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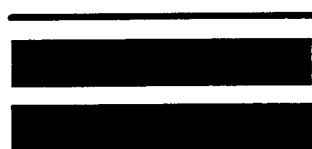
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 930885-EU

**PREPARED DIRECT TESTIMONY
AND EXHIBIT OF**

RUSSELL L. KLEPPER

OCTOBER 15, 1996



GULF POWER



DATE

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FPSC-RECORDS/REPORTING

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
3 Direct Testimony of
4 Russell L. Klepper
5 Docket No. 930885-EU
6 Date of Filing: October 15, 1996

7 Q. Please state your name, business address, and occupation.

8 A. Russell L. Klepper. My business address is 10933
9 Crabapple Road, Suite 105, Roswell, Georgia 30075. I am
10 the founder and principal of Rawson, Klepper & Company, a
11 small utility and energy consulting services firm.

12
13 Q. Do you have any exhibits to which you will be referring
14 during the course of your testimony?

15 A. Yes, I will refer in my testimony to two exhibits.

16 Counsel: We ask that Mr. Klepper's two
17 exhibits (RLK-1 and RLK-2) be numbered for
18 identification as Exhibits _____ and _____,
19 respectively.

20
21 Q. Please describe your educational background.

22 A. I hold a Bachelor of Science in Business Administration
23 with a major in Economics and a Master of Business
24 Administration with a major in Finance, both from the
25 University of Florida, and a Master of Professional

1 Accountancy from Georgia State University.

2

3 Q. Please describe your applicable utility experience.

4 A. I have over nineteen years of applicable utility
5 experience, the first seven as an employee in the
6 financial areas of a major utility. For the past twelve
7 years, the preponderance of my time has been spent as an
8 independent consultant on utility finance, rates and
9 regulation, and regulatory transition issues, as well as
10 certain facets of the economics of both regulated and
11 unregulated firms that produce, sell, and distribute
12 energy for consumption by ultimate customers. I have
13 provided professional services to both investor owned and
14 governmental utilities, to private companies that have
15 significant interests in the energy industry, and to
16 entities such as the World Bank, the United States Energy
17 Association, and the Edison Electric Institute. As a
18 consultant, I have developed and presented two national
19 seminars and numerous in-house seminars which focus on
20 different aspects of utility planning and decision
21 making.

22 A significant portion of my professional activities
23 involves analyzing the public policy implications of
24 alternative forms of utility ownership, as well as
25 writing and speaking on this topic. These public policy

1 implications include examining the necessity of direct
2 federal involvement in the electric utility industry, and
3 determining the true economic cost of electric service
4 inclusive of governmentally funded transfer payments to
5 electric power consumers who are the ultimate
6 beneficiaries of such transfer payments. A more detailed
7 Summary of Professional Credentials is attached to this
8 direct testimony as Exhibit No. ___ (RLK-1).

9
10 Q. Have you previously appeared before the Florida Public
11 Service Commission?

12 A. No, I have not. I previously submitted pre-filed
13 rebuttal testimony before the Florida Public Service
14 Commission (hereinafter the "Commission" or the "PSC") in
15 the first phase of this proceeding, but that testimony
16 was stricken and never considered by the Commission.
17 However, I prepared an Affidavit, briefly describing
18 certain public policy issues relevant to this proceeding,
19 which was submitted to this Commission on or about
20 June 30, 1994, as Exhibit B to the "Motion of Gulf Power
21 Company to limit scope of issues or, in the alternative,
22 to extend time for filing rebuttal testimony."

23
24 Q. What is the purpose of your direct testimony?

25 A. I have been asked by Gulf Power Company ("Gulf Power"),

1 to examine, assess, and address certain public policy
2 issues and the associated economic implications that
3 should be considered by this Commission in deciding the
4 question of whether and to what degree the benefits of
5 customer preference will be enjoyed by new electric
6 service customers locating in the areas of Northwest
7 Florida now served by both Gulf Power and Gulf Coast
8 Electric Cooperative, Inc. ("GCEC"). My testimony as a
9 whole is intended to show that the public interest would
10 be better served by Commission policies and directives
11 that are compatible with existing trends in the electric
12 utility environment and encourage, rather than limit, the
13 ability of new customers to choose between electric
14 service suppliers.

15
16 Q. What activities have you undertaken in the course of your
17 examination and assessments conducted at the request of
18 Gulf Power?

19 A. In conjunction with the first phase of this proceeding, I
20 examined substantially all of the record in Docket No.
21 930885-EU, including but not limited to all pleadings,
22 all direct and rebuttal testimony submitted by Gulf
23 Power, all direct testimony submitted by GCEC, and all
24 items of discovery that had been answered at the time of
25 submission of my rebuttal testimony. I personally

1 attended the depositions of H. W. Norris and Archie W.
2 Gordon, and I reviewed the deposition transcript of
3 John E. Hodges, Jr. I later attended the entirety of the
4 public hearing held before the PSC in this docket, and
5 have subsequently read the Commission's March 1, 1995
6 Order, the Commission's July 27, 1995 Clarifying and
7 Amendatory Order, and the May 23, 1996 Decision of the
8 Florida Supreme Court reversing and remanding the
9 Commission's March 1, 1995 Order. On the basis of the
10 scope of my activities in this matter, I believe it is
11 fair to state that I have a good understanding of the
12 issues to be decided in this phase of the instant
13 proceeding.

14 In addition, in conjunction with my preparation on
15 behalf of Gulf Power in this docket, I reviewed Section
16 366.04 of the Florida Statutes granting Commission
17 jurisdiction over territorial disputes and agreements,
18 and Commission Rules 25-6.0439 et seq. regarding
19 territorial disputes and agreements. I also reviewed the
20 Commission Memorandum regarding HB 405, the proposed
21 territorial bill which, had it passed, would have removed
22 all vestiges of competition between utility suppliers,
23 and in Northwest Florida would have relegated many
24 customers to higher rates and less reliability.

