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DATE: March 15, 2007

TO: Commission Clerk (Cole)

FROM: Division of Economic Regulation (S. Brown) SRB TJB RLT
Office of the General Counsel (M. Brown) MCB

RE: Docket No. 060811-EI – Petition for approval of purchased power agreements between Gulf Power Company and Coral Power, L.L.C., and Gulf Power Company and Southern Power Company.

AGENDA: 03/27/07 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Pending

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060811.RCM.DOC

Case Background

On December 19, 2006, Gulf Power Company (Gulf) filed a petition with the Florida Public Service Commission (Commission) seeking approval of purchased power agreements between Coral Power, L.L.C. (Coral Power) and Southern Power Company (Southern Power). Gulf is seeking to recover the costs of the agreements through its Capacity and Fuel and Purchased Power Cost Recovery Clauses. Gulf would also like consideration from the

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Commission regarding the fairness of the solicitation process and the negotiations that led to the execution of the contracts.[1]

The Coral Power and Southern Power purchased power agreements were negotiated over the period May 2006 through October 2006. The two purchased power agreements consist of 487 MW of capacity, including a total nominal capacity of 195 MW from four combustion turbines from Baconton Power in Mitchell County, Georgia and 292 MW of capacity from four combustion turbines from the Dahlberg electric generating plant in Jackson County, Georgia. The term for each agreement is June 1, 2009, through May 31, 2014.

Jurisdiction over this matter is vested in the Commission by Sections 366.04, 366.041, and 366.076 Florida Statutes.

[1] Gulf asked that the Commission consider whether the solicitation and negotiation of the Coral Contract and the Southern Power Contract was (1) transparent, open and fair, (2) properly and clearly defined and not discriminatory, (3) evaluated consistently with identified criteria without any advantage to any party, and (4) overseen by an independent third party monitor who had access to all communications with respondents and evaluations of proposals and could determine the transparency and fairness of the solicitation process.

Discussion of Issues

Issue 1: Should the Commission approve Gulf Power Company's petition for approval of Purchased Power Contracts with Coral Power, L.L.C. and Southern Power Company?

Recommendation: Yes. Both the Coral Power and Southern Power agreements were negotiated in good faith and are cost-effective. Entering into the agreements could result in projected cost savings of $7.7 million to Gulf's customers. Both agreements will allow Gulf Power Company the opportunity to provide its customers with reliable electric service from 2009 through 2014. (S. Brown)

Staff Analysis: The negotiated contracts between Coral Power and Southern Power consist of 487 MW of capacity. Gulf states that the additional capacity is needed both for reliability and to achieve reasonable costs of providing electric service. Gulf would need the peaking capacity from June 2009 through May 2014 in order to meet its 15 percent reserve margin. Approval of the agreements and the recovery of prudently incurred costs is necessary in order for the contracts to be effective.

Gulf's resource planning to determine its future capacity needs is implemented within the Southern electric system integrated resource planning process. Gulf participates in this process along with other Southern electric system operating companies: Alabama Power Company, Georgia Power Company and Mississippi Power Company. Gulf's 2006 Ten Year Site Plan reveals that the Southern electric system integrated resource planning process confirms a need of 415 MW in 2009.

To fill the need for additional capacity, Gulf decided to look to the market rather than build additional generating capacity itself. There are several reasons for this decision. First, Gulf's assessment of the competitive wholesale market suggested available capacity could be obtained through a Request for Proposals (RFP) process. Second, if the prices were appropriate, Gulf preferred to diversify its portfolio of resources. Third, a short-term purchase would defer a decision to build additional capacity, which provides Gulf with some additional planning flexibility.

Gulf stated that deferring consideration of a self build alternative would provide several advantages to the company. Gulf's 2009 need would be immediately fulfilled by adding combustion turbine capacity. However, the company believes that by deferring that need to 2014, it would allow consideration of other types of technologies besides peaking capacity. Gulf states that deferring the need would allow sufficient time to consider longer lead-time technologies, for example, clean coal technologies. Finally, the company believes deferral of the potential capacity addition date would allow more time for the emergence of technology improvements that could improve performance and/or reduce costs.

Rule 25-22.082, Florida Administrative Code, does not require investor-owned utilities to issue an RFP for generating units that are not subject to the Power Plant Siting Act, but Gulf decided to conduct an RFP rather than engage in independent negotiations with potential providers. Gulf conducted the RFP because the Commission has previously approved the RFP process as an appropriate way to secure cost-effective resource additions, and, if conducted properly, to demonstrate fairness in the selection process. Also, the risk of missing potential market participants is minimized by issuing an RFP. Gulf's evaluation of the wholesale market revealed that excess capacity existed and that it could possibly be available for a five year term. These factors were incorporated into Gulf's RFP to maximize participation.

