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Matthew M. Childs, P.A.

April 23, 2001

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Ms. Blanca S. Bayò, Director
Division of Records and Reporting
Florida Public Service Commission
4075 Esplanade Way, Room 110
Tallahassee, Florida 32399-0850

RE: Docket No. 010283-EI

Dear Ms. Bayò:

Enclosed for filing are an original and fifteen (15) copies of Florida Power & Light Company's Testimony of K. M. Dubin in the above-referenced docket.

Very truly yours,

Matthew M. Childs, P.A.

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CERTIFICATE OF SERVICE
DOCKET NO. 010283-EI

I HEREBY CERTIFY that a true and correct copy of the Florida Power & Light Company's Testimony of K. M. Dubin have been furnished by Hand Delivery (*), or U S. Mail this 23rd day of April, 2001, to the following:

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By: _____
Matthew M. Childs, P.A.

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 010283-EI
FLORIDA POWER & LIGHT COMPANY

APRIL 23, 2001

IN RE: CALCULATION OF GAINS AND APPROPRIATE REGULATORY TREATMENT FOR NON-SEPARATED WHOLESALE ENERGY SALES BY INVESTOR-OWNED ELECTRIC UTILITIES

TESTIMONY & EXHIBITS OF:

K. M. DUBIN

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

TESTIMONY OF KOREL M. DUBIN

DOCKET NO. 010283-EI

April 23, 2001

Q. Please state your name, business address, employer and position.

A. My name is Korel M. Dubin, and my business address is 9250 West Flagler Street, Miami, Florida, 33174. I am employed by Florida Power & Light Company (FPL) as the Manager of Regulatory Issues in the Regulatory Affairs Department.

Q. Please state your education and business experience?

A. I received a Bachelor of Arts in Political Science from Emory University in 1980 and in 1982 I received a Master of Business Administration from Barry University. In June 1982, I joined Florida Power and Light Company's Fossil Fuel Section of the Fuel Resources Department. From 1982 through 1985 my responsibilities included administration of fuel supply and operations contracts, development of procurement procedures, research/analysis of transportation options and by-product sales, and support for regulatory filings. In December of 1985 I joined the Rates and Research Department as a Rate Analyst. Since 1985, I have held various positions of increasing responsibility in the Rates and Research Department and the Regulatory Affairs Department and my primary responsibilities have been in the area of the

adjustment clause filings. In June 2000 I became Manager of Regulatory Issues in the Regulatory Affairs Department where I am primarily responsible for the coordination, development, and preparation of the Company's Fuel, Capacity and Environmental Cost Recovery filings. I am a company witness in the clause dockets and I have also testified in Docket No. 991779-EI entitled Review of the Appropriate Application of Incentives to Wholesale Power Sales by Investor Owned Utilities.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to address the reasonableness and justification for the actions taken by the Commission in Part III of Order No. PSC-00-1744-PAA-EI in the Incentive Docket No. 991779-EI. (Order No. PSC-00-1744-PAA-EI is attached as Appendix A to my testimony). My testimony also addresses how the Commission's decision in Docket No. 991779-EI concerning the application of incentives to wholesale power sales should be implemented.

Q. What action was taken by the Commission in Part III of Order No. PSC-00-1744-PAA-EI?

A. In Part III of Order No. PSC-00-1744-PAA-EI the Commission provided the method for calculating gains on non-separated wholesale power sales and the accounting treatment for revenues and expenses associated with non-separated wholesale power sales. Part III of the Order was issued as a Proposed Agency Action and as such was the only portion of the Order that

could be protested. The Florida Industrial Power Users Group (FIPUG) and Gulf Power Company have protested Part III of the Order.

Q. What other actions were taken by the Commission in Order No. PSC-00-1744-PAA-EI and how do these actions compare with what was done with shareholder incentives in the past?

A. In Order No. PSC-00-1744-PAA-EI, the Commission also addressed the appropriateness, structure, and level of shareholder incentives, as well as the sales that are eligible for shareholder incentives. These actions are final and not subject to protest.

The actions taken by the Commission in Order No. PSC-00-1744-PAA-EI represent the evolution of a long-standing Commission practice of promoting the efficiency of operation by a utility, the realization and maximization of gains on non-separated wholesale power sales, and the sharing of these gains with retail customers. In the Order, the Commission reaffirms this long-standing practice. However, the Commission also acknowledges that the wholesale market in Florida has changed since 1984 when the incentive mechanism was first established in Order No. 12923 and modified the incentive mechanism accordingly. In approving the modified incentive mechanism the Commission stated that:

> "we find that the incentive program established in Order No. 12923 should not be eliminated, but should be modified to provide an

appropriate incentive structure that reflects the changes in the wholesale market and the electric industry that have occurred since Order No. 12923 was issued and maximizes the potential benefits to ratepayers accordingly."

