State of Florida

Public Service Commission

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COMMISSION CLERK

DATE: FEBRUARY 5, 2004

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

FROM: DIVISION OF ECONOMIC REGULATION (HAFF, SICKEL, MAUREY, BAXTER)
OFFICE OF THE GENERAL COUNSEL (VINING)

RE: DOCKET NO. 031093-EQ - PETITION FOR APPROVAL OF REVISED STANDARD OFFER CONTRACT AND REVISED COG-2 RATE SCHEDULE BY FLORIDA POWER & LIGHT COMPANY.

AGENDA: 02/17/04 - REGULAR AGENDA - TARIFF FILING - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: 8-MONTH EFFECTIVE DATE: AUGUST 5, 2004

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\031093.~~WPD.RCM~~ RCM

CASE BACKGROUND

Pursuant to federal law, the availability of standard rates is required for fossil-fueled qualifying facilities (QFs) less than 100 kilowatts (0.1 MW) in size. 16 U.S.C. 2601 *et seq.*, 16 U.S.C. 792 *et seq.*, 18 CFR 292.304. Florida law requires the Commission to "adopt appropriate goals for increasing the efficiency of energy consumption and increasing the development of cogeneration." Section 366.82(2), Florida Statutes. The Commission is further directed to "establish a funding program to encourage the development by local governments of solid waste facilities that use solid waste as a primary source of fuel for the production of electricity." Section 377.709, Florida Statutes.

These federal and state requirements were implemented by the Commission through its adoption of the Standard Offer Contract in Rule 25-17.0832(4)(a), Florida Administrative Code. Pursuant to

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this rule, each investor-owned electric utility must file with the Commission a tariff and a Standard Offer Contract for the purchase of firm capacity and energy from small QFs. These provisions implement the requirements of the Public Utilities Regulatory Policies Act (PURPA) and promote renewables and solid waste-fired facilities by providing a straightforward contract. Larger QFs and other non-utility generators may participate in a utility's Request for Proposals (RFP) process pursuant to Rule 25-22.082, Florida Administrative Code.

To comply with Rule 25-17.0832(4)(a), Florida Administrative Code, on December 5, 2003, Florida Power & Light Company (FPL) filed a Petition for Approval of a Standard Offer Contract for qualifying cogeneration and small power production facilities (QFs). The proposed contract is based on a 20 MW portion of FPL's next planned generating unit addition, a 1,144 MW combined cycle (CC) unit at the Turkey Point site scheduled to enter service on June 1, 2007. This unit is also subject to a pending RFP which was previously issued by FPL on August 25, 2003.

The Standard Offer Contract has a five-year term from June 1, 2007 until May 31, 2012, although a QF may supply capacity and energy up to three years prior to the avoided unit's in-service date. FPL has also proposed an associated tariff, COG-2, for firm capacity and energy. This tariff would expire on the earlier of the date the subscription limit (20 MW) is fully subscribed, or upon the expiration of a two-week open solicitation period.

Rule 25-17.0832(4)(e)5., Florida Administrative Code, requires utilities to complete the open solicitation period for Standard Offer Contracts prior to issuing an RFP for the same avoided unit. However, in Order No. PSC-01-2512-PAA-EQ, issued on December 24, 2001, in Docket No. 011200-EQ, <u>In Re: Petition for approval of standard offer contract and revised COG-2 tariff, and for ruling that waiver of a portion of Rule 25-17.0832(4), F.A.C., is unnecessary, by Florida Power & Light Company</u>, the Commission determined that utilities are not required to seek waiver of Rule 25-17.0832(4)(e)5., Florida Administrative Code, to open a Standard Offer Contract during a pending RFP. Therefore, FPL did not seek a waiver of this rule.

This recommendation addresses FPL's petition for approval of the proposed Standard Offer Contract. 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 FPL's petition for approval of a new Standard Offer Contract, based upon a combined cycle unit with an in-service date of June 1, 2007, be approved?

RECOMMENDATION: No. The Standard Offer Contract includes a claim to the rights to any environmental benefits associated with the QF. Staff believes this term is unreasonable. Therefore, the Standard Offer Contract and associated tariffs should not be approved as filed. (Haff, Sickel, Maurey)

STAFF ANALYSIS: FPL's proposed Standard Offer Contract contains essentially the same terms and conditions as recent FPL Standard Offer Contracts which were approved by the Commission in Order No. PSC-00-1748-PAA-EI, issued on September 26, 2000, in Docket No. 000868-EI, In Re: Petition by Florida Power & Light Company for approval of standard offer contract, and Order No. PSC-01-2512-PAA-EQ, issued on December 24, 2001, in Docket No. 011200-EQ, In Re: Petition for approval of standard offer contract and revised COG-2 tariff, and for ruling that waiver of a portion of Rule 25-17.0832(4), F.A.C., is unnecessary, by Florida Power & Light Company. However, the proposed Standard Offer Contract contains two major changes:

1. FPL is employing an equity adjustment in the calculation of capacity payments, as it has in recent past Standard Offer Contracts. However, in this instance, FPL increased the risk factor from 10% to 30%. As a result, capacity payments under the proposed Standard Offer Contract are below FPL's avoided cost. FPL cites updated methodology by Standard & Poor's (S&P) for evaluating purchased power contracts as the reason for the increased equity adjustment.

