BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET No. 001574-EQ,

IN RE: PROPOSED AMENDMENTS TO RULE 25-17.0832, F. A. C.,

FIRM CAPACITY AND ENERGY CONTRACTS

SUPPLEMENTAL COMMENTS OF GERARD J. KORDECKI

ON BEHALF OF

LEE COUNTY, FLORIDA,

MIAMI-DADE COUNTY, FLORIDA,

AND

MONTENAY-DADE, LTD.

MARCH 7, 2003

DOCKET NO. 001574-EQ, IN RE: AMENDMENT OF COGENERATION RULES

SUPPLEMENTAL COMMENTS OF GERARD J. KORDECKI

Q. Please state your name, address and occupation.

A. My name is Gerard J. Kordecki. My business address is 10301 Orange Grove Drive, Tampa, Florida 33618. I am self-employed as an Energy and Regulatory Consultant.

Q. Mr. Kordecki, have you previously filed comments in this docket?

A. Yes, I filed comments on March 1, 2002.

Q. What is the purpose for your supplemental comments?

A. My comments address the additional proposed amendments to the rule submitted to the Commission on February 27, 2002 on behalf of Lee County, Miami-Dade County, and Montenay-Dade, Ltd. (collectively, "the Petitioners"). These proposed amendments were consolidated into this rule docket on March 14, 2002. I will also comment on some of the utility responses to the staff's proposed amendments, the amendments proposed by Lee County, Miami-Dade County, and Montenay-Dade, Ltd., and on issues which arose during the February 25, 2003 Commission Staff workshop.

<u>Standard Offer Capacity Payments and Determination of Avoided Cost</u>

Q. What was the first amendment in the February 27th, 2002 submission?

A. The first amendment proposed by the Petitioners is intended to more closely match standard offer contract payments to QFs with the costs that the utility would otherwise incur, as the utility would incur them. This amendment is as follows:

(4) Standard Offer Contracts.

* * *

(b) The rates, terms, and other conditions contained in each utility's standard offer contract or contracts shall be based on the need for and equal to the avoided cost of deferring or avoiding the construction or purchase of additional generation capacity or parts thereof by the purchasing utility. Each standard offer contract shall provide the option for the qualifying facility to be paid rates equal to the costs that would be borne by the utility's general body of ratepayers if the utility were to build its avoided unit or purchase capacity and energy from another source. Without limitation, this shall include payments calculated on the same basis as the utility's revenue requirements where the qualifying facility signs a standard offer contract with a term equal to the projected life of the avoided unit, payments calculated on the same basis as payments to be made pursuant to a power purchase arrangement where such power purchase is the generation resource avoided by the purchase from the qualifying facility, and payments calculated on the same basis as the utility's proposed revenue requirements for a proposed plant where the utility plans to limit cost recovery for the proposed plant to a fixed period of time. This requirement shall not preclude the use of the value of deferral payment methodology to calculate capacity payments where the qualifying facility proposes to sign a contract with a term less than the projected life of the avoided unit. Rates for payment of capacity sold by a qualifying facility shall be specified in the contract for the duration of the contract. In reviewing a utility's standard offer contract or contracts, the Commission shall consider the criteria specified in paragraphs (3)(a) through (3)(d) of this rule, as well as any other information relating to the determination of the utility's full avoided costs.

The proposed amendment very simply does three things. It expands the applicability of the standard offer contracts to purchase power contracts and to utility plants where the utility proposes to limit the cost recovery to a fixed period of time and lastly, requires the utility to pay the Qualifying Facilities (QF's) the same revenues, in the same way as the utility would receive them if the utility had built the plant. In this latter instance the QF must be willing to sign a contract which covers the projected life of the avoided unit.

There may be occasions when a utility may sign -- or may have the opportunity to sign -- a firm power purchase agreement in lieu of building a plant. If this situation arises and the contractual performance requirements are such that a qualifying facility could meet the criteria, then it would be appropriate that the QF be eligible through a standard offer to meet the purchase requirements if the purchase is considered as the avoided unit. A unit power sale/purchase would be the most obvious example of this situation.

Q. **Are you familiar with any situations where a utility wanted to rate base a unit for a specific period of time then remove it from the rate base?**

A. I've read about a couple of instances where such treatments were proposed but I haven't heard what the final resolutions were. Situations where the capacity in the rate base is fixed and is less than the life of the unit, fit a standard offer contract situation and the same revenue recoveries proposed by the utility should be applied in the same manner to a QF.

Q. **Mr. Kordecki, your amendment proposes that QFs should receive the same revenue requirements and in the same manner as if the utility built**

the unit. Isn't it true that the QF would receive the same present value of revenues under the present rule through the Value of Deferral methodology?