Q. Specifically, what does Part III of Order No. PSC-00-1744-PAA-EI state about the methodology for calculating the gains on non-separated wholesale power sales?

A. In Part III of the Order the Commission states "Accordingly, we find that each IOU shall measure the gain from its non-separated wholesale power sales by subtracting the sum of its incremental costs from the revenue received for each sale. Further, we find that the calculation of incremental costs for these sales shall include, but not be limited to: incremental fuel cost, incremental SO_2 emission allowance cost, incremental O&M cost, and separately-identified transmission or capacity charges."

Q. Why is this a reasonable and appropriate methodology for calculating the gains on non-separated wholesale power sales?

A. A gain on a non-separated wholesale power sale transaction occurs when the amount collected for the transaction is over and above the cost of the transaction. The use of incremental cost, including incremental fuel cost, is the proper basis and accepted measurement of cost incurred for the transaction. Furthermore, this calculation, where the gain is calculated by subtracting the incremental cost incurred for the transaction from the revenues received for the transaction, is consistent with the well-established manner in which gains on

sales have historically been calculated.

Q. Specifically, what does Part III of Order No. PSC-00-1744-PAA-EI state about the accounting treatment for the revenue and expenses associated with non-separated wholesale power sales?

A. The Commission states in Part III of the order that:

> "In addition, we find that the following regulatory treatment for the revenues and expenses associated with each non-separated wholesale power sale is appropriate:
>
> 1. Each IOU shall credit its fuel and purchased power cost recovery clause for an amount equal to the incremental fuel cost of generating the energy for each such sale;
> 2. Except for FPC, each IOU shall credit its environmental cost recovery clause for an amount equal to the incremental SO_2 emission allowance cost of generating the energy for each such sale. FPC, because it does not have an environmental cost recovery clause, shall credit this cost to its fuel and purchased power cost recovery clause;
> 3. Each IOU shall credit its operating revenues for an amount equal to the incremental operating and maintenance (O&M) cost of generating the energy for each such sale; and
> 4. In accordance with Order No. PSC-99-2512-FOF-EI, issued December 22, 1999, in Docket No. 990001-EI, each IOU shall credit its capacity cost recovery clause for an amount equal to any

transmission revenues or separately identifiable capacity revenues."

Q. Why is this regulatory treatment of revenues and expenses associated with non-separated wholesale power sales reasonable and appropriate?

A. This treatment is reasonable and appropriate in that it is consistent with well established practices whereby gains from non-separated wholesale power sales transactions have been flowed back to customers through the Fuel Cost Recovery Clause. In Part III of the Order, the Commission, recognizing that there has to be a way to identify, review, and audit these transactions, simply provides a way to account for revenue and expenses associated with non-separated wholesale sales matching revenue and expenses with recovery mechanisms.

Q. Is your testimony addressing the substance of any protests of Part III of Order No. PSC-00-1744-PAA-EI?

A. No. As stated previously, FPL believes that the Commission's actions taken in Part III of Order No. PSC-00-1744-PAA-EI regarding the method for calculating gains on non-separated wholesale power sales and the regulatory treatment for revenues and expenses associated with non-separated wholesale power sales are reasonable, appropriate and consistent with historic treatment. However, FPL anticipates that the parties will be filing testimony in this docket and, in accordance with Order PSC-01-0517-PCO-EI dated March 5, 2001, Establishing Procedure in this Docket, FPL will have an

opportunity to address any other issues in rebuttal testimony if necessary.

Q. How should the Commission implement its decision in Docket No. 991779-EI concerning the application of incentives to wholesale power sales?

A. In Order No. PSC-00-1744-PAA-EI the Commission decided to allow the utilities to split (80% to customers and 20% to shareholders) any gains on non-separated wholesale power sales that exceed a threshold based on a three-year average of gains. Consistent with our position presented in the Fuel Docket, FPL believes that the Commission's decision should be implemented by using the methodology proposed by Staff in their memorandum dated September 20, 2000. Staff proposes that the first two and one half years used in the calculation of the average would be the actual gains for those years and the final six months would be estimated. This data is to be supplied with the utilities' fuel projection filings. Later, the threshold of gains on off system sales is to be updated with actual gains for the balance of the third year and filed as part of the fuel true up testimony. Gains on sales are to be measured against this three-year average threshold. FPL believes this approach is appropriate.

