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December 1, 2004

- VIA HAND DELIVERY -

Blanca S. Bayó
Director, Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 040001-EI

Dear Ms. Bayó:

I am enclosing for filing in the above docket the original and seven (7) copies of Florida Power & Light Company's Statement of Position on Issue 14C and Supporting Brief, together with a diskette containing the electronic version of same. The enclosed diskette is HD density, the operating system is Windows XP, and the word processing software in which the document appears is Word 2000.

If there are any questions regarding this transmittal, please contact me at 305-577-2939.

Very truly yours,

Lynne A. Adams

for John T. Butler

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Enclosure
cc: Counsel for Parties of Record (w/encl.)

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Fuel and Purchase Power Cost Recovery Clause and Generating Performance Incentive Factor.	)))	Docket No. 040001-EI Filed: December 1, 2004

FLORIDA POWER & LIGHT COMPANY'S
STATEMENT OF POSITION ON ISSUE 14C AND SUPPORTING BRIEF

At the conclusion of the hearing held in this docket on November 8 and 9, 2004, the Commission reserved ruling on Issue 14C and directed the parties to file briefs supporting their positions on that issue by December 1, 2004. In response to the Commission's direction and in satisfaction of the requirement of the prehearing order (No. PSC-04-1087-PHO-EI) that, where no bench decision is made, the parties shall file a post-hearing statement of issues and positions, FPL hereby files its position on Issue 14C and supporting brief.

STATEMENT OF ISSUE AND POSITION

Issue 14C: Should the Commission approve the three UPS agreements between FPL and Southern Company for cost recovery purposes?

FPL: Yes. The three new UPS agreements represent the most beneficial way for FPL to meet its power supply requirements in the 2010-2015 period. The cost of the new UPS agreements is reasonable in comparison to the market alternatives.

BRIEF IN SUPPORT OF FPL'S POSITION

INTRODUCTION

FPL has negotiated a set of three agreements that replace its existing UPS agreement with the Southern Company on terms that are favorable to FPL's customers (the "UPS Replacement Agreements").[1] The UPS Replacement Agreements represent a substantial financial commitment. All of their benefits will flow to FPL's customers, so FPL needs the Commission's assurance that it likewise will be entitled to recover their costs. The Commission has already determined that (i) it will decide on FPL's approval request in this docket (Issue 14A) and (ii) FPL has satisfactorily explored the wholesale market for alternatives to the UPS Replacement agreements (Issue 14B). All that remains for the Commission to decide is whether to approve the UPS Replacement Agreements for cost recovery (Issue 14C). FPL has demonstrated that the UPS Replacement Agreements preserve important benefits for FPL's customers and allow FPL to meet its power supply requirements in the 2010-2015 period at a reasonable cost in comparison to the market alternatives. The Commission should approve cost recovery of the UPS Replacement Agreements, so that FPL can timely preserve their benefits for its customers.

[1] With one exception, FPL uses the term "UPS Replacement Agreements" throughout this brief to refer to its new agreements with the Southern Company. In the prehearing order, Issues 14A-14C refer to the agreements variously as "purchased power agreements" and "UPS agreements." FPL's prehearing position on each of those issues tracked the terminology used in the issue. For the sake of consistency with the prehearing order, FPL has retained the original terminology when the issues and FPL's positions are quoted herein.

BACKGROUND

1. Replacement of FPL's Existing UPS Agreement.

For years, FPL and its customers have benefited from a UPS agreement with the Southern Company, pursuant to which FPL purchases energy and 930 MW of capacity. Two of the key features of the current UPS agreement are that the energy and capacity are supplied from two Southern Company coal-fired power plants, and that FPL is entitled to firm transmission service on the Southern Company transmission system to deliver that energy and capacity. Tr. 484-85 (Hartman).

The current UPS agreement will expire on May 31, 2010. Because of the lengthy planning horizon for power-supply decisions, FPL needs to know soon whether it will be able to replace the current UPS agreement on favorable terms, thus preserving the transmission-related and other important benefits for its customers. Tr. 575 (Hartman). To that end, FPL entered into negotiations with the Southern Company over the terms that the Southern Company would offer for replacing the current UPS agreement. Tr. 571-72 (Hartman). The negotiations culminated on August 11, 2004 with FPL and the Southern Company signing the UPS Replacement Agreements. Tr. 896 (Hartman). The agreements are for the period June 1, 2010 to December 31, 2015. They are intended to preserve for FPL's customers as many of the benefits of the current UPS agreement as possible.

As with the expiring UPS agreement, the UPS Replacement Agreements will provide energy and 930 MW of firm capacity to FPL from Southern Company power plants: 165 MW of coal-fired capacity from Scherer Unit 3, with the remaining capacity coming from gas-fired Harris Unit 1 and Franklin Unit 1. Tr. 482-84 (Hartman). FPL sought, but the Southern Company was unwilling to provide, additional coal-fired capacity under the UPS Replacement

Agreements. Tr. 571-72, 631-33 (Hartman). However, FPL obtained rights of first refusal for additional firm coal-fired capacity for the Miller and Scherer plants and will have the opportunity to purchase additional "coal-by-wire" on an as-available basis. Tr. 490-91 (Hartman). The Scherer, Harris and Franklin plant locations maximize FPL's argument for requiring the Southern Company to "roll over" FPL's right to firm transmission service on satisfactory terms for the duration of the UPS Replacement Agreements. Tr. 487 (Hartman).

