BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

Petition for approval of early termination amendment to negotiated qualifying facility contract with Orlando Cogen Limited, Ltd., by Florida Power Corporation.

DOCKET NO. 961184-EQ

FIRST DAY - MORNING SESSION

VOLUME 1

Pages 1 through 169

PROCEEDINGS: HEARING

BEFORE: COMMISSIONER SUSAN F. CLARK
COMMISSIONER JOE GARCIA

DATE: Thursday, October 30, 1997

TIME: Commenced at 9:35 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JOY KELLY, CSR, RPR
Chief, Bureau of Reporting
ROWENA NASH
Official Commission Reporters

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APPEARANCES:

JAMES A. McGEE and JEFFREY FROESCHLE, Florida Power Corporation, Post Office Box 14042, 3201 34th Street South, St. Petersburg, Florida 33733, appearing on behalf of Florida Power Corporation.

MATTHEW M. CHILDS, and JONATHAN E. SJOSTROM, Steel, Hector & Davis, 215 South Monroe Street, Suite 601, Tallahassee, Florida 32301, appearing on behalf of Orlando Cogen Limited, Ltd.

JACK SHREVE, Public Counsel and JOHN ROGER HOWE, Deputy Public Counsel, Office of Public Counsel, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400, appearing on behalf of the Citizens of the State of Florida.

WILLIAM COCHRAN KEATING, and JORGE CRUZ-BUSTILLO, Florida Public Service Commission, Division of Legal Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0870, appearing on behalf of the Commission Staff.

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P R O C E E D I N G S

(Hearing convened at 9:35 a.m.)

COMMISSIONER CLARK: We'll call the hearing to order. Mr. Keating, would you please read the notice?

MR. KEATING: Pursuant to notice, dated September 9, 1997, this time and place have been set for a hearing in Docket No. 961184-EQ, petition for approval of early termination amendment to negotiate a qualifying facility contract with Orlando Cogen Limited, Ltd., by Florida Power Corporation.

COMMISSIONER CLARK: We'll take appearances.

MR. McGEE: James McGee and Jeffery Froeschle, Post Office Box 14042, St. Petersburg, 33733, on behalf of Florida Power Corporation.

MR. CHILDS: Matthew M. Childs and John Sjostrom of the firm Steel Hector & Davis, on behalf of Orlando Cogen Limited.

MR. HOWE: I'm Roger Howe with the office of Public Counsel, appearing on behalf of the citizens of the State of Florida.

COMMISSIONER CLARK: Mr. Childs, would you pronounce "Mr. Sjostrom"?

MR. CHILDS: Sjostrom. Don't ask me to spell "John." But it's Sjostrom, S-J-O-S-T-R-O-M.

COMMISSIONER CLARK: Slow.

MR. McGEE: S-J-O-S-T-R-O-M. And probably it would be better if he pronounced it because I might have been mangling it.

COMMISSIONER CLARK: Go ahead.

MR. SJOSTROM: I'll answer to that. That will be fine. Sjostrom.

COMMISSIONER CLARK: Sjostrom. Well, if I get it wrong, I apologize, but I will try.

MR. KEATING: Cochran Keating appearing on behalf of the Commission Staff.

MR. CRUZ-BUSTILLO: And George Cruz-Bustillo also appearing on behalf of Commission Staff.

COMMISSIONER CLARK: Mr. Keating, do we have any preliminary matters we need to take up?

MR. KEATING: Yes, I believe at the prehearing conference that we had decided to -- or that you had decided to handle the proffer of testimony made by OCL.

COMMISSIONER CLARK: Did we put on -- is there something on the Prehearing Order about how we are going to do that?

MR. KEATING: I believe it was left to the parties. (Simultaneous conversation.)

COMMISSIONER CLARK: All right. And there's been an agreement on how to do that. Mr. Childs should handle this.

MR. KEATING: Yes.

MR. CHILDS: I've tried to describe what I believe has been agreed to. We have filed under cover of October 24, 1997, a proffer, styled Orlando Cogen Limited's Proffer of Testimony, concerning proposed agency action order and alternate Staff recommendation.

COMMISSIONER CLARK: Let me see if I've got that. It doesn't look like I do.

MR. CHILDS: What it is, is it's a narrative of the circumstances as well as a narrative of what we would hope to prove in evidence.

COMMISSIONER CLARK: Okay.

MR. CHILDS: This is addressed, I believe, on Page 16 of the Prehearing Order.

COMMISSIONER CLARK: Okay. All right. This is your proffer.

MR. CHILDS: This is the proffer, and in addition, Commissioner, OCL's Exhibits 1 through 4 and 7, which are identified in the Prehearing Order, go with the proffer.

COMMISSIONER CLARK: All right.

MR. CHILDS: And they address these issues;

that is, the issues that are identified in the Prehearing Order. They do not -- neither the proffer, nor the exhibits, are intended to address the other remaining issues.

COMMISSIONER CLARK: Okay.

MR. CHILDS: So what I would like to see, if there is no objection, is to have a ruling that the proffer and exhibits are made part of the record for this purpose.

COMMISSIONER CLARK: Right.

MR. CHILDS: That is the purpose of addressing these issues that are identified on Page 16.

COMMISSIONER CLARK: And the ruling that you were -- that the motion for protective order was issued --

MR. CHILDS: That's correct.

COMMISSIONER CLARK: And you were prevented from either deposing them or calling them as witnesses.

MR. CHILDS: Correct.

COMMISSIONER CLARK: Is that all right with Staff?

MR. KEATING: Staff would object to the introduction of the evidence that has been proffered.

Staff believes that the whole class of evidence is excluded by law. Under the case, State Department of Transportation versus JWC Company, Incorporated, a request for an administrative hearing on proposed agency action initiates a de novo proceeding.

COMMISSIONER CLARK: Hang on, Mr. Keating. I think I've ruled on that, and I've indicated that witnesses wouldn't be called, wouldn't be deposed and evidence wouldn't be taken in the record.

MR. KEATING: Correct.

COMMISSIONER CLARK: He's only proffering for the purpose of having it made as part of record. It's not evidence upon which a decision could be made, but it's only preserving the record for purposes of appealing the ruling.

MR. KEATING: Then we have no objection to that -- wait, I'm sorry.

MR. CRUZ-BUSTILLO: Commissioner?

COMMISSIONER CLARK: Yes.

MR. CRUZ-BUSTILLO: In this case what we are seeking to avoid happening is, if they enter the proffer, they are seeking to challenge basically the Commission panel's right to utilize Staff initiating the proposed agency action. And under South Florida Natural Gas, that is not discretionary but, therefore, closed as a matter of law from seeking to do that.

Now there's a case on point called Reeves versus State, and the issue then that Mr. Childs is seeking to raise is whether or not -- how do they properly preserve their right for objection. And I would pass them out, but let me just read what it says.

It says, "While ordinarily the adversely affected party must proffer the excluded evidence to the court, a proffer is unnecessary where the substance of the excluded testimony is apparent. Moreover, a proffer is unnecessary where the evidence is rejected as a class."

Now, in every other instance, as you ruled in granting the protective order, what you were seeking to do was to prevent them from challenging what in JWC, which was cited, prevents any challenge of the panel's use of Staff in preliminary proceedings. And everything up to the issuance of the proposed agency action is characterized as preliminary, in JWC is still good law.

So we don't want to set a precedent if they don't appeal by citing this order in today's proceeding by saying we can go ahead and challenge Staff and get into that earlier proceeding. If they want to, in effect, the macro view here is challenge the panel's right to utilize Staff, they have properly preserved their right under First DCA law to appeal to the Supreme Court by simply raising the objection in today's proceedings.

So what -- we would ask the Commission to deny this proffer because under current law their objection has currently properly preserved that objection for appeal without the entry.

COMMISSIONER CLARK: It's unnecessary to make the proffer.

MR. CRUZ-BUSTILLO: It's unnecessary to make the proffer to preserve that, and their due process rights are completely protected.

COMMISSIONER CLARK: What's the harm in allowing it?

MR. CRUZ-BUSTILLO: Excuse me?

COMMISSIONER CLARK: What would be the harm in allowing it.

MR. CRUZ-BUSTILLO: Oh, the harm would be simply the first step in creating a precedent in permitting petitioners to challenge the Commission panel. They are not challenging Staff, they are challenging the panel's right to utilize Staff in an advisory capacity in evaluating petitions and issuing proposed agency action. And the First DCA and the Supreme Court have both ruled that those preliminary matters are foreclosed from challenge, and they are seeking to challenge your right do that. And, in effect, what would happen is create a chilling effect on those Staff members. They don't have to appeal to use this as precedent to simply require Staff -- in this case the only way, to put them on direct testimony in an attempt to get them to defend their positions where --

COMMISSIONER CLARK: They are not going to do that now.

MR. CRUZ-BUSTILLO: Well, simply by seeking to proffer anything with respect to their analysis in assisting the Commission panel would, in effect, permit them to do that in future proceedings. And in effect, there really would be no reason for the 120.57 hearing because they want to get into the process before the proposed agency action is ever done. And that's foreclosed. That is the province of the Commission, and the Supreme Court has made that clear.

COMMISSIONER CLARK: Okay. Mr. Childs.

MR. CHILDS: Well, briefly, this was a matter that we discussed at prehearing and was ruled upon. I think it is extremely late to bring in an argument at this point. Secondly, with all due respect, I disagree with the argument.

As we discussed to you, this is not intended for any chilling effect. We argued, and the point of the proffer is to make the point that the conclusion reached was, in our judgment, not self-evident from the analysis. And we believe that the evidence could show something different.

We think that we need to make the proffer, and it was, I thought, ruled upon. And with all due respect, I thought the Staff had told us in advance that the proffer was acceptable to them.

COMMISSIONER CLARK: I'm going to allow the proffer. I don't think it will harm the process. In fact, it may facilitate any court review of the appeal.

Let me just say again, that I think the South Florida Natural Gas does indicate that this type of discovery and calling the Staff as witness is inappropriate, and that's why I issued the protective order but I'll accept the proffer.

Is there anything else we need to do on the issue of the proffer?

All right. Mr. Keating.

MR. KEATING: I'm sorry, I was about to

speak before I listened to your question.

COMMISSIONER CLARK: Go ahead.

MR. KEATING: If there's not -- if there's not, I was just going to say I don't believe that there are any other preliminary matters.

COMMISSIONER CLARK: All right. Mr. McGee.

MR. McGEE: None.

COMMISSIONER CLARK: Mr. Childs.

MR. CHILDS: We have none.

MR. HOWE: None.

COMMISSIONER CLARK: All right. So are we ready to go directly to testimony?

MR. KEATING: Yes.

COMMISSIONER CLARK: Let me ask a question. Are we going to take two days on this now?

MR. CHILDS: Probably not.

MR. HOWE: It could happen. Commissioner Clark, I understood that we were going to have opening statements also.

COMMISSIONER CLARK: You are right, excuse me. You had asked for the opening statements. And what was the ruling on it?

MR. KEATING: The parties were to be allowed ten minutes each for opening statements.

COMMISSIONER CLARK: Was it the parties or the sides? Parties, all right.

MR. KEATING: The parties.

COMMISSIONER GARCIA: Mr. Howe, you worried me with "if it happens." Do you think we will get out of here tonight if we go a little bit late?

MR. HOWE: I just don't have a good sense for this one on how long it's going to take.

COMMISSIONER CLARK: Well, I'm confident that the people we have here today, as I look through them, are not inclined to prolong cross examination. So I'm confident, if any hearing can get done in the right amount of time, it will be this one.

I'll tell you what, I'm going to go ahead and swear in the witnesses, and then we'll begin with the opening statements. Who starts? Did we say who began the opening statements?

MR. KEATING: I believe we should begin with Florida Power as the petitioner.

COMMISSIONER CLARK: All right. And then you, Mr. Childs. And then you, Mr. Howe.

Will all those, Mr. Schuster and Mr. Stallcup and Mr. Larkin, please stand up.

(Witnesses sworn collectively.)

Thank you. Mr. McGee.

MR. McGEE: Good morning, Commissioners. We are here today on Florida Power's petition requesting your approval to an amendment to a 1991 negotiated contract between Florida Power and Orlando Cogen Limited that contracts for the purchase of 79.2 megawatts of committed capacity through the year 2023. And payments are based on the cost of an avoided coal-fired generation.

The amendment provides for the termination or buyout, as we use the term, of the most costly portion of the contract, and that's the last ten years. And it provides for that early termination a payment to OCL of about $49.4 million over a five-year period. Our petition also requests cost recovery for these payments.

In return for the buyout payment, Florida buyout customers are expected to receive savings of nearly half a billion dollars over the ten-year buyout period.

I'd like to address briefly the two major issues that have been raised by the witnesses for Public Counsel and Staff regarding the OCL contract buyout. One is the question of intergenerational fairness, and the other is the quantification of ratepayer benefits on a net present value basis. It will be expected from the buyout.

The intergenerational issue is one that seems to have come into vogue recently. In a traditional sense, the Commission have evaluated generation alternatives based on their ability to provide net present value savings over the planning horizon of the project and irrespective of whether those savings were realized early or late in the planning period. And under this net present value criteria, the Commission has approved cost recovery for generation alternatives using traditional revenue requirements, ratemaking that front-end loads a disproportionate share of the cost on current customers.

And the Commission has also approved cost recovery for generation alternatives such as the OCL contract using a value of deferral methodology that back-end loads a disproportionate share of costs on future customers.

Given this wide ranging regulatory background, we were somewhat perplexed when one of the alternative Staff recommendations in the PPA phase of this proceeding concluded that the buyout shouldn't be approved because, to use their words, it violated the goal of intergenerational fairness.

In all honesty, Commissioners, we don't know what that goal is, and we don't now how to determine when it's been met. But I think there are two things that really need to be said about that. The first is that if the goal is going to be applied in this case to deny approval of the OCL buyout, then an important tool for dealing with high cost QF contracts is going to be taken away from the utilities.

It's inherent in the nature of these QF contracts that the opportunity for significant ratepayer savings exists only in the contract's later years, preventing utilities from capturing these savings in later years by applying this heretofore unknown goal. And a goal that can't be met in the case of QF buyouts is going to burden future customers with horrendous cost.

I think the other point though, that maybe is even more important in this case, is that when you view the OCL buyout from the proper perspective, it doesn't create an intergenerational inequity, it helps to correct an existing intergenerational inequity when the contract was approved in the first instance.

The OCL contract shifted so much cost responsibility from current to future ratepayers, compared to the cost of the coal plant that was avoided, that the current ratepayers will still pay less under the OCL contract, even when you include the buyout payments, than they would have paid had the coal-fired plant been built. So I think it's fair to say that the OCL buyout will mitigate intergenerational inequities that have been placed on future customers.

The other major issue I wanted to address concerns what we view as the distortion of benefits from the OCL buyout in the net present value analysis that's been presented by the Staff witness. I understand that it's not easy to stimulate interest in discussing subjects like discount rates, but the approach that's been used by the Staff witness in this case, I think, warrants the Commission's attention. And rather than getting into the details, I want to just talk about the general concept.

Florida Power presented the kind of net present value analysis that the Commission has traditionally and consistently used when evaluating generation alternatives. And that's an analysis that involves evaluating future cash flows and converting them to present value using a discount rate that's equal to the utility's marginal after-tax cost of capital.

The Staff witness, on the other hand,

proposes the use of a novel present value analysis that's at least three steps removed from the conventional approach that the Commission uses. And the results of it is discount rates that defy logic.

The first departure from convention is the use of what's referred to as risk adjusted discount rates, instead of the utility's cost of capital. And under this approach, risk premiums are adjusted based on the relative risk of individual cash flows, and then are used in conjunction with a risk-free rate.

The witness has never proposed the use of risk adjusted discount rates in a proceeding before the Commission, and he knows of no such proposal by any other member of the Staff.

COMMISSIONER CLARK: Say that again, Mr. McGee. Just that little part.

MR. McGEE: The witness has admitted that he has never proposed using risk adjusted discount rates in a proceeding before the Commission.