Q. Does this conclude your testimony?

A. Yes, it does.

APPENDIX A

Order No. PSC-00-1744-PAA-EI
Docket No. 991779-EI
Issued September 26, 2000

Appendix A
Exhibit : _____
FPL Witness: K. M. Dubin
Florida Power & Light Company
Docket No. 010283-EI
April 23, 2001

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of the appropriate application of incentives to wholesale power sales by investor-owned electric utilities.	DOCKET NO. 991779-EI ORDER NO. PSC-00-1744-PAA-EI ISSUED: September 26, 2000

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
E. LEON JACOBS, JR.
LILA A. JABER

APPEARANCES:

JAMES D. BEASLEY, Esquire, Ausley & McMullen, P. O. Box 391, Tallahassee, Florida, 32302,
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MATTHEW M. CHILDS, Esquire, Steel Hector & Davis LLP, 215 South Monroe Street, Suite 601, Tallahassee, Florida 32301-1804,
On behalf of Florida Power & Light Company (FPL).

STEPHEN C. BURGESS, Esquire, Office of Public Counsel, c/o The Florida Legislature, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400.
On behalf of the Citizens of the State of Florida (OPC).

VICKI GORDON KAUFMAN, Esquire, McWhirter Reeves McGlothlin Davidson Decker Kaufman Arnold & Steen, P.A., 117 South Gadsden Street, Tallahassee, Florida 32301
On behalf of Florida Industrial Power Users Group (FIPUG).

WM. COCHRAN KEATING, IV, Esquire, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850
On behalf of the Commission Staff.

ORDER APPROVING INCENTIVE MECHANISM FOR SPECIFIED NON-SEPARATED WHOLESALE POWER SALES BY INVESTOR-OWNED ELECTRIC UTILITIES
AND
NOTICE OF PROPOSED AGENCY ACTION
ORDER ESTABLISHING METHOD FOR CALCULATION OF GAINS ON NON-SEPARATED WHOLESALE POWER SALES AND ESTABLISHING APPROPRIATE REGULATORY TREATMENT FOR REVENUES AND EXPENSES ASSOCIATED WITH NON-SEPARATED WHOLESALE POWER SALES

BY THE COMMISSION:

By Order No. 12923, issued January 24, 1984, in Docket No. 830001-EU-B, this Commission established a shareholder incentive mechanism to encourage investor-owned electric utilities (IOUs) to make economy energy sales. Prior to the issuance of Order No. 12923, in 1984, the revenues from the sale of economy energy were considered in each IOU's general rate proceeding. By Order No. 12923, this Commission removed these revenues from base rates, and credited the revenues through the Fuel and Purchased Power Cost Recovery Clause (fuel clause). At page 2 of Order No. 12923, we stated that `[t]he chief reason for this proposed treatment was to eliminate the potential for over- or under- recovery of revenues associated with economy energy sales.` Further, we authorized the IOUs to keep 20 percent of the gains on these sales as an incentive to `maximize the amount of economy sales and provide a net benefit to the ratepayer.` In other words, the incentive was created, in part, to encourage the IOUs to use their excess capacity to make economy sales, with 80 percent of the revenue from those sales being credited to the ratepayers.

At our November 22-23, 1999, hearing in Docket No. 990001-EI, the panel heard arguments about whether this incentive mechanism is still necessary or appropriate. By Order No. PSC-99-2512-FOF-EI, issued December 22, 1999, a proceeding was instituted so that the full Commission could hear this matter. Accordingly, an

evidentiary hearing was held on May 10, 2000, and post-hearing briefs were filed by the parties.

I. Appropriateness of Shareholder Incentives

With respect to the question of whether the incentive mechanism approved in Order No. 12923 is still necessary and appropriate, FPC witness Wieland testified that we should continue our policy of providing shareholder incentives to encourage economy sales. Further, witness Wieland testified that because these sales have shifted to more competitive markets outside of the Florida Energy Broker Network (Broker or EBN), with new non-utility participants who retain 100% of the profits, our incentive policy should be updated to reflect current market conditions. FPL argued in its brief that no disputed fact or factual showing has been identified that would sustain the burden of reversing our policy on incentives. Gulf witness Howell also testified that the current shareholder incentive should not be eliminated. Like FPC witness Wieland, witness Howell testified that because today's wholesale market is more competitive, utility economy sales are more difficult to achieve, thus increasing the importance of the incentive to encourage continued participation in the economy energy market. Along with the other IOUs' witnesses, TECO witness L. Brown testified that we should adhere to our existing policy of providing shareholder incentives to encourage non-separated, non-firm wholesale sales.[1] Witness Brown testified that these incentives may provide greater benefits to ratepayers now than when they were first adopted.

