BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for approval of agreement to buy out Cypress Energy Company standard offer contract by Florida Power & Light Company.	DOCKET NO. 960182-EQ
In Re: Petition to resolve territorial dispute with South Florida Cogeneration Associates and Florida Power & Light Company.	DOCKET NO. 940546-EU ORDER NO. PSC-96-0889-FOF-EU ISSUED: July 9, 1996

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman
J. TERRY DEASON
JOE GARCIA
JULIA L. JOHNSON
DIANE K. KIESLING

NOTICE OF PROPOSED AGENCY ACTION ORDER APPROVING PETITION TO BUY OUT STANDARD OFFER CONTRACT

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

CASE BACKGROUND

In 1990, the Commission identified a 500 megawatt (MW) pulverized coal unit with an in-service date of January 1, 1996, as the statewide avoided unit for purposes of setting prices available through the standard offer contract (SOC). Concurrently, the Commission set a 500 MW subscription limit for standard offer capacity designed to meet the identified statewide need. On June 18, 1990, Cypress Energy Company (Cypress) signed a SOC to supply 180 MW of firm capacity and energy to Florida Power & Light

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Company (FPL) for a thirty year term. Because contracts exceeding the 500 MW subscription limit were received, the Commission set a statewide subscription queue. Nassau Power Company was awarded the first 435 MW and Cypress was awarded the remaining 65 MW.

At the time the SOC was signed, Cypress was a wholly owned subsidiary of Mission Energy Company (Mission), which is a wholly owned subsidiary of SCE Corp (Southern California Edison). Cypress had contemplated a 180 MW coal unit at Medley, a town in north central Dade County, Florida. Cypress had to revise its project as a result of the Commission's decision on the statewide standard offer subscription queue. Cypress began to evaluate gas turbine technologies to better match the 65 MW SOC.

In November 1992, FPL filed a petition for declaratory statement. It asked in part if it was the Commission's intention that FPL purchase power from Cypress absent a need or cost effectiveness determination and, if so, did the Commission affirm that the Cypress contract qualified for cost recovery. In Order No. PSC-93-0527-DS-EQ, the Commission granted the petition for declaratory statement. We affirmed that FPL was obligated to purchase 65 MW from Cypress beginning on January 1, 1996, barring failure on Cypress' part to perform under the terms and conditions of the contract. Also, we affirmed that payments associated with the SOC qualified for cost recovery.

On March 1, 1993, as a consequence of FPL's petition for declaratory statement, Cypress requested a delay in the project's in-service date by reason of *force majeure*. No agreement for a delay was reached. Cypress has preserved its right to pursue a claim of *force majeure* should the Commission not approve the settlement agreement.

As part of its project development efforts in the early 1990s, Cypress began working with Stewart & Stevenson Services, Inc., (S&S) primarily as a potential equipment supplier. In 1994, S&S took on the role of project facilitator. Due to delays in project development, S&S was forced to consider fast-track projects which could be placed into service in time to meet the SOC's January 1, 1996, in-service date. S&S continued work to develop the Medley site while it pursued other sites which could more readily allow Cypress to meet the requirements of the SOC. S&S ultimately acquired full equity interest in Cypress from Mission, thereby obtaining decision making authority for the development of the project.

S&S pursued existing sites with Tropicana Products in Bradenton and Fort Pierce, with Blockbuster Corporation at its then-planned entertainment complex in northern Dade County, and with South Florida Cogeneration Associates (SFCG) at the Dade County Government Center facility. Ultimately, S&S determined that the DCGF facility was its best option for fast- track development to meet the January 1, 1996, in service date of the SOC.

Dade County Government Center Facility

Metropolitan Dade County (County) signed agreements, in the mid 1980s, to develop a 32 MW natural gas-fired combined cycle cogeneration project. The County's Downtown Government Center was to utilize the electricity and thermal energy provided by the unit, herein referred to as the Downtown Government Center Facility (DGCF). The unit initially received certification from the Federal Energy Regulatory Commission as a qualifying facility (QF).