COMMISSIONER CLARK: This particular witness?

MR. McGEE: Yes.

COMMISSIONER CLARK: Okay.

MR. McGEE: And indicated further that he wasn't aware of any other Staff members who proposed such an approach.

COMMISSIONER CLARK: Okay.

MR. McGEE: The next departure made in this approach is a departure from the normal use of risk adjusted discount rates. Even though they aren't used by the Commission, they are used in other instances. And that's done by adjusting his discount rates downward instead of upward in recognition of higher risk. And he cites his authority for this sort of intuitively backward treatment of risks, a disputed methodology that's contained in a 20-year old text. But then he goes further. He even departs from this methodology by applying this downward counterintuitive risk adjustment to risk-free rates, producing what's, in effect, a negative risk discount rate, a concept I'm certainly not acquainted with. And he does this even though the academic source that he cites describes a downward adjustment made to average risk, not risks that have been -- that are devoid of any risk at all.

Florida Power's witness shows that when these unconventional approaches are at least properly or reasonably applied, the OCL buyout still produces substantial net present value savings to the ratepayers.

I believe, Commissioners, that when you consider the testimony that more fully describes these issues, you'll conclude that the interest of the ratepayers are best served by approval of the OCL contract buyout. Thank you.

COMMISSIONER CLARK: Thank you, Mr. McGee. Mr. Childs.

MR. CHILDS: Commissioners, it was approximately 14 years ago that this Commission adopted comprehensive rules setting the prices for purchases by electric utilities from cogenerators and small power producers. Those rules were the result of extensive hearings, contested hearings, and participation by, it seemed like, everyone who could potentially have an interest for the next 20 years.

The point is that the Commission adopted detailed rules as to the procedure for calculation of payments by utilities for firm energy and capacity from qualifying facilities, such as OCL. They imposed an obligation on electric utilities to make those purchases, and imposed an obligation on electric utilities to negotiate with qualifying facilities to make those purchases.

So I think you should have as a perspective of this case that it was not simply a matter where

Florida Power Corporation decided one day that wouldn't it be nice to make a purchase of firm energy and capacity. The evaluation of the amendment to that contract, I submit to you, must be made consistent with the Commission rules that apply to the determination of the pricing in the first instance.

It was about a year ago that this Commission addressed the rule having to do with amendment to contracts between electric utilities and qualifying facilities. And one of the provisions that it put in the rule was -- and this is Rule 25-17.0836(6) says, "The modifications and concessions of the utility and developer shall be evaluated against both the existing contract and the current value of the of the purchasing utility's avoided cost."

And I suggest that avoided cost is precisely what the Commission's rules on purchasing from qualifying facilities address in detail and provide formulas for the calculation. Here, I suggest that the methodologies that have been submitted by the Staff and by the office of Public Counsel depart from the standards that your rules say must be applied.

Moreover, the use of full avoided cost is -- has significance in other contexts. It is the basis that this Commission has used for years in evaluating alternative generation sources. That's how you do it. It is the basis that this Commission has used to evaluate conservation programs and set goals for conservation.

You go through the process of evaluating alternative sources of generation, other supply-side alternatives, demand-side alternatives, and you make a decision. And you make a decision based on avoided cost, based upon the utility's after-tax cost of capital.

The term "avoided cost" is what the utility will pay. The Commission rules not only quantify it, but they quantify the conditions under which there may be any variation from full avoided cost.

Since Florida Power Corporation was required to purchase and since it was required to negotiate, I think it is, based on fundamental fairness, improper to change the rules halfway through the game. The Commission has in detail in earlier years reviewed the concept of the value of deferral. It made the choice that the utility's after-tax cost of capital would be used in the qualification of the value of deferral. It made the choice that the utility's after-tax cost of capital would be used to evaluate the extent to which there could be any variation from that payment on an annual basis.

I want to look for a moment at some of the evidence that's been presented against this proposed contract amendment. And I want to do that in the context of urging you not to accept a suggestion that your rationale should be ad hoc, and that you can make a decision from time to time using different standards for one contract, different for another.

The proposal by Mr. Larkin assumes, and if you will look at the document in this case -- assumes that the customer savings amount to $472 million. They show savings in each and every year of that period with a low number of 36 million and a high of 59 million. Those are the actual savings in nominal dollars.

COMMISSIONER CLARK: When do the savings start?

MR. CHILDS: They start in the year 2014.

COMMISSIONER CLARK: Okay.

MR. CHILDS: That's the total savings. The total payment proposed for your review is 49 million. Therefore, you have a payout ratio of approximately nine to one. Really, it's about 9.5.

Now, Mr. Larkin's theory is, well, that's not good enough because the rate for credit cards is

13%. And if you discount these savings at 13%, you get a negative present value of 4.6 million. What he doesn't tell you is you also get a return on that of in excess of 12% compounded annually. That's just not addressed.

But the point that I think the Commission should keep in mind is when it makes the decision in the first instance about payments of full avoided cost, indeed when it makes the decision in the first instance about what generating unit a utility should bill, it doesn't look just to the near term benefits. It doesn't say, "well, if we use the 13% discount rate, because that's the short-term credit card rate, we'd only build combustion turbines."

No, it looks to the long-term benefits and costs. And I think that these substantial savings in the future must be recognized in your decision. They are recognized in setting full avoided cost, and I think they should be recognized here.

COMMISSIONER CLARK: You are saying if we followed the rule, we would have to recognize it.

MR. CHILDS: I beg your pardon?

COMMISSIONER CLARK: You're saying if we followed the rule, we have to recognize it.

MR. CHILDS: I couldn't hear the last part of your sentence.

COMMISSIONER CLARK: If we followed the rule you cited, we would have to recognize them.

MR. CHILDS: You'd have to recognize full avoided cost, and you'd have to recognize the savings.

I believe that Mr. Stallcup ignores the Commission's rules in his analysis. As Mr. McGee points out, the analysis is a novel and, I believe, untested methodology that's never been presented to this Commission in any context. And I believe, as I've said, that it contradicts your rules, which is the utility's after-tax cost of capital not only in quantifying the payment to be made, but to quantify whether variations from that payment are acceptable.

The methodology of Mr. Stallcup's presentation is very complex and difficult to understand. At least it was for me. It involves a lot of calculations. However, I think that -- I think that I would urge you to recognize that there is some bias in his methodology, and we will attempt to point that out. But, for instance, this Commission has looked to the potential bias in forecasting, as it relates to the selection of combined cycles or coal units, and has used in the past the so-called acid test to address potential bias. We don't see an acid test presented in this proceeding by the Staff, although they present a fuel forecast that shows substantial variation in fuel prices in the future.

Instead, we see a risk adjusted discount rate which is biased toward coal and away from gas. And it is biased toward coal because it urges you to make a decision on net present value, but it would discount the coal energy price at a 2.8% based discount rate and would discount natural gas at 1.6%.

So that sends a message, I think, to companies in the future in coming to this Commission, that if you are looking at an alternative, we have a new test. You're looking at an alternative generating source as a new test. And that test says that now, perhaps, there's a bias toward coal.

I also think that the analysis is somewhat mysterious in that it appears to show results that are, I believe, counterintuitive. It's difficult just for me to understand how you can have a positive benefit in excess of $22 million for each of the 10 years in nominal dollars but conclude that there's a substantial negative net present value resulting.

COMMISSIONER CLARK: There is a risk of a negative.

MR. CHILDS: It's the risk calculation. But the bottom line I want to look at is Mr. Stalloup's conclusion. I want to read from Page 13 of his testimony. And I believe he may have changed some of these numbers so that they are a little more favorable to Florida Power Corporation, but I'm going to use the text that he has.

Page 13, he talks about his analysis showing an overall expected net present value of 9.2 million. "From these results I conclude that there is approximately a 40% chance that ratepayers would be harmed if the proposed buyout is approved, and approximately a 60% chance that they would be better off if the proposed buyout is approved."

What he doesn't tell you is that his 40% chance that the ratepayer would be harmed is that the ratepayer would earn only a 9.6% return. And I want you to try to keep that in mind as we go through some questions, that value judgments about whether the customer would be harmed cannot necessarily be answered, even if you are going to ignore your own rules and apply a different discount rate. It can't necessarily be answered simply by looking to the result of a net present value analysis. I think you need to know the underlying actual return.

I urge you to keep in mind that you have for years been quantifying avoided cost in annual planning hearings and in the review of negotiated contracts and in the promulgation of standard offer contracts. You have been doing it on the basis of the purchasing utility's avoided cost. You have just recently concluded reviewing a determination of need proceeding for the City of Tallahassee. And you used Tallahassee's avoided cost. You didn't make the decision as to what unit to build on the basis of customer credit card rates, therefore, I urge you to approve the proposed amendment. Thank you.

COMMISSIONER CLARK: Thank you. Mr. Howe.

MR. HOWE: Commissioners, among the four major investor-owned electrics in the State of Florida, Florida Power Corporation has the highest rates for residential customers. It has the highest rates because it's signed the most cogeneration contracts. Now these cogeneration contracts don't cause Florida Power Corporation any real problem because all the costs are floated through to their customers. But Florida Power Corporation has realized that current generation can be built and put in place at about half the cost of these expensive cogen contracts. So Florida Power Corporation wants to get out of the cogen contracts, because Florida Power

Corporation sees the competition is coming; and in a competitive environment, these cogen contracts will make Florida Power Corporation's electricity to expensive to compete.

Commissioners, the essence of this case is Florida Power Corporation wants its customers to pay today, to pay more on top of what are already the highest residential rates, to purchase an enhanced competitive position for the company in the future. Commissioners, if Florida Power Corporation was to fund this buyout, Florida Power Corporation would reap the benefit of that increased competition in the future.

Now, Commissioners, I'd like to address a couple of graphs we made up. Let me see if I can use this wireless microphone.

Commissioners, this is a bar graph we prepared. We have distributed copies, and the document attached to those copies, you'll see that this exhibit is based exclusively on Exhibit D appended to the company's petition. And, Commissioners, what this tells us, that if we assume Florida Power Corporation can predict the cost of coal for 27 years, can predict the cost of natural gas capacity for 27 years, can predict the fuel cost of natural gas for 27 years, and if we assume that Florida Power Corporation's customers want to invest in the company for 27 years, and if we assume that the customers have the same discount rate as the company, what you find here is there will be no net positive savings before the year 2019.

Commissioners, the two of you, along with your three fellow Commissioners, rejected Florida Power Corporation's petition as a proposed agency action unanimously. And in your order you state that, in a section I might remind you entitled "Conclusion. "We are denying Florida Power Corporation's petition because it is inconsistent with the reverse auction bid solicitation process and because there will be no net savings before the year 2019."

Now, Commissioners, we are going to put up another chart, and you are going to see very, very little difference. This chart is based exclusively on Exhibit 7 to Mr. Schuster's prefiled testimony. And as you can see, under Mr. Schuster's prefiled direct testimony, there will be no net savings before the year 2019.

Commissioners, in Florida Power Corporation's protest of the PAA, Florida Power Corporation said, to raise as one of its disputed issues of fact, that there would be net benefits in less than 22 years. Commissioners, you've read Mr. Schuster's testimony. I read Mr. Schuster's testimony. There is no testimony, and this exhibit demonstrates there will be no net savings before the year 2019.

Commissioners, what Florida Power Corporation wants to do is keep its customers in the red for 22 years. But this exhibit shows us something else. If Florida Power Corporation funded the buyout over the first five years, if Florida Power Corporation was allowed to retain the savings over the years 2014 through 2018, or pro rata over the full ten-year period, Florida Power Corporation would suffer absolutely no loss, would recover all its costs including its cost of capital, which is inherent in its discount rate, and the customers would still receive the projected benefit if all the company's assumptions are right of approximately $34,647,000.

Another interesting aspect of this graph, if Florida Power Corporation were to fund the buyout, those expenses would be tax deductible to the company. It would only cost Florida Power Corporation on a net present value basis approximately $25 million to fund the buyout.

If we assume the same tax rate, and again assume the company's projections are accurate, these savings in future years, even net of taxes, will allow a full cost recovery by the year 2019. Important point about this is the company will be able to recover the cost of the buyout through the capacity and fuel cost recovery clauses, which is exactly what the Company is asking for here.

Commissioners, one other thing. Mr. Childs' opening statement dealt mostly with the Commission's Rule 25-2217.083(6). Commissioners, the Commission's rules dealing with initiation of formal proceedings require that the petition provide a concise statement of the ultimate facts alleged, as well as the rules and statutes which entitle the petitioner to relief.

Commissioners, Florida Power Corporation has not alleged it is entitled to relief under Rule 1722 -- I'm sorry, 25-2217.083(6). None of the prefiled testimony deals with the Company's entitlement to relief under that rule. I do not believe it is before you as a matter for decision. Excuse me. And nothing the Company is offering you in this proceeding will demonstrate that the customers could receive any net savings before the year 2019; and, Commissioners, you've already rejected that proposal.

COMMISSIONER CLARK: Staff, do you have a statement?

MR. [illegible]: No, Staff does not have an opening statement.

COMMISSIONER CLARK: All right.

Mr. Schuster.

MR. HOWE: Commissioner Clark, could I ask as a preliminary matter that the bar graph we used, we distributed, to be identified for the record. And I don't care as an exhibit, but identified for the record so that the transcript will be clear and they'll be some reference to the graph we were using.

COMMISSIONER CLARK: Mr. McGee, Mr. Childs, Staff?

MR. McGEE: Do I understand correctly, Mr. Howe is not asking that it be admitted, he just wants to have it identified so they will be a reference?

MR. HOWE: That's correct.

MR. McGEE: Because I have no objection to that.

COMMISSIONER CLARK: How do you want me to identify it? What do you want me to do specifically?

MR. HOWE: Well, Commissioner Clark, I'm

just concerned that I have referred to a bar graph. The transcript will refer to it. I would ask that these documents we distributed be included in the record in some fashion so that there can be referencing --

COMMISSIONER CLARK: I'll tell you what, I'm going to leave it pending, you tell me how to do it.

MR. HOWE: Okay.

COMMISSIONER CLARK: I just don't know how we would go about doing it, so give it some thought.

MR. HOWE: Well, then, I would just ask that they be identified as an exhibit and not introduced through witness testimony.

COMMISSIONER CLARK: Why don't we do this. When we take a break, maybe you can talk to the parties. If they have no objection and feel it is based on evidence in the record, maybe we can allow it as evidence, stipulate it into the record.

Mr. McGee.

LEE G. SCHUSTER

was called as a witness on behalf of Florida Power Corporation and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. McGEE:

Q Would you give us your name and business address for the record, please?

A Yes, my name is Lee Schuster. My business address is Post Office Box 14042, St. Petersburg, Florida, zip code 33733; and my current position with Florida Power is Manager, Purchased Power Resources.

Q Mr. Schuster, do you have before you a document entitled direct testimony of Lee G. Schuster, it consists of 20 pages and has attached to it Exhibits LGS-1 through 7?

A Yes, I do.

Q And was that testimony prepared by you as your direct testimony for this proceeding today?

A Yes, it was.

Q Do you have any additions or corrections that you would like to make to that testimony?

A Yes, I have one typographical correction on Page 20 of the testimony, Line 14. The savings identified as 474 million should be 472 million.

Q With that correction, Mr. Schuster, if I were to ask you the questions that are contained in your prepared testimony, would your answers be the same today?

A Yes, it would.

MR. McGEE: Madam Chairman, we'd ask that Mr. Schuster's testimony be inserted into the record as though read.

COMMISSIONER CLARK: The prefiled direct --

MR. HOWE: Commissioner Clark, I have an objection to Mr. Schuster's testimony.

COMMISSIONER CLARK: Okay.

MR. HOWE: Two grounds. One is that you'll notice the overall tenor of his testimony, and including the conclusion, is he's asking the Commission to reconsider its vote. Commissioners, there's a specific rule that the Commission has that says the Commission will not entertain motions for reconsideration of proposed agency action.

