

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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In re: Fuel and Purchased Power Cost)
Recovery Clause with Generating)
Performance Incentive Factor)
_____)

Docket No. 040001-EI
Filed: October 4, 2004

COMMISSION
CLERK

DIRECT TESTIMONY AND EXHIBITS

OF

KERRICK KNAUTH

ON BEHALF OF

THE FLORIDA INDUSTRIAL POWER USERS GROUP

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FPSC-COMMISSION CLERK

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

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3 **DIRECT TESTIMONY OF KERRICK KNAUTH**

4 **ON BEHALF OF FLORIDA INDUSTRIAL POWER USERS GROUP**

5 **OCTOBER 4, 2004**

6
7 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

8 A. My name is Kerrick Knauth. My address is 2929 Allen Parkway, Suite
9 2200, Houston, Texas 77019.

10
11
12 **Q. BY WHOM ARE YOU EMPLOYED, AND IN WHAT CAPACITY?**

13 A. I am employed by Northern Star Generation Services Company LLC,
14 which is wholly owned by Northern Star Generation LLC ("Northern Star"). My
15 job title is Asset Manager. In that capacity, I am responsible for the development
16 and commercial aspects of the power generation project owned by Vandolah
17 Power Company LLC, which is also wholly owned (through subsidiaries) by
18 Northern Star.

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21 **Q. FOR WHOM DO YOU APPEAR?**

22 A. I am testifying on behalf of the Florida Industrial Power Users Group
23 ("FIPUG"). FIPUG is an ad hoc group of industrial customers that intervenes in

1 dockets that affect the size of its members' bills. FIPUG favors the use of
2 competition to ensure that ratepayers receive power from the most economical
3 sources available.

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5

6 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
7 **YOUR PROFESSIONAL EXPERIENCE.**

8 A. I received a B.S. degree in Civil Engineering from Tulane University in
9 1986. Following two years with the United States Peace Corps, I worked as a
10 civil engineer with the United Nations Department of Technical Cooperation for
11 Development. I received an M.A. degree in International Relations, with a
12 concentration in Energy, Environment, Science, and Technology, from John
13 Hopkins University in 1994.

14 During the period 1994-1998 I was employed as a business developer and
15 project manager for Coastal Power Company. While with Coastal Power
16 Company, I explored and developed power development opportunities in
17 numerous international settings in the Philippines, Southeast Asia, and Latin
18 America.

19 I then joined Oxbow Corporation. While with Oxbow, I was responsible for
20 the financial management of its geothermal power plants in the Philippines and
21 Costa Rica.

22 I joined El Paso Corporation in 2001. Among other assignments for El
23 Paso, I became involved with the Vandolah power generation project shortly

1 before it began commercial operations in June of 2002. When Northern Star
2 acquired certain of El Paso's assets, including the Vandolah project, I accepted
3 my present position.

4
5

6 **Q. PLEASE DESCRIBE THE VANDOLAH PROJECT.**

7 A. The Vandolah project consists of four simple cycle gas-fired combustion
8 turbines on a site of approximately 40 acres in Hardee County, Florida. The
9 project, built at an initial cost of approximately \$265 million, began commercial
10 operations in June of 2002. The four turbines produce a nominal output of 680
11 MW of capacity. The project is adjacent to Progress Energy's Vandolah
12 substation, which was the site of the recent addition of a 230 kV transmission
13 upgrade between the Vandolah substation and FPL's Whidden substation.

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15

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

17 A. As I mentioned, FIPUG supports wholesale competition as an effective
18 means of ensuring that ratepayers receive the best, most economical electrical
19 service.

20 Florida Power and Light Company and Progress Energy have asked the
21 Commission to approve several proposed Unit Power Sales contracts with
22 members of Southern Company. On behalf of FIPUG, whose members would be
23 affected by the approval of the proposed Unit Power Sales arrangements, I will

1 provide comments - from the perspective of a wholesale provider, to be sure -
2 describing why it would be in the ratepayers' interests for the Commission to
3 deny the requests for approval, and direct the utilities to identify and evaluate the
4 universe of alternatives available in the wholesale market (in Florida and
5 elsewhere) prior to determining which options they should pursue.

