



ORIGINAL

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February 11, 2004

VIA HAND DELIVERY

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

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Re: Docket No. 031057-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket on behalf of Progress Energy Florida, Inc., are an original and fifteen copies each of the direct testimony of Javier Portuondo, Albert W. Pitcher, and James N. Heller.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. A 3½ inch diskette containing the above-referenced documents in Word format is also enclosed. Thank you for your assistance in this matter.

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Jh
FPSC-BUREAU OF RECORDS

Very truly yours,

James A. McGee
James A. McGee

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JAM/scc

Enclosures

cc: Parties of record

Portuondo - 01971-0A
Pitcher - 01972-0A
Heller - 01973-0A

DOCUMENT NUMBER-DA

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PROGRESS ENERGY FLORIDA

DOCKET NO. 031057-EI

CERTIFICATE OF SERVICE

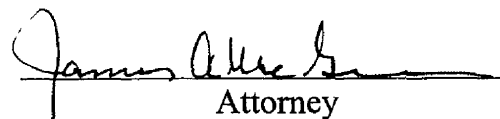
I HEREBY CERTIFY that a true copy of the direct testimony of Javier Portuondo, Albert W. Pitcher, and James N. Heller on behalf of Progress Energy Florida has been furnished to the following individuals by overnight delivery this 11th day of February, 2004.

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PROGRESS ENERGY FLORIDA
DOCKET NO. 031057-EI

DIRECT TESTIMONY OF
JAVIER PORTUONDO

1 **Q. Please state your name and business address.**

2 A. My name is Javier Portuondo. My business address is Post Office Box
3 14042, St. Petersburg, Florida 33733.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by Progress Energy Service Company, LLC, in the capacity
7 of Director, Regulatory Services - Florida.

8
9 **Q. Have your duties and responsibilities as Director of Regulatory
10 Services for Florida remained the same since you testified on the
11 issues deferred to this proceeding at the hearing last November in
12 Docket No. 030001-EI?**

13 A. Yes they have.

14
15 **Q. What is the purpose of your direct testimony?**

16 A. The purpose of my testimony is to address the regulatory treatment that
17 should be established for the costs of waterborne coal transportation
18 services (WCTS) provided to Progress Energy by Progress Fuels
19 Corporation (PFC) beginning in 2004 and thereafter. The need to establish
20 this regulatory treatment arises from the Commission's decision at the
21 conclusion of the November 2003 fuel adjustment hearing to discontinue,

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1 effective January 1, 2004, the prior regulatory treatment for these WCTS
2 costs, the Company's market proxy pricing mechanism, which had been in
3 place since its initial adoption by the Commission in 1993. The
4 Commission's decision at last November's fuel hearing is reflected in Order
5 No. PSC-03-1461-FOF-EI, issued December 22, 2003, which also directed
6 that this docket be opened to determine the regulatory treatment that
7 should replace Progress Energy's market proxy mechanism prospectively.
8

9 **Q. How is your testimony organized?**

10 A. My testimony divides the establishment of the regulatory treatment for
11 Progress Energy's WCTS into two sections. The main section is based on
12 the testimony presented to the Commission at the November 2003 hearing
13 by Staff witness McNulty, who proposed the determination of a market price
14 for each segment of PFC's waterborne transportation system through a
15 competitive bidding process utilizing formal requests for proposals (RFPs).
16 Prior to the hearing, Staff and Progress Energy reached agreement on a
17 methodology for implementing Mr. McNulty's RFP proposal. Because of
18 the lead time associated with the expiration of PFC's existing WCTS
19 contracts and need to conduct a formal RFP process for each segment of
20 the waterborne transportation route, Staff and Progress Energy recognized
21 that the methodology could not be fully implemented for cost recovery
22 purposes until the beginning of 2005. My testimony will address this agreed
23 upon methodology for 2005 and beyond.