In opposition to the IOUs, FIPUG argued in its brief that the current incentive mechanism should be eliminated. FIPUG asserted that we should not provide an additional incentive, beyond the current incentive of a guaranteed return and a captive customer base, for the IOUs to perform their required managerial duties. OPC witness Dismukes also supported elimination of the current incentive. Witness Dismukes testified that factors other than the incentive established in Order No. 12923 are serving as far stronger incentives for Florida's IOUs to maximize their wholesale sales. Further, witness Dismukes testified that the current incentive mechanism is one-sided in that it does not penalize IOUs for substandard performance and that it requires consumers to pay a second time for services for which they are already paying full costs.

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[1]By Order No. PSC-97-0262-FOF-EI, issued March 11, 1997, we defined non-separated wholesale power sales, stating that "[h]istorically, the Commission has treated sales that are non-firm or less than one year in duration as non-separated sales."

The record shows that prior to the issuance of Order No. 12923, the buying and selling of economy energy was a peripheral function of the system dispatcher. Most economy energy transactions were accomplished over the Broker. After meeting their requirements for firm load, the buying and selling utilities would enter quotes determined by decremental and incremental production costs. A computer program would then match buyers and sellers with the greatest cost savings. The transaction price was based on a split-the-savings methodology. Thus, the record demonstrates that the Broker functioned essentially as a simple cost-based market for short-term excess energy within Peninsular Florida. Buyers and sellers benefitted equally from each transaction made over the Broker due to the split-the-savings pricing methodology.

The parties to this proceeding acknowledge that the wholesale market in Florida is more competitive today than when Order No. 12923 was issued. Changes to the wholesale market were prompted in part by the Public Utilities Regulatory Policy Act; the Energy Policy Act of 1992; FERC Orders 888 and 889; and other federal and state regulatory policy initiatives. These regulatory changes have resulted in a more robust wholesale market in Florida, with additional buyers and sellers. The record demonstrates that this movement toward competition has prompted additional efforts on the part of Florida's IOUs to participate in the wholesale market. For example, IOUs have substantially augmented the trained staff in their marketing departments in recent years. Further, the buying and selling of energy has now become the primary function of a specific group of employees, rather than the peripheral function of the system dispatcher.

The record shows that these increased efforts have produced results. As a whole, the data indicates that utilities have increased their presence in the wholesale market through the increased number of their non-separated wholesale transactions and the increased gains on those transactions in recent years. The record also shows that FPC, FPL, and TECO did not apply the 20 percent shareholder incentive approved in Order No. 12923 to the majority of their non-separated sales made over the last six years. FPC witness Wieland, FPL witness Stepenovitch, and TECO witness L. Brown indicated that their respective companies have interpreted the Order to provide an incentive only on their sales made under FERC Schedules C and X. Witness Stepenovitch indicated, however, that FPL recently discontinued Schedule X sales. As a result, FPC, FPL, and TECO received an incentive on sales associated with only 2.1%, 0.2%, and 6.8% of the gains for 1999, respectively. Gulf interpreted Order No. 12923 more broadly and, according to witness Howell, applied the shareholder incentive to the gains for all of its non-firm, non-separated wholesale sales.

The record indicates that this increase in gains is the result of both the increased efforts to make sales and the ability to charge market-based rates. For example, FPL witness Stepenovitch testified that FPL had increased the number of its contracts from approximately 63 to over 400 in the past three years. FPL received authority from FERC to charge market-based rates for out-of-state sales in 1998, the same year in which there is a dramatic increase in the gains reported by FPL. The record also shows that FPC and Gulf have experienced dramatic increases in gains on non-separated wholesale sales since 1996. Since 1996, FPC has received authority from FERC to charge market-based rates for out-of-state sales, and Gulf, through Southern, has received authority from FERC to charge market-based rates for in-state and out-of-state sales. Only TECO has experienced a recent decline in gains. TECO witness L. Brown explained that the decline in its gains from 1998 to 1999 was due to the lack of capacity resulting from the explosion at its Gannon Unit 6 last April. TECO received authority to charge market-based rates for in-state and out-of-state sales in April 1999.