25

1 Q. Please summarize your direct testimony.

2 A. On the basis of my assessment of the relevant public
3 policy considerations and my examination of the evidence
4 and Commission Orders in this proceeding, the decision of
5 the Florida Supreme Court reversing and remanding the
6 Commission's first order, and other documentation which
7 pertains to the matters under consideration in this phase
8 of the proceeding, I have come to the following
9 conclusions:

10 The public policy considerations that are relevant
11 to the issues under examination in this phase of the
12 proceeding overwhelmingly favor a Commission
13 determination that the public interest would be better
14 served by adopting a well considered methodology, such as
15 either of those presented in Gulf Power's proposed
16 "Territorial Policy Statement" or its more general
17 proposed "Policy Statement" attached to the testimony of
18 Gulf Power witness G. Edison Holland as Exhibits GEH-3
19 and GEH-4, to better implement and thereby continue
20 existing Commission policies that provide for the
21 availability of customer preference.

22 The economic protection that would be afforded to
23 GCEC upon the establishment of firm territorial
24 boundaries will result in the disenfranchisement of
25 Florida citizens and businesses that will be consigned to

1 pay higher electric rates and endure lower reliability
2 without the benefit of any regulatory protection or other
3 meaningful means of redress.

4
5 Q. Please briefly describe the significant changes that have
6 occurred and continue to develop in the electric utility
7 environment.

8 A. With the creation of the Department of Energy ("DOE") in
9 1970, the concept of considering and determining national
10 objectives relating to the efficient use of energy was
11 given birth. From that time to the present, the DOE,
12 acting through the Federal Energy Regulatory Commission
13 ("FERC"), has purposefully acted to create a more cost
14 effective electric utility industry in order to minimize
15 electric service costs to ultimate customers.

16 Two important federal actions have served to
17 formalize the trend toward a more efficient utility
18 environment. On October 24, 1992, the Congress of the
19 United States, acting in furtherance of the energy
20 policies already established and implemented by the DOE,
21 enacted the Energy Policy Act of 1992, a public law
22 specifically intended "To provide for improved energy
23 efficiency" by, among other actions, creating an
24 increasingly market oriented electric utility
25 environment.

1 On April 24, 1996, acting on behalf of the
2 Department of Energy and in furtherance of the national
3 energy objectives set forth in the Energy Policy Act of
4 1992, FERC issued Order No. 888, a Final Rule promoting
5 wholesale competition through open access
6 non-discriminatory transmission services by public
7 utilities and addressing recovery of stranded costs by
8 affected utilities. This FERC action manifests the
9 regulatory recognition that the electric generation
10 function in the United States is no longer imbued with
11 "natural monopoly" characteristics, and that the economic
12 benefits of competition in electric power generation will
13 be more effectively realized by ultimate customers if the
14 transmission grid is made available on a
15 non-discriminatory basis to all producers of electric
16 power and energy.

17 Many, if not most, electric utility industry
18 observers believe that further economic benefits will
19 eventually be made available to ultimate customers.
20

21 Q. Are the policy positions established in the Florida
22 Statutes and the Florida Administrative Code consistent
23 with the observable trends in the electric utility
24 environment?

25 A. For the most part, I believe that they are. For instance,

1 in Florida there is no legislation that mandates
2 territorial boundaries between electric utility systems.
3 Instead, territorial boundaries are sometimes negotiated
4 between neighboring utilities, thus allowing for economic
5 efficiency to be naturally implemented through the
6 negotiating process. However, in some instances, more
7 than one utility will have facilities that could cost
8 effectively serve a new customer, and both utilities will
9 desire to provide the service. Under these
10 circumstances, each utility can be expected to argue that
11 the economics of providing service weigh in its favor,
12 because in those instances where other factors are
13 substantially equal, the Florida Administrative Code
14 provides that instead of assigning the right to serve to
15 one utility or the other, the customer should have the
16 right to choose the electric supplier that will provide
17 service. A territorial dispute may ensue when the
18 utility that is not chosen claims that the factors were
19 not substantially equal, and that the customer did not
20 have the right to choose.

21
22 Q. Under the Florida Statutes, what is the proper function
23 of the Commission in resolving territorial disputes, and
24 what is the economic basis for this role?

25 A. The proper function of the Commission is to review

1 territorial disputes for the purpose of determining
2 whether "all other factors are substantially equal". In
3 performing this role, the Commission is guided by Section
4 366.04(5), which provides in part for the avoidance of
5 "uneconomic duplication" of electric facilities. The
6 clear economic underpinning to this guideline is the
7 "natural monopoly" concept that holds that the public's
8 economic welfare will be improved, and consumers of
9 utility services will pay less on a unit basis, if
10 capital intensive utility facilities are not duplicated.
11 A key issue is the question of when duplication is
12 "economic" versus "uneconomic", a notion that would seem
13 to turn on the basis of whether duplication would result
14 in material amounts of additional costs to be borne by
15 pre-existing utility customers. In this regard, it
16 appears that the Florida Supreme Court has said that
17 \$15,000 of incremental expenditure by an electric utility
18 does not cause material harm to pre-existing customers.

19
20 Q. Is GCEC's desire for strict territorial boundaries
21 consistent with its historical position regarding a
22 utility's right to provide electric service?

23 A. No, it is not. This Commission is well aware that GCEC
24 was formerly a full requirements wholesale customer of
25 Gulf Power that migrated from Gulf Power's system. By

1 its insistence on establishing territorial boundaries,
2 GCEC seeks to deny to new or potential customers the very
3 same right of choice in electric suppliers that GCEC
4 itself exercised at the time that it was an existing
5 customer of Gulf Power.

6
7 Q. How was the division of customer service between Gulf
8 Power and GCEC handled when GCEC was a wholesale customer
9 of Gulf Power?

