The Public Utility Commission of Texas (commission) proposes new §25.261 relating to Stranded Cost Recovery of Environmental Cleanup Costs and Redevelopment of Generating Sites. Project Number 21406 has been assigned to this proceeding. This rule sets out requirements and procedures for the implementation of Public Utility Regulatory Act (PURA), Texas Utilities Code Annotated, §39.263. PURA §39.263 allows recovery of capital costs incurred by an electric utility or affiliated power generation company to improve air quality in accordance with the provisions of PURA §39.264. PURA §39.263 also allows recovery of capital costs incurred by an electric utility or affiliated power generation company to achieve national ambient air quality standards. The implementation of PURA §39.264 and regulatory programs designed to achieve compliance with national ambient air quality standards fall under the auspices of the Texas Natural Resource Conservation Commission (TNRCC). This rule also addresses the manner in which stranded costs can be reduced through the redevelopment of certain facilities in non-attainment and transmission constrained areas.

When commenting on specific subsections of the proposed rule or responding to questions set forth in this preamble, parties are encouraged to describe "best practice" examples of regulatory policies, and their rationale, that have been proposed or implemented successfully in other states already undergoing electric industry restructuring, if the parties believe that Texas would benefit from application of the same policies. The commission is only interested in receiving "leading edge" examples which

are specifically related and directly applicable to the Texas statute, rather than broad citations to other state restructuring efforts.

In addition to comments on the proposed rule, the commission solicits input on the following questions regarding the proposed rule:

1. Under the proposed rule, an application for approval of an electric utility's or power generation company's determination regarding the most cost-effective means of meeting the requirements of PURA §39.264 or achieving compliance with national ambient air quality standards, or both, is deemed approved if no objection is filed within 60-days of filing of a complete application and completion of notice. Is the proposed 60-day period for objecting to an application for a cost-effectiveness determination in proposed subsection (e)(3) a sufficient period of time for an interested party to review the application and file an objection, if needed?
2. In the event that an application for approval of a cost-effectiveness determination is protested, the proposed rule requires that the commission render a decision on the application within one year of filing. Should a different time limit be placed on the cost-effectiveness determination than the one-year period specified in proposed subsection (e)(4)?
3. The proposed rule does not allow recovery of costs associated with purchasing emissions allowances, largely because an open market for purchasing allowances does not presently exist. In the absence of an open market, verifying the market value of an emission allowance is problematic. If the commission were to allow

recovery of capital costs associated with purchasing allowances, what mechanisms could be used to determine whether allowance purchases are prudent if spot market prices are not available for comparison? How could the commission ensure that recovery is not allowed both for a utility (Utility A) installing equipment to reduce emissions and another utility purchasing allowances from Utility A? In other words, what methodologies could be used to track traded allowances to ensure against double recovery?

4. Under the proposed rule, the cost of replacement generating capacity is determined from the electric utility's average purchased power cost for the three most current years and the average amount of generation for the same three years. Should the replacement generating capacity be based on a projected market price because the analysis deals with future costs? Included in the commission-approved excess cost over market (ECOM) model are market prices for power. Should these prices be used in the comparative analysis instead of the average historical prices? Alternatively, should the commission rely on market-price estimates proposed by the utility in its calculation of ECOM for setting a competitive transition charge?

5. The commission recognizes that given the configuration of the electric grid at present and in the near future, certain electric generating facilities within the Electric Reliability Council of Texas (ERCOT) area need to operate for the next three to seven years to maintain the reliability of the electric system, despite their age and inefficient operating characteristics. Where a facility is needed to maintain the reliability of the electric system and is designated by the ERCOT

Independent System Operator (ISO) as a reliability must-run unit (RMR), the commission believes that a different analysis must be employed that takes into consideration the benefits of the plant to electric customers. One way of doing so is to explicitly consider customer benefits when comparing retirement and retrofit options. It might also be reasonable to simply assume that the customer benefits of RMR units are significant enough that an explicit assessment of these benefits is not necessary. If this assumption were used, only retrofit options for an RMR unit would be evaluated. How should the commission analyze retirement/retrofit options for RMR units? If it uses a customer benefit analysis, are there accepted values for the customer benefits of electric service that could be incorporated into the rule?

