State of Florida

Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: April 23, 2015

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Engineering (Graves)
Division of Accounting and Finance (Barrett, Lester, Trueblood)
Division of Economics (McNulty, Wu)
Office of the General Counsel (Ames)
Office of Industry Development and Market Analysis (B. Crawford)

RE: Docket No. 150049-EI – Petition for approval of energy purchase agreement between Gulf Power Company and Morgan Stanley Capital Group Incorporated.

AGENDA: 05/05/15 – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: Based on a termination provision contained in the Agreement, a final Commission decision must be rendered by August 20, 2015.

SPECIAL INSTRUCTIONS: None

Case Background

On February 11, 2015, Gulf Power Company (Gulf or Company) filed a petition requesting approval for cost recovery of a negotiated Energy Purchase Agreement with Morgan Stanley Capital Group Inc.[1] (Morgan Stanley). The Energy Purchase Agreement (Agreement) obligates Morgan Stanley to deliver to Gulf a fixed number of megawatt hours (MWh) in each hour of each month of each year throughout the 20 year term of the Agreement.

[1] Morgan Stanley Capital Group Inc. is a wholly-owned subsidiary of Morgan Stanley.

Morgan Stanley's energy delivery commitment is shaped to match the projected hourly and monthly output of a 178 megawatt portion of a wind electric generation facility known as the Kingfisher Wind Farm that is to be constructed in Oklahoma.[2] On an annual basis, Morgan Stanley's energy delivery commitment totals 674,437 MWh. On January 21, 2015, Morgan Stanley entered into an agreement with the owner of the Kingfisher Wind Farm for Morgan Stanley to financially hedge the energy output of the Kingfisher Wind Farm.

Under the Agreement, Gulf is only required to pay for energy which is received from Morgan Stanley on the Southern Companies Transmission System. Energy delivered under the Agreement to the Southern Companies Transmission System will be assigned to Gulf at the prices designated in the Agreement. Although the energy received on the Southern Companies Transmission System may not come from renewable generation, Gulf will be entitled to receive and retain all environmental attributes, including renewable energy credits (RECs), associated with the corresponding output of the Kingfisher Wind Farm.

The Agreement contains a termination provision for failure to obtain Commission approval of the Agreement through a final non-appealable order within 240 days of filing. Based on the termination provision contained in the Agreement, a Commission decision must be rendered by August 20, 2015. In its petition, Gulf indicated that timely Commission approval is critical, because the Agreement requires that the Kingfisher Wind Farm be in-service on or before December 31, 2016, in order to qualify for federal business energy investment tax credits.

On February 19, 2015, the Office of Public Counsel filed a petition to intervene in the docket. On February 20, 2015, the Commission issued an order acknowledging the Office of Public Counsel's intervention.[3]

The Commission has jurisdiction over this matter pursuant to Sections 366.051, 366.91, and 366.92, Florida Statutes (F.S.).

[2] The Kingfisher Wind Farm is expected to have a full nameplate capacity of approximately 300 MW.
[3] Order No. PSC-15-0109-PCO-EI issued: February 20, 2015, in Docket No. 150049-EI, In re: Petition for approval of energy purchase agreement between Gulf Power Corporation [Company] and Morgan Stanley Capital Group Incorporated.

Issue 1: Should the Commission approve Gulf Power Company's petition requesting recovery of costs incurred under a negotiated Energy Purchase Agreement with Morgan Stanley Capital Group Inc.?

Recommendation: Yes. Gulf has reasonably demonstrated that the Agreement will likely produce savings between $11 million and $48 million and will encourage the development of renewable energy. Therefore, staff recommends that the Commission approve Gulf's petition. (Graves, McNulty, Trueblood, Wu)

Staff Analysis: Gulf's petition requests approval for the recovery, through the Fuel and Purchased Power Cost Recovery Clause (fuel clause), of costs associated with the Agreement between the Company and Morgan Stanley. Staff believes that Rule 25-17.0825(6), Florida Administrative Code (F.A.C.), provides a rational evaluation tool for the Agreement between Gulf and Morgan Stanley. Rule 25-17.0825(6), F.A.C., requires consideration of cost-effectiveness and any adverse impacts to electric service that may be caused by a purchased power agreement.

