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PLEASE REPLY TO:
TALLAHASSEE

January 9, 1991

BY HAND DELIVERY

Mr. Steve Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399

Re: Petition of Florida Power and Light Company for Inclusion of the Scherer Unit No. 4 Purchase in Rate Base, Including an Acquisition Adjustment, Docket No. 900796-EI

Dear Mr. Tribble:

Enclosed for filing and distribution are the original and 15 copies each of Nassau Power Corporation's Brief and Post-Hearing Statement of Issues and Positions.

Also enclosed is an extra copy of Nassau Power Corporation's Brief and Post-Hearing Statement of Issues and Positions. Please stamp both with the date of filing and return them to me.

Thank you for your assistance.

Sincerely,

Joe McGlothlin

Joseph A. McGlothlin

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Florida Power and Light Company for Inclusion of the Scherer Unit No. 4 Purchase in Rate Base, including an Acquisition Adjustment.	)	DOCKET NO. 900796-EI FILED: January 9, 1991

BRIEF

OF

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BACKGROUND

Through a "Request for Proposals" ("RFP"), in July 1989, FPL invited cogenerators, utilities and independent power producers to offer to provide generating capacity to meet FPL's projected 1996 need for capacity. FPL was aware at the time that its need for capacity in 1996 might be affected by its obligations relative to cogeneration projects which could arise pursuant to the Commission's rules. (Tr. 172). These projects could take the form of negotiated contracts or standard offer contracts. (Tr. 188). At the time the RFP was issued, the standard offer was inapplicable to the 1996 in-service date. (FPL Petition, p. 9).

Interested entities submitted responses to FPL's RFP in January 1990. One respondent, Southern Company, proposed a Unit Power Sales ("UPS") contract between Southern and FPL that would contractually commit firm capacity from Southern's Scherer 4. (Tr. 178, 215).

Soon after the responses to the RFP were received, and while FPL was evaluating those responses, Southern and FPL began to discuss the possibility of a "bricks and mortar" sale of Scherer 4. This alternative, raised outside the RFP, became the subject of negotiations which took place between Southern and FPL independent of the ongoing RFP process. (Tr. 195-96).

On May 21, 1990, the Commission designated a 1996, 500 MW coal-fired unit as the new statewide avoided unit and directed

utilities to prepare standard offer contracts based on the cost parameters and in-service date of that unit. (Order No. 23234).

On June 13, 1990, Nassau Power Corporation tendered to FPL a standard offer contract to deliver 435 MW of firm capacity beginning January 1, 1996. (Exh. 16). Other standard offer contracts followed during the summer and fall. The Commission conducted proceedings to determine which contract(s) subscribed the statewide avoided unit. (Order No. 23792, Docket No. 900004-EU).

FPL excluded Nassau's contract and project from the inventory of cogeneration projects which is incorporated into its projections of generation supply and its calculation of needed capacity. (Tr. 316).

In the May-June time frame, FPL, using confidential evaluation criteria, settled upon Southern's Scherer 4 UPS proposal as its preferred alternative of those submitted under the terms of the RFP. (Tr. 256). FPL did not inform Southern of that result because FPL and Southern were still negotiating a possible "bricks and mortar" sale of the unit. FPL wanted to finalize a letter of intent with Southern on the sale/purchase before it informed Southern of the results of the RFP evaluation. (Tr. 257).

On July 31, 1990, FPL and Southern signed a letter of intent describing arrangements for the sale/purchase of Scherer 4. (Exh. 13, Document 2). Later on the same day, FPL distributed to all participants in the RFP process a letter to

Southern stating that Southern's RFP submission had been chosen by FPL to become the basis for the development of a capacity addition. (Tr. 253; Exh. 11). This letter was sent after FPL had decided to proceed with the non-RFP alternative of buying the unit. (Tr. 256).

In late September, FPL petitioned the Commission to authorize it to place the investment in Scherer 4 contemplated by the letter of intent in its rate base.

On November 1, 1990 the Commission designated Nassau's standard offer contract as subscribing the first 435 MW of the 1996 500 MW statewide avoided unit. (Order No. 23792). FPL continued to exclude Nassau's project from its generation expansion plan. (Tr. 317).

SUMMARY OF ARGUMENT

The Commission should take no action on FPL's petition. To enable it to discharge its responsibility to fully protect ratepayers, the Commission must review any transaction for prudence and reasonableness after it has been consummated and in light of all pertinent facts. If the transaction is prudent and reasonable, it can be justified at that time. By arguing that advance approval of this proposed transaction is necessary, FPL suggests that it is not confident it can meet the burden of demonstrating prudence and reasonableness.

