DIRECT TESTIMONY OF

JOSEPH E. CALHOUN, SR.

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

REGARDING SEBRING UTILITIES COMMISSION

DOCKET NO. 920949-EU

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY OF

JOSEPH E. CALHOUN, SR.

In re: Joint Petition of Florida Power Corporation and Sebring Utilities Commission for Approval of Certain Matters in Connection With Sale of Certain Assets by Sebring Utilities Commission to Florida Power Corporation _______________________________________/	Docket No. 920949-EU

Q: **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A: My name is Joseph E. Calhoun, Sr. My business address is Post Office Box 971, Sebring, Florida 33871-0971.

Q: **BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A: I am employed with Sebring Utilities Commission ("Sebring") in the capacity of General Manager.

Q: **PLEASE STATE YOUR EXPERIENCE AND QUALIFICATIONS.**

A: Starting in 1964, I have held the following positions with the Sebring Utilities Commission:

02/24/64	Power Plant Maintenance
03/25/66	Control Operator-Steam Plant
10/08/66	Watch Engineer-Steam Plant
02/09/75	Supervisor of Operations
03/14/82	Manager of Special Projects
07/31/83	Superintendent-Power Production
10/01/84	Manager-Power Resources
08/27/90	Acting General Manager
11/28/90	General Manager

Q: **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A: To describe the history of and explain the reasons for Sebring pursuing the sale of its electric and water system assets.

Q: **ARE YOU SPONSORING ANY PORTIONS OF EXHIBIT 1, WHICH CONTAINS THE AGREEMENT FOR PURCHASE AND SALE OF ELECTRIC SYSTEM AMONG SEBRING, FLORIDA POWER CORPORATION ("FPC"), AND THE CITY OF SEBRING ("CITY")?**

A: Yes. I am sponsoring the following portions of Exhibit 1:

Pages 107 to 129	Excluded Assets (Schedule 1.2 of Agreement)
Pages 232 to 240	Territorial Agreement between Sebring Utilities Commission and Glades Electric Cooperative, Inc. (Exhibit F of Joint Petition)
Page 241	Severance Payments (Schedule 2.1-A of Agreement)
Pages 254-255	Third Party Authorizations (Schedule 3.2 of Agreement)
Page 256	Litigation (Schedule 3.3 of Agreement)
Page 257	Permitted Encumbrances (Schedule 3.4 of Agreement)
Pages 259-264	Permits (Schedule 3.10(a) of Agreement)
Pages 265-266	Environmental, Health & Safety Exceptions (Schedule 3.10(d) of Agreement)
Pages 267-269	Schedule of Insurance & Workers' Compensation Claims (Schedule 3.13 of Agreement)
Pages 270-285	Sebring Utilities Commission Employee Benefit Plans (Schedule 3.14(a) of Agreement)
Pages 286-572	Sebring Utilities Commission Benefit Plan Documents (Schedule 3.14(h) of Agreement)
Page 573	Sebring Utilities Commission Benefit Plan Contributions (Schedule 3.14(j) of Agreement)
Page 582	Assets Used But Not Owned (Schedule 3.18 of Agreement)
Pages 629-634	Holland & Knight Opinion Letter (Schedule 10.2(b) of Agreement)

Pages 635-637	Andrew Jackson Opinion Letter (Schedule 10.2(c) of Agreement)
Pages 640-641	Fee Simple Deed (Schedule 10.2(e) of Agreement)
Pages 642-643	Assignment of Leases and Contracts (Schedule 10.2(g) of Agreement)
Page 650	Instrument of Assumption (Schedule 10.4(d) of Agreement)

Q: WHAT PROMPTED SEBRING TO CONSIDER THE SALE OF ITS ELECTRIC AND WATER SYSTEM ASSETS?

A: There are severe, ongoing debt problems related to bonds originally issued primarily for construction of the J. H. Phillips Power Plant and other system improvements. Proceeds from the sale of the electric and water system assets were considered by Sebring as a possible means to eliminate that debt and achieve a substantial electric rate decrease for its customers.

Q: WHY AND WHEN DID THE DEBT PROBLEM CONFRONTING SEBRING ARISE?