A. Yes the present value of total revenues would be the same but the QF is not receiving the avoided costs in the same manner as the utility receives its revenues. Use of Value of Deferral for life of the unit contracts for QFs is not consistent with the mandates of the Public Utility Regulatory Policy Act (PURPA) and the wishes of the Florida Legislature. Promotion of QFs was deemed to be in the public interest. It was stated that QFs should receive the same level of revenues (i.e., avoided cost) that the utility would have received if the utility had built the capacity. Use of the Value of Deferral capacity payment methodology, which has increasing revenue streams, is not the same as the declining streams in the application of revenue requirements. Use of the Value of Deferral methodology also greatly increases the possibility that, at some point in time, after the QF has been paid much less than the utility's revenue requirements, the QF contract will come to be viewed as undesirable, and even attacked, because it is then "above market." This has already occurred in Florida.

Further, this is unfair because cities or counties which own or operate, or both own and operate, waste-to-energy facilities are penalized through the Value of Deferral methodology by losing the higher initial payments that the utility would receive through a revenue requirements collection methodology. The city or county has assumed the same commitment as the utility by signing a contract which covers the expected life of the unit. In fact, the standard offer contract will have certain minimum operating parameters which must be met by the waste energy facility in order to receive the capacity payments. A utility normally doesn't carry these operating requirements in order to "collect" the associated revenue requirements.

A simple way to describe the problem is to think about your own financial position. A company offers you a job paying X dollars a year for four years. You have immediate needs to meet mortgage payments, car payments, food and various household bills. The company says it will pay 60 percent of X dollars the first year, 90 percent the second and so forth. They say that after four years you will receive on a cumulative basis the present value of four years of X dollars and that you should be indifferent to how you receive the money since you get the total amount after four years. The cities and counties have bills to pay today just like you do.

<u>**Term of Standard Offer Contracts**</u>

Q. Mr. Kordecki, what was the second suggested amendment?

A. The second suggested amendment was to change Subsection 25-17.0832(4)(e)7 to provide that, consistent with the utility's obligation to purchase all of the electric power that a QF has available to sell to the utility, the QF would have the option to specify the duration of the standard offer contract. Specifically, the proposed amendment is as follows:

> (E) Minimum Specifications. Each standard offer contract shall, at minimum, specify:
>
> * * *
>
> 7. The period of time over which firm capacity and energy shall be delivered from the qualifying facility to the utility. Firm capacity and energy shall be delivered, at a minimum, for a period of ten years, commencing with the anticipated in-service date of the avoided unit specified in the contract. At a maximum, firm capacity and energy shall be delivered for a period of time equal to the anticipated plant life of the avoided unit, commencing with the anticipated in-service date of the avoided unit. Consistent with the utility's obligation to purchase the firm capacity and energy that a qualifying facility has available to sell to a utility, the qualifying facility shall have the option to specify the duration of its obligation to deliver firm capacity and energy within the above parameters.

Q What does this amendment accomplish?

A. This amendment addition clarifies the right of a qualifying facility to sell its output to a utility for a period of time between 10 years and the life of the unit. The selection of the period for the purchase is the right of the QF. At first this might appear to be contrary to a utility's planning principles but there is no conflict since the utility is required to only pay avoided costs. With payments at avoided costs, the utility's ratepayers are neutral to the transaction. The qualifying facility may have a number of reasons to pick a specific period for the sale but, no matter what period is selected (minimum of 10 years, maximum life of the unit), the utility's ratepayers are held harmless and may even receive lower costs if the period selected has value of deferral payments which are less than the revenue requirements that a utility would receive if the utility had built the capacity. In the workshop held on February 25th of this year, it was very apparent that there were misunderstandings about the effect of adding the word Page 6 "specific" in the staff's proposed amendment found in the description of "Minimum Specifications" Section (E). The result would be to shift to the utilities the right to name the contract period. With this change in contract responsibility, I do not see any reason that the utilities, acting in their own self-interests, would offer QFs contract periods which go beyond the minimum period (10 years presently, 5 years if the staff recommendation is accepted) since the utilities have nothing to gain. Utilities, being financially rational, would prefer to build capacity and earn a return rather than buy the power from a QF. However, this is contrary to the policy adopted by the U.S. Congress through PURPA and by the Florida Legislature through Section 366.051, Florida Statutes, to encourage cogeneration by requiring utilities to buy the power that a QF has available to sell at the purchasing utility's full avoided cost.