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7

8 **Q. WHY WOULD TESTIMONY FROM THE PERSPECTIVE OF A SELLER**
9 **OF WHOLESALE POWER BE RELEVANT TO RATEPAYERS' INTERESTS**
10 **AND TO THE COMMISSION'S CONSIDERATION OF THE REQUESTS FOR**
11 **APPROVAL OF THE PROPOSED UPS CONTRACTS?**

12 **A.** As a seller of wholesale power, Vandolah Power Company LLC has an
13 obvious interest in competing for the opportunity to provide the capacity and
14 energy represented by the proposed contracts. However, Vandolah Power
15 Company LLC - or any other wholesale provider - will be successful only if its
16 product is *considered* and, when compared to alternatives, is determined to be
17 the most beneficial to ratepayers. To the extent any wholesaler capable of
18 meeting all or part of the proposed capacity is not included in the underlying
19 analysis, this omission is directly relevant to the issue of whether the
20 Commission should approve the proposed contracts.

21

22

23 **Q. PLEASE SUMMARIZE THE PROPOSED UPS CONTRACTS.**

1 A. As described in the pre-filed direct testimony of Progress Energy witness
2 Sam Waters and FPL witness Tom Hartman, all of the proposed arrangements
3 would begin in 2010 and terminate in 2015, subject to certain possible
4 extensions. FPL proposes to enter three contracts totaling 955 megawatts. Of
5 that amount, 165 megawatts would be generated by a coal-fired generating unit.
6 The balance, or 790 MW, would be generated from combined cycle capacity.

7 Progress Energy witness Sam Waters says that his company has not yet
8 negotiated definitive contracts with Southern Company. He describes his
9 company's proposal to enter UPS contracts that, when negotiated, would total
10 425 megawatts, including 74 megawatts of coal-fired capacity and 351 MW of
11 combined cycle generation.

12 Both utilities shielded the pricing information in the proposed contracts.
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14

15 **Q. SHOULD THE COMMISSION APPROVE THE UPS CONTRACTS, AS**
16 **REQUESTED BY FPL AND PROGRESS ENERGY?**

17 A. No.
18
19

20 **Q. WHY NOT?**

21 A. Collectively, the proposed UPS arrangements total approximately 1400
22 MW. With respect to both FPL and Progress Energy, each utility's witness
23 testifies that, if the utility were to meet the 2010 need for capacity with units in its

1 generation expansion plan rather than with the proposed UPS arrangements, it
2 would build a large combined cycle unit. (Waters, page 6, lines 15-16; Hartman,
3 page 15, lines 10-12.) I am informed that before either utility could proceed with
4 construction of such a unit, it would be required by rule to conduct a detailed
5 Request For Proposals, and that its decision would be reviewed in a Commission
6 proceeding that typically lasts for several months (and in which bidders routinely
7 participate as parties.) The nature and significance of the needs that the
8 proposed UPS arrangements are intended to satisfy are identical to those of the
9 needs that would trigger that scenario of active competition and detailed review.
10 Yet, neither utility has performed a meaningful analysis of alternatives available
11 in the competitive marketplace, and both utilities are asking the Commission to
12 make a decision within a severely compressed time frame. Absent a thorough
13 analysis of all competitive alternatives, the Commission is simply not in a position
14 to gauge whether the proposed UPS contracts beginning in 2010 comprise the
15 best alternative from the ratepayers' point of view. Nor, in fact, are the utilities.

16

17

18 **Q. HAVE THE UTILITIES JUSTIFIED THE PROPOSAL TO LOCK INTO**
19 **THE PROPOSED CONTRACTS SIX YEARS PRIOR TO THE DELIVERY OF**
20 **POWER WITHOUT EXPLORING AVAILABLE ALTERNATIVES?**

21 A. No.

22

23

1 **Q. PLEASE EXPLAIN.**

2 A. I will begin with FPL. At page 19, FPL Witness Hartman says the “futures
3 market” for wholesale transactions has only a two or three year horizon. I believe
4 Mr. Hartman has failed to distinguish between energy *brokers*, on the one hand,
5 and wholesale providers who own generating assets, on the other. Pure energy
6 brokers may tend to focus on a “futures market” that typically does not extend
7 beyond the near term. However, a developer who has financed and constructed
8 a generating asset having a useful life of 30 years or more can and most
9 certainly will consider contractual arrangements that extend far beyond the
10 “energy futures” horizon that Mr. Hartman mentions. However, this is only one
11 aspect of the utilities’ failure to support their proposals.