A: In 1978, faced with rising power demands and aging generating plants, Sebring began a detailed economic study of its long-term options for meeting the electrical load in 1980 and beyond. Subsequent investigations verified the technical feasibility of a heavy oil-fired power plant using low-speed marine engines. The economic study showed the projected cost of a 40 M/W Diesel Project, with waste heat recovery, to be less than the cost of purchasing equivalent amounts of power from FPC under their RS2A rate, over a ten-year period from 1983 through 1993. The study showed an accumulative savings, during the ten year period, of 13 percent, or $30,000,000.00, with continuous savings projected for the life of the plant.

Q: HOW DID SEBRING ACT UPON THE ECONOMIC STUDY?

A: In 1979, Sebring retained a nationally recognized engineering firm to prepare project specifications and take bids for a turn-key diesel power plant. On April 7, 1981, the Commission issued its Series 1981 Bonds in the aggregate principai amount of $92,750,000.00. A major portion of the proceeds was used to pay for the construction of the J. H. Phillips Power Plant. In connection with the issuance of the Series 1981 Bonds, a number of economic considerations and assumptions were taken into account relating to future energy costs, electrical loads, and the needs for new power supply.

Q: WHAT WERE THE ECONOMIC ASSUMPTIONS?

A: Included in those assumptions was the ability of Sebring to sell energy generated by the Phillips Plant in excess of the demand of Sebring's customers on the Florida Energy Broker, and the ability of the Phillips Plant to generate energy by using residual fuel at a lower cost than those of competing generation facilities.

Q: WAS SEBRING RELYING ON EXPERT ADVICE IN MAKING THESE ASSUMPTIONS?

A: Yes. At that time, Sebring retained a nationally recognized engineering firm to act as consulting engineers on the project. That firm is no longer providing such services to Sebring. In their opinion, the economic considerations and assumptions on which analyses, projections, and recommendations were based, with respect to the bond issue, seemed reasonable.

Q: WERE THE ASSUMPTIONS AND PROJECTIONS OF THE CONSULTING ENGINEERS ACCURATE?

A: No. The projections concerning the revenues from the sale of surplus power from the Phillips Plant, which became operational in March 1983, and concerning the amount of retail electric sales by Sebring, were not realized. Although interest on the Series

1981 Bonds was funded through September 30, 1983, from proceeds of the Series 1981 Bonds, the ability to pay debt service on the bonds after that date depended on the accuracy of the assumptions and projections. The net benefit from surplus energy sales was projected by Sebring's consulting engineers to be $6,132,000.00 and $5,859,000.00 in Fiscal Years 1985 and 1984, respectively. In fact, those net benefits were $367,679.00 and $259,221.00, respectively. As a result, the net cost of power from the Phillips Plant to Sebring is much greater than anticipated, placing Sebring at a severe economic and competitive disadvantage. In addition, Sebring's then-consulting engineers projected retail sales to be $16,250,000.00 and $14,886,000.00 during Fiscal Years 1985 and 1984 respectively, while actual retail sales were $12,331,369.00 and $11,830,567.00.

Q: **WHEN DID SEBRING BECOME AWARE THAT THE CONSULTING ENGINEERS' PROJECTIONS WERE INACCURATE?**

A: In June, 1983, it became evident to Sebring that the financial projections prepared by its consulting engineers would not be realized.

Q: **DID SEBRING TAKE ACTION UPON THIS KNOWLEDGE?**

A: Yes. Sebring notified various parties, including the trustee for the Series 1981 Bonds (Sun Bank, N.A.), of its financial problems. In February, 1984, Sebring, at the direction of the trustee for the Series 1981 Bonds, engaged Black & Veatch, Engineers-Architects, Kansas City, Missouri, to review Sebring's financial condition and operations.

Black & Veatch performed a study of Sebring in May, 1984, entitled "Review of System Financial Conditions." The study concluded in part that projected off-system opportunity sales (broker sales) would not be realized and that if electric rates were increased sufficiently to generate revenues to meet the debt service coverage as required in Sebring's bond documents, such rates would be burdensome and oppressive on Sebring's rate payers.

Q: HOW DID DEBT SERVICE PROBLEMS ON SEBRING'S BONDS DEVELOP?

