

LAW OFFICES
J. PATRICK FLOYD

REPLY TO:
408 LONG AVENUE
POST OFFICE DRAWER 950
PORT ST. JOE, FLORIDA 32456-0950
(904) 227-7413

20 AVENUE D, SUITE 208
POST OFFICE BUILDING
APALACHICOLA, FLORIDA 32320
(904) 653-2709

December 20, 1996

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
1540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0870

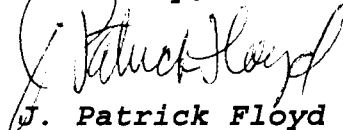
Re: Docket No. 930885-EU

Dear Ms. Bayo:

Attached please find an original and fifteen copies of the Rebuttal Testimony of David J. Hedberg, Rebuttal Testimony and Exhibits of Steve Daniels, Rebuttal Testimony and Exhibits of Archie Gordon, Rebuttal Testimony and Exhibits of William S. Dykes, Rebuttal Testimony of Alex M. Cockey, Jr. and Rebuttal Testimony of George Pratt.

Thank you for your assistance.

Sincerely,



J. Patrick Floyd
Gulf Coast Electric
Cooperative, Inc.

JPF/pb

Enclosure: as stated

cc: Jeffrey A. Stone, Esquire
Russell A. Badders, Esquire

13623-96

ORIGINAL FILE COPY

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition to Resolve Territorial)
Dispute with Gulf Coast Electric)
Cooperative, Inc. By Gulf Power) Docket No. 930885-EU
Company)

REBUTTAL TESTIMONY

OF

DAVID J. HEDBERG

ON BEHALF OF

GULF COAST ELECTRIC COOPERATIVE, INC.

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December 20, 1996

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GULF POWER COMPANY

**Before the Florida Public Service Commission
Rebuttal Testimony of
David J. Hedberg
Docket No. 930885-EU**

Q. Please state your name and address.

A. My name is David J. Hedberg, and my business address is 2201 Cooperative Way,
Herndon, Virginia, 20171-3025.

Q. What is your present occupation?

A. I am employed as the Senior Vice President for Strategic Services at the National Rural
Utilities Cooperative Finance Corporation (CFC).

Q. What are your duties with CFC?

A. My duties at CFC are to supervise workout, acquisition and diversification activities as
well as provide assistance to member cooperatives in the areas of rate of return,
revenue requirements, cost of service, rate design and other financial matters. This
assistance includes appearing as an expert witness on behalf of the cooperatives in
proceedings before various commissions or court proceedings and providing any other
regulatory support as needed.

Q. Please describe your employment history with CFC.

A. I graduated from Kent State University with a Bachelor of Business Administration
Degree in 1972 with a major in Economics and a minor in Finance. In 1976, I received
a Master of Arts Degree in Economics. From 1974 to 1976, I worked as a Economic
Planner for the government of Bostwana in Southern Africa while with the Peace

1 Corps. I was employed by the Federal Energy Regulatory Commission (FERC) from
2 February 1977 until December 1981, when I joined CFC. My responsibilities with
3 FERC included the review and preparation of cost of service and rate design studies of
4 electric utilities involved in rate proceedings before FERC.

5
6 I have attended several conferences and courses concerning income taxes, rate design,
7 rate of return, marketing power and energy and cost of service. I have also attended
8 the National Association of Regulatory Utility Commissioners' Annual Regulatory
9 Studies Program at the Graduate School of Business Administration, Michigan
10 University, East Lansing, Michigan. I presented a paper titled Efficient Management of
11 Resources to rural electric planners in the People's Republic of China as part of the
12 National Rural Electric Cooperative Association program in May 1984. In addition, I
13 have authored or co-authored several articles concerning regulation, economies of
14 scale, etc.

