

**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 060001-EI
CONTINUING SURVEILLANCE AND REVIEW OF
FUEL COST RECOVERY CLAUSES OF ELECTRIC UTILITIES
DIRECT TESTIMONY
OF
ROBERT J. CAMFIELD
ON BEHALF OF
FLORIDA PUBLIC UTILITIES COMPANY**

1 Q. PLEASE STATE YOUR NAME, ADDRESS.

2 A. My name is Robert J. Camfield, and my business address is 4610 University
3 Avenue, Madison, Wisconsin 53705.

4

5 Q. WITH WHOM ARE YOU EMPLOYED AND WHAT IS YOUR
6 POSITION?

7 A. I am employed with Christensen Associates Energy Consulting, LLC, where I
8 serve in the position of Vice President.

9

10 Q. WOULD YOU BRIEFLY DESCRIBE YOUR BACKGROUND AND
11 PROFESSIONAL EXPERIENCE?

12 A. Yes. I joined the Michigan Public Service Commission in 1976 as a staff
13 economist. During my tenure with the Michigan Commission, I was involved
14 in several retail electricity and natural gas pricing issues, and I testified in rate

1 case proceedings regarding cost of capital and retail gas tariff design. I joined
2 the New Hampshire Public Service Commission in 1979 as the senior
3 economist, and held the position of chief economist beginning in 1981. As
4 Chief Economist, I was responsible for the administration of the economics
5 department of the Commission staff. I oversaw the analysis of regulatory
6 issues, the coordination and guidance of staff participation in regulatory
7 proceedings, the preparation and development of testimony, and I provided
8 policy advice to the Commission on a variety of issues such as construction
9 work in progress, financial planning, and the determination of PURPA Section
10 133 rates. I joined Southern Company in 1983, and held positions in several
11 departments including Pricing and Economic Analysis at Georgia Power
12 Company, Costing Analysis of Southern Company Services, and Southern
13 Company's Strategic Planning Group. In 1994, I joined Laurits R. Christensen
14 Associates, Inc. ("Christensen Associates") as a senior economist, and currently
15 hold the position of Vice President with Christensen Associates Energy
16 Consulting LLC., a subsidiary consulting group of Christensen Associates.

17 My experience covers a gamut of issues facing regulated industries. I have been
18 involved in the negotiation of power supply contracts and the terms of franchise
19 licenses. My overseas assignments are several, and I have managed a large
20 market restructuring project in Central Europe. I have served on national and
21 regional advisory panels, and I have advised integrated electric utilities,
22 independent power producers, transmission and distribution companies, utility
23 associations, offices of consumer advocate, and regulatory agencies on

1 numerous policy and technical issues. Innovations include two-part tariffs for
2 transmission services, web-based self-designing retail electric products,
3 marginal cost-based cost-of-service methods, and principles for efficient pricing
4 of distribution services. I have published chapters in technical books, reports,
5 and articles in noted journals such as *The Electricity Journal*, *IEEE*
6 *Transactions on Power Systems*, and *CIGRE*. Currently, I serve as Program
7 Director of the Edison Electric Institute's Market Design and Transmission
8 Pricing School.

9
10 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY**
11 **PROCEEDINGS?**

12 A. I have represented regulatory staff organizations, consumer advocates,
13 independent generation companies, distribution companies, transmission
14 companies, integrated utilities, and utility associations in proceedings before a
15 number of regulatory agencies regarding a host of issues including cost of
16 capital, performance assessment and benchmarking, electricity forecasting,
17 retail rates, cost-of-service allocation, generation expansion planning, and
18 transmission issues.

19
20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. For the consideration of the Florida Public Service Commission, the testimony
22 reviews Florida Public Utilities Company's ("FPUC" or "Company") long-term

1 arrangements for wholesale power supply beginning in 2007 and extending
2 through 2017. These contractual arrangements are new, and succeed FPUC's
3 current power supply agreements. The testimony discusses the wholesale
4 market context and situation of FPUC particularly as regards to transmission
5 services, FPUC's procurement process, and the results of that process including
6 the implications for retail electricity consumers.