6. After the electric utility has shown that retrofitting a facility is more cost effective than retiring, is there a benchmark amount that can be used to determine whether the level of expenditures are reasonable and prudent? If a benchmark is appropriate, then should the benchmark be expressed in dollars per kilowatt, dollars per kilowatt-hour, dollars per ton of nitrogen oxide removed or some other measure? Industry data should be provided to substantiate the comments made about the proper level of benchmarks. Provisions will be made to handle proprietary information if a request is made in response to this question.

7. What alternative procedure can be included in this rule to reduce the reliance on after-the-fact review on the reasonableness and prudence of costs, thereby providing customers and companies greater certainty of the costs to be recovered for air emission reductions?

8. The commission recognizes that regulatory risk is limiting the installation of new power generation in greenfield and brownfield sites in non-attainment and transmission constrained areas, thereby reducing the market value of those plant sites. The commission has been working with the TNRCC and ERCOT to reduce these regulatory uncertainties and to increase the opportunities for the incumbent utility to sell sites for redevelopment that would otherwise be slated for retirement. The commission believes that these sales or redevelopments would reduce ECOM, reduce concentration in the generation sector, and increase power generation within the non-attainment and transmission constrained areas while complying with the TNRCC air quality standards. In subsection (e)(1)(I) of the proposed rule, the owners of the generating facilities in a non-attainment and transmission constrained area will estimate the market value of redeveloping each plant site that contains generating facilities where a retrofit would not qualify for stranded cost recovery. The goal of this provision is to determine the best option for these generating facilities from the perspective of electric customers: retrofit of the facility, retirement, or the redevelopment as a new power plant. This same subsection provides a set of criteria to estimate the market value of redeveloping plant sites in a non-attainment and transmission constrained area. Is using these criteria a reasonable approach? If not, please suggest changes that allow the commission to better assess the market value of redeveloping a plant site.

Brian Almon, Director for Engineering, Office of Regulatory Affairs, has determined that for each year of the first five-year period the proposed section is in effect there will be no

fiscal implications for state or local government as a result of enforcing or administering the section.

Mr. Almon has also determined that for each year of the first five years the proposed section is in effect the public benefit anticipated as a result of enforcing the section will be reliable electric service and improved air quality. There will be no effect on small businesses or micro-businesses as a result of enforcing this section. There is no anticipated economic cost to such persons to comply with the section as proposed.

Mr. Almon has also determined that for each year of the first five years the proposed section is in effect there should be no negative effect on a local economy, and therefore no local employment impact statement is required under Administrative Procedure §2001.022.

The commission staff will conduct a public hearing on this rulemaking under Government Code §2001.029 at the commission's offices, located in the William B. Travis Building, 1701 North Congress Avenue, Austin, Texas 78701, on Thursday, June 22, 2000, at 9:30 a.m. in the Commissioners' Hearing Room located on the 7th Floor.

Comments on the proposed new rule (16 copies) may be submitted to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, PO Box 13326, Austin, Texas 78711-3326, within 30 days after publication. The commission invites specific comments regarding the costs associated with, and benefits that will be gained

by, implementation of the proposed section. The commission will consider the costs and benefits in deciding whether to adopt the section. All comments should refer to Project Number 21406.

This new section is proposed under the Public Utility Regulatory Act, Texas Utilities Code Annotated (Vernon 1998, Supplement 2000)(PURA) §14.002, which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; PURA §39.257, which requires the reduction of stranded costs through the application of any positive difference between certain annual revenues and annual costs; and specifically, PURA §39.263, which authorizes recovery of certain capital costs incurred by an electric utility or affiliated power generation company to improve air quality in accordance with PURA §39.264 or to achieve compliance with national ambient air quality standards and PURA §39.264, which authorizes the TNRCC to adopt rules to improve air quality.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.257, 39.263 and 39.264.

§25.261. Stranded Cost Recovery of Environmental Cleanup Costs and Redevelopment of Generating Sites.

(a) **Purpose.** The purpose of this section is to:

(1) establish the procedures and criteria the commission shall use to determine the amount of stranded cost recovery electric utilities and affiliated power generation companies shall receive for environmental cleanup costs incurred to improve air quality in the state pursuant to Public Utility Regulatory Act (PURA) §39.263; and

(2) reduce stranded costs through the redevelopment of electric facilities.

