

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light.

DOCKET NO. 000824-EI

In re: Review of the retail rates of Florida Power & Light Company.

DOCKET NO. 001148-EI

In re: Review of Tampa Electric Company and impact of its participation in GridFlorida, a Florida Transmission Company, on TECO's retail ratepayers.

DOCKET NO. 010577-EI  
ORDER NO. PSC-01-2489-FOF-EI  
ISSUED: December 20, 2001

The following Commissioners participated in the disposition of this matter:

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ORDER FINDING PROACTIVE FORMATION OF GRIDFLORIDA PRUDENT AND  
REQUIRING THE FILING OF A MODIFIED GRIDFLORIDA PROPOSAL

BY THE COMMISSION:

In December 1999, the Federal Energy Regulatory Commission (FERC) issued Order No. 2000, which required all public utilities that own, operate, or control interstate transmission facilities to file by October 16, 2000, a proposal to participate in a regional transmission organization (RTO). In response to Order No. 2000, Florida Power Corporation (FPC), Florida Power & Light Company (FPL), and Tampa Electric Company (TECO) (collectively, the GridFlorida Companies) developed a Peninsular Florida RTO proposal referred to as GridFlorida. Upon petition by each of the individual GridFlorida Companies, this Commission conducted an expedited proceeding to review the prudence of the formation of and participation in GridFlorida by FPC, FPL, and TECO individually. An evidentiary hearing on these petitions was conducted October 3-5, 2001.

Upon consideration of the evidence produced at hearing, we find that, in light of FERC's Order No. 2000 and its subsequent statements strongly encouraging participation in RTOs, the GridFlorida Companies were prudent in proactively forming GridFlorida. However, as set forth in greater detail below, we believe that certain aspects of GridFlorida are not in the best interests of Florida's retail ratepayers at this time, most particularly the transfer of ownership of transmission assets that would take place under GridFlorida. We also believe GridFlorida should be structured as an independent system operator (ISO). Thus, the GridFlorida Companies shall modify the GridFlorida proposal consistent with the terms of this Order and file the modified proposal with this Commission within 90 days, unless good cause for an extension is shown.

Based on the evidence in the record, we believe that a Peninsular Florida RTO is more appropriate for Florida's utilities and ratepayers than a larger, regional RTO at this time. However, we do not wish to foreclose the option of participation in a larger, regional RTO. Thus, the GridFlorida Companies should continue to participate in discussions and evaluate participation in a larger, regional RTO.

As a policy matter, we support the formation of an RTO to facilitate the development of a competitive wholesale energy market in Florida. In the long term, the efficiencies and benefits identified through our evidentiary hearing should put downward pressure on transmission and wholesale generation rates and, in turn, on retail rates. Accordingly, our decision in this Order is supportive of FERC's clear policy favoring RTO development. Given our responsibilities to regulate retail aspects of transmission, FERC's responsibilities to regulate wholesale aspects of transmission, and GridFlorida's effects on both, we believe that our decision contributes to the collaborative process necessary to ensure development of an RTO that satisfies both Federal and State policy concerns. We intend to work cooperatively with both FERC and the GridFlorida Companies towards this end.

#### I. CASE BACKGROUND

In May 1999, the Federal Energy Regulatory Commission (FERC) issued a Notice of Proposed Rulemaking (NOPR) on Regional Transmission Organizations (RTOs). The scope of this rulemaking was expanded to include not only independent system operators (ISOs), but also other types of regional organizations such as independent transmission companies (transcos), combinations of ISOs and transcos, or other acceptable structures that had not yet been identified. In December 1999, the FERC issued Order No. 2000, which required all public utilities that own, operate, or control interstate transmission facilities to file by October 16, 2000, a proposal to participate in an RTO. Alternatively, utilities that had not finalized an RTO plan were required to make a filing containing: (1) a description of any efforts made by the utility to participate in an RTO; (2) a detailed explanation of the economic, operational, commercial, regulatory, or other reasons the public utility has not made a filing to participate in an RTO, including identification of any existing obstacles to participation in an RTO; and (3) the specific plans, if any, for further work toward participation in an RTO including a proposed timetable for such activity, an explanation of efforts made to include public power entities in the proposed RTO, and any factors (including any law, rule, or regulation) that may affect the public utility's ability or decision to participate in an RTO.

In response to Order No. 2000, Florida Power Corporation (FPC), Florida Power & Light Company (FPL), and Tampa Electric Company (TECO) (collectively referred to as the GridFlorida Companies) sponsored a number of stakeholder meetings to discuss the various aspects of an RTO proposal. On October 16, 2000, after several months of stakeholder meetings, the GridFlorida Companies' proposal was filed at FERC. As there were additional details needed to complete its proposal, the GridFlorida Companies requested and were granted additional time until December 15, 2000, to supplement the filing. On January 10, 2001, the FERC issued its order addressing the governance issues contained in the GridFlorida proposal. The FERC approved the proposed GridFlorida structure, subject to a few minor modifications. On March 28, 2001, the FERC issued an order provisionally approving the GridFlorida proposal. Modifications to the proposal were to be included in a compliance filing with the FERC by May 29, 2001.