Gulf's RFP sought 400 MW to 500 MW of generation capacity and energy beginning June 1, 2009, through May 31, 2014. Gulf's RFP projects a need for peaking capacity, but also considered bids from non-peaking proposals. Gulf's RFP process followed two primary guidelines; the Commission's Rule 25-22.082, Florida Administrative Code and FERC RFP guidelines. Gulf states that it was careful to follow FERC guidelines as well as the Commission's rules in designing and conducting its capacity solicitation, to avoid any unfair advantage to Gulf's affiliate at any stage of the process. Some of those guidelines include: assuring that the RFP process is open and fair to all respondents; the product or products requested through the bidding process are precisely designed, the evaluation criteria was standardized and applied equally to all proposals, and every aspect of the RFP is presided over by an independent third party.[2]

Gulf used Accion Group, Inc. (Accion) as its independent monitor, and did not identify a self-build alternative in its RFP. Accion oversaw the RFP process to make sure it was credible and fair to all respondents. Gulf used Accion as a third party in the contract negotiations to accommodate FERC's guidelines concerning participation by affiliates. Gulf did not set forth a self-build alternative because the RFP was for a short term need and would likely not lead to the construction of a new unit.

Gulf provided public notice of the RFP on December 22, 2005. The notice was published in four newspapers: the *Tallahassee Democrat*, the *Florida Freedom Springs*, the *Daily News* and the *Pensacola News Journal*. Also, Accion forwarded an e-mail to 67 potential respondents informing them of the RFP. The respondents were invited to register and review the documents on a website created by Accion to be used for the RFP process. Gulf issued its press release to trade publications concerning its RFP on December 27, 2005. In the press release, Gulf announced that it planned to issue an RFP on January 20, 2006, soliciting bids by March 21, 2006. The press release gave the Accion website address, www.gulfim.com, a comprehensive website where potential applicants could receive extensive information about the RFP process, review draft RFP documents, and ask questions.

Two RFP discussion sessions were held in Tallahassee, Florida, before and after the RFP was issued. The discussion sessions were attended by interested persons and Commission staff. The first session was held on January 11, 2006, to discuss the requirements of the RFP. The second session was held on January 31, 2006, to discuss the data requirements and to aid potential respondents with the RFP process.

Gulf's initial discussions resulted in interest from eight potential respondents. On March 21, 2006, Accion opened proposals submitted in response to the RFP. Two participants actually responded to the RFP and submitted three proposals. The six respondents who did not submit proposals, did so for various reasons. Those reasons included concerns about anticipated

[2] See, Allegheny Energy Supply Company, LLC, 108 FERC ¶ 61,082 (2004).

transmission costs, unavailability of the requested product, late registration to submit a proposal and change in business plans. Two of the three proposals were for supply of power from existing generating units. The two lowest cost proposals were proposals offered from existing combustion turbine units. The combined cycle alternative had the highest costs. As a result, on May 8, 2006, Gulf informed the respondents with the two lowest cost proposals, Coral Power and Gulf's affiliate, Southern Power, that they had been selected for further contract negotiations.

Gulf's RFP process in this docket, although not required by Commission Rule, was reasonable. With the exception of using Accion as an independent monitor and no identification of a self-build alternative, Gulf's RFP process is consistent with the Commission's solicitation rule, Rule 25-17.082, Florida Administrative Code. The process reviewed the market to find the most cost-effective manner to fulfill Gulf's need for additional capacity. Gulf hired Accion in its RFP process to show that it was fair and reasonable, allowing all interested parties an equal opportunity in the bidding process. Accion had access to all communications with respondents and evaluations of proposals and could determine the transparency and fairness of the solicitation process. In its report on the Gulf Power 2009 RFP, Accion confirmed that the RFP was unbiased, well advertised, contained information readily available to all participants, and gave all participants opportunities to share any concerns about the RFP process. Staff's review of the Accion website and documents provided by Gulf supports Accion's report.

Gulf's evaluation of the proposals submitted revealed that the Coral Contract and the Southern Power Contract were the most cost-effective means of meeting Gulf's forecasted peaking capacity need between 2009 and 2014. The final economic evaluation illustrates that the two contracts are more cost-effective than a comparable self-build combustion turbine. By entering into the contracts, Gulf would move its need to add capacity from 2009 until 2014. There is the possibility that in 2014 increased demand and better economics would permit building a more efficient unit instead of a peaking unit in 2009. Gulf states that when considering the additional cost savings associated with deferring consideration of another capacity alternative to accommodate the use of new generating technology, the projected cost savings to its customers by entering into the Coral and Southern Power Company contracts is approximately $7.7 million in net present value.

Staff believes Gulf's RFP and negotiation process was well-constructed, well-implemented, fair to all participants, and not preferential to its affiliate. Staff also believes that Gulf's cost-effective analysis is reasonable. Gulf's customers will incur savings by entering into the 2009 contracts with Coral Power and Southern Company and will defer the need for additional capacity until 2014. Such a capacity deferral will allow the company to consider other types of technologies that could enhance performance and reduce costs. Finally, by deferring consideration of another capacity choice, Gulf's analysis reveals that entering into the contracts could result in projected cost savings to Gulf's customers of $7.7 million, net present value. Staff recommends that the Commission approve the proposed contracts.

Issue 2: Should this docket be closed?

Recommendation: Yes. If no person whose substantial interests are affected files a protest to the Commission's proposed agency action order within 21 days, the docket may be closed upon issuance of a consummating order. (M. Brown)

Staff Analysis: If no person whose substantial interests are affected files a protest to the Commission's proposed agency action order within 21 days, the docket may be closed upon issuance of a consummating order.