

State of Florida



Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

DATE: September 29, 2016

TO: Office of Commission Clerk (Stauffer)

FROM: Division of Engineering (Wooten) *PaE*
Division of Accounting and Finance (Brown, Cicchetti, Wilson) *ALM*
Division of Economics (Higgins, McNulty) *WFM*
Office of the General Counsel (Corbari) *KW*

RE: Docket No. 160158-EI – Petition for approval of energy purchase agreement between Gulf Power Company and Morgan Stanley Capital Group Incorporated.

AGENDA: 10/11/16 – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: Based on a termination provision contained in the Agreement, a final Commission decision must be rendered by February 22, 2017.

SPECIAL INSTRUCTIONS: None

Case Background

On June 27, 2016, Gulf Power Company (Gulf or Company) filed a petition requesting approval for cost recovery of a negotiated Energy Purchase Agreement (Agreement) with Morgan Stanley Capital Group Inc.¹ (Morgan Stanley). The Agreement obligates Morgan Stanley to deliver to Gulf a fixed number of megawatt-hours (MWh) in each hour, of each month, of each year, throughout the 20 year term of the Agreement. The petition is similar to the previous Gulf

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

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Kingfisher Wind Farm Agreement (“Kingfisher I”) that was approved by the Commission in 2015.²

The Agreement contains a termination provision for failure to obtain Commission approval of the Agreement through a final non-appealable order within 240 days of filing. Based on the termination provision contained in the Agreement, a final Commission decision must be rendered by February 22, 2017.

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

²Order No. PSC-15-0197-PAA-EI issued May 13, 2015, in Docket No. 150049-EI, *In re: Petition for approval of energy purchase agreement between Gulf Power Corporation [Company] and Morgan Stanley Capital Group Incorporated.*

Discussion of Issues

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

Recommendation: Yes. Gulf has reasonably demonstrated that the Agreement will likely produce savings of \$21 million and will encourage the development of renewable energy. Therefore, staff recommends that the Commission approve Gulf's petition. (Wooten, McNulty)

Staff Analysis: Gulf's petition requests approval for the recovery, through the Fuel and Purchased Power Cost Recovery Clause (Fuel Clause), of costs associated with the Agreement between the Company and Morgan Stanley. Morgan Stanley's energy delivery commitment is shaped to match the projected hourly and monthly output of a 94 megawatt portion of a wind electric generation facility known as the Kingfisher Wind Farm in Oklahoma.³ On an annual basis, Morgan Stanley's energy delivery commitment totals 356,843 MWh, beginning in 2016. On June 10, 2016, Morgan Stanley entered into an agreement with the owner of the Kingfisher Wind Farm for Morgan Stanley to financially hedge the energy output of the Kingfisher Wind Farm. Staff believes that Rule 25-17.0825(6), Florida Administrative Code (F.A.C.), addresses non-firm purchased power agreements, such as the Agreement between Gulf and Morgan Stanley. Rule 25-17.0825(6), F.A.C., requires consideration of cost-effectiveness and any adverse impacts to electric service that may be caused by a purchased power agreement.

Economic Evaluation

Staff reviewed Gulf's fuel price forecasts, developed in 2015, as well as the process and methodology by which the forecasts were developed. In response to a staff data request, the Company described the methodology it employed in developing its natural gas and coal price forecasts used in this docket, a methodology which is consistent with that used by the Company to develop its 2016 Ten-Year Site Plan. Gulf's natural gas and coal price forecasts were lower in the budgets used to prepare the analysis in the instant proceeding than those used to prepare the 2015 Ten Year Site Plan. Staff has reviewed Gulf's natural gas and coal price forecasts and believes they are reasonable for evaluating the Agreement.

After evaluating the Agreement and the information provided by Gulf, staff has concluded that the economic evaluation completed by the company demonstrates reasonably that the Agreement is cost-effective. Under the base fuel forecast, customers are anticipated to receive savings of \$21 million in net present value (NPV) and an average customer should realize savings within the first year of the Agreement.

By fixing energy payment rates, the rates are not allowed to float with changes to the avoided unit's fuel costs. This shifts all the risk of fuel price fluctuations to Gulf's ratepayers. Based on the fuel forecasts provided, the low fuel price scenario results in a potential NPV loss of approximately \$6 million. In contrast, the high fuel price scenario resulted in a savings of around \$50 million. Regardless, Gulf would remain obligated to pay the contracted rate and may seek to recover the costs from the ratepayers through the fuel cost recovery clause. Because of the fixed

³ The Kingfisher Wind Farm is expected to have a full nameplate capacity of approximately 298 MW.

price nature of the Agreement, there are potential risks associated with fuel price variability, but staff believes that the potential benefits from the renewable attributes increases the benefit to the ratepayers that the Agreement will provide.

Under the Agreement, Gulf is only required to pay for energy which is received from Morgan Stanley on the Southern Companies Transmission System. Energy delivered under the Agreement to the Southern Companies Transmission System will be assigned to Gulf at the prices designated in the Agreement. Although the energy received on the Southern Companies Transmission System may not come from renewable generation, Gulf will be entitled to receive and retain all environmental attributes, including renewable energy credits (RECs), associated with the corresponding output of the Kingfisher Wind Farm. In this manner, the Agreement is similar to the prior Kingfisher I agreement that was linked to 178 MW of the Kingfisher facilities wind generation. The addition of the Agreement in this petition will secure the renewable attributes associated with the rest of the wind generating capability of the Kingfisher facility.

Renewable Energy Credits

Gulf is anticipating receiving approximately 360,000 RECs annually from the Agreement over its lifetime. The Company states that RECs are currently selling for \$0.33 per credit on the voluntary market. In its petition, Gulf stated that proceeds from the sale of RECs would be returned to Gulf's ratepayers in the form of credits to the fuel clause. Should Gulf decide to sell its RECs, the Company's proposed treatment of RECs associated with the Agreement is appropriate because the proceeds from any sale of the RECs will benefit ratepayers. The RECs also have the potential to assist the Company in complying with Renewable Portfolio Standards or similar compliance obligations should they arise in the future. Staff recommends that Gulf's proposed treatment of RECs associated with the Agreement is appropriate, because the proceeds from any sale of the RECs will benefit ratepayers in the form of credits to the fuel clause.

Security Evaluation

The Agreement includes several provisions to protect Gulf's ratepayers and ensure the adequacy and reliability of electric service. These include protections for covering damages to Gulf if Morgan Stanley fails to deliver energy, the ability for Gulf to curtail or cease energy deliveries for emergency situations and requiring Morgan Stanley to utilize firm transmission for all deliveries with limited exceptions. Staff believes that this provision adequately ensures that the reliability of the Southern Companies Transmission System as well as Gulf's electric service, will not be adversely impacted by the energy delivered under the Agreement

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

Conclusion

Gulf has reasonably demonstrated that the Agreement will likely produce savings of \$21 million and will encourage the development of renewable energy. Therefore, staff recommends that the Commission approve Gulf's petition.

Issue 2: Should this docket be closed?

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

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