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# Public Service Commission

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COMMISSION CLERK

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

**DATE:** January 27, 2011

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Draper, D. Lee)
Office of the General Counsel (Fleming)

**RE:** Docket No. 100459-EI – Petition for authority to implement a demonstration project consisting of proposed time-of-use and interruptible rate schedules and corresponding fuel rates in the Northwest Division on an experimental basis and request for expedited treatment, by Florida Public Utilities Company.

**AGENDA:** 02/08/11 – Regular Agenda – Tariff Filing – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Administrative

**CRITICAL DATES:** 02/14/11 (60-Day Suspension Date)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\100459.RCM.DOC

## Case Background

On December 14, 2010, Florida Public Utilities Company (FPUC) filed a petition to implement optional time-of-use (TOU) and interruptible rate schedules and corresponding fuel factors in the Northwest Division on an experimental basis.

FPUC provides electric service to customers located in two sections of north Florida. The Northwest Division serves Jackson, Calhoun and Liberty counties, and is commonly called the "Marianna Division." The Northeast Division is located in the Fernandina Beach area, and serves Nassau County. FPUC does not generate any of the power it sells, but meets the needs of its customers through contracts for purchased power. In Order No. PSC-07-0476-PAA-EI, the

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Commission approved a 10-year agreement (agreement) for the purchase of generation services for the Northwest Division from Gulf Power Company (Gulf).[1] FPUC's contract with Gulf exclusively applies to the Northwest Division's customers. FPUC purchases power for the Northeast Division from JEA. FPUC recovers its prudently incurred purchased power costs through the Fuel and Purchased Power Cost Recovery Clause (fuel clause). While FPUC's base rates are the same for both divisions, the fuel factors differ since FPUC's two divisions are served by different purchased power contracts.

In February 2009, FPUC entered into a franchise agreement with the City of Marianna (City). The agreement includes a provision that FPUC must put into effect TOU and interruptible rates by February 17, 2011. FPUC explains that if the rates are not in effect by the deadline, the City of Marianna has certain rights under the franchise agreement which may lead to termination of the franchise and purchase of FPUC's distribution facilities within the city limit. FPUC, therefore, requested expedited treatment of its petition.

In 2010, FPUC entered into negotiations with Gulf to amend the agreement in order to modify the method for calculating the amount of capacity to be purchased by FPUC from Gulf. FPUC stated that on January 21, 2011, FPUC executed an amended agreement with Gulf. FPUC filed a separate petition with the Commission requesting approval of the amended agreement on January 26, 2011. The amended agreement will result in fuel savings to FPUC's ratepayers and form the basis for the proposed rate schedules.

On January 7, 2011, the City of Marianna filed a petition to intervene and on January 10, 2011, the Office of Public Counsel (OPC) filed a notice of intervention. On January 20, 2011, staff and the parties to this docket held an informal meeting to discuss FPUC's petition.

On January 24, 2011, the City filed a preliminary statement of issues and positions. The City's states that FPUC's proposed TOU and interruptible rates are inappropriate, unjust, and unreasonable because they are not cost-based and do not provide appropriate price signals or incentives to FPUC's customers. Accordingly, the City contends that the Commission should deny FPUC's petition.

On January 26, 2011, FPUC filed responses to the City's preliminary statement of issues and positions. FPUC disagrees with the City's positions and requests that the Commission approve the rate schedules as filed, and find that they are fair, just and reasonable.

Staff issued two sets of data requests. FPUC provided responses to these data requests on January 6, and on January 21, 2011. On January 26, 2011, FPUC filed supplemental responses to staff's second set of data requests.

The Commission has jurisdiction over this subject matter pursuant to Sections 366.06 and 366.075, Florida Statutes (F.S.).

[1] Order No. PSC-07-0476-PAA-EI, issued June 6, 2007, in Docket No. 070108-EI, In re: Petition for approval of agreement for generation services and related terms and conditions with Gulf Power Company for Northwest Division (Marianna) beginning 2008, by Florida Public Utilities Company.

## Discussion of Issues

**Issue 1**: Should the Commission approve FPUC's proposed new experimental TOU and interruptible rate schedules and corresponding fuel rates?