2. During the term of the Standard Offer Contract, and as part of the capacity and energy purchased from a QF, FPL claims the rights to any environmental benefits associated with the QF, including Tradeable Renewable Energy Credits (TRECs), green tags, or credits toward a Renewable Portfolio Standard.

Increase in Equity Penalty Adjustment

Page 4, paragraph 9 of FPL's petition contains a discussion of the equity adjustment to capacity payments under the proposed Standard Offer Contract. The equity adjustment as applied by FPL is based on the methodology S&P uses when assessing the impact of off-balance sheet obligations, such as purchased power agreements, on a company's capital structure. However, unlike in previously approved Standard Offer Contracts which recognized a 10% risk factor, in the instant docket FPL proposes to adjust capacity payments based on a risk factor of 30%. In support of this change, FPL cites an article published in the May 12, 2003, edition of S&P's Utilities & Perspectives. FPL contends that S&P has updated its methodology and now "would employ a risk factor of at least 30% when assessing the impact of contracts for which cost recovery is addressed through adjustment clauses." For this reason, FPL proposes using a 30% risk factor rather than the 10% risk factor employed in its last Standard Offer Contract.

By Order No. PSC-99-1713-TRF-EG, issued September 2, 1999, in Docket No. 990249-EG, In Re: Petition by Florida Power & Light Company for Approval of a Standard Offer Contract and Revised COG-2 Tariff, the Commission approved FPL's proposed Standard Offer Contract which recognized a risk factor of 10% in the determination of capacity payments. In this Order, the Commission found:

> We recognize the effect that purchased power contracts have on the utility's financial ratios as calculated by S&P. To be consistent with the terms of the Stipulation approved in Order No. PSC-99-0519-AS-EI which allows for the recovery of the "equity adjustment" through base rates, we approve FPL's adjustment to its standard offer contract to recognize the effect of purchased power contracts and to avoid possible double recovery. However, while we are approving FPL's request in the instant case due to the unique circumstances surrounding FPL's Stipulation, the broader policy issue of who should bear the incremental cost of additional equity to

> compensate for purchased power contracts has not been addressed.
>
> Although the facts and circumstances in this case persuade us that this adjustment should be included in the Company's standard offer contract, FPL calculated its equity adjustment using a 20% risk factor. FPL subsequently represented that S&P assigns a 10% risk factor to its existing cogeneration contracts. Therefore, we find that a recalculation of the capacity payments to reflect an equity adjustment based on a 10% risk factor to be appropriate. (Order No. 99-1713, pp. 9-10)

The certain "unique circumstances" mentioned above are still relevant in the instant case. By Order No. PSC-02-0501-AS-EI issued April 11, 2002, in Docket No. 001148-EI, <u>In Re: Review of the Retail Rates of Florida Power & Light Company</u> and Docket No. 020001-EI, <u>In Re: Fuel and Purchased Power Cost Recovery Clause with Generating Performance Incentive Factor</u>, the Commission approved the Stipulation and Settlement entered into by FPL and various intervenors to these dockets. The 2002 Stipulation approved in Order No. PSC-02-0501-AS-EI extended certain "terms" initially set forth in the 1999 Stipulation approved in Order No. PSC-99-0519-AS-EI, issued March 17, 1999, in Docket No. 990067-EI, <u>In Re: Petition by the Citizens of the State of Florida for a Full Revenue Requirement Rate Case for Florida Power & Light Company</u>. Namely, paragraph 4 of the 2002 Stipulation states that the "adjusted equity ratio" will be calculated in the same manner as provided for in the 1999 Stipulation.

The Commission has repeatedly found in numerous orders that consideration of any application of an equity adjustment should be evaluated on a case-by-case basis. Staff has reviewed FPL's petition, the cited S&P article, and past Commission decisions regarding the application of an equity adjustment in general, and for purposes of determining capacity payments under a Standard Offer Contract in particular. At staff's request, FPL provided additional support for its position in the form of a second S&P report dated October 21, 2003. In this report, S&P indicates that it applies a 30% risk factor in its evaluation of purchased power obligations as part of its determination of the consolidated credit profile of FPL Group. Based on the circumstances found in this docket, staff believes it is appropriate for FPL to make an equity adjustment as proposed in the determination of capacity payments in its Standard Offer Contract.

FPL's Claims to Environmental Benefits

A QF that generates electricity from renewable sources can currently sell two commodities to a utility: electricity priced at avoided cost; and TRECs, the market value of the perceived environmental benefits associated with renewable energy. For every unit of electricity generated by a renewable energy QF there is a corresponding TREC.