10 A. Until GCEC changed wholesale electric suppliers, the
11 division of retail electric service was addressed within
12 the wholesale service contract between Gulf Power and
13 GCEC. Gulf Power believes that the then existing
14 contractual procedures were fair and effective in
15 allocating retail service on a rational and economically
16 efficient basis. The substantive terms of that contract
17 that pertain to the division of retail electric service
18 have been recast, presented and discussed within Gulf
19 Power's testimony as the proposed "Territorial Policy
20 Statement" that is attached to Mr. Holland's testimony as
21 GEH-3. This proposed policy, if adopted by the
22 Commission, would provide detailed guidelines that would
23 maintain the economic benefits of customer choice while
24 all but eliminating service disputes between Gulf Power
25 and GCEC.

1 Q. What economic stance should be expected from a new or
2 potential electric service customer with respect to the
3 Commission's determination of whether "all other factors
4 are substantially equal"?

5 A. A new or potential customer does not view the question of
6 utility service from the standpoint of societal welfare,
7 as does the Commission, but rather seeks to serve his or
8 her own economic well-being. Regardless of whether all
9 other factors are substantially equal between two
10 potential suppliers, the new or potential customer would
11 prefer to pay less, rather than more, for utility
12 service.

13
14 Q. If all other factors would not otherwise be substantially
15 equal, what action could a new or potential customer take
16 to equalize the other factors such that the choice of
17 electric suppliers would be available to that new
18 customer under the Commission's existing guidelines?

19 A. If the new customer foresees an economic benefit in being
20 served by one electric supplier in preference to another,
21 but the disfavored utility would otherwise provide
22 service under the Commission's guidelines, the rational
23 economic behavior for the new customer would be to make a
24 "contribution in aid of construction" to the favored
25 utility. This action would cede a portion of the new

1 customer's estimated future benefit, but would equalize
2 the incremental costs of service in order to obtain
3 utility service from the favored supplier, thus
4 preserving the remaining portion of the estimated
5 economic benefit. Accordingly, an integral component of
6 customer choice under the Commission's existing
7 guideline, as implicitly recognized in Gulf Power's
8 proposed "Territorial Policy Statement" (GEH-3), and
9 explicitly reflected in Gulf Power's more generalized
10 proposed "Policy Statement" (GEH-4), is the new
11 customer's ability and right to equalize other factors by
12 making a "contribution in aid of construction".

13

14 Q. From an economic standpoint, would the institution by
15 this Commission of strict territorial boundaries be an
16 appropriate regulatory action?

17 A. No, it would not. The economic purpose of regulation is
18 to act as a surrogate for competition in circumstances,
19 such as the existence of natural monopoly conditions,
20 where free market competition does not exist and the
21 essential nature of the product or service provided would
22 allow for monopoly abuse in the absence of regulation.
23 Accordingly, regulation is considered to be most
24 effective when it produces the same incentives and thus
25 the same results that would occur if free market forces

1 were present. In those situations in Florida where
2 customer choice is now available, and where allowing the
3 customer the opportunity to make that choice will have no
4 material adverse effect on pre-existing customers, the
5 Commission should recognize that the market, rather than
6 regulation, will produce the more economically efficient
7 result. If territorial boundaries are erected, the
8 economic efficiencies widely expected to arise from the
9 continuing availability of customer choice will be
10 precluded to the detriment of both new and existing
11 customers.

12 Moreover, in Florida, as a part of the "regulatory
13 bargain" as set forth in applicable law, it is the
14 Commission's explicit responsibility to resolve
15 territorial disputes, and the regulated utilities have
16 the corresponding right to have territorial disputes
17 resolved by the Commission. The establishment of strict
18 territorial boundaries in Northwest Florida may serve to
19 prevent territorial disputes, but the expense of such
20 prevention is the deprivation of the regulated utility's
21 manifest right to dispute resolution.

22
23 Q. Can you cite any authority, other than federal laws or
24 the acts of federal bodies, that encourages the
25 continuation of customer choice as an alternative to

1 erecting territorial barriers?

2 A. Yes, I can. The National Association of Regulatory
3 Utility Commissioners ("NARUC") is an association that
4 acts as the national representative of the State
5 regulatory commissions. On July 25, 1996, the Executive
6 Committee of NARUC issued a resolution adopting
7 "Principles to Guide the Restructuring of the Electric
8 Industry", and urging "that State and Federal regulatory
9 commissions and legislatures be guided by these
10 principles as they develop and implement new policies to
11 govern the regulation, organization and operation of the
12 electric utility industry." A complete copy of the
13 Resolution and the NARUC Principles is attached to my
14 testimony as Exhibit No. ___ (RLK-2).

15 The NARUC Principles set forth one General Principle:

16 "Consumers should have access to adequate, safe,
17 reliable and efficient energy services at fair and
18 reasonable prices at the lowest long-term cost to
19 society. Structural changes in the industry should
20 be encouraged when they result in improved economic
21 efficiency and serve the broader public interest."

22 The NARUC Principles also set forth ten Specific
23 Principles, the third being Customer Choice, which
24 states:

25 "Customers should have the opportunity to make

1 informed choices among electricity providers and
2 services. The potential for competition to improve
3 economic efficiency rests on having multiple service
4 providers as well as informed customers. Market
5 development should be guided in a way that increases
6 the role of competition among energy service
7 providers and the role of choice for customers."
8

9 Q. Why is it particularly important to continue the
10 availability of customer choice in the areas of Northwest
11 Florida that are at issue in this proceeding?

12 A. The areas at issue in this proceeding are served by Gulf
13 Power and GCEC, two electric utilities with substantially
14 different ownership and operating characteristics.