A: Subsequent to September 30, 1983, Sebring violated certain provisions of its 1981 Bond Resolution by not maintaining sufficient debt service coverage and not making monthly transfers to the bond principal and interest accounts. Sebring issued additional bonds in 1984 and 1985 to make full payment of principal and interest on the series 1981 bonds. In February 1986, Sebring refinanced its outstanding debt as a part of the refunding plan for the purpose of restructuring the debt to match the projected net revenues of the system and issue timely payment on principal and interest on the refunding bonds.

Q: PRIOR TO ENTERING NEGOTIATIONS WITH FPC TO SELL ITS ELECTRIC SYSTEM, WHAT STEPS DID SEBRING TAKE TO RESOLVE THE FINANCIAL CRISIS FACING THE UTILITY?

A: Prior to Sebring's February 1986 refinancing, the AMBAC Indemnity Corporation, which had insured Sebring's then-outstanding bonds, requested and received permission from Sebring to seek out a buyer for Sebring's assets. A representative of AMBAC contacted FPC, Tampa Electric Company, Florida Power and Light, and Seminole Electric. None of these companies expressed any interest in purchasing Sebring's assets at that time. As a result, in February, 1986, Sebring refinanced its outstanding debt by issuing $94,257,271.42 Series 1986A, $20,908,738.71 Series 1986B Bonds, and $5,050,000.00 Series 1986C Bonds. Due to the unwillingness of AMBAC to increase its insurance exposure at Sebring above the $92,750,000.00 of bonds issued in 1981, $20,738,710.00 Series 1986B Bonds were sold without bond insurance and carried an interest rate of 11.5 percent. The 1986 issue was designed to provide Sebring with stable electric rates for the first few years, but provided for increases in principal payments starting in 1987. The Series 1986C Bonds were paid in 1990. Because a portion of the Series 1986A bonds were capital appreciation bonds (i.e., bonds on which interest is added to principal until maturity), the Series A bond debt would increase ultimately to approximately $116,000,000.00.

Faced with ramping debt obligations, Sebring in January, 1990, mailed out 96 copies of a "Request for Proposal to Purchase the Assets of Sebring Utilities Commission." Four firms responded with proposals to purchase a portion of the assets of the electric system: Tampa Electric Company, FPC, Big Bend Engineering, and Florida Municipal Power Agency. Tampa Electric Company was selected as the successful bidder, and, in 1991, Tampa Electric Company purchased the Phillips Plant, Dinner Lake Plant, Park Street Plant, and most of Sebring's 69 KVA Transmission system. As part of this same transaction, Sebring sold to FPC Sebring's ownership interest in Crystal River 3 in 1992.

The proceeds from these sales were used toward redemption of the Series 1986A and 1986B Bonds. The current debt service schedule - Series 1986A and B bonds - is presented in Exhibit 1, pages 574 to 577.

Q: **WHEN DID SEBRING DECIDE TO OFFER FOR SALE ITS REMAINING UTILITY ASSETS?**

A: In May, 1991, Sebring mailed out "Request for Proposals to Purchase the Remaining Electrical Assets." Two firms responded, FPC and Tampa Electric Company. FPC was selected on October 9, 1991, as the company with which to begin negotiations. The negotiations, which were long and arduous, culminated with the signing of the Agreement for Sale and Purchase of Electric System, which was approved on August 31, 1992, by Sebring Utilities Commission in its Resolution 92-7, and on September

15, 1992, by the Sebring City Council in its Resolution No. 92-13. By separate contract, the City has agreed to purchase Sebring's water system. A more detailed description of the agreements with FPC and the City is contained in the testimony of FPC's witness, Mr. Pete Dagostino.

Q: **WHAT IS SEBRING'S CURRENT FINANCIAL CONDITION?**

A: Sebring continues to be in a distressed financial condition due to the excessive amount of its outstanding long-term debt. During fiscal 1991-92, proceeds from the sale of transmission facilities and its ownership share of Crystal River 3 were used to reduce the annual debt service requirement by $4,710,000.00, from $11,445,500.00 to $6,735,500.00. The reduction in annual debt service in fiscal 1991-92 was achieved by paying off some of the capital appreciation bonds from the Utilities System Revenue Refunding Bonds, Series 1986A. This enabled Sebring to avoid a required rate increase of approximately 27 percent in October, 1991.

