

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for approval of
amendment to cogeneration
contract with Bay County
Resource Recovery Facility by
Florida Power Corporation.

DOCKET NO. 011365-EQ
ORDER NO. PSC-02-0483-PAA-EQ
ISSUED: April 8, 2002

The following Commissioners participated in the disposition of
this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
MICHAEL A. PALECKI
RUDOLPH "RUDY" BRADLEY

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING CONTRACT AMENDMENT

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

On June 17, 1988, by Order No. 19509, the Commission approved
a contract for the purchase of capacity and energy between Florida
Power Corporation (FPC) and Bay County (County). The negotiated
contract provides FPC with 11 megawatts of capacity and associated
energy from the County's Resource Recovery Facility. The contract
expires on December 31, 2022. The contract provided for early
capacity payments to Bay County by applying the capacity and O&M
payments from the out years (2013 to 2022) to the County in the
first seven years of the contract (1988 through 1994) on a present-
valued, levelized basis. Years 2013 through 2022 of the contract
provide firm energy with no capacity payments. A series of
capacity buy-down options are also included in the contract.

DOCUMENT NUMBER-DATE

03897 APR-8 2002

FPSC-COMMISSION CLERK

Consistent with Rule 25-17.0832(3)(c), Florida Administrative Code, the contract establishes a contingent liability for the County to reimburse FPC for early capacity payments if a capacity buy-down option is exercised or in the event of a default.

On October 16, 2001, FPC filed a petition for approval of an amendment to its purchased power contract with the Bay County Resource Recovery Facility. As filed on October 16, 2001, the original Amendment: 1) terminates the contract in 2006 rather than 2022; 2) eliminates the County's contingent liability; 3) requires FPC to pay consulting fees of \$610,000 incurred by Bay County; and, 4) provides Bay County with the option to reduce capacity by 1 MW beginning in 2005, with no charge to Bay County from the liability account. FPC requested approval of the Amendment to the current contract for cost recovery purposes.

On February 27, 2002, FPC filed a revised Amendment which was approved by FPC and the Bay County Commissioners on February 26, 2002. The revised Amendment: 1) re-establishes the contingent liability until the contract ends in December 2006; and, 2) deletes the County's option to buy-down 1 MW of the facility's capacity in 2006 without a pay-out from the liability account. In all other respects the Amendment remains unchanged.

By this Order, we approve the revised Amendment. We further require the utility to consider and report on a plan to share the risks and benefits associated with this revised Amendment. Jurisdiction in this matter is vested in the Commission by various provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, 366.06, and 366.051, Florida Statutes.

AMENDMENT TO THE PURCHASED POWER CONTRACT WITH THE BAY COUNTY RESOURCE RECOVERY FACILITY

The Existing Contract: FPC's negotiated contract with Bay County for the purchase of 11 megawatts of firm capacity and energy is a 34-year value of deferral contract beginning in 1988 and expiring on December 31, 2022. The pricing structure of the Bay County contract is very unusual because it includes early capacity payments for the cogenerator in exchange for a ten-year period of firm energy with no capacity payments during the final years of the contract. Bay County received early capacity and O&M payments,

which began seven years earlier than the in-service date for the statewide clean coal technology avoided unit used in pricing FPC's standard offer contract. A high capital cost coal unit was used as the avoided unit because at the time, the greater weight of the evidence suggested that the price of natural gas would escalate faster than the price of coal. As this expectation did not materialize, the capacity costs of the Bay County contract are currently higher than market.

Under the negotiated contract, the coal unit based capacity and O&M payments for 2013 through 2022 were paid to Bay County in 1988 through 1994, on a present-valued, levelized basis. Capacity payments for 1995 through 2013 under the Bay County contract are lower than they would have otherwise been under FPC's standard offer contract. As stated in Order No. 19509, at the time the negotiated contract was signed, the cumulative present value benefit to FPC's ratepayers was projected to be \$1,843,000 over the 34-year term of the contract when compared to the coal unit based standard offer contract. Because Bay County received early capacity payments relative to the standard offer contract, FPC's ratepayers did not begin receiving cost reduction benefits from the contract until 1995. These benefits occur partially due to the reduced capacity payments in years 1995 through 2013. However, the primary ratepayer benefit occurs due to the zero capacity payments in years 2013 through 2022.