By entering into the UPS Replacement Agreements, FPL has secured several benefits for its customers that, while difficult to quantify, are nonetheless real and make the agreements attractive in comparison to market alternatives:

- FPL will maintain 165 MW of firm coal-fired capacity in its portfolio, with the opportunity to purchase additional "coal-by-wire" on an as-available basis and a right of first refusal for additional firm coal-fired capacity from the Miller and Scherer plants.
- FPL will retain 930 MW of firm transmission service into the Southeastern Electric Reliability Council ("SERC") region for the period 2010-2015, and will position itself to extend that service further thereafter.

  This transmission access will allow FPL to procure energy and capacity from the SERC region when market terms are favorable, thus reducing power costs for FPL's customers.
- The transmission access also will enable FPL to obtain firm capacity and/or purchase market energy from outside Florida to enhance FPL's power supply reliability.
- The gas-fired capacity under the UPS Replacement Agreements will be served by two separate gas transmission networks that are independent of those serving FPL's plants. This will provide a valuable increase in the diversity of fuel transportation for FPL's gas-fired resources, which will further enhance FPL's power supply reliability.

- Finally, the UPS Replacement Agreements are for a relatively short duration. Entering into them will allow FPL additional time over the next ten years to investigate non-gas generation technologies which require long development lead times. In contrast, without the UPS Replacement Agreements FPL likely will have to make a long-term commitment to additional gas-fired capacity and thereby lose that flexibility.

Tr. 504-5 (Hartman). Each of those benefits will be addressed in greater detail below.

The UPS Replacement Agreements contain two key contingencies to address uncertainties that could not be resolved prior to their execution. First, FPL has a limited opportunity to terminate the UPS Replacement Agreements if FPL is unable to obtain adequate firm transmission service (both cost and amount) from Southern Transmission, the Southern Company transmission system operator. Tr. 485 (Hartman). This contingency ensures that FPL and its customers are protected in the unlikely event that FPL were unable to obtain firm transmission service from Southern Transmission on acceptable terms and hence could not deliver the power purchased under the UPS Replacement Agreements to FPL's system. Tr. 509, 655-57 (Hartman). Second, FPL has a limited opportunity to terminate the UPS Replacement Agreements if this Commission does not approve recovery of the payments that FPL will make to the Southern Company under the agreements. FPL will pass the benefits of the UPS Replacement Agreements through to its customers and hence needs to know that it will be able to recover their costs. Tr. 485, 580-81, 658-59 (Hartman).

Initially, the Southern Company offered FPL only 90 days from the date when the UPS Replacement Agreements were executed to secure Commission approval. FPL sought to increase the approval period to one year, but the longest period to which the Southern Company would agree was the greater of (i) 180 days after execution, and (ii) the date when FPL secures

adequate firm transmission service. Thus, the date by which FPL will need Commission approval could be as early as February 7, 2005 (*i.e.,* 180 days from the date of execution). Tr. 583-84, 896, 899 (Hartman).

2. FPL's Presentation of the UPS Replacement Agreements for Commission Review and Approval.

Upon execution of the UPS Replacement Agreements on August 11, 2004, FPL promptly brought them to the attention of Staff and all parties in this docket, indicating that it intended to seek approval of the agreements in this docket.[2] On August 26, 2004 Staff held a status update meeting with FPL that was noticed to all parties of record in this docket. FPL made a presentation at that meeting outlining the new agreements and stating that it would file testimony concerning the agreements as part of the September 9 projection filing. Tr. 771, 899 (Hartman); Memorandum dated August 2, 2004, from Adrienne Vining, Esq. to all parties of record advising of a status meeting to be held on August 26, 2004 (FPSC Document. No. 08423-04).

FPL witness Tom Hartman filed direct testimony and exhibits on September 9, 2004 in support of FPL's request for approval of the UPS Replacement Agreements. Included in his exhibits were complete copies of the agreements.[3] On September 17, 2004 FPL participated in another meeting, which was also noticed to all parties of record and which was intended to

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[2] Bringing the UPS Replacement Agreements to the Commission for review and approval prior to their execution would not have been productive. Progress Energy Florida, Inc. ("PEF") initially sought to have the Commission review and approve in this docket a letter of intent with the Southern Company to extend PEF's existing 1988 Unit Power Sales Agreement. Issue 13F was identified to address this request. Staff recommended at the prehearing conference that Issue 13F be removed, however, because "we don't believe that it's ripe for determination at this point in time since [PEF] does not yet have a signed purchased power agreement with Southern Company. Until there's an executed purchased power agreement filed with the Commission, we don't believe that the Commission should address that agreement." Prehearing Conference Transcript at 21-22; *see also* Order No. PSC-04-1087-PHO-EI at 21.

