

BEFORE THE PUBLIC SERVICE COMMISSION

Merchant Plant Workshop

May 13, 1999

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JOINT COMMENTS OF
DUKE ENERGY NEW SMYRNA BEACH POWER COMPANY,
CONSTELLATION POWER DEVELOPMENT,
RELIANT ENERGY, AND U.S. GENERATING COMPANY

With respect to many of the topics they wish to address, Duke Energy New Smyrna Beach Power Company Ltd., L.L.P. (Duke New Smyrna), Constellation Power Development (Constellation), Reliant Energy (Reliant), and U.S. Generating Company (USGen) find that their positions are aligned. To facilitate a more efficient presentation, the developers have decided to sponsor these comments jointly. The developers reserve the opportunity to supplement these comments with individual remarks or to address other topics, as their individual interests and separate positions may require.

Duke New Smyrna, Constellation, Reliant, and USGen understand that one of the chief purposes of this workshop is to address certain policy concerns that arose in the form of questions from Commissioners during the Duke New Smyrna Beach case. These concerns were faithfully recorded in the Tentative Issue List that Staff prepared and attached to the Notice of the May 3

Staff workshop. During the May 3 workshop, numerous additional issues were proffered, many of which -- in the opinion of these developers -- are irrelevant to the effort to establish a dialogue on the legitimate subjects previously raised by the Commissioners. These joint comments will be limited -- not only to those topics on which the sponsoring developers have found common

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ground -- but also to those topics that the developers believe are germane and relevant to the purpose of the workshop.

We begin with a general observation, on which we will elaborate in responses to individual topics. In the Duke New Smyrna Beach case, the Commission recognized that merchant capacity can play a valuable role in creating a more competitive wholesale market that will deliver cheaper and more reliable service to consumers. However, in general, we believe the tenor of some of Staff's tentative issues is inclined too much toward the view that the Commission needs to strictly limit and control the development of merchant capacity to avoid undesirable results.

Duke New Smyrna, Constellation, Reliant, and USGen submit that, after an appropriate analysis, the Commissioners will realize that their interests, and the interests of the consumers, coincide with the interests of merchant developers. On behalf of consumers, the Commission wants the quantity of merchant capacity that yields economic benefits for them; no more and no less. We urge the Commission to make consumers' interests the paramount consideration as it considers the role that merchant capacity should play in the wholesale market. If the Commission does, it will look to the market as the appropriate optimizing mechanism, and it will structure a regulatory framework that is conducive to the ability of developers to respond to the market.

Duke New Smyrna, Constellation, Reliant, and USGen provide the following comments to the categories of issues prepared by Staff:

Category 1

FPC III-1 What is a merchant plant?

FPC III-2 **Would a merchant plant still qualify if it entered into a contract with a utility?**

Response: A merchant plant is a power generation facility whose owners bear all development, financial, business and operational risks, and whose electrical output is sold exclusively into the competitive wholesale market. Because a merchant plant is not part of a utility's rate base, the utility's retail customers are shielded from development, construction, interest rate, fuel, operating, and other risks. Further, a merchant plant is not necessarily limited in sales to a single wholesale customer; rather, it will likely seek contracts with varying time frames with multiple wholesale customers throughout Florida. Finally, a merchant plant is characterized by its performance. Because it sells into a competitive market whereby cost and reliability considerations are paramount to a merchant plant's financial success, consumers are assured that they will receive electricity at the lowest possible prices and at the highest levels of reliability.

The essence of a merchant plant is that the developer accepts the investment and business risk associated with constructing and operating the plant; it is not in the rate base of a retail-serving utility. Once the developer has contracted to supply the capacity, energy, and, if applicable, ancillary services of the unit to wholesale customers such as utilities, municipal electric authorities, and electric cooperatives, the developer will have managed that initial risk, but only because the purchasers found it in their customers' best interests to obtain the merchant's capacity, energy, and other services.

FPL 20 **What are the impacts of merchant plants on retail electric customers?**

Response: A prudent retail-serving utility will purchase capacity, energy, and other services from a merchant supplier if that capacity and energy is advantageous (cost-effective) when compared to the purchaser's alternatives, e.g., its own generation resources or other purchase options. Accordingly, retail customers will benefit from merchant plants because merchants will impose downward pressure on wholesale power costs, thereby reducing retail-serving utilities' purchased power costs, which reductions are in turn passed through to retail customers. Merchant plants will also improve the reliability of Florida's power supply system, while relieving retail customers of capital, investment, and operating risk. To be clear, merchant plants will sell only to the wholesale market.