(b) **Applicability.** This section applies to:

(1) electric utilities that seek to recover capital costs incurred during the period January 1, 1999 to April 30, 2003 to improve air quality;

(2) affiliated power generation companies that seek to recover capital costs incurred during the period January 1, 2002, to April 30, 2003 to improve air quality; and

(3) any electric utility or affiliated power generating company operating electric generating facilities in a non-attainment and transmission constrained area that has stranded costs.

(c) **Definitions.** The following words and terms, when used in this chapter, shall have the following meanings unless the context clearly indicates otherwise:

(1) **Conservation Commission —** The Texas Natural Resource Conservation Commission.

(2) **Cost of replacement generating capacity —** The cost of replacing generating capacity lost through retirement of an electric generating facility. The annual cost of replacement generating capacity will be calculated using the following equation:

RGC=(PP)(G)	
Where:	
RGC =	Annual cost (in dollars) of replacement generating capacity
PP =	Weighted average cost of purchased power (dollars per megawatt-hour) for the electric utility, excluding cogeneration, for those months in which the electric generating facility operated during the three most current years as reported to the commission in the Fuel Efficiency Report.
G =	Amount of generation (megawatt-hour) which is the annual average of the output of the applicable electric generating facility for the three most current years as reported to the commission in the Generating Unit Performance Data.

(3) **Electric generating facility** — A facility that generates electric energy for compensation and is owned or operated by a person in this state, including a municipal corporation, electric cooperative, or river authority.

(4) **Net book value** — The original cost of an asset less accumulated depreciation.

(5) **Non-attainment area** — Any applicable ozone non-attainment area as designated by the conservation commission at 30 TAC §117.10.

(6) **Offset —** The allocation of emission allowances or credits from one facility to another facility in the same region.

(7) **Redevelopment** — The retirement of an existing electric generating facility and the construction of a new electric generating facility on the same site.

(8) **Region** — The East Region, West Region, or El Paso Region, as defined by the conservation commission at 30 TAC §101.330.

(9) **Retirement** — The permanent removal from service of an electric generating facility.

(10) **Retrofit** — The installation of control technology on an electric generating facility to reduce the emissions of nitrogen oxide, sulfur dioxide, or both.

(11) **Transmission constrained** — A limit in the transmission system that prevents the reliable delivery of electricity from the source generation selected by the load as determined by the independent organization designated for the area under PURA §39.151.

(12) **Transportation equipment** — A rail spur at a lignite-fired electric generating facility installed to receive deliveries of western coal.

Transportation equipment does not include rail cars and unloading facilities.

(d) **Requirements.**

(1) **Qualifying costs.** To qualify for recovery as invested capital pursuant to PURA §39.263, a cost must be:

(A) reasonable and prudent;

(B) incurred in carrying out the most cost-effective alternative for improving air quality that meets the requirements of this section;

(C) incurred to reduce or offset emissions by an amount and at a location that is consistent with the air quality goals and policies of the conservation commission;

(D) incurred to offset or reduce the emission of airborne contaminants from an electric generating facility, where

(i) the emission reduction or offset is determined by the conservation commission to be an essential component in achieving compliance with a national ambient air quality standard. For purposes of this section, any emission reduction or offset achieved by an electric utility or affiliated power generation company to comply with conservation commission regulations at 30 TAC Chapter 117 is deemed to have been determined by the conservation

commission to be an essential component in achieving compliance with a national ambient air quality standard; or

(ii) the reduction or offset is necessary for an unpermitted electric generating facility to obtain a permit in the manner provided by PURA §39.264; and

(E) associated with the engineering, procurement, or installation of pollution control equipment or transportation equipment, or the retirement of an electric generating facility.

(2) **When costs incurred.** For purposes of this section, the electric utility or affiliated power generation company has incurred costs if it has expended funds or has committed to expend funds under the terms of a written agreement.

(3) **Operating and maintenance costs.** This section does not authorize the recovery of operating and maintenance costs, the capital cost of a new electric generating facility, or for the purchase of allowances or credits.