On May 11, 2001, FPC, FPL, and TECO filed a joint motion with this Commission to establish a generic docket to determine, on an expedited basis, the prudence of the formation of and their participation in GridFlorida LLC (GridFlorida). By Order No. PSC-01-1372-PCO-EI, issued June 27, 2001, the joint motion was granted in part (with respect to expediting a decision concerning GridFlorida) and denied in part (with respect to establishing a generic docket). The Order directed that FPC and FPL each file, by June 28, 2001, a separate petition in the respective earnings/rate review docket currently open for each utility. TECO was ordered to file its petition in a new docket opened specifically to address its participation in GridFlorida. The Order referred to the proceedings to be held on each petition as "Phase 1". "Phase 2" of the earnings/rate review dockets will address the general rate proceedings initiated by this Commission and the specific ratemaking aspects, including, but not limited to, recovery of costs associated with the formation of and participation in the GridFlorida RTO.

On June 12, 2001, FPC, FPL, and TECO filed separate petitions in these dockets asking the Commission to determine the prudence of the formation of and their participation in GridFlorida, thus initiating the Phase 1 proceedings. By Order No. PSC-01-1485-PCO-EI, issued July 16, 2001, and Order No. PSC-01-1641-PCO-EI, issued August 10, 2001, the issues to be addressed in Phase 1 of each

docket were established. An evidentiary hearing on these dockets was held October 3-5, 2001. The following persons intervened in these dockets: Calpine Corporation; CPV Atlantic, Ltd.; Duke Energy North America; Dynegy Mid-Stream, Limited Partnership and Dynegy, Inc.; Enron Corporation; Mirant Americas Development, Inc.; Reliant Energy Power Generation, Inc.; PG&E National Energy Group; Publix Super Markets, Inc.; Thomas P. and Genevieve E. Twomey, Buddy L. Hansen, Louis D. Putney and Sugarmill Woods Civic Association, Inc.; Walt Disney World Company; Seminole Electric Cooperative; Florida Industrial Power Users Group; and the Office of Public Counsel (OPC).

This Order addresses the issues that were the subject of the October 3-5, 2001 hearing. We have jurisdiction over this subject matter pursuant to Chapter 366, Florida Statutes, including Sections 366.04, 366.05, and 366.06, Florida Statutes.

## II. PRUDENCE OF FORMATION OF GRIDFLORIDA

We find that the GridFlorida Companies were prudent in forming an RTO in response to FERC's Order No. 2000. Although participation in an RTO is voluntary under Order No. 2000, FERC has acknowledged that it may use its regulatory authority in other areas to compel RTO participation. Further, formation of an RTO should provide benefits for Peninsular Florida and its ratepayers, most importantly by facilitating an improved wholesale electricity market, encouraging competition by removing access impediments and restrictions.

### A. PROACTIVE FORMATION OF RTO

Pursuant to FERC Order No. 2000, participation in an RTO is voluntary. However, FERC acknowledged that it may use its regulatory authority in other areas such as market power analyses, market-based rate authority, and merger requests to mandate RTO participation. In addition, the filing requirements of FERC Order 2000 are mandatory.

Witness Naeve asserted that the GridFlorida Companies were prudent in determining that they should form an RTO because FERC would require such participation in the long run. By proactively forming an RTO, witness Naeve asserted, the GridFlorida Companies

avoided forced participation in an RTO in which they would have had no opportunity to be involved in structure and policy decisions.

We agree. It is apparent from the policy stated in Order No. 2000 and FERC's subsequent statements strongly encouraging RTO participation that FERC is resolved to institute RTOs nationwide. Based on our analysis of the potential benefits of an RTO for Peninsular Florida and utility ratepayers, set forth below, and on FERC's resolve to institute RTO's nationwide, we find that the proactive steps taken by the GridFlorida Companies to comply with Order No. 2000 were prudent.

#### B. RTO BENEFITS TO PENINSULAR FLORIDA AND UTILITY RATEPAYERS

In addition to being consistent with FERC policy, participation in an RTO should provide benefits to Peninsular Florida. The parties to this proceeding presented several views regarding the benefits to Peninsular Florida associated with each utility's participation in GridFlorida. The benefits asserted by the parties are predominately qualitative in nature, with some reference to potential quantitative benefits.

According to witness Hoecker, former FERC Chairman, the major driving force of RTO development around the nation during the past several years has been the FERC's desire to enhance competition by opening access to the transmission grid on a national basis. Witness Hoecker testified that FERC believed competitive generation markets would bring tangible benefits to consumers. Witness Hoecker stated that several benefits would result from RTO development: (1) curbing market power; (2) eliminating pancaked rates; (3) more efficient planning on a regional basis; (4) the ability to improve regional reliability through regional operations; (5) improved emergency response; (6) more efficient treatment of loop flows; (7) the creation of market-based real-time balancing and ancillary services markets; and (8) more efficient allocation of transmission capacity.

Witness Mechler testified that RTO formation would result in substantial savings in the cost of generation. He asserted that because the costs of generation are approximately 18 times greater than the total cost of transmission, only a very small reduction in generation cost is needed to outweigh incremental RTO cost.

Witness Mechler testified that these savings will more than offset the incremental cost of establishing and operating the RTO. He also indicated that the extent of these savings will be a function of the level of competition in the wholesale market.

The parties presented very limited evidence concerning benefits in terms of estimated dollars of potential savings. Witness Naeve stated that the benefits cited in FERC's Order 2000 and discussed by witness Hoecker produce positive economic benefits. However, witness Naeve testified that those benefits are very difficult to quantify with enough precision to yield results that are sufficiently reliable to support a decision.

Witness Hernandez offered some testimony regarding the expected time frame in which Florida consumers might realize net benefits from the formation of GridFlorida. He asserted that some savings, such as those resulting from the elimination of pancaked rates, would be realized as soon as GridFlorida becomes operational, while other savings would be realized "as the market progresses." Witness Hernandez testified that he believes GridFlorida benefits will be realized in a "tiered timing" and that the benefits are cumulative.