In two recent dockets, FPL has stated that electricity from renewable energy resources is not available at avoided cost. Recognizing that PURPA restricts a utility from paying in excess of avoided cost for QF generated power, FPL petitioned for a declaratory statement from the Commission that FPL could pay more than avoided cost to a renewable energy QF, if the incremental cost was paid by FPL customers who voluntarily agreed to the higher rates. In Order No. PSC-02-1059-DS-EQ, issued on August 6, 2002, in Docket No. 020397-EQ, <u>In Re: Petition for declaratory statement by Florida Power & Light Company that FPL may pay a Qualified Facility (QF) for purchase of renewable energy an amount representing FPL's full avoided cost plus a premium borne by customers voluntarily participating in FPL's Green Energy Project</u>, the Commission provided a declaratory statement that such an arrangement would not violate PURPA and its implementing rules, or section 366.051, Florida Statues, and its implementing rules.

Subsequently, by Order No. PSC-03-1442-TRF-EI, issued on June 22, 2003, in Docket No. 030752-EI, <u>In Re: Petition for approval of green power pricing research project as part of Demand Side Management Plan by Florida Power & Light Company</u>, FPL was authorized to commence a Green Power Pricing Research Project. Under the voluntary research program, ratepayers have the option to pay a premium of $9.75 per month above standard rates for a block of 1000 TRECs. The premium is designed to encourage renewable technologies that might not otherwise be available. FPL intends to purchase TRECs from a third party supplier.

In the instant docket, tariff sheet 9.851, at paragraph 4.2, contains language that would give FPL the unqualified ownership and rights to any environmental attributes associated with the QF, for any QF that agrees to provide capacity and energy under the terms of the proposed Standard Offer Contract. If a QF signed the proposed Standard Offer Contract, FPL would acquire some quantity of TRECs at zero cost. Staff is concerned that such language contradicts the Commission's decision in Docket No. 020397-EQ that FPL could pay more than avoided cost for renewable energy if the incremental cost was paid by FPL customers who voluntarily agreed to higher rates. The rationale behind FPL's green pricing program approved in Docket No. 030752-EI was to allow voluntary contributions for the purchase of TRECs. Approval of the proposed Standard Offer Contract language would have the effect of allowing FPL to purchase renewable energy at avoided cost but not compensate the QF for the market value of the TRECs. This would be a disincentive to QFs entering into the standard offer contract as they would be losing the economic benefit of the TRECs. Staff believes that such an arrangement would discourage QFs from signing the Standard Offer Contract, thereby decreasing the development of renewable technology.

Other Considerations

Staff believes that FPL's evaluation criteria will be readily understandable to any developer who wishes to sign FPL's proposed Standard Offer Contract. The avoided unit cost and unit performance parameters are reasonable for a combined cycle unit and are the same as those contained in FPL's August 25, 2003 RFP for the Turkey Point unit. The resulting capacity payments are appropriate. The performance provisions include dispatch and control, and on-peak performance incentives.

Given that the subscription limit of FPL's avoided unit is only a portion of its total capacity, staff believes that purchases made by FPL pursuant to the proposed Standard Offer Contract will not result in the deferral or avoidance of the proposed 2007 Turkey Point combined cycle unit. If FPL enters into a Standard Offer Contract, but the need for the proposed generating unit is not deferred or avoided, FPL will essentially be paying twice for the same firm capacity. Therefore, the requirements of federal law and the implementation of state regulations discussed above may result in a subsidy to QFs. Staff notes, however, that the potential subsidy could be mitigated, as FPL may have opportunities to sell any surplus capacity to the wholesale market.

Ideally, QFs should compete on equal footing with all other producers of electricity. However, until and unless there is a change in federal and state law, QFs are given some preferential treatment. The Commission has minimized this unequal footing by requiring Standard Offer Contracts only for small QFs, renewables, or municipal solid waste facilities. These types of facilities may not be in a position to negotiate a purchased power agreement due to their size or timing. Thus, the Commission's rules balance market imperfections with the existing policy of promoting QFs.

In summary, staff does not expect that FPL's proposed Standard Offer Contract will result in the avoidance of its proposed avoided unit, a 2007 combined cycle unit at the Turkey Point site. However, because the proposed contract contains a claim to the rights to any environmental benefits associated with the QF, staff recommends that FPL's petition to establish its new Standard Offer Contract and associated tariffs be denied.

ISSUE 2: On what date should FPL's proposed Standard Offer Contract become effective?

RECOMMENDATION: If the Commission denies the staff recommendation on Issue 1, FPL's proposed Standard Offer Contract should become effective ten days after the issuance of a consummating order if there is no timely protest filed. FPL's two-week open solicitation period should begin ten days after the date of issuance of the consummating order. (Vining, Haff, Baxter)

STAFF ANALYSIS: If the Commission denies the staff recommendation on Issue 1, FPL's proposed Standard Offer Contract should become effective ten days after the issuance of a consummating order. As a result, FPL's two-week open solicitation period should begin ten days after the date of issuance of the consummating order.

<u>ISSUE 3</u>: Should this docket be closed?

<u>RECOMMENDATION</u>: Yes. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order. (Vining)

<u>STAFF ANALYSIS</u>: If no timely protest is filed, this docket should be closed upon the issuance of a consummating order.