7
8 The process of power procurement for Florida Public Utilities Company has
9 proved to be unusually arduous for service for the Northeast Division. The
10 electrical flow constraints attending the Georgia-Florida Interface facilities,
11 when coupled with key interpretations of market rules regarding transmission
12 access, severely limit Florida Public Utilities Company's options for power
13 supply from the regional pool of relatively plentiful generation resources
14 situated to the north of the Florida Peninsula. As a consequence, the Company
15 is unable to take delivery of power supply from the selected and winning bidder
16 to its 2005 Request for Proposal (RFP) process for service to the Northeast
17 Division. Transmission service limitations thus constitute a serious
18 complication, and have forced the Company to engage in a cost-based supply
19 arrangement with the incumbent supplier to the Northeast Division.

20 Fortunately, the commercial terms of the Company's new contract for service
21 beginning in 2007 with its incumbent supplier are favorable and generally
22 comparable to the offer prices obtained through the competitive solicitation
23 process initiated through the Company's 2005 RFP.

1 **Q. COULD YOU DESCRIBE THE ELECTRIC SERVICE TERRITORY OF**
2 **FLORIDA PUBLIC UTILITIES COMPANY?**

3 A. Florida Public Utilities Company is a small diversified distribution utility
4 providing electricity, natural gas, and propane services in the State of Florida.
5 The Company's electric operations consist of two divisions in northern Florida,
6 referred to as the Northeast and Northwest Divisions. These two divisions
7 provide bundled retail services to residential, commercial, and industrial
8 consumers in two non-contiguous service territories. During 2005, the
9 Northeast Division, also known as Fernandina Beach, served 15,099 customers
10 with gross electricity sales of 495,370 MWh, while the Northwest Division, also
11 known as Marianna, served 15,147 customers with gross electricity sales of
12 356,704 MWh. The Northeast Division is interconnected with the JEA
13 (previously referred to as Jacksonville Electric Authority) transmission network
14 at one delivery point with 150 MVA of transformer capability and 138 kV
15 primary feeders. The Northwest Division interconnects with Southern
16 Company's (Gulf Power Company) transmission network at six delivery points
17 with a total of 130 MVA of capability and 12.5 kV primary feeders.

18
19 **Q. DOES FPUC GENERATE ANY OF THE POWER WHICH IT SELLS TO**
20 **RETAIL CUSTOMERS IN THESE TWO SERVICE DIVISIONS?**

21 A. No. The Company is a distribution utility, and purchases all generation and
22 transmission services from regional wholesale service providers.

1 **Q. WHAT ARE THE COMPANY'S CURRENT ARRANGEMENTS FOR**
2 **POWER SUPPLY AND PLANS FOR THE FUTURE?**

3 A. The Company purchases bundled generation and transmission services under
4 long-term supply contracts that date from 1997 and are scheduled to expire on
5 December 31 of 2007. More specifically, the Company's Northeast Division is
6 served by the JEA, and the Northwest Division is served by Gulf Power
7 Company, where both contracts provide full requirements services including
8 energy and reserve services, and also cover transmission services. As a
9 consequence of the current contractual arrangements nearing expiration, the
10 Company is in the process of finalizing contracts for power supply for both
11 electric divisions over the ensuing years.

12
13 **Q. WHAT ARE THE POWER PROCUREMENT OBJECTIVES OF**
14 **FLORIDA PUBLIC UTILITIES COMPANY?**

15 A. The Company's power supply objectives align with the Company's
16 longstanding goal of providing, over the long term, high quality service at the
17 favorable prices to its retail customers. Stated more explicitly, the Company's
18 underlying power procurement objectives are to obtain long-term power supply
19 at favorable terms and prices, while assuming an acceptable level of risk. To
20 this end and as I have documented elsewhere before this Commission, Florida
21 Public Utilities Company is currently a low-priced service provider within the
22 region, with very favorable retail electricity prices. The Company's costs of
23 generation and transmission services, as provided under the Company's current

1 wholesale supply contracts, are very low with reference to wholesale power
2 prices within the region. In addition, the Company provides comparatively low-
3 cost distribution services and, although of small scale, the Company has
4 realized substantial gains in productivity in distribution services over recent
5 years.