Approval by the Commission of the proposed Scherer 4 purchase in advance of the transaction is not legally required to enable FPL to proceed. It is a "condition" only of a non-binding letter of intent; FPL admits it could waive that condition now and proceed even if the Commission does not approve rate base inclusion at this time. Even the "urgency" of the time frame for decision--such as it is--was contrived and self-imposed by FPL.

FPL pins its hopes for dispensation from traditional regulatory scrutiny on economic comparisons of the Scherer 4 purchase with several scenarios, including the discounted standard offer. The results of those exercises are functions of the assumptions which are made concerning cost parameters. An examination reveals that certain of FPL's assumptions are unreasonable, unsupported, and serve to bias the analysis in favor of the Scherer 4 acquisition. Still, the results of FPL's

comparisons do not support the extraordinary action requested by FPL.

The looming of a huge acquisition adjustment for which customers would pay constitutes more of a reason, not less, to perform any prudence review and process the related rate base request after the transaction, when all pertinent facts could be fully and deliberately reviewed. However, this case involves much more than FPL's attempt to eliminate its business risk and gain approval of an acquisition adjustment before the final contract documents are even available for review. It also involves FPL's attempt to preempt the Commission's mechanism for allowing cogenerators to meet a portion of the state's need for capacity by subscribing the Commission's designated statewide avoided unit. When it identified capacity sources other than Scherer 4 which could meet its 1996 need, FPL improperly disregarded Nassau's standard offer contract with FPL, which by Commission vote counts toward the first 435 MW of the Commission's 500 MW 1996 statewide avoided unit.

By its premature request, FPL hopes to exclude Nassau's project from capacity which could meet FPL's individual need and simultaneously be absolved of ignoring the Commission's policies. The Commission must avoid this result, whatever action it takes. Any consideration of the prudence of the proposed Scherer 4 transaction--which, again, should take place after the fact--must include FPL's failure to take the Commission's mechanism and Nassau's contract into account. Only

if the need exists for both Nassau's project and the proposed Scherer 4 purchase would this cavalier treatment of the Commission's policy have no bearing on the prudence issue.

If the Commission takes action, Nassau submits that it should not in any event approve for rate base inclusion more than the first increment of Scherer 4 capacity. By reserving a decision on the balance of FPL's request until after consideration of Nassau's project in a determination of need setting, the Commission can provide an opportunity to effectuate its policy by carrying the subscription process to completion.

Issue 1: Should the difference between FPL's purchase price and Georgia Power's net original cost of Scherer Unit 4 be given rate base treatment as an acquisition adjustment on a pro rata basis consistent with the phased purchase of the unit?

As framed, this issue seems to presume a decision favorable to FPL authorizing rate base treatment. The order of voting should recognize that the issue does not arise unless and until the threshold issue of FPL's rate base request has been determined.

The Commission should take no action on any portion of FPL's petition--including the request for approval of an acquisition adjustment--until after any transaction has been consummated and all the pertinent facts can be reviewed. At that time, whether to include or exclude the acquisition adjustment would be dependent upon a finding that management's

decision to acquire 646 MW of Scherer 4 capacity was prudent and the costs reasonable. One aspect of the review would be FPL's failure to take into account Nassau's standard offer contract and the Commission's policies regarding subscription of the designated statewide avoided unit when FPL measured its need for capacity in 1996. The Commission should not by its action on FPL's petition endorse FPL's conscious disregard of the Commission's cogeneration policy or allow FPL to preempt the Commission's mechanism for implementing that policy.

Issue 2: Does FPL, as an individual utility interconnected with the statewide grid, exhibit a need for the additional capacity provided by Scherer Unit 4?

Whether FPL exhibits a need for the 646 MW of Scherer 4 depends upon the relationship between FPL's load and the other resources available to serve that load. FPL has not included the 435 MW of Nassau's project in its generation expansion plan, even though (1) FPL acknowledges the ability of PSC rule-based cogeneration projects to provide capacity to FPL (Tr. 172); (2) the terms and conditions of Nassau's standard offer contract were preapproved by the Commission; (3) the Commission has determined that Nassau's contract subscribes the Commission's designated statewide avoided unit; and (4) at the same time it chose to disregard Nassau's contract, FPL included a contract between FPL and ICL that had not even received Commission approval. (Tr. 400).

Nassau has not attempted to independently measure FPL's need for capacity in 1996. Nassau's position is that, because of the policy and rules governing standard offer contracts at the time and in light of the Commission's November 1 action, FPL should include Nassau's contract in the "contracted or committed" portion of its generation expansion plan (as it did the Indiantown contract) prior to including the Scherer 4 purchase. In other words, the Commission should not help FPL preempt the Commission's own cogeneration policy by unnecessary regulatory action. As stated above, the Commission should take no action on the petition. If it does take action, the Commission's decision should recognize the legitimate role of the subscription of the statewide avoided unit in meeting FPL's 1996 need for capacity. Any decision in this case, including measurement of need, should recognize the Commission's November 1 vote and provide to Nassau a reasonable opportunity to pursue its project and implement the Commission's policy.

