



**Florida
Power**
CORPORATION

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**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

DOCKET No. 970096-EQ

**Petition for Expedited Approval of an
Agreement to Purchase the Tiger Bay
Cogeneration Facility and Terminate
Related Purchase Power Contracts**

**REBUTTAL TESTIMONY OF
JOHN SCARDINO, JR.**

For Filing March 7, 1997

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**FLORIDA POWER CORPORATION
DOCKET NO. 970096-EQ**

**REBUTTAL TESTIMONY OF
JOHN SCARDINO, JR.**

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

2 **A. My name is John Scardino, Jr. My business address is P. O. Box 14042,**
3 **St. Petersburg, Florida 33733.**

4
5 **Q. Have you previously testified in this proceeding?**

6 **A. Yes. I filed direct testimony on behalf of Florida Power Corporation**
7 **("Florida Power" or "the Company") on January 25, 1997.**

8
9 **Q. What is the purpose of your rebuttal testimony?**

10 **A. I focus my rebuttal on the fourth and fifth conclusions summarized at**
11 **pages 6 and 7 of the direct testimony of Mr. Randall J. Falkenberg**
12 **submitted on behalf of the Florida Industrial Power Users Group ("FIPUG").**
13 **I will begin with Mr. Falkenberg's conclusion (at pages 6-7) that Florida**
14 **Power should treat the Tiger Bay project in the same way as it would treat**
15 **the purchase of a conventional power plant -- i.e., include the plant in rate**
16 **base and defer consideration of the Company's prudence and need until**
17 **a future rate case.**

18
19 **Q. Do you agree with Mr. Falkenberg's recommended approach?**

20 **A. I could not disagree more. The Company agreed to pay Tiger Bay \$445**
21 **million in a single transaction intended to save money for its customers**

1 while holding the Company harmless against any adverse financial impacts
2 associated with the payment. In particular, the Company agreed with
3 Tiger Bay to make the payment on the condition that the Company would
4 be allowed to recover the entire payment over a five year recovery period.
5 Such a period would allow us to finance the project without unacceptable
6 risk and while also avoiding an excessive rate impact on the customer that
7 might result from a shorter recovery period. In suggesting that the
8 Company "rate base" the project (at page 6), Mr. Falkenberg totally
9 misconceives the purpose of the transaction.

10
11 Mr. Falkenberg's misunderstanding of the transaction is nowhere more
12 evident than his proposal (at page 7) to require Florida Power to withstand
13 "a review of prudence and need in FPC's next rate case." I will reiterate
14 a point that is also made in Mr. Dolan's rebuttal testimony. Florida
15 Power seeks approval in this proceeding of the entire transaction. Florida
16 Power did not agree to the transaction based on a bifurcated analysis of
17 "prudence and need" with respect to the power plant and termination of
18 the PPAs, but rather on an analysis of the value of the entire deal to its
19 customers.

20
21 If Mr. Falkenberg is truly "astounded" at the Company's proposal to
22 recover the entire \$445 million payment over five years, as he professes
23 (at page 24), it is because he erroneously characterizes the acquisition of
24 the power plant as an isolated transaction undertaken for the benefit of
25 the shareholder rather than part of a single integrated transaction

1 undertaken for the benefit of the customer. If Mr. Falkenberg truly can
2 "see no distinction" between the purchase of a power plant and this
3 transaction (at 24), he has missed the point of why Florida Power entered
4 into the deal, which is to mitigate the effects of high priced contracts to
5 which the ratepayers are already committed, not to create a new asset
6 altogether.

7
8 **Q. Does Mr. Falkenberg's reference to Florida Power & Light Company's**
9 **acquisition of the Scherer Unit 4 from Georgia Power Company (at pages**
10 **24-25) have any relevance here?**

11 **A. None whatsoever. Florida Power & Light Company purchased a 76.36%**
12 **(646 MW) undivided interest in Scherer Unit 4 from Georgia Power based**
13 **on a need for additional capacity. Florida Power's main objective, and the**
14 **lion's share of the transaction costs, involve a unique opportunity to end**
15 **the customers' responsibility for the single largest block of uneconomic**
16 **QF capacity on the Florida Power system and obtain as much as \$ 2.4**
17 **billion in savings for the customer.**

18
19 **Q. Turning to Mr. Falkenberg's fifth conclusion, he proposes to allow the**
20 **Company to recover the costs of terminating the PPAs according to what**
21 **he describes as a "revenue neutral" approach. Please state your**
22 **understanding of that approach.**

23 **A. He describes his approach at pages 26 and 27 of his testimony. He**
24 **proposes that the Company be allowed to collect from customers an**
25 **amount equivalent to the revenues for capacity and energy associated**

1 with the current contracts. The amounts received from the customers
2 would then be credited against all fuel and operating costs, leaving the
3 Company with the excess of those amounts to reduce the remaining
4 balance of the termination charges. He states that the deferred balances
5 would be eliminated in about twelve years based on the Company's
6 projections (at page 23). He ignores, however, that in the meantime, the
7 Company would be forced to finance the outstanding balance of the
8 termination payment, thereby increasing the cost to the customers, and
9 to carry the balance on its books as a regulatory asset.

