units exceeded 11,000 tons in calendar year 2002, as reported in the EPA clean air markets program database, shall not collectively emit from all such oil and gas-fired or oil-fired generating units more than an annual weighted average of .26 pounds of nitrogen oxide per million BTUs of fuel consumed in calendar year 2010 or any calendar year thereafter.

Also, an investor-owned public utility that on the effective date of this act owns or operates residual oil and natural gas-fired or residual oil-fired electric utility steam generating units for which the collective emissions of particulates from all such oil and gas-fired generating units exceeded 7,000 tons in calendar year 2002, as reported in the Annual Operating Reports of the investor-owned public utility filed under Title V of the Clean Air Act, shall not collectively emit from all such oil and gas-fired or oil-fired generating units more than an annual average of .030 pounds per million BTUs of fuel consumed in calendar year 2012 or any calendar year thereafter.

An investor-owned public utility to which these emission standards apply may determine how it will achieve compliance with the collective air emission limitations imposed by this section and shall submit its compliance plan to the DEP no later than August 1 of the year this section

becomes effective. Within 30 days after a compliance plan or a revised compliance plan is submitted, the DEP shall certify whether the compliance plan or revised compliance plan is capable of achieving the required emissions limitations. Compliance with these air emissions limitations does not alter any obligation to comply with any other federal or state law, regulation, or rule related to air quality or visibility.

The electric utility steam generating units that are subject to these collective air emissions limitations on the effective date of this act shall remain subject to the collective air emissions limitations regardless of whether each individual generating unit thereafter continues to be owned or operated by an investor-owned public utility.

The DEP shall expedite the issuance of any permit or modified permit to an investor-owned public utility for electric utility steam generating units subject to this section and shall include conditions that provide for compliance with the requirements of this section by incorporating the emissions limitations contained herein and requiring testing, monitoring, recordkeeping, and reporting adequate to ensure compliance.

Section 4. This act takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

This bill implements more stringent air emission standards for investor-owned public utilities. It would significantly reduce the emissions of SO_2 and NOx in Florida starting in 2010, and significantly reduces the emission of particulates starting in 2012. Although these increased standards are not required since Florida is in attainment with the federal Clean Air Act provisions, the proposed new standards would assure that Florida air quality remains good for all of its citizens.

The bill allows investor-owned public utilities (notably Progress Energy and Florida Power and Light) to enter into voluntary agreements with the Department of Environmental Protection to purchase and install the equipment necessary to achieve the more stringent air emission standards now and petition the Public Service Commission to allow for recovery of those costs from the ratepayers.

Both companies have experienced an under-recovery for fuel costs. Progress Energy's under-recovery amounts to $210 million and Florida Power and Light's under-recovery amounts to $345 million. An adjustment to recover those from the ratepayers will occur in 2004. The companies then propose to use the additional revenue from this recovery to purchase equipment that will enable them to reduce certain emissions and also use a portion of those proceeds to begin to pay for new generating facilities. The bill proposes to freeze the rates to the ratepayer at the 2004 level for a period not to exceed 7 years. If fuel costs decline, those additional revenues will also be used by the companies to finance their environmental and generating capacity costs. Without this bill, the ratepayers would still have increased rates to recover any increased fuel costs. The fuel adjustment clause is a direct pass-through recovery to the consumers.

Progress Energy has estimated that a total of approximately $1.5 billion will be collected from the ratepayers over the 7-year period to pay for the emission control equipment (environmental costs), and a portion of new generation facilities. Of the $1.5 billion, approximately $900 million will pay for the environmental costs and about $650 million will be for new generation cost. Florida Power and Light has estimated that a total of approximately $3.12 billion would be collected from the ratepayers over the 7-year period. Of that amount, $760 million would be to pay for emission control equipment (environmental costs) and $2.36 billion for new generation construction. By allowing this type of recovery for costs, the companies are using money collected by freezing rates and, therefore, are not having to borrow the money in the bond market, which may be more expensive. Without this bill, if such equipment is needed in the future to meet a mandate, then the companies would be forced to borrow the money at the prevailing bond rates.

Even without this bill, the ratepayer would still experience an increase in rates to pay for the new generating capacity and fuel adjustments.

The Florida Retail Federation has expressed great concerns over this bill. While they support the intent of the bill to enhance emission reductions by the electric utilities, they strongly oppose the provision in the bill that provides a rate freeze for electric utility customers for 7 years. The Federation believes that the existing regulatory framework within the PSC is sufficient to ensure utilities are allowed to fully recover their costs for enhancing environmental protection measures. The rate freeze would come at a time when rates are at their highest. Industries that would be particularly affected by this bill include those large users of electricity such as manufacturing concerns, agricultural operations such as dairy farms and citrus processing plants, pulp and paper companies, and mining operations. The higher utility rates raise their costs of doing business and put them at a competitive disadvantage with companies operating in other states with lower electric utility costs. As an example, for the fourth quarter in 2003, the average retail

cost/kwh in Florida is $0.0706. For the same period, the average retail cost/kwh charged by Georgia Power is $0.0474 and for Alabama Power is $0.0659.

C. Government Sector Impact:

No substantial fiscal impact.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.