15
16 **Q. Have you previously qualified and submitted testimony as an expert witness?**

17 **A. Yes, I have submitted testimony before FERC in the following proceedings:**

18 Commonwealth Edison Company, Docket No. E-9002; Indiana & Michigan Electric
19 Co., Docket Nos. ER78-379, ER78-103, ER76-716; Ohio Edison, Docket Nos. ER77-
20 530, ER78-490; Central Illinois Public Service Co., Docket Nos. ER78-80, ER77-89;
21 Ohio Power Co., Docket No. ER80-673; Utah Power and Light Co., Docket No.
22 ER79-121; Kansas City Power and Light Co., Docket Nos. ER80-315, ER80-450;
23 Public Service Co. of New Mexico, Docket Nos. ER80-313, ER81-187; Wisconsin
24 Electric Power Company, Docket No. ER80-567.

25
26 In addition, I either supervised or participated in approximately 50 rate cases before the
27 FERC that resulted in a settlement of issues so that a hearing was not required.

1 I have also submitted testimony in over 100 cases before more than 20 state
2 commissions on a variety of issues including territorial matters, rates, regulation and a
3 variety of financial matters.
4

5 **Q. Describe any experience you have concerning service territory for electric
6 utilities.**

7 A. I have testified in several cases concerning service territory in Indiana, Florida, New
8 Mexico, Colorado, Virginia and Alaska. In addition, I have testified before committees
9 of the Missouri and Kansas Legislature on this subject. I have also worked with several
10 CFC members on similar issues over the last several years, and I have served on a joint
11 NRECA/CFC committee that surveyed and analyzed territorial problems on a national
12 basis.

13
14 **Q. What is the purpose of your testimony in this proceeding?**

15 A. The purpose of my testimony is to support Gulf Coast Electric Cooperative in its
16 territorial dispute with Gulf Power Company. I will do this by discussing how
17 important having defined service territories is from a lender's perspective and the
18 problems that arise if the lowest cost (highest density) customers are taken. Finally, I
19 will address several issues raised by Gulf Power's Witnesses Russell Klepper and G.
20 Edison Holland, Jr.
21

22 **Q. Have you familiarized yourself with the facts which give rise to this proceeding?**

23 A. Yes I have.
24
25

1 **Q. Please outline the principal sections of your testimony.**

2 A. I will first explain CFC and the important role CFC serves in the financial life of rural
3 electrics. Next, I will address the present financing ability of Gulf Coast Electric and all
4 cooperatives, through their participation in CFC. Then, I will discuss important factors
5 in evaluating financial health of an electric utility, including territorial integrity. Next, I
6 will briefly explain why the cost to Gulf Coast's customer increases if service territory
7 is reduced and growth is curtailed. Finally, I will address several issues raised by Gulf
8 Power Witnesses Klepper and Holland regarding differences between different types of
9 utilities.

10

11 **Q. Please explain the purpose of CFC.**

12 A. CFC is a self-help, independent financing institution, organized as a cooperative and
13 operated on a non-profit basis. CFC's equity was originally provided by the member
14 rural electric systems through the purchase of Capital Term Certificates (CTCs) which
15 mature in 79 years and currently earn interest at the rate of four percent per annum.
16 Equity is also provided when borrowers purchase additional CTCs, when necessary as
17 a part of each long-term loan, and through CFC's margins, which are retained for a
18 time before being returned to our member systems as capital credit payments. As a
19 cooperative organization, CFC is member-owned and controlled. The purpose of the
20 organization, as stated in its Articles of Incorporation, is "to provide, secure, and
21 arrange financing for its members and patrons...for the primary and Mutual benefit of
22 the patrons of the Association and their patrons, as ultimate consumers."

23

24 **Q. How many members does CFC now have and how are they represented in the**
25 **decision making of the organization?**

1 A. The CFC membership is presently composed of more than 1,000 rural electric
2 distribution systems, power supply systems and related organizations located in 46
3 states. The membership is represented by twenty-two directors who are elected to the
4 CFC Board, two from each of eleven geographic districts. One director from each
5 district must be a director of a member-system and the other a manager of a member-
6 system. These directors must be from different states within the district. The Chief
7 Executive Officer of CFC is employed by and is responsible to the CFC Board of
8 Directors. He, in turn, employs a staff to assist him in carrying out policies set by the
9 Board in handling the day-to-day operations of the organization. At the present time,
10 CFC has approximately 165 employees.

