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: JANUARY 9, 2003

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

FROM: DIVISION OF ECONOMIC REGULATION (HARLOW, HAFF, D. LEE)
OFFICE OF THE GENERAL COUNSEL (C. KEATING)

RE: DOCKET NO. 020995-EI - JOINT PETITION FOR APPROVAL OF FIRST AMENDMENT TO RESTATED AGREEMENT FOR PURCHASE OF FIRM CAPACITY AND ENERGY BETWEEN FLORIDA POWER & LIGHT COMPANY AND AES CEDAR BAY, INC. BY FLORIDA POWER & LIGHT COMPANY.

AGENDA: 1/21/03 - REGULAR AGENDA - PROPOSED AGENCY ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\020995.RCM

CASE BACKGROUND

In accordance with Commission rules, AES Cedar Bay, Inc. (Cedar Bay) and Florida Power & Light Company (FPL) negotiated a contract dated May 6, 1988, for FPL to purchase firm capacity and energy from Cedar Bay (Power Purchase Agreement). Cedar Bay is a coal-fired cogeneration facility located near Jacksonville, Florida. The Power Purchase Agreement provides FPL with a maximum of 250 megawatts (MW) firm capacity and energy for the period February, 1994, through February, 2025. Pursuant to Order No. 21468, issued June 28, 1989, in Docket No. 881570-EQ, the Commission approved the First Amended Power Purchase Agreement between FPL and Cedar Bay, as amended on November 9, 1988.

On December 20, 1990, by Order No. 23907, in Docket No. 900686-EQ, the Commission approved a Second Amended Agreement between FPL and Cedar Bay, which provided FPL with the ability to economically dispatch the Cedar Bay cogeneration facility, subject to certain conditions and limitations. Under the provisions of the Second Amended Agreement, the monthly capacity payment made to Cedar Bay is impacted by FPL's actions in dispatching the facility. The existing methodology for calculating the monthly capacity factor often results in Cedar Bay receiving credit for less energy than is actually produced during periods when FPL is dispatching the facility. This reduces the monthly capacity factor and, thus, reduces the monthly capacity payment made to Cedar Bay when FPL dispatches the facility more often. The Second Amended Agreement is referred to by FPL in its current petition as the Restated Agreement.

On December 26, 1997, Cedar Bay filed a complaint against FPL in the Circuit Court for the Fourth Judicial Circuit, in and for Duval County, Florida (Circuit Court). Cedar Bay alleged that FPL was dispatching the Cedar Bay facility more often than allowed by the contract in order to reduce the capacity payments paid to Cedar Bay. On August 13, 1999, the Circuit Court ruled in favor of Cedar Bay, awarding damages of approximately $13 million to compensate for the additional capacity payments FPL should have made to the cogenerator. By Order No. PSC-01-2516-FOF-EI, dated December 26, 2001, in Docket No. 010001-EI, the Commission approved FPL's recovery of these costs through the Fuel and Purchased Power Cost Recovery Clause and the Capacity Cost Recovery Clause.

On September 7, 1999, the Circuit Court entered a declaratory judgement in this matter which includes the following language regarding FPL's rights to dispatch the unit and the calculation of capacity payments:

> 1) FPL is not authorized to consider any portion of Cedar Bay's capacity payment in determining whether and when to dispatch the Cedar Bay cogeneration facility;
>
> 2) FPL is not authorized to make capacity payments on the basis of Monthly and Annual Capacity Factors which have been calculated based on past instances of improper dispatch that the jury implicitly found violated the implied covenant of good faith and fair dealing; instead, the [Power Purchase Agreement] requires that FPL make capacity payments as if the Cedar Bay cogeneration facility had been properly dispatched in the past.

These findings resolved the dispute between FPL and Cedar Bay with respect to FPL's dispatch of the unit during peak demand periods. However, the dispute over off-peak periods continued. FPL and Cedar Bay filed cross motions with the Circuit Court regarding FPL's right to dispatch the facility during off-peak periods. The parties entered into negotiations to resolve these disputes.

On September 18, 2002, FPL and Cedar Bay Generating Company, Limited Partnership, the successor in interest to AES Cedar Bay, Inc., filed a joint petition for approval of the First Amendment to the Restated Agreement (Amendment). The intent of the Amendment, dated August 19, 2002, is to "implement the resolution and compromise of FPL and Cedar Bay's continuing dispute over the calculation of the Monthly Capacity Factor and Monthly On-Peak Capacity Factors." FPL and Cedar Bay have requested that the Commission approve the Amendment and authorize FPL to recover the associated purchased power costs through the Fuel and Purchased Power Cost Recovery Clause and the Capacity Cost Recovery Clause.