6
7 **Q. WHAT POWER PROCUREMENT STRATEGIES DID THE COMPANY**
8 **PURSUE FOR POWER SUPPLY BEYOND 2007?**

9 A. In view of the pending expiration of the Company's current supply contracts,
10 Florida Public Utilities Company engaged in a deliberate process that began by
11 exploring alternative procurement approaches. The Company then initiated an
12 open solicitation for power supply, referred to as a Request for Proposal, during
13 2005. Specifically, the Company released a formal *Request for Proposals to*
14 *Provide Wholesale Power Supply* on April 21, 2005 ("2005 RFP").

15
16 An open solicitation for supply is one of several procurement formats that are
17 potentially available to the Company. Alternative formats were initially
18 explored by the Company including sequential short-term purchases that could
19 involve contract laddering, as well as self-supply where FPUC owns and
20 operates generation resources. Because power generation resources are sizable
21 facilities involving large investment in specialized capital, self-supply would
22 likely involve a jointly owned facility. In addition, the Company could engage
23 in several forms of bilateral contracts including, for example, a tolling

1 agreement with a power generation entity where the Company would purchase
2 primary fuels that would then be transformed to electricity and transmitted to
3 the Company's designated delivery points (points of withdrawal of power from
4 transmission networks). The contractual arrangements for power supply under a
5 tolling agreement would involve three separate contracts covering primary fuel
6 inputs, power transformation, and transmission services.

7
8 The solicitation of power supply by others can be approached in a variety of
9 ways, and several formats are possible. As mentioned, FPUC currently takes
10 power under two bundled power supply contracts covering full requirements
11 generation services (energy and reserves) and transmission services.

12 Alternative solicitation formats include the two general categories of sealed bid
13 and auction procedures. In the case of a so-called sealed bid solicitation, the
14 solicitation—which can be as simple as a one- to two-page letter requesting
15 power services or a formal RFP that is highly specific as regards to information
16 requirements, process including pre-qualifying, engagement rules, and
17 timetable—can involve a limited number of pre-identified potential suppliers, or
18 can be an open invitation seeking offers from interested parties.

19
20 Auctions for electric power supply first appeared, at least in recent years, within
21 the unbundled wholesale markets of California (CAISO), PJM, and New York
22 (NYISO). Auctions are, literally, markets that operate under highly specific
23 rules. For electricity, auctions can be organized as short-term sequential or

1 simultaneous market procedures involving related services such as energy and
2 reserves which are provided over same-day and day-ahead timeframes. These
3 short-term auctions can include pay-as-bid and uniform-price auction formats.
4 Because these auctions are repeated with high levels of frequency, they are
5 organized electronically as a matter of necessity. Long-term auctions for
6 standard offer service (“SOS”) have recently been organized in the Eastern and
7 the Midwest regions of the U.S. (e.g., New Jersey, Maryland, Ohio, and
8 Illinois). In these auctions, pre-qualified candidate bidders provide offers to
9 serve load shape shares. A type of auction recently implemented in wholesale
10 electricity markets is referred to as a declining clock auction, where the market
11 price follows a schedule of pre-defined decrement steps at periodic intervals
12 (rounds) over the course of the auction. Electricity auctions usually cover very
13 large loads, enjoy wide participation by many candidate suppliers, and can
14 involve numerous auction rounds (i.e., 50 iterations or more).

15
16 **Q. PLEASE DESCRIBE THE COMPANY’S APPROACH AND POWER**
17 **PROCUREMENT FORMAT?**

18 Of the various alternative procurement formats that are potentially available, the
19 Company settled on the open solicitation format, where bidders are free to
20 propose a variety of service arrangements and terms. The open solicitation
21 format, manifest as the 2005 RFP, was designed in a manner to facilitate
22 participation in order to increase the level of contestability and supply options
23 available to the Company.

1 **Q. DID THE POWER PROCUREMENT STRATEGY OF THE COMPANY**
2 **CONSIDER DIVERSIFICATION OF CONTRACTS?**

3 A. Yes. The Company's 2005 RFP provided bidders with options to submit offer
4 packages with multiple offers covering full requirements, partial requirements,
5 and energy only services. Energy offers could be submitted for a variety of
6 timeframes such as, for example, specific hours of weekdays of defined seasons
7 for individual years. The Company sought offers for a five-year term, although
8 offers of shorter duration would also have been considered. In addition, the
9 Company's 2005 RFP requested ten-year offers as options. Finally, the 2005
10 RFP provided bidders with considerable flexibility regarding the proposed
11 commercial terms; bidders could submit offers with fixed charges, demand
12 charges, energy charges, or energy charges indexed to primary fuel prices and
13 wholesale electricity prices.

