State of Florida

Public Service Commission

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RECORDS AND REPORTING

DATE: June 17, 1999

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

FROM: DIVISION OF ELECTRIC AND GAS (DUDLEY, DRAPER)
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (LESTER, MAUREY)
DIVISION OF LEGAL SERVICES (PAUGH)

RE: DOCKET NO. 990249-EG - PETITION BY FLORIDA POWER & LIGHT COMPANY FOR APPROVAL OF A STANDARD OFFER CONTRACT AND REVISED COG-2 TARIFF AND VARIANCE FROM RULE 25-17.0832(4)(e)

AGENDA: 06/29/99 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE - TARIFF SUSPENDED BY ORDER NO. PSC-99-1053-TRF-EG - 90 DAY REQUIREMENT OF SECTION 120.542, F.S. WAIVED BY UTILITY

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\EAG\WP\990249.RCM

CASE BACKGROUND

On March 3, 1999, Florida Power and Light Company (FPL) filed a Petition for Approval of a Standard Offer Contract (Petition) for qualifying cogeneration and small power production facilities. The proposed contract is based on a 5 MW subscription limit of a 209 MW combustion turbine generating unit with an in-service date of 2001. In determining the appropriate payment amounts, FPL accounted for an offsetting equity adjustment to compensate for costs imposed on its customers due to a risk adjusting practice of the Standard and Poor's rating agency. The proposed standard offer contract also includes a "Regulatory Disallowance" section which permits FPL to adjust payments to a signatory to compensate for any unforeseen regulatory action.

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Along with its March 3, 1999, Petition, FPL filed a Petition for a Variance from Rule 25-17.0832(4)(e), Florida Administrative Code (Petition for Variance). FPL seeks a variance from the 10 year minimum contract term required by the rule and instead proposes a fixed five year contract term.

The 60 day suspension date of May 3, 1999, has been waived by FPL pursuant to correspondence dated April 14, and 16, 1999. Order No. PSC-99-1053-TRF-EG, issued May 24, 1999, suspended FPL's proposed standard offer contract and COG-2 tariff revision until final review. By letter dated May 12, 1999, FPL agreed to waive its right to a decision on the Petition for Variance within 90 days after receipt pursuant to Section 120.542(8), Florida Statutes.

On May 4, 1999, the Florida Industrial Cogeneration Association (FICA) filed comments requesting denial of both FPL's Petition and Petition for Variance. In its comments, FICA asks the Commission to enter an order: (1) denying FPL's petition and variance request; (2) instructing FPL to file a standard offer contract based on its next proposed generating plant; and (3), directing FPL to open a solicitation period on its standard offer contract ending July 1, 2000. On June 11, 1999, FPL filed a Response to Comments of the Florida Industrial Cogeneration Association.

This recommendation addresses both the petition for approval of the proposed standard offer contract and the requested rule waiver. The merits and conformity of FPL's proposed standard offer contract with Commission Rules is discussed in Issue 1. Issue 2 addresses FPL's use of an Equity adjustment when determining capacity payments under the proposed contract. Issue 3 deals with FPL's Petition for Variance. If the Commission approves staff's recommendation to deny FPL's proposed standard offer contract and associated tariffs in Issue 1, no decision is necessary on Issue 2. However, if the Commission chooses to approve the contract as filed, the Commission must address all issues.

DISCUSSION OF ISSUES

ISSUE 1: Should FPL's Petition for Approval of a Standard Offer Contract, based upon a combustion turbine unit with an in-service date of 2001, be approved?

RECOMMENDATION: No. FPL's proposed standard offer contract and revised COG-2 tariff should be denied for the following reasons: 1) Contrary to the Commission's rule requirements, the proposed standard offer contract is not based on FPL's next avoided unit, 2) the proposed subscription limit does not accurately reflect the pool of currently eligible signatories thereby precluding at least one municipal solid waste facility, 3) Order No. 24989, issued August 29, 1991, prohibits "Regulatory Out Clauses" standard offer contracts, and 4) FPL may have acted imprudently in filing its proposed standard offer contract at such a late date. Absent approval to waive the requirements of Rule 25-17.0832, Florida Administrative Code, FPL should revise its standard offer contract to reflect the recommended changes and provide no less than a two week availability FPL should submit a revised standard offer contract and associated tarriffs no later than 60 days from the date of the Commission vote. [Dudley]

