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: MAY 9, 2002

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

FROM: DIVISION OF ECONOMIC REGULATION (HARLOW, HAFF, BOHRMANN, LEE)
OFFICE OF THE GENERAL COUNSEL (GERVASI)

RE: DOCKET NO. 020164-EQ - PETITION BY FLORIDA POWER CORPORATION FOR APPROVAL OF AGREEMENT WITH CEDAR BRAKES IV, LLC TO RESTRUCTURE THREE EXISTING COGENERATION CONTRACTS WITH A TOTAL CAPACITY OF 184 MEGAWATTS.

AGENDA: 05/21/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020164.RCM

CASE BACKGROUND

In 1991, Florida Power Corporation (FPC) signed three contracts for the purchase of capacity and energy with Royster Phosphates, Inc. (Royster), Mulberry Energy Company (Mulberry), and CFR Bio-gen Corporation. These companies were recognized as qualifying facilities (QFs) under the Public Utilities Regulatory Policies Act OF 1978 (PURPA), and this Commission's rules. The Commission approved the Royster and Mulberry contracts by Order No. 24734, issued July 1, 1991, in Docket No. 910401-EQ. The CFR Bio-gen contract was approved by Order No. PSC-92-0129-FOF-EQ, issued March 31, 1992, in Docket No. 900383-EQ. Subsequent to the Commission's approval, the Royster and Mulberry contracts were assigned to the Polk Power Partners, L.P. (Polk LP). The CFR Bio-gen contract was later assigned to Orange Cogeneration Limited Partnership (Orange LP).

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The following shows the megawatt (MW) size, contract term, and avoided unit on which each contract was based, for each of the three contracts:

Contract	Committed Capacity	Contract Signed	Contract Terminates	Avoided Unit
Royster	30.8 MW	3/17/91	8/8/09	1991 Coal Unit
Mulberry	79.2 MW	3/12/91	8/31/24	1991 Coal Unit
Orange	74 MW	11/19/91	12/31/25	1991 Coal Unit

By Order No. PSC-95-0540-FOF-EQ, issued May 2, 1995, in Docket No. 940797-EQ, the Commission approved material changes to several of the cogeneration contracts held by FPC. Included in these changes were Royster's request to relocate the facility to the Polk LP site which also was to provide power for the Mulberry contract.

Currently, the Royster and Mulberry contracts are served by a 115 MW natural gas-fired combined cycle unit in Polk County (Mulberry facility). The Orange contract is served by a 106 MW natural gas-fired combined cycle unit in Polk County (Orange facility). The Orange facility also serves a 23 MW QF contract with Tampa Electric Company (TECO).

On June 4, 1999, FPC filed a petition for approval of an agreement between FPC and El Paso Power Services Company (El Paso), to restructure and reduce the costs of the Royster, Mulberry, and Orange contracts. By Order No. PSC-99-1623-PAA-EQ, issued August 18, 1999, in Docket No. 990723-EQ, the Commission approved the restructuring agreement between FPC and El Paso. This agreement never came to fruition because El Paso failed to meet a condition precedent regarding its then pending merger.

FPC subsequently entered into negotiations with Cedar Brakes IV, LLC (Cedar Brakes), to restructure and reduce the costs of the three cogeneration contracts. On February 26, 2002, FPC filed a petition for approval of the resulting Agreement with Cedar Brakes to restructure the Royster, Mulberry, and Orange contracts

(Agreement). By petition dated March 20, 2002, El Paso Merchant Energy North American Company (EPME) requested permission to intervene in this docket. EPME will form the entity, Cedar Brakes, that will be a party to the Agreement. EPME's petition to intervene was granted by Order No. PSC-02-0455-PCO-EQ, issued April 3, 2002.

FPC requests approval of the Agreement for cost recovery purposes. In addition, as stated in the petition, FPC requests that:

> the Commission include language in its order approving the Agreement providing a reasonable assurance that the restructuring of the Existing Contracts, which were entered into pursuant to the mandate of PURPA, will not impair Florida Power's ability to recover any stranded costs associated with the Existing Contracts that may remain under the Agreement.

The Commission has jurisdiction in this matter pursuant to Section 366.051, Florida Statutes.

ISSUE 1: Should the Commission approve the Agreement between Florida Power Corporation and Cedar Brakes IV, LLC, to restructure three existing cogeneration contracts, including approval for cost recovery?