Witness Hoecker testified that important benefits may be achieved using either a for-profit transco structure or a not-for-profit ISO structure. Witnesses Southwick, Mennes, and Ramon further indicated that a not-for-profit ISO structure could provide all of the same operational, planning, and congestion management benefits that a for-profit transco could provide.

While the GridFlorida Companies have provided little evidence concerning the estimated dollar savings and the timing of any such savings that may be derived from GridFlorida, we agree that the benefits identified by witness Hoecker will most likely materialize under an RTO. Based upon the evidence in the record, we find that the central benefit associated with each utility's participation in an RTO is the facilitation of an improved wholesale electricity market encouraging competition among wholesale generators by removing transmission access impediments and restrictions. Further, the record indicates that an RTO will potentially improve the current Peninsular Florida transmission grid. The record indicates that additional operational efficiencies among utilities

and the consolidation of planning and maintenance can be achieved by participation in GridFlorida. GridFlorida will also eliminate pancaked rates and create a market-based real-time balancing market and ancillary services market. GridFlorida may provide improved regional reliability, more efficient allocation of transmission capacity, improved emergency response, and more efficient treatment of loop flows.

At this time, it is impossible to predict exactly what the new wholesale market will look like or exactly what reductions in power costs might result. Therefore, it is difficult to quantify any benefits that may be achieved from improvements in the wholesale electricity market. However, we believe that the efficiencies and benefits identified above will, in the long-term, put downward pressure on transmission and wholesale generation rates, and, in turn, retail rates, while maintaining or enhancing quality and reliability of service.

#### C. START-UP COSTS ASSOCIATED WITH FORMATION OF GRIDFLORIDA

The GridFlorida Companies estimate GridFlorida's actual start-up costs at \$9 million as of May 31, 2001, with the following allocation: \$5 million to FPL; \$1 million to TECO; \$2 million to FPC; and \$1 million to the wholesale jurisdiction. FPL provided minimal justification for its portion of these amounts, while FPC's and TECO's witnesses indicated that no supporting documentation existed for the amounts attributed to their respective companies. As a result, we were unable to examine any supporting documents or workpapers related to these expenses and are unable to determine whether these estimated expenses are accurate, reasonable, or prudent for the purposes of this proceeding.

Of the GridFlorida Companies, only FPL is maintaining that this Commission should explicitly approve, in this proceeding, recovery of the incremental transmission costs through a recovery clause. FPL asserts that such a finding is necessary in this proceeding in order for it to proceed with RTO development. Witness Dubin admitted that FPL did not evaluate any cost recovery mechanism other than the recovery clauses. Moreover, FPL did not evaluate the impact on its ratepayers of recovery through base rates or a pass-through mechanism.

We find that the appropriate recovery mechanism for costs associated with GridFlorida is best addressed in Phase 2 of these proceedings, after a more in-depth review of the GridFlorida costs and possible recovery mechanisms is made. The record evidence in this Phase 1 proceeding is not sufficient to make a determination of the most appropriate recovery mechanism, whether through base rates, a cost recovery clause, a pass-through clause, or some other mechanism. Because TECO has no Phase 2 proceeding, we will address the appropriate recovery mechanism at the time it seeks recovery of these costs.

Nonetheless, as stated above, we believe that the GridFlorida Companies were prudent to be proactive in the development of an organization that would satisfy FERC Order No. 2000. Thus, we find that the GridFlorida Companies should be afforded recovery, subject to audit, of the approximately \$8 million in actual jurisdictional start-up expenditures incurred through May 1, 2001.

### III. PRUDENCE OF ONGOING PARTICIPATION IN GRIDFLORIDA

Although we have found that the GridFlorida Companies were prudent in proactively forming an RTO that should yield benefits to Peninsular Florida and its ratepayers, we believe that certain aspects of GridFlorida are not in the best interests of Florida's retail ratepayers at this time, most particularly the transfer of ownership of transmission assets that would take place under GridFlorida. We believe that the benefits associated with the transco structure of GridFlorida can be achieved under an ISO structure, in which participants would continue to own their transmission assets while the RTO would have operational control over those assets. Thus, the GridFlorida Companies shall modify the GridFlorida proposal consistent with the terms of this Order and file the modified proposal with this Commission within 90 days of issuance of this Order, unless good cause for an extension is shown.

#### A. TRANSFER OF OWNERSHIP VS. TRANSFER OF OPERATIONAL CONTROL

The GridFlorida Companies propose that GridFlorida be structured as a for-profit transco, although FPC would retain ownership of its transmission assets and transfer only operational control to GridFlorida. TECO has notified the FERC of its intent

to contribute its transmission assets to GridFlorida and asserted that it will make its final decision whether to go forward with that contribution nearer to the operational date of GridFlorida. FPL has also indicated its intention to transfer ownership of transmission facilities to GridFlorida.

The GridFlorida Companies' selection of a transco model as opposed to an ISO is based on their belief that the transco model provides the best incentives for efficient operation because it aligns: (1) the ownership of transmission assets with the operation of those assets; (2) the responsibility of planning for expansion with the responsibility for investing in that expansion; and (3) the responsibility for investing capital and recovery of the capital investment with the responsibility for rate design.