Economic Evaluation of Payments

The Agreement was analyzed, negotiated, and executed under Gulf's 2014 energy budget which included the Company's 2014 fuel price forecasts. Based on the Company's 2014 energy budget, the Agreement is projected to result in a savings of approximately $48 million (in 2015 dollars) with savings occurring in each year of the 20-year term. Following the negotiation and execution of the Agreement, Gulf's 2015 energy budget was released and the Company performed a second economic evaluation based upon the 2015 forecasts. Based on Gulf's second economic evaluation, the Agreement is projected to result in a savings of approximately $11 million with savings again occurring in each year of the 20-year term.

Gulf indicated that the primary driver of the differences between the 2014 and 2015 evaluations is a lower fuel cost projection for the 2015 energy budget. Staff reviewed both of the fuel price forecasts, as well as the process and methodology by which the forecasts were developed. In response to a staff data request, the Company asserted that the methodology it employed in developing the fuel price forecasts used in this docket is the same as that used by the Company to develop its 2014 Ten-Year Site Plan. Staff believes that Gulf's 2014 and 2015 fuel price forecasts are reasonable for evaluating the Agreement.

Gulf's payments to Morgan Stanley, which are fixed for each year of the Agreement, will not change as Gulf's avoided energy costs change. This allocates the risk of fuel price fluctuations, which impact avoided energy costs, to Gulf's ratepayers. Although there is a risk that fuel costs may be lower than those forecasted by Gulf, which would reduce the benefits of the Agreement, other variables not considered in Gulf's economic evaluation could increase the benefits. Specifically, staff believes an economic evaluation that considered the potential benefits associated with RECs would increase the benefits of the Agreement.

Per the Agreement, RECs will be sourced directly from the Kingfisher Wind Farm. If, however, the energy output falls below Morgan Stanley's energy delivery commitment, RECs will be sourced from other comparable wind facilities. Gulf anticipates receiving more than 13 million RECs (one REC per delivered MWh) over the term of the Agreement. Gulf stated that RECs are presently selling on the voluntary market for approximately $0.85 per REC. In its petition, Gulf stated that proceeds from the sale of RECs would be returned to Gulf's ratepayers in the form of credits to the fuel clause. Should Gulf decide to sell its RECs, the Company's proposed treatment of RECs associated with the Agreement is appropriate because the proceeds from any sale of the RECs will benefit ratepayers.

The RECs also have the potential to assist the Company in complying with Renewable Portfolio Standards or similar compliance obligations should they arise in the future. Staff recommends that Gulf's proposed treatment of RECs associated with the Agreement is appropriate, because the proceeds from any sale of the RECs will benefit ratepayers in the form of credits to the fuel clause.

Based on the information provided, staff concludes that Gulf's economic evaluations reasonably demonstrate that the Agreement is cost-effective. While there is risk associated with the Agreement and potential fuel price fluctuations, staff believes potential benefits from renewable attributes increases the likelihood that the Agreement will result in savings to Gulf's ratepayers over the term of the Agreement.

Electric Service Adequacy and Reliability

The Agreement allows Gulf to curtail energy deliveries under various circumstances including emergency conditions. Staff believes that this provision adequately ensures that the reliability of the Southern Companies Transmission System as well as Gulf's electric service will not be adversly impacted by the energy delivered under the Agreement.

Additional Considerations

The Agreement contains provisions that encourage the construction and performance of the Kingfisher Wind Farm. The Agreement provides for daily liquidated damages for construction delays and certain termination rights in the event that the Kingfisher Wind Farm does not reach commercial operation as required by the Agreement. Commercial operation is anticipated to be achieved on or before December 31, 2015, but may occur no later than December 31, 2016, under the Agreement.

The Agreement also provides that a failure to deliver hourly energy, in amounts specified in the Agreement, will result in Morgan Stanley paying cover costs to Gulf. Per the Agreement, if Morgan Stanley fails to pay such cover costs, or the failure to deliver energy exceeds certain limits, Gulf has the right to declare the contract in default and Morgan Stanley must pay a termination payment. Staff believes this requirement, as well as the commercial operation requirement discussed above, is favorable to Gulf and its ratepayers.

Conclusion

Staff concludes that Gulf has reasonably demonstrated that the Agreement will likely produce savings between $11 million and $48 million and will encourage the development of renewable energy. Therefore, staff recommends that the Commission approve Gulf's petition.

Issue 2: Should this docket be closed?

Recommendation: Yes. This docket should be closed upon issuance of a Consummating Order unless a person whose substantial interests are affected by the Commission's decision files a protest within 21 days of the issuance of the proposed agency action. (Ames)

Staff Analysis: This docket should be closed upon issuance of a Consummating Order unless a person whose substantial interests are affected by the Commission's decision files a protest within 21 days of the issuance of the proposed agency action.