



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: DECEMBER 22, 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF LEGAL SERVICES (ELIAS) *RVE*
 DIVISION OF ELECTRIC AND GAS (JENKINS, TRAPP, DUDLEY) *JBJ*
 DIVISION OF AUDITING AND FINANCIAL ANALYSIS (SALAK, MAUREL) *RD* *VTB* *RTT*

RE: DOCKET NO. 981360-EI - PETITION BY FLORIDA POWER CORPORATION FOR WAIVER OF RULE 25-22.082, F.A.C., SELECTION OF GENERATING CAPACITY.

AGENDA: 01/05/99 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: JANUARY 18, 1999 - PETITION DEEMED APPROVED IF NOT GRANTED OR DENIED WITHIN 90 DAYS OF RECEIPT

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\LEG\WP\981360.RCM

CASE BACKGROUND

Section 403.519, Florida Statutes, commonly called the Need Determination Statute, requires that the Commission consider "whether the proposed plant is the most cost-effective alternative available" in the context of a need determination proceeding. Pursuant to Rule 25-22.082(2), Florida Administrative Code, prior to filing a petition for determination of need, each investor-owned electric utility shall evaluate supply-side alternatives to its next planned generating unit by issuing a Request for Proposals (RFP). Section 120.542, Florida Statutes, provides for rule waivers when certain statutory criteria are met. Rule 25-22.082(9), Florida Administrative Code, allows the Commission to waive the RFP requirements upon a "showing that the waiver would likely result in a lower cost supply of electricity to the utility's general body of ratepayers, increase the reliable supply

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

DOCKET NOS. 981360-EI
DATE: December 22, 1998

of electricity to the utility's general body of ratepayers, or is otherwise in the public interest." While the later expression of legislative intent in Section 120.542, Florida Statutes, supersedes the rule, the analysis in this recommendation addresses both sets of criteria.

On October 20, 1998, Florida Power Corporation filed a request to waive Rule 25-22.082, Florida Administrative Code. FPC's requested rule waiver is based on what it believes to be unique cost, scheduling, site, environmental, and utility control advantages of constructing the second unit at its existing Hines Energy complex. As authority for its request, FPC cites to Rule 25-22.082(9), Florida Administrative Code, as well as Section 120.542, Florida Statutes. As required by Section 120.542, Florida Statutes, notice of FPC's waiver request was published in Florida Administrative Weekly on November 13, 1998. Rule 28-104.003, Florida Administrative Code, provides for written comments on the petition for waiver to be filed within 14 days after the notice is published in Florida Administrative Weekly. Thus, the comment period was over on November 27, 1998. Since Friday, November 27, 1998 was a state holiday, the comment period expired November 30, 1998. Two interested persons filed comments. On November 30, 1998, the Electric Power Supply Association filed comments. On December 1, 1998, the Florida Industrial Cogeneration Association. A summary of these comments is presented in the Staff analysis for Issue 2.

On December 21, 1998, Edison Mission Energy filed a Petition for Leave to Intervene in this docket. As of the filing date of this recommendation, the time for responding to the Petition has not run.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

DISCUSSION OF ISSUES

ISSUE 1: Should the Florida Industrial Cogeneration Association's comments, filed December 1, 1998, be accepted as timely?

RECOMMENDATION: Yes. (ELIAS)

STAFF ANALYSIS: On December 1, 1998, the Florida Industrial Cogeneration Association (FICA) also filed comments requesting denial of the petition. By letter dated December 10, 1998, FPC suggests that FICA's comments are untimely and not entitled to consideration in this proceeding. FPC claims the due date was November 30, 1998. In response to FPC's letter, FICA provided a Federal Express waybill showing that its comments were forwarded in time to be filed on the 30th. A delivery error appears to be responsible for the one day delay.

Staff believes that the one-day's lateness is not fatal to the Commission's ability to review the comments. The comments are technically late under the Uniform Rule. However, in staff's opinion, the comment date is not a jurisdictional date. Further, the Federal Express waybill shows FICA's effort to assure that the comments would be timely filed. Finally, this recommendation is being considered by the Commission as Proposed Agency Action. Thus, any interested person, including FICA, can address the Commission at the agenda conference. Having apparently acted in good faith to assert its rights, staff believes it is appropriate to consider FICA's comments.

ISSUE 2: Should the Commission waive the requirements of Rule 25-22.082, Florida Administrative Code, as to Florida Power Corporation (FPC)?