STAFF ANALYSIS: Pursuant to federal law, the availability of standard rates is required for fossil-fueled qualifying facilities (QFs) less than or equal to 100 kilowatts (0.1 MW) in size. 16 U.S.C. 2601 *et seq.*, 15 U.S.C. 791 *et seq.*, 16 U.S.C. 792 *et seq.*, 18 CFR 292.304. Florida law requires the Commission to "adopt appropriate goals for increasing the efficiency of energy consumption and increasing the development of cogeneration." Section 366.82(2), Florida Statutes. The Commission is further directed to "establish a funding program to encourage the development by local governments of solid waste facilities that use solid waste as a primary source of fuel for the production of electricity." Section 377.709, Florida Statutes.

These federal and state regulations are implemented in part by the Commission through its adoption of the standard offer contract rules. Pursuant to Rule 25-17.0832(4)(a), Florida Administrative Code, each investor-owned electric utility must file a tariff and a standard offer contract with the Commission. These provisions effectuate the requirements of the Public Utilities Regulatory Policies Act (PURPA) and promote renewables and solid waste facilities by providing a straightforward "no hassle" contract. Larger QFs and other non-utility generators may participate in a utility's Request For Proposal process, referred to as the bidding rule.

Staff believes that FPL's proposed standard offer contract and revised COG-2 tariff should be denied for the following reasons: 1) Contrary to the Commission's rule requirements, the proposed standard offer contract is not based on FPL's next avoided unit, 2) the proposed subscription limit does not accurately reflect the pool of currently eligible signatories thereby precluding at least one municipal solid waste facility, 3) Order No. 24989, issued August 29, 1991, prohibits "Regulatory Out Clauses" in standard offer contracts, and 4) FPL may have acted imprudently in filing its proposed standard offer contract at such a late date. The following sections address these concerns in greater detail.

Avoided Unit

To comply with the Commission's rules, FPL proposed a standard offer contract based on a hypothetical combustion turbine (CT) unit with an in-service date of January 1, 2001. This is the same unit FPL used to evaluate Demand-side management programs in the on-going Conservation Goals proceedings. FPL's April, 1998, and its April, 1999, *Ten Year Site Plan* identifies the Ft. Myers Repowering project as its next planned generation addition.[1] This project entails replacing the existing steam boilers with six 150 MW GE-7FA combustion turbines and Heat Recovery steam generators at the Ft. Myers site by January, 2002. The contract-based hypothetical CT has no relationship to the repowering project nor any of the proposed additions identified in FPL's current *Ten Year Site Plan*. Commission Rules require that standard offer contracts be based on a utility's "avoided unit" which is its next planned generating unit addition. More specifically, Rule 25-22.082(2), Florida Administrative Code, states that:

> Prior to filing a petition for determination of need for an electrical power plant pursuant to Section 403.519, Florida Statutes, each investor-owned electrical utility shall evaluate supply-side alternatives to its <u>next planned generating unit</u> by issuing a request for proposals. (Emphasis added)

Though this Rule pertains to those planned additions that are subject to the Florida Electric Power Plant Siting Act (PPSA), Rule

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[1] See Schedule 9 of FPL's 1998 and 1999 *Ten Year Site Plan* filings.

25-17.0832(2), Florida Administrative Code, encourages utilities and QFs to:

> ...negotiate contracts for the purchase of firm capacity and energy to avoid or defer the construction of <u>all planned utility generating units which are not subject to the requirements of Rule 25-22.082</u>. (Emphasis added)

In lieu of a separately negotiated contract, standard offer contracts are available to QFs as defined in Rule 25-17.0832(4)(a)1-3, Florida Administrative Code. Staff believes these rules collectively require investor-owned utilities to pursue construction deferring alternatives for their next planned resource additions, whether they are PPSA affected or unaffected. Basing a standard offer contract on something other than the next generating unit addition would render the intended construction deferring purpose of such an option meaningless. Moreover, it is likely that subsequent planned additions may indeed be delayed or modified from an original proposal, depending on load growth, the effect of demand-side management measures, and technological changes. See Order No. PSC-94-1008-FOF-EQ, issued August 22, 1994, whereby the Commission agreed that it was important that TECO not purchase standard offer capacity too far in advance of the avoided unit's in-service date.