[3] Confidential information was redacted from the copies of the UPS agreements that were served on the parties.

provide a forum for Staff and all parties to pose questions to FPL based on their review of FPL's projection filing. Mr. Hartman responded to questions at that meeting about the UPS Replacement Agreements. Tr. 899 (Hartman); Memorandum dated September 14, 2004, from Adrienne Vining, Esq. to all parties of record advising of informal status meeting between Staff and FPL to be held on September 17, 2004 (FPSC Document. No. 10003-04).

FPL has subsequently responded to voluminous discovery concerning the UPS Replacement Agreements: it has answered numerous interrogatories and requests for admission, made hundreds of pages of documents available for inspection by the Office of Public Counsel, and responded to document production requests from Staff and intervener Thomas Churbuck.[4] In addition, Mr. Hartman was deposed for approximately four hours by counsel for Staff, the Office of Public Counsel, Mr. Churbuck and the Florida Industrial Power Users Group ("FIPUG").

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[4] Mr. Churbuck is the president of a subsidiary of merchant power company, Calpine Corporation ("Calpine"). He also happens to be a residential customer of FPL. Since Calpine's competitive interests would not gain it standing to participate in this docket, Mr. Churbuck intervened as Calpine's proxy interest. Calpine, through Mr. Churbuck, served 76 requests for production of documents on FPL, as well as 57 interrogatories and 49 requests for admission. Many of Calpine's requests sought competitively sensitive data that is confidential to FPL and to third parties, including Southern Company. FPL objected to a number of the discovery requests and sought a protective order from the Commission because of the harm to FPL's customers and third parties that could result from disclosing confidential documents and information to Calpine or Mr. Churbuck. For those documents that FPL made available to counsel for Mr. Churbuck, FPL's fears of producing confidential documents to Mr. Churbuck were confirmed when Joseph Regnery, an attorney employed by Calpine, arrived at FPL's offices to review documents.

Before a ruling on FPL's motion for protective order was issued, Mr. Churbuck's counsel withdrew the discovery requests that were the subject of FPL's motion. In disregard of representations he had made in withdrawing the discovery requests, Mr. Churbuck's counsel reversed course during the hearing and asked FPL to provide certain confidential documents that had been the subject of FPL's motion for protective order (*i.e.,* the right-of-first-refusal letter agreements ("ROFRs") between FPL and the Southern Company related to the output of the Miller and Scherer units). Tr. at 548-54. At the hearing, FPL provided the Commission and all parties a redacted copy of the ROFRs, which were marked as Exhibit 69.

On October 4, 2004, one witness filed testimony jointly sponsored by FIPUG and Mr. Churbuck, and two witnesses filed testimony sponsored only by FIPUG. The three witnesses opposed approval of the UPS Replacement Agreements and asked that the Commission require FPL to issue a request for proposals ("RFP"). FPL established in cross examination that, in fact, these witnesses were directly and exclusively serving the interests of certain merchant power providers. Dr. David Dismukes, who supposedly was testifying on behalf of Mr. Churbuck, has never met the man, has spoken to him on only one occasion for less than an hour, and has no written or oral engagement with him to testify. Instead, Dr. Dismukes was contacted about testifying -- and has received all of his direction about testifying -- from Joseph Regnery, whom Dr. Dismukes identified as counsel for the Calpine Corporation. Tr. 833-38 (Dismukes). The other two witnesses -- Michael Vogt and Kerrick Knauth -- submitted testimony sponsored by FIPUG but are in fact employees of merchant power providers. They received no compensation from FIPUG to testify, they did not know or speak with any member of FIPUG before filing their testimony, and they or their employers actually initiated the contact with FIPUG's counsel concerning their participation in this docket. Tr. 859-60 (Knauth), 884-85 (Vogt). In opposing FPL's request to admit the depositions of Messrs. Vogt and Knauth into the record, FIPUG's counsel asserted at the hearing that neither was an expert witness and instead they were merely presenting the merchant industry view of the UPS Replacement Agreements.[5]

On October 18, 2004, FPL witness Hartman filed both rebuttal testimony and exhibits, which refuted all of the points made by the merchant witnesses. Specifically, Mr. Hartman explained that, contrary to the merchant witnesses' assertions: (1) it is critical for the

[5] Tr. 826-27. Once FPL withdrew its request to admit the witnesses' depositions, however, FIPUG's counsel was emboldened to rethink their status and return to asserting that they are experts. Tr. 829-31.

Commission to approve the UPS Replacement Agreements promptly in order to ensure that their benefits are preserved for FPL's customers, (2) FPL considered all relevant alternatives that could provide similar benefits to FPL's customers and found that the UPS Replacement Agreements were clearly superior, (3) the RFP process contemplated by the Commission's bid rule does not apply to the UPS Replacement Agreements and would not serve the interests of FPL's customers in this case, (4) when all of the benefits of the UPS Replacement Agreements are considered, they are a superior choice to accelerating a self-build option into the 2010 time frame, and (5) FPL has no assurance that it could obtain all the benefits associated with the UPS Replacement Agreements under any other market alternative. Tr. 895. Mr. Hartman also observed that the merchant witnesses do not have the interests of FPL's customers in mind when they recommend against prompt Commission review of the UPS Replacement Agreements, because Commission approval of the agreements would be against the interests of the merchant power providers regardless of whether the agreements benefit FPL's customers. Tr. 901, 913.