PRIMARY RECOMMENDATION: Yes. The requested waiver should be granted due to the uncertain reliability of generation reserves planned for Peninsular Florida and the rate savings which will occur as a result of FPC's commitment not to seek base rate recovery of Hines 2 for a period of at least five years from the

DOCKET NOS. 981360-EI
DATE: December 22, 1998

unit's commercial in-service date. Since FPC has demonstrated that the purposes of the underlying statute will be achieved by other means, and that its ratepayers will suffer a substantial hardship, FPC has met the requirements of Section 120.542, Florida Statutes. (Jenkins, Trapp)

ALTERNATIVE RECOMMENDATION: No. FPC should be required to comply with Rule 25-22.082, Florida Administrative Code, in order to provide assurances that its ratepayers benefit from the most economical resource addition and to avoid the potential for extensive litigation during the later need determination process. FPC has failed to demonstrate that the purposes of the underlying statute will be achieved by other means. Therefore, FPC has not met the requirements of Section 120.542, Florida Statutes. Furthermore, accelerating the in-service date of Hines 2 will not remedy FPC's Winter 2000/01 capacity shortfall. (Dudley, Maurey)

PRIMARY STAFF ANALYSIS: Commission Rule 25-22.082, Florida Administrative Code, Selection of Generating Capacity, was adopted by the Commission in 1994 in lieu of a more restrictive Commission scored bidding process. Rule 25-22.082, Florida Administrative Code, implements Sections 366.051 and 403.519, Florida Statutes. The purpose of the rule is to afford investor owned electric utilities the opportunity to explore, through an RFP process, cost-effective supply side alternatives which may be available in the competitive wholesale marketplace prior to filing a formal, and statutorily time-constrained, need determination. Municipal electric utilities and rural electric cooperatives are not covered by the rule. Further, investor owned utilities may be excused from the requirements of the rule if they demonstrate that the waiver would likely result in a lower-cost supply of electricity, increase the reliable supply of electricity, or is otherwise in the public interest.

FPC has requested a waiver of Rule 25-22.082, Florida Administrative Code, in order to proceed with the certification of Hines 2, a second 500 MW combined cycle unit to be built at its existing Hines Energy complex in Polk County. In addressing the public interest aspects of their request for rule waiver, FPC has alleged that:

1. Hines 2 will be an advanced technology 500 MW combined cycle unit similar in design to Hines 1.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

2. Because of concerns with recent record high summer temperatures, practical limitations experienced with the company's reliance on dispatchable DSM programs (direct load control), and the adequacy of reserves statewide, FPC has decided to accelerate the in-service date of Hines 2 from late 2004 to the summer of 2001.
3. As the second unit at an existing developed site, Hines 2 will have a scheduling and cost advantage over other supply side alternatives.
4. Hines 2 will improve the balance between company-owned generation and purchased power. Because of FPC's relatively high percentage of purchased power and the practice of major bond rating agencies to impute a portion of a utility's long-term purchased power obligations to the debt component of its capital structure, Hines 2 will help maintain the utility's debt/equity ratio.

In addition to these factors, FPC has committed not to initiate any proceeding to increase its current base rates which includes Hines 2 for a period of at least five years from the unit's commercial in-service date (or through mid-2006 based on the unit's current in-service schedule).

Waiver pursuant to Section 120.542, Florida Statutes

Section 120.542, Florida Statutes, mandates threshold proofs and notice provisions for variances and waivers from agency rules. Subsection (2) of the statute states:

Variances and waivers shall be granted when the person subject to the rule demonstrates that the purpose of the underlying statutes will be or has been achieved by other means by the person and when application of the rule would create a substantial hardship or would violate principles of fairness. For purposes of this section, "substantial hardship" means a demonstrated economic, technological, legal, or other type of hardship to the person requesting the variance or waiver. For purposes of this section, "principles of fairness" are violated when literal application of a rule affects a particular person in a manner significantly different from the way

DOCKET NOS. 981360-EI
DATE: December 22, 1998

it affects other similarly situated persons who are subject to the rule.

FPC asserts that the application of the rule in this instance creates a substantial hardship for FPC and its customers. FPC further argues that the purpose of the underlying statute will be achieved if FPC's petition is granted.