The record indicates that the potential for customer benefits is just as likely under an ISO structure as the transco structure proposed for GridFlorida. Witnesses Southwick, Mennes, and Ramon each indicated that they believe an ISO structure could provide the same operational, planning, and congestion management benefits as a for-profit transco. When asked whether there are any differences in the benefits that could be achieved under the two structures, witness Hoecker testified that there are important benefits to be gained from either organizational structure. Witness Naeve acknowledged that there are some operational ISOs in this country, although none have yet been approved as RTOs under FERC Order No. 2000. Witness Naeve further stated his belief that many such ISOs function very similarly to how an RTO would function and that many people believe they have yielded operational benefits. Both witnesses Naeve and Hoecker expressed their belief that a not-for-profit ISO could be approved by FERC as an RTO. Further, although a FERC-appointed administrative law judge (ALJ) recommended an RTO model for the Southeast United States following the overall form of a transco, the ALJ proposed the formation of an Independent Market Administrator (IMA) who would be responsible for the day-to-day operational authority of the transmission system. An ISO may avoid the need for this apparent shortcoming with respect to independence in the transco structure.

While we appreciate the merits of transferring ownership of transmission assets to GridFlorida, we believe that a more cautious, transitional approach is prudent for Peninsular Florida

at this time. The record indicates that there are uncertainties surrounding the development of a competitive wholesale market in Florida. In addition, the record indicates that there is uncertainty concerning whether Florida's utilities will be compelled to participate in a larger, regional RTO. Although the record of this proceeding supports a Peninsular Florida RTO at this time, we recognize that a larger, regional RTO may ultimately prove to be the most prudent, as discussed below. The record indicates that once FPL and TECO divest their transmission assets to GridFlorida, the GridFlorida proposal makes no provision to allow them to reacquire ownership of those assets.

Uncertainties in Development of a Competitive Wholesale Market in Florida

As stated above, we find that the central benefit associated with each utility's participation in GridFlorida is the facilitation of an environment encouraging competition among wholesale generators by removing access impediments and restrictions. Witness Mechler testified that the extent of the savings to be derived from a more competitive wholesale market depends on the level of competition developed in that market. However, at present, competition in the wholesale market is limited to incumbent generation companies and to a limited class of independent power producers willing to risk building peaking units which are exempt from the Florida Electrical Power Plant Siting Act in the hope that a Florida competitive wholesale market will develop. A Florida RTO will initially do little to foster further competition in wholesale generation markets than exists today. The proposed ancillary services market represents less than two percent of the total energy market in Peninsular Florida. Moreover, while an effective RTO may be necessary to the efficient workings of a competitive wholesale generation market, it alone will not lead to the development of a competitive wholesale generation market.

Further work is needed to establish a statewide competitive wholesale generation market in Florida. Working toward this goal, the Governor has established the Energy 2020 Study Commission to examine Florida's current energy infrastructure and to propose an energy plan and strategy for Florida's future. Recommendations by the Study Commission will be considered by the Florida Legislature.

Accordingly, we believe that it would be premature to allow the divestiture of existing transmission assets in this state. While we do not want to foreclose eventual movement to a transco RTO model, we believe that the adoption of an ISO at this time appears to be a prudent first step in adopting an RTO for Peninsular Florida. An ISO would capture benefits associated with integrated transmission planning, operations, and pricing. An ISO at this time may also make it attractive for Florida's municipal electric utilities and rural electric cooperatives to participate in an RTO (thus potentially increasing GridFlorida's operating control of Florida's transmission from 83% to 100%), because some municipal electric utilities and rural electric cooperatives are currently restricted from selling and transferring assets.

We make no judgment at this time as to whether GridFlorida should be structured as a for-profit or not-for-profit RTO. We do not disagree that the profit motive is a strong incentive to operate efficiently in a competitive environment. However, since any RTO will operate as a regulated monopoly, the incentives provided by competitive forces will be lacking. It is not clear in this instance whether a for-profit RTO is pressured to perform anymore efficiently than a not-for-profit RTO.

We believe that operating efficiency is a major concern for any utility and is a central concern regarding RTOs. For that reason, it is important that in the absence of competitive pressures or profit motive, performance measures and incentives should be developed for the RTO, regardless of structure. The GridFlorida Companies understandably made no attempt in their testimony to identify what, if any, measures could be taken to improve or provide incentive for an ISO. Thus, the record is not sufficiently developed for us to conclude whether a not-for-profit or for-profit RTO is preferable.

In preparing and filing a modified GridFlorida proposal consistent with the provisions of this Order, the GridFlorida Companies shall address and justify in their filing whether the proposed ISO would be a for-profit or not-for-profit entity. The GridFlorida Companies shall also include in their filing any specific performance incentives they wish to incorporate in the modified proposal.

Responsibilities over Retail Aspects of Transmission

Under several provisions of Chapter 366, Florida Statutes, this Commission is charged with the responsibility of establishing fair and reasonable retail rates for Florida's investor-owned electric utilities, which include the GridFlorida Companies. We believe that under the transco model proposed for GridFlorida, it would be difficult for this Commission to retain ratemaking and cost control jurisdiction over the retail component of transmission. In essence, our approval of the transco model could be viewed as a voluntary unbundling, because ownership of transmission assets would be transferred away from the retail-serving utility. However, under an ISO model, where the ownership of transmission assets is retained by the individual retail-serving utilities, we believe this Commission would continue to set the revenue requirements needed to support retail transmission service and retain oversight over cost control and cost recovery. The retail transmission revenue requirement set by this Commission would then be an input into the FERC ratemaking process, to which would be added the appropriate and prudently incurred management and operating costs of the ISO. This view was supported by witness Southwick who indicated that the revenue requirement approved by this Commission for FPC, which would retain ownership of its transmission assets and keep those assets on its books, would be an input into FERC's establishment of a revenue requirement for GridFlorida.