Apart from that, Commissioners, I have specific portions of Mr. Schuster's testimony that I would move to strike.

COMMISSIONER CLARK: All right. First of all, you are saying the whole testimony should be stricken because it's a motion for reconsideration. I thought I've already ruled on that with respect to the Prehearing Order.

MR. HOWE: Commissioner Clark, the Commission had denied my motion on that basis, but it was before Mr. Schuster had filed testimony. In other words, there was no testimony filed at the time I filed my --

COMMISSIONER CLARK: I appreciate that. Commissioner Garcia? Where in the Prehearing Order? Is it in the Prehearing Order? No, the whole Commission ruled on it; is that right?

MR. HOWE: Ruled on my motion to dismiss, yes.

COMMISSIONER CLARK: Okay.

MR. HOWE: Which was based on the company's petition. There was no testimony filed at that time.

COMMISSIONER CLARK: I thought this also came up at the prehearing.

MR. HOWE: It did, Commissioner Clark.

COMMISSIONER CLARK: Wasn't it an issue?

MR. HOWE: Yes, and I stated -- you moved to strike it, I stated that I was raising it to make sure it was properly preserved. I'm raising it again for that same purpose.

COMMISSIONER CLARK: All right. It's

preserved.

MR. HOWE: Commissioner Clark, I assume then --

COMMISSIONER CLARK: Your motion to strike the full testimony is denied.

MR. HOWE: Commissioner Clark, if we could then, just going through the testimony, for example, beginning at Page 3, the question as you will see that begins on Line 13 of Page 3 is, "Do you agree with alternative Staff conclusion." Starting here at that point on Page 3 and continuing through to Page 5, Line 9, this testimony is dealing solely with the Staff's recommendation that led to the proposed agency action.

COMMISSIONER CLARK: It is the alternative Staff recommendation that was followed, correct?

MR. HOWE: Yes.

COMMISSIONER CLARK: Okay.

MR. HOWE: Commissioners, this is totally irrelevant as to whether the Commission is able to prove up its petition in this case and at this hearing. I would move to strike it on that basis.

COMMISSIONER CLARK: Mr. Howe, I'm not going to strike it. I'm not going to hear from Power Corp. I think it is relevant.

MR. HOWE: Well, if I might continue then, I'll identify the other portions of the testimony that I think are improper.

COMMISSIONER CLARK: That's fine.

MR. HOWE: On Page 6, Line 17, going through to Page 12, Line 3.

COMMISSIONER CLARK: Okay.

MR. HOWE: This is solely a discussion of the Staff's recommendation, and I would make the same argument that this is not relevant evidence, it is not evidence of a type that the Commission could base any findings of fact upon in this proceeding.

COMMISSIONER CLARK: Let me just -- Page 12, what line?

MR. HOWE: Line 3.

COMMISSIONER GARCIA: Not to argue with the Chairman's decision on this, but could you state your objection to this testimony a little bit?

COMMISSIONER CLARK: I apologize, he can state his objection, and we'll hear from Power Corp.

MR. HOWE: Certainly.

COMMISSIONER GARCIA: I don't necessarily need to hear from Power Corp --

COMMISSIONER CLARK: Okay.

COMMISSIONER GARCIA: -- I'm going to stay with the chair on this. But I want to understand it more properly, and maybe it's something you brought up at the prehearing, which I was --

MR. HOWE: Commissioner Garcia, this is a de novo proceeding in which Florida Power Corporation is going to try to present evidence to prove by a preponderance of the evidence that's its initiating petition should be approved by you two Commissioners. What the Commission did and what the Commission considered before it acted in the proposed agency action is completely irrelevant. It is, I believe, the basis upon which Commissioner Clark denied Orlando Cogen's request to call Staff witnesses and to delve into the deliberative process. This testimony --

COMMISSIONER GARCIA: Stop right there. That was the question I had for you, Madam Chairman, that's why the reasoning -- I wanted to understand it better because it was the basis of your denial of the Company's offered -- was it new testimony, or --

COMMISSIONER CLARK: That's right. I viewed this as being tangentially relevant in the sense that it dealt with a written recommendation and speaking to the written recommendation.

MR. HOWE: Commissioner Clark, the written recommendation was the embodiment of the deliberative process and the recommendation made by the Staff. I honestly fail to see how we can be in a de novo proceeding and we are going to be faced with dealing with evidence and I'm going to have to cross examine a witness on what Staff recommended to the Commissioners before they issued a proposed agency action. I don't think any of that is appropriate, and I don't think it's appropriate for the Commission to allow it to be entered into the record, or to form a basis upon which you can make your findings.

If I might continue, on Page 12, Line 7, as you can see, that begins with the question, "Do you agree with the alternative Staff assertion," which is dealing exclusively with the recommendation. And my objection to that testimony would continue through to Page 13, Line 2, which is all dealing with Staff's recommendation.

On Page 15, Line 6, I do not object to the question, but you'll notice the answer begins "In the Staff recommendation," and it refers to the Staff recommendation in another case. I believe it is totally irrelevant. It's irrelevant for the same reasons the Staff recommendation in this case is irrelevant. But Staff's recommendation in another case should not form any basis of this Commission's decision. My objection to that testimony, beginning on Page 15, Line 6, would continue through to Page 16 Line 2.

Continuing on Page 17, Line 2, the answer to the question is an introductory phrase and then a quote from the primary Staff recommendation. It's purportedly supporting the Company's position in this case. Again, the Company is challenging. Comments made in the deliberative process, it objects to, and quoting with approval to comments made by Staff in the deliberative process that agrees with. And my objection there would be from Page 17, Line 2 through Line 13.

On Page 20 --

COMMISSIONER GARCIA: I'm sorry. Through Line 13 on Page 18 or line --

MR. HOWE: I'm sorry, Line 13 on Page 17.

COMMISSIONER GARCIA: Correct, got you.

MR. HOWE: On Page 20, and please note at the top of the page the question is, "Should the Commission reconsider its decision," which was the basis of my earlier objection. But on Page 20, Line 16 through Page 20, Line 18, the sentence beginning with "Approval." The full sentence reading, "Approval of the transaction was endorsed by the primary Staff recommendation of December 26, 1996."

Commissioners, I believe allowing this testimony in, in this forum, is prejudicial and is opening the door for companies to use Staff's recommendations to prove up their case in lieu of evidence. Thank you.

COMMISSIONER GARCIA: Madam Chairman, I'm going to follow your decision on this --

COMMISSIONER CLARK: Hang on a minute. I think we should hear from Power Corp in response to it.

COMMISSIONER GARCIA: If you feel comfortable.

COMMISSIONER CLARK: Just so you hear that.

COMMISSIONER GARCIA: Well, I'll just say this, if you want to do that, that's fine, but I don't think we need to take up anymore time. I think you've look at this, and you've thought it out thoroughly.

I am a bit concerned with the fact that we are arguing against ourselves here, and we're using the deliberative process to prove up issues that this Commission did not decide, and using our own process to make a point against ourselves, so --

COMMISSIONER CLARK: I think what the difficulty is here, is that we used a PAA process and the law has changed somewhat with respect to PAA processes in terms of what's at issue and what may not be at issue. I think the recommendation is out there. It was certainly the basis on which we made a decision, and I think it's appropriate to respond to that. The question is, does it go further and allow what Mr. Childs's wanted to do? I don't think it does. That's the distinction I make.

I recognize that we have some changes in the 120 process. I note that Mr. Howe at one point suggested we dismiss this because Power Corporation has no standing to argue this case, because it doesn't affect them one way or the other. On that basis I think there is a whole lot of business we could get rid of because it's always passed through to the customer.

These are not black and white issues. They tend to be very gray. I think -- I don't think there is a basis for striking the testimony, but I think you do draw the line somewhere. Mr. McGee, do you want to add anything?

MR. McGEE: Madam Chairman, I don't know if I could say it any better than you just did. I was struck by one bit of -- apparently, in Mr. Howe's argument in that -- the reference to the Staff recommendations he refers to deals with the issues that were disputed in our petition request in this hearing as we were required to do by the statute in lieu of waiving them.

And Mr. Howe previously had indicated that because our testimony didn't address one particular issue, that with respect to the year in which net savings were achieved, because our testimony didn't address that point, that that issue should be deemed stipulated. So I sense he wants to have it both ways. If it's appropriate to put it in there for that purpose, it's appropriate to put it in here for this one.

COMMISSIONER CLARK: We've made the appropriate notations in the record. You have identified that which you believe should be stricken if on appeal the court feels that we made the ruling in error.

MR. HOWE: Commissioner Clark, in that same vein, so the record is clear, I would have also moved to strike the exhibits referred to in those portions of the testimony. I would also ask for clarification, Commissioner Clark. And the clarification is, is this hearing today a de novo proceeding?

COMMISSIONER CLARK: Well, Mr. Howe, you know, the law is it says what it is. And I think there appears to be a debate as to whether it's a de novo hearing as to everything or as to just those issues which are not in dispute.

MR. HOWE: I guess I am asking now for clarification from the Chair. Are you viewing this as a de novo proceeding?

COMMISSIONER CLARK: Well, Mr. Howe, I'll think about it.

MR. HOWE: Okay.

COMMISSIONER CLARK: I think it's appropriate for us to go forward. It is not clear under the new APA provision as to what is the proper procedure. I personally feel from the standpoint of trying to get at the issues and making a decision on the merits that we are going about it the appropriate way. And we shouldn't allow procedure to get in the way of making a right decision on the merits. And quite frankly, I think some of that has gone on.

All right. Let's identify the exhibits. Let me make one thing clear to you, Mr. Howe. Is it clear from the testimony which exhibits you would also object to, because if it's not, we probably need to do that.

MR. HOWE: All right. I would --

COMMISSIONER CLARK: We don't need to do it now, but we need to make it clear so that we don't later get into a debate, well, it was referenced, or it wasn't. So let's identify the exhibits.

First of all, we are going to insert the prefiled direct testimony of Mr. Schuster as though read with those objections noted by Mr. Howe. Now, let's move to the exhibits.

MR. McGEE: Mr. Schuster has 7 exhibits, and they are designated LGS-1 through 7.

COMMISSIONER CLARK: We'll identify them as Composite Exhibit 1.

(Exhibit 1 marked for identification.)

FLORIDA POWER CORPORATION

DOCKET No. 961184-EQ

DIRECT TESTIMONY OF
LEE G. SCHUSTER

Q. Please state your name and business address.

A. My name is Lee G. Schuster. My business address is Post Office Box 14042, St. Petersburg, Florida, 33733.

Q. By whom are you employed and in what capacity?

A. I am employed by Florida Power Corporation (FPC) in the capacity of Manager, Purchased Power Resources.

Q. Would you please describe your educational background and work experience?

A. I graduated with a Masters Degree in Industrial Administration from Purdue University in 1975 and I received a Bachelor's Degree in Chemical Engineering from the University of South Florida in 1973. I began my employment with Florida Power in 1980. Since then, I have held the following positions: Corporate Planning Analyst, Corporate Budget Analyst, Director of Corporate Budgets (Florida Progress), Director of Investor Relations (Florida Progress), Corporate Planning Analyst, Principal Business Planning Analyst, Senior Planning Analyst (Florida Progress) and Manager, Purchased Power Resources. In my position as the Director of Corporate Budgets, I was responsible for coordinating the development of subsidiary budgets and financial plans as well as for the preparation of budgets and financial plans for the holding company and on a consolidated basis for Florida Progress. In my position as the Director of Corporate Relations I was responsible for investor relations and communications, stockholder records, production of the annual report and relations with brokerage and institutional analysts. In my various analyst positions I have worked on a wide variety of special projects at both Florida Power and Florida Progress.

Q. What are the responsibilities of your present position as Manager of Purchased Power Resources?

A. As Manager of Purchased Power Resources my job responsibilities are to administer Florida Power's cogeneration contracts in compliance with state and federal laws and regulations, and performing activities such as negotiation and financial analysis of contract changes, management of requests for proposals, technical and financial analysis of proposed projects, and providing information to and maintaining coordination with FPSC staff, FPC internal departments and cogenerators.

Q. What is the purpose of your testimony and how is it organized?

A. The purpose of my testimony is to explain FPC's position regarding the disputed issues of fact and policy identified in FPC's Petition on Proposed Agency Action filed February 17, 1997. In addition, I will explain the justification for approval of the Orlando Cogen Limited, Ltd. (OCL) contract buyout as requested in FPC's original petition filed October 1, 1996, and the benefits that will result from this transaction. My testimony is divided into the following sections:

I. Consistency of the OCL Bid with FPC's Request for Proposals

II. Staff's Cost Effectiveness Sensitivity Analysis Cases

III. Effect of the Buyout Proposal on Intergenerational Fairness

IV. Benefits of the OCL Contract Buyout

V. Conclusions

I. Consistency of the OCL Bid with FPC's Request for Proposals

Q. Do you agree with alternative Staff conclusion in the recommendation issued on December 26, 1996 that the OCL contract buyout contradicts the "primary" objectives of FPC's reverse auction bid solicitation (RFP)?

A No, I do not. The quotations from FPC's RFP that Staff asserts state the "objectives" were taken out of context from the RFP document and are not objectives of the RFP. When each of these statements are placed into proper context it becomes clear that they are not primary objectives of the RFP and that FPC's petition violates neither these statements nor the true objectives of the RFP.

Q. The first "primary objective" quoted by staff was "Bids that provide net benefits (revenue requirement reductions) to customers sooner rather than later will be given preference." What is the actual context of this statement in the RFP?

A. This statement was taken from the section of the RFP that describes how FPC will evaluate and compare bids (Exhibit No. Comp 1 (LGS-2), page 6). The statement in question is actually the second of two bid evaluation criteria and it expresses a preference for bids with near term benefits when two or more bids are available for comparison. Staff's interpretation of this statement fails in two respects. First, the context makes clear that the statement is not a primary objective of the RFP process. Second, the statement refers to a preference between bids, not an absolute test which a single bid can be subjected to and pass or fail. Given that only a single successful bid, namely the OCL buyout transaction, resulted from the RFP process, this statement obviously cannot be used as a criteria to accept or reject the OCL bid.

Q. The second "primary objective" quoted by staff was "Bids that result in a near term increase of capacity payments may be limited to an aggregate net present value rate impact of $17.7 million, the amount of the 1995 over-recovery from the revenue decoupling experiment." What is the actual context of this statement in the RFP?

A. This statement was also taken from the section of the RFP that describes how FPC will evaluate bids (Exhibit No. Comp 1 (LGS-2), page 6). The statement was intended to provide general information to bidders and not to describe an absolute limit on acceptable bids. This was accomplished by clearly stating that the amount of bids accepted

"...may be limited..." and by the following sentence of the RFP which states that FPC may choose to pursue bids with the FPSC that exceed $17.7 million. FPC did elect to pursue the OCL bid and filed a petition with the Commission for approval of the OCL buyout transaction. Staff's interpretation of this statement fails in two respects. First, the context makes clear that the statement is not a primary objective of the RFP process. Second, Staff unaccountably describes the OCL transaction as contradicting this statement in the face of the plain language of the RFP and FPC's action in filing the petition.

Q. In FPC's opinion, what were the primary objectives of the RFP against which the OCL buyout should be judged?

A. FPC made the following statement on pages 1 and 5 of the RFP: "Proposals will be judged according to their ability to reduce the long term cost of purchases under existing QF contracts in a manner that is cost effective to FPC's customers." (Exhibit No. Conf 1 (LGS-2)) FPC described a typical scenario that may result from the RFP process by stating that it was soliciting proposals for capacity payment buy downs which "would result in a rescheduling of capacity payments over the remaining life of existing purchase agreements, resulting in higher capacity payments in the near term and lower capacity payments in the future." (Exhibit No. Conf 1 (LGS-2), page 1)

Q. Is the OCL buyout consistent with these objectives of the RFP?

A. Yes. The OCL transaction is typical of the type of proposal that the RFP process was designed to elicit from its inception. As such, it is fully consistent with the objectives of the RFP.

