



Public Service Commission

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DATE: January 6, 2000

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

FROM: DIVISION OF ELECTRIC AND GAS (FUTRELL, DRAPER)
DIVISION OF LEGAL SERVICES (JAYE) *EJD CBW MF RVE DRW RKT*

RE: DOCKET NO. 991526-EQ - PETITION OF FLORIDA POWER CORPORATION FOR APPROVAL OF STANDARD OFFER CONTRACT AND ACCOMPANYING RATE SCHEDULE COG-2.

AGENDA: 01/18/00 - PROPOSED AGENCY ACTION EXCEPT FOR ISSUE TWO - RULE WAIVER AND TARIFF - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: Both the 60 day suspension and the 90 day decision on the rule waiver request deadlines were waived by the company on November 24, 1999.

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\EAG\WP\991526.RCM

CASE BACKGROUND

On October 8, 1999, Florida Power Corporation (FPC) 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 20 megawatt (MW) subscription limit of a 90 MW combustion turbine generating unit with an in-service date of January 1, 2001.

Along with its October 8, 1999, Petition, FPC filed a Petition for Waiver of Rule 25-17.0832(4)(e)(7), Florida Administrative Code (Petition for Waiver). FPC seeks a waiver from the 10 year minimum contract term required by the rule, and instead proposes the contracted be limited to a term of five years. The petition for rule waiver was noticed in the October 29, 1999, Florida

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Administrative Weekly. The comment period expired on November 12, 1999.

On November 12, 1999, the Florida Industrial Cogeneration Association (FICA) filed comments in opposition to FPC's petition. In its comments, FICA requests the Commission to enter an order: (1) denying FPC's petition and waiver request; (2) directing FPC to file a standard offer contract based on an appropriate avoided unit in full compliance with Commission rules; and (3), directing FPC to open a solicitation period on its standard offer contract ending October 1, 2000.

By letter dated November 24, 1999, FPC waived its right under Section 366.04, Florida Statutes, to a consent or suspension decision on its proposed tariff within 60 days of filing its petition. In the same letter, FPC also waived its right under Section 120.542, Florida Statutes, to a decision on its rule waiver request within 90 days of its petition.

This recommendation addresses both the petition for approval of the proposed standard offer contract and the requested rule waiver.

DISCUSSION OF ISSUES

ISSUE 1: Should FPC's petition for a waiver from the ten year minimum contract term required by Rule 25-17.0832(4)(e)(7), Florida Administrative Code, be granted?

RECOMMENDATION: Yes. FPC has demonstrated that the purpose of the underlying statute will be met, and that FPC and its ratepayers will suffer substantial hardship if the variance is not granted. (JAYE, FUTRELL)

STAFF ANALYSIS:

A. Standard Of Review

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.

The waiver requested by FPC is for a standard offer contract term limited to five years instead of the ten year minimum contract term required by Rule 25-17.0832(4)(e)(7), Florida Administrative Code.

B. FPC's Petition For Waiver

1. Purpose of the Underlying Statute

In its Petition For Waiver, FPC identifies the underlying statute implemented by the rule as Section 366.051, Florida Statutes. According to FPC, the purposes of the statute, and the purposes of the Public Utility Regulatory Policies Act of 1978 (PURPA), to encourage cogeneration while at the same time protecting ratepayers from paying costs in excess of avoided costs, will be achieved by utilizing a five-year contract term.

FPC states that its Petition For Waiver will meet the underlying purpose of the statute. FPC submits that new technologies and other factors may lower FPC's costs in the future. FPC contends that limiting the term of the standard offer contract to five years will give the company an opportunity to reassess its avoided costs and take advantage of lower costs for the benefit of ratepayers prior to the passage of ten years. FPC also states that PURPA and Section 366.051, Florida Statutes do not establish a minimum term for standard offer contracts.

2. Substantial Hardship

FPC argues that obligating it to a ten year contract term in the face of declining costs would subject the it to substantial hardship by adversely affecting its cost structure. FPC also states that ratepayers would be subjected to substantial hardship by raising the price that they would otherwise have to pay for electricity, in the face of declining costs.

C. FICA's Comments

Florida Industrial Cogeneration Association members own and/or 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 FPC.

1. 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. 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. Traditional revenue requirements begin high and decrease over time.