B. GEOGRAPHIC SCOPE OF RTO

On July 12, 2001, FERC issued a series of orders in which it concluded, among other things, that the geographic scope of the RTO filings before it were not sufficient to encompass the natural markets for bulk power that existed in different regions of the country. FERC expressed its opinion that there should be a focus on developing four RTOs nationwide. These four RTOs would encompass the Western, Midwestern, Northeastern and Southeastern regions of the country. With respect to the Southeast, the FERC issued a separate order initiating mediation for the purpose of facilitating the formation of a single RTO for the Southeastern United States. This order required proposers of various RTOs within the Southeast to meet with a FERC appointed administrative law judge (ALJ) presiding over the mediation process. FERC

encouraged, but did not require, GridFlorida to participate in the proceedings.

The mediation began on July 17, 2001. On September 10, 2001, the ALJ released her final report for the Southeast RTO. Her recommendation entails forming a multi-tiered RTO encompassing ten Southern states, including Peninsular Florida. The other states included are Alabama, Arkansas, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. While the ALJ's recommended RTO model follows the overall form of a for-profit transco and incorporates many of the elements of GridFlorida, there are a number of added features. The most significant is the proposed formation of an Independent Market Administrator (IMA) who would be responsible for the day-to-day operational authority of the transmission system.

On September 26, 2001, FERC Chairman Pat Wood issued a memorandum proposing that FERC initiate, under Section 206, rulemaking on market design and market structure, to translate the eight RTO functions in Order No. 2000 into concrete protocols for the RTO organizations. Workshops to begin this process were convened on October 15, 2001. The purpose of these workshops is to focus on core subject areas, such as congestion management, cost recovery, market monitoring, transmission planning, business and reliability standards, nature of transmission rights, etc. It is expected that this Section 206 proceeding will yield a new *pro forma* tariff to replace the Order No. 888 Open Access Transmission Tariff (OATT).

There still remains a high degree of uncertainty associated with a Southeast regional RTO. While the ALJ filed a report at FERC that contained a proposed governance model and recommendations regarding some of the other issues involving a Southeast regional RTO, there still remain numerous issues to be resolved. At this point, it is impossible to determine what the rate impact of participation in a Southeast regional RTO would be on Florida ratepayers, how congestion management would affect Florida, or how a Southeast regional RTO would direct operations in Florida.

The GridFlorida participants contend that they are continuing to actively participate in the Southeast RTO process. Witness Naeve testified that if GridFlorida is to be merged into a

Southeast regional RTO, then it is important to ensure that the two RTOs have compatible structures, market designs, and rates. He further stated that if the rates and market designs are incompatible and the structures of the corporation are different, integration becomes difficult. However, Mr. Naeve goes on to explain that the operation of GridFlorida would be turned over to an independent board, and, once that happens, the participating companies have no control over GridFlorida. Likewise, FERC would require that the Southeast regional RTO also have an independent board. If GridFlorida were to be merged into a Southeast regional RTO, only the independent boards would dictate the terms and conditions under which the RTOs would be combined.

At this time, it does not appear advantageous to the participating utilities and their respective ratepayers to discard the notion of a Peninsular Florida RTO in favor of joining a regional RTO. The benefits are not clear and the possibility that a regional RTO would not adequately recognize and incorporate the unique characteristics of Florida in planning and operating decisions warrants concern. Florida's peninsular geography has motivated its electric utilities to be highly interconnected with each other because the region is considered an "ending point" of the nation's electric transmission grid. Because of our relative isolation from national trading hubs, the Florida electric utility industry has a history of cooperating with each other through the Florida Reliability Coordinating Council (FRCC) to coordinate transmission and maintain reliability. This cooperation is critical because the generation necessary to meet Florida's growing demand must be: (1) built within the state; (2) interconnected to the existing transmission network; and (3) delivered in a reliable manner on the state's internal electric transmission grid. To date, interties with the rest of the nation are relatively few and Peninsular Florida can only import, at a maximum, less than 10 percent of its total peak demand (summer 2001) over the high-voltage transmission system. While we should be ever mindful of opportunities to enhance the capacity and utilization of the state's transmission interface with the rest of the nation, current demographic and economic conditions point to Peninsular Florida as being a natural market region.

We believe that the GridFlorida Companies would be prudent to evaluate participation in a larger Southeast regional RTO, and we

encourage the GridFlorida Companies to continue participation in discussions concerning a Southeast regional RTO. By our Order, we do not wish to foreclose the option of participation in a Southeast regional RTO by Florida's utilities.

C. RELATED MATTERS

In reviewing the GridFlorida proposal, several other matters merit discussion, as set forth below.

1. Demarcation Point for Transmission Facilities

The GridFlorida collaborative effort established the transmission facilities demarcation at 69kV and above. According to the testimony of the Panel, there were four factors considered by the GridFlorida Companies in determining the demarcation point. These factors are: (1) historically, facilities 69kV and above have been considered to be transmission facilities, from a planning/operations and ratemaking perspective; (2) stakeholders in the collaborative process generally expressed the need for open access to all 69kV and above transmission facilities in Florida; (3) classification of radial facilities as distribution instead of transmission would make access to transmission more complicated than it needs to be; and (4) the rate structure proposed for GridFlorida would result in subsidies across utilities if each utility chose a different demarcation point for facilities to turn over to the RTO. The GridFlorida Companies contend that "a uniform demarcation point is a reasonable approach to achieve fairness and equal access to the transmission system of the RTO."