14
15 The approach taken, the open solicitation format, provides two main
16 advantages. First, multiple offers covering a variety of forms provide a basis
17 for the Company to potentially build a portfolio of supply including laddered
18 contracts to hedge risks. Second, by allowing for a broad range of potential
19 services and structure of terms, the 2005 RFP design to the extent possible held
20 to a minimum the level of constraints and impediments to participation by
21 serious, potential bidders. As a result, participation by bidders, at least
22 conceptually, is enhanced thus increasing the potential level of competition and
23 contestability, all in the interest of obtaining the lowest possible prices.

1 **Q. WOULD YOU DESCRIBE THE IMPLEMENTATION OF THE**
2 **PROCUREMENT PROCESS?**

3 A. The Company's 2005 procurement process began with the identification of
4 power suppliers and power marketing entities operating within the Southeast
5 and Midwest regions. Selected potential suppliers situated toward the west
6 were also identified. Potential suppliers were then surveyed in order to gauge
7 their interest in taking receipt of the Company's formal RFP. The 2005 RFP
8 was released on April 21 to suppliers that expressed interest in participation.
9 The RFP explicitly defines several procedural steps, and the necessary
10 information and data to be included in the offer packages submitted by bidders.

11
12 **Q. CAN YOU BRIEFLY DISCUSS THE POWER SUPPLY SERVICES**
13 **ASSOCIATED WITH THE RFP?**

14 A. Yes. As a result of the unbundling of wholesale markets into separable
15 transmission and generation services beginning in 1996, the Company's 2005
16 RFP process involves generation services including energy and certain ancillary
17 services. Bidders were free to offer various bundles of services within offer
18 packages. The implication is that, for example, a selected bidder could provide
19 a service bundle including energy and load following service, such that the
20 Company would be required to self-supply or contract for transmission and
21 other ancillary services not covered under the bundle provided by the energy
22 service provider (winning bidder).

1 Transmission services would be provided under separate contracts between the
2 selected generation service provider (on behalf of the Company) and the
3 relevant control areas, or between the Company and the control areas directly.

4
5 **Q. BRIEFLY REVIEW THE DATA AND INFORMATION INCLUDED IN**
6 **THE OFFER PACKAGES OF BIDDERS RESPONDING TO FPUC'S**
7 **RFP FOR POWER SUPPLY.**

8 A. In addition to the commercial terms and defined services, several information
9 items were requested to be included in offer packages submitted by bidders.
10 First, bidders were requested to provide a summary statement or business
11 overview with a focus on the bidder's activities in wholesale markets and the
12 generation technologies available to them. A business overview provides a
13 means to gauge the full range and extent of the business activities of bidders, as
14 bidders are often subsidiary organizations within the diversified business
15 activities of very large firms—for example, a commodity group of an
16 investment banking firm, a merchant supply business unit of an independent
17 power producer, or an energy company involved in oil and gas exploration.
18 Where relevant, bidders were requested to list their wholesale market
19 certification.

20
21 The RFP requested bidders to provide statements of financial condition and
22 credit worthiness and identified financial surety in the form of letters of credit.

1 The 2005 RFP also imposed non-disclosure obligations on bidders including
2 confidentiality agreements and signed submission agreements.

3

4 **Q. PLEASE DESCRIBE THE RFP PROCESS.**

5 A. The RFP identified specific procedural steps with an accompanying schedule, as
6 follows. First, *Response Window for Inquiries and Questions* (April 22 – May
7 16) provided candidate bidders with the opportunity to obtain additional
8 information to assist them in deciding whether to prepare an offer package and
9 in the preparation of such packages. Responses to questions were circulated to
10 all candidate bidders. Bidders were requested to indicate their *Intent to Submit*
11 *Offer Packages* on May 17, and *Offer Packages Were Due* on June 2. The
12 Company conducted an *Initial Screen of Offers* and provided *Notice of Status* to
13 bidders on June 22. Specifically, offer packages of bidders were reviewed for
14 completeness and conformance with the delineated information requested
15 within the 2005 RFP. Bidders were advised of non-conforming conditions of
16 offer packages, and were provided one week to correct or provide additional
17 information as identified. Under the original schedule of the 2005 RFP process,
18 the Company then conducted an initial assessment of offer packages, identified
19 qualifying bids, and noticed qualifying bidders by July 29 of their status. The
20 Company then proceeded to interview qualifying bidders during early
21 September 2005.