24 The other section of my testimony will address the treatment of
25 Progress Energy's WCTS costs in 2004. Given the Commission's decision

1 to discontinue the market proxy mechanism after 2003 and the inability to
2 implement the agreed upon RFP methodology before 2005, calendar year
3 2004 of necessity becomes a transition period. My testimony proposes the
4 use of an updated market price proxy as a temporary transition mechanism
5 to bridge the gap between the end of 2003 and the beginning of 2005.
6

7 **Q. Taking the sections of your testimony in chronological order, what**
8 **transition mechanism do you propose for the costs of WCTS provided**
9 **to Progress Energy in 2004?**

10 A. I think most would agree that establishing a fair and workable regulatory
11 treatment of WCTS for the long term is and should be the principal focus of
12 this proceeding. For this reason, I believe an updated variation of a
13 mechanism based on the prior market proxy can be readily established for
14 the 2004 transition period that would address the concerns of Mr. McNulty
15 and the Commission at the November 2003 hearings regarding the prior
16 mechanism. Just as importantly, using the basic elements of a long-used
17 mechanism that the Commission, Staff, and parties are already familiar with
18 as a means to bridge the one-year gap will avoid the complexities of
19 developing an alternative mechanism from scratch for this limited purpose
20 and distracting valuable time and attention from developing the more
21 important ongoing regulatory treatment.

22 The use of a properly modified variation of the prior market proxy
23 mechanism in 2004 for transition purposes would also maintain consistency
24 with the Commission's policy of using market-based pricing, rather than
25 cost-based pricing, for affiliated fuel transactions. From a customer

1 perspective, using a market proxy would provide price stability irrespective
2 of unexpected costs, and thereby avoid the risk under cost-based prices of
3 unusual, extreme, or even catastrophic events that could significantly
4 increase the costs customers must pay for waterborne coal deliveries.
5 Finally, the use of a modified market proxy mechanism in 2004 for transition
6 purposes would recognize that PFC's existing WCTS contracts, which were
7 entered into under prices governed by the Commission-approved market
8 proxy mechanism, also require a transition period for an orderly expiration
9 in accordance with their negotiated terms, mostly in 2004.

10
11 **Q. What would this variation of the prior market proxy mechanism**
12 **consist of?**

13 A. The variations would consist of, first, updating and resetting the prior
14 proxy's 1992 base cost to a current level. This can be accomplished by
15 using currently available 2002 audited actual contractual and non-
16 contractual costs of PFC developed for the November 2003 hearing, as
17 reported in the Company's response to Staff Interrogatory Nos. 76 and 77.
18 This new 2002 base cost would then be escalated to 2004 by the weighted
19 indices approved by the Commission in its order establishing the market
20 price proxy (Order No. PSC-93-1331-FOF-EI). The result of this
21 mathematical calculation is an updated 2004 market proxy price of \$██████████
22 per ton for domestic coal.

1 **Q. How would the updated market proxy price for 2004 domestic WCTS**
2 **developed in this manner address the concerns about the prior market**
3 **proxy expressed at the November 2003 hearing?**

4 A. By resetting the 1992 base costs using audited costs for 2002, the concern
5 over the disparity that had gradually emerged over a ten-year period
6 between actual WCTS costs and escalated 1992 costs is effectively
7 addressed. The updated 2004 proxy also addresses the concern raised by
8 Mr. McNulty that the application of the market proxy's escalators over long
9 periods of time may not necessary track PFC's actual experience with
10 WCTS cost changes. In the case of the updated 2004 market proxy, these
11 escalators that, while not perfect, reasonably reflect the relevant WCTS
12 costs and are applied only twice to bring the 2002 base costs to a 2004
13 level, thereby minimizing any distortion between costs and the proxy price.