While Nassau strenuously opposes any action, Nassau submits that in no event should the Commission approve for inclusion in rate base more than the first increment of Scherer 4 capacity. The Commission should express its intent to consider Nassau's project in a determination of need setting before considering the balance of FPL's request.

During the hearing, FPL sought to attack both the Commission's policy and Nassau's contract. Its challenges were singularly ineffectual. For instance, during cross-examination

of Dr. Dennis Thomas, FPL's counsel asked whether Dr. Thomas would be in favor of enforcing a standard offer contract even if it meant requiring the utility to purchase power more expensive than it could itself provide. As Dr. Thomas quickly pointed out, the question was hypothetical and inapposite. Nassau's discounted standard offer contract clearly is less expensive than the IGCC unit described by FPL as next in its own plan. (Exh. 18, Document 10). More significantly, the question was directed--not at Nassau's project--but at the Commission's consciously designed policy, firmly in place at the time of Nassau's contract, of establishing a statewide market for QF power. In fact, FPL's next question undermined its "point." Mr. Childs asked Dr. Thomas to agree that Nassau could have signed a standard offer with a utility other than FPL. (Tr. 414). The question acknowledges--in fact employs--the very statewide market which the earlier question attempted to criticize.

FPL also sought to challenge aspects of Nassau's contract on legal grounds by questioning Nassau's plan for interconnection. FPL's questions concerning Nassau's intent to interconnect at FPL's Yulee Substation have two aspects. The first is the suggestion that Nassau must interconnect with Florida Public Utilities Company. The second relates to Nassau's plan to purchase start-up power from FPL via the transmission line it intends to construct from the site of the steam host on Amelia Island to FPL's substation.

The Interconnection with FPL

The contention concerning the site of interconnection loses on two grounds. First, a QF has the unqualified right under PURPA to sell to and, incidental to that sale, interconnect with any utility. Second, transmission lines associated with and necessary to the generating unit are included as a part of the "Qualifying Facility."

The FERC has recognized the right of QFs under PURPA to sell to distant utilities, and the obligation of utilities to purchase QF power that can be delivered to their systems. Utah Power and Light Co., 45 FERC ¶61,095 (1988), rehearing granted in part and denied in part, 47 FERC ¶61,209 (1989).

State regulatory agencies have similarly acknowledged the "reach" of QFs under PURPA. In Smith Cogeneration, Inc., 112 PUR 4th 92 (1990), Smith proposed to build a cogeneration facility in Danville, Virginia, outside of the service area of Virginia Electric and Power Company; provide transmission facilities (with the city's active involvement) to interconnect with VEPCO's system; and sell its power to VEPCO. The Virginia State Corporation Commission concluded that, pursuant to PURPA, VEPCO was obligated to purchase power from Smith.

Finally, when one couples the fact that, according to the FERC, section 210 of PURPA "does not limit the obligation to purchase to any particular utility; rather, it is a generally applicable requirement" with the observation that ". . . an electric utility must make any interconnections with a

qualifying facility which may be necessary to permit purchases from or sales to the qualifying facility," Nassau's right under PURPA to interconnect with FPL is clear. FERC Statutes and Regulations, Regulations Preambles, 1977-1981, ¶30,128 at pp. 30,872, 30,874.

Contrary to the suggestion implicit in FPL's questions to Dr. Thomas, the exercise of that right does not conflict with the language of Nassau's contract. Because the 12 mile transmission line is a part of the qualifying facility, a portion of the QF will be in FPL's service area. Beginning with the case of Clarion Power Company, 39 FERC ¶61,317 (1987), the FERC has on many occasions included a transmission line, switching and/or interconnection facilities as part of the certified qualifying facility. With respect to transmission lines, it has done so where the line is an integral part of and necessary to the operation of the facility and is used only to transmit power from the QF to the purchasing utility or (in many instances) backup and maintenance power from the utility to the QF. Clarion involved a small power producer located in the service area of one utility which wished to interconnect with a different utility whose need for power and avoided cost rates were greater. In Clarion, the FERC quoted from its preamble to the regulations:

> In the preamble to section 292.303(b) of the Commission's regulations, where the Commission establishes the requirement of the electric utilities to sell electric energy to qualifying facilities, the

Commission stated:

> . . . the Commission requires electric utilities to serve any qualifying facility, and . . . to interconnect with any such facility as required in paragraph (c). However, an electric utility is only required to construct lines or other facilities to the extent authorized or required by state or local law. As a result, a qualifying facility outside the service area of a utility may be required to build its line into the service area of the utility.