Q. Does the RFP document provide any further evidence that the OCL contract buyout bid is consistent with the objectives of the RFP?

A. Yes. The instructions to bid respondents (Exhibit No. Comp 1 (LGS-2), page 8) describes contract buyouts as one type of bid which FPC will give full consideration to and describes such contract buyouts as follows: "Contract buy outs may be designed to partially or completely buy out the existing contract. Partial buy outs can be based on a reduction in the term of the contract, a reduction in committed capacity, or other changes in the existing terms of the contract." The OCL contract buyout bid is a proposal to shorten the term of the contract by ten years and, as such, it is perfectly consistent with the RFP's definition of a contract buyout.

II. Staff's Cost Effectiveness Sensitivity Analysis Cases

Q. The alternative Staff analysis, which was incorporated into the Commission's Proposed Agency Action Order, states that the buyout's cost-effectiveness was determined using the fuel price forecast from FPC's 1996 Ten Year Site Plan (TYSP) filing, specifically the Base Case and High Case fuel forecasts. (Exhibit No. Comp 1 (LGS-1), page 6) Do you agree with this statement?

A. No. Staff did not use fuel price forecast data from FPC's TYSP filing for the time period relevant to the evaluation of the OCL contract buyout (2014 through 2023). The fuel price forecast data contained in FPC's 1996 TYSP filing extends only to 2005. My Exhibit No. Comp 1 (LGS-3) contains the fuel price forecast data from pages 14 through 19 of FPC's TYSP Supplemental Information submitted to Staff on April 26, 1996.

Q. What was the source of the fuel price forecast used by Staff to determine the buyout's cost effectiveness and create the sensitivity analysis cases purported to be based on FPC's TYSP fuel forecast data?

A. Based on available information, it appears that the fuel price forecasts mistakenly described by Staff as FPC TYSP fuel price forecasts were created by Staff for the purpose of evaluating the OCL contract buyout.

Q. What information is available to determine the source and nature of the fuel price forecasts used to perform Staff's evaluation of the buyout?

A. Staff has provided a copy of the Lotus spreadsheet file used to prepare the sensitivity analysis cases included in the alternative Staff recommendation. This spreadsheet file contains the fuel price forecast used in the Staff evaluation. The method used by Staff to create a fuel price forecast for 2006-2023 was documented in this spreadsheet file. Staff used the coal and natural gas high band fuel prices for 2005 from FPC's TYSP as the starting point for its forecast. The price forecast for 2006 through 2023 for each scenario was created by using a constant price escalation rate selected by Staff.

Q. In contrast to the price forecasting assumptions used by Staff, was information available from FPC to extend the subject fuel price forecasts beyond 2005?

A. Yes. FPC's 1996 TYSP filing was based on FPC's Fuel Cost Projection (FCP) 9501 forecast. The FCP 9501 natural gas forecast specified an escalation rate equal to 85% of the forecasted inflation rate to be used after 2005. The escalation assumption for coal prices after 2005 was equal to 67% of the forecasted inflation rate.

Q. How do the fuel price forecasts used by Staff compare to FPC's FCP 9501 high band fuel price forecast during 2014-2023, the time period relevant to the OCL buyout?

A. The fuel price forecasts used by Staff are substantially different from FCP 9501.

Q. If Staff had, in fact, used Florida Power's fuel forecast FCP 9501 to perform the cost-effectiveness sensitivity cases (summarized at page 8 of Exhibit No. Comp 1 (LGS-1)) how would the savings for the cases be affected?

A. The sensitivity analysis cases supporting Staff's alternative recommendation on the OCL buyout have been reproduced by FPC and the results of this analysis are summarized in my Exhibit No. Comp 1 (LGS-

4). Column (1) contains the net present value (NPV) savings from the Staff recommendation dated December 26, 1996.

Column (2) shows the results of an independent reproduction of the Staff results by FPC. The NPV results were derived by applying Staff's fuel price forecast assumptions to the original Excel spreadsheet used by FPC to file Exhibit D of the petition for approval of the OCL contract buyout. In this manner, it was possible to exactly reproduce the results for seven of the eight cases. There is an unexplained discrepancy of $1,086,000 in the result for case #5.

Column (3) shows the results of reproducing Staff's cases using FPC's FCP 9601 fuel forecast rather than Staff's fuel forecast. Cases 3, 4, 7 and 8 are affected by this difference in assumptions. Using FPC's FCP 9601 fuel forecast results in positive NPV savings for all of Staff's cases.

Q. Was it necessary for Staff to independently create the sensitivity analysis cases contained in the alternative Staff analysis?

A. No. Prior to issuing the recommendation Staff requested and FPC provided the results for a number of sensitivity analysis cases for the buyout (see Exhibit No. Comp 1 (LGS-5)). The primary Staff recommendation found that the assumptions and methodology used by FPC in its analysis were reasonable and appropriate and relied on FPC's results to conclude that "Further, according to staff's sensitivity analysis of the buyout, the NPV remains positive, $23.3 million, for a worst case scenario which employs the high band of FPC's most recent fuel forecast."

Q. Do you agree with the statement in the alternative Staff recommendation that the scenarios used in its sensitivity analysis represent reasonable scenarios for the future?

A. No, I do not. Apart from discrepancies in the values used in Staff's fuel forecast discussed above, I have two primary disagreements with the scenarios prepared by Staff.

Q. What is the nature of your first disagreement with the scenarios prepared by Staff?

A. The alternative Staff recommendation departs from the standard, accepted practice in forecasting to use the most recent and accurate forecast assumptions to perform its evaluation. In response to a Staff question (see Exhibit No. Comp 1 (LGS-5)), FPC explained that FPC's Ten Year Site plan was based on FPC's 9501 fuel forecast issued on May 1, 1995 and indicated that the 9501 forecast had been superseded by the 9601 fuel forecast issued on January 16, 1996 and subsequently by the 9603 fuel forecast issued on October 28, 1996. Subsequent to its filing on October 1, 1996 FPC provided an updated economic evaluation and sensitivity cases based on fuel forecast 9603.

Simply put, the 9501 fuel forecast had been replaced with a new forecast and was no longer the most recent and accurate basis for planning. Although the primary Staff analysis relied on results based on current forecast assumptions, the alternative Staff analysis nevertheless reverted to the use of the obsolete 9501 fuel forecast in its sensitivity analysis, and did so without providing any justification for this action.

Q. What is the nature of your second disagreement with the scenarios prepared by Staff?

A. The alternative Staff recommendation departs from standard forecasting and evaluation practices in a second important respect. A proper sensitivity analysis includes an evaluation of the expected value for a forecast as well as the variation or range of uncertainty around the expected value. Conclusions should be based on a balanced assessment of both risks and benefits, not based exclusively on risks.

The alternative Staff recommendation based three of its seven sensitivity cases on the TYSP High Case fuel forecast and none on the TYSP Low Case fuel forecast. In addition, the scenarios based on the TYSP High Case fuel price forecast were characterized by Staff as being "reasonable scenarios for the future." It was not disclosed that the TYSP High Case fuel forecast is defined as having a probability of 25% versus a probability of 50% for the Base Case. It also was not disclosed that the TYSP Low Case fuel forecast is equally probable with the High Case (25%) and would have resulted in cases with customer savings in excess of $33 million on a net present value basis. For these reasons, the presentation of results in the alternative Staff recommendation is misleading. The results of the analysis are biased against the transaction due to the fact that only scenarios that are adverse to the transaction are included, and the alternative recommendation is based on only these results.

III. Effect of the Buyout Proposal on Intergenerational Fairness

Q. Do you agree with the alternative Staff assertion that the OCL transaction violates the goal of intergenerational fairness?

A. No. The alternative Staff's assertion that the OCL transaction violates the goal of intergenerational fairness is conclusionary and unsupported. Staff neither stated nor provided a reference to an objective definition of intergenerational fairness in its recommendation. As a result, Staff's assertion appears to be based entirely on its subjective opinion of the transaction.

Q. Did Staff raise the issue of intergenerational fairness as part of its review of FPC's OCL buyout petition prior to issuing its recommendations?

A. Yes. FPC responded by explaining that opportunities to create savings for customers by buying out or buying down QF contracts, by their nature, exist primarily at the "back end" of the term of existing contracts where those contract costs are at their highest level. A typical transaction might modify or eliminate the terms for the final years of a contract while leaving the near term contract payments unaffected. The circumstances of both QFs and FPC favor transactions with this type of deferred timing.

Q. What are the circumstances affecting QFs that favor transactions with deferred timing?

A. Cogeneration projects typically have obligations to pay off project debt financing in a shorter time period than the term of the power purchase agreement. Due to the restrictive terms of these loan agreements, the QF generally has the flexibility to consider transactions such as contract buydowns and buyouts only after the project loan has been retired. In the case of OCL, the proposed transaction affects 2014-2023, after the project loan is retired in 2010.

It is unlikely that a buyout or buydown transaction could be successful if it overlapped with the period when project debt remained outstanding. In fact, another bid in FPC's RFP process failed for exactly this reason. The Tiger Bay project proposed a buyout of the smallest of its five purchased power agreements with FPC (the 6 megawatt Timber 2 contract) as of December 31, 1996. This transaction failed due to problems encountered in obtaining lender approval.

Q. What are the circumstances affecting FPC that favor transactions with deferred timing?

A. The capacity payment escalation rates in FPC's QF contracts will result in a widening gap over time between the cost of these contracts and

FPC's generation alternatives. As a result, the problem that FPC seeks to solve is most severe and the opportunity for reductions in the cost of power are greatest at the "back end" of these QF contracts. Moreover, the opportunity to create customer savings exists largely because some QFs are willing to accept current buyout payments that are less than the nominal capacity and energy payments which would be paid in the future if the contract remained unchanged. It is not possible to create substantial savings by altering near term payments to QFs because potential risk factors and the time value of money do not create a sufficient opportunity to discount the face value of the payments.

Q. Did FPC perform an analysis to demonstrate the potential effect of the OCL buyout on intergenerational fairness?

A. Yes. In response to a Staff request, FPC compared the OCL buyout transaction to the cost of providing the same capacity and energy to customers from the avoided coal plant using conventional accounting and rate recovery. (See FPC response dated November 22, 1996 to Staff question 3 and attached table contained in Exhibit No. Comp 1 (LGS-5)) Such a coal plant is a reasonable basis for comparison because the OCL contract is predicated on the assumption that it is avoiding coal-fired generation.

As shown in the table attached to FPC's response, this analysis demonstrated that the OCL contract buyout had a lower net present value cost in the near term (1993-2001) than the coal alternative and therefore does not have an objectionable intergenerational impact on customers in the near term.

Q. What evidence is there that the OCL contract buyout may mitigate existing intergenerational inequity?

A. In the Staff recommendation dated August 12, 1997 in Docket No. 961477-EQ (the Lake Cogen settlement docket) Staff made the following statement regarding the contract buyout included in the Lake Cogen settlement:

> "The intergenerational equity issue is unclear in this docket because cogeneration purchased power contracts have inverted payment streams to ensure performance in the later years. Compared to setting base rates using traditional regulatory accounting, cost recovery of the inverted cogeneration purchased power payment stream defers to future customers costs that would have been recovered in base rates from existing customers. Thus, existing customers are already paying less than their fair share of cost. For residential customers, adding an approximately 50 cents per 1000 Kilowatt-hours surcharge until 2009 to recover the buyout cost helps correct the present intergenerational inequity." (emphasis added)

Staff's analysis of the Lake Cogen transaction applies equally to the OCL contract buyout, suggesting that the OCL transaction actually mitigates existing intergenerational inequity rather than violating the goal of intergenerational inequity.

Q. What other actions has FPC taken that relate to the issue of intergenerational fairness?

A. The bid that OCL originally submitted in the RFP process was for a five-year contract buyout for the period 2019-2023. In an effort to create customer savings sooner, FPC negotiated a ten-year buyout with OCL which would result in customer savings beginning in 2014, five years earlier than OCL's initial proposal.

IV. Benefits of the OCL Contract Buyout

Q. What customer savings are expected to result from the OCL contract buyout transaction?

A. As stated in FPC's October 1, 1996 petition, restructuring the OCL contract is expected to save Florida Power and its customers $462 million ($33 million net present value) relative to what they would pay with the contract's full 30-year term in effect. The projected savings included in FPC's original petition were based on fuel forecast FCP 9601. Based on FPC's most recent long term fuel forecast FCP 9702 and an updated forecast for future escalation the savings are now estimated to be $472 million ($34.6 million net present value). (See Exhibit No. Comp 1 (LGS-7))

Q. How is the buyout transaction expected to achieve these savings?

A. The basis for the savings were well summarized in the primary Staff recommendation (Exhibit No. Cons 1 (LGS-1), page 4):

> "Buying out the Contract relieves the obligation to pay $459 million in known capacity costs and a projected $283.3 million in fuel costs. As mentioned previously, capacity payments in the Contract are based on a 1991 coal-fired avoided unit. Due to technology improvements and low gas prices, those costs are much higher than today's avoided costs. Also, due to the use of the value of deferral method in calculating the capacity payments of the Contract, the highest capacity payments are in the last years of the Contract. The buyout therefore terminates the most expensive part of the Contract."

The buyout will give FPC the flexibility to provide this capacity and energy to customers at a replacement cost substantially lower than the cost of the OCL contract.

Q. What effect will these savings have on the cost of the OCL contract during the buyout period?

A. The transaction is expected to reduce the average cost of power over the last ten years of the contract from 11.0 cents per kWh if provided under the existing contract to an average replacement cost of 3.6 cents per kWh, a reduction of over 67%.

Q. How does the OCL contract buyout relate to FPC's business objectives?

A. FPC's objective is to continue to meet the electric needs of its customers at competitive prices. The Company has recognized that the rising cost of its portfolio of cogeneration contracts poses a threat to this objective. As the Commission is well aware, this problem is not unique to FPC but is a national problem confronting many electric utilities. For example, FERC and several state Commissions have gone on record as encouraging utilities to pursue Qualifying Facility (QF) buyouts and restructured contracts to mitigate the onerous cost of QF contracts. As one example of this encouragement, FERC has said, "[We] have encouraged utilities to buy-out (or buy-down) higher-priced fuel contracts in order to substitute lower-priced fuel currently available and we have allowed the recovery of prudently-incurred buy-out/buy-down costs." West Penn Power Company, FERC ¶ 61,485 (1995)

FPC has taken the initiative to seek solutions to this problem and as a result, the evaluation of the proposed OCL contract buyout should recognize this larger context. FPC's activities have included energy pricing settlements with five QF suppliers which have resulted in reduced costs to customers, with three of these settlements including contract buyouts that shorten the term of the QF contracts. In addition, FPC has completed a buyout of five contracts related to the Tiger Bay QF facility and acquired the facility itself for the benefit of FPC's customers. The Tiger Bay transaction alone is expected to save customers $2 to $2.4 billion ($384 to $456 million on a net present value basis) in the future.

Q. How should the decision to approve the OCL buyout transaction be viewed in this larger context?

A. Approval of the OCL buyout will contribute to the solution of FPC's overall QF cost problem. A decision to disapprove the proposed OCL buyout transaction is tantamount to a reaffirmation of the existing contract, a type of contract that has been recognized by FPC, Staff and the Commission as being a burden to FPC's customers.

Q. Is it appropriate for the Commission to address the issue of potential strandable costs as part of its decision regarding the OCL contract buyout?

A. No. In the case of the OCL transaction, the effect of reducing future costs from the level of the contract to FPC's projected avoided cost during the buyout period 2014-2023 has, for all intents and purposes, the same effect as eliminating potential strandable costs of a like amount. Describing the resulting cost reduction as potential strandable costs does not alter the evaluation of the transaction. However, if the Commission chooses to address the issue of stranded cost, it is FPC's opinion that the transaction would eliminate potential strandable costs in an amount approximately equal to the customer savings due to the transaction. The analysis supporting the primary Staff recommendation shared this opinion (see Exhibit No. Comp 1 (LGS-1), page 4).