11

12 **Q. How does CFC function in relation to its members and the capital market?**

13

14 A. CFC functions both as a borrower and a lender. As a lender, CFC makes short-term
15 and long-term loans to its member systems. As security for its long-term loans, CFC
16 receives a first mortgage on a borrower's facilities, shared ratably with Rural Utility
17 Services ("RUS"), formerly the Rural Electrification Administration ("REA"). These
18 mortgages and related mortgage notes are used as security to support CFC's collateral
19 trust bonds issued in the public capital market. Through the sale of such bonds, and
20 through the sale of commercial paper, CFC obtains capital to meet the financing
21 requirements of its members. In this role, CFC acts as a borrower from investors.

22

23 **Q. Is Gulf Coast Electric a member of CFC?**

24 A. Yes, Gulf Coast is a member of CFC and has long term loans and a line of credit.

25

1 Q. Would you explain the relationship between RUS and CFC as it relates to the
2 financing of rural electrics?

3 A. The relationship between RUS, the federal agency that has been responsible for
4 financing for the rural electric program for more than 50 years, and CFC, the private
5 organization responsible for meeting the capital gap between demand for funds and
6 funds available from RUS, is one of close operation. Although RUS and CFC loans are
7 treated and processed as separate loans, the combined total reflects the amount of
8 capital needed by the applicant for about two years. RUS predicated the approval of its
9 loan on the borrower's obtaining the required amount of supplement capital.
10 Therefore, before loan approval is announced, RUS informs CFC of its intention to
11 make its portion of the loan.

12

13 Q. Are you familiar with Gulf Coast's condition?

14 A. Yes. CFC regularly receives information from Gulf Coast and it presently is in good
15 financial condition.

16

17 Q. Is Gulf Coast Electric a member in good standing with CFC?

18 A. Yes, it is in good standing with CFC, and we stand ready to provide any capital needs
19 Gulf Coast might have.

20

21 Q. Based upon your knowledge and experience, is Gulf Coast financially able to
22 serve load growth in the near future?

23 A. Yes. Gulf Coast will clearly be able to serve all its load growth in the future just as
24 many other systems in growth areas have done.

25

1 **Q. What are the major criteria CFC uses in evaluating whether to make a standard**
2 **distribution loan?**

3 A. A major concern to CFC is obviously the borrower's ability to repay the loan. The
4 primary criteria we use to evaluate a system's ability to repay the loan are:

5
6 1. The immediate and long term competitiveness of the system which includes the
7 adequacy of territorial protection and the assurance that the investment in plant
8 for today's and projected members of tomorrow will be paid by those
9 consumers.
10

11
12
13 2. Various financial ratios such as Times Interest Earned Ratio ("TIER"), Debt
14 Service Coverage Ratio ("DSC"), members per mile (density) and the members'
15 equity in the system.
16

17
18 3. Assurance of future supply of power, including full requirements
19 contracts.
20

21
22 **Q. How does Gulf Coast meet these criteria?**

23 A. Gulf Coast is a financially healthy system that has a long term contract for wholesale
24 power from Alabama Electric Cooperative at competitive rates. So it meets criteria 2
25 and 3 very successfully. The results of this case and other precedent will help
26 determine how well Gulf Coast does on criteria 1.
27

1 **Q. Given your experience in the electric utility area and your expertise with regard**
2 **to financial institutions that make loans to utilities, what criteria are used**
3 **generally in the industry to evaluate loan programs?**

4 A. The above criteria and considerations used by CFC would be used by any financial
5 institution or lender in evaluating a loan to Gulf Coast. The loss of rate payers and
6 territory, including the loss of projected rate payers of tomorrow, would be a major
7 concern of any lender that is evaluating a loan to Gulf Coast.

8
9 **Q. Does CFC provide assistance to rural electric who are facing attempts by**
10 **competing electric utilities to acquire their facilities?**

11 A. Yes. In addition to testifying before commissions on behalf of the threatened rural
12 electric, CFC has created a program to provide financial assistance. Since June 1,
13 1986, CFC has operated the Cooperative System Integrity Fund to provide financial
14 assistance to rural electric organizations that face threats to the integrity of their service
15 territories.