Id., at ¶62,013.

Viewing its own language, the FERC reflected, "Clearly, the Commission had considered the possibility of a qualifying facility building a transmission line in order to interconnect with the purchasing utility." Id. It then concluded that including the line as a part of the qualifying facility was permitted by PURPA, necessary to avoid cumbersome regulations under the Federal Power Act, and consistent with PURPA's goals of encouraging the development of cogeneration and providing a market for the power from such facilities. Id. at ¶62,013-14.

The FERC has included associated transmission lines as part of the QF in a variety of factual circumstances and physical configurations, including situations similar to Clarion and to the case at hand. Examples of the many FERC decisions similar to Clarion include Panther Creek Operating Limited Partnership, 42 FERC ¶62,172 (1988) (30 mile transmission line needed to interconnect with different utility having greater avoided cost

rates); Oxbow Geothermal Corporation, 43 FERC ¶61,286 (1988) (small power producer in Nevada, in an area of limited utility transmission capacity, built a 214 mile, 230 KV line to distant utility); Gamma Mariah, Inc., 44 FERC ¶61,442 (1988) (46 miles of 230 KV line collectively owned by several entities defined as part of QF;) N.B. Partners, Ltd., 45 FERC ¶62,074 (1988) (FERC defined as part of the Qualifying Facility a 6.7 mile line used only to deliver power to the purchasing utility); and Penntech Papers, Inc., 48 FERC ¶61,120 (1989) (cogenerator had option of building a 7 mile line to Utility A, which would then wheel to purchasing Utility B, or alternatively of building a 58 mile line direct to the distant purchasing utility--the FERC defined the QF so as to include either). Accordingly, a portion of Nassau's Qualifying Facility will physically be located in FPL's service area.

Even if this Commission were to conclude, despite the above authority, that the Nassau QF is not in FPL's service territory, this would not relieve FPL of its obligation to interconnect with and purchase energy and capacity from Nassau pursuant to the federal mandate and the standard offer and COG-2 tariff. Both those documents make it clear that a utility must purchase from a QF, irrespective of the QF's location, so long as the QF transmits the power to the utility. See Exhibit 18 (standard offer contract between Nassau and FPL), ¶3, ¶4.1; Exhibit 19, Third Revised Sheet No. 10.200 (interconnection agreement between Nassau and FPL), Availability (FPL will purchase from

any QF "irrespective of its location"), Applicability (tariff applicable to any QF "irrespective of location.")

FPL also advanced, through questions at hearing, the legal argument that the "standard form" interconnection agreement is a part of the "standard offer" contract to purchase capacity and energy. The applicable documents and rules belie this contention. The standard offer contract contemplates and refers to a separate interconnection agreement, which (1) is not required by the power purchase document to be the utility's standard form and (2) is treated--not as part of the standard offer contract to purchase power--but as a separate instrument to be appended to it. This treatment of the interconnection agreement is to be contrasted with the standard offer contract's treatment of the COG-2 rate schedules which are incorporated into the terms of the contract by reference. (Exh. 16, Sheet No. 9.856). Further, the Commission's rules prescribing the content of standard offer contracts recognize that the standard offer contract governs the prices, terms and conditions for the purchase of firm capacity and energy, Rule 25-17.083(3), Florida Administrative Code ("old rules"). A separate rule governs the different subject of interconnection, and calls for a different document. Rule 25-17.087, Florida Administrative Code ("old rules"). Therefore, to state in a proffered interconnection agreement that the facilities and costs identified therein are subject to modification upon mutual agreement is not to "modify"

the standard offer contract for the purchase of firm capacity and energy.

FPL attempted to characterize its unaltered "standard form" for an interconnection agreement as the only permissible vehicle. That argument is refuted by the very language of the pertinent documents.

First, the standard offer contract refers--not to a specific "standard" interconnection agreement--but to an interconnection agreement. (Exh. 16, 3d Revised Sheet No. 9.850). This language contemplates the possibility of the use of an agreement other than the utility's standard form.

Second, and perhaps most telling, FPL's COG-2 tariff contemplates and provides for variations on the "form" interconnection agreement. Paragraph (5)[1] of the Terms of Service on Third Revised Sheet No. 10.206 of FPL's COG-2 tariff explicitly recognizes that the QF need not use the exact

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[1] Paragraph (5) provides:

> The Qualifying Facility must enter into an interconnection agreement with the Company which will, among other things specify safety and reliability standards for the interconnection to the Company's system. In most instances, the Company's filed Interconnection Agreement for Qualifying Facilities will be used; however, special features of the Qualifying Facility or its interconnection to the Company's facilities may require modifications to this agreement or the safety and reliability standards contained therein.