15 Gulf Power is an investor owned, profit seeking
16 (taxable), vertically integrated, business entity that
17 raises new capital for investment at market rates in
18 capital markets, and is subject to rate, rate structure,
19 and public interest regulation by the Commission. As an
20 investor owned utility subject to rate regulation by the
21 Commission, Gulf Power is economically motivated by the
22 profit incentive to maintain rates at the lowest possible
23 level consistent with levels of service acceptable to its
24 customers. As a corporation that obtains investment
25 capital in the open market, Gulf Power must continue to

1 perform or it will lose its economic viability.

2 By contrast, GCEC is a non-profit rural electric
3 cooperative that is owned by its customers but controlled
4 by restrictive by-laws and operated for the benefit of
5 the entrenched management and directors. Rather than
6 being vertically integrated, GCEC owns only distribution
7 facilities. It buys all generation and transmission
8 "G&T" services, constituting the preponderance of its
9 operating costs, under a long term all requirements
10 contract from an unregulated "G&T" cooperative over which
11 it exercises no direct control. Further, the rates,
12 terms and conditions of wholesale service to GCEC are
13 also established by the "G&T" cooperative without any
14 meaningful input from GCEC. GCEC raises capital by
15 borrowing from the federal government at subsidized
16 interest rates or through forced equity contributions
17 from members who have no discretionary ability to
18 terminate their memberships in the cooperative
19 organization. GCEC also receives other federal subsidies
20 through freedom from income taxation and certain other
21 forms of taxation and through the preferential receipt of
22 federally generated hydroelectric power. As a rural
23 electric cooperative operating in Florida, GCEC is
24 subject to regulation of its rate structure, but not its
25 rates. Because GCEC is free of regulatory oversight, it

1 has little economic motivation to control its expenses.

2

3 Q. How do the Commission guidelines regarding the resolution
4 of territorial disputes address the above described
5 differences in characteristics between the two utilities?

6 A. The Commission guidelines do not address such
7 differences, and instead focus on the incremental
8 distribution costs that would be incurred by each utility
9 in providing service to the new customer. As a practical
10 result, the guidelines incorporate an implicit assumption
11 that the generating and transmission expenses of each
12 electric utility in Florida are both reasonable and
13 substantially of the same magnitude. In fact, this
14 important implicit assumption is not accurate with
15 respect to GCEC because the Commission has never reviewed
16 the reasonableness of GCEC's expenses or the level of
17 GCEC's rates. Recognizing this deficiency, it should be
18 more difficult for the Commission to resolve any
19 territorial dispute in favor of GCEC.

20

21 Q. What would be the expected impact of the above described
22 pervasive differences in utility characteristics on the
23 new customers who might be afforded the opportunity to
24 choose between electric suppliers?

25 A. As a primary result of the pervasive differences between

1 the two electric utilities, the rates paid by customers
2 of Gulf Power are significantly lower than the rates paid
3 by customers of GCEC, and there is every reason to
4 believe that this rate difference will persist, or even
5 increase, in the foreseeable future. If new customers
6 are offered the opportunity to choose their electric
7 supplier, it must be reasonably assumed that they would
8 recognize both the existing and prospective rate
9 differential and would act rationally to minimize their
10 electric service costs by choosing Gulf Power over GCEC.
11 To the extent that the electric rates of each entity are
12 subject to change in the future, the customers of Gulf
13 Power now enjoy and are expected to continue to receive
14 regulatory protection provided by this Commission's
15 review of requests for changes in rates. By contrast,
16 the customers of GCEC have no such regulatory protection
17 with respect to rates or terms of service. Further, the
18 customers of GCEC have no alternative means or forum to
19 protest the reasonableness of any proposed change in
20 rates, or to protest any other action or inaction by
21 GCEC, including inadequacy of service. I can think of no
22 legitimate reason why any electric consumer, faced with
23 the option of choosing service from one of two potential
24 providers, would fail to choose the provider that offers
25 the lower current price, the better service reliability,

1 and possibly more importantly, the better prospect for
2 maintaining lower prices and better reliability.

3

4 Q. What effect will the establishment of strict territorial
5 boundaries have on both GCEC and the new customers that
6 would otherwise have the opportunity to express a
7 preference for one electric supplier or the other, but
8 that would now be assigned to GCEC?

9 A. As a result of the drawing of territorial boundaries,
10 GCEC will obtain economic protection that will
11 substantially limit any incentive that may exist within
12 GCEC to control costs and the level of rates. As a
13 result, the new customers locating in GCEC's service
14 territory will be disenfranchised to the extent that they
15 will pay higher electric rates and suffer lower
16 reliability now and in the future. Further, under the
17 present circumstances, the customers locating in GCEC's
18 service territory will be further disenfranchised
19 because, unlike Gulf Power's customers, they will have no
20 available means of protesting either the price, the
21 adequacy, or the reliability of electric service provided
22 by GCEC.

23

24 Q. Mr. Klepper, in your opinion, what other public policy
25 consideration should be weighed in this Commission's

1 determination of whether customer choice either will be
2 eliminated or will continue to exist between Gulf Power
3 and GCEC?

4 A. There should be no argument among the parties that the
5 economic foundation of the United States is anchored in
6 the concept of capitalism, an economic system whereby
7 capital is invested in enterprises by investors who hope
8 to earn a fair and compensatory return, known as a
9 profit, on their equity investment. In some special
10 circumstances, such as the provision of electric service
11 to rural customers, governments may decide that it serves
12 the public interest to subsidize the price that
13 disadvantaged consumers would pay for a particular
14 commodity if purchased under free market conditions.

15 However, it would be contrary to the fundamental
16 economic system employed in the United States if an
17 investor owned, profit seeking utility were denied the
18 opportunity to pursue and expand its legitimate business
19 interests, while at the same time causing the
20 disadvantaged consumer to purchase the desired electric
21 service at a higher, albeit subsidized, price. For this
22 reason alone, it is appropriate that the issue under
23 examination in this phase of this proceeding be resolved
24 in a manner that will allow new customers the opportunity
25 to be served by Gulf Power, the investor owned utility

1 that currently has far lower rates than GCEC, and serves
2 without the necessity of subsidies from the federal
3 government.

