



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-

RECEIVED 11:00 AM  
02 MAR - 7 11:19:53  
COMMISSION CLERK

DATE: MARCH 7, 2002  
TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK ADMINISTRATIVE SERVICES (BAYO)  
FROM: DIVISION OF ECONOMIC REGULATION (HARLOW, BOHRMANN, BREMAN, LEE) *RV ENH as JDT*  
OFFICE OF THE GENERAL COUNSEL (ELIAS) *1988*  
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: 03/19/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE  
SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\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 (County). The negotiated contract provides FPC with 11 megawatts of capacity and associated energy from the County's Resource Recovery Facility. 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 seven years of the contract (1988 through 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

DATE: March 7, 2002

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. As filed on October 16, 2001, the original Amendment: 1) terminates the contract in 2006 rather than 2022; 2) eliminates the County's contingent liability; 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, with no charge to Bay County from the liability account. FPC requested approval of the Amendment to the current contract for cost recovery purposes.

On December 26, 2001, staff filed a recommendation to deny FPC's petition. This recommendation was scheduled to be addressed at the January 8, 2002, Agenda Conference. FPC requested that this item be deferred to allow additional discussions between the parties. Staff subsequently withdrew the original recommendation and met with representatives of FPC, Bay County, and the Office of Public Council. These discussions did not result in a change in the Amendment. Consequently, on February 21, 2002, staff filed a revised recommendation to deny the Amendment. Staff's February 21, 2002, recommendation included several options suggested by staff in the meetings with the parties which would make the proposed Amendment more favorable for FPC's ratepayers.

On February 27, 2002, FPC filed a revised Amendment which was approved by FPC and the Bay County Commissioners on February 26, 2002. This revised Amendment is consistent with one of the options suggested by staff in its February 21, 2002, recommendation. Staff subsequently withdrew the recommendation filed on February 21, 2002.

The revised Amendment, as filed on February 27, 2002, addresses the concerns raised by staff regarding Bay County's contingent liability. The revised Amendment: 1) re-establishes the contingent liability until the contract ends in December 2006; and, 2) deletes the County's option to buy-down 1 MW of the facility's capacity in 2006 without a pay-out from the liability account. In all other respects the Amendment remains unchanged.

This recommendation addresses the revised Amendment and is therefore substantially revised compared to the recommendations

DOCKET NOS. 011365-EQ

DATE: March 7, 2002

filed on December 26, 2001, and February 21, 2002. Jurisdiction in this matter is vested in the Commission by various provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, 366.06, and 366.051, Florida Statutes.

**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:** Yes. The contract costs are currently above market costs and are expected to remain above market until 2013. The revised amendments will allow FPC to replace the contract's above market priced capacity in 2007. The revised amendment retains Bay County's contingent liability until the proposed contract termination date. This is consistent with the intent of Commission Order No. 19509, which guaranteed any payments from Bay County's contingent liability to FPC's ratepayers to compensate ratepayers for early capacity payments made to Bay County. The \$610,000 payment to Bay County should be recovered by FPC through the Fuel and Purchased Power cost recovery clause.

**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 pricing structure of the Bay County contract is very unusual because it includes early capacity payments for the cogenerator in exchange for a ten-year period of firm energy with no capacity payments during the final years of the contract. Bay County received early capacity and O&M payments, which began seven years earlier than the in-service date for the statewide clean coal technology avoided unit used in pricing FPC's standard offer contract. A high capital cost coal unit was used as the avoided unit because at the time, the greater weight of the evidence suggested that the price of natural gas would escalate faster than the price of coal. As this expectation did not materialize, the capacity costs of the Bay County contract are currently higher than market.

Under the negotiated contract, the coal unit based 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 Bay County contract are lower than they would have otherwise been under FPC's 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 projected to be \$1,843,000 over the 34-year term of the contract when compared to the coal unit based

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 ratepayer benefit occurs due to the zero capacity payments in years 2013 through 2022.

As stated in 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." The contract establishes a contingent liability for Bay County to reimburse FPC in the event of a default or certain buy-down provisions, in order to ensure that FPC will receive a capacity benefit for which early capacity payments have been made. 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 existing contract contains several buy-down provisions which are relevant to the proposed contract amendment. 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:** On February 27, 2002, FPC filed a revised letter agreement between FPC and Bay County which outlines the revised contract modifications.

The revised modifications include:

- The contract will expire on December 31, 2006, rather than December 31, 2022.