Staff's position with respect to the correctness of basing a standard offer contract on a utility's next planned unit is consistent with Commission precedent recently affirmed in Docket Nos. 981346-EU and 981893-EU[2]. In resolving each of these matters, the Commission found it appropriate to base both Gulf Power Company's (Gulf) and Tampa Electric Company's (TECO) proposed standard offer contracts on their next planned generating unit. Gulf's next planned unit addition is required to go through the PPSA process whereas TECO's next planned unit addition is not.

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[2] DOCKET NO. 981346-EQ - Petition to Establish New Standard Offer for Purchase of Firm Capacity and Energy from Small Qualifying Facilities (Under 100 MW) or from Solid Waste Facilities by Gulf Power Company.

DOCKET NO. 981893-EQ - Petition to Establish New Standard Offer Contract for Qualifying Cogeneration and Small Power Production Facilities by Tampa Electric Company, Order No. PSC-99-0748-FOF-EQ, issued April 19, 1999.

Subscription Limit

After receiving FPL's Petition, staff contacted one potential standard offer contract signatory, the Lee County Resource Recovery Facility (Lee County), a 40 MW solid waste facility located within FPL's service territory. FPL currently purchases as-available energy from Lee County pursuant to its COG-1 tariff. This arrangement does not augment FPL's capacity reserve. Lee County has attempted to negotiate a contract with FPL whereby Lee County would also receive capacity payments for delivery of firm power and contribute towards FPL's reserve requirements. To date, FPL and Lee County have been unable to reach a negotiated agreement. Lee County has recently expressed a willingness to enter into a standard offer contract with FPL. However, FPL proposed a 5 MW subscription limit that would preclude Lee County from providing its full capacity to FPL. Staff notes that our Rules place no restrictions on standard offer contract subscription limits other than avoiding oversubscription of the avoided unit.

FPL advances two arguments in support of its proposed 5 MW subscription limit. First, FPL states that the generating capacity additions proposed to meet its currently planned need "provide system benefits not available from new facilities." Staff recognizes that the Ft. Myers Repowering project should provide improvements in the efficiency of FPL's existing generation facilities though recovery of associated costs has not been reviewed. Nonetheless, the intent of the Commission's cogeneration rules is to promote solid waste facilities and the use of renewable resources whether they are existing or potential facilities. Staff asserts that until current regulations are modified or repealed, standard offer contracts must continue to be made available and be based on a utility's next planned unit addition.

Secondly, FPL has alleged that the eligibility pool for standard offer contracts is limited and that it is highly unlikely that purchases made by FPL pursuant to the proposed contract will defer or avoid any utility generating facility. (Petition, pg. 2) Absent avoiding or delaying construction of a generating addition, signing standard offer contracts may result in FPL paying for unneeded capacity. In effect, the standard offer contract's firm capacity payments can be construed as a subsidy to the QF. Although undesirable, this potential subsidy is presently mandated by the requirements of federal law and the implementation of state regulations. Staff believes the untimeliness of FPL's filing is a major contributing factor to ensuring that any accepted standard offer contracts would not defer or avoid any portion of the Ft. Myers Repowering Project. In addition, staff believes that the small subscription limit proposed by FPL will indeed result in subsidization because 5 MW would not materially affect the timing or size of FPL's capacity need.

FPL's proposed standard offer contract replaces a previous contract approved by Order No. 24989[3]. That contract was for 125 MW of a 1997 907 MW Integrated Gasification Combined Cycle facility. In addressing FPL's proposed subscription limit in that proceeding, the Commission found that:

> FPL set its subscription amount by projecting the number of small Qfs that will be willing to sign a standard offer contract. Witness Cepero stated that FPL projects 125 MW of small Qfs that can deliver by 1997. (TR 320) No party has demonstrated that FPL's prediction is not reasonable. While it is difficult to project the number of Qfs who will want to sign a standard offer contract, we find that FPL has made a reasonable prediction. Therefore, FPL's proposal of a 125 MW subscription limit is approved.

Order at page 30.

FPL's petition in this docket never references any similar type of projection to substantiate its assumed "limited" eligibility pool. Staff believes the 5 MW limit needlessly excludes projects like Lee County which would nearly satisfy the approximately 45 MW of additional capacity needed by FPL to maintain its 15% reserve margin reliability criterion in the year 2002. Though potentially rendered unattainable by FPL due to the filing delay, a greater subscription limit conceptually provides an opportunity for standard offer contracts to affect the timing or size of FPL's capacity need.

