

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for expedited ) DOCKET NO. 961407-EQ  
approval of settlement ) ORDER NO. PSC-97-0523-FOF-EQ  
agreement, regarding negotiated ) ISSUED: May 7, 1997  
contract for purchase of firm )  
capacity and energy from a )  
qualifying facility, with Pasco )  
Cogen, Ltd. by Florida Power )  
Corporation. )  

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The following Commissioners participated in the disposition of this matter:

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

NOTICE OF PROPOSED AGENCY ACTION  
ORDER APPROVING SETTLEMENT AGREEMENT

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**

Florida Power Corporation (FPC) and Pasco Cogen Ltd. (Pasco), a qualifying facility (QF), entered into a Negotiated Contract (Contract) on March 13, 1991. The term of the Contract is 20 years, beginning July 1, 1993 when the facility began commercial operation, and expiring July 31, 2013. Committed capacity under the Contract is 109 megawatts, with capacity payments based on a 1991 pulverized coal-fired avoided unit. The Contract was one of eight QF contracts which were originally approved for cost recovery in Order No. 24734, issued July 1, 1991, in Docket No. 910401-EQ.

DOCUMENT NUMBER-DATE

04493 MAY-76

FPSC-RECORDS/REPORTING

In August, 1994, a dispute arose between FPC and Pasco regarding the interpretation of the energy pricing methodology as defined by Section 9.1.2 of the Contract. Section 9.1.2 of the Contract provides:

Except as otherwise provided in section 9.1.1 hereof, for each billing month beginning with the Contract In-Service Date, the QF will receive electric energy payments based upon the Firm Energy Cost calculated on an hour-by-hour basis as follows: (i) the product of the average monthly inventory chargeout price of fuel burned at the Avoided Unit Reference Plant, the Fuel Multiplier, and the Avoided Unit Heat Rate, plus the Avoided Unit Variable O&M, if applicable, for each hour that the Company would have had a unit with these characteristics operating; and (ii) during all other hours, the energy cost shall be equal to the As-Available Energy Cost.

In 1991, the time at which FPC entered into its contract with Pasco, FPC's forecasts indicated that as-available energy prices would exceed firm energy prices throughout the entire term of the Contract. Based on these projections, prior to August 1994, FPC paid Pasco firm energy payments for all energy delivered from the cogeneration facility. In 1994, FPC conducted an internal audit of its cogeneration contracts. Because of falling coal, oil, and natural gas prices, FPC's modeling of the avoided unit indicated that during certain hours, firm energy prices would be greater than as-available energy prices indicating that the avoided unit would be cycled off in FPC's dispatch. FPC adjusted its payments to Pasco and other cogenerators to reflect these changes in the operation of the avoided unit. This reduced the total energy payment to Pasco and ultimately led to the pricing dispute.

FPC's position is that the avoided 1991 pulverized coal unit should be modeled based on four operating parameters specified in the Contract, which are, fuel costs, heat rate, variable operation & maintenance costs, and a fuel multiplier. Using these four parameters to model how the 1991 pulverized coal unit would have operated translates into a lower contract cost making the modified contract, including the buyout not cost-effective. However, Pasco's position is that the energy payments should be based on 100% firm energy for all hours.

On July 21, 1994 FPC filed a petition (Docket No. 940771-EQ) seeking a declaratory statement that Section 9.1.2 of the negotiated contract was consistent with then Rule 25-17.0832(4)(b), Florida Administrative Code. This rule referenced avoided energy payments for standard offer contracts, and was a basis for

evaluating negotiated contracts. Several cogenerators, including Pasco, filed motions to dismiss FPC's petition. FPC later amended its petition and asked the Commission to determine whether its implementation of Section 9.1.2 was lawful under Section 366.051, Florida Statutes, and consistent with Rule 25-17.0832(4)(b), Florida Administrative Code. In Order No. PSC-95-0210-FOF-EQ, we granted the motions to dismiss on the grounds that the Commission did not have jurisdiction to adjudicate a dispute over a provision in a negotiated contract. Moreover, we stated that we will not interpret the meaning of a contract term and that we defer to the circuit courts to answer the question of contract interpretation.

Consequently, FPC and Pasco proceeded to litigate their dispute in the circuit court of the Sixth Judicial circuit in Pasco County. After considering the contested issues, the ongoing litigation expenses, and the benefits that the parties and FPC's ratepayers would realize if Pasco and FPC resolved their dispute, Pasco and FPC executed a Settlement Agreement.