**Recommendation**: Yes. FPUC shall also file annual reports with the Commission providing an evaluation of the proposed rate schedules. (Draper, D. Lee)

**Staff Analysis**:

Background

FPUC purchases power for its Northwest Division from Gulf. The current agreement with Gulf includes the obligation by Gulf to serve the peak demand requirement of the Northwest Division on a firm basis. FPUC compensates Gulf for this reliability through a monthly capacity payment. The capacity payment is based on the Capacity Purchase quantity specified in the agreement, which was set at 97.944 mega-watts (MW) beginning in 2008. This amount was established by determining the peak capacity requirements during the peak season (May through September) for the period 2004 through 2007. The agreement further provides that this Capacity Purchase quantity floor can ratchet up based on a subsequent increase of FPUC's system peak demand. However, if actual demand requirements are reduced in the future through conservation, or load control, there is no corresponding reduction in the capacity payments to Gulf. Similarly, the implementation of TOU and interruptible rates would not result in cost decreases under the current agreement. In general, TOU and interruptible rates are designed to encourage participating customers to shift usage to the off-peak period, resulting in savings to the participating customers and a reduction in the utility's peak demand.

To establish a more favorable cost relationship between consumer behavior and purchased power costs passed through to ratepayers through the fuel clause, FPUC states that it entered into discussions with Gulf to modify the demand ratchet component of the agreement. The amended agreement, which was executed on January 21, 2011, reduces the Capacity Purchase quantity from the current level of 97.944 MW to 91 MW. The result of this amended Capacity Purchase quantity is approximately $900,000 in average annualized savings over the extended term of the agreement, assuming no increase in the Capacity Purchase quantity. For 2011, the estimated annual savings is $725,000. In addition to modifying the Capacity Purchase quantity, FPUC stated that the amended agreement extends the current agreement by two years through December 31, 2019.

The amended Capacity Purchase quantity would remain constant for the remainder of the term of the agreement as long as actual peak demand during the peak season does not exceed 91 MW. If the Capacity Purchase quantity rises above the 91 MW floor in any particular year, the demand will rise to the new level in the subsequent year. However, if the Capacity Purchase quantity subsequently reverts back to the 91 MW or lower, FPUC will again be billed for 91 MW. Thus, the demand ratchet feature contained in the current agreement has been eliminated in the amended agreement.

The cost reductions negotiated in the amended agreement will provide benefits to FPUC Northwest Division's customers in the form of lower fuel factors. To meet the requirements of the franchise agreement to develop time sensitive rates, FPUC has proposed to allocate approximately 50 percent of the expected annualized savings to new experimental TOU rates, and 5 percent to the proposed new interruptible rate. The remaining 45 percent of the savings will benefit customers who do not choose to take service under the TOU or interruptible rate schedules, i.e., non-participants, in the form of lower fuel factors starting in 2012. The amended agreement savings were not projected in FPUC's 2011 fuel factors, and FPUC is not proposing to modify the 2011 fuel factors that were approved in Docket No. 100001-EI. The savings resulting from the amended agreement during 2011 will be reflected in the 2011 true-up for the Northwest Division, which will take place in 2012. Staff notes that the savings are not large enough to trigger a mid-course correction.

Proposed rate schedules

Firm customer TOU rate schedules. All base rate charges will be equal to the non-TOU options for the proposed TOU options for the Residential, General Service, and General Service Demand rate classes. The existing fuel charge for these classes will be adjusted by an incremental (on-peak) or decremental (off-peak) factor to provide for rate increases for usage during the on-peak period, and provide a discount for usage during the off-peak period. FPUC states the proposed TOU rate design will encourage customers to modify usage, a behavior change that will provide future system benefits.

FPUC has proposed to limit the participation under the TOU rate schedules to achieve targeted annual savings levels. FPUC engaged a consulting firm to develop a model that projects demand reductions and energy usage during on- and off-peak times and annual savings compared to FPUC's standard fuel rates. The fuel differentials were designed so that the revenue impact of the maximum participation rate allowed under the experimental tariff would equal the amount of savings resulting from the purchased power contract allocated to the TOU rates. This prevents non-participating customers from subsidizing participating customers. If participation in the experimental rate options does not reach the stated maximums upon which the rates are based, any remaining fuel savings not used to offset revenue losses under the TOU plans will be flowed back to all ratepayers. The maximum participation rate varies by rate class.