Regulatory Out Clause

Within its proposed standard offer contract, FPL has opted to include a section entitled "Regulatory Disallowance", Section 18, Second Revised Sheet No. 9.857. This type of provision, more commonly referred to as a "Regulatory Out Clause", permits FPL to adjust a QF's scheduled payments based on some unforeseen

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[3] Order No. 24989, issued 8/29/91, Docket No. 910004-EU, "Planning Hearings on Load Forecasts, Generation Expansion Plans, and Cogeneration Prices for Florida's Electric Utilities", pages 70-72.

regulatory action. Staff recommends that FPL remove this section from its proposed standard offer contract. In Order No. 24989, the Commission instructed FPL and the other three large investor-owned electric utilities to remove the "Regulatory Out Clause" from standard offer contracts. In that decision, the Commission concluded that it would not allow utilities to include a "Regulatory Out Clause" in their standard offer contracts citing them as "unnecessary surplusage" given the Commission's commitment to allow recovery of the mandated payments. FPL appealed Order No. 24989 to the Supreme Court alleging that "the Commission's decision to eliminate the regulatory out clause was based on a misrepresentation of the doctrine of 'administrative finality' and the faulty legal conclusion that the finality of the Commission's decision rendered regulatory out clauses unnecessary." In Florida Power & Light Co. v. Beard, 626 So.2d 660, (Fla. 1993), the Supreme Court held that "the Commission's decision to remove regulatory out clauses from standard offer contracts with small QFs is supported by substantial competent evidence and consistent with the doctrine of administrative finality." FPL did not present any additional arguments beyond those previously made during the proceedings which culminated in Order No. 24989. Therefore, staff recommends that FPL submit revised tariff sheets that reflect removal of Section 18, "Regulatory Disallowance".

Clearly, FPL should have been aware of the Commission's decision to remove Regulatory Out Clauses from standard offer contracts. This places the Commission in the position of having to deny FPL's petition and then wait for FPL to refile its standard offer contract further delaying achievement of any capacity deferring benefits. As discussed in the following section, this timing problem has been exacerbated, in large part, due to FPL waiting so long to file with the Commission.

Timing

Staff began questioning FPL regarding its required filing immediately after FPL identified the Ft. Myers repowering as its next planned generation addition. On July 15, 1998, staff sent a letter to FPL questioning when it would be filing a petition seeking approval of a standard offer contract or, in the alternative, a waiver of Rule 25-17.0832(4). FPL was asked to respond by July 31, 1998. Staff again contacted FPL by letter on October 1, 1998, requesting that it provide an estimated date of filing and the avoided unit(s) the contract would be based on. This letter requested FPL to respond no later than October 15, 1998. FPL ultimately responded on October 15, 1998, and again on December 22, 1998, indicating that it would be filing a standard offer contract by January 22, 1999, based on a 5 MW portion of a 209 MW CT with an in-service date of January 1, 2002. The instant Petition was not filed until March 3, 1999 (see Attachment A letters). Staff believes FPL filing its proposed standard offer contract at such a late date suggests imprudence. It has essentially ensured that its ratepayers will subsidize any signed standard offer contract due to an inadequate opportunity to avoid any portion of FPL's next capacity addition.

Conclusion

Aside from being untimely, as filed, FPL's standard offer contract does not comply with either Rule 25-17.0832, Florida Administrative Code, or Order No. 24989, nor does it accurately recognize the current eligibility pool. The proposed contract is based on a purely hypothetical unit that is not part of FPL's current or previous generation expansion plan. The purpose of a standard offer contract is to offer small QFs, renewable, and municipal solid waste facilities a "no hassle" contract after all other cost-effective measures have been taken. The dual benefit of these contracts is that they encourage energy efficiency while avoiding or deferring the construction of generating plants at a cost no greater than that which would otherwise be incurred by an electric utility. To allow utilities to select avoided units other than their next planned addition as the basis for a standard offer contract renders the intent of the Commission's rules regarding these contracts meaningless. Furthermore, standard offer contracts must be offered in a timely fashion to minimize the possibility of subsidizing unneeded capacity. It is for these reasons as more fully discussed within the body of this recommendation that FPL's Petition should be denied. Staff further recommends that FPL should be required to file a revised standard offer contract consistent with this recommendation.