<u>Fuel Cost Risk Management</u>

Q. What are your suggestions regarding a fuel cost risk management amendment?

A. The Petitioners' suggestions regarding fuel risk management, with which I agree, arose from comments made by the Commissioners at one or more agenda conferences in which energy payment risk was discussed. The Petitioners' specific proposed amendment is as follows:

<u>(d) As a risk management and fuel-cost hedging measure, each public utility subject to this rule shall provide for a minimum of twenty (20) percent of the energy purchased pursuant to standard offer contracts entered into following the effective date of this subsection to be purchased at the projected energy costs reflected in the utility's analyses and plans as of the date that the standard offer contract is executed by the utility and the qualifying facility. Such projected energy costs shall reflect not only the projected fuel costs associated with the avoided unit, but also the avoided operation and maintenance costs of the avoided unit, and shall also be based on the projected operations of the avoided unit as of the time the standard offer contract is executed. Further, all such costs shall be calculated on a directly comparable basis to that upon which the utility would calculate the costs associated with its avoided unit for the purpose of seeking recovery of such costs from its customers if it were to build and operate the avoided unit.</u>

Q. What is the rationale for this amendment?

A. This amendment would provide for some limited fuel cost hedging by providing for fixed energy payments based on projections at the time that the standard offer contract is entered into. It does not require the utility to agree to make all energy payments on the basis of projected energy payments, but rather simply requires that a minimum of twenty (20) percent of the energy purchased under future standard offer contracts be purchased at energy prices that are fixed on the front end. This is no different than the utility entering into a longer-term fuel purchase contract. It will protect the utility against the risk of fuel costs escalating more rapidly than projected at the time that the contracts are entered into. I believe that the 20 percent requirement is a sound risk management measure for the utilities, reasonably balancing the risks of fuel costs going either way, and reasonably giving the utility great leeway, i.e., between 20 and 100 percent, in specifying the amount of energy that they choose to contract for at energy prices that are fixed on the front end

Planning Analyses to Determine Avoided Unit and Avoided Cost

Q. Have you any other amendments to offer?

A. Yes. The following amendment addresses the planning assumptions in which avoided units and avoided costs are determined:

> (6) Calculation of standard offer contract firm capacity payment options.
>
> (a) Calculation of year-by-year value of deferral. The year-by-year value of deferral of an avoided unit shall be the difference in revenue requirements associated with deferring the avoided unit one year. <u>All analyses to identify the type and timing of a utility's avoided unit, and all calculations of the value of deferral of an avoided unit, shall be conducted on a basis that treats supply-side and demand-side options equally and comparably. Specifically, all such analyses and calculations shall include only the impacts of existing and contractually committed demand-side management measures and shall not include the effects of any projected demand-side management measures that are not already in place or contractually committed to the utility.</u> The value of deferral shall be calculated as follows:

Q. Please describe the effect of this proposed change.

A. By removing the non-committed conservation and load management programs from the forecast, all potential resources that could meet the utility demand will be evaluated on a level playing field. From the responsive comments of the utilities and some limited discussion at the recent workshop, there are three arguments presented against this amendment.

First, there is a claim that the utilities can't just start, stop and adjust their demand-side programs. From both experience and observation, utilities have, in fact, made significant program adjustments with very little lead time in many cases. They have also been forced to deal with significant customer-initiated adjustments – i.e., attrition – in their programs on relatively short notice. Due to the limited availability of the standard offer, both in megawatts and fuel sources, only relatively small qualifying facilities are in the market to sell to the utilities. On a practical basis, only small amounts of QF power would be expected to be available at any one time. Adjusting demand-side management programs to reduce not-yet-committed and/or not-yet contracted installations to reflect an addition of a relatively small increment of waste-to-energy supply-side resources would not, in my experience and opinion, be difficult.

The next set of comments involved the fact that the Commission had heard similar amendments some 20 years ago. They argue that it would be redundant to hear it again. A lot of water has gone over the dam since then. The applicability of the QF standard offer has been limited significantly and the fear that standard offer customers may not be viable or might walk away and so forth, is not applicable today; this argument is particularly inapplicable to waste-to-energy facilities, which exist primarily for the purpose of disposing of municipal waste using a preferred technology, i.e., combustion to generate power as opposed to a disfavored technology, i.e., landfills. The utilities, since those hearings, have been required to adopt an Integrated Planning Process

(IRP) to determine their resource plans. A true IRP would include QFs as potential resources during the planning process. Under the planning practices used by the utilities today, however, QFs appear to be an afterthought to be dealt with after the resource plan is decided.

Lastly, the Commission has changed demand-side evaluations. If a program (measure) or the demand reduction's life is not as long as the life of the unit to be "avoided", then a value of deferral methodology will also be included along with revenue requirements analysis in the evaluation. The Value of Deferral methodology can greatly reduce program benefits. Of course, some will say that since a demand-side program must have a cost/benefit of 1.2 or greater contrasted to the avoided costs, how can a standard offer QF be more cost effective?