FPC I-3 **Does the Commission have any basis in its enabling statutes for discriminating among different types of new merchant plants for purposes of need determinations (e.g. projects that have a photovoltaic component, plants with different heat rates or emission standards)?**

Response: The proper role of the Commission is to ensure that merchant projects are developed by qualified market participants who will agree to abide by the rule established by an appropriately governed regional transmission organization and in accordance with all necessary State permits. The Commission should rely upon market forces (proven in other areas of the country) to "discriminate" among or between merchant projects to ensure that only those projects that can ultimately benefit consumers are built.

FPL 10 **What obligations to provide electric service does an EWG have independent of any bilateral agreement for such service?**

Response: In accordance with what we believe should be a generator's obligation to become a member and abide by the duly established rules of an appropriately governed regional transmission organization, such generators (including EWG's) will be required to operate in the best interest of the interconnected grid when it is called upon for support in emergency situations.

OUC 2 **Should existing Florida utilities be relieved of their obligation to serve retail customers when, in the interest of the utility, it is not cost effective to do so?**

Response: [This topic is irrelevant to the purpose of the workshop.] No. Regulated utilities have an obligation to serve all the retail load in their service areas. The Commission affords the regulated utility an opportunity to earn a return on its investment and to recover its reasonable costs. Outside of an environment of retail customer choice, there is no reason why a utility should be allowed to avoid its obligation to serve. However, one of the ways to lower electric prices is to have a competitive and vibrant wholesale market.

Category 3

FPC II - 1 **What is the purpose of this workshop?**

Response: We understand the purpose to be to allow interested parties to engage in a dialogue on the implications of the Duke New Smyrna Beach decision for future applications for merchant plants, and to address the questions raised by the Commissioners in their deliberations on the New Smyrna Beach Power Project

need determination. We believe that the implications are positive for Florida's electric customers because merchant plants will enhance system reliability and reduce wholesale power costs, thereby also reducing retail power supply charges, at no risk to Florida's electric customers.

FPC II - 2 **What, if any, problem is the Commission proposing to address?**

Response: Correctly perceived from the perspective of consumers, the willingness of developers to place efficient new generators in the wholesale market at their own risk presents an opportunity, not a problem. The appropriate question is how to structure a framework that will maximize the benefits that merchants can provide to the ultimate consumers. These benefits include lower costs, enhanced reliability, and environmental improvements -- all resulting from competition in the generation sector.

Category 4

Staff 1 **Whether merchant capacity should be considered to supplement the FRCC's 15% reserve margin. If so, what amount of supplementary reserve margin is considered reasonable and prudent for reliability purposes?**

Response: "Reserve Margin" is a measurement of generation capacity above some identified load requirement after prudent consideration of appropriate contingencies. This calculation is intended to be a "floor" for reliability purposes and not a "ceiling." Once the established reserve margin in a region is attained, there is no need to monitor, regulate, or classify additional reserves, especially when those reserves are from facilities not included in rate base. In fact, as long as the additional

reserves above an established margin are constructed and operated at the expense of the developer, and not the ratepayer, these additional reserves simply add to reliability within the region they serve. Also, reserve margin requirements are a responsibility of load-serving entities (LSEs) such as utilities who serve retail customers. Practically speaking, in a competitive wholesale market, LSEs will look to merchant generators to help them meet their reserve margin obligations.

Staff 11 **Appropriate Peninsular Florida minimum percent planning reserve margin. Per cent of firm load unserved when another Christmas 1989 occurs.**

Response: See response to Staff 1 above. This issue is properly addressed in Docket No. 981890-EU, the Reserve margin docket.

OUC 1 **Should merchant plants be required to meet the 15% reserve margin requirements consistent with Florida utility responsibilities?**

Response: See response to Staff 1, above. This issue is properly addressed in Docket No. 981890-EU, the Reserve Margin docket.

