State of Florida

# 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:** AUGUST 24, 2000

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

**FROM:** DIVISION OF SAFETY AND ELECTRIC RELIABILITY (HAFF, BOHRMANN, HARLOW, LEE) Tb
DIVISION OF ECONOMIC REGULATION (LESTER)
DIVISION OF LEGAL SERVICES (C. KEATING)

**RE:** DOCKET NO. 000982-EI - PETITION BY FLORIDA POWER & LIGHT COMPANY FOR APPROVAL OF CONDITIONAL SETTLEMENT AGREEMENT WHICH TERMINATES STANDARD OFFER CONTRACTS ORIGINALLY ENTERED INTO BETWEEN FPL AND OKEELANTA CORPORATION AND FPL AND OSCEOLA FARMS, CO.

**AGENDA:** 09/05/00 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

**CRITICAL DATES:** PAA ORDER REQUIRED BY OCTOBER 19, 2000 TO SATISFY CONDITION OF SETTLEMENT AGREEMENT

**SPECIAL INSTRUCTIONS:** ATTACHMENT IS NOT PART OF ELECTRONICALLY FILED VERSION

**FILE NAME AND LOCATION:** S:\PSC\SER\WP\000982.RCM

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## CASE BACKGROUND

On August 29, 1991, the Commission issued Order No. 24989, in Docket No. 910004-EU, which required Florida Power & Light Company (FPL) to issue a standard offer contract for up to 125 megawatts (MW) of capacity. The capacity and energy payments for the standard offer contract were based on FPL's next avoided unit, the 1997 stage of an Integrated Coal Gasifier Combined Cycle unit.

On September 20, 1991, Okeelanta Corporation (Okeelanta) and Osceola Farms, Co. (Osceola) (collectively, QFs) submitted signed standard offer contracts to FPL. The Okeelanta contract was to provide FPL with 70 MW of firm energy and capacity starting on

January 1, 1997 and continuing through 2026. The Osceola contract was to provide 42 MW of firm energy and capacity (subsequently upgraded to 55.9 MW under a provision of the contract) to FPL from January 1, 1997 through 2026. On March 11, 1992, by Order No. PSC-92-0050-FOF-EQ issued in Docket No. 911140-EQ, both standard offer contracts were approved by the Commission for cost recovery.

A dispute arose between FPL and the QFs concerning whether the QFs accomplished commercial operation by January 1, 1997, as set forth in Section 2 of the standard offer contract, and the effect, if any, of a failure to do so on the parties' respective rights and obligations under the various provisions of the standard offer contract. FPL reviewed the output of the facilities prior to January 1, 1997, and determined that the facilities had not achieved commercial operation. Therefore, FPL chose not to exercise what it believed to be its option to extend the commercial operation deadline. The QFs disagreed with FPL's interpretation of this option. FPL initiated litigation in state circuit court to determine its rights under the standard offer contract. The QFs subsequently filed a countersuit seeking approximately $490 million in damages for breach of contract.

The QFs filed for bankruptcy in May, 1997. However, the bankruptcy court ruled that the litigation in state circuit court could continue. Operations at both QF locations were shut down in September, 1997. The Okeelanta facility was restarted in February, 1998. FPL is currently purchasing energy from this facility on an as-available basis. The Osceola facility has not been restarted.

On July 28, 2000, FPL filed a petition for approval of a Conditional Settlement Agreement (Agreement) to buy out the QF standard offer contracts. The Agreement calls for the following:

(1) termination of the QF standard offer contracts;

(2) settlement of all claims by and/or against FPL; and,

(3) settlement of the pending judicial proceedings relating to the QF contracts.

In return, FPL would make a one-time payment of $222.5 million to the QFs. FPL stated in its petition that, "Approval of the Agreement will not only resolve the pending disputes and claims, it will eliminate the risk and uncertainty of litigation, and will enable FPL to reduce the cost exposure of FPL customers under the Okeelanta and Osceola Standard Offer Contracts." To date, FPL has spent approximately $7.6 million on attorney's fees and court costs related to the contract litigation. Approximately $6.9 million of these fees and costs have been approved for recovery from FPL's ratepayers through the Energy Conservation Cost Recovery Clause.

FPL's petition further requests approval for recovery of the $222.5 million settlement payment through FPL's Capacity Cost Recovery Clause (capacity clause) and/or Fuel and Purchased Power Cost Recovery Clause (fuel adjustment clause). FPL's petition does not specify a cost recovery methodology; rather, FPL plans to raise this issue in the upcoming fuel adjustment clause proceedings scheduled for November, 2000.

FPL also requests expedited approval of its petition in order to meet timing requirements of the Agreement. These timing requirements were established in order to resolve this matter prior to the scheduled April 9, 2001 hearing in state circuit court. The Agreement provides that all conditions precedent to its effectiveness, including the Commission's approval, should be completed four months prior to this trial date. Thus, a final Commission order, with all appeals exhausted, is required by December 9, 2000, for the agreement to become effective. Allowing 21 days for potential protests and 30 days for potential appeals if the Agreement is approved, the Commission's proposed agency action (PAA) order would be required by October 19, 2000, to satisfy the conditions of the Agreement.

The Commission is vested with jurisdiction over this matter through several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, 366.051, 366.06, and 366.80-.82, Florida Statutes.

## DISCUSSION OF ISSUES

**ISSUE 1:** Should the Commission approve Florida Power & Light Company's Petition for Approval of Agreement to Buy Out the Okeelanta Corporation and Osceola Farms Standard Offer Contracts?