V. Conclusions

Q. Should the Commission reconsider its decision to disapprove the OCL buyout transaction?

A. Yes. In its petition dated February 17, 1997, FPC raised nine disputed issues of fact and policy regarding the alternative Staff recommendation that served as the basis for the Commission's decision. FPC has provided substantial and compelling evidence regarding these issues that, taken together, justify a reconsideration of the Commission's prior decision.

Q. Should the OCL contract buyout be approved by the Commission?

A. Yes. Restructuring the OCL contract is expected to save Florida Power and its customers $472 ~~$474~~ million ($34.6 million net present value) relative to what they would have paid with the contract's full 30-year term in effect. Approval of the transaction was endorsed by the primary Staff recommendation of December 26, 1996 (Exhibit 1, page 3).

Q. Does this conclude your testimony?

A. Yes.

MR. McGEE: All right.

COMMISSIONER CLARK: Mr. Howe, when we come to the point of moving it in, if you would let me know which ones that you want to identify as being subject to your objection, I would appreciate it.

All right, Mr. McGee.

Q (By Mr. McGee) Mr. Schuster, would you give us a summary of your testimony, please?

A Yes, I will. My testimony speaks to the savings that the OCL contract buyout will provide to customers estimated to be $472 million. As Mr. McGee mentioned, nearly a half billion dollars in savings will result from this transaction. On a net present value basis that's $34.6 million calculated in a very conventional net present value analysis using Florida Power's after-tax cost of capital.

The savings can be characterized in a different way by looking at the cost of power that will result from this transaction. Under the contract, the cost of power average over that ten-year period from 2014 to 2023 will be approximately 11 cents per kilowatt-hour. After the buyout, the replacement case indicates that the cost of power will be approximately 3.6 cents per kilowatt-hour. That's a reduction of approximately two-thirds of the cost of power. A very substantial reduction. That is the basis for the savings, and it is not a nominal or an incremental decrease in the cost. It's a very substantial decrease. It will result from Florida Power's ability to defer the decision as to how to replace that power and get it at the lowest cost and in the most optimal way that they can as they approach the year 2014.

My testimony also speaks to the larger context of this buyout. And I would describe that larger context as being the nationwide problem with cogeneration contracts that has been faced by many utilities.

As it's been pointed out here today, Florida Power signed more of these contracts than the other utilities in the state of Florida. Florida Power has also done more than the other utilities in the state of Florida and many of the utilities across the country in order to address this problem.

Recently, the Commission approved the buyout of the Tiger Bay contracts and the Tiger Bay facility which will provide savings in excess of $2 billion to our customers in the future. The OCL contract is a part of that larger program, it's a very important part. And I can't stress enough that a potential savings of a half billion dollars to our customers is something that should be considered very carefully as an opportunity.

The buyout itself is not just a stand-alone opportunity to take or leave. It should be recognized as being a solution to a problem. The problem is the cost of power under the OCL contract in that last ten years. And if the buyout is not approved, effectively what we're doing is saying we like the contract the way it is better. And I think that over time, with respect to the OCL contracts and the other contracts similar to it that Florida Power has in place, it's been recognized by everyone that these contracts are onerous, they are relatively high cost contracts in the near term, and they will get progressively more onerous over time. This type of buyout represents, in my opinion, the only opportunity that Florida Power has to prevent that cost increase from ultimately hitting the customers' pocketbooks.

In addition, my testimony discussed the disputed issues of fact and policy that were filed in Florida Power's original motion, and I'd just like to mention briefly, as Mr. McGee had covered some of those, the intergenerational issue, which is one that has become more and more important in this proceeding as it has progressed. The buyout itself is -- it should be viewed as a correction of the inherent intergenerational bias of the original contract.

I think it's a mistake to look at the effect of the buyout in a vacuum. It should be viewed as it counterbalances the intergenerational bias of the OCL contract. And the whole issue of intergenerational equity or bias should be viewed in the sense that every transaction has an element of bias in it. And the thing that has allowed the Commission in the past to not grapple with that issue is that it averages out over time. As Mr. McGee pointed out, many projects and cost requests by utilities are front-end loaded, many others are back-end loaded, and these thing average out over time. They are not in and of themselves, with respect to an individual transaction, a burden to ratepayers. The averaging out of our time makes them essentially a nonissue.

The important issue, and the one that has been focused on by the Commission in the past, is the savings that are afforded by an opportunity or a transaction of this type. And I would submit to you that the savings of this particular transaction are very substantial, approaching a half a billion dollars, approaching $9 to $10 of savings per dollar up-front cost of the buyout. And I believe that should be the basis for the Commission's review and approval of this transaction. Thank you.

MR. McGEE: I tender Mr. Schuster.

COMMISSIONER CLARK: Okay. OCL has no questions?

MR. SJOSTROM: No questions, Your Honor.

COMMISSIONER CLARK: "Commissioner" would be fine.

Go ahead, Mr. Howe.

CROSS EXAMINATION

BY MR. HOWE:

Q Mr. Schuster, would it be fair to say that Florida Power Corporation is motivated to buy out its purchased power agreements, to put itself in a more competitive posture for the future?

A Yes.

Q Mr. Schuster, would it be correct to say that when you refer to the savings that you think the customers will receive in the future, that you are assuming that there will be some cost recovery clauses, fuel and capacity cost recovery clauses available through regulation to flow those savings back to customers?

COMMISSIONER GARCIA: Mr. Howe, could you do me a favor, speak a little bit closer into the mike.

MR. HOWE: Certainly, sir. Would you like for me to repeat that question?

COMMISSIONER GARCIA: Yeah, because I missed a part of it.

Q (By Mr. Howe) What I'd asked was, Mr. Schuster, would you agree in the Company's proposal and in the analysis of future customer benefits, Florida Power Corporation is assuming there will be cost recovery mechanisms, such as the fuel and capacity cost recovery clauses available through regulation to flow the savings back to customers?

A Yes, that was an implicit assumption in the analysis as it always is or almost always is, in my opinion. I'd like to add that I believe that even if there were some changes in cost recovery under regulation or some departure from regulation as has been described as restructuring, in my view, the transaction, if it is a good transaction, should be good in either case.

Q By "either case" do you mean under retail competition or under traditional utility regulation?

A When I said "in either case," I meant in either of the two cases you just described.

Q If there is not traditional utility

regulation and, in fact, if there is retail competition in the years 2014 and beyond, how could Florida Power Corporation possibly flow any savings back to its customers?

A They could do it in exactly the same fashion they would under regulation by having low rates. As you pointed out, we are doing this to become more competitive, and competition is one in the same with having low rates.

It seems to me that our ability to deliver low rates to our customers in the future is unchanged by whether we are regulated or we're able to deliver low rates in a deregulated competitive environment.

Q Mr. Schuster, let's just assume for the purposes of discussion that there is retail competition in the years 2014 and beyond. And let's assume further that the average cost per kilowatt-hour in the competitive market, the market clearing price if you will, is 8 cents per kilowatt-hour for a residential customer.

Customers at that time will have a choice, will they not, whether they get their electricity at 8 cents from Florida Power Corporation or from some other provider?

A I'm sorry, I don't understand your question.

Are you saying that everyone will have an 8 cent rate?

Q Let's just assume that 8 cents is the average market clearing price under retail competition in the years 2014 and beyond. My question is, are you suggesting that Florida Power Corporation would charge its retail customers less than 8 cents, or less than what otherwise would be Florida Power Corporation's market price, because its customers in the years 1997 through 2001 gave the company $49,405,000 to buyout the OCL contract?

A I want to say the answer to your question is yes. But I want to provide an explanation because I'm not quite sure I understand it.

As I mentioned before, Florida Power's price in the future after 2014, under regulation or deregulation, would reflect this transaction. It would enable Florida Power to have lower prices to its customers as a result of this transaction. And if that turns out to be 8 cents as in your example, then I agree with you.

Q Well, if there is competition in the years 2014 and beyond, would you agree that Florida Power Corporation's current customers would have the right to get their electricity from Florida Power Corporation or any other provider available in the retail market at that time?

A You could assume that. In many cases under deregulation only, some customers get choice, or some variation of that get choice under certain circumstances.

Q Wouldn't Florida Power Corporation have to meet the market price in the year 2014 and beyond regardless of whether its high cost cogen contracts were in place?

A Well, that's purely based on your assumptions. You could assume that they would or could assume that they wouldn't. If I may add a point of clarification, I think you're implying that if the market clearing price is 8 cents, then every single supplier sells at 8 cents, and the customers are indifferent regardless of where they go.

My perception of competitive markets is that even under competition in the total absence of regulation, different suppliers sell at different prices. Markets -- I guess as an economist would say, the market is imperfect. Florida Power will sell, as you'd mentioned before and I agree with you, at a competitive price. It will sell at the lowest price it can deliver energy to its customers at. And if this transaction is approved, that price will reflect the cost reductions accruing from this transaction.

Another supplier may sell at a slightly different price because they either have lower costs for some reasons, or they may sell at a slightly higher price because they have higher costs.

Q Mr. Schuster, I'll try to make this question as simple as possible. Let's assume that the market clearing price is 8 cents per kilowatt-hour for residential customers, and there's only one competitor of Florida Power Corporation. And please assume further that Florida Power Corporation's price, because of these cost -- costs, I'm sorry, because of these cogeneration contracts is 11 cents. I believe we've heard that number. It may be in your testimony, is it?

COMMISSIONER CLARK: Just so I'm clear, Mr. Howe, it's -- 11 cents is the cost not the price.

MR. HOWE: The cost to Florida Power Corporation.

COMMISSIONER CLARK: Okay.

Q (By Mr. Howe) And assume we have retail competition in the years 2014 and beyond.

COMMISSIONER GARCIA: Mr. Howe, forgive me, but I've lost you. What year are we talking about?

MR. HOWE: My attempt to make it simple,

yeah. (Laughter)

Q (By Mr. Howe) Mr. Schuster, please assume competition beyond the year 2014, please assume there's a competitive environment, that a competitor of Florida Power Corporation can meet the market clearing price at 8 cents per kilowatt-hour, and assume that Florida Power Corporation's cost is 11 cents per kilowatt-hour because of these high cost contracts. With those assumptions, what price will Florida Power Corporation being selling electricity in that market?

A Given your assumptions, I would have to say that Florida Power Corporation would not be in the business anymore if their cost was 11 and they could sell for no more than 8.

COMMISSIONER GARCIA: Mr. Schuster, let me ask you a question. If you don't mind, Mr. Howe. Based on all Mr. Howe's facts, now further assume that this Commission were not to approve this and that we were in market-based competition, with all Mr. Howe's assumptions contained in this in the year 2005, what would happen?

WITNESS SCHUSTER: I'm afraid I'm -- the hypothetical is getting too far out in the future and too complicated.

COMMISSIONER GARCIA: If I stretch it too far, all I'm saying is, let's say that this Commission did not approve this.

WITNESS SCHUSTER: Okay.

COMMISSIONER GARCIA: Let's say then that the costs -- you were still above what the market price was in your cost, how would the Company have addressed that to be able to get into a competitive market? In other words, would you not have come in here under another guise before we got into a competitive arena to address these high cost production that this Commission approved?

WITNESS SCHUSTER: Certainly, that's a possibility. Going into the discussion of industry restructuring, one of the very common proposals is that exactly this type of cost, the cost of -- high cost QF contracts be flowed through to customers as what's described as a non-bypassable transition charge. And that could be the result of these particular costs we're talking about here.

COMMISSIONER GARCIA: I'm sorry, Mr. Howe. Thank you.

Q (By Mr. Howe) Mr. Schuster, let me see if I understand the Company's proposal in this case. Florida Power Corporation wants to buy out the last ten years of the OCL contract; is that correct?

A Yes.

Q And when was that contract first signed?

A Approximately 1991, I believe.

Q At the time Florida Power Corporation signed this contract in 1991, did Florida Power believe that it was appropriate to do so and that the capacity and energy costs were fair and reasonable?

A Yes.

Q Since that time, has the company concluded that something called "competition" will come into the energy market and make the capacity and energy costs of this cogeneration purchase uneconomic?

A Yes, with a qualification that with respect to the first part of your question, many people believe that some form of competition is going to happen. I don't know that I characterize that our company has that position. And secondly, the fact that these are high cost contracts is also true, but it is independent of the competition issue. It is simply a matter of the changes in the generation business; the changes in fuel prices, the development of combined cycle technology have resulted in those contracts being high cost relative to current alternatives.

Q What is the cost of these contracts compared to current alternatives? In other words, just relate, if you would, in total cost. Is it approximately twice as expensive of new combined cycle generation?

A It's' hard to generalize on a fuel-cost basis. Just ballpark numbers, contracts are in the low $20 range, whereas combined cycle power may be below $20 on a gas-fired basis. On a total all end cost basis, these contracts are generally at or above $50 a megawatt-hour, whereas the alternatives talked about currently for new combined cycle units may be in the $30 to $35 range in an all end basis for a combined cycle unit.

Q Mr. Schuster, would I be safe in assuming that if Florida Power Corporation had known that the OCL contract would become -- or would have been uneconomic in 1991, that it would not have requested approval of the contract?

A Yes, that's correct.

Q Mr. Schuster, is it correct that the Company was not able to project the cost of energy and capacity that would exist today seven years ago, but the Company is claiming in this proceeding that it can project the cost of capacity and energy through the year 2023?

A No, I would disagree with that.

COMMISSIONER CLARK: Mr. Howe, would you say that question again?

MR. HOWE: I'll try to rephrase it or say it as close as what way I said it.

Q (By Mr. Howe) Mr. Schuster, isn't it correct that the Company was not able to project the cost of energy and capacity seven years ago or six years ago, say in 1991 when the contract was entered into, but the Company is claiming in this proceeding to be able to project the cost of capacity and energy through the year 2023?

A No, I would disagree with that. It's clear that the Company did project the cost of capacity and energy in 1991 when these contracts were signed. That's the concept of avoided cost. I think what you're trying to get at is the accuracy of those projections. And nobody can forecast anything, much less fuel prices, accurately out into the future. But these types of decisions must be made, and they must be made based on projections, the best projections that we can make. That's why we do forecasts of fuels by professional people that do the best job they can. That's why when we consider this type of transaction we do a sensitivity analysis to test the certain knowledge that our forecasts are not going to be absolutely accurate.

Q Well, Mr. Schuster, would you agree that the company's forecasts in 1991 which indicated to the Company that this contract, this OCL contract, would be economical, that changes just in the last six years have indicated that it is not economical today?

A Yes, that's correct. It is not as economical as the alternatives that are available today.

Q Mr. Schuster, do you have a copy of -- I'm going do refer to the Company's petition and to the original contract that is appended to that. Do you have that with you?

A Yes, I believe I do.

Q And, Mr. Schuster, I'm going to be referring you to Page 33, which is Article XX, in Roman numerals, of the original contract.

MR. HOWE: And, Commissioners, for your benefit I'm just distributing that page. It is part of the documents attached to the Company's petition in this docket.

WITNESS SCHUSTER: I'm sorry, I don't have the attachments to the original petition, if I could get a copy, please?

Q (By Mr. Howe) Mr. Schuster, do you want to see the original petition so you can compare that, or are you familiar enough with the document that --

A I have the petition, just I don't have the attachments.

Q What I'm asking is, do you want to see the petition with attachments so you can verify that --

A No.

Q -- that was an attachment?

A No, thank you.

Q Are you familiar with the contract?

A Yes.

Q Are you familiar with this Article XX entitled Regulatory Changes?

A Yes, I am.

Q Mr. Schuster, would you refer please to the first sentence in Section 20.1?

A Yes.

Q Mr. Schuster, my reading of this, it appears that Florida Power Corporation's obligation to make payments under this purchased power agreement are expressly conditioned upon there being in existence a fuel and purchased power cost recovery clause. Now, if we assume that there is retail competition in the years 2014 and beyond, and if we assume further that

Florida Power Corporation's retail operations are no longer regulated and there is no fuel and purchased power cost recovery clause, or another mechanism to authorize rates and charges from a regulatory body, would Florida Power Corporation be obligated to make payments under this OCL contract?