There are several answers. First, QF generation will add to reliability, which, of course, has value; and QF generation, and waste-to-energy generation in particular, will add to reliability more reliably than DSM measures, because it is more reliable on a megawatt-for-megawatt basis and because contracted waste-to-energy generation cannot simply disappear from the utility's system with 30 days notice without incurring substantial penalties, unlike the case of DSM programs. Secondly, many of the "avoided" units have been combined cycle units, which will run well below the incremental generators in an economic dispatch. Ultimately this may mean that a demand-side management measure may have a fuel penalty assigned to the program due to the type of unit being avoided But the QF will not. Purchased QF power will lead to lower average fuel costs in this case More importantly the QF can select a contract period, which can make the QF option more cost-effective than a conservation program due to lower capacity payments.

Another utility argument against removing incremental DSM is that QF capacity payments would be higher. This is true, but only if the QF is the more cost-effective option when evaluated on a truly comparable, level-playing-field basis. For all of these reasons, the commission should require that all incremental demand-side management programs be removed from the forecast that is used to determine the "avoided" unit.

Other Anti-QF Arguments

Q. Mr. Kordecki, do you have any other concerns about this rulemaking.

A. Yes I do. There seems to be some underlying belief by many of the parties that standard offer power creates undue risks for ratepayers and that the megawatts available from eligible QFs are so small that there is no real value in their purchase. Let's first look at the idea of ratepayer risks associated with purchasing this QF power. If the QF receives only avoided cost, then the ratepayers have no financial risk. The risk of the utility paying more than avoided costs for QF power is not due to the length of the period after the forecast of the avoided unit but to errors (even with prudent estimates) made in the planning analyses and forecasts. This risk is exactly the same, on a present value basis, as the risk associated with the utility building its own unit: if the QF payments are the same as the utility's revenue requirements on a present value basis, and the QF contract comes to be above-market at some future point in time, the utility's self-built unit would also be above-market on a present value basis.

It is my understanding that the utility picks the avoided unit (which may or may not be be the next unit) and specifies the operating characteristics of this avoided unit. Along with selecting the unit type and timing, the utility picks the subscription level (number of megawatts). I have no idea how this subscription level is determined. The utility tells any potential QFs what the required operating performance parameters will be in order for the QF to receive full (or even any) capacity payments. With these performance standards, the utilities' ratepayers are protected against poor operating performance. I might add, in most cases, utilities do <u>not</u> have performance standards assigned to assets which the utilities must reach in order to receive the revenue requirements from those assets. The planning process as far as lead time for generation unit construction is much shorter today with the selection of simple combustion turbine technology without steam generators driven by heat recovery from the CT exhaust gases. The lead time now ranges from 18 months to 36 months.

What this all means is that if there are risks being created with generation selection, the utilities are the ones creating the risks in their planning processes The highest risk is created when the utility builds the unit and receives revenue requirements over the life of the unit, typically twenty or thirty years, and sometimes longer in practice. If avoided costs are accurately forecasted then the QF receives the costs and the ratepayers are unaffected. Allowing the utilities to only offer short term contracts, which have low capacity payments due to the value of deferral valuation methodology, only discourages QF investment which in turn, encourages utility construction which has the highest potential risks over its life.

Q. What about the argument that small incremental megawatts of capacity have little or no value?

A. All generation resources have value. If every megawatt that a utility might have that is over and above its reserve margin or other planning criteria were deemed to have no value, then I would expect that the value of that plant would not be allowed in the utility's rate base and no earnings for that plant would be allowed. It is well understood that plant additions are lumpy in the sense that from year-to-year there will not be an exact match of plant and level of plant need.

The addition of standard offer QFs generally will have addition sizes similar to some of the conservation programs of the utilities. Though these programs and QF power are dissimilar in operation, they are somewhat comparable in size and collectively support the utilities' overall resource plans.

At this time, Florida has a total of 11 waste-to-energy plants with 357.2 megawatts of firm capacity committed under contract to Florida load-serving utilities; two other plants have a combined 12.0 MW of power available to sell on a non-firm basis. There can be no doubt that this 357 MW of firm capacity has avoided some significant amount (probably between 350 and 400 MW) of capacity that would otherwise have had to be built by Florida's load-serving utilities or purchased from other sources. This is significant. And, while there may be some differences due to different payments being made to different QFs on the basis of different avoided units that were identified at different points in time, this does not mean that the QFs don't provide significant, meaningful capacity avoidance benefits to the State as a whole, nor does it necessarily mean that the QFs are being paid more than the value that they provide.

Q. Mr. Kordecki, does this conclude your comments?

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served by hand delivery (*), or by U.S. Mail, on this 7th day of March, 2003, to the following:

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