- The balance of the Capacity Account will remain in place until the new contract expiration date of December 31, 2006. All requirements for a pay-out from Bay County to FPC in the event of a capacity buy-down or default are therefore in effect until December 31, 2006. Bay County's contingent liability is eliminated thereafter, provided that no conditions requiring repayment pursuant to the contract exist.
- FPC will pay \$610,000 to Bay County to cover the County's consulting fees associated with the revised contract Amendment.

Per staff's request, Bay County provided documentation on a planned environmental retrofit to the facility which is necessary in order to meet Clean Air Act requirements. The retrofit must be in place prior to December 31, 2005. On September 14, 2001, Bay County signed a contract to complete the retrofit. The total estimated cost of the retrofit is \$15.7 million, plus a construction cost overrun contingency of \$1.7 million. Due to the retrofit, there is the potential for a derating of the facility to approximately 10 MW in 2005. A representative of Bay County stated that if the plant's capacity is derated, Bay County expects that additional energy will be available from Gulf Power to cover Bay County's obligations to FPC. However, if the unit is derated and Bay County is unable to obtain additional energy to meet its obligations to FPC, it is staff's understanding that the revised contract Amendment requires a pay-out from Bay County to FPC from the liability account.

FPC provided an estimated 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 latter 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. FPC's analysis assumes full performance of Bay County under the contract. Therefore, no pay-out from the liability account is included in the analysis.

FPC also provided a graph displaying FPC's estimated costs of the Amendment compared to costs associated with the remaining life of the existing contract. This is included as Attachment C. The graph highlights the timing of FPC's expected costs and benefits to FPC's ratepayers of the Amendment compared to the current contract, with: 1) an initial payment of \$610,000 in 2002; 2) savings from 2007 through 2012; and, 3) increased costs from 2013 through 2022. Also included in the graph are expected cents per kWh cost differentials between the current contract and the proposed amendment. FPC shows an expected 6 to 9.5 cents per kWh savings for ratepayers for the years 2007 through 2012, with an expected 3.5 cents per kWh added cost for ratepayers during the final ten years of the contract.

As illustrated by Attachment C, FPC expects replacement power costs to remain relatively flat from 2006 until 2022. These costs were modeled using PROSYM software, which estimates replacement costs based on FPC's current and expected future generation resources, along with outside purchases. FPC stated that a sensitivity test completed by the company showed that a 30 percent increase in the expected replacement costs would be necessary to reduce the NPV of the proposed amendment to zero.

Staff recommends that FPC's petition for approval of the Amendment to the purchased power contract with Bay County, as revised on February 26, 2002, be approved. The contract costs are currently higher than wholesale market costs and FPC expects the contract costs to remain higher than market costs until 2013. Staff agrees with FPC that the proposed amendments will allow FPC to go to the wholesale market sooner to replace the contract's capacity and energy with a potentially less expensive power source in years 2007 through 2012. Staff believes that FPC's assumption that the current contract costs will be higher than market in the years 2007 through 2012 is reasonable, resulting in ratepayer savings during these years if the Amendment is approved. The final

NPV savings to ratepayers will also depend on market costs relative to the contract in years 2013 through 2022, when the current contract provides firm energy with no capacity costs. Market costs in these years are more difficult to predict, resulting in greater uncertainty surrounding the ratepayer impact in years 2013 through 2022. However, if replacement power costs over the life of the current contract fall within a 30 percent range of FPC's estimates, a positive net present value benefit to ratepayers will result from terminating the contract in 2006.

Under the revised Amendment, FPC's ratepayers will experience an immediate rate increase of \$610,000 in exchange for future benefits. This translates into 1.6 cents increase per month for one year for a typical residential customer with 1,000 kWh per month usage. Staff notes that the payback period for the \$610,000 cost increase is expected to occur in 2007, the first year FPC replaces the contract with an alternative power source. Staff believes it is appropriate for these costs to be recovered through the Fuel and Purchased Power cost recovery clause. This is consistent with Commission orders in previous cogeneration contract restructuring dockets.

FPC and Bay County have addressed one of staff's concerns by retaining Bay County's contingent liability in the revised agreement. The previous agreement eliminated Bay County's contingent liability immediately, while FPC's obligation to purchase capacity and energy continued through 2006. Staff believes that eliminating Bay County's liability prior to the contract's end would have placed FPC's customers at risk of losing any pay-out from this liability in the event of a capacity buy-down or default occurring prior to 2007. This could have resulted in an outcome in which FPC's ratepayers were worse off under the proposed Amendment than under the current contract. Staff believes that the revised Amendment is consistent with the intent of Commission Order No. 19509. The Order guaranteed any payments from Bay County's contingent liability to FPC's ratepayers to compensate ratepayers from early capacity payments made to Bay County. Staff would like to emphasize that it is FPC's obligation to ensure that Bay County compensates FPC's ratepayers according to the contract's requirements if Bay County fails to perform.



