**FLORIDA PUBLIC SERVICE COMMISSION**

**Fletcher Building**

**101 East Gaines Street**

**Tallahassee, Florida 32399-0850**

**M E M O R A N D U M**

**OCTOBER 22, 1992**

**TO : DIRECTOR OF RECORDS AND REPORTING**

**FROM : DIVISION OF AUDITING AND FINANCIAL ANALYSIS (SLEMKEWICZ)**

**DIVISION OF ELECTRIC AND GAS (SHINE)**

**DIVISION OF LEGAL SERVICES (ELIAS)**

**RE : DOCKET NO. 900621-EI, REVIEW OF POWER SALES CONTRACT SETTLEMENT AGREEMENT BETWEEN GULF POWER COMPANY (SOUTHERN COMPANY) AND GULF STATES UTILITIES COMPANY**

**AGENDA: NOVEMBER 3, 1992** **- CONTROVERSIAL - PROPOSED AGENCY ACTION**

**- PARTIES MAY PARTCIPATE**

**CRITICAL DATES:NONE**

**FILENAME: I:\PSC\AFA\WP\GSURECR.JS**

**CASE BACKGROUND**

In 1982, the Southern Companies (including Gulf Power Company) were parties to contracts with Gulf States Utilities Company (GSU) providing for the sale to GSU of unit power capacity from specific coal-fired generating units and other long-term power from fossil units on a system availability basis. Under these contracts, GSU agreed to purchase certain power during the period January 1, 1985 through May 31, 1992. The unit power capacity was to be supplied, in part, from Gulf Power Company's (Gulf) ownership interests in Plant Daniel and Plant Scherer. In 1985, however, GSU requested that negotiations commence and proceed quickly for consideration of the elimination or suspension of capacity sales and purchases.

The ensuing negotiations failed to resolve the matter and GSU filed suit in the U.S. District Court for the Eastern District of Texas on July 2, 1986. The suit was filed against The Southern Company, including Gulf. The complaint sought a judgement declaring that GSU be excused from further obligation under its unit power and other long-term power sales contracts with the Southern Companies and an award for unspecified damages. Among other things, GSU alleged that the Southern Companies had failed to negotiate and renegotiate in good faith to reduce the amount of capacity purchases under the contracts and had engaged in fraudulent conduct in entering into the contracts. The court permitted GSU to make escrow payments under the contracts pending the outcome of the lawsuit.

Subsequently, GSU received orders from the Texas and Louisiana commissions disallowing the recovery of the capacity charges under these contracts. As a result of these actions, GSU refused to make any further escrow payments. Due to GSU's refusal to pay, the Federal Energy Regulatory Commission allowed the Southern Companies to suspend performance under these contracts effective July 1, 1988. On December 5, 1988, the Southern Companies filed a counterclaim against GSU seeking recovery of all past due payments and damages for breach of the contracts.

In December 1990, the Southern Companies (including Gulf) entered into a settlement agreement with GSU setting forth the terms and conditions of the settlement to resolve the pending litigation. After receiving all of the requisite regulatory and court approvals, the settlement agreement documents were executed on November 7, 1991.

As a result of the Settlement Agreement, The Southern Company received cash, a promissory note and GSU common stock with a net present value of approximately $300 million. The net present value of Gulf's portion of the settlement is $27.9 million.

This docket was opened at the conclusion of Gulf's last rate case in Docket No. 891345-EI to monitor the progress and resolution of the Proposed Settlement Agreement.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should any of the $27,883,613 received by Gulf Power Company (Gulf) as a result of the Power Sales Contract Settlement Agreement with Gulf States Utilities Company (GSU) be refunded to Gulf's retail ratepayers?

**RECOMMENDATION:** No.

**STAFF ANALYSIS:** The $27,883,613 settlement that was received by Gulf was allocated to the following components of the GSU contract:

Unit Power Sales - Scherer $10,574,048

Unit Power Sales - Daniel 9,411,484

Unit Power Sales - Energy 2,002,098

Schedule E 3,474,935

Interest 2,421,048

Total $27,883,613

In determining whether the retail ratepayers are entitled to any of the settlement, the various components should be reviewed.

**PLANT SCHERER**

The first component is the $10.6 million related to Plant Scherer. Plant Scherer has never been included in the jurisdictional rate base or NOI, and the retail ratepayers have never provided a return on Plant Scherer. Therefore, the retail ratepayers should not receive any benefit from the settlement attributable to Plant Scherer. In addition, page 13 of Order No. 23573 in Docket No. 891345-EI states that, "All profits and losses derived from unit power sales of Scherer, and any costs or benefits accruing from any settlement with Gulf States Utilities are to go to the stockholders of Gulf Power Company."