OPC witness Dismukes testified that these changes to the wholesale market and other changes that have occurred in the electric industry since Order No. 12923 was issued in 1984 now provide the IOUs with the necessary incentives to make non-separated wholesale sales. According to witness Dismukes, '[n]o utility today can afford not to participate in the wholesale markets.' Witness Dismukes testified that the IOUs face greater pressure today to keep their rates low due to the threat of customer loss resulting from retail competition and better options for self-generation. Witness Dismukes noted that making economy energy sales and crediting revenues from those sales to retail customers helps the IOUs to keep rates low. Further, witness Dismukes testified that today's more competitive wholesale market provides the IOUs with greater opportunities and flexibility to make these sales. Therefore, OPC argues in its brief that the shareholder incentive established in Order No. 12923 is no longer necessary because there are other incentives driving the IOUs' participation in the wholesale market.

We agree that there are factors other than the 20 percent shareholder incentive that affect the IOUs' participation in the wholesale market. Clearly, as the IOUs' witnesses have readily admitted, they are not going to stop making economy energy sales if we eliminate the shareholder incentive approved in Order No. 12923. However, as all of the witnesses in this proceeding agreed, incentives may be used to prompt a positive response. The IOUs' witnesses testified that a shareholder incentive is an effective tool to drive management to focus on, and devote resources to, sustaining or increasing the level of their economy energy sales and the level of gains on those sales, in turn creating benefits

for ratepayers. We agree. Thus, while there is no way to precisely measure the effect of a shareholder incentive on the IOUs' participation in the wholesale market, we find that a properly structured incentive will result in greater management efforts to increase economy energy sales, yielding gains on those sales to the benefit of ratepayers.

Further, as noted above and discussed in part II of this Order, FPC, FPL, and TECO are engaged in a broad range of non-separated wholesale energy sales to which an incentive is not currently applied, although the gains from these sales, which account for over 90 percent of these IOUs' total gains on non-separated sales, are credited to ratepayers to reduce the costs that they would otherwise have to bear. Thus, we find that a properly structured incentive may achieve even greater benefits for ratepayers by encouraging the types of sales from which ratepayers are currently receiving the greatest benefit. In conclusion, we find that the incentive program established in Order No. 12923 should not be eliminated, but should be modified to provide an appropriate incentive structure that reflects the changes in the wholesale market and the electric industry that have occurred since Order No. 12923 was issued and maximizes the potential benefits to ratepayers accordingly.

II. Structure for Shareholder Incentive

Five proposals were presented in this proceeding for the appropriate structure of an incentive on non-separated wholesale power sales on a going-forward basis. These proposals are summarized as follows:

1. FPC witness Wieland proposed a 20 percent shareholder incentive on the gains from all non-separated sales, including firm sales. Witness Wieland proposes to include such sales made under existing Federal Energy Regulatory Commission (FERC) schedules and under new FERC schedules as they are approved.

2. FPL witness Dubin proposed a sliding scale approach to the shareholder incentive. The incentive would be applied to the gains on all non-firm, non-separated sales, including such sales made under newly approved FERC schedules. Under this proposal, FPL's shareholders would receive 20 percent of the first $20 million of gains, 40 percent of the next $20 million of gains, and 50 percent of the gains over $40 million. Witness Dubin stated that the specific thresholds for the

sliding scale apply only to FPL and should be adjusted as appropriate for other IOUs.

3. Gulf witness Howell proposed no change to its current incentive treatment. As noted above, Gulf currently applies the 20 percent shareholder incentive to all non-firm, non-separated sales, including market-priced sales.

4. TECO witness L. Brown proposed a shareholder incentive on the gains from all non-firm, non-separated sales. Under TECO's proposal, the incentive varies based on whether the sale is an in-state or an out-of-state sale. TECO witness D. Brown proposed a 40 percent shareholder incentive for in-state sales, and a 20 percent incentive for out-of-state sales.

5. As stated above, OPC argued that an incentive is not necessary or appropriate. However, as an alternative, OPC witness Dismukes proposed an incentive only on gains from sales made over the Broker. Witness Dismukes suggested a five year moving average to determine a benchmark based on past energy sales. Under this proposal, an IOU would only receive an incentive if the benchmark is exceeded by 25 percent. The proposal would penalize an IOU if its sales are 75 percent of the benchmark or less.