12

13

14 **Q. PLEASE ELABORATE.**

15 A. The principal observation to be made is that Mr. Hartman does not explain
16 adequately *why* FPL wishes to contract for 955 megawatts of power so far in
17 advance of the time it is needed, when sufficient time is available to consult the
18 market prior to making a decision. This is a serious shortcoming, because a
19 decision made now would not take into account any developments that may
20 impact the wholesale landscape prior to 2010. For instance, there is time to
21 factor into the analysis the extent of progress on the development of an RTO, or
22 any other change that could increase the competitive nature of the wholesale
23 landscape in Florida.

1 Nor does Mr. Hartman explain why, to the limited extent FPL looked into
2 the availability of wholesale merchant power, FPL considered merchants located
3 in SERC, but apparently did little or nothing to contact potential suppliers in
4 Florida. With respect to the "analysis" of the Florida wholesale market, Mr.
5 Hartman says he picked the most appropriate proposal submitted in FPL's 2003
6 RFP and adjusted it to represent the present. An outdated bid that is (1) nearly
7 two years old and (2) has been modified - not by the bidder, but by the recipient -
8 is a poor proxy for an indication of the current market as indicated by a
9 solicitation or competitive process - particularly when the alternatives are
10 available to be consulted.

11

12

13 **Q. WHAT ABOUT PROGRESS ENERGY?**

14 A. The discrepancies in the approaches used by the two utilities should, in
15 and of itself, lead the Commission to require far more in the way of analysis.
16 Based on Mr. Waters' testimony, it appears that Progress Energy made even
17 less of an effort to identify and assess alternatives in the marketplace. As far as I
18 can tell, Progress Energy compared term sheets being negotiated with Southern
19 (again, there are no proposed contracts at this point) with only its self-build
20 option. Mr. Waters does refer vaguely to some alternative assumptions
21 regarding the cost of economy energy. While this reference is ambiguous, it is
22 clear that Progress Energy did not consult the wholesale market for firm capacity

1 prior to settling on the UPS proposals now being negotiated with Southern
2 Company.

3

4

5 **Q. ISN'T IT TRUE THAT THE WITNESSES FOR FPL AND PROGRESS**
6 **ENERGY CLAIM BENEFITS THAT WOULD BE ASSOCIATED WITH THE UPS**
7 **CONTRACTS?**

8 A. Yes. However, the claims are insufficient to justify the proposed UPS
9 contracts.

10

11

12 **Q. PLEASE EXPLAIN.**

13 A. For example, the witnesses stress the advantage of maintaining firm
14 transmission rights on Southern's system. As a starting point, and assuming for
15 the moment that there is in fact an advantage to maintaining such rights, it is not
16 clear that the proposed UPS contracts are essential to the ability to acquire such
17 rights. More importantly, whether such firm transmission rights would be
18 advantageous would turn completely on two points: (1) the cost of the firm
19 transmission, which is not known by either utility, and (2) the extent to which the
20 utilities utilize those rights over time to acquire power at prices more favorable
21 than alternatives that do not require such rights-and so do not require the utilities
22 to incur the costs of firm transmission across Southern. FPL and Progress
23 Energy offer no projections or assumptions of the relative merits, and offer no

1 cost/benefit analysis. Having expressly made the proposed UPS agreements
2 subject to prior Commission approval, the utilities ask the Commission to act in
3 the absence of the cost of firm transmission that the contracts will require - a
4 crucial factor on which the prudence and cost-effectiveness of the arrangements
5 will depend heavily.

6 Progress Energy's witness, Sam Waters, says that one advantage of the
7 proposed UPS arrangement would be a contribution to "cost certainty."
8 However, the term sheet attached to his testimony indicates that Progress
9 Energy would be responsible for any costs - - including the cost of capital
10 additions - - occasioned by a "change in law." For an existing coal-fired
11 generating unit, this provision creates the potential for a significant increase
12 related to changes in environmental requirements. (One thinks, for example, of
13 the increasing interest of federal regulators in controlling mercury emissions from
14 existing plants.) Committing to the transaction years prior to the time it is
15 necessary to do so would increase the exposure to that risk.

16 Each potential source of capacity and energy will have its own set of
17 advantages and disadvantages. By way of example, projects located near the
18 load centers of Progress Energy and FPL would have fewer line losses and
19 would cost less to transmit. At the same time they would provide "intangibles" of
20 their own, such as added jobs and tax revenues to the local economy.