Emphasis supplied.

interconnection form provided by the utility but that modifications may be required in individual circumstances.

It is clear that FPL doesn't like the Commission's rule creating a statewide market for QF power which governed Nassau's contract; and doesn't like finding itself with responsibilities under a standard offer contract prescribed by the Commission that may hinder its preferred course of action. However, FPL has made no showing that it had any legitimate basis for ignoring either the Commission's mechanism for subscribing the statewide avoided unit or Nassau's contract.

Start-up Power

FPL also vaguely questioned the ability of Nassau to purchase power from FPL. Apparently FPL was alluding by its questions to the case of Lee County Electric Cooperative v. Marks, 501 So.2d 585 (Fla. 1987). There, the Florida Supreme Court ruled that the Commission had erred in refusing to provide Lee County Electric Coop with a hearing on its allegations of a violation of a territorial agreement. The Court proceeded in its opinion to offer dicta concerning the significance of territorial agreements between utilities to Florida's regulatory scheme. At hearing, FPL did not suggest that the area is the subject of a territorial agreement between FPL and FPUC. More significant, however, is the fact that start-up power from FPL--while one expedient, logical alternative--is not necessary to Nassau's project. Nassau could elect to purchase start-up power

from FPUC or could install its own start-up generation capability. (Tr. 442).

Issue 3: Is the capacity to be provided by the purchase of Scherer Unit 4 reasonably consistent with the needs of Peninsular Florida, taking into consideration timing, impacts on the reliability and integrity of the Peninsular Florida grid, cost, fuel diversity and other relevant factors?

As to timing, the basic economic principle underlying capacity additions is that the requirement of capital expenditures should be deferred as long as possible, thereby minimizing the present value of the cost of capacity additions. In its zeal to add Scherer 4 to its rate base, FPL proposes to incur costs for capacity additions years before the capacity is needed in 1996, with the result that on a present value basis the fixed costs associated with acquiring Scherer 4 capacity far exceed the present value of the corresponding costs associated with the discounted 1996 standard offer. (Tr. 29; Exh. 18, Document 10).

As its response to the balance of this issue, Nassau incorporates by reference its positions on the other identified issues, which also treat reliability and cost.

Issue 4: How will the proposed purchase of Scherer Unit 4 affect the reliability and integrity of FPL's electric system?

The proposal to acquire Scherer 4 is but one alternative for supplying reliable capacity. As shown in other sections of the brief, FPL has not shown the proposed Scherer 4 purchase to be advantageous relative to the discounted standard offer contract.

Issue 5: How will the proposed purchase of Scherer Unit 4 affect the adequacy of the fuel diversity for FPL's system?

Nassau takes no position on this issue.

Issue 6: Has FPL reasonably considered alternative supply side sources of capacity?

In order to enhance its quest for the acquisition of--and the placement in rate base of--Scherer 4, FPL has totally disregarded the Commission's mechanism for providing capacity through the subscription by QFs of the Commission's designated statewide avoided unit. FPL witness Roberto Denis testified that the RFP issued by FPL was not designed to minimize FPL's obligations to purchase QF capacity which could become available--in the form of negotiated or standard offer contracts--pursuant to the Commission's cogeneration rules. (Tr. 188). Notwithstanding FPL's lip service to cogeneration in its petition (FPL Petition, p. 9), FPL by its actions is trying

to avoid the impact of those rules and to thwart the activities of the Commission in implementing those rules. By unilaterally placing Nassau's standard offer contract in limbo rather than including it among committed 1996 resources--notwithstanding the Commission's November 1, 1990 decision memorialized in Order No. 23792--FPL has refused to incorporate a source of capacity which is a direct consequence of the Commission's cogeneration policy. Neither FPL's misplaced legal challenges nor its unpersuasive economic comparisons warrant that refusal.

Issue 7: Does FPL's power supply plan reasonably consider the ability of conservation or other demand side alternatives to mitigate the need for the capacity represented by the purchase of Scherer Unit 4?

Nassau takes no position on this issue.

Issue 8: Is the purchase of Scherer Unit 4 the most cost-effective means of meeting FPL's capacity needs, taking into account risk factors that are part of the cost-effectiveness analysis?

Two types of analyses can be used to gauge the relative economics of capacity alternatives: "value of deferral" and "revenue requirements." Value of deferral considers, on a present value basis, the total of the fixed costs of capacity, the O&M expense associated with the unit, and the cost of fuel consumed by the unit over its life. (Tr. 491).

FPL used the "value of deferral" approach to compare alternatives in the recent Indiantown determination of need case. (Docket Nos. 900709-EQ, 900731-EQ). In fact, with respect to the comparison between the Indiantown project and the standard offer, the value of deferral method--which does not encompass system fuel costs--was the only comparison which FPL performed. (Tr. 563). If the approach was meaningful enough to enable FPL to base its claims in favor of the Indiantown contract on that methodology, it is certainly pertinent to the relative economics of the Scherer 4 transaction and the discounted standard offer.