Purpose of the Underlying Statute

In its petition, FPC points out that Rule 25-22.082, Florida Administrative Code, implements Section 403.519, Florida Statutes. FPC asserts that the purpose of this underlying statute is to "ensure that a utility's customers receive the benefit of the most cost-effective generation supply alternative in satisfying the need for new capacity." FPC contends that this purpose will be achieved with the rule waiver sought by FPC. FPC states that given its offer to not initiate base rate recovery of the capital and non-fuel O&M costs associated with Hines 2 means "that customers will not only be provided new capacity at the least cost, it will be provided at no cost for at least five years. And when the units fuel savings are taken into account, customers will actually receive a rate reduction."

As discussed below, the primary staff believes that FPC's reasons for foregoing an RFP solicitation are compelling and that the requirements of Rule 25-22.082, Florida Administrative Code, should be waived in this instance. It should be noted, however, that FPC will be required to file a need determination for the construction of Hines 2. Pursuant to the requirements of the Need Determination Statute, FPC must demonstrate, among other things, that the proposed construction of Hines 2 is the most cost-effective alternative available. Waiving FPC's obligation to issue an RFP pursuant to Rule 25-22.082, Florida Administrative Code, should not, in any way, alter or reduce the company's burden of proof in a need determination proceeding to demonstrate the cost-effectiveness of Hines 2 relative to other supply-side alternatives, including purchased power. Cost-effectiveness is from a customer viewpoint. Hence the demonstration should include cash-flow impacts to the customer between FPC building the plant versus purchasing capacity from others.

Consistent with the underlying purposes of Section 403.519, Florida Statutes, primary staff believes there are two main reasons

DOCKET NOS. 981360-EI
DATE: December 22, 1998

to approve the requested rule waiver. They are: (1) the uncertain reliability of generation reserves planned for Peninsular Florida and; (2) the rate impact savings to ratepayers which will occur as a result of FPC's commitment not to seek base rate recovery of Hines 2 for a period of at least five years from the unit's commercial in-service date.

Statewide Reliability

An RFP solicitation procedure takes about six to nine months to complete, thereby delaying the in-service date of a generating unit needed to bolster sagging Statewide reserves by at least one summer or winter peak demand season. Planned generating reserves have become questionable because of a series of unforeseen reliability modeling questions that arise primarily from the recent higher generating unit availabilities and an unprecedented reliance on load management and other non-firm load.

At the September 1997 Ten-Year Site Plan (TYSP) workshop, staff learned that the Florida Reliability Coordinating Council (FRCC) was no longer studying planned electric reliability using Loss-of-Load Probability (LOLP) methods. LOLP and similar probabilistic methods have been used by the utility industry for decades. Staff requested and the FRCC provided an LOLP study of the 1997 aggregate TYSP. However, the LOLP reliability study yielded unrealistic results. Basically, the study showed that about an 8 percent reserve margin was adequate for Peninsular Florida. This low of a reserve margin is unrealistic.

The major reason for the 1997 and 1998 LOLP studies yielding unrealistic results is that generating unit availabilities have increased from about 80 percent in 1988 to 89 percent in 1997 because of improved maintenance and spare parts practices. The higher the generating unit availabilities the lower the reserve margin required for a given overall generating reliability. After much discussion, the FRCC agreed to develop a new methodology to evaluate planned Peninsular Florida electric reliability.

Since the FRCC method of reliability assessment is untested, a conservative course of action would be to advance the construction of Hines 2 as proposed by FPC. This would enhance the reliability of FPC and the peninsular grid while not exposing FPC's ratepayers to increased rates for at least five years. While this

DOCKET NOS. 981360-EI
DATE: December 22, 1998

does not relieve FPC's ratepayers from the commitment for the remaining life of the unit, it is a step in the right direction.

FPC has relied on load management more than any other electric utility in the nation. Load management has been viewed as the functional equivalent of a peaking type generating unit. These units have a low installed cost, a lower fuel efficiency than a combined-cycle unit, and are operated only a few hundred hours per year. The 1998 summer heat wave caused the use of load management to exceed customer tolerance levels. About 46,000 FPC residential customers opted out of load management during the 1998 heat wave. This drop out translated to about 50 MW of Summer capacity. While over reliance on load management is a critical issue for FPC, staff is also concerned with the extensive reliance on load management and other non-firm load on a Peninsular Florida basis. On a Peninsular Florida basis, load management and other non-firm load currently range from 44 to 58 percent of the reserve margin. The uncertainty as to what the reserve margin should be is exacerbated by the fact that a high percentage of the planned reserve margin is in the form of load management and other non-firm load.