FPC II-3 **If the Commission is proposing to address the need for generating capacity in Florida, does the Commission have a basis to conclude that existing utility Ten-Year Site Plans and FRCC methodology are inadequate?**

FPC II-6 **Should utilities build capacity sufficient to cope with Christmas 1989 weather conditions?**

Response: See response to Staff 1, above. These issues are properly addressed in Docket No. 981890-EU, the Reserve Margin docket.

FPC III-3 Why does the Commission believe that merchant plants are needed?

Response: Based on the decision in the Duke New Smyrna Beach case, these developers conclude the Commission has recognized the benefits that merchant capacity confer on ratepayers: lower costs and additional reliability. If risk free, they are beneficial, regardless of the criteria employed.

FPC III-7 What impact would merchants have on statewide reserve margins?

FPC III-8 What impact would merchants have on individual utility reserve margins?

Response: It is important to bear in mind that a reserve margin standard is a floor. Any measure that increases actual reserve margin without increasing risk to ratepayers is a welcome development for consumers. A utility that contracts to purchase from a merchant developer would include the purchase in its available resources. When individual resources are aggregated, the amount of committed merchant power would increase both the utilities' and the indicated statewide reserve. Uncommitted merchant capacity will improve statewide (or Peninsular-wide) reserve margins and will also improve other reliability calculations, e.g., LOLP.

FPC III-18 What rules would govern merchant sales during statewide emergencies?

Response: See response to FPL 10, above.

Category 5

Staff 2 The number of merchant plants which should be permitted in Florida and the maximum amount of supplementary reserve margin considered reasonable and prudent for reliability purposes.

- Staff 3a Consideration of a selection criterion for subscription under a merchant power plant MW cap based on number of proposed megawatts of solar photovoltaic capacity.
- Staff 3b Consideration of selection criterion based on efficiency ratings of plants.
- FPC III-4 How many are needed?
- FPC III-5 Does the Commission have any basis to impose a cap on the number or size of merchant plants entering the State?
- FPC III-6 How would the Commission determine who gets to build merchant plants?
- CFR 1-6 See FAX to Joe Jenkins from The Corporation for Future Resources (CFR), dated April 20, 1999.
- Response: All of the topics in Category 5 relate to the subject of limiting the number of merchant plants based on selection criteria. The emphasis is misplaced. The number of merchant plants that should be permitted is the number that can provide benefits to consumers; it will be determined by the market. The Commission should gauge proposals on their individual merits.

Category 6

- Staff 9 Minimum reporting requirements for entities owning merchant transmission, generation or distribution. (For example, size, type and location.)
- FPL 13 How is merchant capacity to be treated in future need proceedings?
- FPC III-9 What impact would merchants have in current utility generation expansion plans (Ten-Year Site Plans)?
- FPC III-20 What impact would merchants have on existing rules and policies, e.g., the Ten-Year Site Plan process, the bid rule?

Response: Other than with their interconnection requirements, Duke New Smyrna, Constellation, Reliant, and USGen have no plans to engage in "merchant transmission" activities, and are responding to these issues as developers of merchant generation. In all future need proceedings, the applicant will have the burden to show that its proposed plant meets the statutory criteria. Prior to filing an application for a determination of need, an investor-owned utility will be required to demonstrate that it has issued a Request for Proposals and its project is the most cost-effective alternative. If existing merchant plants avail themselves of the opportunity to respond to the RFP, the applicant must factor such merchant power into its evaluation of cost effectiveness.

With respect to the utilities' Generation Expansion Plans, a utility would include any merchant capacity for which it contracts on a firm basis in the resources reported in the Ten-Year Site Plan. Uncommitted merchant capacity should be incorporated into utilities' LOLP and related calculations as potentially available uncommitted capacity, just as the possibility of being able to purchase capacity from other retail-utility-owned resources is presently factored into such calculations.

Category 7

Staff 12 **Diversity of ownership with respect to market power issues.**

Staff 14 **Florida retail-serving electric utilities being allowed to build merchant plants in Florida and being allowed to charge market prices.**

FPL 17* **Should investor-owned public utilities, with an obligation to serve, be able to obtain a determination of need under the same basis and justification as Merchants?**

Developers' Group Issue 1*

The necessary market structure that is conducive to merchant plant development and/or integration into Florida's bulk power supply system.