2. 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. FPC'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. "Granting the waiver sought by FPC would deny SQF's [small qualifying facilities] the opportunity to provide electric generating capacity to FPC. 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. 9)

3. Inadequate Basis

FICA's third argument is that FPC has not adequately pled a basis for a variance. Citing the uniqueness requirement of Section 120.542, Florida Statutes, FICA states that FPC's request is based on "vague allegations and unsubstantiated opinions". (Comments, pg. 8) If granted, FICA asserts, FPC's request would defeat the underlying statutory objective and render the standard offer rules meaningless. FICA states that FPC's petition is more in the nature of rulemaking insofar as it undermines the purpose of the rule. In sum, FICA argues that FPC's Petition For Variance should be denied because the request defeats the purpose of the statute and does not satisfy the burden of proof.

D. Analysis

1. 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, at a minimum, for a period of ten years, commencing with the anticipated in-service date of the avoided unit specified in the contract. At a maximum, firm capacity and energy shall be delivered for a period of time equal to the anticipated plant life of the avoided unit, commencing with the anticipated in service date of the avoided unit;

Rule 25-17.0832(4)(e)7, Florida Administrative Code.

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, Amendment of Rules 25-17.80 through 25-17.89 relation to cogeneration, 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.

The purpose of the underlying statute is to encourage cogeneration. To promote cogeneration, investor-owned utilities' planned generation units not subject to Rule 25-22.082, Florida Administrative Code, are encouraged to negotiate contracts for the purchase of firm capacity and energy with utility and nonutility generators. Rule 25-17.0837(1), Florida Administrative Code. The alternative provision is standard offer contracts. Insofar as cogenerators' ability to enter into negotiated contracts is unaffected by the waiver request, and a cogenerator retains the ability to enter into a five year minimum standard offer contract with FPC, FPC's request for a variance appears to satisfy the underlying purpose of the statute.

2. Substantial Hardship

An allegation of substantial hardship requires an affirmative demonstration by the petitioner of economic, technological or legal hardship. The hardship demonstrated by FPC is economic hardship to its ratepayers who may bear the risk of generation which is not avoided or deferred. Staff disagrees with FICA's argument that the value of deferral payment methodology compels a minimum ten year contract term. First, value of deferral is but one of four payment methodologies provided for in Rule 25-17.0832(g), Florida Administrative Code. Second, the value of deferral payments compensate the cogenerator for the service provided. For example, if a cogenerator signed a 12 year contract, it would be paid the value of deferring construction of an avoided unit for 12 years. The cogenerator would not be paid the entire cost of the unit because of the finite term of the contract.

3. Inadequate Basis

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FICA's argument that FPC 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. FPC did not allege that principles of fairness were violated, therefore, the standard does not apply.

In sum, staff believes that FPC's Petition For Waiver from the minimum standard offer contract term should be granted because it satisfies the mandatory, statutory requirements. Staff believes that FPC has demonstrated that the purpose of the underlying statute will be met if the variance is granted. This is so because cogeneration will continue to be encouraged through negotiated as well as standard offer contracts. In addition, staff believes that FPC's Petition For Waiver demonstrates substantial hardship to its ratepayers.

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ISSUE 2: Should the Commission initiate a rulemaking proceeding to amend Rule 25-17.0832(4)(e)(7) Florida Administrative Code.

RECOMMENDATION: Yes. Staff believes that the Commission should amend Rule 25-17.0832(4)(e)(7), Florida Administrative Code, to allow for five year fixed term standard offer cogeneration contracts.

STAFF ANALYSIS: Staff believes that the Commission should be aware of the number of requests for variance or waiver of Rule 25-17.0832(4)(e)(7), Florida Administrative Code, that it is receiving. In at least two dockets, Docket No. 991973-EI, and the present docket, utilities have requested a variance of this rule. Both of these instances have occurred since Order No. PSC-99-1713-TRF-EG was issued on September 2, 1999, in Docket No. 990249-EG, granting Florida Power and Light Company a variance of this rule. Staff recommends that if the Commission believes that five year terms for standard offer cogeneration contracts are sufficient, that the Commission initiate rulemaking proceedings to amend the contract term provision of Rule 25-17.0832(4)(e)(7), Florida Administrative Code.