Peninsular Florida has not experienced prolonged low temperatures since the Christmas 1989 blackouts. In Christmas 1989, lows of 28, 24, and 26 degrees were recorded at the Tampa weather station on December 23, 24, and 25, respectively. Since 1970, and prior to 1989, similar low temperatures have been experienced on 17 occasions. During the three-day 1989 Christmas period, about 4,700 Megawatts, or at that time more than 10 percent of the state, was without electricity. Should another cycle of prolonged low temperatures occur, as experienced from about 1970 through 1989, the amount of load lost could range from half as bad to twice as bad as that lost during the Christmas of 1989 depending on whether utilities continue to achieve high generating unit availabilities.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

Ratepayer Savings

A second reason to grant the rule waiver is because the capital costs for utility owned generating unit additions do not raise customer rates unless there is a rate case. Conversely, purchased power capital costs are immediately recovered through the fuel and purchased power cost recovery clause. Of course, if the Commission were to adopt a policy of recovering the capital costs for utility owned power plants and purchased power costs in an identical manner, either both through base rates or both through a cost recovery clause, this second reason for the waiver would become moot.

Recovering capital costs for utility owned power plants and purchased power costs in an identical manner raises many other issues that would take time to resolve. Because of the uncertain generating resource adequacy, rule waivers such as Florida Power's should be granted until the FRCC reliability model has been fully tested.

The downside to approving FPC's bid rule waiver is that customers bear the long-term risk of the plant being of the wrong fuel type and/or foregoing the savings of unforeseen technological advances. Power plants typically have a 30 to 40 year life. During the 1960s, oil-steam was the fuel and technology of choice for Peninsular Florida. After the 1973 oil embargo, coal-steam was the choice and remained so until the early 1990s. In the 1990s, natural gas-fired combined cycles with unprecedented efficiency became the fuel and technology choice. While FPC's proposed natural gas-fired combined cycle unit appears to be the optimal choice, there is no guarantee that it will remain so for the next 30 to 40 years. Ideally, primary staff would like to see a regulatory policy wherein customers no longer assume the long-term risk of power plant or purchased power decisions that cost-wise, for unforeseen events, become sub-optimal.

Primary staff agrees that the purpose of the underlying statute would be achieved with the requested rule waiver. In addition to the criteria asserted by FPC, the Commission must consider "the need for electric system reliability and integrity" in considering a petition for determination of need pursuant to Section 403.519, Florida Statutes. Adequate reserve margins, which this plant would help achieve, are essential to achieve electric system reliability and integrity.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

Substantial Hardship

It is not clear whether the application of this rule creates a substantial hardship for FPC alone. However, if FPC is correct and its proposal would provide substantial benefits for its ratepayers, those benefits would be foregone if the requested waiver is not granted. The Commission has previously determined such "foregone benefits" can constitute a "substantial hardship" within the meaning of Section 120.542, Florida Statutes.

In Docket No. 980740-EI, Florida Power & Light Company (FPL) sought a waiver, pursuant to Section 120.542, Florida Statutes, of the requirement in Rule 25-17.015(1), Florida Administrative Code, that it file its Conservation Cost Recovery petition for consideration during the first calendar quarter of every year. This requirement would have delayed by a year the conversion to a once a year cost recovery proceeding in November. The Commission had previously found that there were substantial benefits to the ratepayers associated with that change. In Order No. PSC-98-1211-FOF-EI, issued September 14, 1998, the Commission stated:

We note that the Legislature intended the provisions of Section 120.542, Florida Statutes, to remedy situations where "strict application of uniformly applicable rule requirements can lead to unreasonable, unfair, and unintended results . . ." Section 120.542(1), Florida Statutes (1997). We believe that this language should be read together with subsection (2) of the statute in order to determine whether FPL has demonstrated a substantial hardship in this case.

In terms of the rule's impact on FPL alone, it is arguable whether the rule creates a substantial hardship. However, FPL's ratepayers may achieve substantial benefits, as delineated in Order No. PSC-98-0691-FOR-PU, if FPL's request for a rule waiver is granted. Conversely, if the rule waiver is not granted, FPL's ratepayers must forego those benefits. We believe that this is the type of "unreasonable, unfair, and unintended result" that Section 120.542, Florida Statutes, was intended to remedy. Therefore, given the interests of FPL's ratepayers and our responsibility to those ratepayers, we find that FPL has demonstrated that

DOCKET NOS. 981360-EI
DATE: December 22, 1998

application of Rule 25-17.015(1), Florida Administrative Code, creates a substantial hardship.