3. The Commission's Review of the UPS Replacement Agreements.

Staff initially identified three issues for resolution by the Commission concerning the UPS Replacement Agreements:

Issue 14A: Should the Commission defer all issues related to the purchased power agreements between FPL and Southern Company to a separate docket?

Issue 14B: Should the Commission require FPL to explore other alternatives in the wholesale power market prior to seeking approval of the purchased power agreements?

Issue 14C: Should the Commission approve the three UPS agreements between FPL and Southern Company for cost recovery purposes?

Only Issue 14C remains because, as described below, the Commission has already resolved Issues 14A and 14B.

FIPUG and the Office of Public Counsel filed a motion on October 4 to remove the issues related to FPL's UPS Replacement Agreements from this docket. On October 7, Mr. Churbuck filed his own motion to remove and joined in the FIPUG/Public Counsel motion. The prehearing officer denied both motions in Order No. 04-1018-PCO-EI, dated October 19, 2004. FIPUG and Mr. Churbuck (but not Public Counsel) filed a joint motion for reconsideration of Order No. 04-1018-PCO-EI on October 29, which the Commission unanimously denied at the outset of the hearing in this docket on November 8. Tr. 27-28. Thus, the Commission has resolved Issue 14A by declining to spin off review and approval of the UPS Replacement Agreements to a separate docket.

Issue 14B was the subject of a bench decision at the conclusion of the hearing in this docket. Staff recommended that the Commission vote "no" on this issue, because the Commission's bid rule does not apply and the evidence showed that FPL has already made inquiries in the wholesale power market that resulted in no satisfactory alternative offers. The Commission unanimously approved Staff's recommendation. Tr. 948-49.

Thus, the Commission has before it for decision at this time only Issue 14C: "should the three new UPS agreements between FPL and the Southern Company be approved for cost recovery purposes?" FPL emphasizes that only Issue 14C remains to be decided, because it anticipates that the merchant parties may reargue Issues 14A and 14B. The merchant witnesses all address essentially the same point in their testimony: namely, that FPL did not adequately consider alternatives to the UPS Replacement Agreements, so FPL should be required to conduct an RFP prior to seeking Commission approval of the agreements. This point is the subject of

Issues 14A and 14B, which the Commission has already resolved in FPL's favor. The great majority of the merchant witnesses' testimony is therefore irrelevant to the only issue open for decision. The Commission's sole remaining task is to evaluate FPL's evidence that the UPS Replacement Agreements should be approved for cost recovery. As discussed below, the evidence clearly shows that the agreements are in the interests of FPL's customers and should be approved.

ARGUMENT

The Commission should approve the three UPS Replacement Agreements because they offer extremely important benefits that are not available via any relevant alternatives, and their cost is reasonable in comparison to those alternatives.

1. By Entering into the UPS Replacement Agreements, FPL Will Secure Several Valuable Benefits For its Customers.

The UPS Replacement Agreements offer a substantial package of benefits for FPL and its customers, which make the agreements extremely attractive and which simply cannot be matched by the relevant alternatives.

a. Coal-fired capacity.

FPL and its customers have benefited greatly from being able to buy coal-fired power from the Southern Company under the current UPS agreement. The UPS Replacement Agreements preserve as much of that benefit as possible. They provide access to coal-fired power in three ways. First, FPL has a firm commitment of 165 MW of coal-fired energy and capacity from Scherer Unit 3. Second, FPL has the opportunity to buy additional coal-fired energy from within the SERC region by virtue of the firm transmission rights discussed below. Finally, in conjunction with the UPS Replacement Agreements, FPL has secured rights of first refusal on wholesale sales from the Miller plant and on the sale of 75 MW of additional output from Scherer Unit 3. Tr. 489-91, 938 (Hartman).

There has been no disagreement among the parties as to the value of maintaining and/or adding coal-fired generation to FPL's power-supply portfolio. Coal-fired generation is economically attractive, it provides effective hedges against volatility in the price of natural gas and oil and against potential disruptions in the supply of those fuels, and it addresses the Commission's desire for utilities to pursue fuel diversity. Tr. 489, 530 (Hartman). Rather, the

debate about the benefit of coal-fired power under the UPS Replacement Agreements has centered on two topics: why FPL did not negotiate the purchase of additional firm coal-fired capacity from the Southern Company, and the value to FPL of the rights of first refusal.

The first dispute simply does not merit serious consideration. There is a seller's market for existing coal-fired generation, and FPL obtained as much as it could. The Southern Company would like to have sold FPL only gas-fired power; FPL would like to have purchased only coal-fired power. The UPS Replacement Agreements represent the compromise FPL was able to negotiate. Tr. 571-72, 632-33, 897-98 (Hartman). There is nothing in the record to suggest that FPL could have obtained more coal-fired power than it did, so the merchant parties' criticism on this point is simply unsupported Monday morning quarterbacking. Equally irrelevant is the merchant parties' emphasis on the small percentage of FPL's total power supply represented by the UPS Replacement Agreements' 165 MW of coal-fired power. In essence, the merchant parties are arguing that, unless one can acquire a large percentage of one's total need for a valuable commodity in a single transaction, it is not worth acquiring the commodity at all. This sort of thinking ignores the utility -- and often necessity -- of meeting important needs one step at a time.