1 **Q. HOW WERE BIDS SOLICITED AND HOW MANY RESPONSES**
2 **WERE OBTAINED?**

3 A. The Company contacted numerous potential suppliers, and thirty-five entities
4 expressed interest in taking receipt of the 2005 RFP. Nine entities provided
5 Letters of Intent to submit offer packages following the release of the RFP.
6 Seven offer packages were submitted.

7
8 **Q. WITH RESPECT TO THE SUBMISSIONS RECEIVED, WERE THE**
9 **OFFERS BY BIDDERS TO SERVE ONE OR BOTH DIVISIONS?**

10 A. Three bidders provided offers to serve either or both electric divisions of the
11 Company. Other offer packages focused on one of the two divisions.

12
13 **Q. OF THE OFFER PACKAGES RECEIVED, WERE ANY PACKAGES**
14 **SUBMITTED BY ENTITIES AFFILIATED WITH FPUC?**

15 A. No entities providing offer packages, or for that matter participating in the RFP
16 process, are affiliated with FPUC in any way.

17
18 **Q. ONCE THE RESPONSES WERE RECEIVED AND QUALIFIED**
19 **BIDDERS IDENTIFIED, WHAT WERE THE NEXT STEPS?**

20 A. At the time that the RFP was released, the schedule would have placed the
21 Company in the position of selecting bidders during August and subsequently
22 negotiating contracts during the September-October timeframe. However, the
23 overall level of participation was greater than anticipated, and several viable

1 bidders for both the Northeast and the Northwest Divisions were identified.

2 Also, it became evident that, at least potentially, the Company could induce
3 lower prices through an auction-style market procedure. Thus, the Company's
4 2005 RFP concluded with a quasi-auction involving three rounds, where bidders
5 were invited to provide revisions to the price terms of offers. The relative
6 standings of the offers of bidders were noticed to bidders following the first and
7 second rounds.

8
9 **Q. WHAT FACTORS WERE INCLUDED IN THE EVALUATION?**

10 A. The criteria for evaluation of offers of bidders, as stated within the Company's
11 2005 RFP, included overall price level, counterparty risk, environmental quality
12 of the underlying resources used to provide services, and delivery risks. To the
13 extent possible, the analyses involve quantitative assessment and utilize multi-
14 criteria analysis methods. Particular attention was given to the implied level of
15 price risks, as some of the terms of the offer packages of bidders contained
16 variable price terms. In fact, one specific offer package with highly favorable
17 terms stated on an expected value basis, would involve a contract for differences
18 with a major financial institution in order to hedge much of the inherent price
19 risk associated with the commercial terms of the offer, should the offer be
20 selected.

1 **Q. HOW WAS THE EVALUATION CONDUCTED?**

2 A. The evaluation was conducted independent of the Company by Christensen
3 Associates Energy Consulting, and the results of the evaluation were presented
4 to the Company as an outside study result. The evaluation included unit-
5 specific and total bills criteria, where the commercial (price) terms are
6 converted to an equivalent price basis, stated as net present value over the term
7 of the potential contract.

8
9 An evaluation of the final terms of the offers, as obtained during the third round,
10 was conducted during late 2005. The evaluation of terms, when combined with
11 the assessment of non-price factors, provided the basis for the recommendations
12 provided to the Company. The Company selected the winning bidder and
13 bidders were advised of the outcome during late January 2006.

14

15 **Q. PLEASE IDENTIFY THE SERVICE PROVIDERS SELECTED**
16 **THROUGH THE 2005 RFP PROCESS.**

17 A. Through the 2005 RFP process, the Company selected Southern Company as its
18 prospective service provider, including Southern Power Company (“Southern
19 Power”) to serve the Northeast Division over the 2008 – 2017 period, and Gulf
20 Power Company to serve the Northwest Division from 2008 through 2012.