Upon filing revised tariff sheets, staff suggests that the revised standard offer contract remain available for a period of no less than two weeks from the date of Commission approval. This approach is consistent with the approach recently taken by Tampa Electric Company (TECO) in Docket No. 981893-EQ. In that case, TECO's planning process indicated that its next planned generating unit would need to be built sooner than expected. While TECO was not required to issue an RFP for the unit, there was no time to issue a standard offer contract that could effectively defer the necessity to construct the unit. In order to comply with the rule, however, TECO petitioned for approval of a standard offer contract based on that unit. The contract called for a brief open solicitation period of two weeks. By Order No. PSC-99-0748-FOF-EQ, issued April 19, 1999, the Commission approved TECO's petition.

ISSUE 2: Is it appropriate to include an equity adjustment when determining FPL's proposed standard offer contract payments?

RECOMMENDATION: Yes. If the proposed standard offer contract is approved in Issue 1, an equity adjustment as described in the supporting documentation to FPL's petition is appropriate. However, FPL should recalculate the capacity payments to reflect an equity adjustment based on a 10% risk factor. [Lester, Maurey]

STAFF ANALYSIS: A utility can add capacity by buying power with a long-term contract or by building generating plants. Both alternatives have advantages and disadvantages. Regarding financial risk, building capacity can involve adding debt to finance the construction, cost overruns, and regulatory lag. Buying power increases the utility's fixed charges, which, in turn, can reduce financial flexibility. Standard & Poor's (S&P) notes that, "regardless of whether a utility buys or builds, adding capacity means incurring risk."

Particularly since the passage of the National Energy Policy Act of 1992, bond rating agencies have viewed the fixed charges from long-term purchased power contracts in part as off-balance sheet debt equivalents. S&P's method for recognizing off-balance sheet obligations is to discount a utility's future capacity payments under a long-term purchased power contract at a 10% discount rate. Part of the present value of the capacity payments is added to the utility's balance sheet as debt for rating purposes. Financial ratios - including the equity ratio and interest coverage ratio - are adjusted for this off-balance sheet obligation. The risk factor, which is how much of the present value of capacity payments is treated as debt, depends on S&P's qualitative analysis of market, operating, and regulatory risks. These include the following:

Whether the contract is take-or-pay or take-and-pay, with take-or-pay being riskier;

Whether the power is economic and needed;

Whether there is a recovery clause for capacity payments;

Whether there is a regulatory out clause that passes disallowances to the seller;

Whether there are performance standards;

Whether the utility has a say in maintenance and dispatch; and

Whether the contract has been preapproved by regulators.

In its standard offer contract, FPL has included an "equity adjustment" reflecting the adjustment to the equity ratio that bond rating agencies make. In including this equity adjustment, FPL is reflecting the cost, in the form of less financial flexibility, that is imposed on electric utilities with purchased power contracts. Staff notes that the adjustment to a utility's equity ratio for the effects of purchased power is made only for bond rating purposes. For regulatory and accounting purposes, the amount of equity and debt on the utility's books is the actual amount and is not adjusted to reflect the effect of purchased power contracts.

The discussion of the perceived need for utilities to increase the level of equity in the capital structure to offset the adjustment made to the financial ratios by rating agencies and how this affects the overall cost of capital has not been specifically addressed by the Commission. Staff notes that there are persuasive arguments on both sides of the issue of who should be responsible for the incremental cost of additional equity to compensate for these contracts. Given the terms of the recently approved Stipulation and Settlement (Stipulation) involving FPL, staff believes FPL's current cost of capital includes recognition of this cost.

In Order No. PSC-99-0519-AS-EI issued March 17, 1999, the Commission approved the Stipulation entered into by FPL, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG), and the Coalition for Equitable Rates (the Coalition) to settle the issues raised in Docket No. 990067-EI. Provision 4 of the Stipulation caps FPL's adjusted equity ratio at 55.83% for surveillance purposes. This adjusted ratio equates to an actual ratio of 65.7% as reported in the Company's projected 1998 Rate of Return Report.

Staff recognizes the effect that purchased power contracts have on the utility's financial ratios as calculated by S&P. To be consistent with the terms of the Stipulation approved in Order No. PSC-99-0519-AS-EI which allows for the recovery of the "equity adjustment" through base rates, staff recommends FPL's adjustment to its standard offer contract to recognize the effect of purchased power contracts be approved to avoid possible double recovery. However, while staff recommends approval of FPL's request in the instant case due to the unique circumstances surrounding FPL's Stipulation, staff believes the broader policy issue of who should bear the incremental cost of additional equity to compensate for purchased power contracts has not been addressed.