As noted above, FIPUG argued that a shareholder incentive is not appropriate. Therefore, FIPUG did not offer a specific proposal for incentives.

A. Sales Eligible for Shareholder Incentive

As stated above, FPC, FPL, and TECO have applied the incentive approved in Order No. 12923 only to their sales under FERC Schedules C and X. As also noted above, these sales account for only 2.1%, 0.2%, and 6.8% of the total gains on non-separated wholesale sales in 1999 for FPC, FPL, and TECO, respectively. For example, the record shows that of the $59.2 million in gains earned by FPL on non-firm, non-separated wholesale energy sales, FPL received an incentive on sales that resulted in only $41,660 of those gains. FPL witness Stepenovitch testified that 75 to 80 percent of the gains on FPL's total non-separated wholesale energy sales for 1999 are attributed to market-based sales to which FPL does not currently apply a shareholder incentive. As the witnesses for these IOUs noted, the types of non-separated sales that did not

qualify for an incentive have the same beneficial effect that Schedule C and X sales have: they reduce the costs that the selling utility's retail customers would otherwise have to bear. Accordingly, we agree that a properly structured shareholder incentive should encourage utility management, on a going-forward basis, to focus on sustaining and increasing the gains from this broader range of non-separated wholesale sales to provide cost reduction benefits to Florida's ratepayers.

FPC witness Wieland testified that both firm and non-firm, non-separated wholesale sales should be eligible for the shareholder incentive. He testified that in today's wholesale market it is difficult to differentiate between firm and non-firm wholesale sales because so many of these sales are made with various levels of 'firmness.' The record indicates that the recent grants of authority for the IOUs to engage in market-based transactions have provided the IOUs with greater flexibility in structuring wholesale transactions. This flexibility has led to more tailored, negotiated contract terms that provide various levels of commitment from the seller. Thus, we agree with witness Wieland that in today's wholesale market, it will be very difficult, if not impossible, to prevent a shareholder incentive from being applied to sales with a certain degree of firmness.

FPC witness Wieland and FPL witness Stepenovitch both testified that the shareholder incentive should apply to both current and future FERC-approved schedules, as long as the sales made under these schedules are non-separated sales. Over time, utilities may petition the FERC for changes to existing FERC schedules and for new schedules as the market changes. Thus, we agree with FPC witness Wieland that structuring an incentive based only on current FERC schedules may lead to unnecessary difficulties in our administration of the incentive in the future.

All of the IOUs took the position that emergency sales should not be eligible for a shareholder incentive. As stated by FPC witness Wieland, emergency sales are 'made upon the request of the buyer, not marketed by the seller.' Therefore, emergency sales are less under a seller's control than other types of non-separated wholesale sales. Because emergency sales are primarily determined by the buyer's need for power, rather than the potential for cost savings, we agree that emergency sales should not be eligible for a shareholder incentive.

In summary, we find that to encourage the types of wholesale sales that are currently providing the greatest cost reduction benefit to Florida's retail ratepayers, a properly structured shareholder incentive should apply to all non-separated wholesale

sales, firm and non-firm, excluding emergency sales, made under current and future FERC-approved schedules.

B. Level of Shareholder Incentive

As evidenced by the parties' various proposals, there are potentially an unending number of ways to devise an incentive. As FPC witness Wieland testified, there is no 'magic number' for an appropriate incentive level. In establishing an appropriate incentive structure, we believe that the incentive should not be designed to encourage behavior that is already occurring. Therefore, the incentive should be based on some type of threshold that represents the level of sales that would be expected to occur in the absence of an incentive. This threshold should be determined using past data on the gains on non-separated wholesale sales eligible for the incentive. As OPC witness Dismukes testified, any incentive provided for gains below this threshold will create the potential for a free rider effect, rewarding utilities for behavior which is taking place for reasons other than the incentive. We disagree with the IOUs' argument that an appropriate threshold cannot be determined because these sales are difficult to predict. The record shows that FPC, FPL, and TECO employ some type of sales standard in determining the compensation of marketing employees. Gulf has no marketing department, and Southern acts its agent for these sales. As TECO witness L. Brown testified, while it is difficult to establish these standards, it is nevertheless done.