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ISSUE 3: Should FPC's petition for approval of a new Standard Offer Contract, based upon a combustion turbine unit with an in-service date of 2001, be approved?

RECOMMENDATION: Yes. FPC's new Standard Offer Contract complies with Rule 25-17.0832, Florida Administrative Code. (FUTRELL, DRAPER)

STAFF ANALYSIS: Pursuant to federal law, the availability of standard rates is required for fossil-fueled qualifying facilities less than 100 kilowatts (0.1 MW) in size. 16 U.S.C. 2601 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." Chapter 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." Chapter 377.709, Florida Statutes.

These federal and state requirements were implemented by the Commission through its adoption of the Standard Offer Contract in Rule 25-17.0832(4)(a), Florida Administrative Code. Pursuant to this rule, each investor-owned electric utility must file a tariff and a Standard Offer Contract with the Commission. These provisions implement the requirements of the Public Utilities Regulatory Policies Act and promote renewables and solid waste-fired facilities by providing a straightforward contract. Larger qualifying facilities and other non-utility generators may participate in a utility's Request For Proposal process pursuant to Rule 25-22.082, Florida Administrative Code.

To comply with Rule 25-17.0832(4)(a), Florida Administrative Code, FPC proposed a new Standard Offer Contract based on a combustion turbine (CT) unit with an in-service date of January 1, 2001. Specifically, the Contract is based on a 20 MW portion of a 90 MW CT.

FPC's proposed COG-2 (firm capacity and energy) tariff shall expire on the earlier of the date the subscription limit (20 MW) is fully subscribed, or July 1, 2000. Staff believes that the nearly six month open season period will increase the probability that FPC will receive offers under its proposed Standard Offer Contract.

FPC's evaluation criteria should be readily understandable to any developer who signs FPC's Standard Offer Contract. The avoided unit cost parameters appear to be reasonable for a CT unit, and the

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resulting capacity payments are appropriate. The performance provisions include dispatch and control, and on-peak performance incentives.

Given that the subscription limit of FPC's avoided unit is only a portion of its total capacity, purchases made by FPC pursuant to the proposed Standard Offer Contract will not result in the deferral or avoidance of the 2001 CT unit. If FPC enters into Standard Offer Contracts, but the need for the 2001 CT unit is not deferred or avoided, FPC will essentially be paying twice for the same firm capacity. Therefore, the requirements of federal law and the implementation of state regulations discussed above may result in a subsidy to the qualifying facilities. Staff notes, however, that the potential subsidy could be mitigated, as FPC may have opportunities to sell any surplus capacity to the wholesale market.

Ideally, qualifying facilities should compete on equal footing with all other producers of electricity. However, until and unless there is a change in federal and state law, qualifying facilities are to be given some preferential treatment. The Commission has minimized this unequal footing by requiring Standard Offer Contracts only for small qualifying facilities, renewables, 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 qualifying facilities.

In summary, staff does not expect that FPC's proposed Standard Offer Contract will result in the avoidance of the 2001 CT unit. Nonetheless, FPC's proposed contract and tariffs comply with the Commission's cogeneration rules. For this reason, staff recommends that FPC's petition to establish its new Standard Offer Contract and associated tariffs be approved.

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ISSUE 4: On what date should FPC's proposed Standard Offer Contract become effective?

RECOMMENDATION: Florida Power Corporation's proposed standard offer contract should become effective upon the issuance of a consummating order if there is no timely protest filed.

STAFF ANALYSIS: Since it would not be reasonable to have this tariff go into effect if the waiver portion of the Commission's order were protested, the tariff should be processed as a proposed agency action. Florida Power Corporation's proposed standard offer contract should become effective upon the issuance of a consummating order.

ISSUE 5: Should this docket be closed?

RECOMMENDATION: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order.

STAFF ANALYSIS: In order to process both the waiver request and the tariff filing simultaneously we recommend that the proposed agency action process be utilized instead of the tariff process. While both processes provide for a point of entry for protest, under the tariff process, if there is a protest, the tariff would go into effect pending the outcome of the hearing; whereas under the proposed agency action process, if protested, the tariff would not go into effect as the proposed agency action order becomes a nullity. Since it would not be reasonable to have this tariff go into effect if the waiver portion of the Commission's order were protested, the tariff should be processed as proposed agency action. If there is no timely protest, the docket should be closed.