1 **Q. IS IT YOUR PROFESSIONAL VIEW, THAT AS A RESULT OF THE**
2 **2005 RFP PROCESS, THE SELECTION OF SOUTHERN COMPANY**
3 **TO SERVE BOTH THE NORTHEAST AND NORTHWEST DIVISIONS**
4 **WOULD BE IN THE BEST INTEREST OF RETAIL CUSTOMERS.**

5 A. Yes, given the offer packages and potential suppliers available to the Company
6 through the 2005 RFP process, and providing that a satisfactory resolution to
7 the transmission delivery issue with respect to the Northeast Division could be
8 reached. As I will discuss, the Company encountered and continues to
9 encounter technical and institutional obstacles that, as a practical matter,
10 preclude the delivery of service by Southern Power for the Northeast Division.

11

12 Southern Company is a well recognized, established electricity service provider
13 with attending low levels of counterparty risks. Through conservative resource
14 management and a focus on the markets that it serves, Southern Company
15 provides very high levels of customer satisfaction to electricity consumers
16 through high service quality and innovative products at favorable prices. These
17 attributes were tested over the course of the Company's 2005 RFP.

1 Q. AT THE OUTSET OF YOUR TESTIMONY, YOU MENTION THE
2 LIMITATIONS OF TRANSMISSION CAPABILITY, AND THE
3 COMPLICATIONS THAT TRANSMISSION HAS PRESENTED FOR
4 POWER DELIVERY TO THE COMPANY'S NORTHEAST DIVISION.
5 PLEASE ELABORATE.

6 A. In the case of the Company's Northwest Division, the Company is recognized
7 as an entity serving native loads and is thus entitled, as a matter of the market
8 rules regarding transmission access rights, to Network Integration Transmission
9 Service. Essentially, the Company over many years has drawn upon system-
10 wide generation resources situated at various locations across the network.
11 Because of its longstanding status as native load, the Company is entitled to
12 continued access to the network transmission resources of its service provider,
13 Southern Company (Gulf Power Company). For its new contract with Gulf
14 Power for generation services, the Company *rolls over* (continues) the
15 transmission service provided under the current agreement with Gulf Power.
16 Going forward, however, the Company assumes the position of a direct
17 transmission customer of Southern Company and, under the transmission
18 service agreement with Southern Company, will pay transmission charges
19 monthly, where the level of those charges are set by the Federal Energy
20 Regulatory Commission (FERC).

21
22 The Company's Northeast Division resides within the JEA control area. The
23 initial selection of Southern Power for service for the Northeast Division

1 involved two control areas, JEA and Georgia Transmission Company (“GTC”).
2 The implementation of a power contract between the Company and Southern
3 Power—or other bidders with generation resources situated north of Florida—
4 implied pancaked transmission charges for the transmission services provided
5 by JEA and GTC (on behalf of members), *if* the Company were to schedule
6 power delivery from Southern Power’s resources in the north across the
7 Georgia-Florida Interface to the delivery point for the Northeast Division. The
8 scheduling of firm power across the interface involves a key issue: the
9 Company’s transmission access rights, as native load, where the designated
10 resources have changed from the generation plants within the JEA control area
11 to generators within the Southern Company/GTC territory and under the control
12 of Southern Power.

13
14 At the outset, the Company’s status regarding transmission service for the
15 Northeast Division was unclear, and thus the Company engaged in two
16 alternative transmission strategies in support of potential contracts with bidders
17 to the north. First, the Company pursued transmission service with JEA/GTC
18 involving network flows over the George-Florida interface. Second, the
19 Company pursued the development of a radial transmission service line that
20 would interconnect the Northeast Division with the Southern Company/GTC
21 control area. This second alternative removes the Northeast Division from the
22 FRCC region and the JEA control area such that, prospectively, the Company’s
23 generation supply and resource options are benchmarked to the sharply lower

1 wholesale electricity market prices within the Southeast region, with respect to
2 wholesale prices in the Florida Peninsula.

3
4 **Q. WHERE ARE MATTERS CURRENTLY AND WHAT ARE THE**
5 **RESULTS OF THE PROCUREMENT PROCESS?**

6 A. At this point, it appears that the Company may not obtain transmission access
7 rights with the designation of redirected resources. The Company and its legal
8 team are reviewing this situation currently. Further exploration of the second
9 transmission alternative, the radial interconnection to SERC, requires additional
10 power flow analysis—initial studies were sponsored by Southern Power
11 Company and carried out by Southern Company Services—an engineering
12 assessment, facility siting and permitting, arrangements for facility financing,
13 and construction.