The Gross Revenue for the combined electric and water system for fiscal 1991-92 is projected to be $21,364,710.00. Operation and Maintenance Expenses are projected to be $13,220,000.00, resulting in projected Net Revenue of $8,144,701.00.

Q. **DOES THE PURCHASE AND SALE OF THE ELECTRIC AND WATER SYSTEM RESULT IN THE REDEMPTION OF ALL OF SEBRING'S OUTSTANDING BONDS?**

A. Yes. The New Purchase Price, the $21.5 million price to be paid by the City under the water system agreement, together with the balance of funds on hand will pay in full the outstanding bonds of Sebring.

In the fiscal 1992-93 budget, the debt service requirement on the bonds increases to $12,375,500.00, resulting in a projected cash deficit of $5,101,000. The 1992-93 budget does not include an electric rate increase because Sebring's rates, at $110.14

per 1,000 KWH residential, are already the highest in Florida and among the highest in the nation. In fact, Sebring's rates would be required to be increased by 37.1% to $151.00 per 1,000 KWH residential to meet its bond covenants. In lieu of a rate increase, Sebring plans to transfer funds from the Debt Service Reserve Fund under its bond documents to meet the required principal and interest payments. Due to these circumstances, Sebring will not be in compliance with several of the covenants contained in its bond documents, especially its rate covenant, which requires net revenue to be 1.10 times debt service for the forthcoming twelve month period. Faced with this picture, Sebring decided the best alternative would be to sell its assets, pay off its bonds and its other debts, and achieve a substantial electric rate decrease for all its customers. The sale of the electric system assets to FPC, together with the sale of its water system to the City, meets all of these objectives.

Q: DID SEBRING CONSIDER ALTERNATIVES TO SOLVE THE PROBLEM?

A: Yes. Sebring considered the following alternatives:

1. <u>Operate in compliance with its bond covenants</u>. If Sebring were to operate in compliance with its bond covenants, rates would have to increase between 55 percent and 60 percent from the present level through 1996. Because Sebring's rates are already the highest in Florida, such drastic increases would be unduly burdensome to Sebring's customers.

2. <u>Refinancing</u>. Sebring has considered a refinancing, but its analysis shows that a sale to FPC will produce a lower electric rate for Sebring's customers. The effect of refinancing would mean higher costs to Sebring's customers over a 30 year period, not just this year or next. Thus, refinancing does not meet Sebring's objective of <u>decreasing</u> rates.

3. <u>Bankruptcy</u>. Bankruptcy was also considered by Sebring. However, the

uncertainty of whether Sebring would qualify for bankruptcy, the uncertainty of the outcome, the time delays and expense of bankruptcy proceedings, and the potential damage to the City's credit rating make bankruptcy an unacceptable alternative.

4. <u>Sale to the City</u>. A sale of the electric system to the City was considered, but the City Council has stated that this alternative is not acceptable unless the sale to FPC is not possible. Given that the City made no offer to purchase the electric system assets, and has in fact signed the Agreement for Purchase and Sale of Electric System, which sells those assets to FPC, Sebring has concluded that a sale to the City is not a viable option.

Q: **WHY IS THE SALE TO FPC THE MOST APPROPRIATE SOLUTION?**

A: Having considered all the alternatives, Sebring has concluded that the sale to FPC is the best solution for all concerned. This conclusion has been reached only after Sebring, its current consulting engineers, and its financial consultants performed an extensive evaluation of the FPC proposal to purchase the Commission's remaining electric assets, and of the other alternatives. These analyses conclusively show a substantial rate reduction for Sebring's customers if the sale to FPC, under the terms and conditions set forth in our Joint Petition, is approved. This rate reduction will be substantial and will be even greater for customers who qualify for FPC's load control programs. The Sebring Utilities Commission and the Sebring City Council have approved the sale of the Commission's electric system assets to FPC. The sale of the electric system assets to FPC, together with a sale of the water system to the City, offers the best solution to Sebring's unique problems.

Q: **DOES THIS CONCLUDE YOUR TESTIMONY?**

A: Yes.

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