(4) **Apportionment of reductions.** As provided in this paragraph, the commission may apportion the capital invested to reduce emissions of nitrogen oxides, sulfur dioxide, or both, among one or more entities owning facilities located in the same region. The capital investments for which recovery is sought must have been incurred pursuant to a written agreement between the entities executed prior to the date any such costs were incurred. The commission may not apportion capital costs under this provision unless the criteria of paragraph (1) of this subsection are met for

each electric generating facility seeking capital cost recovery. Capital costs shall be apportioned by prorating the total capital invested between entities on the basis of reductions of nitrogen oxides, sulfur dioxide, or both, realized at each participating entity's facilities in the region.

(e) **Request for approval of cost-effectiveness determination.**

(1) **Application.** On or before January 1, 2003, each electric utility or affiliated power generation company that seeks recovery of capital costs pursuant to this section shall file an application for a determination that its plan for meeting the requirements of PURA §39.264 and the regulatory programs designed to achieve compliance with national ambient air quality standards are cost-effective under this section. No more than one application may be filed for generating facilities owned by the same electric utility or affiliated power generation company in the same region. The application shall include the information specified in subparagraphs (A) - (I) of this paragraph.

(A) **Description.** A general description of the generating facility, including but not limited to:

(i) net generating capacity in megawatts;

(ii) type of fuel used for electric generation;

(iii) the county and region in which each facility addressed in the application is located;

(iv) average capacity factor for the three most current calendar years as reported to the commission; and

(v) average generation in megawatt-hours for the three most current calendar years, as reported to the commission.

(B) **Total emissions**. The total annual emissions (in tons) of nitrogen oxides and sulfur dioxide:

(i) for the year 1997;

(ii) for the most recent calendar year for which data is available;

(iii) that is expected for the first calendar year after the implementation of the air quality improvement strategies for which cost recovery will be requested; and

(iv) for the calendar years 2003 through 2005.

(C) **Allocated emissions allowances.** The number of emission allowances allocated to the electric generating facility by the conservation commission.

(D) **Capital cost estimate**. The total amount of qualifying capital costs for each option evaluated by the electric utility or affiliated power generation company.

(E) **Alternatives.** A decision analysis for all electric generating facilities owned by a utility or affiliated power generation company in the same region comparing the cost-effectiveness of the retirement option with retrofit options and other possible

options considered by the electric utility or affiliated power company. Other options shall include:

(i) offsetting emissions at the electric generating facility by installing control technology at another facility; and

(ii) switching fuel used for electricity generation at the electric generating facility.

(F) **Comparative cost analysis.** The net present value of the cost of each option considered pursuant to subparagraph (E) of this paragraph. The period of the analysis shall begin on May 1, 2003, and extend for a period of 15 years. The discount rate used in the analysis and the cost of capital associated with each option shall be calculated differently. Both shall start with the capital structure and cost of capital as they are reported for the end of 1999 in the utility's annual report made pursuant to PURA §39.257. The discount rate shall be the after-tax weighted cost of capital, while the cost of capital associated with each option shall be taken directly from the annual report, except for the cost of debt. The cost of debt for this purpose shall be the average cost of debt for the months of October, November, and December 1999 as reported by Moody's Investors Service for utilities with the same Moody's bond rating as the utility making the filing. All assumptions used in the analysis shall be provided. If the lowest-cost alternative is

not selected as the most cost-effective, an explanation of why it was not selected shall be provided.

(G) **Retrofit.** The retrofit alternative analysis shall include a calculation of the net present value of the capital and operating costs, and an estimate of the total cost per ton of pollutant reduced. The operating costs shall be the average of the historical operating costs for the particular generating facility for the three most recent calendar years plus the additional incremental operating costs associated with the control technology, adjusted for inflation using an appropriate factor for each year of the analysis. The capital costs shall be an estimate for each control technology as of May 1, 2003.

(H) **Retirement.** The retirement analysis shall include the net present value of all relevant costs of retirement for each electric generating facility, including:

(i) the cost of replacement generating capacity in dollars per megawatt-hour as defined in subsection (c)(2) of this section; and

(ii) the net book value of the facility, including retirement costs and offsetting salvage value, which includes but is not limited to the market value of the land after the facility is retired, and the value of water rights, pollution credits or

benefits associated with the facility, and other infrastructure.