RECOMMENDATION: Yes. Capacity payments will be discounted for the term of each contract resulting in ratepayer savings in excess of $34 million, net present value. Per unit energy payments may also be reduced, and are forecasted to be no higher than current per unit energy payments. There is no up-front payment associated with this Agreement. Additional liquidated damage language is included in the Agreement to insure delivery of energy to FPC when called upon. The costs associated with this Agreement, on a going forward basis, should be recovered through the Fuel and Purchased Power Recovery Clause, and the Capacity Cost Recovery Clause. Consistent with Order No. PSC-99-1623-PAA-EQ, it is premature for the Commission to make any pronouncement regarding the future treatment of any stranded costs associated with this Agreement.

STAFF ANALYSIS: As stated in FPC's petition, Cedar Brakes will acquire the Royster, Mulberry, and Orange contracts by assignment, upon consummation of the proposed Agreement. The Agreement contains the following changes to the existing three contracts:

- The entire 184 MW capacity of the three existing contracts currently committed to FPC will be committed to FPC and priced under the terms of the Agreement, if Cedar Brakes is able to renegotiate its 23 MW contract from the Orange facility with TECO. If Cedar Brakes is unable to renegotiate its 23 MW contract with TECO, capacity committed to FPC under the terms of the Agreement will be reduced to 160 MW. The remaining 24 MW will continue to be committed to FPC under the terms of the existing Orange contract.

- Annual capacity payments will be substantially discounted for the remaining term of each contract, beginning on the date the Agreement is consummated.

- The Agreement includes a slight overall increase in the amount of energy to be delivered to FPC, compared with the existing contracts. The Agreement also requires an increase in the amount of energy delivered during FPC's peak periods.

- The Orange and Mulberry facilities will no longer be required to maintain their status as qualifying facilities under the Public Utilities Regulatory Policies Act of 1978 (PURPA).

- Cedar Brakes will be liable for substantial liquidated damages if Cedar Brakes fails to deliver energy pursuant to the Agreement. The Agreement calls for more punitive liquidated damages if Cedar Brakes fails to deliver energy when the designated capacity resource, either the Royster or Orange facility, is in operation.

- Cedar Brakes will have a one-time option to select between the existing floating energy pricing methodology and a fixed energy pricing methodology with a specified annual price escalator. This option must be exercised prior to the commencement date of the Agreement.

FPC currently has 184 MW of firm committed capacity under contract from the Orange and Mulberry facilities. These contracts are priced based on a high capacity cost 1991 avoided coal unit, and are therefore priced well above current market prices.

As stated above, the Agreement applies a capacity payment discount percentage to each contract. These discounts begin on the commencement date of the Agreement and apply to each year remaining in each contract. These capacity payment discounts will result in immediate savings to FPC's retail ratepayers through reductions in Capacity Cost Recovery Clause charges. Total capacity savings are expected to range from $34 million to $54 million, net present value (NPV). FPC will not make any up-front payment to Cedar Brakes in exchange for these capacity discounts. However, as discussed further below, Cedar Brakes will gain additional operational flexibility compared with the existing contracts.

The Agreement includes a slight overall increase in the amount of energy to be delivered to FPC, compared with the existing contracts. The Agreement has essentially increased the amount of energy provided, at a reduced capacity cost. Perhaps more importantly, the standard has been increased for energy delivery during FPC's peak periods, in a sense shifting required energy delivery from winter to summer months. Cedar Brakes will be entitled to sell energy on an as-available basis from the Mulberry and Orange facilities in the wholesale market. However, the

contracted capacity from these facilities will be committed to FPC and will therefore continue to count toward FPC's reserve margin.

Cedar Brakes will no longer be required to maintain the Mulberry and Orange units as qualifying facilities under PURPA. However, Cedar Brakes will still be obligated to meet the capacity commitments pursuant to the three existing contracts, as FPC will have a first call option on the contracted capacity. Eliminating the current requirement that the facilities meet PURPA's qualifying facility standard will benefit Cedar Brakes by increasing its operational flexibility. Cedar Brakes will no longer be required to maintain the steam host at each of the facilities. Cedar Brakes will also have the option of meeting its capacity obligations to FPC from either the Mulberry and Orange facilities, or by purchasing power sufficient to meet its capacity obligations.