Although the facts and circumstances in this case persuade staff to recommend this adjustment be included in the Company's standard offer contract, FPL calculated its equity adjustment using a 20% risk factor. Staff notes that FPL subsequently represented that S&P assigns a 10% risk factor to its existing cogeneration contracts. Therefore, if the Commission elects to approve FPL's standard offer contract in Issue 1, staff recommends that FPL recalculate the capacity payments to reflect an equity adjustment based on a 10% risk factor.

ISSUE 3: Should FPL's request for a variance from the ten year minimum contract term required by Rule 25-17.0832(4)(e), Florida Administrative Code, be granted?

RECOMMENDATION: No. FPL has not demonstrated that the purpose of the underlying statute will be met or that it will suffer substantial hardship if the variance is not granted. [Paugh]

STAFF ANALYSIS:

I. Standard Of Review For Rule Variance Requests.

Section 120.542, Florida Statutes (1997), 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 statute 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 it affects other similarly situated persons who are subject to the rule.

Thus, under the statute a person requesting a variance or waiver must affirmatively demonstrate that the purpose of the underlying statute has been met. In addition, the petitioner must demonstrate that it will either suffer "substantial hardship" or that "principles of fairness" will be violated. If the allegations relate to fairness, an additional proof of uniqueness to the petitioner is required by the statute.

As stated in the case background, FPL filed its Petition For A Variance From Rule 25-17.0832(4)(e) on March 3, 1999, in conjunction with its Petition For Approval Of A Standard Offer Contract. The variance requested by FPL is for a fixed standard

ISSUE 3: Should FPL's request for a variance from the ten year minimum contract term required by Rule 25-17.0832(4)(e), Florida Administrative Code, be granted?

RECOMMENDATION: No. FPL has not demonstrated that the purpose of the underlying statute will be met or that it will suffer substantial hardship if the variance is not granted. [Paugh]

STAFF ANALYSIS:

I. Standard Of Review For Rule Variance Requests.

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As stated in the case background, FPL filed its Petition For A Variance From Rule 25-17.0832(4)(e) on March 3, 1999, in conjunction with its Petition For Approval Of A Standard Offer Contract. The variance requested by FPL is for a fixed standard

Rules 25-17.080 through 25-17.0832, Florida Administrative Code. (Petition for Variance, pg. 4) In addition, FPL states that any cogeneration contracted for under the standard offer contract will not defer or avoid the construction of additional generating capacity. "To the extent that FPL's customers are required to make any capacity payments where no generation is avoided or deferred, FPL's electric consumers are prejudiced." (Petition For Variance, pg. 4) FPL's argument appears to be that a fixed five year standard offer contract term accomplishes the purpose of the statute to encourage cogeneration but at a cost to the ratepayers. Apparently, with the passage of time, the cost to the ratepayers becomes a substantial hardship.

III. FICA's Comments

Florida Industrial Cogeneration Association members own and operate small qualifying facilities which generate and sell electricity in conjunction with their industrial operations. FICA advances three arguments against the five year contract term requested by FPL. First, FICA argues that the Rule's minimum ten year term correlates to the value of deferral pricing mechanism and is, therefore, necessary to effectuate the intent of the rule. Second, FICA opines that the purpose of the underlying statute will not be met if FPL's variance request is granted. Third, FICA states that FPL's basis for a variance request is inadequate and is tantamount to rulemaking designed to abolish small QFs.

A. Value Of Deferral

FICA's first argument is that the objective of the value of deferral pricing mechanism for capacity payments, a component of the standard offer rules, will not be met if standard offer contracts are limited to five years. This is so, according to FICA, because value of deferral pricing assumes that a small qualifying facility will sell capacity to the utility over the projected useful life of the utility's avoided unit. (Comments, pg 3)

The value of deferral methodology inverts the capacity revenue stream in comparison to what the utility would receive if it constructed the avoided unit and added it to rate base. Value of deferral payments begin low and increase over time. (Comments, pg. 4) Traditional revenue requirements begin high and decrease over time. "The ten year minimum term was deemed necessary both from the utility planning perspective, and to be of sufficient length to confer substantial capacity benefit on the utility ratepayers." (Id.) *(Citing* Order No. 12634, issued September 27, 1983, Docket