14
15 **Q. How would the updated WCTS market proxy price for domestic coal**
16 **translate to a market proxy price for foreign coal?**

17 A. The prior market proxy mechanism established the price for foreign coal
18 based on 50.2% of the domestic market proxy price, which was the ratio of
19 1992 Gulf terminalling and trans-Gulf transportation costs to total 1992
20 WCTS costs. Mr. McNulty was critical of the foreign market proxy price
21 calculated with this percentage, contending that the price was higher than a
22 ratio using current WCTS costs would produce. The updated market proxy
23 price described above allows this criticism to be addressed as well. The
24 same audited 2002 WCTS costs used to update the market proxy price for
25 domestic coal would also be used to update the ratio of Gulf terminalling

1 and trans-Gulf transportation costs to total WCTS costs. The 2002 cost
2 data produces an updated ratio of 41.3%, which, when applied to the
3 updated 2004 domestic price, results in a market proxy price for foreign
4 coal of \$█████ per ton.

5
6 **Q. Is there any other variation of the market proxy mechanism that could**
7 **be used for the transition to a long-term regulatory treatment?**

8 A. Although I believe the updated market proxy mechanism described above is
9 the most sound, efficient, and equitable method for bridging the one-year
10 gap between the discontinued market price proxy and the competitive
11 bidding methodology we have agreed to with Staff, a simplified alternative
12 would be to use the audited 2002 contractual and non-contractual costs as
13 an updated base year, but apply only the CPI-U index to escalate the 2002
14 base year costs to a 2004 level. This would produce an updated market
15 proxy price of \$█████ per ton for the 2004 transition period.

16
17 **Q. Turning now to the regulatory treatment for WCTS that Progress**
18 **Energy proposes as a long-term replacement for the discontinued**
19 **market price proxy beginning in 2005, please describe the**
20 **circumstances that led to the agreement between Staff and the**
21 **Company on this regulatory treatment.**

22 A. The agreement reached by Progress Energy and Staff prior to outset of the
23 November 2003 hearing is attached to this testimony as Exhibit ____ (JP-1).
24 This document was subsequently the subject of discussion and comment
25 by Staff witness McNulty during the hearing and by the Commission during

1 its post-hearing deliberations. As a result, certain provisions in paragraph 1
2 related to the use of the market price proxy in 2004 were negated by the
3 Commission's decision to discontinue its use after 2003, and certain other
4 details may require revision or additions to accommodate the Commission's
5 decision and comments during its deliberations. Nonetheless, the document
6 continues to represent the basis of the Company's agreement and
7 understanding with Staff regarding the RFP methodology for 2005 and beyond.

8 The starting point for this methodology is the conceptual description of
9 Mr. McNulty's proposal in his prepared testimony presented at the
10 November 2003 hearing, in which he states that Progress Energy should

11 "justify its projected WCTS cost recovery upon the basis of a fair and
12 complete competitive bid procedure for each component of WCTS.
13 The Commission should establish a market price proxy for particular
14 components of WCTS only in the event [Progress Energy] and PFC
15 are unable to procure a competitive bid from one or more qualified
16 vendors after administering a fair and complete competitive bid process."

17 The agreement in my exhibit JP-1 is essentially an attempt by Staff and
18 Progress Energy to flesh out the details of a methodology for implementing
19 this proposal.

20
21 **Q. Why does Progress Energy believe that the methodology in its**
22 **agreement with Staff is the appropriate regulatory treatment of the**
23 **costs for WCTS provided to the Company by PFC?**

24 **A.** To begin with, the methodology is based on Mr. McNulty's underlying
25 proposal quoted above, which is both conceptually sound and fairly

1 balanced. Equally important, the conceptual premise and the implementing
2 methodology promote and advance the Commission's major policy decision
3 in 1989 adopting the use of market-based pricing as the basis for regulating
4 fuel-related transactions between utilities and their affiliates, rather than the
5 cost-based pricing approach previously used for this purpose. (See Order
6 No. 20604, issued January 13, 1989 in Docket No. 860001-EI-G.) The
7 methodology itself, which requires greater formality than previously used by
8 PFC for conducting the competitive bidding process, is nonetheless
9 workable. Furthermore, it enhances the Commission's capability for
10 effective regulatory oversight through the establishment of predefined
11 criteria for conducting the competitive bidding process and a readily
12 available audit trail. In addition, the methodology appears to provide a
13 somewhat unusual common ground in terms of acceptability. Obviously, it
14 has been accepted by both Staff and the Company and, although the other
15 parties still have the opportunity to file formal testimony, neither I nor others
16 within Progress Energy are aware of any negative comments or
17 suggestions of concern regarding the proposed methodology since it was
18 made available last November. I consider this a testament to the
19 methodology's soundness and I urge the Commission's endorsement as
20 well through its approval.