The situation in this case is similar to that addressed by the Commission in the above Order. Therefore, primary staff believes FPC has demonstrated a substantial hardship within the meaning of Section 120.542, Florida Statutes.

Comments of Interested Persons

On November 30, 1998, the Electric Power Supply Association (EPSA) filed comments requesting that the Commission deny FPC's requested waiver. EPSA states "there is no assurance that Florida Power's construction will provide the best price for existing Florida ratepayers, who will, after Florida Power's proposed five year rate freeze, be asked to foot the bill for this project..." EPSA does not believe FPC can be assured of procuring the lowest cost reliable supply of energy absent a competitive solicitation. EPSA also believes FPC's proposal increases risk for FPC's ratepayers, exacerbates FPC's market power in the wholesale generation market and increases the possibility that FPC's ratepayers will subsidize FPC's participation in the competitive market.

On December 1, 1998, the Florida Industrial Cogeneration Association (FICA) filed comments. In Issue 1 above, staff has recommended that these comments be considered by the Commission. FICA states that Rule 25-22.082, Florida Administrative Code, was adopted at a time when the Commission amended its Cogeneration rules so that standard offers would only be available to solid waste facilities and small cogenerators (ie., no more than 100kw). FICA claims the bidding rule was intended to provide opportunities for cogenerators to sell power to utilities. FICA believes the proposed waiver is contrary to long-standing federal and state policy. FICA also suggests the absence of competitive bidding for this resource addition could create "stranded costs" or otherwise burden the ratepayers.

ALTERNATIVE STAFF ANALYSIS: As detailed below, alternative staff does not believe that FPC's request assures that the lowest cost generation alternative will be selected by FPC. This is one underlying purpose of Section 403.519, Florida Statutes. Alternative staff believes that although it appears the proposed plant may represent a low cost supply of electricity and stands to

DOCKET NOS. 981360-EI
DATE: December 22, 1998

increase FPC's reliability, FPC has not sufficiently demonstrated the unavailability of other equally reliable less costly utility or non-utility options. Therefore, FPC has not met the requirements of Section 120.542, Florida Statutes. Moreover, for the reasons discussed below, alternative staff also believes that it would not be in the public interest and would further be contrary to the intent of the bidding rule to approve the requested waiver.

Alternative staff generally agrees with primary staff with respect to generation reliability concerns and the attractiveness of the proposed five year rate commitment. However, alternative staff notes that the same result may be equally achieved via other utility and non-utility alternatives. It is unclear exactly how FPC would become aware of such proposals absent soliciting the market.

Rate Commitment

Alternative staff believes that FPC's commitment to "not initiate any proceeding to increase its current base rates which includes the capital costs and non-fuel operating and maintenance expenses associated with Hines 2 for a period of at least five years from the unit's commercial operation date" has value, but it is limited. The company can still ask for a base rate increase through a limited proceeding for other items. The company further states that the "commitment is conditioned upon the understanding that these capital costs and non-fuel O&M expenses will be considered legitimate utility expenditures for surveillance reporting purposes when Hines 2 is placed in commercial operation." Under FPC's commitment, Hines 2 will be included for all earnings purposes except a full-fledged rate proceeding initiated by FPC. Earnings tracked by the Commission surveillance program will include Hines 2. If any other party were to initiate a proceeding with FPC to review base rates, Hines 2 costs would also be included.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

Purchased Power versus Utility Ownership Construction

In paragraph 11 of FPC's petition, the Company states that meeting its capacity need "with Hines 2 will improve the balance of its total capacity resources between Company-owned generation and purchased power. FPC currently has a higher proportion of its total capacity resources provided by purchased power than any other major Florida utility." These statements are true. As reported by Standard & Poor's Rating Service (S&P) in its 1997 Operating Statistics report, FPC relied upon purchased power for 30% of its capacity during 1997. This level compares with 21% for Florida Power & Light Company, 13% for Gulf Power Company, and 7% for Tampa Electric Company. Of the 19 electric utilities rated double A by S&P, FPC had the second highest level of purchased power for the period. The average for the peer group, excluding FPC, was 15.2%.