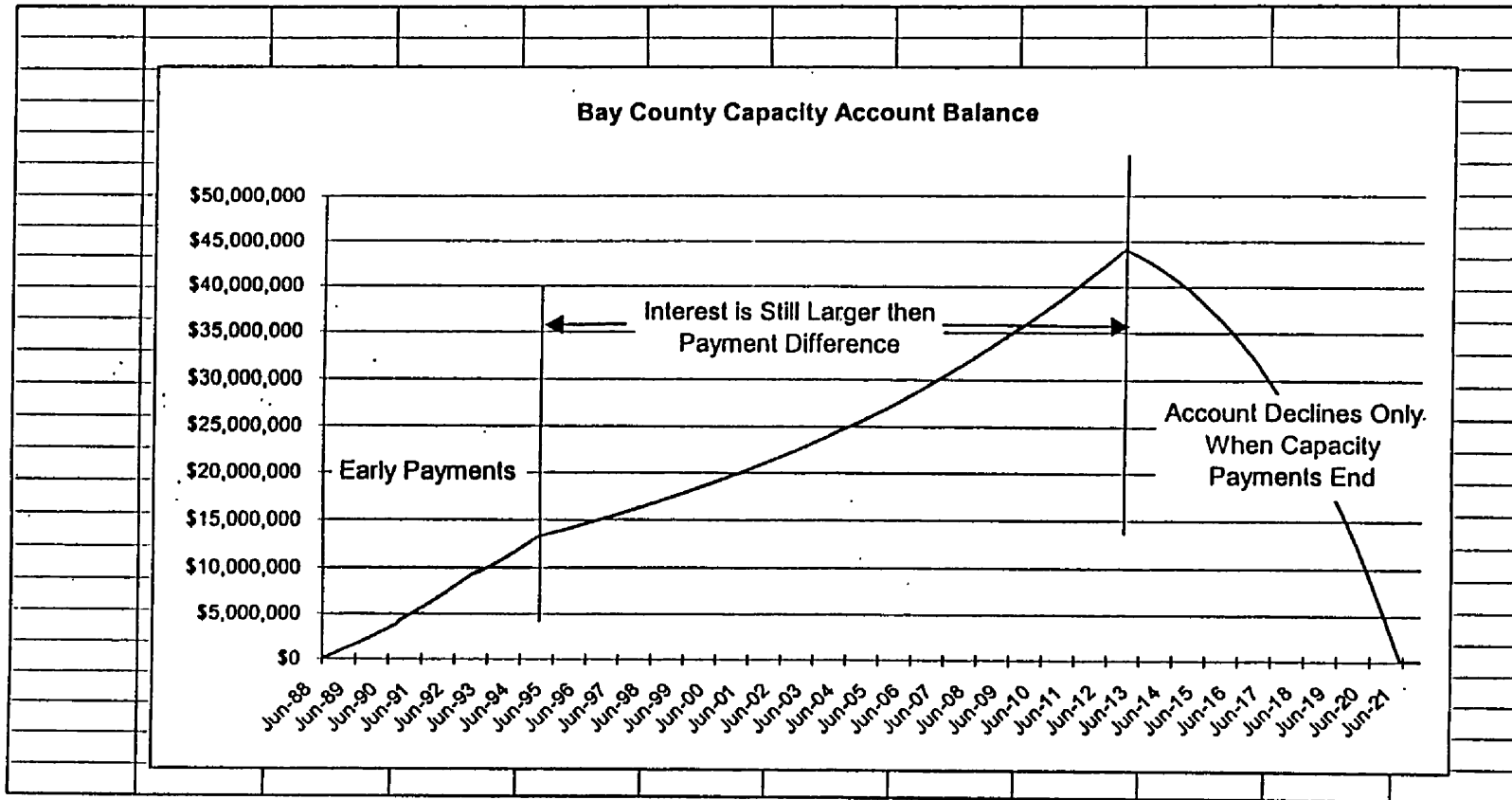
DOCKET NOS. 011365-EQ  
DATE: March 7, 2002

**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.

Graph



**Exhibit C**

**Bay County Early Termination Comparison**

Based on PROSYM Analysis

Year	Existing Capacity	Existing Energy	Existing Total	Modified Capacity	Modified 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

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

NPV @ 8.94%  
Sum \$4,367  
\$3,501

# Bay County Early Termination

