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: DECEMBER 26, 2001

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF SAFETY & ELECTRIC RELIABILITY (HARLOW, BOHRMANN, BREMAN, LEE) WBM
DIVISION OF LEGAL SERVICES (DODSON) RVE JDJ

RE: DOCKET NO. 011365-EQ - PETITION FOR APPROVAL OF AN AMENDMENT TO COGENERATION CONTRACT WITH THE BAY COUNTY RESOURCE RECOVERY FACILITY, BY FLORIDA POWER CORPORATION

AGENDA: 01/08/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\SER\WP\011365.RCM

CASE BACKGROUND

On June 17, 1988, by Order No. 19509, the Commission approved a contract for the purchase of capacity and energy between Florida Power Corporation (FPC) and Bay County. FPC signed the negotiated contract for the purchase of 11 megawatts of capacity and associated energy from the County's Resource Recovery Facility on April 29, 1988. The contract expires on December 31, 2022. The contract provided for early capacity payments to Bay County by applying the capacity and O&M payments from the out years (2013 to 2022) to the County in the first five years of the contract (1988 to 1994) on a present-valued, levelized basis. Years 2013 through 2022 of the contract provide firm energy with no capacity payments. A series of capacity buy-down options are also included in the contract. Consistent with Rule 25-17.0832(3)(c), Florida Administrative Code, the contract establishes a contingent liability for the County to reimburse FPC for early capacity payments if a capacity buy-down option is exercised or in the event of a default.

On October 16, 2001, FPC filed a petition for approval of an amendment to its purchased power contract with the Bay County Resource Recovery Facility. The amendment: 1) terminates the contract in 2006 rather than 2022; 2) eliminates the County's contingent liability, currently valued at approximately $21.1 million; 3) requires FPC to pay consulting fees of $610,000 incurred by Bay County; and, 4) provides Bay County with the option to reduce capacity by 1 MW beginning in 2005. FPC requests approval of the Amendment to the current contract for cost recovery purposes.

Issue 1: Should Florida Power Corporation's petition for approval of an amendment to the purchased power contract with the Bay County Resource Recovery Facility be approved?

Recommendation: No. Under the amendments, FPC's ratepayers will: 1) experience an immediate cost increase of $610,000 in exchange for estimated benefits that do not occur until 2007; 2) lose the benefit of zero capacity payments for firm energy from 2013 through 2022; and, 3) lose reimbursement of approximately $21.1 million for early capacity payments in the event of a buy-down of capacity or default by Bay County.

Staff Analysis:

The Existing Contract: FPC's negotiated contract with Bay County for the purchase of 11 megawatts of firm capacity and energy is a 34 year value of deferral contract beginning in 1988 and expiring on December 31, 2022. The contract provided Bay County with early capacity and O&M payments, beginning seven years earlier than the in-service date for the statewide avoided unit used in pricing FPC's standard offer contract. Under the contract, the capacity and O&M payments for 2013 through 2022 were paid to Bay County in 1988 through 1994, on a present-valued, levelized basis. Capacity payments for 1995 through 2013 under the contract are lower than those for the standard offer contract. As stated in Order No. 19509, at the time the negotiated contract was signed, the cumulative present value benefit to FPC's ratepayers was $1,843,000 over the 34 year term of the contract when compared to the standard offer contract. Because Bay County received early capacity payments relative to the standard offer contract, FPC's ratepayers did not begin receiving cost reduction benefits from the contract until 1995. These benefits occur partially due to the reduced capacity payments in years 1995 through 2013. However, the primary benefit occurs due to the zero capacity payments for firm energy in years 2013 through 2022.