The evidence indicates that the yearly gains on these sales may be erratic due to changes in capacity, or other factors beyond a seller's control, such as the needs of buyers. We agree with OPC witness Dismukes that it is appropriate to use a moving average to determine the threshold to reduce the impact of anomalies in individual years. We find that a three year moving average is appropriate for two reasons. First, as noted above, FERC Orders 888 and 889 have helped increase the volume of wholesale sales in the past three years. Second, Florida's two largest IOUs, FPL and FPC, received FERC approval for out-of-state market-based rates within the past three years. TECO also received approval to make both in-state and out-of-state market-priced sales. As OPC witness Dismukes testified, and as evidenced by the IOUs' level of non-separated wholesale transactions and gains, these factors have substantially impacted the potential gains for the IOUs. These two factors have caused a systemic change in the wholesale market in Florida.

As stated above, OPC witness Dismukes has proposed a five year moving average as part of its proposed reward/penalty methodology. We disagree that five years is an appropriate period. Including

years prior to FERC Orders 888 and 889 and the IOUs' authority to engage in market-based transactions fails to recognize the market changes caused by these events and would set the incentive threshold too low. Thus, we believe this approach would reward the IOUs for normal effort, rather than the superior effort that should be required to receive an incentive.

Therefore, we find that a three year moving average of the gains on non-separated sales, firm and non-firm, excluding emergency sales, is an appropriate threshold for the shareholder incentive. All gains at or below this threshold shall be credited to the ratepayers. All gains above this threshold shall be split 80%/20% between ratepayers and shareholders, respectively. We find that this incentive structure will allow ratepayers: (1) to continue to receive the substantial cost reduction benefits achieved through the IOUs' current level of non-separated sales; and (2) to benefit from a credit to the fuel clause of 80 percent of the gains on non-separated sales above the threshold. This incentive structure also minimizes the possibility that the IOUs could be rewarded for behavior that is already occurring. The IOUs are rewarded only for performing better than they performed, on average, over the previous three year period. To the extent an IOU surpasses the threshold, its threshold will increase for the next year. To the extent an IOU does not surpass the threshold, its shareholders will not receive as an incentive any portion of the gains that the IOU does achieve.

As noted above, both FPC witness Wieland and Gulf witness Howell proposed a 20 percent shareholder incentive as an appropriate incentive level. As witness Wieland conceded, the 20 percent figure is subjective in that there is no scientific basis used in selecting that percentage. However, we find that a 20 percent incentive is consistent with Order No. 12923, is reasonable, and should provide utilities with an adequate incentive.

We reject FIPUG and OPC's contention that any shareholder incentive structure should include a penalty for substandard performance, because imposing such a penalty would potentially counteract the incentive. We believe that the incentive approach described above is sufficient to encourage performance. As witness L. Brown testified and witness Dismukes conceded, a utility that does not make an adequate effort to make these sales is experiencing the opportunity cost of forgone profits. Further, we note that the shareholder incentive approved in Order No. 12923 did not include a penalty. Thus, including a penalty would represent a change in Commission policy which we believe has not been adequately justified.

We also reject FPL witness Dubin's sliding scale approach. We are not persuaded that IOU shareholders should receive a higher percentage incentive as gains increase. Witness Dubin admitted that the levels of FPL's sliding scale were subjective and not based on any analysis. Witness Dubin also testified that these levels should apply to FPL alone, and other levels should be developed for other IOUs. Thus, using a sliding scale approach places this Commission in the difficult position of developing the gain levels for the scale for each IOU without any record evidence to support such a determination.

In addition, we reject TECO witness D. Brown's proposal to apply a higher incentive to in-state sales. The record evidence shows that approximately 95 percent of TECO's non-separated wholesale sales revenues are currently earned on in-state sales. Further, unlike FPL and FPC, TECO is authorized to make market-based sales in-state. Thus, providing a higher incentive on these sales would reward TECO for behavior that is already taking place. We are also concerned that providing a higher incentive on in-state sales could result in a perverse incentive for IOUs to make sales with the highest shareholder incentive, rather than the highest gain. Sales with the highest gain benefit the selling utility's ratepayers the most by resulting in the highest credit to ratepayers.

Finally, we reject the 'deadband' approach proposed by OPC witness Dismukes. Witness Dismukes' approach calculates a benchmark based on a five-year moving average of sales made on the Broker. Under this approach, the IOU would credit 100 percent of the gains to ratepayers when the current year's sales fall between 75 and 125 percent of this benchmark. If a current year's sales exceed 125 percent of this benchmark, the IOU could retain for its shareholders up to 20 percent of those incremental gains. Conversely, if a current year's sales do not reach 75 percent of this benchmark, the IOU would incur a penalty up to 20 percent of the shortfall. Witness Dismukes proposed this deadband approach in part to reduce the possibility that IOUs would be rewarded for actions beyond their control. As discussed above, we believe that a 20 percent incentive on gains above a three year moving average would address these concerns. Further, we are concerned that the deadband could potentially reduce the impact of a shareholder incentive in encouraging these sales. Thus, we find that this deadband approach is inappropriate.