The second dispute likewise lacks perspective. The merchant parties ask the Commission to disregard the value of having rights of first refusal on wholesale sales from two existing coal-fired plants. Again, there is a seller's market for such generation. No one (probably including the Southern Company itself) knows for sure today whether wholesale power from those units will be made available in the future. But if it is made available, there likely will be a line of people waiting to buy it. No one can seriously deny the value to FPL's customers of being entitled to jump to the front of that line. Tr. 556-58, 609, 747-49 (Hartman).

b. Firm transmission service.

Among the most important benefits of the UPS Replacement Agreements is that they will facilitate "rolling over" FPL's current right to 930 MW of firm transmission service from the Southern Company. Tr. 592-93 (Hartman). FPL is entitled to roll over that transmission service so long as changes in the delivery points for the power to be transmitted do not cause substantial changes in the Southern Company's transmission system flows. In this case, the new "delivery points" are the three plants from which FPL will take power under the UPS Replacement Agreements. Those plants were chosen to minimize the impact on the transmission system flows, thus maximizing FPL's argument for roll-over. Tr. 486-87, 898-99 (Hartman). Late-Filed Exhibit 68 illustrates this point clearly: the two "new" UPS plants (Harris and Franklin) connect via 230 kV lines into the very same Southern Company 500 kV line that has delivered power from an "existing" UPS plant (Miller). And, of course, Plant Scherer is both a "new" and "existing" UPS plant.

Firm transmission access from the SERC region into Florida is so valuable because it is so scarce. From a practical standpoint, this firm transmission is the bridge between the Florida and SERC region wholesale power markets. The cost of wholesale power is often lower in the SERC region than in Florida, especially in off-peak periods. Tr. 564-66 (Hartman); *see* Ex. 16 (2003 wholesale off-peak price spread between Florida and the southeastern portion of SERC). Whoever possesses firm transmission rights can benefit from that differential. If FPL has the rights, then it can buy power in the SERC region and pass the savings on to its customers. If it does not have those rights, then it will have to arrange with others to import the power and will expect the transmission providers to keep most of the cost differential for themselves. As Mr. Hartman explained during his cross-examination, if there is a $10 price differential between

Florida and SERC wholesale power markets and FPL has the transmission rights, then FPL's customers will save $10 when FPL imports power from the SERC region, but if FPL does not have those rights, then the transmission provider likely will pocket $9.50 of the differential and FPL's customers will save only $.50.[6]

There was no disagreement at the hearing over the value of having firm transmission rights into Florida. The only question raised by the merchant parties was whether FPL could acquire similar transmission rights without the UPS Replacement Agreements. Again, their criticism was long on speculation and short on specific, viable alternatives. They mischaracterized FPL's testimony as suggesting that FPL could acquire firm transmission rights only by buying power from the Southern Company. Tr. 799 (Dismukes). This is not the case, and FPL has never claimed that it is. As discussed above, what matters is the similarity of flow paths between what FPL is transmitting over the Southern Company system under the current UPS agreement and what FPL would be transmitting under a replacement for that agreement. The flow path of the power that FPL will buy under the UPS Replacement Agreements is demonstrably similar to the existing one. In contrast, the merchant witnesses offered not a single example of (i) viable, existing and economically attractive plants that are (ii) aligned along a flow path similar to FPL's current UPS agreement. *See* Tr. 901-5, 910 (Hartman). FPL would be taking a serious risk of losing its valuable firm transmission rights if it pursued any of the alternatives proposed by the merchant parties rather than the UPS Replacement Agreements.

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[6] Tr. 537-39. FPL suspects that the prospect of pocketing the $9.50, and/or of not having to compete with FPL's ability to save $10, is a large part of the merchant parties' motivation for participating in this docket. As Mr. Hartman observed from his personal experience in the merchant power industry, the goal of a merchant provider is to generate profits for its shareholders, not to protect customers of the utility with which it is negotiating. Tr. 916-18.

Finally, it is important for the Commission to recognize that rolling over FPL's firm transmission rights not only benefits FPL and its customers during the 2010-2015 term of the UPS Replacement Agreements, but also sets the stage for continued roll-over thereafter. In contrast, if FPL were to pursue alternatives today that do not result in roll-over at the end of the current UPS agreement, the opportunity to secure such a large block of firm transmission rights may be lost for the foreseeable future. Tr. 610-11, 672, 915, 944-45 (Hartman).

c. Economy purchases from the SERC region.

The ability to make economically attractive purchases of energy and capacity from within the SERC region is one of the major benefits of FPL's having firm transmission access to that region. There is a large quantity of base-load, coal-fired and nuclear generating capacity in the SERC region. During off-peak periods the output of those units often exceeds the native load, so the excess output can be purchased on very favorable terms. *See* Ex. 16. The UPS Replacement Agreements give FPL broad dispatch rights over the units to which they apply, which will allow FPL to scale back the output of those units or shut them down when less expensive power is available elsewhere in SERC. Thus, the UPS Replacement Agreements give FPL price protection in essentially two directions: FPL can operate the UPS units when SERC wholesale market prices are high, and it can throttle the UPS units back and take advantage of the SERC wholesale market when prices are low. Tr. 490-91 (Hartman).