On November 25, 1996, FPC filed a petition for approval of the Settlement Agreement between FPC and Pasco. The modifications to the Contract pursuant to the Settlement Agreement have the following components: (1) a revised energy pricing methodology for future energy payments and a settlement of disputed coal transportation costs; (2) restructuring of variable O&M and capacity payments; (3) reimbursement for the historic energy pricing dispute; (4) curtailment of energy during off-peak periods from 109 MW to 96 MW; and, (5) a buyout of the last four years and seven months of the Contract, resulting in a termination date of December 31, 2008, rather than July 31, 2013.

#### DECISION

In Order No. PSC-95-0210-FOF-EQ, the Commission stated that it believed FPC was requesting the Commission to decide that FPC's interpretation of the contract's pricing provision is correct. The Commission also stated that it believed ". . . that endeavor would be inconsistent with the intent of PURPA to limit our involvement in negotiated contracts once they have been established." That order explains in detail the rationale for our conclusion that contract disputes are a matter for civil courts to resolve. We further indicated in that order, which cites In Re: Implementation of Rules 25-17.080 through 25-17.091, Florida Administrative Code, Order No. 25668, Docket No. 910603-EQ, February 3, 1992, that we would not revisit a decision to allow cost recovery for a negotiated cogeneration contract unless there was fraud, misrepresentation or mistake.



Given this background, we must test the appropriateness of a settlement of a contract dispute based on the possible outcomes of the court decision and its potential impact on ratepayers. The net present value (NPV) of the payment stream under the Settlement Agreement is projected to be \$468.2 million. As the chart below indicates, if the court were to find in favor of Pasco, FPC would be liable for an additional \$39 million NPV above the amount called for in the settlement agreement. On the other hand, if the court were to decide in favor of FPC, FPC's liability under the contract would be \$17.3 million NPV less than the Settlement Agreement.

Cost-Effectiveness Analysis (\$ Millions NPV)				
Court Outcome	Contract Costs	Treble Damage	Total	Compared to Settlement
FPC Prevails	450.9	0.0	450.9	(17.3)
Pasco Prevails	490.4	16.8	507.2	39.0
Settlement	468.2	----	468.2	----

(Numbers may not add due to rounding)

Finally, if the court's decision resulted in a cost stream midway between the cost positions espoused by the parties in the circuit court proceeding, FPC would be liable for an additional \$10.8 million NPV more than the Settlement Agreement.

The settlement agreement includes a buyout provision which shortens the term of the existing contract. In analyzing the payment stream called for by the settlement agreement, we made assumptions regarding the cost of replacement capacity in the years following the expiration of the settlement agreement until the expiration of the term of the existing contract. There is substantial uncertainty involving the need for and the cost of replacement power during this period. However, forces at work in the electric industry have been driving prices for additional capacity down. To the extent that this trend continues into the future, the benefits of the settlement agreement's buy-out provision are increased.

In deliberating this matter, the Commission addressed the concern of intergenerational inequity caused by approving the settlement agreement. The buyout of the last four years and seven

months of the contract, roughly 2009 through 2013, leads to a concern that customers may not benefit from the buy-out until 2009.

The payment structure of the existing contract calls for payments to Pasco that increase over time. The increasing payment schedule relates to a concept adopted by the Commission when establishing avoided costs. While acknowledging that power plant revenue requirements decrease over time, the increasing avoided cost structure was thought by the Commission to provide an incentive for cogenerators to fulfill the terms of their contracts. Thus, customers have benefitted from the capacity payments under the existing contract to the extent that the capacity payments have been less than the revenue requirements that would have been recovered if FPC had built and owned the capacity.

On balance, we find it appropriate to approve the Settlement Agreement. The only outcome of the dispute that results in less cost liability to FPC is if the court decides the case in FPC's favor. Given the fact that a court appears to have rejected FPC's position in a similar case, there is at least a heightened concern that the court is likely to reject FPC's position in this case. Therefore, under more likely scenarios, the settlement agreement results in less costs to FPC. Moreover, the benefits of the Settlement Agreement may in fact be greater when giving recognition to the uncertainty surrounding the need for replacement capacity in the contract's final years. Finally, the concerns about intergenerational inequity caused by approving the Settlement Agreement are mitigated due to the fact that customers have paid less in capacity payments than they would have using traditional rate base accounting as the basis for calculating the capacity payments.

#### **Energy Settlement Payment and Ongoing Capacity and Energy Payments**

On October 31, 1996, FPC made a payment of \$5.5 million to Pasco pursuant to the Settlement Agreement. This payment results from the settlement of the dispute regarding the pricing of energy payments pursuant to the contract during the period August, 1994 through September, 1996. It represents the difference between recalculated energy payments for the period and the actual energy payments, as well as accrued interest. Since energy payments are recovered through the Fuel and Purchased Power Cost Recovery Clause, and this portion of the settlement payment relates solely to disputed energy payments, FPC should recover the energy settlement payment with accrued interest, through the Fuel and Purchased Power Cost Recovery Clause. The ongoing capacity payments should continue to be recovered through the Capacity Cost

Recovery Clause. Any portion of these payments that were not included for recovery in the February 19, 1997 Fuel Adjustment hearing should accrue interest from the date they were incurred.