Interruptible rate schedule. The proposed interruptible IS-EXP rate is available to customers in the General Service Large Demand (GSLD) rate class. Like the GSLD class, the experimental rate will be limited to customers with demand between 500 and 5,000 KW per month, with the extra requirement that the customers have a load factor equal to or exceeding 35 percent. FPUC states that it currently serves 13 customers under the GSLD rate class. Under the proposed rate, the customer, demand, and non-fuel energy charges would be the same as the existing GSLD rate. Participating customers will receive a discounted fuel charge during the on-peak time period, which is the period the customer would be subject to interruption for the purpose of reducing peak demand. The on-peak period is defined in the agreement with Gulf as the period May through September. For all other months, the standard GSLD fuel charge would apply, since the customer would not be subject to interruption. FPUC explained that since it does not currently offer interruptible service, a potential interruptible customer would be required to enter into a special contract with FPUC, which would be subject to Commission approval. The special contract would specify any operational requirements that the customer needs in order to receive interruptible service.

FPUC has allocated 5 percent of the 2011 amended agreement savings, or $36,250, to the interruptible rate in the form of a lower on-peak fuel charge. As a general principle, customers on an interruptible rate are compensated through lower rates for this lower level of service. The proposed interruptible rate limits participation to one customer to limit potential revenue losses associated with load shifting to the savings allocated to the IS-EXP rate.

Other matters

FPUC has proposed to absorb all incremental costs related to the experimental programs, including costs for any TOU and interruptible metering requirements. Since FPUC is currently not offering any TOU or interruptible rate schedules, FPUC is proposing to implement a customer education program (mail outs, advertising, radio, customer meetings) and a mandatory energy audit for each participant in the new rates. Assuming the rates are effective by February 17, 2011, FPUC plans to have an open enrollment period until the end of April, and customers will be able to start taking service under the TOU or interruptible rates in the beginning of May. As part of the open enrollment process, customers will be enrolled on a first-come, first-served basis, until the maximum participation level as defined in the TOU or interruptible tariffs is reached.

FPUC is proposing to provide to the Commission annual reports that would include the number of customers that have selected the experimental rates, the amount of participant savings by rate class as compared to standard rates, and the annual savings resulting from the amended agreement.

City of Marianna's preliminary statement

The City filed its preliminary statement stating that the City's experts are continuing to review FPUC's proposed rate schedules and the amendment to the agreement with Gulf. While the City states that its detailed positions on FPUC's proposals may be expanded, the City at this point opposes FPUC's proposed rates. The City asserts that the proposed rates are not cost-based and do not provide accurate price signals to FPUC's customers. Furthermore, the City states that FPUC's proposal to limit the subscription to the TOU and interruptible rate is unduly discriminatory. Finally, the City states that there is no time-of-use cost basis in the costs incurred by FPUC under the agreement with Gulf for approximately 65-70 percent of the costs. The City concludes that the Commission should either deny or, in the alternative, suspend the proposed rate schedules pending further proceedings.

FPUC's response to the City's preliminary statement

FPUC asserts that the City has provided no data to support its assertion that the proposed rates should be rejected because the rates are not cost-based and do not send the appropriate pricing signals. FPUC states that proposed TOU rate schedules are supported by costs approved by the Commission and incorporate known savings to derive the proposed TOU rates. FPUC states that the Commission approved FPUC's 2011 levelized fuel factors in Docket No. 100001-EI, based on the costs expected to be incurred in 2011 as defined in the current Gulf agreement. FPUC's proposed TOU rates incorporate all of the same costs, but then utilize the expected savings from the amended agreement to derive the on- and off-peak TOU rates. As such, FPUC contends, the rates are cost-based.