21
22 **Q. What are the key features of the agreed upon methodology?**

23 A. The following is a summary description of the key features in the
24 methodology Progress Energy and Staff have agreed upon:

- 1 ● Prior to the expiration of any WCTS contract, PFC will conduct a
2 competitive bidding process for the WCTS provided under the expiring
3 contract and maintain sufficient documentation for Commission review.
4 In the case of competitive bidding proposals for the cross-Gulf
5 segment, Staff and affected parties will be consulted at least 30 days
6 before issuing the proposal for consideration of their input. PFC will
7 attempt to time the issuance of an RFP to begin the process such that
8 the signing of a contract upon its completion will occur at least 120
9 days before contract services commence, unless good cause is shown
10 to do otherwise. (See the testimony of Mr. Pitcher and Mr. Heller
11 regarding the details of conducting this competitive bidding process,
12 and market considerations that may justify a delay in issuing bid
13 solicitations and impact the 120-day Staff review period.)
- 14 ● The results of the competitive bidding process will be presented to the
15 Commission for review and approval. If the Commission determines
16 that the process did not produce sufficient competitive bids, Progress
17 Energy will develop and request approval of a market price proxy for
18 the WCTS segment in question based on guidelines enumerated in the
19 agreement.
- 20 ● If sufficient time is not available for Commission consideration of the
21 competitive bidding process and the resulting WCTS contract or
22 market proxy proposal before the existing contract or proxy expires,
23 costs incurred under the new contract or proposed market proxy may
24 be charged to fuel expense, subject to true-up. (See my testimony
25 below elaborating on this point.)

- 1 • A Commission-approved competitively bid WCTS contract or market
2 price proxy will be deemed reasonable for cost recovery purposes. In
3 addition, Progress Energy will be allowed to recover two categories of
4 reasonable non-contractual WCTS costs incurred by PFC: (1) its
5 Administrative and General (A&G) expenses directly assignable to
6 providing WCTS, and (2) miscellaneous charges imposed directly on
7 PFC in conjunction with providing WCTS, provided that these charges
8 do not exceed \$0.25 per ton in total. (See my testimony below for a
9 discussion and examples of these non-contractual WCTS costs.)
10

11 **Q. Does the agreement contain any provision for documenting the**
12 **competitive bidding process?**

13 A. Yes, the agreement specifies that documentation sufficient to allow the
14 Commission to fairly evaluate the bidding process will be maintained by
15 PFC. Mr. Pitcher will address this requirement in his testimony. I would
16 add that, consistent with long standing practice, Progress Energy's internal
17 audits department will also conduct periodic compliance audits of PFC's
18 competitive bidding process to verify that the procedures and requirements
19 established by Commission order have been adhered to in conducting the
20 competitive bidding process. Audits of this kind would be a logical
21 extension of the annual internal audits performed by Progress Energy to
22 verify compliance with the methodology and procedures of the market price
23 proxy that PFC operated under through 2003. Another ongoing example is
24 the annual internal audit of PFC's so called "short-cut method" to verify that
25 it accurately simulates a utility-type capital structure, the results of which

1 are presented to the Commission in response to an issue raised each year
2 for consideration at the November fuel adjustment hearing.

3
4 **Q. What is the reason for the provision in your agreement with Staff**
5 **regarding the treatment of costs under a WCTS contract or market**
6 **proxy that becomes effective before final Commission approval can**
7 **be obtained?**

8 A. It goes without saying that contracts or market proxies produced by the
9 competitive bidding process provided in the agreement with Staff need to
10 be reviewed by the Commission to ensure that the process has been
11 properly followed. Ideally, this review would take place at the November
12 hearing before the contracts or market proxies go into effect, so that any
13 regulatory issues or concerns are resolved by the time costs begin to be
14 incurred. Progress Energy and PFC have agreed that they will attempt to
15 time the issuance of their RFPs to meet this objective.