16

17 **Q. It is clear the degree of territorial protection is a major concern to CFC, but how**
18 **concerned are CFC'S bankers, investors and the bond rating agencies with this**
19 **area of regulation?**

20 A. At the present time, CFC holds quarterly meetings with our bankers and at least one
21 annual formal session and numerous informal sessions with each rating agency every
22 year. Regulation both as to rates and territorial protection are always regular topics of
23 discussion. All of these groups are extremely concerned about territorial protection, or
24 more specifically in recent years, the lack of it in some areas. The investment becomes
25 more risky if the rural utility, such as Gulf Coast, loses part of its financial integrity -
26

1 its growth territory or has a high degree of uncertainty as to which customers it will
2 serve in the future.

3
4 I believe it can be said that competition for new load growth - not just in Florida, but
5 around the country - will increase the number of service territory problems without the
6 certainty of territory boundaries. Territorial protection regulation could become a
7 major factor in determining bond ratings and thus the cost of capital for all type of
8 utilities.

9
10 **Q. If Gulf Coast loses existing or potential large, high use (low cost) customers or**
11 **territory that has the potential for large customer growth, what would you expect**
12 **the impact to be on the cost and revenue of Gulf Coast in the future?**

13 **A.** The estimated revenue for Gulf Coast would be reduced and lost due to the loss of
14 existing or potential large, high use (low cost) customers from its service territory.
15 Gulf Coast would lose the difference between the revenue generated by these
16 customers and the incremental cost Gulf Coast incurs serving these customers. This
17 difference - which would be a net benefit to Gulf Coast and its customers - would be
18 lost. This problem is especially severe for rural electric cooperatives because of the
19 low density (Gulf Coast has a density of 7 customer per mile of line). When its
20 highest density or most desirable areas are lost, it puts cost/rate pressure on the
21 remaining customers. Another concern is that there are significant economies of scale
22 for rural electrics as their systems expand.

23
24 Additionally, the loss of territories that hold excellent potential for growth hampers the
25 planning process of Gulf Coast and affects the future financial well being of Gulf Coast.

1 **Q. What effect will losing large loads and losing future growth in large loads have on**
2 **Gulf Coast's retail rates?**

3 A. With fewer KWH sales available to cover costs, Gulf Coast would have to recover
4 more revenue with each KWH sold. If retail rates continue to go up, consumers will
5 use less electricity, use alternate sources of power, or move off the system. All of these
6 events further reduce Gulf Coast's KWH sales and thereby increasing the need for
7 additional rate increases.

8
9 **Q. Do you believe the method of determining appropriate service territory**
10 **boundaries should include an analysis of the public policy implications of**
11 **alternative forms of utility ownership?**

12 A. No, I do not. Trying to determine whether investor owned utilities (IOUs),
13 cooperatives or municipals receive the greatest subsidies is at best a debatable subject,
14 but is clearly irrelevant in my opinion to the task of assigning service territory in a way
15 that maximizes the public interest.

16
17 **Q. What method of service territory allocation works best in your opinion?**

18 A. Having clear boundaries is, in my opinion, the method that has worked best. It allows
19 for the most certainty in planning, construction and financing and will generally result in
20 the least disputes.

21
22 **Q. On the top of page 17 of Mr. Klepper's testimony he states "By contrast, GCEC**
23 **is a non-profit rural electric cooperative that is owned by its customers but**
24 **controlled by restrictive by-laws and operated for the benefit of the entrenched**
25 **management and directors". Would you comment on this statement?**

1 A. All utilities obviously have management and directors of some type, including Gulf
2 Power. The difference is that the ratepayers elect the directors of a cooperative. While
3 management and stockholders select the directors for an IOU. If the ratepayers
4 become unhappy with the rates or service at the cooperative, they vote them out of
5 office. The new directors then have the right to select new management. This process
6 has happened many times throughout the country and I believe it usually works in the
7 ratepayers best interests.

8
9 **Q. On the last line of page 17 and the first line of page 18, Mr. Klepper states**
10 **“Because GCEC is free of regulatory oversight, it has little economic motivation**
11 **to control expenses”. Do you believe this is true?**

12 A. Definitely not! Cooperatives do not have the conflicts that arise for IOUs such as Gulf
13 Power, because of the desire to maximize profits for stockholders while keeping rates
14 competitive for ratepayers. Further more, ratepayers can not replace directors and
15 management if they do not do a good job. The cooperative in contrast has only one
16 primary purpose and that is to provide its owners with reliable power at the lowest
17 long-term rates consistent with good business practices.