FPUC also disagrees with the City's position that nothing in the Gulf agreement reflects the fact that Gulf's production costs vary from hour to hour, and accordingly FPUC's proposed TOU rates can not reflect costs incurred to provide service. FPUC states that it appears that the City is describing real time pricing, which is separate from TOU rates. FPUC states that the TOU rates can be best described as a premium and discount to the approved 2011 fuel factors, with the premium and discount revenues resulting from the amended agreement savings.

With respect to the City's statement that the proposed rates are discriminatory because of the subscription limitation, FPUC notes that the rates are available to all customers on a first-come, first-served basis, and there is no limitation on who may participate. Finally, FPUC notes that its proposal is for a demonstration project on an experimental basis, consistent with Section 366,075, F.S.

Conclusion

Staff recommends the Commission approve FPUC's proposed experimental TOU and interruptible rate schedules and associated fuel factors. In addition, staff recommends that FPUC file annual reports evaluating customer participation and customer response. The proposed rates are designed to provide customers who are capable of modifying their electric usage with savings on their bills and ensure that FPUC's peak demand remains at or below the 91 MW. It will also allow FPUC to gather important data on price responsiveness to TOU rates while protecting the non-participating customers from lost revenue impacts.

With respect to the City's comments, staff notes that the franchise agreement between FPUC and the City includes a provision that FPUC must put into effect TOU and interruptible rates by February 17, 2011. Staff explored with the parties the option of extending this deadline, to allow FPUC and the City to reach agreement on the appropriate design of the proposed rates; however, the City stated that if FPUC misses this deadline, the City has the right to initiate proceedings pursuant to the franchise agreement to purchase the distribution system within the City.

While the City raises some valid concerns about the cost basis of the rates, staff believes that FPUC's situation as a non-generating utility creates some special constraints. FPUC's purchased power costs are determined by the energy, demand, and transmission charges contained in the Gulf contract. FPUC does not have information on Gulf's hourly or monthly production costs, nor can it require Gulf to adjust the contract price based on Gulf's hourly production prices. Absent a purchased power contract that reflects the hourly differences in production costs, staff is unclear as to how FPUC could design TOU or interruptible rates that accurately reflect such cost differences. The proposed rates appear to provide a sufficient differential between on- and off-peak rates to encourage some customers to shift usage. Given the lack of true cost data available to FPUC, staff believes the proposed rates are reasonable to implement as an experimental pilot tariff. The experimental pilot will allow FPUC to determine participating customers' load response and the effect on participating customers bills.

The City also objects to the limitations on participation in the experimental rates. Currently, the only cost savings attributable to any load shifting is the savings in overall purchased power costs discussed above. FPUC's proposal to use a portion of the savings resulting from the amended agreement to establish time-differentiated rates appears to be a reasonable first step to designing viable TOU rates. FPUC's consultant used an econometric model to project on- and off-peak usage. The expected revenue shortfall resulting from load shifting was limited to the savings allocated to the program. To allow participation beyond this break even point would require non-participants to subsidize participants. Therefore, staff believes that limiting participation at this point is reasonable.

FPUC has a strong incentive to ensure that its peak season demand remains at or below the 91 MW Capacity Purchase quantity established in the amended agreement. Maintaining a peak demand at or below 91 MW benefits all of FPUC Northwest Division's ratepayers, as an increase in the Capacity Purchase quantity above 91 MW will result in higher fuel costs. Since FPUC has no experience with TOU or interruptible rates, offering the tariff on an experimental basis will allow FPUC to gather customer-specific data to gauge customer demand response. FPUC stated that the savings resulting from the amended agreement are expected to increase annually, which will allow FPUC to modify the TOU and interruptible rates on a going-forward basis. Staff will evaluate as part of the on-going fuel clause hearings FPUC's TOU and interruptible fuel charges. Any interested parties will have the ability to participate in the evaluation of FPUC's TOU and interruptible fuel charges.

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

**Recommendation**: Yes. If Issue 1 is approved, the tariffs should become effective on February 8, 2011. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order. (Fleming)

**Staff Analysis**: If Issue 1 is approved, the tariffs should become effective on February 8, 2011. If a protest is filed within 21 days of the issuance of the order, the tariffs should remain in effect, with any revenues held subject to refund, pending resolution of the protest. If no timely protest is filed, this docket should be closed upon the issuance of a consummating order.