During the hearing, Staff inquired about the level of economy purchases that FPL projects during the term of the UPS Replacement Agreements. In particular, Staff noted that the projected level of such purchases exceeded the levels of "non-Florida economy/OS purchases" in FPL's Schedule A9 for the years 2000-2003. The projected increase in such purchases is reasonable, however, when one takes into account a crucial distinction between FPL's firm

transmission access under the current UPS agreement and the access it seeks in connection with the UPS Replacement agreements. Currently, FPL's transmission rights are bundled into the UPS agreement and apply only to delivery from the UPS plants (Miller and Scherer). In contrast, the firm transmission service FPL seeks in connection with the UPS Replacement Agreements is not plant-specific. FPL will be able to make purchases from any plant in the SERC region, which expands substantially the pool of potential sources of economy transactions. Tr. 524-26, 678, 756-59 (Hartman).

d. Reliability purchases from the SERC region.

The ability to depend on importing power from the SERC region will also facilitate reliability purchases. This can be a valuable adjunct to FPL's own reliability reserves. The UPS Replacement Agreements contain financial incentives for the Southern Company to use other available resources to supply the power to which FPL is entitled under the agreements, should the UPS units be unavailable. Moreover, the pool of potential non-Southern Company sources of power that FPL will be able to access under the new transmission arrangements will further enhance reliability. Tr. 493-94 (Hartman). None of the merchant witnesses disputed this benefit.

e. Diversity of gas supply.

All of FPL's current fleet of gas-fired plants are served by one of two gas transmission pipelines: Florida Gas Transmission ("FGT"), and Gulfstream. In contrast, the gas-fired Franklin and Harris units from which FPL will be purchasing power under the UPS Replacement Agreements are supplied by the Southern Natural Gas system, which is independent of both FGT and Gulfstream. This independence increases the reliability of FPL's gas supply, an important benefit in view of FPL's substantial reliance on gas-fired generation. Tr. 492-93 (Hartman).

The merchant parties have tried to minimize this benefit with two arguments. First, they note that FPL has experienced few reliability problems with its existing gas transmission arrangements. This is true, but misses the point. Insurance policies are not rendered worthless merely because no claim has yet been made under them. Similarly, FPL's favorable reliability experience in the past is no reason to disregard the benefits of reliability improvements in the future. *See* Tr. 618-19 (Hartman). Second, the merchant parties argue that there are plans to expand the gas-transmission capacity in Florida. As they do elsewhere, however, the merchant parties want to substitute speculation for certainty. The Southern Natural Gas system is in place and operating. In contrast, the merchant parties point only to proposals.

f. Flexibility for future power supply planning.

This benefit results from what the UPS Replacement Agreements are *not*: long-term. Without the agreements, FPL likely would have to make a long-term commitment (build or buy) to additional gas-fired capacity to fill the need left by the expiration of the current UPS agreement. In contrast, by entering into the UPS Replacement Agreements, FPL gives itself a crucial five more years to explore coal and other non-gas energy sources that require long lead times, while not being locked into any power supply option at the end of that study period.[7] No one disputed this benefit of the UPS Replacement Agreements.

2. The Cost of the UPS Replacement Agreements is Reasonable.

In order to assure itself that the cost of the UPS Replacement Agreements is reasonable, FPL compared them to several relevant alternatives. These comparisons convinced FPL that the UPS Replacement agreements are in the interests of its customers.

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[7] Tr. 908 (Hartman). Mr. Hartman also testified that, even if FPL were able to accelerate the process of building a coal plant so that the plant would be online before the 2010 expiration of the current UPS agreement, it would not change his recommendation to proceed with the UPS Replacement Agreements. Tr. 770.

The Commission should keep in mind the importance of focusing on *relevant* alternatives, meaning those that have a high degree of certainty that they actually could and would be in a position to deliver power to FPL's system in the required time frame at a reasonable cost. FPL's discipline in focusing on relevant alternatives is the principal difference between the comparisons it performed and the wide, speculative net cast by the merchant witnesses. It is one thing to point to plants spread around SERC's far reaches that might have power available for sale; it is another entirely to figure out how that power could be transmitted to FPL's system at a reasonable price. *See* Tr. 596-98 (Hartman). Likewise, it is easy to speculate about what plants the merchant industry might build, but quite another to secure any reasonable assurances that those plants actually will be built, on time to deliver power in the 2010-2015 time frame when FPL will need it. *See* Tr. 599-600 (Hartman). Finally, in perhaps the merchant witnesses' greatest leap of faith, it is easy to speculate about the benefits that could be derived from buying power from a simple-cycle combustion turbine plant that is under contract to others and would require conversion to combined cycle configuration to meet FPL's needs, but much harder to deal with the unpleasant realities that the existing contracts would somehow have to be bought out and the combined-cycle conversion would have to be financed and implemented before there would be even a possibility of sales to FPL. *See* Tr. 945-46 (Hartman). In short, FPL has dealt in the real and the tangible, while the merchant witnesses would substitute speculation for certainty. And the merchant witnesses would ask the Commission to accept this conjecture, even though they lack expertise in the subjects about which they are speculating. Tr. 838-39 (Dismukes), 859-60 (Knauth), 883-84 (Vogt); *see also* Tr. 829-31. Such speculation might serve the interests of the merchant industry, but it hardly

squares with FPL's duty to serve its customers. *See generally* Tr. 901-5 (Hartman's critique of merchant witnesses' speculative alternatives).