14
15 Both transmission alternatives involve considerable expenditure of resources
16 and time and, in view of the upcoming 2007 expiration of the current contract
17 and precisely because of transmission limits, the Company is forestalled from
18 implementing a power supply agreement with Southern Power for service for
19 the Northeast. In addition, the expiration of the current contracts and the power
20 procurement process are taking place within an unusually difficult and
21 challenging timeframe. Currently, primary fuel supplies at the national level are
22 unusually tight, a direct consequence of high worldwide demands for fuels and
23 fairly high levels of uncertainty in several dimensions including random

1 weather-induced supply disruptions (e.g., natural gas, oil, and Powder River
2 Basin coal supplies). Accordingly, wholesale electric prices reside at fairly high
3 levels and remain sensitive to unplanned events.

4
5 Together, these factors caused the Company to pursue additional supply options
6 within the Florida Peninsula for the Northeast Division. These discussions
7 developed outside of the 2005 RFP process, and involved expressions of interest
8 as well as in-depth negotiations of two options with JEA, the incumbent
9 supplier. Indeed, the new arrangement with JEA is a long-term power supply
10 contract for service for the Northeast Division beginning January of 2007 and
11 ending in December 2017.

12
13 As a result of the enormous gap (with corresponding economic losses for JEA)
14 between the commercial terms of the Company's current power supply contract
15 with JEA (about \$31/MWh including transmission service, ancillary services,
16 and reserve services), and contemporary regional wholesale electricity prices
17 (\$87/MWh since June 2005 and \$72/MWh since January 2006 absent
18 transmission, ancillary services, or reserves), JEA offers the embedded cost-
19 based service option with a start date of January 1, 2007 only.

20
21 With the exception of voltage control and reactive power, the services provided
22 under the new contract with JEA include energy and the full complement of

1 ancillary services, as defined by the Open Access Tariff (OATT) first
2 established by Order 888 of the FERC.

3
4 **Q. FOR THE NORTHEAST DIVISION, WHAT ARE THE TERMS OF THE**
5 **POWER SUPPLY CONTRACT WITH JEA?**

6 A. As mentioned, the commercial terms of the new contract are based upon JEA's
7 embedded costs of generation resources. The commercial terms include three
8 elements: a non-fuel energy charge (\$/MWh), a fuel charge (\$/MWh), and a
9 demand charge (\$/kW-month). The non-fuel price terms will be based on the
10 results of prospective cost of service allocation studies. The fuel charge of the
11 new contract is set at a price equal to the fuel charge within JEA's retail tariff.
12 All price terms vary periodically over the course of the contract term, and are
13 subject to the review and approval of the JEA Board.

14
15 The Company will engage in a separate transmission service agreement with
16 JEA for Network Integration Transmission Service (NITS). JEA's transmission
17 tariff largely follows the OATT established by the FERC, and the invoice
18 amounts for transmission services are based on \$/kW-month charges. Demands
19 are measured on an annual coincident peak load basis.

1 **Q. FOR THE NORTHEAST DIVISION, HOW DO THE NEW CONTRACT**
2 **PRICES COMPARE TO THE PRICES RESULTING FROM THE RFP**
3 **PROCESS?**

4 The expected all-in prices for power supply are \$45.16, \$59.47, and \$73.17 for
5 2007, 2008, and 2009, respectively. These prices include transmission charges
6 of \$3.17, stated on a \$/MWh basis, for 2008 and 2009. For purposes of
7 comparison, it is useful to gauge the new contract prices with reference to the
8 average of the 2008 and 2009 offer prices resulting from the Company's 2005
9 RFP process. Specifically, the offer prices average \$79.94/MWh for these years
10 including transmission charges, although the final offer price of the winning
11 bidder selected by the Company is somewhat below this near-\$80/MWh price
12 level. Thus, the price level of the new JEA contract is favorably positioned
13 when viewed from the perspective of long-term wholesale prices, where the
14 2005 RFP serves to provide a benchmark for the costs of long-term supply.
15 Market context is important, and the low levels of market liquidity for the
16 Florida region limit the long-term supply options available to the Company.