As stated in Section 6 of the contract: "The parties recognize that capacity payments paid prior to January 1, 1995, are in the nature of 'early payment' for a future capacity benefit to the Company." The contract establishes a contingent liability for Bay County to reimburse FPC in the event of a default or certain buy-down provisions, in order to ensure that FPC will receive a capacity benefit for which early capacity payments have been made. This liability is represented by a Capacity Account that keeps a cumulative balance of all early capacity payments paid prior to the in-service date of the statewide unit. After January 1, 1995, the Capacity Account is debited for the difference between the capacity payments under the contract and those under the standard offer contract. Interest accrues to the Capacity Account in the amount of 10.72 percent per year. The balance in the Capacity Account, representing Bay County's contingent liability, is \$21.1 million as of December 2001, growing to \$44.1 million by 2012.

Section 8.5 of the existing contract contains several buy-down provisions which are relevant to the proposed contract amendment. According to the contract, if Bay County exercises any of the buy-down provisions, FPC must be reimbursed for early capacity payments. Bay County is liable for the balance of the Capacity Account multiplied by the percentage of total capacity reduction.

The Proposed Contract Amendments: On February 27, 2002, FPC filed a revised letter agreement between FPC and Bay County which outlines the revised contract modifications. The revised modifications provide that:

- The contract will expire on December 31, 2006, rather than December 31, 2022.
- The balance of the Capacity Account will remain in place until the new contract expiration date of December 31, 2006. All requirements for a pay-out from Bay County to FPC in the event of a capacity buy-down or default are therefore in effect until December 31, 2006. Bay County's contingent liability is eliminated thereafter, provided that no conditions requiring repayment pursuant to the contract exist.
- FPC will pay \$610,000 to Bay County to cover the County's consulting fees associated with the revised contract Amendment.

Bay County also provided documentation on a planned environmental retrofit to the facility which is necessary in order to meet Clean Air Act requirements. The retrofit must be in place prior to December 31, 2005. On September 14, 2001, Bay County signed a contract to complete the retrofit. The total estimated cost of the retrofit is \$15.7 million, plus a construction cost overrun contingency of \$1.7 million. Due to the retrofit, there is the potential for a derating of the facility to approximately 10 MW in 2005. A representative of Bay County stated that if the plant's capacity is derated, Bay County expects that additional energy will be available from Gulf Power to cover Bay County's obligations to FPC. However, if the unit is derated and Bay County is unable to obtain additional energy to meet its obligations to FPC, the revised contract Amendment requires a pay-out from Bay County to FPC from the liability account.

FPC provided an estimated net present value analysis of the cost savings to FPC's customers if the revised Amendment to the existing contract is approved. FPC estimates net present value savings to ratepayers of \$4.4 million by comparing the capacity and energy costs of the current contract to: 1) the capacity and energy costs of the contract until 2006; 2) the cost of replacement capacity and energy from 2007 through 2022; and, 3) the \$610,000 immediate payment from FPC to Bay County to cover Bay County's consultant fees.

FPC views the revised Amendment as an opportunity to shift ratepayer savings from the latter years of the contract (2013 through 2022) to 2007 through 2012. According to FPC, these savings occur because the capacity and energy costs of the existing contract are higher than estimated market costs for 2007 through 2012. Ratepayer costs would increase in 2002 (\$610,000 payment to Bay County) and in 2013 through 2022. Market costs of replacement power are expected to be higher in 2013 through 2022 because FPC pays no capacity costs for these years under the existing contract. FPC's analysis assumes full performance of Bay County under the contract. Therefore, no pay-out from the liability account is included in the analysis.

FPC expects replacement power costs to remain relatively flat from 2006 until 2022. FPC expects 6 to 9.5 cents per kWh savings for ratepayers for the years 2007 through 2012, with an expected 3.5 cents per kWh added cost for ratepayers during the final ten years of the contract. Replacement power costs were modeled using PROSYM software, which estimates replacement costs based on FPC's current and expected future generation resources, along with outside purchases. FPC stated that a sensitivity test completed by the company showed that a 30 percent increase in the expected replacement costs would be necessary to reduce the NPV of the proposed amendment to zero.