NO. 820406-EU *In re: Amendment Of Rules 25-17.80 Through 25-17.89 Relation To Cogeneration.*)

B. Purpose of Underlying Statute

FICA's second argument is that the purpose of the underlying statute will not be met if the five year variance is granted. The underlying statute is designed to encourage cogeneration and small power production. (Comments, pg. 6) FPL's proposed five year fixed term guarantees less than full avoided cost payments to the cogenerator and will discourage, rather than encourage, cogeneration and small power production. (Comments, pg. 5) "Granting the waiver (sic) sought by FPL would deny SQF's the opportunity to provide electric generating capacity to FPL. Such a result would be contrary to both Florida and Federal law which favors QFs as an alternative to the construction of generating capacity by electric utilities." (Comments, pg. 7)

C. Inadequate Basis

FICA's third argument is that FPL has not adequately pled a basis for a variance. Citing the uniqueness requirement of Section 120.542, Florida Statutes, FICA states that FPL's request is based on "vague allegations and unsubstantiated opinions". (Comments, pg. 6) If granted, FICA asserts, FPL's request would defeat the underlying statutory objective and render the standard offer rules meaningless. (Comments, pg. 6 & 7) FICA states that FPL's petition is more in the nature of rulemaking insofar as it undermines the purpose of the rule. "FPL's request for approval of a standard offer and variance appears to be more properly cast as a request for wholesale amendment of the Commission's standard offer rules." (Comments, pg. 2) In sum, FICA argues that FPL's Petition For Variance should be denied because the request defeats the purpose of the statute and does not satisfy the burden of proof.

III. Analysis

A. Purpose Of The Underlying Statute

The purpose of Section 366.051, Florida Statutes, to encourage cogeneration and small power production, is express. "Electricity produced by cogeneration and small power production is of benefit to the public when included as part of the total energy supply of the entire electric grid of the state...." Rule 25-17.0832(4), Florida Administrative Code, implements Section 366.051, Florida

Statutes. Pursuant to the Rule, standard offer contracts must contain certain minimum specifications relating to, among other things, the term of the contract and the calculation of firm capacity payments. With respect to the term of standard offer contracts, Subsection 25-17.0832(4)(e)7, requires:

> Firm capacity and energy shall be delivered, <u>at a minimum</u>, for a period of ten years, commencing with the anticipated in-service date of the avoided unit specified in the contract. <u>At a maximum</u>, 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;
>
> Rule 25-17.0832(4)(e)7, Florida Administrative Code. (emphasis added)

The rule provides a range for the contract period tied to the plant life of the utilities' avoided unit by establishing a minimum and a maximum term for standard offer contracts.

The ten year minimum contract term, while not a requirement of PURPA, was mandated by the Commission in order to assist utilities and cogenerators with planning. In Order No. 12634, issued October 27, 1983, Docket No. 820406-EU, <u>Amendment of Rules 25-17.80 through 25-17.89 relation to cogeneration</u>, the Commission addressed the issue of a ten year minimum contract term. The Commission stated:

> The requirement that a QF be willing to sign a contract for the delivery of firm capacity for at least ten years after the originally anticipated in service date of the avoided unit is important from a planning perspective. While a ten-year contract will not offset the expected thirty year life of a base load generating unit, we believe it is of sufficient length to confer substantial capacity related benefits on the ratepayers.
>
> Order No. 12634, pg. 19.

In addition to the contract term, the Rule enunciates the methodology for the calculation of firm capacity payments. The value of deferral methodology is founded on and tied to the ten year minimum contract term.

> IMC, <u>et al</u>, urged us to adopt a capacity payment rule that would set a maximum cap on the level of permissible

> payments equal to the revenue requirements of a generic base load coal unit. We believe that the value-of-deferral methodology is superior to a revenue requirements methodology for a couple of reasons. First, revenue requirements are based on a thirty-year depreciation life for a power plant. The payments are relatively high in the early years and relatively low in the later years; if ratepayers receive service from the plant for thirty years, the disadvantage of high payments in the early years is offset by the benefit of low payments in the later years. That symmetry is missing if a QF makes only a ten-year commitment; a QF would receive the high end of the deferred revenue requirements stream without a concomitant obligation to provide service in exchange for relatively low deferred revenue requirements in later years. Second, capacity payments based on deferred revenue requirements would overpay the QF in early years, thus getting into the thorny problem of securing all capacity payments for a number of years, not just those made pursuant to the early payment option.
>
> The value-of deferral methodology overcomes these problems. First the deferral method pays the QF only what it earns in any given year, the value of an annual deferral, thus eliminating the security question in ordinary circumstances. Second, the value-of-deferral method will, over the thirty-year depreciation life of the avoided unit, pay a QF the same amount it would have received if its capacity payments had been based on deferred revenue requirements. That is, at the end of thirty years, a QF would have received the same total amount on a present value basis, under either methodology; the difference between the two methods lies in the level of payment in any given year in that thirty year period.
>
> Id.