C. Conclusion

In conclusion, we approve the following as the appropriate structure for a shareholder incentive:

1. The incentive shall apply to the gains from all non-separated wholesale power sales, firm and non-firm, excluding emergency sales, made under current or future FERC-approved schedules.

2. A three year moving average of gains on all non-separated wholesale power sales, firm and non-firm, excluding emergency sales, shall be established each year as the threshold for application of the incentive. All gains below this threshold shall be credited to the ratepayers. All gains above this threshold shall be split 80%/20% between ratepayers and shareholders, respectively.

III. Notice of Proposed Agency Action - Calculation of Gains and Appropriate Regulatory Treatment

NOTICE is hereby given by the Florida Public Service Commission that the action discussed in this part only is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

The record of this proceeding indicates that the IOUs calculate total gains differently for similar types of non-separated wholesale power sales. Because the IOUs sell short-term wholesale energy based upon their willingness and ability to sell at or above incremental costs, we believe that the IOUs should measure the costs of these sales on an incremental basis. Accordingly, we find that each IOU shall measure the gain from its non-separated wholesale power sales by subtracting the sum of its incremental costs from the revenue received for each sale. Further, we find that the calculation of incremental costs for these sales shall include, but not be limited to: incremental fuel cost, incremental SO_2 emission allowance cost, incremental O&M cost, and separately-identified transmission or capacity charges.

In addition, we find that the following regulatory treatment for the revenues and expenses associated with each non-separated wholesale power sale is appropriate:

1. Each IOU shall credit its fuel and purchased power cost recovery clause for an amount equal to the incremental fuel cost of generating the energy for each such sale;

2. Except for FPC, each IOU shall credit its environmental cost recovery clause for an amount equal to the incremental SO_2 emission allowance cost of generating the

energy for each such sale. FPC, because it does not have an environmental cost recovery clause, shall credit this cost to its fuel and purchased power cost recovery clause;

3. Each IOU shall credit its operating revenues for an amount equal to the incremental operating and maintenance (O&M) cost of generating the energy for each such sale; and

4. In accordance with Order No. PSC-99-2512-FOF-EI, issued December 22, 1999, in Docket No. 990001-EI, each IOU shall credit its capacity cost recovery clause for an amount equal to any transmission revenues or separately identifiable capacity revenues.

If a person whose substantial interests are affected by our proposed action in this portion of the Order timely files a protest, the issue shall be addressed as part of our Fuel and Purchased Power Cost Recovery proceedings.

IV. Conclusions of Law

This Commisison is vested with jurisdiction over this matter through several provisions of Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06, Florida Statutes.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the shareholder incentive mechanism approved in Order No. 12923, issued January 24, 1984, in Docket No. 830001-EU-B, is hereby modified as set forth in parts I and II of this Order. It is further

ORDERED that gains on non-separated wholesale power sales shall be calculated as set forth in part III of this Order. It is further

ORDERED that the revenues and expenses associated with non-separated wholesale power sales shall be treated for regulatory purposes as set forth in part III of this Order. It is further

ORDERED that the provisions of part III of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the `Notice of Further Proceedings` attached hereto. It is further

ORDERED that this Docket shall be closed after the time for filing an appeal of parts I and II has run or upon issuance of a Consummating Order on part III, whichever occurs later. If a person whose substantial interests are affected by the Commission's proposed action in part III timely files a protest, the issue shall be addressed as part of the Commission's Fuel and Purchased Power Cost Recovery proceedings, and this Docket shall be closed after the time for filing an appeal on parts I and II has run.

By ORDER of the Florida Public Service Commission this 26th day of September, 2000.

/s/ Blanca S. Bay¢
BLANCA S. BAY , Director
Division of Records and Reporting

This is a facsimile copy. A signed copy of the order may be obtained by calling 1-850-413-6770.

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

As identified in the body of this order, our action in part III of this order is preliminary in nature. Any person whose substantial interests are affected by the action proposed in part III of this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, at 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on October 17, 2000. If such a petition is filed, mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing. In the absence of such a petition, part III of this order shall become effective and final upon the issuance of a Consummating Order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

Any party adversely affected by the Commission's final action in parts I and II of this order may request: (1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or (2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.