Starting before and continuing throughout its negotiation of the UPS Replacement Agreements with the Southern Company, FPL constantly surveyed the wholesale power market to identify attractive alternatives. *See* Tr. 615-16 (Hartman). As explained below, nothing superior was found.

FPL's first comparison resulted from surveying publicly available information on merchant transactions in the SERC region, from quarterly filings with FERC. Information is available for three gas-fired facilities, which would be potentially comparable to the energy and capacity that FPL will receive from the gas-fired Franklin and Harris units under the UPS Replacement Agreements. Two of those units -- Tenaska Lindsey Hill and Central Alabama -- both have reported prices that are higher than FPL will pay under the Franklin and Harris UPS Replacement agreements, when the operating characteristics of the plants are taken into account. The third point of comparison is the Southern Company's McIntosh Units 10 and 11, for which detailed information is available from a FERC filing on a June 2002 power sale. After allowance for 3% inflation between 2002 and 2010 (when power deliveries under the UPS Replacement Agreements will commence), the price per kW-month for capacity from McIntosh Units 10 and 11 is higher than FPL will pay under the Franklin and Harris UPS Replacement Agreements. Tr. 497 (Hartman).

For its next point of comparison, FPL sought indicative offers from several owners of existing merchant facilities that have no known constraints on delivering power to FPL's transmission system. FPL received only one expression of interest, which had a relatively attractive price per kW-month but reflected a heat rate that would make actual power purchases

on the terms of the indicative offer more costly to FPL than purchases under the UPS Replacement Agreements. Tr. 497-98 (Hartman). Counsel for Mr. Churbuck criticized FPL's reliance on indicative offers, suggesting that they are merely "opening bids" and that FPL might be able ultimately to negotiate a better deal. Once again, however, this is idle speculation. Mr. Hartman testified that the pricing in indicative offers can just as well be structured to be unrepresentatively low, such that the economic attractiveness of the offer fades as more is learned about its terms. Tr. 512-15, 928-30.

FPL's next point of comparison arose out of the RFP that FPL conducted in 2003 in connection with the need determination for Turkey Point Unit 5. FPL performed an economic analysis of the offer it received in response to that RFP which is most comparable to the UPS Replacement Agreements. The analysis was conducted using the same methods as the RFP evaluation but with current economic assumptions. The results showed the UPS Replacement Agreements to be between $4 million and $51 million less costly on a NPV basis than the 2003 RFP offer, even without considering the less quantifiable benefits of the agreements discussed above. Tr. 498-99 (Hartman); Ex. 18 (computation of NPV comparison).

Counsel for Mr. Churbuck criticized this analysis for applying an equity adjustment, pointing out that the Commission did not apply an equity adjustment in its 2002 determination of need for Martin Unit 8 and Manatee Unit 3. What he failed to note, however, is that the Commission actually found in the Martin 8/Manatee 3 proceeding that "consideration of an equity adjustment is appropriate," but decided not to apply FPL's equity adjustment for reasons specific to that case. Moreover, the Commission took pains to note that "while we have decided not to apply an equity adjustment, FPL's Martin Unit 8 and Manatee Unit 3 are still the most cost effective options by at least $2 Million." In other words, the application of an equity adjustment

was unnecessary to the Commission's determination of need for the units in question. Order No. PSC-02-1743-FOF-EI, Docket Nos. 020262-EI and 020263-EI, dated December 10, 2002, at 18-20. More recently, in fact, the Commission has accepted applications of an equity adjustment in Docket No. 031093-EQ, *In re: Petition for approval of revised standard offer contract and revised COG-2 rate schedule by Florida Power & Light Company*, Order No. PSC-04-0249-TRF-EQ, dated March 5, 2004, and in Docket No. 040206-EI, *In re: Petition to determine need for Turkey Point Unit 5 electrical power plant, by Florida Power & Light Company*, Order No. PSC-04-0609-FOF-EI, dated June 18, 2004. Here, FPL has applied an equity adjustment in consistent fashion to both the UPS Replacement Agreements and the 2003 RFP offer, using the methodology employed by Standard & Poors to compute the the portion of a purchased power obligation that is to be treated as debt-equivalent. FPL's use and computation of the equity adjustment is entirely consistent with Order No. PSC-02-1743-FOF-EI and subsequent Commission decisions. *See* Tr. 521, 544-45 (Hartman).