Based upon FPL's own exhibit (Waters' Exh. 18, Document 10), it is clear that the present value of the total of unit-specific costs (capacity, O&M, and unit fuel costs) is far less with the discounted standard offer than with the Scherer 4 acquisition. This is true even after one removes from the cost of Scherer 4 capacity $136 million of transmission improvements associated with that scenario (Tr. 497), and even though Mr. Waters priced out for the comparison 646 MW of standard offer capacity--an impossibility, given the subscription limit of 500 MW.

Mr. Waters testified that, in order to make the value of deferral analysis comparable to that which he performed in the Indiantown case, it would be necessary to equalize the assumed capacity factors of the units. This was done in Exhibit 25, which includes both the Scherer 4 unit and the standard offer

unit at a 70% capacity factor. Given the lack of materiality of any minor compensating adjustments to capacity payments which would be occasioned with the different capacity factor in the Scherer 4 scenario, Mr. Waters acknowledged that Exhibit 25 forms the basis for an economic comparison analogous to the one between the Indiantown contract and the standard offer contract which he sponsored in the Indiantown case. (Tr. 560). On a present value basis, utilizing the "value of deferral" approach--which incorporates capacity costs, O&M costs, and unit fuel costs--the discounted standard offer is cheaper than the Scherer 4 acquisition by some $304 million.[2] For a frame of reference, the entire <u>total</u> of costs associated with the Scherer 4 acquisition scenario under the value of deferral method is only $1.9 billion. (Tr. 561). In other words, the difference is significant and material.

FPL's claim that the Scherer 4 acquisition is superior economically to the discounted standard offer (and other alternatives) rests upon its assertion that the impact of the unit on system fuel costs over 30 years will more than offset the serious economic <u>disadvantages</u> of incurring with Scherer 4 significant capacity costs well prior to 1996 and of burning in Scherer 4 fuel more expensive than that associated with the

[2] This number results from summing and comparing the values for capacity, O&M, and unit fuel costs at 70% capacity factor from Exhibit 25 (difference of $440 million, Tr. 562) and then subtracting from that difference the $136 million of transmission costs which Mr. Waters built into the Scherer scenario. (Tr. 497). <u>It continues to incorporate</u> FPL's impossible assumption of 646 MW of standard offer capacity.

statewide avoided unit. FPL's "revenue requirments" exercises yielded a difference in total costs between the Scherer 4 acquisition and the discounted standard offer of only 0.5%. (Tr. 566). On close inspection of even this small differential (something not possible if limited to the scant information which FPL supplied prior to the hearing in its direct case), the claim doesn't hold up. FPL's assertion loses credibility when the "revenue requirements" methodology and assumptions are examined.

<u>Methodology</u>

To predict system fuel costs over time, FPL utilizes a computer program which is designed to mimic the way FPL actually dispatches the units on its system. The actual dispatch system takes into account a myriad of variables. In reviewing the attempt to duplicate mathematically what the dispatch system does physically, the first inquiry should be the accuracy which is associated with the attempt. Mr. Waters uses two "production costing simulation" programs--PROMOD and PROSCREEN. To test the ability of the program to faithfully replicate the actual system, it is possible to "benchmark" it by comparing calculations generated by the program to known real results. (Tr. 501). PROMOD is by far the more detailed and sophisticated of the two.

However, Mr. Waters did not use PROMOD in these analyses; he used PROSCREEN, which he described as a simpler, less

detailed tool. (Tr. 501). While it would have been possible to calibrate these applications of PROSCREEN for accuracy by benchmarking them against PROMOD, Mr. Waters chose not to do so. (Tr. 503).

Other information concerning Mr. Waters' methodology which was developed during the hearing also makes his conclusion suspect. Mr. Waters purports to have "studied" a period of 30 years. For the last one third of that period, however, Mr. Waters assumed that system load would not change and that no additions would be made to the generating mix. (Tr. 525). In other words, for the last ten years of the exercise he held other variables constant and simply assumed that fuel would continue to escalate. (Tr. 525). Mr. Waters acknowledged that he could have optimized the generation expansion plan for the last ten years, but he explained that FPL typically does not prepare load projections for such distant periods. (Tr. 526). Either the methodology contains shortcuts, or the methodology is incapable of performing a rigorous 30 year analysis. In either event, the simplifying assumptions for the latter part of the "study period" only exacerbate the unreliability of the numbers.