In paragraph 12 of its petition, FPC states:

Compounding the concern over an undue reliance on purchased power is the practice of major bond rating agencies to impute a portion of a utility's long-term purchased power obligations to the debt component of its capital structure, which necessitates a commensurate infusion of additional, higher cost equity capital to maintain (in the eyes of the rating agencies) the utility's debt/equity ratio and, thus, its bond rating. In fact, however, the need to add real equity to offset imputed debt increases, rather than maintains, the percentage of equity in the utility's actual capital structure, (and with no additional utility asset to support the increased equity). The resulting increase in the utility's overall cost of capital means that its customers may pay for the equity associated with purchased power twice; once for the higher cost of capital reflected in the utility's base rates, and again for the seller's equity costs reflected in the price of purchased power.

The major rating agencies adjust the debt component of utilities with purchased power contracts to recognize the financial impact of these off-balance sheet obligations. In FPC's case, S&P added approximately \$375 million to the debt component of the Company's 1998 financial statements to reflect the obligation of outstanding purchased power contracts. S&P noted in its Utility Credit Report

DOCKET NOS. 981360-EI
DATE: December 22, 1998

on FPC issued October 1998, that "adjusted for purchased-power obligations, debt totaled a hefty 57% of total capital in 1997." It was also noted that FPC's capital structure was affected by a debt issuance of \$450 million for the buy out of the Tiger Bay cogeneration facility (Tiger Bay). However, S&P noted that while the Tiger Bay buy out "will temporarily increase debt leverage", the lower capacity charges "are a long-term credit positive." For the 12-months ended March 31, 1998, S&P reported capital structure ratios for FPC on an adjusted basis of 57.1% total debt, 0.9% preferred stock, and 42.0% common equity. The Company's actual equity ratio for the period was 47.2%.

The discussion of the perceived need for utilities to increase the actual level of equity in the capital structure to offset the adjustment made to the financial ratios by the rating agencies and how this affects the overall cost of capital has not been definitively addressed by the Commission. While alternative staff agrees in principal that increasing a company's equity ratio results in a higher cost of capital, it is staff's belief that it will be up to the Commission to decide whether this is an appropriate cost to be borne by ratepayers.

Alternative staff agrees with FPC's contention that its level of purchased power is above the levels maintained by other Florida utilities and the average level for its peer group of double A-rated utilities. Alternative staff also agrees with the Company's description of how the rating agencies adjust the financial statements of utilities with purchased power contracts to recognize the financial impact of these off-balance sheet obligations. However, alternative staff disagrees with the underlying premise of the investor-owned utility industry's argument that the incremental cost of additional equity to compensate for these contracts should be borne solely by ratepayers since this issue has not been explicitly addressed by the Commission. While alternative staff believes FPC's concerns regarding an increased reliance on purchased power should be addressed as issues in a need determination proceeding, we do not agree that these concerns justify a waiver of the bidding rule.

Intent of Rule 25-22.082, Florida Administrative Code

Alternative staff also agrees with the primary staff that if the requested waiver is granted, FPC will still be obligated to demonstrate the cost-effectiveness of Hines 2 relative to other

DOCKET NOS. 981360-EI
DATE: December 22, 1998

alternatives during a need-determination proceeding. Recognizing this obligation, absent completing the RFP process, a utility undertakes an increased risk of having to prove the worthiness of its project during a need determination proceeding. In that situation, since the RFP process was not used to preclude likely intervenors and so called eleventh-hour proposals, the utility and Commission alike stand to endure the same lengthy litigation experienced during the Cypress case¹.

As the Commission may recall, the Cypress proceeding prompted in part the adoption of Rule 25-22.082, Florida Administrative Code. In that case, Florida Power & Light Company presented what it believed to be the most cost-effective generation alternative based on a limited selection process. Through the course of the proceeding, two additional projects contested FPL's choice and offered alternatives. The Commission expressed frustration that the limited selection process used by FPL to select Cypress did not facilitate the Commission's statutory responsibility to determine the most cost-effective generating unit under Section 403.519, Florida Statutes. In part the Commission stated:

In this case we find that FPL's selection process was less than optimal. FPL did not ensure that all interested parties had an equal opportunity to submit capacity proposals, but instead considered one project left over from a 1989 request for proposals (RFP) and 14 unsolicited proposed projects. As a result, FPL did not adequately consider all potential purchased power options. (Order page 16)