The Orange facility also serves a 23 MW qualifying facility contract with TECO. Cedar Brakes intends to renegotiate its TECO contract in a similar manner to the proposed Agreement with FPC, such that the Orange facility would no longer be maintained as a qualifying facility under PURPA. If a portion of the Orange facility must be maintained as a qualifying facility, FPC's total committed capacity under the terms of the Agreement will then be reduced by 24 MW to a total of 160 MW. The remaining 24 MW would continue to be committed to FPC under the terms of the existing Orange contract.

FPC appears to have sufficient protection for its ratepayers in the event of non-performance by Cedar Brakes. Substantial monetary liquidated damages have been negotiated in the event Cedar Brakes does not provide capacity and energy when required. These damages are substantially higher in the event Cedar Brakes fails to provide energy when the designated capacity resource, either the Royster or Orange facility, is in operation. This provides assurance that Cedar Brakes will not sell firm energy to an alternative buyer rather than FPC in order to obtain a higher price than specified by the Agreement. FPC has requested that the specific monetary values of these liquidated damages, as outlined in Sections 5 and 9.3 of the proposed Agreement be held confidential, and a decision is pending on that request.

Under the proposed Agreement, Cedar Brakes will have a one-time option to select from two energy pricing methodologies. This option must be exercised by Cedar Brakes by written notice to FPC

prior to the commencement date of the Agreement. The first option ties the energy price to the price of coal burned at Crystal River Pulverized Coal Units 1 and 2, just as in the current contracts. The second option is based on a fixed energy price in 2001, and is escalated by 2 percent each year thereafter. In response to staff's request, FPC provided a comparison of ratepayer costs under the two options. FPC's analysis used the base, low and high case forecasts of coal prices from FPC's 2002 Ten-Year Site Plan. FPC's analysis provides adequate assurances that the net present value of energy costs under the fixed energy pricing option are expected to be lower than expected energy costs under the existing energy pricing methodology.

FPC requested in its petition that the Commission provide assurances that the Agreement will be accorded the same treatment as a contract entered into pursuant to PURPA, in any Commission proceeding regarding FPC's stranded costs. The Agreement does not have specific language regarding this request. Section 2.1.2(h) of the Agreement states only that prior to commencement of the Agreement, FPC must obtain final orders from all "Governmental Authorities having applicable jurisdiction, in form and substance reasonably acceptable to the Buyer." FPC made a similar request concerning the El Paso cogeneration restructuring agreement in Docket No. 990723-EQ. In its Order No. PSC-99-1623-PAA-EQ, issued August 18, 1999, in Docket No. 990723-EQ, the Commission stated:

> At this point we do not know the timing and nature of any electric industry restructuring. Specifically the definition, calculation, and treatment of stranded costs, if any, remains unknown at present. We need not reach a decision on this particular contract as a PURPA contract. We note, however, that to the extent that the contract does not continue to be treated as a PURPA contract, it may act as a disincentive to renegotiations if potential legislation gives favorable treatment to PURPA contracts. We do not want to provide a disincentive to renegotiate. We acknowledge that FPC's efforts in reaching this agreement will reduce the costs its ratepayers otherwise would have to bear, ... , and therefore mitigate any potential stranded costs.

No significant information concerning potential stranded cost recovery has come to light since the Commission issued Order No. PSC-99-1623-PAA-EQ. Therefore, consistent with the Commission's

order, staff believes it is premature to make a determination on whether the Cedar Brakes Agreement will be afforded the same treatment as a PURPA contract in future restructuring or stranded cost recovery proceedings.

In summary, the Agreement appears to be a cost-effective means of reducing capacity payment obligations. Current and future retail ratepayers of FPC are expected to experience lower capacity costs without any up-front payments by current customers. Total capacity savings are expected to range from $34 million to $54 million, NPV. Per unit energy payments may also be reduced, and are forecasted to be no higher on a NPV basis than those specified in the existing contracts. The Agreement has also increased the standard for energy delivery during FPC's peak periods. Protections for non-performance are provided in the Agreement in the form of punitive monetary penalties. Staff therefore recommends that the Agreement between FPC and Cedar Brakes to restructure the Royster, Mulberry, and Orange contracts be approved for cost recovery purposes.

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: 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.