Assumptions

The reliability of the results of a production costing simulation is no better than the quality of the assumptions concerning cost variables that are incorporated into the calculation. In its economic comparisons of alternatives, FPL's

assumptions in the areas of fuel costs, economy energy, and terms and conditions of UPS power are unreasonable, unsupportable, and serve to tilt the exercises in favor of the Scherer 4 acquisition.

1. Fuel--FPL reviewed two Scherer 4 "scenarios"--the UPS arrangement submitted by Southern as a proposal under the RFP process and the "bricks and mortar" Scherer 4 acquisition. For the fuel costs of the UPS alternative, Mr. Waters used the energy prices estimated by Southern in the RFP document. For the acquisition, FPL assumed its fuel costs would be lower than Southern's by some $7/ton--this despite the fact that FPL will have responsibility for 25% of the existing Scherer 4 contracts. (Tr. 1073).

The difference between Southern's fuel prices and FPL's fuel prices are based on FPL's "expectation" that it will be able to lower the fuel costs previously experienced by Southern. (Tr. 521). Such an "expectation" is merely speculative and has no record basis.

2. Economy Sales--Mr. Waters placed a "location penalty" in the form of a $136 million dollar investment in additional transmission facilities on the Scherer 4 scenarios. This "penalty" was not added to the discounted standard offer. (Tr. 495-97). However, through the assumptions that (1) Southern's

willingness to participate in an enhancement of the Florida-Georgia interface is solely attributable to the Scherer 4 transactions; (2) absent the Scherer 4 transaction (purchase or UPS) no improvements would take place for 30 years; and (3) the improvements would enable FPL to significantly increase economy sales, FPL transformed the "penalty" into an economic advantage. Exhibit 36 demonstrates that the present value of total costs for the Scherer 4 acquisition are $83 million less <u>with</u> the transmission line than <u>without</u> it--indicating that FPL has assumed fuel savings from increased economy sales would more than pay for the "penalty" of a transmission upgrade. In other words, FPL's "location penalty" works to make the Scherer 4 acquisition appear far cheaper relative to the "unpenalized" alternatives than it would without the measure. In fact, this item accounts for more than one third of the difference between the Scherer 4 acquisition and the discounted standard offer.

Several factors indicate the penalty "rationale" biases the exercise in favor of the Scherer 4 scenario. First, the letter of intent between FPC and FPL, which recites the understanding that they will develop a third 500 KV transmission line and help Southern defray Southern's costs of upgrading, is not

contingent in any way upon the approval of the proposed Scherer 4 transaction. (Exh. 6; Tr. 115). Second, it is clear that Southern desperately needs to market the capacity of Scherer 4; if FPL doesn't acquire it, Southern is certain to try to market it in Florida to others, and would continue to be amenable to upgrades in conjunction with other transactions. (Tr. 531). Finally, FPL witness Waters agreed that it is reasonable to assume that--for reasons of reliability, sales, or both--all parties will be interested in effecting improvements at some point during the next 30 years even if the Scherer 4 transaction doesn't take place. (Tr. 531-32). In short, the area of economy sales is yet another example of self-serving assumptions which are embedded in the projections of system fuel costs.

3. Alternate Energy--Under existing UPS contracts with Southern, FPL's cost of unit power frequently is reduced by decisions of Southern to substitute cheaper sources as it operates its system under economic dispatch. The availability of cheaper "alternate energy" resulted in Scherer 4 having only a 17% capacity factor (Tr. 535) and thus significantly lowered FPL's cost of UPS energy.

The availability of alternate energy was an explicit part of Southern's UPS bid proposal. (Exh.

10 (Exh. 6.2.1, p. 5 of 27)). However, in performing his economic analyses, Mr. Waters assumed that in all hours the cost of UPS energy would be the price associated with energy generated by Scherer 4. (Tr. 534). By this assumption, he artificially increased the cost of the UPS alternative.

4. Emission Credits--Near the end of the hearing, Mr. Waters attempted to increase the calculated cost of the UPS alternative relative to the acquisition by suggesting that Southern would add the value of emission credits to its quoted price. The suggestion was discredited on the spot; the witness agreed with Commissioner Gunter that Southern incurs no cost--direct or indirect--to receive the credits. (Tr. 1047-50). Nor did the witness support the sudden view that Southern regarded the item as an "adder" to its RFP submission. In fact, this view is repudiated by Exhibit 10 (Exh. 8.3.1, p. 11 of 14), in which Southern offered to negotiate UPS sales for earlier periods at prices lower than those quoted in the RFP document.

Issue 9: Will FPL be able to deliver electricity from Scherer Unit No. 4 to its load centers in the same time frames in which it is proposing to add investment to rate base?

Nassau has no position on this issue.