Any non-utility generator, having seen the price in FPL's next need petition, will be able to intervene in the need proceeding and put a better price on the table. If a need is then denied because the proposed plant is not the most cost-effective alternative available, the process could repeat itself ad infinitum, with the need never being filled, and with more cost-effective alternatives presented at each successive need determination proceeding. (Order page 17)

¹ Joint Petition to Determine Need by Cypress Energy Partners, L.P. and Florida Power and Light Company, Docket 920520-EQ, Order No. PSC-92-1355-FOF-EQ, issued 11/23/92.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

Although alternative staff agrees with the permissiveness of need determination review of generation alternatives, we do not suggest that it is the more optimal method of capacity selection. Much like FPL, FPC should consider the advantages of the RFP process and avoid the potential for eleventh-hour proposals and the possibility of an unsatisfied need. Doing so would allow FPC to identify and evaluate all capacity alternatives as well as reaching closure on the issue of cost-effectiveness during the need-determination process due to the intervention preclusion. Alternative staff believes such an outcome is the intent of Rule 25-22.082, Florida Administrative Code, and more importantly is in the public interest.

Alternative staff notes that FPC previously requested a certification of need for the Hines 2 unit (formerly Polk Unit 3 and 4) in Docket 910759-EI. In Order No. 25550, the Hearing officer held that FPC indeed had a need to construct the first two of the four requested units but that a need for the last two was premature at that time. The granted need for the first two units came in part due to FPC having "evaluated ten alternative generating plans in its Integrated Resource Study. These plans included various generating technologies, as well as purchased power options from other utilities." (page 37) In addressing the final two units, now known as Hines 2, the Hearing officer stated:

At this time, I will not make a finding on how Florida Power should meet the needs of its third and fourth units. I will not require bidding for purchased power to avoid construction of these units for two reasons: the need for the third unit is not mature, and we have no policy or rules requiring bidding. However, Florida Power should reevaluate all of the options for meeting the needs of the third and fourth units before requesting certification in order to ensure that it chooses the most cost-effective option. (page 40)

But for the maturity of the need and the lack of a bidding rule, alternative staff believes the Hearing officer had all intentions of requiring FPC to "reevaluate all of the options" before granting the second part of FPC's requested need. This Commission should impose the same requirement. According to its petition, FPC now believes that the need for the remaining two units is mature. Likewise, since 1994, this Commission has had a rule requiring bidding.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

As a general matter of policy, alternative staff believes that bypassing the RFP process ultimately contributes to stifling the economic benefits of competitive generation in Florida. If in fact Hines Unit 2 is the most cost-effective alternative for FPC's ratepayers, this would be confirmed during the initial stages of the RFP process. However, if this is not the case, this too would be confirmed and the process will have worked as originally intended.

Timing

Though presented as new information, alternative staff believes that FPC has known of its near-term need for additional capacity resources since the early part of this year. This realization should have prompted FPC to start the RFP process at that point in time. Having done so, finalization would be very near complete and FPC would be concentrating its efforts on a determination of need instead of requesting the instant waiver.

FPC's current TYSP filed in April of 1998 indicated that its next planned generation addition, known as Hines 2, was a 487 MW combined cycle unit to be ready for commercial operation by November 2004. FPC's TYSP also indicated that it expected to drop below its 15 percent winter reserve margin criteria in the year 2000/01. FPC explained that it intended on covering this shortfall with short-term power purchases. FPC was also aware of the potential termination of the 75 MW Panda-Kathleen, L.P. standard offer contract.² Furthermore, though FPC knew it already had less than sufficient capacity resources during the Winter 2000/01 time frame, it was negotiating with the City of Barrow in early May for, and has subsequently signed, a five year full-requirements power supply contract beginning in 1999.

With this information, alternative staff believes that FPC was fully aware during the early part of this year that additional capacity would be needed beginning in the year 2000. It is unclear why FPC did not seek to issue an RFP at that point in time. Having done so, FPC would be no less than six months into the process by

² Staff received notification from Florida Power Corporation on July 20, 1998 that it had officially terminated the standard offer contract with Panda-Kathleen, L.P. due to their failure to perform.

DOCKET NOS. 981360-EI
DATE: December 22, 1998

ISSUE 3: Should this docket be closed?

RECOMMENDATION: This docket should be closed if no person whose substantial interests are affected by the proposed action files a protest within the 21-day protest period.

STAFF ANALYSIS: At the conclusion of the protest period, if no protest is filed, this docket should be closed.