16 For a variety of reasons, however, the agreement recognizes the
17 possibility that the competitive bidding process may not be completed at a
18 time that permits advance review by the Commission. For example, the
19 time of year that an existing contract expires may make it impossible for the
20 new replacement contract to be considered at the November hearing prior
21 to its effective date, even if signed and submitted more than 120 days
22 before it becomes effective, as the example in my answer to the following
23 question illustrates. The testimony of witnesses Heller and Pitcher describe
24 possible market conditions that would justify delaying the issuance of a
25 competitive bid solicitation to avoid or minimize the effect of an existing

1 seller's market or capture the benefits of an anticipated buyer's market.
2 When conditions such as these occur, the agreement provides an
3 alternative approval procedure utilizing the true-up mechanism to avoid a
4 problematic regulatory gap between the expiration of an old contract or
5 market proxy and the commencement of a new contract or proxy.

6
7 **Q. How would this alternative approval procedure work?**

8 A. To illustrate the application of this procedure by way of example, consider
9 an existing WCTS contract that will expire on March 31 of a given year and
10 a replacement contract resulting from a competitive bidding process that
11 has been signed and submitted to the Commission on the preceding
12 December 1, or 120 days before its effective date. The contract could not
13 have been considered at the November fuel adjustment hearing before it
14 becomes effective, since that hearing would have occurred a week or two
15 before the contract was submitted.

16 Under the alternative approval procedure, if an estimate of the costs
17 under the not yet finalized contract were available at the hearing, the
18 Commission could choose to include these costs in the fuel cost recovery
19 factor for the upcoming year, subject to true-up. Either way, however, the
20 costs incurred under the new contract beginning effective date, April 1,
21 would be recorded as a charge to fuel expense and reflected in the
22 Company's actual/estimated year-end true-up balance submitted for
23 consideration at the November hearing later that year, along with the
24 contract itself. If the contract and the related fuel expenses are approved
25 by the Commission, the full effect of the contract would flow forward in the

1 subsequent years through the normal operation of the fuel adjustment
2 proceeding. If, on the other hand, approval is denied or granted in some
3 modified form, the costs previously recorded would be adjusted, with
4 interest, along with any necessary adjustments to the Company's projected
5 costs for the following year, consistent with the Commission's decision. In
6 other words, under the alternative approval procedure any decision made
7 by the Commission after the effective date of a new WCTS contract or
8 market proxy would be applied in a manner to produce the same net result
9 as if the decision had been made in the prior year, before the new contract
10 or proxy went into effect.

11
12 **Q. What kind of non-contractual Administrative & General expenses and**
13 **miscellaneous WCTS charges would be recoverable under the last of**
14 **the key features summarized above?**

15 A. Under the agreement reached with Staff, the A&G expenses of PFC directly
16 assignable to providing WCTS would be recoverable by Progress Energy.
17 For instance, PFC's A&G expenses associated with conducting the
18 competitive bidding process would be recoverable, as would PFC's
19 expenses to integrate, coordinate and schedule the activities of each WCTS
20 segment with related activities in the other segments. With respect to
21 recoverable miscellaneous charges, the agreement specifies that these
22 charges must be individually identified and must have been imposed
23 directly on PFC in conjunction with providing WCTS. The agreement
24 further tightens the kind of miscellaneous charges that are intended to be
25 recovered in two ways. The first way is by providing a list specific examples

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that illustrate the kind of clear and direct connection to providing waterborne services that these charges should have, *i.e.*, "port, harbor, and line handling fees, customs and marine survey charges, etc." The second way is to ensure that miscellaneous charges covered by the agreement are also understood to be minor charges. This was done by establishing a limited maximum recovery cap of 25¢ per ton in total for all miscellaneous charges recovered at any one time.

Q. Does this conclude your direct testimony?

A. Yes, it does.