We agree that a uniform demarcation point is necessary to ensure equal access for all participating companies and to ensure that subsidies resulting from different demarcation points do not occur. There is no evidence in the record suggesting that the demarcation point should be something other than 69kV. In addition, this demarcation point has been consistently used by this Commission when determining appropriate cost allocations to distribution, transmission, and generation facilities.

## 2. Independence from Market Participants

We agree that it is in the overall public interest for GridFlorida to be governed by an independent board of directors, as the GridFlorida Companies have proposed. The management of the RTO by an independent board with none of the members having any connections to any of the member companies or any other market participant is a necessary step to (1) dispel any notions of discrimination; (2) ensure that the transmission services provided by the RTO are fair and equitable; and (3) meet the needs of Florida's electric ratepayers in a safe, adequate, reliable, and cost effective manner.

We also concur with the formation of an advisory committee consisting of a broad array of stakeholders. The advisory committee should be authorized to: (1) make presentations to the board at regularly scheduled board meetings on matters that a majority of the representatives of the advisory committee agree are of sufficient importance to merit board attention; (2) prepare and submit written recommendations and reports, at any time, to the board and senior management of the RTO; (3) meet and confer with senior management of the RTO on matters of concern or interest to the advisory committee; and (4) have reasonable and timely access to information concerning the operation of the RTO.

In order to ensure that the management and operation of the RTO is independent, neither the board or the management of the RTO should be obligated to accept the recommendations of the advisory committee. The purpose of forming an advisory committee is to give stakeholders a formal avenue for providing their advice to the board. While the board should give appropriate consideration to this advice, it should not be bound by any specific actions recommended by the advisory committee. Further, we believe that any interaction between the board and the advisory committee should be conducted in full public view with appropriate opportunity for public input.

We also believe that the board should be responsible for justifying its actions to this Commission. As discussed below, GridFlorida will be subject to our jurisdiction under Chapter 366, Florida Statutes. As such, GridFlorida and its management will be held responsible for the prudence of the actions they take that

impact our jurisdiction. One of our principal concerns is that if we approve the formation of GridFlorida, the board should not be able to take unilateral action to change the organizational structure or operation of GridFlorida without this Commission's prior review regarding prudence and public impact.

3. Exclusive Authority for Maintaining Short-Term Reliability of the Grid

We concur with the GridFlorida Companies' proposal for GridFlorida to assume the responsibility of Security Coordinator for Peninsular Florida in order to ensure short-term reliability of the transmission grid. The execution of these responsibilities would be subject to reliability standards set by the Florida Electric Reliability Coordinating Counsel and this Commission's continuing jurisdiction under the Grid Bill.

The GridFlorida Companies indicated that they have taken steps to keep this Commission involved in the planning and reliability processes that GridFlorida will follow. Specifically, the GridFlorida Companies indicated that this Commission will: (1) have access and input into the Stakeholder Advisory Committee; (2) be involved with the regional transmission planning process; (3) be asked to approve an Installed Capacity and Energy (ICE) provision; and (4) continue to exercise its jurisdiction in the siting of transmission lines.

While we generally concur with these inclusions, it should be made clear that the inclusions in no way bind this Commission in the exercise of its jurisdiction. Under those sections of Chapter 366, Florida Statutes, that comprise the Grid Bill, which provides this Commission jurisdiction over, among other things, the planning, development, and maintenance of a coordinated electric power grid throughout Florida, GridFlorida will be an electric utility subject to our jurisdiction. As such, this Commission, as guided by the Florida Legislature, will determine how it will discharge its regulatory responsibilities over a new wholesale provider just as we have for the existing wholesale providers in Florida, such as Seminole Electric Cooperative and the Florida Municipal Power Authority. While we generally agree with the processes that provide for our input into the planning and reliability aspects of GridFlorida, this in no way affects our

ability to regulate GridFlorida in a manner consistent with Florida law.

#### 4. Balanced Schedules

As the name suggests, a balanced schedule is one where a utility commits sufficient resources to meet its projected demand, including reserves, for the next day. A balanced schedule approach limits the amount of spot energy transactions that will occur and therefore limits price volatility. An unbalanced schedule is one where the utility relies upon the spot market for meeting some or all of the projected demand on its system. The GridFlorida Companies have proposed utilizing a balanced schedule approach for the day-ahead market. However, the GridFlorida Companies also acknowledged that GridFlorida could change to an un-balanced market design without any approval from this Commission.

In an effort to transition to a more competitive generation market, any RTO should start with balanced schedules as a foundation. As experience is gained and market participation increases, the RTO can evolve to accommodate such changes. In addition, however, the GridFlorida Companies shall be required to seek this Commission's approval before changing from the proposed balanced schedule approach in order to ensure that retail ratepayers are not adversely affected.

#### 5. Balancing Energy Market

Utilizing market-based approaches for congestion management was encouraged by FERC in Order 2000. Any variations in load or generation availability beyond the balanced schedules create a spot market for energy. A similar spot market for energy occurs when a transmission interconnection becomes overloaded or congested. Both situations can be handled through a market-based mechanism. Originally, the GridFlorida Companies requested that FERC approve a clearing price methodology to determine the balancing/congestion energy price. A clearing price methodology stacks bidders in order of their price bid until the required generation, in megawatts (MW), is achieved. The highest accepted bid becomes the clearing price and is paid to all generators who were selected. A clearing price methodology is one method to self-regulate a market if there are sufficient market participants without market power. Under a

"get what you bid" approach, bidders are selected in order of their price bid until the required generation, in MWs, is achieved. Unlike a clearing price methodology, each generator is paid its bid price, and the buyer of such balancing energy would pay an average price of all bids.