**RECOMMENDATION:** Yes. The Agreement appears to be cost-effective and in the best interest of FPL's ratepayers. The Agreement will enable the Okeelanta and Osceola facilities to become merchant plants on the electric grid, thus mitigating potential price spikes in the wholesale electricity market. If the Agreement is approved, FPL should adjust the capital structure in its earnings surveillance reports to comply with the equity ratio cap contained in the stipulation approved by the Commission in Order No. PSC-99-0519-AS-EI.

**STAFF ANALYSIS:** As a condition of the Agreement, FPL proposes to make a one-time payment of $222.5 million to the QFs in return for termination of FPL's responsibilities under its standard offer contracts and settlement of all claims arising from its litigation with the QFs. Even after accounting for the lump-sum payment, FPL expects that the termination of these contracts will save its ratepayers approximately $412 million on a net present value (NPV) basis. The $412 million savings is the net result of comparing the total cost of capacity and energy payments that would have been paid under the contracts ($1.1092 billion) to the sum of the settlement payment($222.5 million) and the replacement capacity and energy cost ($474.7 million). See Attachment A.

There appear to be four possible outcomes to the pending litigation between FPL and the QFs. These four outcomes, and their potential cost to FPL's ratepayers, are summarized below:

| OUTCOME OF LITIGATION | COST TO FPL'S RATEPAYERS |
|---|---|
| FPL prevails in litigation | FPL's attorney's fees and court costs (approx. $7.6 million) |
| Agreement APPROVED, litigation ends | Settlement payment ($222.5 million) |
| QFs prevail in litigation | Breach of contract award to QFs ($490 million) |
| Court orders performance of QF contracts | Value of QF contract payments ($1.1092 billion NPV) |

FPL has not requested a Commission decision on the mechanism (e.g., fuel adjustment clause, capacity clause, or combination of the two) for recovering the Agreement's costs from FPL's ratepayers. FPL plans to raise this issue in the upcoming fuel adjustment clause and capacity clause proceedings. However, assuming a worst-case scenario in which the entire $222.5 million is recovered over a one-year period through the fuel adjustment clause, the fuel adjustment charge would increase over that year by approximately 0.25 cents/kWh, or 12%. This translates into a $2.50 monthly bill increase for a typical residential customer using 1,000 kWh per month.

If a lump-sum payment is assumed, the Agreement has a four-year payback because the high-cost standard offer contract capacity is replaced with cheaper electricity from FPL's own system. Even though the combined capacity of the QF contracts is about 126 MW, removal of the units from FPL's expansion plan does not cause much change. FPL's base-case generation expansion plan, which for the last three years has not included the QFS, is substantially the same as an expansion plan which incorporates the QFS. Both expansion plans are identical until 2006.

Both QF facilities burn biomass as a generator fuel. Approval of the Agreement by the Commission and the courts will free up these facilities from their standard offer contracts, thus making them the first renewable merchant plants in the state. The facilities could then operate to mitigate potential price spikes in the wholesale electricity market.

The Agreement differs from past buyout settlements of cogeneration contracts which the Commission has considered, such as those between FPC and Lake Cogen, Pasco Cogen, and Orlando Cogen. In those three cases, there was a dispute over which baseline to use to evaluate the cost-effectiveness of the buyout. In this case, FPL's dispute with the QFS is over contract performance.

From a financial perspective, the Agreement will reduce FPL's off balance sheet liabilities, which, in turn, will increase its adjusted equity ratio. The adjusted equity ratio for FPL was capped at 55.83% in the stipulation approved by Order No. PSC-99-0519-AS-EI, issued March 17, 1999. The off balance sheet liability associated with the QF facilities is $61,721,894 as of June 30, 2000. Removal of the off balance sheet liability, in accordance with the Agreement, will increase FPL's adjusted equity ratio from 56.40% to 56.81% as of June 30, 2000. Staff believes that FPL should adjust the capital structure in its earnings surveillance reports to comply with the equity ratio cap in the Agreement.

If approved, the $222.5 million lump-sum payment will create a regulatory asset. FPL intends to address the recovery of this regulatory asset, including a return on the unrecovered balance (carrying costs), at the upcoming fuel adjustment clause and capacity clause proceedings. Specifically, FPL's financing of the lump-sum payment and the immediate tax deductibility of the payment will affect the appropriate return on the unrecovered balance.

Based on staff's review of the Agreement and of data provided by FPL, the Agreement appears cost-effective and in the best interests of FPL's ratepayers. Therefore, staff recommends that the Commission approve FPL's petition.

**ISSUE 2**: Should this docket be closed?

**RECOMMENDATION:** Yes. 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**: At the conclusion of the protest period, if no protest is filed, this docket should be closed upon the issuance of a consummating order.

08/22/2000

## Okeelanta/Osceola Settlement

**Savings to Customers Based on Proposed Settlement**

| | DISCOUNTED $ | | NOMINAL $ | |
|---|---|---|---|---|
| Net Present Value (1/1/2001 $) of Contract Payments to Okeelanta/Osceola | $1,109,222,959 | (a)+(b) | $2,900,557,014 | (a)+(b) |
| Net present Value of Capacity and Energy Avoided by Okeelanta/Osceola | (474,692,979) | | (1,110,917,058) | |
| Settlement Payment to Okeelanta/Osceola | (222,500,000) | | (222,500,000) | |
| **Net Savings to Customers from Settlement** | $412,029,980 | | $1,567,139,956 | |

| | | | | |
|---|---|---|---|---|
| Okeelanta | $620,624,263 | (a) | $1,615,750,986 | (a) |
| Osceola | 488,598,696 | (b) | 1,284,806,028 | (b) |
| | $1,109,222,959 | | $2,900,557,014 | |

**Comments:**
Discount rate is 8.4%
Contract Payments assumed to start 1/1/2001
All $ are year 2001 (or 12/31/2000)

Attachment A