FPL's final point of comparison is to an FPL self-build gas-fired plant. Mr. Hartman cautioned that the costs for the self-build option used in this comparison were based on a preliminary engineering estimate. They were intended for screening purposes, to evaluate the reasonableness of the costs FPL will incur under the UPS Replacement Agreements, not to form the basis of a detailed cost comparison. Tr. 749-50. Using the preliminary cost estimate and looking only at readily quantifiable economic terms, FPL calculated the NPV of the self-build option to be between $69 million and $93 million less expensive than the UPS Replacement Agreements. However, the self-build option would not offer the benefits of the UPS Replacement Agreements discussed above. FPL believes that those benefits more than offset the calculated cost differential. Tr. 494-95, 751-52 (Hartman).

3. FPL and its Customers Are Adequately Protected Against Cost Risks Under the UPS Replacement Agreements.

Mr. Churbuck's counsel raised questions at the hearing about three areas of potential cost risks under the UPS Replacement Agreements: (i) the cost of upgrades to the Southern Company transmission system to accommodate FPL's firm transmission service, (ii) the cost of complying with changes in environmental laws, and (iii) the risk of locking in to market-based pricing in the event that the Southern Company is required by FERC to sell wholesale power at cost-based rates. For the reasons discussed below, FPL and its customers are adequately protected against each of these cost risks.

a. Transmission upgrades.

Mr. Churbuck's counsel questioned Mr. Hartman about the potential that there will be "redirect costs" associated with FPL's securing firm transmission service for the UPS Replacement Agreements, and that those costs could make the agreements less attractive economically. Mr. Hartman showed that this risk is extremely remote. The three plants that are subject to the UPS Replacement Agreements were chosen to minimize the potential that upgrades would be required on the Southern Company transmission system. Tr. 654-55 (Hartman). Moreover, in the event that FPL is asked to pay additional costs for transmission service beyond what is required under the Southern Company's Open Access Transmission Tariff ("OATT"), then FPL has options under the UPS Replacement Agreements to request that the Southern Company make other arrangements to provide transmission service at the OATT

prices. Ultimately, if the Southern Company is unwilling or unable to do so, FPL has remedies under the agreements.[8]

b. Compliance with environmental requirements.

Mr. Churbuck's counsel raised questions about FPL's obligation under the "change-in-law" provisions of the Scherer UPS Replacement Agreement to pay for increased environmental compliance costs that the Southern Company might incur with respect to Plant Scherer. Mr. Hartman pointed out that (i) the definition of what constitutes a change in law that would trigger FPL's obligations under that provision is narrow; (ii) in the event that capital expenditures are required to comply with a change in law, recovery of those expenditures would be spread over the remaining life of Plant Scherer and FPL would only have to pay for the portion allocated to the five years covered by the agreement; (iii) the change-in-law provision is typical of what he has seen in power purchase agreements throughout the industry, and it exposes FPL and its customers to the same risk that exists with respect to the plants FPL owns; and (iv) FPL and its customers have benefited from more favorable pricing under the agreement in exchange for assuming the risk of changes in law. Tr. 665-67.

Mr. Churbuck's counsel also referred to the power purchase agreement ("PPA") form that was included with the RFP FPL issued in connection with the Turkey Point Unit 5 need proceeding. He pointed out that this PPA form would require the seller to bear the change-in-law risk, suggesting that FPL should likewise insist that the Southern Company do so in the Scherer UPS Replacement Agreement. Mr. Hartman pointed out that the change-in-law provision in the PPA form was not a minimum requirement, meaning that it could and likely

[8] Tr. 655-57 (Hartman); *see* Article 7 of the Scherer, Harris and Franklin UPS Replacement Agreements, Ex. 12, 13 and 14, respectively. These remedies have been designated as confidential.

would have been negotiated between FPL and a bidder to place the risk on the party in the best position to bear it. Tr. 667-68; *see* Article 11 of the Scherer UPS Replacement Agreement, Ex. 12 (the change-in-law provision was misidentified as Article 13 by Mr. Churbuck's counsel at Tr. 665).

c. Market-based pricing.

Finally, Mr. Churbuck's counsel noted that FERC is evaluating whether the Southern Company has market power, such that it might require the Southern Company to charge cost-based rates instead of market-based prices for wholesale power. He then observed that the UPS Replacement Agreements obligate both parties to take certain steps to defend the market-based pricing reflected in the agreements. Mr. Hartman responded by refuting the implication that FPL was somehow compelled by Southern Company market power to accept unfavorable terms for the UPS Replacement Agreements. FPL had options to self-build and to buy power from other providers, so it would not have agreed to terms with the Southern Company unless they were in the interests of FPL's customers. Tr. 639. He also pointed out that the provisions of the UPS Replacement Agreements concerning FERC regulatory actions are typical in this type of agreement and simply contemplate that the parties will try to preserve their bargain. Tr. 641-44; *see* Article 10 of the Scherer UPS Replacement Agreements, Ex. 12, and Article 12 of the Harris and Franklin UPS Replacement Agreements, Ex. 13 and 14, respectively.

CONCLUSION

For the foregoing reasons, the Commission should approve the UPS Replacement Agreements for cost recovery. The UPS Replacement Agreements provide important benefits to FPL's customers, represent the most beneficial way for FPL to meet power supply requirements in the 2010-2015 period for its customers, and their overall cost is reasonable in comparison to relevant market alternatives.

Respectfully submitted,

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CERTIFICATE OF SERVICE
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