We find that FPC's petition for approval of the Amendment to the purchased power contract with Bay County, as revised on February 27, 2002, should be approved. The contract costs are currently higher than wholesale market costs and FPC expects the contract costs to remain higher than market costs until 2013. The revised Amendment will allow FPC to go to the wholesale market sooner to replace the contract's capacity and energy with a

potentially less expensive power source in years 2007 through 2012. We find that FPC's assumption that the current contract costs will be higher than market in the years 2007 through 2012 is reasonable, resulting in ratepayer savings during these years if the revised Amendment is approved. The final NPV savings to ratepayers will also depend on market costs relative to the contract in years 2013 through 2022, when the current contract provides firm energy with no capacity costs. Market costs in these years are more difficult to predict, resulting in greater uncertainty surrounding the ratepayer impact in years 2013 through 2022. However, if replacement power costs over the life of the current contract fall within a 30 percent range of FPC's estimates, a positive net present value benefit to ratepayers will result from terminating the contract in 2006.

Under the revised Amendment, FPC's ratepayers will experience an immediate rate increase of \$610,000 in exchange for future benefits. This translates into 1.6 cents increase per month for one year for a typical residential customer with 1,000 kWh per month usage. The payback period for the \$610,000 cost increase is expected to occur in 2007, the first year FPC replaces the contract with an alternative power source. We believe it is appropriate for these costs to be recovered through the Fuel and Purchased Power cost recovery clause. This is consistent with Commission orders in previous cogeneration contract restructuring dockets.

FPC and Bay County have addressed one of the concerns by retaining Bay County's contingent liability in the revised Amendment. The previous agreement eliminated Bay County's contingent liability immediately, while FPC's obligation to purchase capacity and energy continued through 2006. Eliminating Bay County's liability prior to the contract's end would have placed FPC's customers at risk of losing any pay-out from this liability in the event of a capacity buy-down or default occurring prior to 2007. This could have resulted in an outcome in which FPC's ratepayers were worse off under the revised Amendment than under the current contract. We believe that the revised Amendment is consistent with the intent of Commission Order No. 19509. The Order guaranteed any payments from Bay County's contingent liability to FPC's ratepayers to compensate ratepayers for early capacity payments made to Bay County. We emphasize that it is FPC's obligation to ensure that Bay County compensates FPC's

ratepayers according to the contract's requirements if Bay County fails to perform.

SHARING PLAN

The risks associated with variances from the projected energy and capacity costs used to measure the cost-effectiveness of this amendment are, at present, borne entirely by FPC's ratepayers. If the costs for any replacement capacity and energy are significantly higher than projected, the amendment could actually cost more than the current agreement. On the other hand, if the costs are lower than projected, the contract could be even more beneficial to ratepayers than estimated.

All these projections are based on long term estimates, that is, over the twenty year remaining life of the existing contract. There could conceivably be much risk and volatility associated with those projections compared to the existing agreement, given that at present, beginning in year 2013, the capacity payments are zero. In addition, the fuel costs are indexed to the price of coal delivered at Big Bend Unit 4 which is likely to be a very stable index. A sharing of both the risks and rewards associated with this amendment could be beneficial to both the utility and its customers. Accordingly, we direct the utility to consider a sharing plan and to either 1) file a petition seeking approval of a sharing plan; or, 2) submit a report detailing that it concluded a sharing plan was not appropriate and explaining the reasons why, within 30 days after the issuance of this order.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Florida Power Corporation's Petition for Approval of Amendment to Cogeneration Contract with Bay County Resource Recovery Facility, as revised on February 27, 2002, is approved. It is further

ORDERED that Florida Power Corporation shall either 1) file a petition seeking approval of a sharing plan; or, 2) submit a report detailing that it concluded a sharing plan was not appropriate and explaining the reasons why, within 30 days after the issuance of this order. It is further

ORDER NO. PSC-02-0483-PAA-EQ
DOCKET NO. 011365-EQ
PAGE 8

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 8th day of April, 2002.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records and Hearing
Services

(S E A L)

RVE

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 that is available under Section 120.57, 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 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. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on April 29, 2002.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

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