Jurisdiction in this matter is vested in the Commission by several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, 366.06, and 366.051, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should the Commission grant the joint petition of Florida Power & Light Company and Cedar Bay Generating Company, Limited Partnership, for approval of the First Amendment to the Restated Agreement for purchase of firm capacity and energy between FPL and AES Cedar Bay, Inc.?

RECOMMENDATION: Yes. The First Amendment to the Restated Agreement (Amendment) appears to balance the interests of both parties, and will avert further litigation. If Cedar Bay's performance remains the same or deteriorates, capacity payments will be reduced. If Cedar Bay's performance increases significantly, FPL's ratepayers will be responsible for higher capacity payments. However, FPL will enjoy increased reliability and improved flexibility in dispatching the facility. FPL will likely experience energy savings because the Amendment provides an incentive for Cedar Bay to provide additional energy priced below FPL's as-available energy price. FPL should be authorized to recover costs incurred under the Amendment through the Fuel and Purchased Power Cost Recovery Clause and the Capacity Cost Recovery Clause, subject to annual review in those proceedings.

STAFF ANALYSIS: The intent of the proposed Amendment is to resolve a complicated and long-term legal dispute over FPL's rights to dispatch the Cedar Bay facility and the calculation of capacity payments. The calculation of the facility's monthly capacity factor under the existing contract is at the heart of this dispute.

Under the existing contract, the monthly capacity payment varies according to the Cedar Bay facility's capacity factor for each month. The existing contract provides Cedar Bay with a financial incentive to achieve higher levels of performance by awarding bonus capacity payments if the monthly capacity factor exceeds 89 percent. However, the existing agreement also includes a provision which results in Cedar Bay receiving credit for less energy than is actually produced during periods when FPL is dispatching the facility. This reduces the monthly capacity factor used for billing purposes and, thus, reduces the monthly capacity payment made to Cedar Bay. Disputes have arisen between the parties regarding whether FPL is dispatching the unit more often than provided for by the contract in order to reduce capacity payments.

The proposed Amendment consists of negotiated changes to the Restated Agreement which are designed to: 1) resolve the historical capacity payment dispute; and, 2) resolve the dispute over FPL's rights to dispatch the facility and the calculation of capacity payments on a going-forward basis. FPL and Cedar Bay state that these changes "constitute a complete settlement 'package' and should be viewed collectively rather than in isolation."

Resolving the Historical Dispute:

- FPL must make approximately $5.3 million in up-front payments to Cedar Bay to resolve the historical capacity payment dispute. The specific amount will be determined by recalculating historical monthly capacity payments beginning April 1, 2001 through the effective date of the Amendment, using negotiated historical capacity factors as inputs. This figure could increase by approximately $200,000 per month, depending on the effective date of the Amendment.

- FPL will pay Cedar Bay an additional $100,000 due to a one-month shift in the recalculation of past monthly capacity payments, caused when negotiations continued longer than expected.

Resolving the Dispute on a Going-forward Basis:

- The Amendment deletes the existing controversial provision which tends to reduce the capacity factor during periods of dispatch. Under the Amendment, the hourly energy used as an input in the capacity factor calculation during periods of dispatch will be the capability of the facility during that hour, rather than the actual energy level dispatched by FPL. Hourly energy will be capped at 250 MWh during off-peak hours and 258 MWh during peak hours.

- Cedar Bay must achieve a capacity factor of 95 percent, rather than 89 percent under the existing contract, to receive bonus capacity payments.

- The calculation of energy payments to Cedar Bay will remain the same, with the exception of a financial incentive to encourage Cedar Bay to provide additional energy to FPL. If Cedar Bay operates above 250 MW in off-peak hours and above 258 MW in on-peak hours, Cedar Bay and FPL will split the savings between Cedar Bay's energy cost and FPL's as-available avoided energy cost. The capacity payment paid by FPL will not increase during periods when Cedar Bay provides this additional energy.

Both FPL and Cedar Bay state that the Amendment is fair and reasonable and provides the following benefits to FPL and its ratepayers:

- The Amendment resolves a complicated and long-term legal dispute over FPL's rights to dispatch the facility and the calculation of capacity payments. The parties believe that if the Amendment does not become effective, this dispute has the potential to recur throughout the remaining life of the contract. This could result in additional litigation costs and uncertainty for FPL and its customers. Further, the parties claim that resolution of the dispute will promote a more stable working relationship, which will likely result in increased efficiency regarding FPL's dispatch decisions.

- The parties assert that the Amendment's revised calculations for monthly capacity payments are reasonable because capacity payments are more directly correlated with the performance of the facility. If performance remains the same or deteriorates, Cedar Bay will receive lower capacity payments. Increased performance will result in increased capacity payments. This provides Cedar Bay with the incentive to improve performance, increasing reliability for FPL. Further, Cedar Bay must achieve a higher level of performance under the Amendment than under the current arrangement before earning bonus capacity payments.