10
11 **Q. Mr. Falkenberg describes his proposal as "self-financing" (at page 23). Do**
12 **you agree with that characterization?**

13 **A. No. The Company will be out-of-pocket in the amount of \$445 million as**
14 **soon as it pays that amount to Tiger Bay. The \$445 million will not**
15 **finance itself. The Company will be unable to make the payment unless**
16 **it is able to raise enough outside capital to cover the payment. Mr.**
17 **Falkenberg ignores the reduction in savings to the customer which result**
18 **from debt financing over a longer period than five years or from using a**
19 **combination of debt and equity. To place the purchase price in**
20 **perspective, it is equivalent to about 25 % of Florida Power's 13-month**
21 **average common equity, as of December 1996.**

22
23 **Q. Do you believe Mr. Falkenberg's approach should be adopted?**

24 **A. No. The rating agencies have indicated that there would be substantial**
25 **concern if the financing for the Tiger Bay transaction remained outstanding**

1 for as long as ten years. Mr. Falkenberg's proposal would impose a
2 regulatory asset on the Company as well as long-term costs or obligations
3 that may not be recoverable when exposed to market forces. In my
4 experience, these factors, in the eyes of the financial community, could
5 adversely impact the debt rating of the Company and harm the position of
6 its stockholders because of a transaction undertaken solely to achieve
7 customer savings. In fact, the Company is already assuming some such
8 risk because it is willing to initially absorb the additional non-fuel operating
9 expenses costs as a result of this transaction, in order to achieve the
10 highest possible savings to the customer.

11
12 **Q. Why do you believe that the rating agencies are concerned about the term**
13 **of the Tiger Bay financing?**

14 **A.** I believe they are concerned because they see the industry changing
15 toward more competition and see a risk that utilities will not be able to
16 make good on long-term commitments in a competitive environment.
17 There is a general consensus among the rating agencies that it is prudent
18 to reduce debt cost and avoid assuming new long-term costs or
19 obligations that may not be recoverable when exposed to market forces.
20 For example, Standard & Poor's Global Sector Review, November 1996
21 states:

22 In the face of impending competition, utility managements are taking
23 definitive actions to bolster financial profiles. Utilities are reducing
24 operating costs, cutting capital expenditures, slowing dividend
25 growth, or cutting the dividend outright. By and large, the resulting

1 improved cash flow is being used to pay down debt. This is clearly
2 positive from a rating standpoint. Utilities are cleaning up their asset
3 quality by expensing rather than capitalizing and reducing their
4 regulatory assets. It is entirely appropriate that utilities reduce debt
5 as competition looms.
6

7 **Q. Did these considerations factor into the Company's decision to seek rate
8 recovery over five years for its Tiger Bay transaction?**

9 **A. Yes. Florida Power wanted to recover the \$445 million payment as
10 quickly as practicable without causing an excessive rate impact on the
11 customer. By recovering the payment over five years and supporting non-
12 fuel operating costs initially with existing base rates, Florida Power
13 believed that it would be able to finance the transaction at a reasonable
14 cost to the customer and without jeopardizing the Company's credit
15 ratings or adversely impacting its overall cost of capital. The impact on
16 the retail customer with the five-year recovery period is only two to three
17 percent, after which the customer will begin to realize very substantial
18 savings from the transaction.**
19

20 **Q. Mr. Falkenberg describes the five-year recovery period as a "poor deal for
21 ratepayers" (at page 5). Do you agree?**

22 **A. No. The "deal" proposed by the Company is a good one for the customer
23 and is designed to enable the Company to finance the payment to Tiger
24 Bay without undue risk. Mr. Falkenberg's proposed "deal," in contrast,
25 would greatly increase the risks and financing costs associated with the**

1 transaction, while reducing the savings to the customer. Therefore, this
2 proposal would not be good for either the customer or the Company. Mr.
3 Falkenberg's "deal" also is not the one that the Company agreed to and
4 asked the Commission to approve.

5
6 **Q. Do you agree with Mr. Falkenberg's contention (at page 32) that a utility**
7 **should be required to absorb termination costs if it is earning above the**
8 **low end of its allowed return on equity ("ROE") range?**

9 **A. No. The Commission set the Company's ROE at 12% on the basis that**
10 **it would:**

11 continue to provide the company with comfortable coverage ratios
12 that, along with its strong qualitative factors, maintain the
13 company's present credit rating. (Order No. PSC-92-1197-FOF-EI,
14 Docket No. 910890-EI, at page 28.)

15 The range of 100 basis points is a monitoring mechanism and does not
16 suggest that the Company should only be earning at the bottom of the
17 ROE range. Evidence has not been presented in this proceeding to even
18 hint that the Company should be earning less than the authorized 12%
19 ROE.

20
21 **Q. Does that conclude your rebuttal testimony?**

22 **A. Yes, it does.**