As stated by Section 6 of the contract, "The parties recognize that capacity payments paid prior to January 1, 1995, are in the nature of "early payment" for a future capacity benefit to the Company. To ensure that the Company will receive a capacity benefit for which early capacity payments have been made, or alternatively, that the QF will repay the amount of early payments received to the extent the capacity benefit has not been conferred," the contract establishes a contingent liability for Bay

County to reimburse FPC in the event of default or certain buy-down provisions. This liability is represented by a Capacity Account that keeps a cumulative balance of all early capacity payments paid prior to the in-service date of the statewide unit. After January 1, 1995, the Capacity Account is debited for the difference between the capacity payments under the contract and those under the standard offer contract. Interest accrues to the Capacity Account in the amount of 10.72 percent per year. The balance in the Capacity Account, representing Bay County's contingent liability, is $21.1 million as of December 2001, growing to $44.1 million by 2012. FPC provided a graph of the capacity account balance over the life of the contract, which is included as Attachment A. As can be seen in Attachment A, the balance of the Capacity Account continues to increase until capacity payments cease in 2013.

Section 8.5 of the contract contains several buy-down provisions which are relevant to the proposed contract amendment. Prior to January 1, 2005, Bay County may buy-down up to 5 megawatts of capacity. After January 1, 2005, Bay County may buy-down up the entire 11 megawatts. These amendments require notice of 6 months for under 6 megawatts and 36 months for greater than 6 megawatts. The capacity must be used to provide steam sales to other members of the industrial park in which the QF is located. According to the contract, if Bay County exercises any of the buy-down provisions, FPC must be reimbursed for early capacity payments. Bay County is liable for the balance of the Capacity Account multiplied by the percentage of total capacity reduction.

The Proposed Contract Amendments: FPC provided a letter agreement between FPC and Bay County which outlines the proposed contract modifications. FPC did not provide a type and strike copy of the existing agreement.

The modifications include:

- The contract will expire on December 31, 2006, rather than December 31, 2022.
- The balance of the Capacity Account will be eliminated immediately, removing Bay County's liability for default or specified capacity buy-downs.
- FPC will pay $610,000 to Bay County to cover the County's consulting fees associated with the contract amendment. A

representative of FPC stated that this is estimated to cover all of Bay County's consultant costs.

- Bay County will have the option to reduce capacity by 1 megawatt beginning in 2005. This capacity reduction will not require a payment by Bay County to FPC of a portion of the liability account, as required by the current contract.

FPC's Analysis of the Impact to Retail Ratepayers:

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

FPC views the amendments as an opportunity to shift ratepayer savings from the later years of the contract (2013 through 2022) to 2007 through 2012. According to FPC, these savings occur because the capacity and energy costs of the existing contract are higher than estimated market costs for 2007 through 2012. Ratepayer costs would increase in 2002 ($610,000 payment to Bay County) and in 2013 through 2022. Market costs of replacement power are expected to be higher in 2013 through 2022 because FPC pays no capacity costs for these years under the existing contract.

Staff's Analysis of the Impact to Retail Ratepayers:

Staff agrees with FPC that the proposed amendments will allow FPC to go to the market sooner to replace the contract's capacity and energy with a potentially less expensive power source in years 2007 through 2012. However, staff notes that the proposed amendments to FPC's contract with Bay County will impose the following costs on FPC's ratepayers:

- FPC proposes to recover a $610,000 payment made to Bay County in 2002. Recovery through the fuel clause will result in an immediate rate impact. The payback period for these costs does not occur until 2007.

- FPC's ratepayers will lose the benefits of the later years of the contract. Years 2013 through 2022 provide firm energy with no capacity payments. FPC estimates that market costs for replacement power will exceed the contract costs in these years. As stated above, at the time the negotiated contract was signed, the cumulative present value benefit to FPC's ratepayers was $1,843,000 over the 34 year term of the contract when compared to the standard offer contract. The bulk of these benefits were expected to occur in 2013 through 2022, due to the lack of capacity payments.