(I) **Redevelopment**. If retirement of the electric generating facility is determined to be the more cost-effective alternative than retrofit and if the facility is located in a non-attainment area as designated by the conservation commission, and in an area of constrained transmission, as determined by the independent organization designated for the area under PURA §39.151, then the utility or affiliated power generation company shall perform a redevelopment analysis. The utility or affiliated power generation company shall make reasonable effort to facilitate a sale of the redevelopment site before April 30, 2003. To determine the value of redevelopment, the utility or affiliated power generation company shall assume the following in its analysis for each site and the electric generating facilities located on the site:

(i) The physical configuration of the site and the maximum number of emission credits obtained for closing the existing facility will be used to optimize the size of the new facility in megawatts.

(ii) Capacity factors for the new facility will be consistent with the size and function of a new plant on the site and shall be 10% for peaking units; 50% for intermediate units; and 80% for baseload units.

(iii) Any costs for transmission upgrades at the sites that are designated for potential redevelopment may be excluded from the estimated redevelopment costs.

(iv) The site will have sufficient access to natural gas pipeline capacity at competitive prices.

(v) Full assessment of the potential environmental cleanup cost at each facility site.

(2) **Notice.** Notice of an application for approval of a cost-effectiveness determination shall be provided through newspaper publication once a week for two consecutive weeks in a newspaper of general circulation throughout the service area of each electric generating facility addressed in the application. Such newspaper notice shall state in plain language:

(A) the purpose of the application;

(B) the electric generating facilities addressed in the application;

(C) the air quality improvement strategy proposed for each electric generating facility addressed in the application; and

(D) the date the application will be deemed approved if no objection is filed with the commission.

(3) **Approval of an application for determination of cost-effectiveness.** An application shall be deemed approved without further commission action if no objection to the application is filed with the commission within 60 days after the application was filed and adequate notice has been completed.

(4) **Decision.** If an application is not approved by the method provided in paragraph (3) of this subsection, the commission shall render a decision approving or denying an application for a cost-effectiveness determination within one year from the date of filing of a complete application.

(f) **Reconciliation of environmental cleanup costs during the true-up proceedings.** Capital invested for environmental cleanup in accordance with the provisions of this section shall be considered for inclusion as net invested capital under PURA §39.263 during the true-up proceedings under PURA §39.262, subject to the provisions of this paragraph:

(1) **Burden of proof.**

(A) **Recovery of costs**. In determining the amount of environmental cleanup costs that the electric utility may recover as invested capital under PURA §39.263, the electric utility or affiliated power generation company has the burden of showing that its qualifying costs during the period were prudent, reasonable, and necessary and were incurred to implement the most cost-effective alternative as determined by the commission pursuant to the provisions of subsection (e) of this section. For those electric generating facilities where their owners can show that retrofitting the facilities is more cost effective than retiring them, the commission presumes that costs for retrofitting a natural gas-fired electric generating facility that are no more than $10 per kilowatt for combustion

control technology and $25 per kilowatt for technology that reduces emissions by 80% or more are reasonable and prudent. Likewise, the commission presumes that costs for retrofitting a coal-fired electric generating facility that are no more than $20 per kilowatt for combustion control technology and $80 per kilowatt for technology that reduces emissions by 80% or more are reasonable and prudent.

(B) **Excess cost over market (ECOM) savings.** The market value of plant sites estimated in the redevelopment analysis as described in subsection (e)(1)(I) of this section will be compared to the actual sales price of the sites by the utility at the time of the true-up in 2004. If the commission determines the sales price is not an accurate reflection of the redevelopment potential of these sites, the commission retains the right to reduce ECOM by an appropriate amount to reflect the redevelopment value of those sites.

(2) **Scope.** Any issue related to determining the prudence and reasonableness of the environmental clean-up costs which the electric utility or affiliated power generation company is seeking recovery as invested capital or the value of the redeveloped sites shall be within the scope of the proceeding. The prudence and reasonableness of the alternative selected for each electric generating facility is not within the scope of this proceeding.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

ISSUED IN AUSTIN, TEXAS ON THE 28th DAY OF APRIL 2000 BY THE PUBLIC UTILITY COMMISSION OF TEXAS
RHONDA G. DEMPSEY