For a clearing price methodology to work properly, the market must include a sufficient number of sellers without market power. FERC realized these shortcomings of the Florida market when it rejected the clearing price method proposed by the GridFlorida Companies. In response to the FERC's concerns, the GridFlorida Companies have proposed two alternatives for the balancing energy/congestion pricing market. Alternative A would utilize a clearing price concept, but limit generators who had cost-based rates to only collect up to their cost-based rate. All other generators would receive the higher clearing price for energy balancing and congestion management. Alternative B would implement a "get what you bid" approach for all generators. Utilities with cost-based rates would be capped at their cost. Under either alternative, the cost for such energy will likely be recovered through one of the existing cost-recovery clauses.

While Alternative A seems to solve the market power issue, it does not address the problem of having too few participants in the market to make a clearing price method valid. In addition, market power will likely re-emerge as market power can arise at any time with little notice. FERC recently approved an amendment to the PJM ISO that would grant authority to the ISO to cap a generator at cost if that generator became a must-run unit and therefore had local market power. The GridFlorida Companies stated that the current proposal did not attempt to address local market power issues, such as must-run units. However, the GridFlorida Companies did ask the FERC to grant a new market monitor company the authority to deal with such issues without any specific recommendations. Utilities that currently have cost-based rates may in fact receive market-based rates for the new "balancing energy service" when such rates are filed for approval with the FERC. In other words, based on a rate yet to be filed, utilities who currently have cost-based rate authority, such as FPL and FPC, could have market-based rates for balancing energy and receive the clearing price, just as they would have under the original proposal.

Alternative B is a simple "get what you bid" approach. Regardless of whether the seller has market or cost-based rates, the bids are prioritized from lowest to highest bid until sufficient energy is committed. Each seller will be paid what was bid, and the buyer pays an average of all the bids. While this approach does not mitigate localized market power issues, it does limit the exposure of the buyer of balancing/congestion energy. In keeping with the step-by-step approach that we are taking in this Order, we think that the "get what you bid" alternative is preferable for all transactions until the GridFlorida Companies can demonstrate that sufficient participants exist and that localized market power has been adequately addressed. The modified GridFlorida proposal to be filed pursuant to this Order shall utilize this alternative.

6. Physical Transmission Rights versus Financial  
Transmission Rights

With any RTO, the control of the transmission facilities will be in the hands of an independent entity. As such, the allocation of existing transmission capacity must recognize current contractual and statutory obligations. The GridFlorida Companies have identified two methods of transmission capacity allocation, physical and financial rights. Under a physical rights system, customers are allocated capacity rights based on the physical capacity of the system. Under a financial rights system, the customer is placed in the same financial position as if they possessed the physical rights. The GridFlorida Companies have chosen a physical transmission rights method for simplicity and additional security for serving retail load. We concur with this selection of transmission capacity allocation. The GridFlorida Companies further refined the transmission capacity allocation to manage congestion through "flowgates", which are the transmission facilities that are most likely to be subject to significant congestion based on both past experience and an analysis of proposed future uses of the system. The rights to transmit power through a flowgate are called Physical Transmission Rights (PTRs). PTRs will be allocated annually in amounts necessary to preserve existing uses. If a utility does not use a PTR, the amount of capacity can be sold pursuant to an auction, with the revenues being credited to the GridFlorida transmission rate for all transmission customers.

The GridFlorida Companies are in the process of identifying the flowgates from which PTRS will be allocated. It is possible that no facilities will be identified as flowgates and, therefore, no PTRS would be allocated. This fact is important because if congestion occurs across a predetermined flowgate, then the costs of congestion are socialized to all transmission customers. If congestion occurs elsewhere in the system, or if no flowgates are identified, then congestion costs are borne only by the affected parties. If this occurs, localized market power could become a problem. As mentioned previously, the GridFlorida Companies have not developed procedures to deal with localized market power on a real time basis. We find that the approach of using PTRs shall remain fixed until such time that GridFlorida petitions this Commission and justifies a different approach.

#### 7. Pricing Protocol and Rate Design

The record indicates that there will likely be some need for cost shift mitigation under any type of RTO structure. Under the proposed transco structure, there will be a greater need for some type of formalized cost mitigation procedure as proposed by the GridFlorida Companies. Given the assumptions used in the transco model in its conceptual form, the pricing protocol proposed by witness Ashburn appears to be a plausible theoretical attempt to balance the cost shifts and other pricing issues inherent in adopting the RTO structure.

Under a less structured ISO model, we believe that this Commission may be able to retain greater control over the cost of facilities included in any RTO system rate, as well as the manner of recovery of those costs. Witness Ashburn notes that FERC specifically allowed for a flexible pricing approach for the allocation of fixed costs. Witnesses Ashburn and Southwick admitted that the impact of depancaking rates depended on whether a utility is paying or receiving revenues now. Under an ISO structure, this Commission would have greater latitude in assessing the impact of depancaking and the recovery of transmission investment from transmission-dependent utilities on individual utilities. We could also determine if a single statewide transmission rate is appropriate. Moreover, these issues could be addressed on a case-by-case basis, balancing the costs and benefits to ratepayers. In addition, the need for, or magnitude of, any

grid management charge could significantly decline if an ISO structure is implemented in lieu of the transco structure proposed by the GridFlorida Companies. A less structured organization should have a lower price tag because many of the functions attributed to the transco would remain with the transmission owners and not be duplicated on a statewide level.