- Perhaps most importantly, the contract amendments would release Bay County from its contingent liability. As explained in Order No. 19509 and consistent with Rule No. 25-17.0832(3)(c), F.A.C., this liability was established to reimburse FPC's ratepayers for early capacity payments received by Bay County in the event of a capacity buy-down or default. FPC's estimate of the benefits from the proposed amendments neglects to include the loss of this liability to its ratepayers. The contract amendments negate this liability immediately, placing FPC's customers at risk in the event of any capacity buy-down or default occurring prior to 2006. Bay County's liability is estimated at $21.1 million as of December 2001. The liability is estimated at $29.5 million as of December 2006, the proposed contract expiration date. The liability account will grow to a maximum of $44.1 million in 2012, and will then decrease each year, resulting in a zero balance in May, 2021. The value of this liability is greater today than the $17.2 million net present value of the capacity payments (2007 through 2012) FPC's ratepayers would be relieved of under the amendment. Order No. 19509 assigns any payments from this liability to FPC's ratepayers in order to guarantee that ratepayers are reimbursed for early capacity payments, stating, "...we find that all liquidated damages collected pursuant to this contract shall be completely credited to FPC's fuel adjustment account." Staff therefore believes that any amendment which provides for early termination of the contract should include a continuation of Bay County's contingent liability until the revised termination date.

Staff recommends that FPC's petition for approval of an amendment to the purchased power contract with Bay County be denied. The benefits of the proposed contract amendments appear to favor Bay County, rather than FPC's ratepayers. Bay County will be released from a $21.1 million contingent liability and will be free to sell its capacity at market beginning in 2007. FPC's ratepayers will experience an immediate cost increase of $610,000 in exchange for estimated benefits that do not occur until 2007. FPC's ratepayers will also lose the benefit of free capacity in the later years of the contract. Perhaps most importantly, FPC's ratepayers will lose the benefits from any buy-down of capacity or default on the part of Bay County. Any payments from this contingent liability by Bay County were guaranteed to FPC's ratepayers by Order No. 19509 to compensate ratepayers for early capacity payments made to Bay County. Staff therefore believes that early termination of the contract should include a continuation of Bay County's contingent liability until the revised termination date.

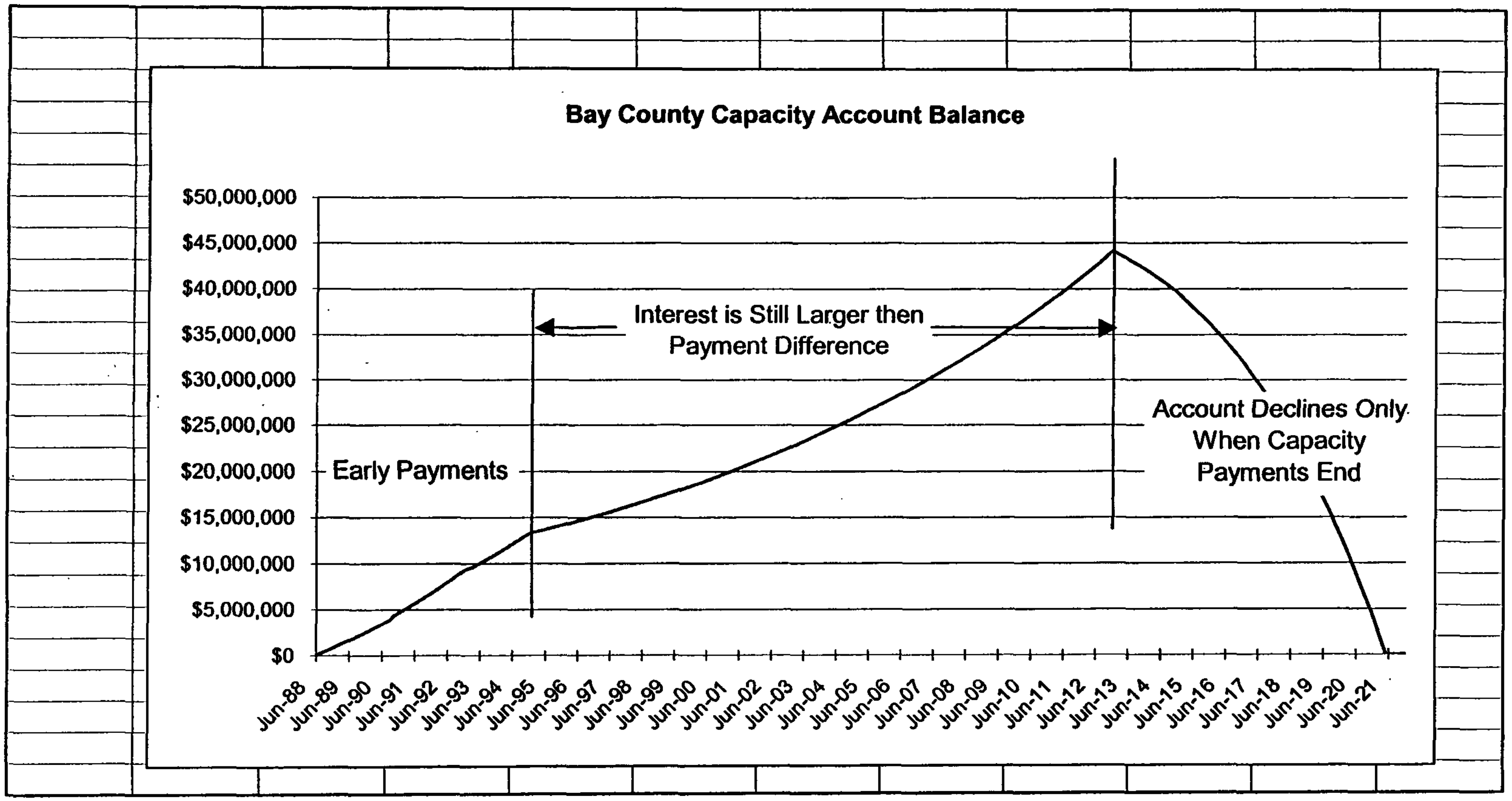
Issue 2: Should this docket be closed?