4
5 Q. How is the public policy matter of electric service by
6 investor owned utilities versus rural electric
7 cooperatives addressed by the laws of the State of
8 Florida?

9 A. Chapter 425 of the Florida Statutes mirrors federal law
10 in that the legislative intent in creating cooperatives
11 was to complement investor owned and municipal utilities
12 in electrifying the state, but there clearly was no
13 legislative intent that cooperatives would compete with
14 or supplant investor owned utilities. Moreover, Section
15 425.04, subsection (4) of this chapter reflects the
16 legislative intent that cooperatives shall not serve
17 Florida's electric customers that can be adequately
18 provided with electric service by either an investor-
19 owned or municipal utility. Given the preference under
20 Florida law that is accorded to investor owned utilities
21 over cooperative utilities, it would be inconsistent with
22 Florida law, the Commission's policies, and the sound
23 economic principles favoring economic efficiency for this
24 Commission to eliminate existing customer choice
25 situations in favor of establishing territorial

1 boundaries.

2

3 Q. Does this conclude your direct testimony?

4 A. Yes, it does.

5

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AFFIDAVIT

STATE OF GEORGIA)
)
COUNTY OF FULTON)

Docket No. 930885-EU

Before me the undersigned authority, personally appeared Russell L. Klepper who being first duly sworn, deposes, and says that he is a consultant from Rawson, Klepper & Company for Gulf Power Company, a Maine corporation, that the foregoing is true and correct to the best of his knowledge, information, and belief.

Russell L. Klepper
Russell L. Klepper
Rawson, Klepper & Company

Sworn to and subscribed before me this 8th day of October,
1996.

Lawrence M. Smith
Notary Public

Notary Public, Spalding County, Georgia
My Commission Expires Sept. 26, 1997

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RUSSELL L. KLEPPER

SUMMARY OF PROFESSIONAL CREDENTIALS

Mr. Klepper is the founder and principal of Rawson, Klepper & Company, a utility and energy consulting services firm established in February of 1984. With a strong academic background and nineteen years of experience as a utility practitioner and consultant, Mr. Klepper specializes in the areas of energy economics, utility finance and planning, ratemaking, and analysis and decision making in a regulated or transitory environment.

PROFESSIONAL INTERESTS

Mr. Klepper prepares and presents public and in-house seminars and advises utilities, utility constituents, and other interested parties on matters related to analysis of capital expenditure alternatives, acquisition and allocation of capital, strategic, financial, and integrated resource planning, and determination of revenue requirements and rate structuring in an increasingly competitive utility environment. He is a noted writer and speaker in the areas of privatization of utility operations and the impacts arising from federal participation in the electric industry.

In addition, Mr. Klepper has prepared and presented reports on topics such as Strategic Issues in Utility Planning, Utility Service Obligations in a Changing Environment, Competition within the Utility Industry, Co-Ownership of Utility Assets, Resource Recovery and Waste Utilization, Cogeneration and Independent Power Production, Transmission Access and Pricing, Determination of Costs in Railroad Ratemaking, and Fuel Acquisition and Transportation.

PROFESSIONAL ACTIVITIES

Instructor of Economics and Money and Banking. American Institute of Banking, 1974-75.

Expert Witness on Financial and Regulatory matters.
Interstate Commerce Commission, 1979-81.
Utah Public Service Commission, 1985-86.
Kentucky Public Service Commission, 1993-96.
Florida Public Service Commission, 1994.

Southeastern Electric Exchange. Member, Finance Committee, 1982-83.

Financial Management Association. Industry Reviewer of utility related presentations. 1983 Southeastern Conference.

Edison Electric Institute. Member, Committee on Electric Power Ownership Alternatives, 1983-84. Presenter of "A Strategic View of the 1990s" to EEI Strategic Planning Committee, 1989.

Southeastern Regional Public Utilities Conference. Presenter of "A Viewpoint on Utility Privatization". 1990.

The Management Exchange, Inc., faculty member, 1982-92. Co-Developer and Co-Presenter of national seminar "Capital Expenditure Analysis for Utilities". Developer and Presenter of national seminar "Financial Planning for Utilities."

Energy Bureau. Presenter of "Evaluating Financing Techniques." Conference on "Utility Financing for a Beleaguered Industry". 1984.

Public Utility Reports. Conference Moderator and Discussion Group Leader. "Managing Utilities in a Changing Environment." 1984.

The World Bank. Consulting Member of the Power Section Mission to PLN, the National Electric Utility of the Republic of Indonesia, specializing in utility financial and strategic planning. 1987. Developer and Presenter of internal seminar "Financial Planning and Analysis for Underdeveloped Countries." 1989. Developer and Presenter of materials for "Seminar on Energy Policy and the Environment", presented in Ethiopia in collaboration with the United Nations Economic Commission for Africa and in Egypt in collaboration with the Organization of Energy Planning. 1992.

United States Energy Association. Developer and Presenter of Materials at "Seminar on Natural Monopolies: Regulation, Structure and Pricing Decisions", a conference conducted in Vienna, Austria, for electric utility executives from Hungary, Poland, and the Czech and Slovak Republics. Jointly sponsored by the World Bank and the U.S. Agency for International Development. 1992.

The Cato Institute and the Institute for Energy Research. Presenter of "Federal Participation in the Electric Industry; A Review and Assessment of the Implications Upon Industry Restructuring". Conference on "New Horizons in Electric Power Deregulation". 1995.

National Rural Utilities Cooperative Finance Corporation. Presenter of "Federal Participation in the Electric Industry; A Focus on the Rural Utilities Service". Cooperative Financing Forum. 1995.

The World Research Group. Presenter of "The Impact of Federal Participation in the Power Industry". Conference on "Public Power in a Restructured Electric Industry". 1995.