MR. McGEE: Madam Chairman, I'd like to object to that.

COMMISSIONER CLARK: Hold on a minute. Give me the question again.

MR. HOWE: Would Florida Power Corporation be obligated to make payments?

COMMISSIONER CLARK: The whole thing.

MR. HOWE: Well, I started out by saying, as I read this, Florida Power Corporation's obligation to make payments is expressly conditioned upon the existence of a fuel and purchased power cost recovery clause or otherwise authorized rate mechanism.

COMMISSIONER CLARK: Okay.

MR. HOWE: If there is no regulation, no retail regulation, in the years 2014 and beyond, would Florida Power Corporation have to make payments to OCL under this contract provision?

COMMISSIONER CLARK: Okay. And your objection?

MR. McGEE: My objection was based on Mr. Howe's original characterization of the first sentence in which he indicated that it contemplated recovery exclusively through the fuel and purchased power clause.

COMMISSIONER CLARK: Right.

MR. McGEE: When, in fact, I wanted to make sure it's understood that it also talks about other authorized rates and charges.

COMMISSIONER CLARK: Right. With that clarification is there still an objection?

MR. McGEE: No.

COMMISSIONER CLARK: Go ahead, Mr. Schuster.

WITNESS SCHUSTER: I do not know the answer to your question. My understanding is that you're getting into an area that is referred to as "reg out" which is a utility's obligation to continue making payments under changes that would potentially trigger a reg out. And it's my further understanding that that is a legal area that is unsettled.

Q (By Mr. Howe) Mr. Schuster, would you agree that in your testimony and in the exhibits you are sponsoring, that you have assumed that Florida Power Corporation will be able to recover the capacity and energy costs of the OCL contract in the years 2014 through 2023 through some form of recovery mechanism, some form of regulatory recovery mechanism?

A Yes. We have assumed the recovery of those costs, and as I have mentioned previously in response to one of your questions, we have implicitly assumed a continuation of the current regulatory framework. That is the conventional way of doing this type of an analysis.

Q I'd like to --

COMMISSIONER CLARK: Mr. Schuster, is it your testimony then that in evaluating this we should not look at the possibility of deregulation or more competition, we should strictly look at it under the notion of continued regulation for the life of this contract?

WITNESS SCHUSTER: No. I don't think that's the case. We have conducted the analysis using, basically, a status quo assumption. We did speak briefly to the idea of restructuring, the idea of viewing this as a stranded cost issue. And we concluded that we don't believe it's necessary to get into those types of issues and discussions in this proceeding. But it certainly is possible, and perhaps appropriate, to give that some thought as I'm sure it's in everyone's mind.

COMMISSIONER CLARK: Okay.

Q (By Mr. Howe) Mr. Schuster, would you refer please to your Exhibit 7?

A Yes.

Q Now, Mr. Schuster, would it be fair to say that what you are trying to -- what you are showing in your Exhibit 7 is that the buyout proposal would result in a 1997 net present value benefit to the customers in the amount of $34,647,000?

A Yes.

Q And, Mr. Schuster, the way we arrive at that $34,647,000 is to use a cost from the customers over five years in present value terms of $40,411,000, which Florida Power Corporation projects will be offset by $75,058,000 of savings in net present value terms over the years 2014 through the year 2023; is that correct?

A Yes.

MR. HOWE: And, Commissioners, for your edification, the $75,058,000 figure is merely the sum of the last ten entries in Column 8 of Exhibit 7.

COMMISSIONER CLARK: Does Mr. Schuster agree with that?

WITNESS SCHUSTER: It's the net present value of that series of figures.

MR. HOWE: Excuse me. Yes, the net present value of those series of figures.

Q (By Mr. Howe) Now, Mr. Schuster, just kind of moving from left to right through this Exhibit 7, Column 1, Capacity, that is the capacity cost associated with the Orlando Cogen contract over those last ten years; is that correct?

A Yes.

Q Now the energy costs under Column 2, are those projected figures?

A Yes.

Q And those are projections going out to the year 2023 which would be including 1997, a period of 27 years; is that correct?

A Yes.

Q Now, can you tell me, Mr. Schuster, how the Orlando Cogen contract is structured? And I guess the point I'd like to focus on, would you agree that Orlando Cogen, under the contract, receives capacity and energy payments based upon the avoided coal unit for Florida Power Corporation?

A Yes.

Q Now what kind of unit is the Orlando Cogen project?

A It's a combined cycle unit.

Q Is it a natural gas-fired combined cycle?
A Yes, it is.
Q Would it be correct to say that Orlando Cogen earns its profit under this contract through the mechanism by which Orlando Cogen's capacity and energy cost of a natural gas-fired combined cycle are less than the capacity and energy cost of the coal-fired avoided unit?
A No. I don't think I could characterize their profits as being that. That's certainly a factor in their overall financial posture, but given the fact that they're a cogeneration unit, there's more to the determination of their profits than just that fuel differential.
Q Could you describe, give us some -- an explanation of exactly what this project is? What is the Orlando Cogen project in total, and what piece of it is Florida Power Corporation purchasing?
A Very simply, it's a cogeneration project that produces two co-products, electric and steam. It sells the electricity to Florida Power, and it sells the steam to a steam host. Florida Power purchases the electricity pursuant to the contract that's the subject of this proceeding.
Q Under the current contract, would you agree

that Orlando Cogen bears all the risk that the price of natural gas will escalate significantly above the cost of coal?

A No, I would not agree with that. Because the project has a gas supply contract in place that insulates it from market fluctuations in gas to a large extent. So their risk, necessarily, in order to finance the project, has been mitigated relative to fuel prices.

Q What is the term of the gas supply contract at the OCL facility?

A Offhand, I don't know.

Q Does it go through the year 2023?

A I do not know.

Q Well, then, I guess my question remains, if the cost of natural gas escalates significantly and Orlando Cogen is only going to be paid under the contract a coal price, hasn't Orlando Cogen accepted the risk of escalation in natural gas prices?

A Only to the extent that there might be a period during the -- Florida Power's contract when they would not be covered by a gas supply contract that imposed some limits on the price of natural gas, in effect, if they were supplying some or all of their gas supply needs at spot market gas prices.

COMMISSIONER CLARK: Mr. Schuster, the fact is they have accepted the risk, and they've chosen to mitigate it through the long-term contracts.

WITNESS SCHUSTER: Yes.

Q (By Mr. Howe) And, Mr. Schuster, would the company's proposal place the risk back on the customers, the risk that natural gas prices will escalate significantly in relation to coal prices?

A Yes, they would. They would also relieve the customer of the risk of fluctuation in coal prices. It's a trade-off of risk, I think is the proper characterization.

Q Mr. Schuster, in the replacement case shown on your Exhibit No. 7, beginning on Line 4, your capacity cost projections, those are projections of a combined cycle unit, are they not?

A Yes.

Q Is it a natural gas-fired combined cycle unit?

A Yes.

Q Of what size?

A In this particular instance, it would be -- the analysis assumes that it's a size equal to Orlando Cogen. In other words, the unit is delivering the same amount of energy that the contract would have delivered. The actual size of the unit if it were built would actually be larger than the committed capacity of the OCL contract.

Q If you had to build a larger unit, shouldn't your analysis reflect the unit that would, in fact, have to be built to replace the OCL capacity?

A No, I don't believe it should.

Q And here again, Mr. Schuster, you have projected the capacity costs of a natural gas combined cycle for the years 2014 through 2023; is that correct?

A Yes.

Q In 1991, when Florida Power Corporation asked the Commission to approve the OCL contract, did Florida Power Corporation believe that natural gas-fired combined cycle units would be less expensive than the OCL contract seven years in the future?

A No.

Q Would it be fair to say that Florida Power Corporation in 1991 could not have anticipated the efficiencies that would be achieved from natural gas-fired combined cycles in this time frame? By that, I mean 1997.

A I don't believe they did anticipate that level of efficiency improvement. Your question said, could they have. I suppose they could have.

Q Well, let's leave it that way. Did Florida Power Corporation anticipate seven years in advance the development of combined cycle technology?

A In my previous answer I said they did not.

Q Yet, Mr. Schuster, aren't you in your Exhibit 7 claiming an ability to project coal costs, natural gas capacity costs, natural gas fuel costs over a period of 27 years?

A Yes, with the qualification once again that, to use your words, yes, I am claiming the ability to project those items as we necessarily must do to do this type of analysis. I think your question, without saying so, is going to the question of risk and accuracy.

And I'd like to add, as you continue to draw comparisons between 1991 and the present, there is a very significant difference in that seven-year time interval that's taken place. In 1991, as you point out the comparison between coal and combined cycle, as today this analysis compares coal to combined cycle. The very significant difference that has taken place is that in 1991 combined cycle units were an immature technology. They were on the horizon, but they were not proven. They were in the transition from aircraft to utility operation. There were very few combined cycle units out there. That's to some degree even the case today, relative to coal units.

However, my point is, is that I think Florida Power and many other people can be forgiven their inability to project combined cycles in 1991 as an immature technology progressing to the point where they are today and where they are expected to be three to five years from now in terms of efficiency. As we stand here today, we know where combined cycles are today. There are significantly more units in operation with some history to demonstrate what their capabilities are. Coal units are a known quantity, they are a mature technology with known operating characteristics right on down the line.

So I would be much more confident in our projections comparing coal to combined cycle units today than we could have possibly been in 1991, that the major uncertainty that remains in the analysis is the ability to forecast fuel prices. And once again, that is an unfortunate necessity when you have to compare generation alternatives for the future.

The salvation in my mind, and it's one that is in the back of a forecaster's mind all the time, is that there are limits on the relative fuel prices that can take place before technology shifts and there begins to be substitutions. So even though there's uncertainly in your ability to forecast exact prices, there is a considerable level of certainty and a comfort that comes from that, that relative fuel prices will stay within bounded ranges, and your analysis can only be judged by those ranges.

Q Mr. Schuster, have you projected any significant change in technology over the next 23 years, or let's say 27 years?

A No, not a significant change. Our analysis includes an incremental change, an incremental improvement in the efficiency of combined cycle units. That trend is established, and we see that trend continuing on out into the future.

Q Mr. Schuster, still referring to your Exhibit No. 7, is Florida Power Corporation providing any guarantees at all that its customers will receive the savings the company is projecting for the years 2014 to 2023?

A No.

Q Just as a comparison of certainty, how would you relate the certainty that the customers would have to pay $9,881,000 a year for five years, versus the certainty that they would see savings in the year 2014 through 2023?

A Well, that is the crux of the analysis. Near term is always a little more certain than long term. The most significant item in the last ten-year analysis is the avoidance of the capacity payments under the contract. And those are fairly certain, almost approaching the certainty of the buyout cost up front. So the ability to avoid those certain payments with certainty through the buyout, substantially reduces the risk of this transaction in my mind.

Q But, Mr. Schuster, don't you have what you -- you consider certainty of capacity payments, but which you are comparing in your replacement case against speculative capacity and energy costs in the years 2014 through 2023?

A I'm sorry, could you repeat the question?

Q The question is, regardless of how certain the capacity costs would be, the savings that you are using to calculate customer savings in your Column 8 are based on projections of coal energy, natural gas capacity, natural gas energy, that are very speculative projections in the distant future?

A No, I would disagree with that. They are projections, but they are very carefully developed projections that we believe are the expected value, the best estimate at to future fuel prices. They have uncertainty, but I would not describe them as being very speculative.

Q Were your projections in 1991 done to the same degree of certainty as we are seeing here?

A They were done on a best efforts basis in an attempt to forecast fuels and technology as accurately as possible. The major flaw in those forecasts was the inability to foresee the maturation of combined cycle technology, and that is not what I see as a bread and butter forecasting issue. It's more of an outlier one time event that caught the whole industry by surprise.

MR. HOWE: Commissioner Clark, I would ask that these documents we previously distributed be identified as an exhibit, a composite number would be fine.

COMMISSIONER CLARK: We will identify the two charts that were used in your opening statements, and one is titled Florida Power Corporation's Proposal, FPC Petition Exhibit D. The other one is Florida Power Corporation's Proposal, Schuster Exhibit 7. They will be marked as Composite Exhibit 2.

(Composite Exhibit 2 marked for identification.)

Q (By Mr. Howe) Mr. Schuster, do you have those?

A No, I do not.

COMMISSIONER CLARK: Mr. Howe, how much more do you have?

MR. HOWE: An hour.

COMMISSIONER CLARK: All right, we'll take a ten-minute break and we'll come back. Maybe that will give you time to review what questions you have.

Staff, I would also ask that you be looking at your questions. To the extent they've been asked, let's eliminate them. Thank you.

We'll come back at 25 till --

(Brief recess.)

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COMMISSIONER CLARK: We'll get started. Commissioner Garcia is on his way down.

You estimated another hour?

MR. HOWE: Yes, ma'am.

COMMISSIONER CLARK: Have you changed that?

MR. HOWE: No.

COMMISSIONER CLARK: Okay. Staff, can you give me an estimate of how long for this witness?

MR. KEATING: I guess about a hour and a half.

COMMISSIONER CLARK: All right. I'll tell you what, we're going to try and get this witness finished before we take a lunch break. So after that, that will make us about -- well, it might be 1:30 before we take a lunch break. Okay? Is that all right with you, Commissioner Garcia?

COMMISSIONER GARCIA: Sure.

COMMISSIONER CLARK: Even then, we'll probably only take a half hour. All right. Go ahead.

Q (By Mr. Howe) Mr. Schuster, if you would please refer to the document that's been identified as Exhibit No. 2, and we'll deal first with the packet that has the graph and the title -- deals with FPC Petition Exhibit D. Do you see that, sir?

A Yes.

Q If you would refer, please, to the third page which is Exhibit D, do you recognize that as the Exhibit D to the Company's petition?

A Yes.

Q Okay. And then the next page forward -- Mr. Schuster, what we did is we just took the entries in your Exhibit D, and where you just show a NPV, present value savings at January 1st, '97 in total, we broke it down both year-by-year and on an accumulated basis. I should tell you, also, that in a couple columns -- for example, if you would refer to your Exhibit D for the year 2014 under your Column 3, you'll notice, for example, you have 60,634,000; whereas we on ours have 60,633,000 and apparently the difference is just in the rounding. We took the columns off your Exhibit D, the entries. And you'll see, for example, on your Exhibit D that Columns 1 and 2 for the year 2014 do not exactly add to Column 3.

A Yes.

Q Okay. Mr. Schuster, do these -- now I'm dealing here with the spreadsheet our office prepared. Would you agree that this provides the detail for both the NPV savings and accumulated NPV savings that lead to the $32,984,000 of NPV savings shown on Exhibit D?

A Yes.

Q All right. And, Mr. Schuster, would you agree that as shown on the accumulated NPV savings column, the Company's proposal as reflected in its petition, Exhibit D, will not show positive net savings before the year 2019?

A Yes, that's correct, on a cumulative basis. On a year-by-year basis it will show net savings beginning in 2014.

Q I see. Okay. But on an accumulated NPV savings basis there will be no net savings before the year 2019; is that correct?

A Yes.

COMMISSIONER CLARK: 2,000 what?

MR. HOWE: 2019.

Q (By Mr. Howe) Now, Mr. Schuster, if you would refer to the first page there, we have -- all we did on this was graph the accumulated NPV savings from the Company's proposal on Exhibit D and put it on a bar graph form. Would you agree that this accurately represents the Company's proposal in Exhibit D as filed with the Company's petition? (Pause)

A No, I wouldn't. And let me qualify that. I think it's an accurate graph of the numbers, but the numbers that you're graphing are all numbers in 1997 dollars. And I think it's a little bit confusing and possibly misleading to attribute those numbers to future years. So to that extent, there is some potential confusion.

I think it's also a little bit misleading to continue the net present value at the end of the fifth year through the intervening years until 2014 when, in fact, there is no transactions or cash flows occurring during those years.

Q Mr. Schuster, do you remember answering the Commission Staff's Interrogatory No. 7?