The ownership of the DGCF is rather involved. The County has legal title to the building in which the electrical generating equipment is located, the land on which the building is located, and the associated ancillary equipment for the generating unit. The actual electrical generating equipment for the DGCF was funded in part by equity raised through a partnership formed by Winthrop Financial Corporation, called Florida Energy Partners (FEP). FEP leased the generating equipment to South Florida Cogeneration Associates (SFCA) a partnership made up of TEC Cogeneration, Inc., Thermo Electron Corporation, and Rolls-Royce Inc. SFCA was to operate the DGCF for the 16 year term of the equipment lease, ending in 2002.

SFCA is obligated to make basic rent payments, which have escalated to approximately $5.4 million annually, to FEP under the terms of the lease agreement. SFCA also entered into an agreement with the County whereby the County would make its best efforts to take the entire electrical output from the DGCF. During the late 1980s and early 1990s, the economics of the DGCF worsened. SFCA was unable to make sufficient sales to cover its expenses. SFCA ultimately filed suit against the County and FPL for allegedly limiting its ability to sell the entire electrical output from the DGCF.

On September 9, 1994, the DGCF experienced a forced outage due to a major turbine failure. The plant ceased operating and SFCA took action to suspend operations indefinitely. SFCA, however, was still obligated to make basic rent, insurance and tax payments.

In early 1994, SFCA and the County signed a settlement agreement ending the disputes between the parties. The Agreement proposed an initiative be brought to the Dade County voters to create a county "municipal" electric utility specifically to serve other county facilities from the DCGF through wholesale wheeling arrangements. FPL filed a petition to resolve a territorial dispute with SFCA (Docket No. 940546-EU) in response to that settlement agreement. By Order No. PSC 94-1509-PCO-EU, the Commission granted SFCA's motion to hold proceedings in the territorial dispute in abeyance since operations at the DGCF had been suspended. Ultimately, Dade County voters did not approve the initiative; however, the Agreement between SFCA and the County had other provisions that remain in effect.

S&S contacted SFCA in late 1994. By mid 1995, S&S determined that the DGCF was the most promising existing facility which could be expanded to meet the January 1, 1996, in-service date of the SOC. S&S and SFCA developed a plan to repair the existing DGCF, and install temporary generating equipment to meet the electrical output requirements of the SOC by January 1. Permanent generating equipment would be installed later to meet the long-term requirements of the SOC. Given this project plan, S&S and SFCA agreed to pursue settlement of the SOC with FPL. SFCA assumed the negotiation responsibility with FPL. If settlement of the SOC did not come to fruition, S&S and SFCA agreed to pursue development of the expanded DGCF.

In the summer of 1995, negotiations began with FPL. The proposal to modify and expand the DGCF was presented. A settlement agreement for the buy out of the SOC was executed by the various players on February 12, 1996. On February 15, 1996, FPL filed its petition for approval of the agreement and for recovery of the associated costs of the settlement agreement through the capacity cost recovery, and the fuel and purchased power cost recovery clauses. The agreement provides for FPL to pay Cypress through 2002, a total amount less than FPL would have under the terms of the SOC. The agreement also postpones the January 1, 1996, in-service date of the SOC pending our decision on the settlement agreement.

DECISION

VIABILITY OF SITES

Our analysis of the settlement agreement between FPL and Cypress centered on whether the project could be brought into service at the originally contemplated site at Medley and whether

the modified and expanded DGCF project, as proposed, was a viable project. If this project appeared to be viable, then it would form a legitimate basis for FPL to consider and ultimately buy out the SOC. Conversely, if the proposed project did not appear to be viable, then a strong possibility existed that Cypress would default on the SOC due to its inability to comply with the terms of the contract.

Medley Site:

As mentioned above, Medley was the original site location contemplated by Cypress. Development at this site stalled for reasons discussed earlier and the focus shifted to the DGCF. Cypress and S&S have the capability and have retained the option of developing the project at the Medley location. Air, water and construction permitting is necessary for the additional site development work that is required; however, time has become the relevant factor. S&S has represented that in order to develop the project at this site, it would have had to extend the January 1, 1996, in-service date of the SOC. This would necessitate pursuit of the *force majeure* claim.

South Florida Cogeneration Associates Site:

In order to meet the in-service date, S&S and SFCA devised a phased approach to modify and expand the DGCF. Phase one, which included the repair of the existing unit and installation of a temporary unit, would have begun in September 1995. Repairs to the existing 32 MW unit were already partially completed. After the September 1994 forced outage, the turbine was removed and repaired off-site. The turbine was returned to the facility available to be re-installed. S&S also proposed to install a temporary General Electric LM 2500 gas turbine to provide 22 MW. It appears phase one could have been completed in a short time-frame thus allowing S&S to meet the in-service date of the SOC.