We believe that the absence of any hard cost data makes any final judgment on the proposed rate structure a risky decision at this time. There is simply too little information to determine what impact any RTO pricing structure will have on retail ratepayers because the record provides no quantification of either the short-term or long-term benefits of an RTO. In addition, the GridFlorida Companies testified that significant costs will go into a billing program designed for the specific tariff filed, and any pricing protocol adopted for GridFlorida may not be acceptable in a regional RTO configuration. It would not be prudent to expend significant funds to develop a billing system for a tariff that may never be implemented. Therefore, we make no decision on the acceptance of a specific pricing proposal absent a showing of the quantifiable impacts on retail ratepayers. Without these quantifiable impacts, there is no sound basis for designing any rate proposal.

#### 8. Fallout Issues

In addressing the cost impacts of the GridFlorida proposal on FPC, FPL, and TECO, we reviewed certain other aspects of GridFlorida that were dependent on its structure as a transco. Those aspects included cost of capital impacts, income tax impacts, valuation of the assets to be transferred to GridFlorida, and the impacts of Class B common stock. Because we have found that GridFlorida should be modified to incorporate an ISO structure, we believe that these issues need not be addressed at this time.

#### D. SUMMARY

Based on the foregoing, we find that the GridFlorida Companies - FPC, FPL, and TECO - shall file with this Commission a modified RTO proposal that conforms the GridFlorida proposal to the findings of this Order and uses an ISO structure in which each utility maintains ownership of its transmission facilities. The

GridFlorida Companies shall file this proposal within 90 days following the issuance of this Order, absent a showing of good cause why that time should be extended. The filing shall specifically identify the costs, the benefits, and the allocation of costs to each participating utility, as discussed in Section C.7. of this Order, based on the benefits received by each. The filing shall also address whether the proposed ISO would be a for-profit or not-for-profit entity and include justification for the form chosen. The filing shall include any specific performance incentives proposed by the utilities, as well as a discussion of how those incentives should be incorporated.

If the GridFlorida Companies believe that certain terms should be included in the modified proposal, but those terms are inconsistent with the findings in this Order, the GridFlorida Companies may address the appropriateness of those terms in their proposal. However, the parties should note that this Commission will not relitigate the issues addressed in this Order. As stated above, we approve the "get what you bid" approach for congestion management until such time as the GridFlorida Companies can demonstrate that sufficient participants exist in the wholesale generation market and that localized market power has been adequately addressed. We also require that the GridFlorida provisions for physical transmission rights and balanced schedules remain fixed until such time as GridFlorida petitions this Commission and justifies a different approach.

As a policy matter, we support the formation of an RTO to facilitate the development of a competitive wholesale energy market in Florida. Given our responsibilities to regulate retail aspects of transmission, FERC's responsibilities to regulate wholesale aspects of transmission, and GridFlorida's effects on both, we believe that our decision contributes to the collaborative process necessary to ensure development of an RTO that satisfies both Federal and State policy concerns. We intend to work cooperatively with both FERC and the GridFlorida Companies towards this end.

#### IV. PROCEDURAL MATTERS

Docket No. 000824-EI and Docket No. 0001148-EI shall remain open to permit this Commission to complete its pending rate reviews

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in those dockets for FPC and FPL, respectively. Docket No. 010577-EI shall be closed. Upon the filing of the modified RTO proposal required by this Order, a new generic docket shall be opened to address the filing.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the GridFlorida Companies (Florida Power Corporation, Florida Power & Light Company, and Tampa Electric Company) were prudent in proactively developing a regional transmission organization to satisfy FERC Order No. 2000, and, therefore, that the GridFlorida Companies shall be permitted recovery of the approximately \$8 million in actual jurisdictional start-up expenditures incurred through May 1, 2001, subject to audit, as set forth in the body of this Order. It is further

ORDERED that the GridFlorida Companies shall file with this Commission, pursuant to the terms set forth in body of this Order, a modified regional transmission organization proposal that conforms the GridFlorida proposal to the findings of this Order and uses an independent system operator structure in which each utility maintains ownership of its transmission facilities. It is further

ORDERED that the GridFlorida Companies shall file the modified regional transmission organization proposal required by this Order within 90 days following the issuance of this Order, absent a showing of good cause why that time should be extended. It is further

ORDERED that, upon the filing of the modified regional transmission organization proposal required by this Order, a new generic docket shall be opened to address the filing. It is further

ORDERED that Docket No. 000824-EI and Docket No. 0001148-EI shall remain open to permit this Commission to complete its pending rate reviews in those dockets for Florida Power Corporation and Florida Power & Light Company, respectively. It is further

ORDERED that Docket No. 010577-EI shall be closed.

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By ORDER of the Florida Public Service Commission this 20th  
day of December, 2001.

BLANCA S. BAYÓ, Director  
Division of the Commission Clerk  
and Administrative Services

By: Kay Flynn  
Kay Flynn, Chief  
Bureau of Records and Hearing  
Services

( S E A L )

WCK

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.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak

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Boulevard, Tallahassee, Florida 32399-0850, 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 and/or wastewater utility by filing a notice of appeal with the Director, Division of the Commission Clerk and Administrative Services 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.