A Yes, I do.

MR. HOWE: And, Commissioners, Interrogatory No. 7 from the Commission Staff, the preparer is identified as L. G. Schuster. The question is, "Please depict in line graph format the annual cumulative net present value of ratepayer savings associated with the FPC's buyouts of each of the following negotiated contracts." And then it refers to several and the last of which is Orlando Cogen, Limited.

Q (By Mr. Howe) Do you have the graph, Mr. Schuster, that you provided in response to Staff's Second Set of Interrogatories, Interrogatory No. 7?

A Yes, I have it in front of me.

Q Was that graph prepared by you in response to Staff's Interrogatory No. 7?

A Yes, it was.

Q In that graph did you keep the accumulative net present value savings constant at a negative 40,411,000 for the years 2001 through 2013?

A Yes.

Q Is the bar graph shown on the first page of that portion of Exhibit 2 dealing with FPC's Petition Exhibit 2 consistent with your graph prepared in response to Staff's Interrogatory No. 7?

A Essentially, it's consistent, yes.
Q When you say "essentially," isn't it the same, except you have a line graph and we have prepared a bar graph?
A Yes.
Q And Mr. Schuster, in fact, stated in 1997 net present value dollars the customers will gradually, over the years 1997 through 2001, reimburse the Company for the buyout cost and arrive at a position at the end of year 2001 at which the customers on a net present value, 1997 terms, will be out $40,411,000; is that correct?
A Yes, according to these calculations, that would be the result.
Q And when you say "according to these calculations," according to your own calculations; isn't that correct?
A Yes.
Q And the customers will stay in that negative posture, will they not, through the year 2013 under the Company's proposal as reflected on Exhibit D?
A Yes.
Q And the customers will start to achieve savings under the Company's proposal in using the Company's assumptions in the year 2014; is that

correct?

A Yes.

Q And that is as reflected on this bar graph of FPC Petition Exhibit D; is it not?

A Yes.

Q And the customers will not see any net savings in the sense that their savings on a net present value basis will exceed their expenditures before the year 2019; is that correct?

A As you asked that question before, I would have to say no on a net basis, with the qualification, as I think you intended, on a cumulative net basis it would be 2019.

Q All right. Thank you, sir.

A On a current year net basis it's 2014.

Q All right, sir. And now would you agree, Mr. Schuster, now that this bar graph with the title FPC Petition Exhibit 2 -- Exhibit D accurately reflects the Company's proposal as filed with the Company's petition in this case?

MR. McGEE: Madam Chairman, I'd object to that. That question has been already answered.

MR. HOWE: Commissioner Clark, he said it was inaccurate. It was inconsistent because, for example, it showed the negative amounts for the years

2001 through 2013.

COMMISSIONER CLARK: Go ahead, Mr. Howe.

A You have phrased the question this time differently than you did the last time.

I'll answer this question as being yes, in that it accurately reflects the numbers. My recollection is that your prior question asked if it fairly represents. And my concern -- and let me just make two points: One is that you've made much of Interrogatory Response No. 7. All I did was answer Staff's question. I didn't choose to present the information in that format, so I don't claim that that's the best or the most illustrative way to present this information.

My second point is that these are what are referred to in the system planning vernacular as fish curves. They are graphs of the cumulative net present value of the cost or benefit of a project or a group of alternatives.

My concern and my reason for answering "no" in response to your first question, phrased, as I recall, as being does it fairly represent, this is a -- in my opinion, this is a very technical presentation that is very easily misunderstood. In reference to your blowup over here, there is a tendency, if you don't fully understand what's being graphed here, to interpret the bars as being year-by-year flows or year-by-year impacts. And your graph makes it appear that there is a huge red area and a much smaller blue area, implying that the costs are huge and the benefits are tiny. I think that is the risk and that's the reason why I said, no, that it fairly represents the proposal.

I think it's technically accurate, but it's -- it's very easily misunderstood and misinterpreted.

Q Did you have any problem understanding it?

A No, I didn't.

Q Mr. Schuster, if you would now please refer to that portion of Exhibit No. 2 which has the bar graph, the first page entitled, "Schuster's Exhibit 7." And, again, if you would refer to the third page, do you recognize that as Exhibit 7 to your prefiled direct testimony?

A Yes.

Q Now, Mr. Schuster, moving one page forward, what we've done is taken your Exhibit No. 7 and just added two columns based, as we understand it, solely on the calculations that you did to arrive at your net present value; by that, I mean we used an 8.67

discount rate, and calculated both the NPV savings and the accumulated NPV savings based upon your Exhibit No. 7.

Would you agree that that represents the year-by-year savings and the accumulated net present value savings that lead to your total net present value savings for the customers of $34,647,000, as shown on your Exhibit 7?

A Yes.

Q Now, would you agree also, Mr. Schuster, that this -- the accumulated NPV savings column accurately reflects the fact that under -- applying the proposal embodied in your prefiled direct testimony and your Exhibit 7 that the customers would not expect to see net savings on an accumulated NPV savings basis before the year 2019?

A Yes.

Q Would you agree, Mr. Schuster, that the bar graph on the first page accurately represents the accumulated NPV savings year-by-year from your Exhibit No. 7?

A Yes.

Q Mr. Schuster, what does an NPV savings of $34,647,000 in 1997 dollars tell us?

A It tells us that at the discount rate

assumed to calculate that number; that the net present value of the projected cash flows that are being evaluated as positive to the tune of $34.6 million.

Q And you have used a discount rate of 8.67%; is that correct?

A We started our analysis with 8.67. That has been revised by the Company to 8.81, and our most recent exhibits reflect 8.81%.

Q When you say your "most recent exhibits," what are you referring to?

A I believe the Exhibit 7 reflects the 8.81. Excuse me. It does not. That was discovered subsequent to filing of the testimony and it was -- it was in some of our subsequent updates in discussions with Staff that we provided the analysis using the 8.81%.

Q But as far as your prefiled direct testimony and your Exhibit No. 7, you used an 8.67% discount rate; is that correct?

A Yes, I believe that's correct. And both of those numbers are conceptually the same. They are the after-tax discount rate.

Q Where does that number come from? What source within the Company gave you that 8.67%?

A There's a document which has been prepared and maintained for -- to my knowledge, since 1980 and probably long before then, called the Engineering Economy Manual. It's a manual that describes how to do engineering economy evaluations of projects in Florida Power on a consistent basis. One of the appendices to that manual lays out key assumptions for this type of an analysis, and that appendix details the calculation of the after-tax discount rate and it is updated periodically by the Company.

Q Is the Engineering Economy Manual used by Florida Power Corporation to evaluate generation alternatives when it's considering what kind of capacity it has to add to its system?

A Generally speaking, yes.

Q So would Florida Power Corporation do the type of analysis shown in your Exhibit 7 when it was, for example, comparing whether it should build a natural gas-fired combined cycle versus a coal plant?

A Yes, at a very high level it would be a comparison of alternatives. In generation expansion planning, the analysis is much more detailed, much more complex. But, in essence, its purpose is the same.

Q And I believe you mentioned that you have seen the discount rate increase recently in the

Engineering Economy Manual; is that correct?

A Yes.

Q And what caused it to increase?

A I'd have to take a moment and refer to the development of that. It's based on the cost components for equity and debt and the weightings applied to those cost components. I don't recall at this moment which of those changed to result in that difference.

Q Would you agree that it would be reflective of some change in the Company's capital structure and/or its cost of debt or equity?

A Yes.

Q Mr. Schuster, under the analysis that the Company has used and the approach it has used to doing this net present value analysis, would it be your position that as the Company's cost of equity changes, the customer's discount rate changes in lockstep?

A No. And it's a fine distinction, but we are using the after-tax cost of capital as a proxy for the customer's discount rate, recognizing that we don't know what the true customer cost of capital or discount rate is. Because we're using it as a proxy and the proxy is defined as being the after-tax discount rate, they do move in lockstep.

Now the actual customer cost of capital or customer opportunity cost or customer discount rate moves, I don't know.

Q Do you know of any reason why the customer's discount rate should be affected in any way by a change in an electric utility's discount rate?

A Yes.

Q And what would that be, sir?

A Well, very simply, the Company and the customers are faced with the same financial market conditions. And to the extent that those general conditions affect the Company, I would expect that they would affect the customers as well and probably in the same direction and probably to the same degree.

Q Would you suggest that my discount rate changed because Florida Power Corporation's did?

A No.

Q Would that only apply, then, to customers of Florida Power Corporation?

A No, it would apply in general terms, not to any specific individual.

Q Mr. Schuster, I'm referring to Exhibit 2 and that portion from -- I'll set aside the FPC Petition Exhibit D part, and we'll talk about the Schuster Exhibit 7 part.

Would it be fair to say that based on the Company's analysis that the customers would be neutral to any alternative that also gave them a $34,647,000 1997 net present value?

A No.

Q Why not?

A Well, as the discussion in this proceeding has indicated, there's more to the evaluation than just that one single number. I would assume that another alternative that had that net present value would have different optimistic and pessimistic projections, would have different perceived risks, would have different timing of the benefits, perhaps. So there would be other considerations that would very likely make them noninterchangeable.

Q Isn't it the Company's position in this case that the reason it's a good deal for the customers is because it has a $34,647,000 1997 net present value?

A Yes, that is a reason, and it is the primary reason. But there, again, I agreed in my rebuttal testimony that it is entirely proper to do a sensitivity analysis and include the results of that sensitivity analysis in a decision to accept or reject the proposal.

Q We're talking here, Mr. Schuster, about your direct testimony.

What is the Company's net present value cost or savings from this proposal?

A There is none.

Q Actually there is. It's zero; isn't it? If you assume no cost and no savings at an 8.67% discount rate over 20-some years?

A No, I would disagree with that. The Company is not a participant in this transaction. It's not that they are receiving or paying cash flows and those are equal to zero or net to zero. They are not a participant.

Q I'm going to ask you some questions about making the Company a participant. If we look at the bar graph entitled, "Schuster's Exhibit 7," would you agree that if the Company were to fund a buyout over the years 1997 through 2001, and the Company were allowed to retain a savings over the years 2014 through 2018 and whatever point it takes to get back to the zero line, that the Company would recover all of its costs, including its cost of capital at 8.67%, and be made whole?

A Can I ask a procedural question?

Q Sure. It's not for me to answer. Ask Commissioner Clark.

A My concern is that you appear to be getting into Mr. Larkin's proposal which I address in my rebuttal testimony. I haven't talked about anything like that in my direct testimony. So is this just a hypothetical or are you referring to Mr. Larkin's testimony?

COMMISSIONER CLARK: Mr. Howe, I think he brings up a good point. How about taking that up in rebuttal?

MR. HOWE: Well, Commissioner Clark, I think I have the latitude to address anything that is inherent in an exhibit he has sponsored, so I will address my questions to his Exhibit 7, then.

COMMISSIONER CLARK: Okay.

Q (By Mr. Howe) And, Mr. Schuster, with reference to your Exhibit No. 7 attached to your prefiled direct testimony, if the Company were to fund the buyout and pay the $9,881,000 per year for the five years 1997 through 2001, and if the Company were then allowed to retain the savings for the years 2014 through 2018, would the Company recover the buyout costs including its cost of capital?

A I don't know the answer to that question. My feeling is that they would not.

Q Why would it not be symmetrical between the

Company and the customers? If the customers fund the buyout they will end back up at zero, you know, somewhere into 2019. And if the Company stepped into the same shoes -- since you're using the Company's cost of capital, why wouldn't the Company recover all its costs on a net present value basis over the same time period if it were to fund the buyout?

A The problem is that it's not the same thing. The Company cannot, as I would put it, step into the customers' shoes and do the same thing that the customer would do in this transaction. If the Company, as you described, were to fund this transaction and receive the benefits of the cost differential, starting in 2014, it would be a fundamentally different transaction. And that -- I have not evaluated that transaction, and I'm not aware of anybody that has.

Q But would it be a fundamentally different transaction? By that, I mean once the Company is made whole by retaining the savings in the years 2014 through 2018, for example, the customers would then receive the savings from 2019 through 2023. The net present value to the customers in 1997 dollars would be the same $34,647,000, would it not?

A I'm sorry, would you repeat your question?

You appear to have at least two questions buried in there.

Q Okay. If the Company were to fund the buyout and recover its cost over the years 2014 through 2018 -- basically I'm saying the time it takes to get back to the zero line -- the customers being allowed to retain the saving in the years 2019 through 2023 would receive the same 1997 net present value dollars of $34,647,000 embodied in your proposal, would they not?

A No, they would not.

Q Why not?

A Well, for a number of reasons. Let me just mention two. One is that once again your premise that the Company would be made whole at the crossover point in 2019, I know of no reason to assume that. And I'm very certain that it would not occur that way.

COMMISSIONER CLARK: Mr. Schuster, let me ask you -- that's true with the customers, too. They may not be made whole at that point.

WITNESS SCHUSTER: I agree with you but for totally different reasons.

COMMISSIONER CLARK: Okay. What are the different reasons?

WITNESS SCHUSTER: Well, the reasons why the customer might not be made whole is the uncertainty in the forecast items. Gas prices may turn out to be different than what we forecast, and so the crossover point could occur earlier or later. But the assumption that the customers will pay the buyout cost over the next five years in a amount that's indicated in the analysis is accurate. And the assumption that the customers will receive the benefits to the extent that they are accurately projected is a valid assumption in the analysis.

If you cross over and put the Company in this position, you have to rethink the entire transaction. And the primary reason, in a nutshell, is that from the Company's perspective there would be tax consequences to this transaction. From the customer's perspective there are not. The buyout costs are paid by the customers dollar for dollar; the benefits flow back to the customers in the form of lower electric bills dollar for dollar. If the Company were to engage in this transaction they would be paying approximately $10 million a year for five years out to fund the buyout.

Those costs would be tax deductible. I don't know whether they would be tax deductible on a current basis or not.

COMMISSIONER CLARK: Well, then, what I hear you saying is the sole difference is the taxability of it.

WITNESS SCHUSTER: That is the main difference. In a analysis of this type we have our tax people, our legal people look at this to determine if there are other differences that need to be included that would have a material effect.

COMMISSIONER CLARK: But in your rebuttal testimony and now you've really only said taxes.

WITNESS SCHUSTER: I'm not supposed to talk about that but I probably do.

COMMISSIONER CLARK: Okay.

MR. HOWE: Commissioner Clark, we're going distribute another document. I'd ask for an exhibit number, please.

COMMISSIONER CLARK: The next I have is No. 3.

This appears to be a chart with eight columns entitled, "FPC Schuster Exhibit 7."

MR. HOWE: Yes, ma'am. And below that, tax rate, .38575.

COMMISSIONER CLARK: Okay.

(Exhibit 3 marked for identification.)

Q (By Mr. Howe) Now, Mr. Schuster, before we address this exhibit in detail, I'd like to ask some questions about your understanding about a net present value analysis.

Would you agree that a net present value analysis that, for example, you can evaluate the net present value of $100 over some time frame at a particular discount rate by first finding the net present value of a dollar for that same time period at that same discount rate and multiplying it by hundred.

A Yes.

Q And if you want to take into consideration taxes in your analysis on a net present value basis, you can take the net present value of that dollar, multiply it by hundred, and then take the tax effect, and you'll get the net present value of the net tax number?

A Yes, with the qualification that that be the correct tax rate and the correct tax treatment to apply to the transaction.

Q Mr. Schuster, in what has been identified as Exhibit No. 3, our office did some calculations based on the tax rate reflected in the documents provided by the Company that are portrayed as coming from the Engineering Economy Manual which was .38575. Would that be the appropriate tax rate to use?

A Yes.