**PLANT DANIEL** Now use {Alt i}, type NUMBER, press {ENTER}. Type in the issue statement. Press {ENTER} twice. Now use {Alt r} for recommendation. Press {ENTER} twice after statement. Now use {Alt s} for staff analysis. Press {ENTER} twice after analysis. Now press {Ctrl}{ENTER} for a page break and start {alti-**#**, altr, alts} routine over and over until recommendation is finished. See Linda Huck for further assistance.

The next component to be considered is Plant Daniel. In mid 1970, Gulf committed to purchase a 50% ownership interest of Plant Daniel Units 1 and 2 with its sister company Mississippi Power. In 1981, upon completion of Unit 2, Gulf's ownership interest in Daniel was approximately 511 Megawatts (MW) of coal capacity. The Commission has made a series of adjustments in Gulf's rate cases to separate the amount of capacity needed for territorial customers from the excess capacity used for Unit Power Sales (UPS), sales to the Southern Company Intercompany Interchange Contract (IIC), and Schedule E sales.

In the 1984 rate case, as shown on the attachment, 241 MW of UPS sales out of Plant Daniel were removed from jurisdictional investment and expenses. The remaining 270 MW of Plant Daniel capacity were allocated to jurisdictional customers. In the years 1984 through 1988, increasing amounts of the jurisdictional 270 MW were committed to UPS contracts and Schedule E sales. Profits from the Daniel UPS contracts enured to the benefit of the stockholders. Capacity purchases from the power pool were made to replace the MW sold to GSU from the 270 MW amount whose cost was included in retail rates.

The pool capacity priced at average embedded cost was cheaper than the Daniel capacity which it replaced. The substitution of pool capacity had the effect of increasing NOI resulting in a higher tax savings refund to the ratepayers in 1987. As a result of this, the tax savings for the first half of 1988 were also greater. In addition, the Settlement only allowed Gulf to recoup 30 cents on the dollar of its investment in the 105 MW of Plant Daniel dedicated to GSU during the first half of 1988 while it was excluded from the jurisdictional rate base. However, the inclusion of the additional 105 MW of Plant Daniel in the jurisdictional rate base beginning in July 1988 served to reduce the 1988 tax savings refund for the second half of 1988. On an overall basis for 1988, it is Staff's opinion that these two factors offset each other. In 1989, Gulf's earnings were below the stipulated 13.75% ROE; therefore, the Company did not have a 1989 tax savings refund.

For rate of return surveillance purposes, the Plant Daniel GSU UPS capacity was removed from the jurisdictional rate base and

the associated expenses were removed from the jurisdictional income statement. These adjustments reduced the jurisdictional rate base and increased the jurisdictional NOI, thereby increasing the reported return on equity (ROE). Despite the fact that the base rates still included the revenue requirement for 270 MW of Plant Daniel capacity, Gulf did not exceed its authorized ROE during that time. Therefore, the retail ratepayers are not entitled to any of the settlement related to Plant Daniel.

**UPS ENERGY**

Since the UPS Energy is related to Plant Scherer and Plant Daniel, this $2,002,098 component should also enure to the benefit of Gulf's stockholders.

**SCHEDULE E**

Schedule E Sales are firm capacity and energy contracts with a take or pay provision requiring a capacity payment regardless of the purchasing utility's utilization. Schedule E sales are negotiated on a total Southern Company price which reflects the age, price and dispatch order of the various units within the Southern Company system. Availability of units is calculated based on MW which are in excess of the territorial and UPS amounts. In Gulf's 1984 rate case, a test year Schedule E revenue credit of approximately $ 6,975,000 was included in the calculation of the jurisdictional revenue requirement for the ratepayers. The Schedule E revenue credit was used to calculate rates on a going foreword basis until the next rate case in 1990. These revenues increased and decreased during this period in a manner similar to most other expenses and revenues between rate cases. Gulf reported the actual monthly Schedule E revenues in the surveillance reports when calculating their earnings and tax savings refunds in 1987 and 1988. Therefore, the retail customers are not entitled to the settlement related to Schedule E sales because these amounts did not cause Gulf to over earn during these periods.

**INTEREST**

Since the interest is related to the other components, this component should also enure to the benefit of the stockholders.

**ISSUE 2:** Should this docket be closed?

**RECOMMENDATION:** Yes. This docket should be closed if no protest is filed within 21 days following the issuance of the Notice of Proposed Agency Action.

**STAFF ANALYSIS:** If no protest is timely filed, the Order will become final. Absent an appeal, no further Commission action will be required. Therefore, this docket should be closed.