Response: Any player should be able to build merchant capacity. The ability of retail-serving electric utilities to apply for a determination of need and build a merchant plant would be contingent on the willingness of the utility to accept all of the risk associated with the plant, promulgation of measures (such as a code of conduct and structural separation), and the ability of the Commission to ensure that none of that risk is transferred to retail ratepayers through the ratemaking process. To maximize benefits that merchants can provide to consumers, the Commission should promote a framework characterized by: 1) genuine open access overseen by an independent regional transmission operator; and 2) a liquid wholesale market whose chief attributes are price transparency, vigorous trading, numerous buyers and sellers, multiple products and transactions, and minimal barriers to market entry.

Category 9

FPC III-16 **What impact would merchant plants have on the transmission system in the State?**

Response: The transmission impact of a merchant plant will be evaluated by the transmission provider. Like any other independent, a merchant developer would be required

to pay in accordance with the current methodology for recovery of impacts to the grid.

Category 10

Staff 6 **Establishment of a wholesale, market price, merchant cost-effectiveness standard. Reporting requirements for wholesale market prices for the purpose of determining the optimum level of merchant power plants.**

Response: We do not believe that reported wholesale prices would constitute an appropriate mechanism for determining the optimal level of merchant power plants. As was demonstrated in the Duke New Smyrna Beach case, a more appropriate measure would be the ability of a proposed merchant plant to economically displace existing generating capacity, or economically serve new load.

FPL III-10 **What impact would merchants have on the dispatch of existing generation in the State?**

Response: Where merchant plants are more efficient and cost-effective than existing generation resources, they will enhance the overall dispatch efficiency of Florida's generation resources. In other words, in a competitive market, efficient, cost-effective merchant generation can be dispatched ahead of existing, less efficient and less cost-effective resources. Where merchant plants are not as efficient and cost-effective as other available resources, their presence will have no impact on the dispatch order.

Category 11

Staff 7a Use of allowable ambient air pollution increments by merchant power plants.

Staff 7b Use of available power plant sites and other finite resources.

FPC III-15 What impact would merchant plants have on the environment of the State?

FPC III-23 If merchant plants are built and are rendered unprofitable by technology advances or market saturation, what impact would this have on the environment?

FPL 18* Will the use of limited resources and infrastructure in Florida by Merchants affect investor-owned public utilities with an obligation to serve, ability to use that infrastructure for public purpose? (gas transportation, transmission line capacity, air, water, land, etc.)

Response: By operating new, state-of-the-art plants that must conform to stringent standards, merchant plants will likely result in a net gain for the environment. Moreover, existing retail-serving utilities have no priority right to such infrastructure.

Category 12

Staff 5a Job creation/enhancement.

Staff 5b Increase in state and local tax base.

Response: To the extent that merchant plants drive the cost of wholesale power down by increasing competition in the wholesale market, they will stimulate economic growth and development. To the extent that the advent of a policy that allows merchants to participate fully in the market results in more total capacity being built than if market entry were constrained, there will be a corresponding effect on the tax base.

Category 13

- Staff 8 Impact, if any, of merchant plants on conservation goals and plans.
- FPC III-19 What impact would merchants have on DSM programs and the DSM goals process in Florida?
- FPL 21 Will Merchant Plants frustrate DSM/Conservation programs goals of improved efficiency and/or power plant avoidance by either building additional capacity or lowering costs that must be considered in utilities cost-effectiveness calculations?
- FPL 22 Should utility conservations cost-effectiveness test be performed anticipating lower marginal costs in Florida due to Merchants? Will this result in same or less conservation measures by utilities?

Response: There should be no significant impact on the goals process. However, the price transparency provided by the competitive wholesale market may facilitate better conservation decisions.

Category 14

- Staff 13 Fuel diversity - what is it and is it needed?
- FPC III-17 What impact would merchants have on the fuel supply system in the State?

Response: The topic of fuel diversity is not appropriately limited to merchants: If anything, the development of merchant plants would create incentives to improve the fuel supply system in the State, because the fuel supply industry is market-driven as well. With respect to the question of back-up fuel, the decision as to whether to provide back-up fuel at a particular site should be left to the developer, based on proper economic decisions.