In addition, the ongoing energy payments resulting from the modified contract will be recovered through the Fuel Clause.

#### **Recovering the Monthly Payments Associated with Early Termination of the Contract**

As a part of the Settlement Agreement, the term of the Contract was reduced by four years and seven months. The Contract will terminate on December 31, 2008, instead of July 31, 2013. In return for shortening the contract, FPC agreed to make monthly payments to Pasco beginning in October, 1996 and ending in December, 2005.

FPC proposed to recover these payments from its ratepayers exclusively through the Capacity Cost Recovery Clause (CCRC). However, we find that a portion of these payments should be recovered through the Fuel and Purchased Power Cost Recovery Clause (Fuel Clause).

The CCRC is a mechanism which is intended to recover capacity charges paid by the utility for power purchased from other utilities and from cogenerators, provided such costs are not already recovered in base rates. The CCRC is intended to allocate such costs to the rate classes in the same manner as demand-related production plant costs are allocated in rate cases. In the case of FPC's last rate case, production plant costs were allocated to the classes based on their estimated contributions to the 12 monthly system peak hours. Such a method is based on the premise that fixed production plant expenses are incurred to meet the system peak demand. Thus, costs which are recovered through the CCRC are allocated to the rate classes based on their estimated contribution to peak demand, using the latest available load research data. By contrast, expenses which are recovered through the Fuel Clause are related to energy.

The Contract buy-out is justified by FPC based on both energy and capacity savings. Therefore, the buy-out payments will be recovered through the Fuel Clause and the CCRC in proportion to the estimated energy and demand savings they will provide in the buy-out years. The estimated energy and capacity savings during the buy-out years 2009 through 2013 were arrived at by estimating what would have been paid based on Pasco's contract interpretation and subtracting from that amount, the estimated cost of replacement energy and capacity.



ORDER NO. PSC-97-0523-FOF-EQ  
DOCKET NO. 961407-EQ  
PAGE 7

The buyout's capacity savings are approximately \$124.2 million. This represents 72 percent of the total \$172.1 million in savings. Therefore, 72 percent of the buyout payments shall be recovered through the CCRC. The remaining 28 percent, reflecting energy savings shall be recovered through the Fuel Clause. Accordingly, monthly payments attributable to the buyout of a portion of the contract that were not included for recovery in the February 19, 1997 Fuel Hearing should be recovered through the Fuel and Capacity Cost Recovery Clauses with accrued interest.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Florida Power Corporation's Petition for expedited approval of Settlement Agreement regarding negotiated contract for purchase of firm capacity and energy from a qualifying facility, with Pasco Cogen, Ltd., is approved. It is further

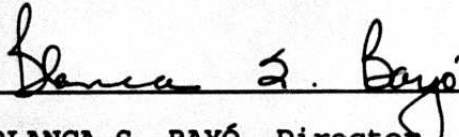
ORDERED that Florida Power Corporation shall recover amounts pursuant to the Settlement Agreement in the manner described in the body of this Order. It is further

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, this Docket shall be closed.

ORDER NO. PSC-97-0523-FOF-EQ  
DOCKET NO. 961407-EQ  
PAGE 8

By ORDER of the Florida Public Service Commission, this 7th  
day of May, 1997.

  
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BLANCA S. BAYÓ, Director  
Division of Records and Reporting

( S E A L )

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**DISSENTS**

Commissioner Deason dissents, with comment, from the Commission's decision to approve the Settlement Agreement. Commissioner Kiesling concurs with this dissent.

**Commissioner Deason:** I am concerned that the retail ratepayers are being asked to pay a total of \$59.4 million in settlement costs beginning October 1997 and continuing through the year 2005 for net present value benefits that are to projected to materialize until the year 2011, if at all. I do not contend that the settlement is completely without merit. However, the projected benefits of the settlement are speculative and distant while the costs are certain and immediate.

In addition, Commissioner Kiesling dissented from the majority decision on the issue of allocation of cost recovery.

**NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW**

The Florida Public Service Commission is required by Section 120.569(1), 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



ORDER NO. PSC-97-0523-FOF-EQ  
DOCKET NO. 961407-EQ  
PAGE 9

should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

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 May 28, 1997.

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.