Kentucky Industrial Utility Customers, Inc. Presenter of "Economic Underpinnings to the Changing Regulatory Environment". Annual Conference. 1996.

MONOGRAPHS

The Utah Transmission Proceeding: Public vs. Private Ownership - A Case Study. Prepared under contract with the Economics Division of the Edison Electric Institute. 1987.

Privatization: An Overview of Worldwide Experience with Implications for the Electric Utility Industry in the United States. Prepared under contract with the Public Policy Analysis Division of the Edison Electric Institute. 1988-89.

Discussion of Considerations and Recommendations for Appropriate Methodologies for Determining the Cost of Equity Capital for Independent Telephone Systems. Co-authored with Roger A. Morin. Prepared under contract with the Ontario Telephone Service Commission. 1989.

Review and Assessment of Recent Executive Branch Initiatives with Ownership Implications for the Electric Utility Industry in the United States. Prepared under contract with the Bulk Power Policy Group of the Edison Electric Institute. 1993.

An Overview of the Bonneville Power Administration: Its Purpose, Performance, and Prospects. Prepared under contract with the Bulk Power Policy Group of the Edison Electric Institute. 1994.

Federal Participation in the Electric Industry; A Review and Assessment of the Implications Upon Industry Restructuring. Prepared for publication of proceedings on "New Horizons in Electric Power Deregulation", a conference cosponsored by the Cato Institute and the Institute for Energy Research. 1995.

EDUCATIONAL HISTORY

Bachelor of Science in Business Administration,
Major in Economics, University of Florida, 1971.

Master of Business Administration, Major in Finance,
University of Florida, 1972.

Master of Professional Accountancy, Georgia State
University, 1980.

EMPLOYMENT HISTORY

First National Bank of Florida in Tampa, Investment Division. Employed 1972. Assistant Cashier 1973-74. Assistant Vice President 1974-76. Exercised responsibilities for liabilities portfolio management, analysis of bank operations, and pricing of deposit related bank services.

Georgia Power Company, Corporate Finance Department. Financial Analyst 1977-81. Financial Services Manager 1981-84. Participated in the financial planning process, special financial projects, and the development and preparation of rate filings. Later directed the evaluation of capital expenditure alternatives, managed the administration of the portfolio of outstanding capital instruments, and coordinated the financial, regulatory, legal and marketing aspects of raising over \$1.2 billion in capital through the issuance of preferred stock, first mortgage and pollution control bonds, and other debt instruments.

RELATED BUSINESS ACTIVITIES

In November of 1987, Mr. Klepper participated in the founding and initially served as Director, Vice President and Chief Financial Officer of Bio-Gas Development, Inc. (BGD), a venture enterprise focusing on the development of economically viable waste energy recovery projects using proprietary environmental remediation technologies. In December of 1992, substantially all of BGD's assets were sold to Methane Treatment Technologies, Inc. (MTec), which continues the effort to achieve the business objectives of BGD. For a period of one year, Mr. Klepper continued to serve MTec in the same professional capacities of Director, Vice President and Chief Financial Officer, and now continues his relationship with MTec in a consulting capacity.

**Resolution Adopting
"Principles to Guide the Restructuring of the Electric Industry"**

WHEREAS, State commissions and legislatures, the Federal Energy Regulatory Commission (FERC) and the Congress are in the process of developing and implementing new policies to move the electric industry to reliance on greater competition in the marketplace; and

WHEREAS, It is appropriate that the National Association of Regulatory Utility Commissioners (NARUC), as the national representative of the State regulatory commissions, adopt principles providing guidance to State and Federal decisionmakers to ensure that this transition serve the interests of consumers, providers, the national economy and the public good; now, therefore, be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), convened at its 1996 Summer Meeting in Los Angeles, California, hereby adopts the attached "Principles to Guide the Restructuring of the Electric Industry" and urges that State and Federal regulatory commissions and legislatures be guided by these principles as they develop and implement new policies to govern the regulation, organization and operation of the electric utility industry.

Sponsored by the Ad Hoc Committee on Electric Industry Restructuring and the
Committees on Electricity, Energy Conservation and Gas
Adopted July 25, 1996

NARUC Principles To Guide The Restructuring of the Electric Industry

Introduction to the NARUC Principles

As the nation's electric industry becomes more competitive, decision-makers should be guided by certain principles. Since its inception, regulation has sought to safeguard the public interest and to ensure economic efficiency. These goals should remain.

General Principle

Consumers should have access to adequate, safe, reliable and efficient energy services at fair and reasonable prices at the lowest long-term cost to society. Structural changes in the industry should be encouraged when they result in improved economic efficiency and serve the broader public interest.

This general principle should remain the goal for all restructuring proposals. Many of the specific principles listed below will be in tension and will require balancing in light of this general principle.

Commentary

The general principle describes the overarching goals of public policy in providing energy services to the nation's consumers. These goals should remain, regardless of the market structure through which services are delivered. This general principle encourages policy-makers to consider the effects that restructuring initiatives will have on the long-standing goals of regulation and public policy, and to develop mechanisms (market-based or otherwise) that will preserve the beneficial public interests of the current electric system. The principle also recognizes that restructuring holds the potential for additional benefits to society, in the form of increased economic efficiency, and that it is incumbent upon policy-makers to seek to capture those benefits when doing so is consistent with the broader public interest.¹

¹By economic efficiency we mean efficiency in the production and consumption of goods and services. Societal welfare is improved as economic efficiency is increased, which is to say that scarce resources are put to their most highly valued uses and are used most efficiently in production. There are several components of economic efficiency: (a) allocative efficiency (when society's resources have been organized for productive purposes in such a way that it would be impossible to reorganize them to benefit one party without making another party worse off); (b) productive efficiency (a given quantity of output is produced at the lowest possible total cost); and (c) other production efficiencies (associated with management of the production process). Furthermore, this notion of efficiency is not limited to merely static efficiency, but also includes dynamic efficiencies (such as innovation and technological development) that arise over time from the stimulus of competition in an environment in flux.