- Under the Circuit Court's August 13, 1999, Order and September 7, 1999, Declaratory Judgement, FPL currently has limited dispatch rights during peak hours. FPL anticipates that dispatch during off-peak hours could also be limited by future court rulings. The Amendment provides FPL with the right to dispatch the facility and use the facility for power supply regulation during all hours.

- The parties further assert that due to the energy incentive established by the Amendment, FPL will be provided with additional energy from the facility without an associated increase in capacity payments. This energy will be priced according to the coal-based energy price of the contract, plus half the differential between the contract energy cost and FPL's as-available energy price. This will provide economic gains for FPL because the energy cost of the contract is often below FPL's as-available cost, or incremental system cost.

Staff agrees with the parties that given the complexity and long-term nature of the dispute, it is probable that litigation will recur if the Amendment is not approved. Taken as a whole, the Amendment appears to balance the interests of both parties and will avert further litigation on FPL's dispatch of the facility and the calculation of capacity payments.

The specific dollar impact of the Amendment on capacity payments relative to the existing contract is indeterminate because it depends on: 1) Cedar Bay's performance; 2) FPL's dispatch decisions; and, 3) a final court ruling in lieu of the Amendment. FPL and Cedar Bay provided calculations of the expected capacity payments of the existing contract as interpreted by each party, and the expected capacity payments under the Amendment. If Cedar Bay maintains its historical average performance (6 percent forced outage rate), the current contract would result in a net present value (NPV) of $1.231 billion in capacity payments given Cedar Bay's interpretation, compared to a NPV of $1.220 billion in capacity payments assuming FPL's interpretation. The parties agree that the Amendment would reduce capacity payments to approximately $1.215 billion NPV if Cedar Bay maintains a 6 percent forced outage rate (EFOR). Thus, if historical performance is maintained, comparing the Amendment to Cedar Bay's interpretation of the existing contract yields an estimated $16.0 million net present value (NPV) reduction in capacity payments, while a comparison using FPL's interpretation of the existing contract results in a NPV reduction in capacity payments of $4.4 million. If Cedar Bay significantly improves its performance to a 4 percent EFOR, both parties expect that capacity payments under the Amendment will increase compared to their respective interpretations of the contract. These calculations are summarized in the following table:[1]

---

[1]Note: These estimates are determined on a going-forward basis beginning on January 1, 2003, and do not include the estimated $5.4 million up-front payment to resolve the historical capacity payment dispute.

	NPV Impact on Capacity Payments Due to Amendment (Historical 6% EFOR)	**NPV Impact on Capacity Payments Due to Amendment (Improved 4% EFOR)**
Cedar Bay's Interpretation of Existing Contract	- $16.0 million	+ $ 8.0 million
FPL's Interpretation of Existing Contract	- $ 4.4 million	+ $33.8 million

If Cedar Bay's performance increases significantly, staff agrees that FPL's ratepayers will be responsible for higher capacity payments under the Amendment. However, FPL will have vastly improved flexibility in dispatching the facility and the ability to use the facility for power supply regulation purposes. FPL has been prevented from dispatching the unit during on-peak periods since the 1999 court ruling. FPL has also refrained from dispatching the unit during off-peak hours recently in order to facilitate negotiations.

Staff agrees with the parties that the Amendment is likely to result in increased reliability because it strengthens the correlation between capacity payments and performance. These benefits are difficult to quantify. Staff also agrees that the Amendment is likely to result in energy savings to FPL's customers because it encourages Cedar Bay to provide additional energy priced below FPL's as-available energy price without a corresponding increase in capacity payments. In response to a request by staff, FPL estimated the energy savings associated with the Amendment over the remaining life of the contract at $8.1 million NPV.

In conclusion, staff recommends that the Amendment should be approved. Taken as a whole, the Amendment appears to balance the interests of both parties and will avert further litigation on FPL's dispatch of the Cedar Bay facility and the calculation of capacity payments. If Cedar Bay's performance remains the same or deteriorates, capacity payments under the Amendment will be reduced compared with the existing contract. These savings are likely to overcome $5.4 million in up-front payments from FPL to Cedar Bay to resolve the parties' historical dispute. In contrast, if Cedar Bay's performance increases significantly, FPL's ratepayers will be responsible for higher capacity payments under the Amendment. However, FPL will enjoy higher reliability and improved flexibility in dispatching the facility. Further, the Amendment is likely to result in significant energy savings because it provides an incentive for Cedar Bay to provide additional low-cost energy without a corresponding increase in capacity payments. FPL should be authorized to recover costs incurred under the Amendment through the Fuel and Purchased Power Cost Recovery Clause and the Capacity Cost Recovery Clause, subject to annual review in these proceedings.

ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes, if no person whose substantial interests are affected by this 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 this 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.