Issue 10: If any transmission facilities and/or upgrades are required to accommodate the purchases of energy and capacity already under contract to FPL and the proposed Scherer purchase, what is the cost of such transmission facilities and/or upgrades and who will bear such cost?

There was much discussion of transmission capability at hearing. However, it is still unclear what additional transmission facilities are necessary to accommodate the Scherer 4 purchase <u>and</u> the 435 MW which Nassau will provide to FPL pursuant to its standard offer contract.

Nassau's standard offer contract was executed on June 13, 1990 (before the letter of intent and before any definitive Scherer 4 contracts). Therefore, FPL must insure that there is sufficient transmission capacity for Nassau's project.

Issue 11: Are the fuel supply and transportation costs presented in FPL's economic analysis for Scherer Unit 4 reasonable and prudent?

No, for the reasons set forth in Nassau's discussion of Issue 8, which Nassau adopts by reference.

Issue 12: Does the schedule being followed by the Commission in this case afford all interested parties adequate opportunity to protect their interests?

The sufficiency of the schedule to protect parties' interests is a function of the significance and complexity of the issues and the adequacy of the information provided by the petitioner to enable parties and the decision-makers to evaluate its request. This case involves a request for approval to increase rate base by more than $600 million. Many full-blown rate cases requiring comprehensive MFRs have been processed which involved far less. The support consists of economic claims which require detailed analysis and scrutiny. However, FPL submitted only a barebones, conclusory initial presentation and coupled it with a request for expedited consideration. Interestingly, at hearing FPL bolstered its original direct presentation by adding responses to parties' discovery requests to its direct case. Nassau respectfully submits that the ability of parties and the Commission to assess FPL's support was adversely affected by this schedule.

Issue 13: What effect, if any, does the Scherer Unit 4 purchase have on the Southern/Florida interface?

Nassau has no position on this issue.

Issue 14: Under what circumstances should the portion of the purchase price of assets in excess of book value (the "acquisition adjustment") be given "rate base treatment," such that amortization may be included in operating expenses and the unamortized acquisition adjustment may be included in rate base?

Nassau has no position on this issue.

Issue 15: Should the Commission address in this docket transmission access disputes that may arise from the Scherer Unit 4 purchase?

The Commission should address the effect of the proposed Scherer 4 purchase on Nassau's standard offer contract to sell 435 MW to FPL. As discussed in Issue 10, Nassau's contract was executed prior to any arrangements for the proposed Scherer 4 purchase. Therefore the Commission must ensure that FPL provides sufficient transmission capacity for Nassau's project.

Issue 16: Is the purchase of an undivided ownership interest in Scherer Unit No. 4 a reasonable and prudent investment necessary to enable FPL to meet its forecast 1996 system load requirements?

The discussion of the preceding issues demonstrates that the Commission is not in a posture to decide that the proposed Scherer 4 purchase is a reasonable and prudent investment, especially in light of the fact that the Commission does not even have before it for analysis the definitive agreements

memorializing the transaction. However, even if the Commission takes some action, it must in its ruling on this and other issues take into account its cogeneration policy built into the subscription of the statewide avoided unit.

Issue 17: Should FPL be authorized to include the purchase price of its undivided share of Scherer Unit No. 4, including the acquisition adjustment, in rate base?

No. See Issue 16.

Issue 18: In the event FPL's petition is approved, should the Commission impose guarantee requirements on the electrical output of the unit and delivery to FPL and limit the amount of total investment, operation and maintenance expenses and fuel costs that will be allowed for recovery through rates?

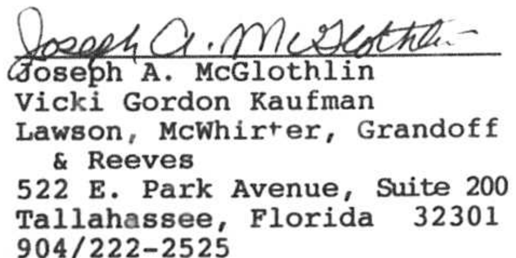
Nassau has no position on this issue.

CONCLUSION

The Commission should take no action on FPL's petition. Prior approval by this Commission is not required to enable FPL to purchase Scherer 4. Premature action without the benefit of all the facts will certainly lessen FPL's business risk, but only at the cost of increasing risks to FPL's customers.

Based on unit-specific costs, the discounted standard offer scenario would be clearly cheaper than FPL's proposal. In view of the uncertainties, biases, and controversial assumptions in FPL's calculations of system fuel costs, those scenarios do not justify the extraordinary action requested by FPL.

Given the manner in which it has excluded the standard offer contract which subscribes 435 MW of the statewide avoided unit, FPL's request is an attempt to preempt the process through which the Commission implements its cogeneration policy. If it takes any action, the Commission must avoid that result.



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CERTIFICATE OF SERVICE

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