Specific Principles

NETWORK INTEGRITY

The safety, reliability, quality and sustainability of electric service should be maintained or improved in a restructured electric industry.

Market-based decisions, driven by economics and competition alone, could jeopardize critical safety and reliability and long-term strategic resource and facilities planning. Public policy should ensure the integrity of the electric grid and encourage prudent long-term resource planning, acquisition and utilization.

Commentary

Restructuring should not jeopardize the safety, reliability or quality of electric service. The importance of a reliable electric system cannot be overemphasized. Consumers now rely on very high service quality; their well-being, and the country's economic growth, require that it be maintained. No changes in the electric utility industry or the regulatory regime should be allowed to compromise reliability, even if the intention is to lower consumer prices, except where a lower level of reliability is freely chosen by a customer and does not impair service to other customers (*e.g.*, interruptible service).

As the industry moves toward a more competitive model, traditional means of ensuring a diverse long-term power supply may give way to more market-based mechanisms. Policy-makers should carefully monitor this transition and should be prepared to create new mechanisms to assure that state goals in these areas are being properly addressed in such markets.

Any restructuring plan should be designed to preserve sufficient latitude and flexibility for the States to take actions, consistent with federal policy, to ensure that safety, reliability and quality concerns are satisfied. Transmission system operators should have the authority and means to continue the provision of safe and reliable electric service, while at the same time facilitating a competitive generation market. The integrity of the transmission system should be assured regardless of how it is operated.

UNIVERSAL SERVICE

Universal service at reasonable rates, including adequate protections for low-income customers, should be maintained.

Because electricity service is vital for health, safety and economic opportunity, universal service is a cornerstone of the public interest. Customers are entitled to access to reasonably priced power, and to a forum for dispute resolution.

Commentary

Electric service is a basic need. Therefore, preserving and protecting the public interest in a restructured electric industry should include assuring that consumers have access to an adequate supply of electricity to satisfy their basic needs at a reasonable price. Policy-makers should continue to address the needs of low-income customers. The health and safety of all consumers is paramount.

Defining universal service will be a critical issue. Continuing and improving universal service involves two goals: maintaining service for those who already have it and expanding service to those who do not yet have it. Continuing and expanding customer access to basic electric services should be done in a way that is both economically efficient and fair. While all customers should be entitled to non-discriminatory access to the electric system, for some customers the most efficient and affordable means of obtaining basic energy services might not be through a connection to the electric grid, but through combinations of demand-side management measures and renewable and fossil-based distributed or self-generation. Restructuring initiatives should be designed to accomplish universal service goals at the lowest cost to society. In order to minimize market distortions, the price for grid connections should be cost-based, and any subsidies should be explicit.

CUSTOMER CHOICE

Customers should have the opportunity to make informed choices among electricity providers and services.

The potential for competition to improve economic efficiency rests on having multiple service providers as well as informed consumers. Market development should be guided in a way that increases the role of competition among energy service providers and the role of choice for customers.

Commentary

All types of customers have expressed a preference for choosing their electricity providers and services. This is particularly true for commercial and industrial customers, who maintain that increased customer choice would lower prices. Residential customers and others are also beginning to express their desire to share equally with business customers in enjoying the benefits of increased customer choice.

Customers acting in their own self-interest, when presented with a variety of market choices, will tend to arrange their consumption to maximize their welfare, save costs and enhance their satisfaction. Allowing customers to choose not only encourages the development of new providers who would engage in creative marketing, but also permits a dissatisfied customer to change providers. If electric industry restructuring is guided prudently, customer choice is likely to result in a greater variety of pricing options, including innovative rate designs and lower prices, as providers compete with one another to deliver services to customers. Further, this competition will bring with it a greater incentive to provide diverse terms, conditions and payment plans in response to customer interest and needs.

While the general theme of customer choice holds appeal, markets in the electric industry across the country are at different stages of development and contain different potentials for cost savings and service alternatives. Knowledge of local markets is the preferred basis for determining how customer choice can best be implemented to result in greater benefits to all participants. Thus, it is for the States to determine the extent of and pace for expanding choice for customers under their regulatory oversight.

CONSUMER PROTECTION

Consumers should be protected from anti-competitive behavior, undue discrimination, poor service and unfair billing and disconnection practices.

Regulatory processes should continue where effective competition is absent and where monopolies and other forms of market power remain. Market power concerns are particularly relevant when considering electric utility mergers and acquisitions.

Commentary

In a restructured industry, certain consumer protections should be preserved, particularly those that guard against undue discrimination, failure to meet minimum service quality and safety requirements and other unfair business practices. In a competitive environment, other consumer abuses such as deceptive marketing practices should also be prevented. Associated with these issues are questions of service quality, providers of last resort and the obligations of distribution companies.

Policy-makers should also assure the continued, efficient operation of the competitive generation market. The potential for providers to amass market power sufficient to allow them to raise prices above competitive levels will remain a central public policy concern. Protecting against this problem may involve the development of appropriate standards for entry, ownership, bidding, operation and other market behavior.

PUBLIC PARTICIPATION

Industry restructuring policies should be developed in public processes with participation open to all.

All stakeholders should receive fair consideration in public processes.

Commentary

Electric restructuring will affect every person, either directly or indirectly. Even individuals not tied to the electric grid will be affected by restructuring and by consumer products that become available as an indirect result of restructuring. There is an inherent responsibility for policy-makers and industry to develop a strategy for public participation in the formation of restructuring policies.

In many ways, the task may seem daunting because of the breadth of stakeholders and the scope of issues. But electricity use is intertwined in our daily lives, affects the environment and other public interests and is essential to the economic well-being of our industries and businesses. There should be a commitment to bring diverse ideas into the discussion and to address the questions and concerns of the public.