It is clear from the foregoing that a minimum contract term of ten years was considered necessary to assure that capacity related benefits were conferred on a utility's ratepayers. Ten years is the point at which revenue requirements and value of deferral methodologies achieve theoretical symmetry. To encourage cogenerators to commit to contracts longer than ten years, the initial payment obligation was established at an artificially low level with increases occurring in the later years of the contract. It is within this regulatory framework that FPL's request for a variance for a maximum five year standard offer contract term must be considered.

Under the existing regulatory framework, cogenerators have the option of contracting for a period of time from ten to thirty years, depending on the anticipated plant life of the avoided unit. Because the majority of a cogenerator's payments are received in years eleven and higher, it would be neither logical nor prudent for a cogenerator to enter into a five year contract. Therefore, because the value of deferral pricing mechanism is dependent on long term standard offer contracts, the diminished contract period requested by FPL, without a concomitant adjustment of the pricing mechanism, will discourage cogeneration. As such, FPL has not demonstrated that the purpose of the underlying statute has been met.

B. Substantial Hardship

FPL has not met the burden of proof for a variance. An allegation of substantial hardship requires an affirmative demonstration by the petitioner of economic, technological or legal hardship. FPL does not demonstrate a nexus between contract years six through ten and the substantial hardship alleged to be borne by its ratepayers. Instead, it merely asserts that five years subjects it and its ratepayers to less risk. In support of its position, FPL avers that two bills currently before Congress would repeal Section 210 of PURPA giving rise to uncertainty surrounding the statutory foundation for FPL's obligations relative to cogeneration. The future effect of pending federal legislation is, at best, speculative and does not affirmatively demonstrate substantial hardship. FPL appears to have arbitrarily selected the half way point of the Rule's stated minimum requirement without any demonstrated link between the later contract years and hardship. In sum, FPL's petition for variance fails for lack of demonstrated substantial hardship.

FICA's argument that FPL has not demonstrated uniqueness, incorrectly applies the law of waivers and variances. Section 120.542, Florida Statutes states that when 'principles of fairness' are alleged to be violated, the petitioner must demonstrate application of the rule affects it differently than similarly situated persons subject to the rule. FPL did not allege that principles of fairness were violated, therefore, the standard does not apply.

In sum, FPL's Petition For Variance from the minimum standard offer contract term fails because it does not satisfy the mandatory, statutory requirements. FPL has not demonstrated that the purpose of the underlying statute will be met if the variance is granted. On the contrary, the purpose of the underlying statute will be undermined if FPL's variance request is granted because it will discourage, rather than encourage, cogeneration and small power production. In addition, FPL's Petition For Variance fails because there is no demonstrable substantial hardship.

Ideally, QFs should compete on *an* equal *footing in* the wholesale market with all other producers of electricity. However, until and unless there is a change in Federal and State law, QFs are to be given some preferential treatment. The Commission has minimized this unequal *footing* by *requiring* standard offer contracts only for small QF, renewable, or municipal solid waste facilities. These types of facilities may not be in a position to negotiate a purchased power agreement due to their size or timing. Thus, the Commission's rules balance market imperfections with the existing policy of promoting Qfs.

ISSUE 4: Should this docket be closed?

RECOMMENDATION: No. [Paugh]

STAFF ANALYSIS: Staff is recommending in Issue 1 that FPL's proposed standard offer contract and associated tariffs be denied as filed. Staff further recommends that FPL file a revised standard offer contract and associated tariffs that is consistent with Commission Rules as outlined in Issue 1. This docket should remain open to consider the revised filing. Such revision should be filed with the Commission no later than 60 days from the date of Commission vote. If a person whose substantial interests are affected protests the Commission's decision to deny the tariff, the matter will be set for hearing.