Phase two would include the installation of a General Electric LM 6000 gas turbine which would provide 65 MW. Under this plan the LM 2500 would be removed, and the existing unit at the DGCF would be operated to meet peak requirements and to act as backup to the LM 6000. Phase two would have come into service in June 1996 according to the plans of S&S and SFCA.

Air permitting for the first phase has in fact been granted by the Department of Environmental Protection. Permitting efforts for the second phase were underway prior to settlement. It was anticipated this permitting would have been granted. In addition,

S&S has agreements with Peoples Gas System to provide sufficient natural gas to meet the fuel requirements for the modified and expanded DGCF.

S&S and SFCA prepared a feasibility study which was presented to FPL during settlement negotiations. This study indicates that development of the modified and expanded DGCF would be financially viable for both S&S and SFCA given the revenue which would have been derived from the SOC. As a stand alone project, the internal rate of return (IRR) of the proposed DGCF is 18.84 percent. SFCA claims that in order for this project to be feasible, a minimum IRR of 15 percent would have to be forecast.

The financial analysis provided considers only those costs that are prospective. Both SFCA and S&S agreed to share all prospective costs for project development and revenue from the SOC on a fifty/fifty basis. If the settlement agreement was not proposed, we believe that both SFCA and S&S would have financial incentive to pursue development of the planned DGCF.

From the information presented to us, we find that FPL entered into settlement negotiations facing a viable project which could have met the requirements of the SOC.

COST EFFECTIVENESS OF THE SETTLEMENT AGREEMENT

The settlement agreement requires FPL to pay Cypress $39.2 million in order to buy out the SOC. FPL determined that approval of the settlement will result in estimated savings to its ratepayers of $49.8 million. This amount was calculated by first comparing the total revenue requirements of two capacity-addition scenarios: 1) capacity additions as reflected in the 1995 FPL Ten Year Site Plan (the TYSP scenario), which excludes the SOC; and 2) capacity additions which would take place if the SOC were to remain in effect (the SOC scenario). According to FPL's analysis, the revenue requirements associated with the TYSP scenario is $89.0 million less, in 1996 present value terms, than the revenue requirements associated with the SOC scenario.

Secondly, deducting the $39.2 million negotiated SOC buy out amount from the $89.0 million revenue requirements savings, results in a net savings of $49.8 million. Thus FPL's ratepayers would be estimated to benefit by this amount as a result of the settlement agreement.

Reasonableness of the estimated revenue requirements differential:

The TYSP scenario does not include the 65 MW from Cypress. This scenario identifies FPL's next unit addition as Martin Unit 5, a 423 MW combined-cycle unit, in 2004. In contrast, the SOC scenario includes the 65 MW from Cypress beginning in 1996. The capacity payments associated with the Cypress contract are based on a pulverized coal unit which are greater than the incremental capacity costs of Martin Unit 5. Despite the inclusion of the Cypress capacity in 1996, FPL's next unit addition in the SOC scenario remained Martin Unit 5 in 2004. Its capacity is rated at 358 MW, or 65 MW less than the capacity identified in the TYSP scenario.

The higher fixed costs associated with the SOC's coal-based capacity payments compared to the incremental combined cycle fixed costs in the TYSP scenario is the primary driver of the $89.0 million differential. The fixed costs of the SOC scenario are $167 million higher than the TYSP scenario. By comparison, the SOC scenario's fuel costs are $78.0 million lower than the TYSP scenario's fuel costs. This differential can be primarily attributed to the fact that FPL's average replacement fuel cost in the TYSP scenario far exceeds the coal-based cost included in the SOC scenario.

By settling the SOC, FPL would save its ratepayers an estimated $167 million in fixed costs, but cost its ratepayers an estimated $78.0 million in fuel expenses. The net of these two differentials, $89.0 million, is the revenue requirements differential which ultimately leads to the estimated savings for FPL's ratepayers.