The techniques and tools of public participation will vary depending on the timing of and participants in the process. While at times the commitment to public participation may appear to slow the restructuring process, in the long run it will result in an improved process and smoother transition. Public participation is time and resource intensive, and it is best to acknowledge these needs early in the process because it will be demanding of policy leaders

in both the regulatory agencies and industry. While public participation does not mean that all of the public must agree on the outcome of restructuring, it does mean that all members of the public should have the opportunity to be heard, be treated fairly and be provided with clear and accurate information.

SHARED BENEFITS

All classes of customers should benefit from improvements due to structural changes in the industry.

Electric industry restructuring should be done in a way that benefits all customer classes fairly and does not unduly disadvantage any customer class nor preserve any undue cross-class subsidy.

Commentary

Decisions concerning how and to what extent customer choice should be expanded among the customer classes should be left to the States so that orderly access to the benefits of restructuring occurs. Given their knowledge of and experience with the local history of rates, rate designs and cost allocations for all customer classes, the States can best address how to alleviate undue subsidies among customer classes.

All customer classes should have access to electricity suppliers, and applicable laws and rules should require all electricity suppliers to compete fairly. Non-discriminatory availability of service, including ancillary services, back-up power and interconnection services, should be assured for all firm service customer classes.

PUBLIC BENEFITS

The public benefits of energy efficiency, renewable resource technologies and research and development should be maintained through existing or new mechanisms.

Energy efficiency, renewable resource technologies and research and development provide significant economic and other benefits for the nation and are critical to achieving a long-term, sustainable and efficient electricity future.

Commentary

Competitive markets have the potential to reduce the total costs of electricity production in the country, to lower rates if benefits accrue to customers fairly, and to stimulate innovation and new investment. Nevertheless, policy-makers should recognize that, in certain instances, barriers to efficient competition prevent market participants from correctly valuing the full costs and benefits of certain production and consumption decisions. Many aspects of utility regulation, and many utility practices, including integrated resource planning, have been developed to address these market barriers, and have delivered significant benefits to consumers and the nation.

The development of competitive markets can be consistent with the ultimate goals of traditional utility regulation. As the economics and technology of generation evolve, new

products and services can be expected to proliferate in the market. This market evolution will depend in part on the availability of information, low transactional hurdles and the appropriate alignment of risks and rewards. However, for public policy reasons and because not all potential risks will be fully reflected in short-term market prices, it will be necessary for policy-makers to promote and implement mechanisms that will serve the long-term needs and aspirations of the nation. To the extent that cost-effective investments in energy efficiency, renewable resources, and research and development are not fully valued in the competitive marketplace, there will continue to be a need for alternative methods for capturing the benefits that they offer.

ENVIRONMENT

Structural changes to the electric industry should maintain or improve the quality of the environment.

The electric industry affects the environment, and environmental protection continues to be a high priority for society. The environmental benefits and costs of different generation, delivery and service options should be recognized through market mechanisms, where they are effective, or by regulation.

Commentary

The electric industry has profound impacts upon the environment. Under the principles of traditional utility regulation and, in particular, integrated resource planning, it has been possible for utilities and governments to pursue environmentally responsible development policies.

The invisible hand of the market is powerful, but the limitations of markets are real: external costs, by definition, are not accounted for by markets, competitive or otherwise. Historically, regulation of electricity generation and transmission offered a means of partially, if imperfectly, addressing external costs. Restructuring initiatives should be designed to maintain or improve society's ability to consider external costs when making resource and delivery decisions. There is a variety of mechanisms that policy-makers can consider in order to achieve this goal, and their ultimate choices will be guided by the particular needs of their States and regions.

STRANDED COSTS

Existing commitments of utilities arising from past decisions made pursuant to historical regulatory and legal principles should be addressed in a fair and reasonable manner by States.

Claims to recover net, verifiable and non-mitigatable costs potentially "stranded" in a restructured market should be decided by States.

Commentary

In moving from traditional regulation to a market-based electricity supply system, some embedded utility costs will be above the market prices of presently available alternatives. Because the circumstances of how these cost commitments arose are unique to state decisions,

the States should determine which costs are stranded and the degree to which and manner in which they should be recovered. The States are in the best position, because of their history of regulation of the electric utilities, to develop methods for verifying the legitimacy and magnitude of stranded costs and for assessing the adequacy and appropriateness of measures proposed for mitigating stranded costs.

In order to address these costs in a fair and reasonable manner, the States should equitably consider utility investors' reasonable expectations along with ratepayers' expectations of access to the benefits of restructuring. Because of the unique character of each electric utility's costs, financial condition, and customers, and the history and remaining lives of its physical and regulatory assets, only the States can tailor a fair solution to the extent and timing of recovery of any costs determined to be stranded.

STATE RESPONSIBILITIES

States and state commissions should determine retail electric policies, including restructuring policies.

Restructuring should recognize the unique characteristics of the various States. State legislatures and state public utility commissions are most accountable to the people and are closest to the people, problems and opportunities that restructuring will present at the retail level. Accordingly, the policy and implementation decisions related to retail electric service should be determined by the States.

Commentary

The restructuring of the electric utility industry cannot occur efficiently or reliably in a "one-size-fits-all" fashion. Although the electrons that flow to homes and businesses throughout the United States may, for all practical purposes, be indistinguishable, the method, quality and cost of providing electric service vary by state and region. For example, population density can affect availability, quality and cost of service.

Throughout the years, the States have taken into account the unique problems associated with the public they serve, and restructuring should be no different. In fact, during this time of great change in the electric utility industry, States should have the opportunity to employ the expertise they have gained through the regulatory process to benefit the public. Allowing the States to determine the retail electric policy and implementation issues associated with restructuring insures that each state is responsible for choosing a path which best recognizes the unique problems and opportunities its citizens may experience.

Federal agencies and federal legislation should facilitate effective decision-making by the States, and empower States to create regional mechanisms to address transmission, reliability, market power, and other regional concerns.