Recommendation: Yes, if no protest is filed within 21 days of the issuance of the order.

Staff Analysis: 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.

Attachment A

Graph



Attachment B

Exhibit C

Bay County Early Termination Comparison

Based on PROSYM Analysis

Year	Existing Capacity	Energy	Existing Total	Modified Capacity	Energy	Replacement and Added Costs	Modified Total	Savings/(Cost)
2002	$2,483	$1,673	$4,156	$2,483	$1,673	$610 *	$4,766	-$610
2003	$2,639	$1,693	$4,332	$2,639	$1,693		$4,332	$0
2004	$2,803	$1,783	$4,586	$2,803	$1,783		$4,586	$0
2005	$2,979	$1,245	$4,224	$2,979	$1,245		$4,224	$0
2006	$3,165	$1,264	$4,429	$3,165	$1,264		$4,429	$0
2007	$3,363	$1,283	$4,646			$2,567	$2,567	$2,079
2008	$3,575	$1,307	$4,882			$2,229	$2,229	$2,653
2009	$3,798	$1,323	$5,121			$2,539	$2,539	$2,582
2010	$4,036	$1,337	$5,373			$2,256	$2,256	$3,117
2011	$4,290	$1,350	$5,640			$2,487	$2,487	$3,153
2012	$4,569	$1,367	$5,936			$2,468	$2,468	$3,468
2013		$1,377	$1,377			$2,623	$2,623	-$1,246
2014		$1,391	$1,391			$2,569	$2,569	-$1,178
2015		$1,405	$1,405			$2,680	$2,680	-$1,275
2016		$1,423	$1,423			$2,621	$2,621	-$1,198
2017		$1,433	$1,433			$2,742	$2,742	-$1,309
2018		$1,447	$1,447			$2,690	$2,690	-$1,243
2019		$1,462	$1,462			$2,809	$2,809	-$1,347
2020		$1,481	$1,481			$2,792	$2,792	-$1,311
2021		$1,491	$1,491			$2,972	$2,972	-$1,481
2022		$1,506	$1,506			$2,859	$2,859	-$1,353
							NPV @ 8.94%	**$4,367**
							Sum	**$3,501**

* Denotes the added up front costs for 2002 of $610,000.