Based on both fuel and fixed costs considerations, it is possible that FPL's estimated $89.0 million difference in revenue requirements associated with the SOC and TYSP scenarios may be understated. Fuel price forecasts for natural gas, light oil and heavy oil provided by FPL appear high. In this case, the effect of overstating future fuel prices is a conservative estimate of total savings. Further, FPL's fixed cost estimates in the SOC scenario appear to be low, thereby understating fixed cost savings. The SOC scenario assumes that Martin Unit 5 is scaled down by 65 MW, as a result of the inclusion of the Cypress capacity. In all probability, FPL would fully build out Martin Unit 5 to 423 MW because generation units typically come in discrete sizes.

The result of these understatements may be that there is even greater savings to FPL's ratepayers than those stated. We find the estimated revenue requirements differential to be reasonable.

Reasonableness of the Cypress Energy Buy Out Amount:

The settlement agreement provides that FPL will pay Cypress a one-time "Initial Payment" of $6.0 million in 1996. In addition, FPL will make "Progress Payments" of $5.4 million per year and "Maintenance, Taxes, and Insurance Payments" of $0.7 million per year, to Cypress from 1996 through 2002. The total of these payments on a net present value basis is $39.2 million. We examined the extent to which the settlement amount is cost-based in order to determine the reasonableness of the settlement.

An Agreement to Distribute Funds, signed February 12, 1996, by S&S, Cypress, and SFCA, provides that S&S will receive $4.52 million and SFCA will receive $1.48 million of the initial $6.0 million payment from FPL. The agreement further provides that SFCA shall be the beneficiary of all future "Progress Payments" from FPL.

Regardless of our decision on this petition, SFCA is obligated to continue making equipment rent payments of $5.4 million annually through 2002 to the DGCF's lease holder FEP. The settlement agreement and the disbursement agreement clearly show that the "Progress Payments" will cover only the amount that SFCA is obligated to pay under its lease agreement.

The operating expenses associated with the DGCF (including maintenance, real estate taxes, and insurance) are estimated to be $0.7 million, as shown in the settlement agreement. In addition, any deviation between actual operating expenses and the estimated expense of $0.7 million is subject to subsequent audit and true-up based on certain time-initiated audit restrictions. Thus, the Progress Payments and the Maintenance, Taxes, and Insurance Payments as shown above are, by definition, cost-based.

The $6.0 million Initial Payment is the only other payment included in the Settlement. As noted above S&S's share is the Initial Payment is $4.52 million; however, this amount will be shared 50/50 with Mission as part of the arrangement whereby S&S gained full interest in Cypress. This share of the settlement amount covers costs incurred in developing the Cypress Project at the DGCF and at other sites in Florida. It also provides S&S with what has been represented to be "a reasonable profit." Finally, SFCA's $1.48 million share covers costs incurred in the development of the DGCF.

A legitimate question could be raised as to why SFCA and S&S agreed to settle with FPL, when the modified and expanded DGCF was projected to produce an IRR of 18.84 percent. SFCA is obligated to

fulfill its lease obligation of $5.4 million per year through 2002 regardless our decision on the settlement agreement. S&S has incurred substantial costs in acquiring control of Cypress and in project development to fulfill the SOC. The site of the fast-track proposed project, the DGCF, is controlled by SFCA. SFCA also negotiated directly with FPL pursuant to agreement with S&S. S&S, therefore, was in a position to either agree to the settlement negotiated by FPL and SFCA, or to pursue the *force majeure* claim and, if successful, develop the Medley site. It appears that comparing the certainty of the settlement agreement, versus the relative uncertainty associated with the alternatives, SFCA and S&S made a reasonable business decision in agreeing to the settlement.

In the summer of 1995, FPL was presented with a technically and financially viable project which could have met the requirements of the SOC. FPL apparently negotiated in a reasonable manner such that its ratepayers should realize approximately $50 million in savings. The costs associated with the settlement appear to reimburse the parties direct costs and are appropriate. Accordingly, we find that FPL's ratepayers will not pay for excessive profits, that the total settlement amount is reasonable, and we approve the agreement to buy out Cypress' SOC.

SETTLEMENT OF LITIGATION

Attached to the settlement agreement is Exhibit B titled Mutual Release of All Claims. This document provides for a mutual release of all claims which would effectively end all pending litigation between the parties to the settlement agreement should we approve FPL's petition to buy out the Cypress Energy Company Standard Offer Contract.