17
18 In addition to the embedded cost-based 10-year contract option, the Company
19 also negotiated a 2-year incremental-cost based option with JEA. The all-in
20 prices of this second option, stated with the inclusion of transmission charges,
21 are \$79.79/MWh and \$82.09/MWh for 2008 and 2009, respectively.

1 **Q. WILL CUSTOMERS IN THE NORTHWEST DIVISION EXPERIENCE**
2 **ANY CHANGES IN 2007, AS A RESULT OF THE NEW CONTRACT?**

3 A. No. Retail customers of the Company's Northwest Division will experience no
4 change in the level of customer bills during 2007 as a result of the pending
5 contract with Gulf Power Company. However, the overall contract prices for
6 the Northwest may change slightly as a result of small changes in the price
7 terms of the current contract, and changes in the billing determinants from 2006
8 levels.

9
10 **Q. HOW WILL THE FUEL COSTS PAID BY CUSTOMERS IN THE TWO**
11 **DIVISIONS COMPARE, FOR 2007?**

12 A. Historically, the overall retail price level for the Northeast Division has been
13 below the corresponding prices of the Northwest Division because of the
14 differences in the commercial terms of the power supply contracts for the
15 Northeast and Northwest Divisions. The contract price difference is about
16 \$9/MWh currently. The new power supply contract for the Northeast will bring
17 the overall cost of generation and transmission services for the Northeast
18 Division to a level somewhat above that of the Northwest Division during 2007.

19
20

1 **Q. PLEASE SUMMARIZE THE STATUS OF THE POWER SUPPLY**
2 **CONTRACTS FOR THE NORTHWEST AND NORTHEAST**
3 **DIVISIONS FOR 2007.**

4 A. The pending new contract for power supply for the Northwest Division with
5 Gulf Power Company is under negotiation; the contract will become effective in
6 January 2008 and extend through 2017. The new Northwest Division contract
7 will have no impact on the retail prices of the Company's Northwest Division
8 during 2007, as mentioned above.

9
10 The 10-year embedded cost-based option of the new contract for the Northeast
11 Division is effective January 1, 2007 and will cause retail electricity prices
12 (excluding GSLD1) during 2007 to increase to a level that approaches that of
13 the Northwest Division.

14
15 **Q. IN YOUR PROFESSIONAL OPINION, IS THE COMPANY'S**
16 **SELECTION OF THE EMBEDDED COST-BASED OPTION WITH JEA**
17 **FOR THE NORTHEAST DIVISION THE MOST PRUDENT**
18 **ARRANGMENT FOR RETAIL CUSTOMERS OVER THE SHORT-**
19 **AND LONG-TERM?**

20 A. Yes, when the limits of transmission delivery, low levels of market liquidity,
21 and underlying levels of uncertainty are accounted for, the embedded cost-based
22 contract with JEA, the incumbent supplier, for service for the Northeast

1 Division, is the best long-term least cost power supply option and choice
2 available to the Company and its retail consumers at this time.

3
4 The commercial terms of the new contract with JEA are based on embedded
5 costs and, while the prices will be adjusted from time to time, such prices are
6 likely to demonstrate high levels of stability. The outlook for the overall level
7 of the contract prices are favorable though it is possible that future wholesale
8 electricity prices within the region may be somewhat below (or somewhat
9 above) the terms of the new contract with JEA. JEA is a well known and
10 established municipal electricity service provider. Like Southern Company,
11 JEA has obtained high levels of credit worthiness and provides good service
12 quality. JEA's generation supply mix is well balanced and draws upon a
13 substantial amount of coal-fired resources that utilize petroleum coke fuel
14 supply and fluidized bed technologies, which are complemented by combined
15 cycle gas generators.

16
17 It is perhaps useful to mention that the design features of wholesale electricity
18 markets matter a lot. Alternative market arrangements in the Southeast can
19 potentially realize much higher levels of transparency at all levels that, in turn,
20 can give rise to improved market liquidity, higher levels of exchange, and
21 expanded opportunities for trade. As it is, particularly for Florida, transmission
22 constraints, generation resource limits, and institutional and market design
23 impediments of various dimensions limit power supply options and availability.

1

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

3 **A. Yes, it does.**