18
19 **Q. Why do most state regulatory commissions not regulate the revenue requirements**
20 **of electric cooperatives and does that impact rates in your opinion?**

21 A. Electric cooperatives operate in 46 states and are rate regulated in 16 states. The
22 majority of states do not regulate the rates of electric cooperatives because they have
23 found it is not necessary due to the lack of conflicts between stockholder’s interests
24 and the ratepayer’s interests.

1 In the studies we have done at CFC, we have determined the overall rate levels are
2 virtually identical in the rate regulated states versus the unregulated states.

3
4 **Q. Could you please summarize your testimony, with particular emphasis on your**
5 **opinion of the impact of territorial problems and the possible loss of potential and**
6 **existing large high use (low cost) customers and loss of territory with a high**
7 **potential for growth upon Gulf Coast, its rate payers, and the public interest?**

8 **A.** As a lender to Gulf Coast, and across the country, CFC is very concerned about the
9 nationwide trend of territorial problems and in many cases rural electrics losing
10 consumers and service territory. Traditionally, the right to serve a protected service
11 area has been a major factor in allowing utilities of all types favorable financing in the
12 money markets. With slower load growth and excess capacity in parts of the country,
13 there has been increased competition among investor-owned utilities, municipals and
14 rural electrics. In some respects this competition may be beneficial to consumers, but
15 in other ways, it is clearly detrimental.

16
17 In the case of Gulf Coast, I believe the uncertainty that exists when boundaries are not
18 clearly defined is harmful to Gulf Coast and its customers. There has been considerable
19 time, money and resources expended on these disputes in the past and it is clearly not in
20 the public interest for this to continue. It makes planning for the future much riskier
21 and more expensive than it already is currently and it can cast a cloud over Gulf
22 Coast's financial future. This taken with similar situations across the country and what
23 appears to be a growing trend will no doubt increase the uncertainty in the utility
24 industry - which will in turn increase financing costs.

1 Finally, the type of utility ownership is not a valid basis for determining service
2 territories. It introduces factors that can not be easily measured, involves a variety of
3 national and state policy implications and is not relevant in determining the public
4 interest of defining service territory.

5
6 **Q. Mr. Hedberg, does this conclude your testimony?**

7 **A. Yes, it does.**

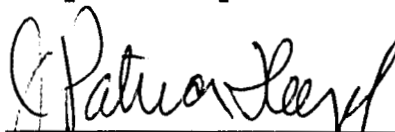
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition to Resolve)
Territorial Dispute with Gulf Coast)
Electric Cooperative, Inc. by) Docket No. 930885-EU
Gulf Power Company)

REBUTTAL TESTIMONY
OF DAVID J. HEDBERG
ON BEHALF OF
GULF COAST ELECTRIC COOPERATIVE, INC.

Gulf Coast Electric Cooperative, Inc. (Gulf Coast) hereby
files the attached original Rebuttal Testimony of David J. Hedberg
together with 15 copies thereof this 20th day of December, 1996.

Respectfully Submitted,



John H. Haswell, Esquire
Chandler, Lang & Haswell, P.A.
P. O. Box 233879
Gainesville, FL 32602
(352) 376-5226
Florida Bar No. 162536

J. Patrick Floyd, Esquire
408 Long Avenue
P. O. Box 950
Port St. Joe, FL 32456
(904) 227-7413
Florida Bar No. 257001

I HEREBY CERTIFY that a true copy of the following
together with one copy of the Rebuttal Testimony of David J.
Hedberg have been furnished this 20th day of December, 1996 by U.S.
Mail or hand delivery to the following:

Vicki Johnson, Esquire
Staff Counsel
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0863

Jeffrey A. Stone
Beggs & Lane
Post Office Box 12950
Pensacola, Florida 32576
Attorney for Gulf Power Co.

Roberta S. Bass
Division of Electric & Gas
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0870


J. PATRICK FLOYD, ESQUIRE