SFCA commenced an antitrust proceeding against FPL in 1988 in district court (No. 88-2145-Civ-Atkins). The court denied FPL's motion for summary judgement in 1994. FPL filed an interlocutory appeal in the Eleventh Circuit in 1994 (No. 94-4323). The court reversed and remanded the district court's decision on March 6, 1996. SFCA filed a petition seeking a rehearing en banc, which was denied on June 10, 1996.

Also a proceeding at the Federal Energy Regulatory Commission to determine whether the DGCF met the requirements for QF status in the years 1987-91 is currently on appeal.

In May 1994, FPL filed a petition with the Commission to resolve a territorial dispute with SFCA and Dade County (Docket No. 940546-EU). This docket is currently being held in abeyance.

In accord with the Mutual Release of All Claims, Exhibit B to the Settlement Agreement, our approval of the petition moots the issues in Docket No. 940546-EU. When the Proposed Agency Action Order issued in these dockets becomes final in both dockets, Docket No. 940546-EU shall be closed.

FUTURE RATE BASE IMPACTS

The settlement agreement also provides FPL with certain rights which it could exercise in the future. Specifically, FPL has the option, prior to the end of 2002, to require SFCA to exercise its purchase option of the DGCF under the terms of its lease agreement with FEP, and to then assign title to FPL. FPL would pay costs which would not exceed the fair market value of the DGCF.

Our approval of the settlement agreement is limited in that it does not give FPL approval to purchase the DGCF nor include the purchase amount in rate base. The settlement agreement does not provide a basis for the calculation of the fair market value of the DGCF. Should FPL exercise this option, it shall petition the Commission for approval for inclusion of the purchase amount in its ratebase. The prudence of the purchase will be reviewed at that time.

RECOVERY OF EXPENSES ASSOCIATED WITH BUY OUT

The settlement agreement payments are negotiated amounts and are not separated into fuel or capacity. This necessitates a reasonable and fair method to allocate the settlement agreement payments to each rate class for recovery purposes. An easy method would be to allow recovery of the settlement agreement payments through just one of the clauses. This method, however, would result in inequities in cost allocation.

Fuel costs are allocated to customer classes based on their relative energy (kwh) consumption. Therefore, allocating recovery only through the fuel clause would result in commercial/industrial customers paying more of the cost relative to residential (RS) customers. Capacity costs, on the other hand, are allocated to customer classes based on their contribution to peak KW demand. Since RS customers contribute relatively more to peak demand than commercial/industrial customers, allocating recovery through the capacity clause would unfairly burden the RS class. Therefore, assigning all recovery to just one clause is not a fair and equitable method for allocation of costs to customer classes.

The SOC provides the means to allocate recovery in a fair and reasonable manner. Had the contract remained in place, on average, 42 percent of the total contract payments for the years 1996-2002 would have been for fuel and 58 percent for capacity. Therefore, in order to make a fair allocation of the settlement agreement payments, we find it appropriate to assign 42 percent to be recovered through the Fuel and Purchased Power Cost Recovery clause and 58 percent to be recovered through the Capacity Cost Recovery clause.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Florida Power & Light Company's petition for approval of agreement to buy out Cypress Energy Company Standard Offer Contract is approved as discussed herein. It is further

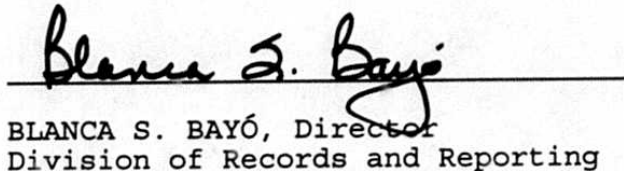
ORDERED that should Florida Power & Light Company exercise the option to purchase the Dade County Government Facility, it shall petition the Commission for approval for inclusion of the purchase amount in ratebase as discussed herein. It is further

ORDERED that Florida Power & Light Company shall recover costs associated with the buy out by assigning 58 percent of costs to the Capacity Cost Recovery Clause and 42 percent of costs to the Fuel and Purchased Power Cost Recovery Clause. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final in both Dockets 960182-EQ and 940546-EU, then the dockets shall be closed. In the event the provisions of this Order are protested in either docket, then both dockets shall remain open.

By ORDER of the Florida Public Service Commission, this 9th day of July, 1996.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on July 30, 1996.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.