21 To be very clear, with these comments I am not asserting - - and it is not
22 FIPUG's position - - that Vandolah, or any other alternative (including the UPS
23 proposals), should be chosen at this time and based on this record. My point is

1 that until all of the alternatives available in the market have been fully identified
2 and explored, there is no way of determining whether the benefits claimed for the
3 proposed UPS contracts are superior to other alternatives. There is time to
4 conduct such a comparison, and, given the size and nature of the need for
5 capacity and energy, as well as the number of significant unknowns regarding
6 the proposed UPS arrangements, there are compelling reasons to do so.

7

8

9 **Q. DID PROGRESS ENERGY OR FPL CONTACT VANDOLAH POWER**
10 **COMPANY LLC REGARDING A NEED FOR POWER IN THE 2010 – 2015**
11 **TIME FRAME?**

12 A. No.

13

14

15 **Q. DOES VANDOLAH POWER COMPANY LLC OWN ANY GENERATING**
16 **CAPACITY THAT WOULD BE AVAILABLE FOR SALE IN THE 2010 – 2015**
17 **TIME FRAME?**

18 A. Yes. The capacity of the Vandolah project is currently subscribed until
19 2012. Absent a change in Vandolah's current commercial arrangements, it will
20 be available for sale in the wholesale market thereafter.

21

1 Q. WOULD VANDOLAH POWER COMPANY LLC BE INTERESTED IN
2 PRESENTING A PROPOSAL TO PROGRESS ENERGY AND/OR FPL IF
3 GIVEN THE OPPORTUNITY?

4 A. Yes. We are in the business of seeking and responding to all such
5 opportunities to market our power.

6
7

8 Q. DO YOU THINK THE FACT THAT VANDOLAH IS CURRENTLY
9 COMMITTED THROUGH PART OF 2012 WOULD PRECLUDE VANDOLAH
10 POWER COMPANY LLC FROM BEING A CANDIDATE?

11 A. Not necessarily.

12
13

14 Q. PLEASE EXPLAIN.

15 A. Conceptually, it is possible for a utility to structure short-term
16 arrangements at the outset of the period in order to avail itself of a wholesale
17 source that is available later in the period. Further, earlier I added the caveat that
18 Vandolah's capacity is subscribed until 2012 unless the commercial
19 arrangements change. A competitive opportunity could also lead Vandolah to
20 consider converting a portion of its capacity to a combined cycle configuration for
21 the purpose of a proposal. Using Vandolah as an illustration, these are some
22 examples of the different dynamics that potentially could be brought to bear in a
23 way that would benefit ratepayers if the utilities were to engage in thorough,

1 competitive processes prior to committing to arrangements to meet the 2010-
2 2015 need.

3
4

5 **Q. WOULD YOU SUMMARIZE YOUR RECOMMENDATIONS?**

6 A. Collectively, Progress Energy and FPL propose to enter UPS contracts
7 totaling approximately 1400 megawatts six years before the power is needed,
8 without first soliciting or evaluating alternative proposals and without knowing all
9 of the costs associated with the proposed UPS arrangements.

10 If one has any faith in the proposition that competition benefits ratepayers,
11 one must believe that competition for large blocks of capacity and energy would
12 benefit ratepayers more. Further, large, discrete increments of capacity - 955
13 megawatts in the case of FPL and 425 megawatts for Progress Energy - lend
14 themselves to effective competitive processes. These situations are precisely the
15 type in which the opportunity to apply market forces to reduce costs should be
16 maximized, not avoided.

17 Finally, while FPL and Progress Energy make some quantitative claims in
18 support of their request, neither supports its claims with assumptions or
19 information that would be necessary to evaluate those claims. More time than is
20 available in the compressed hearing scheduling in this docket would be needed
21 to obtain and analyze the needed information. There is no requirement to make
22 a decision on the proposed, multi-year UPS agreements within the confines of
23 the proceeding on the annual cost recovery factors that the Commission must

1 authorize prior to the beginning of the coming calendar year. I recommend that
2 the Commission defer a decision on the proposed UPS contracts and order FPL
3 and Progress Energy to explore and evaluate alternatives available in the
4 wholesale market before determining the best means of addressing their 2010
5 needs.

6

7

8 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 A. Yes.

CERTIFICATE OF SERVICE

I **HEREBY CERTIFY** that a true and correct copy of the foregoing Direct Testimony of Kerrick Knauth on behalf of Florida Industrial Power Users Group has been provided by (*) hand delivery and U.S. Mail, this 4th day of October, 2004, to the following:

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