Q Now, Mr. Schuster, what we did is we took your -- from your Exhibit No. 7, we took your Column No. 8 -- and to be honest with you, you'll find a dollar or two difference because of some rounding, apparently, that was done on your schedule -- and we assigned customer savings -- the customers are to get 46.16% of the savings each year, 2014 through 2023. And Florida Power Corporation is to get 53.84% of the savings -- and, by the way, Mr. Schuster, those are just plug numbers that were necessary to get us down to the zero in the lower right-hand column. And we then applied -- we calculated what Florida Power Corporation's net of tax savings would be if Florida Power Corporation funded the buyout and what their net of tax savings would be if they were allowed to retain 53.84% of the savings in each of the years 2014 through 2023. In other words, what this table shows is assuming that for the full ten years 2014 through 2023 the savings are shared, company and customer, in the ratio of 53.84% to 46.16%, and the Company has to pay taxes on the savings it receives.

What this shows -- I should say in Column 7, we calculated that the Company, because of the tax effect, that the Company would have to pay $24,822,000 if it were to fund the $40,411,000 net present value of the buyout. Now, although these tables are kind of complicated, in fact, you get the same result if you 40,411,000 and multiply it by the reciprocal of the tax rate. That would be a reasonable measure of the Company's net present value net of tax cost if it were to fund the buyout, would it not?

A No, it would not.

Q The buyout cost will be approximately $9,881,000 per year; is that correct?

A Yes.

Q And if Florida Power Corporation paid those buyout costs and were able to treat it as a tax deductible expense, on a net present value basis over the five years 1997 through 2001, the net present value cost to the Company would be $24,822,000, would it not?

A No, it would not. Because it could take it as a tax deduction, but I don't believe it could take it as a current tax deduction as you've assumed here.

Q Well, all right. So then the Company if it could not take it as a tax deduction, let's assume that it paid the full $9,881,000. Then the Company's cost would be $40,411,000 in 1997 net present value terms over the time period 1997 through 2001, would it not?

A No. I'm sorry, I think you misunderstood me. I agreed that the buyout cost amounts to the Company would be tax deductible, but -- I don't believe they would be deductible on a current basis as you've assumed in your analysis.

Q Would it be correct to say you don't know one way or the other?

A No.

Q All right. Do you know one way or the other?

A I don't know, but I have a fairly high certainty as to how it would turn out. You're getting into an area of tax law that applies to the deductibility of cogeneration contract buyout payments, and there are specific rules that apply to the tax treatment of those buyout costs. Two of those qualifications are that the contract be completely bought out -- excuse me, in order to qualify for a current deduction, generally speaking the IRS requires that the contract be completely bought out and terminated at the point in time that the transaction occurs, and also that there be no continuing future benefit to the party engaging in the transaction, okay?

This transaction as you're proposing it does not meet either of those tests. The contract is being bought out on a forward basis, and it remains in place until 2013. And the Company would have an unquestionable continuing benefit in receiving the cost of the buyout in the future.

So, let me just summarize by saying I feel very, very strongly that this transaction would not qualify for a current tax deduction. However, I don't make those tax determinations. I would rely on our tax department to make that determination. And, ultimately, it would be the subject of an IRS audit to determine if it was appropriately taken.

Q Mr. Schuster, would it be fair to say, though, that if the Company were to fund the buyout on a 1997 net present value basis, the Company's net of tax costs would be less than $40,411,000?

A Yes.

Q Would it be fair to say if the Company were allowed to recover a similar amount, net of tax through savings in the years 2014 through 2023 that the Company would be made whole?

A Yes.

Q Mr. Schuster, when you were giving the summary of your testimony you referred to the Tiger

Bay transaction and how that has saved the customers or will save the customers approximately $2 billion, I believe you said; is that correct?

A Yes.

Q What was the buyout cost of the Tiger Bay transaction?

A The entire transaction cost was $445 million plus some adjustments at closing.

The buyout cost, as I understand you're describing it, would be the portion of the total purchase price attributable to the five purchased power agreements associated with the Tiger Bay facility, and that is approximately $345 million.

Q And over what time period was that buyout payment made?

A It was made on July 15th of this year.

Q It was a one-time payment, was it not?

A Yes, it was.

Q Did Florida Power Corporation fund the buyout?

A Yes, it did.

Q Will Florida Power Corporation be made whole in the future by being able to credit savings against its buyout costs?

A That is the plan, yes.

Q Mr. Schuster --

A If I might add one additional comment relative to my last response relating to Tiger Bay which I think is relevant to the current discussion.

The Company in proposing the Tiger Bay transaction to the Commission and in analyzing it internally for purposes of determining whether it was a good thing to do all the way around, assumed that the buyout costs would not be tax deductible on a current basis. They took the conservative approach which is different from what you're showing in your analysis. Prior to the closing of the transaction and continuing afterwards, we have had a dialogue with the IRS to resolve the exact question that's being discussed here. We've taken -- we've filed for a private letter ruling, we have made presentations to the IRS staff regarding this transaction. This is an unsettled area of tax law. I can't say it any more strongly than that.

As I understand it right now, at this moment we don't know what the tax treatment of the Tiger Bay transaction will be. And the OCL transaction is in many respects similar to Tiger Bay. So your analysis of putting the Company into the shoes of the customer is entering into an area where I think it's essential to make conservative assumptions with respect to taxes, assume that the buyout cost will not be deductible on a current basis.

Q Well, thank you for that, Mr. Schuster. But I'm afraid that asked me to revisit some earlier questions, because did you not agree that regardless of whether the buyout costs if funded by the Company are deductible, currently are not, the net of tax, net present value cost to the Company in 1997 dollars would be less than the $40,411,000 net present value cost to the customers under your proposal?

A As I answered that question previously the answer is yes.

Q And would you agree it still remains that if the Company is allowed to in the future retain savings that provide it with the same net present value net of tax costs in 1997 dollars, the customer -- I'm sorry, the Company will be made whole?

A Generally speaking, yes. They will be made whole at some point in time, not necessarily in 2019 as you began your discussion. And I must stress again that I have not tested the assumptions that would be required for that analysis with the areas of the Company that I would normally touch base with, and I have not performed that analysis.

Q And to the extent that the total savings projected by the Company over the years 2014 through 2023 would exceed the Company's net present value net of tax cost in 1997 dollars, those savings would still flow to the customers, would they not?

A Yes.

Q Mr. Schuster, I want to change subjects a bit.

What part of the Company do you work for? Are you in a particular division or --

A I work in the -- what would be described as the generation area of the Company; the department name is Purchased Power Resources.

Q Has Florida Power Corporation recently restructured?

A There have been organizational changes over time. I don't know that I'd describe them as a restructuring.

Q Well, for example, has the Company recently organized itself into strategic business units?

A Yes.

Q Do you know what those three units are?

A Well, there's --

Q Let me help you, if I might. Would you agree that they are --

A Well --

Q Energy supply, energy delivery, and energy solutions?

A Yes. I was struggling for the exact names.

Q And would you agree that Florida Power Corporation is adopting that structure to prepare the Company for competition?

A Yes, I believe that's the way it's described in our public documents.

Q And would you agree that Florida Power Corporation anticipates retail competition being here before the year 2023?

A I really don't know the answer to that question with certainty.

Q Would you agree that the Company is probably not restructuring to get ready for competition 27 years in the future?

A I would agree that they are probably not, but I hear different speculations as to when or if competition may arrive on a daily basis.

Q Mr. Schuster, this past week there was a conference of the Edison Electric Institute at Walt Disney World to discuss, among other things, competition in the electric industry. Did you attend that meeting?

A No.

Q Do you know who in the Company did?

A No.

Q We did a little research of just newspaper articles, magazine articles, and such things, about where the Company may have reported its view of future competition. For example, in a 1994 -- May 1994 Florida Trend article, Mr. Korpan is quoted. Can you tell me who Richard Korpan is?

A He is chief executive officer of Florida Progress.

Q And what was his position in 1994?

A I believe it was the same position, but I'm not certain.

Q In this article it quotes Mr. Korpan -- it states and I'm quoting from the article rather, "Within ten years and perhaps sooner, Korpan says, customers may be able to choose between Florida Power, Tampa Electric Company, Florida Power and Light Company or anyone else for their electricity." Is that statement consistent with things you have been told within the Company, that the Company expects retail competition to be here within the next ten years?

MR. McGEE: Madam Chairman, I object to this line of questioning. I think he's gone well beyond anything that was remotely covered in this area in Mr. Schuster's direct testimony.

COMMISSIONER CLARK: Speak louder.

MR. McGEE: I would object to this line of questioning because Mr. Howe has gone beyond anything to do with the subject in Mr. Schuster's direct testimony.

COMMISSIONER CLARK: Mr. Howe.

MR. HOWE: In my first questions of Mr. Schuster I asked him if in his proposal he was assuming traditional utility regulation in the years 2014 through 2023, such that there would be something similar to a fuel and capacity cost recovery clause, and he said yes. Now I'm testing that assertion to see if the Company, in fact, believes that there will be something other than traditional regulation in those years.

COMMISSIONER CLARK: I'll allow the question, but I think we could move through it faster than we are.

Q (By Mr. Howe) Mr. Schuster I'll rephrase.

From your experience in Florida Power Corporation, what have you heard about what the Company or when the Company expects elements of retail competition to appear in Florida?

A Well, I guess I could just repeat a previous answer. I have heard comments as to when and if deregulation and restructuring will occur almost on a daily basis.

Q Mr. Schuster, when do you believe retail competition will be present in some form or in any form in Florida?

A I think we're probably in an environment right now where there's some in existence right now that is being tested by some retail customers in Florida. There are current procedures, things like self-service wheeling, that could be categorized as a form of competition and something other than rigorous retail regulation.

Q Mr. Schuster, under the Company's proposal as reflected in Exhibit 7 to your prefiled testimony, a customer -- a Florida Power Corporation customer who is on line today, but leaves the system, say, in the next three years, will he see any net benefits from the Company's proposal?

A No, he won't. And I feel compelled to add that we don't do our analysis on a customer-by-customer basis. We do our analysis on our overall customer base and look at the benefits that will accrue to our retail customers as a class.

Q Would it be fair to say that customers currently on Florida Power Corporation's system, who leave Florida Power Corporation's system within the next 22 years, will not see any net savings in the sense that their recovery on a net present value basis exceeds their cost?

A I'm sorry, would you repeat the question?

Q In simple terms, would you agree that customers currently on your system who leave over the next 22 years will not see any net savings under the Company's proposal?

A Yes.

Q Mr. Schuster, is the Company experiencing growth in customers?

A Yes, it is.

Q Would you expect that in the future the cost of the OCL contract, if the Commission were to deny the Company's petition, would be spread over a larger number of customers?

A Yes, generally speaking, continuation of growth, we would have a larger customer base in the future than we do today.

MR. HOWE: I have no further questions.

COMMISSIONER CLARK: Thank you. Staff.

MR. KEATING: Staff is going to pass around Staff's exhibits previously identified as LGS-24 and LGS-25. LGS-24 consists of Mr. Schuster's Late-Filed Deposition Exhibit Nos. 1, 3, 4 and 7 through 13. LGS-25 consists of Florida Power Corporation's response to Staff's Third Request for Production of Documents, No. 5.

COMMISSIONER CLARK: Mr. Keating, we'll identify the two of them as Composite Exhibit 4. Is that okay?

MR. KEATING: I think that would be fine.

COMMISSIONER CLARK: All right.

(Exhibit 4 marked for identification.)

CROSS EXAMINATION

BY MR. KEATING:

Q Mr. Schuster, do you have a copy of those exhibits now?

A Yes, I do.

Q Were the responses that you provided to Staff's request for production prepared by you or under your supervision?

A Yes.

Q First, could you tell us who prepared the fuel forecast provided by Florida Power Corporation in this docket?

A Our Fuels Department.

Q Referring to your response to Staff's Third Request for Production of Documents No. 5 that is part of the exhibit before you -- I think it's marked as LGS-25.

A Yes.

Q Could you please refer to Page 2 of that exhibit?

Does Florida Power Corporation's 9702 coal price forecast as shown in Column 16 of that exhibit reflect the projected delivered charge-out price of Crystal River 1 and 2?

A I'm sorry, I didn't hear the very last part of that question.

Q I'm sorry. Does FPC's 9702 coal price forecast as shown in Column 16 of that exhibit reflect the projected delivered charge-out price of Crystal River 1 and 2?

A Yes.

Q In reference to that forecast, is it correct that Florida Power Corporation's projects coal to be priced at a $1.70 per MMBtu for the year 1997 and $2.44 MMBtu for the year 2023?

A Yes.

Q Then for the 27-year period from 1997 to

2023, is it correct that Florida Power Corporation has projected that Crystal River 1 and 2 coal prices will grow by roughly 44% or roughly 1.6% per year?

A Subject to check, yes, I agree.

Q Could you please refer to Page 4 of the exhibit before you. Is it correct that Columns 26 and 27 contain the projected price of natural gas and transportation respectively used to develop Florida Power Corporation's net present value savings estimate?

A Yes.

Q So is it correct, then, that if Columns 26 and 27 are added together, Florida Power Corporation's projection of the delivered price of natural gas would be derived and that would result in a price of $3.23 per MMBtu for 1997, and $4.09 per MMBtu for the year 2023?

A Yes.

Q So for the period 1997 to 2023, subject to check, is it correct that Florida Power Corporation projects that the delivered price of natural gas will grow by roughly 27% or about 1% per year?

A Subject to check, yes.

Q So does it follow that your net present value savings calculations are based upon a scenario in which natural gas prices are assumed to grow at approximately two-thirds the rate of coal prices?

A Yes.

Q Now, if you could turn back to Page 1 of that exhibit, and look at Columns 2 and 5.

Is it correct to observe that if natural gas prices grow at as rate lower than that of coal prices, the net present value savings of the buyout will be larger?

A Yes.

COMMISSIONER CLARK: I'm sorry, Mr. Keating, say that again.

MR. KEATING: I'd asked if it is correct that if natural gas prices grow at a rate lower than that of coal prices, the net present value savings of the buyout will be larger.

COMMISSIONER CLARK: Mr. Schuster, is that lower than what you project?

WITNESS SCHUSTER: I understood his question to be just a delta, relative --

COMMISSIONER CLARK: Oh, all right.

WITNESS SCHUSTER: -- a movement of the two.

COMMISSIONER CLARK: And the answer is yes.

WITNESS SCHUSTER: Yes.

COMMISSIONER CLARK: Okay.

Q (By Mr. Keating) So, conversely, if natural gas prices grew at a faster rate, the net present value savings would be smaller?

A Yes.

Q Before you applied these fuel price assumptions to your analysis, did you compare them to fuel price forecasts from other sources to see if they appear consistent with other long-term projections?

A I didn't personally, but our Fuels Department does that as part of the development of each of their forecasts.

Q Are you aware of any other fuel price forecasts from other sources that show natural gas prices growing at a slower rate than coal prices?

A I haven't done an analysis on other forecasts to look at the relationship between coal and gas. I know with respect to gas there are other forecasts that are higher as well as lower than Florida Power's.

Q Going back to the previous questions, I'd asked if you had compared the fuel price assumptions in your analysis to fuel price forecasts from other sources to see if they appeared consistent with other long-term projections. I think you stated that the forecast came from the Fuels Department?

A Yes.

Q Do you know if they compared -- did they compare the forecasts with other sources for consistency with those sources?

A Yes, they do.

Q Could you please explain the difference between firm and incremental natural gas price forecasts?

A I'd like to ask you where you're referring to those terms from because that may change the answer.

Q Okay. If you would give me just a second?

A Excuse me. Let me just continue.

Generally speaking, we refer to it as firm versus spot. Firm is a fixed or a locked-in price and spot is a floating price. I assume by saying incremental you're referring to a spot concept.

Q Yes, that is correct.

A Okay. Yeah, then the interpretation would be as I described.

Q And could you repeat that?

A Firm prices are generally a price that's been fixed by some type of an agreement or contract over some period of time, and it may not even be fixed. It may have a fixed escalation. It may change year-by-year but be predictable. Whereas, a spot gas price is strictly market driven and is going to be a function of the marketplace at any point in time.

Q Now, referring to Page 4 of the exhibit marked as LGS-25, did the prices represented in Florida Power Corporation's 9702 natural gas price forecast, as shown in Column 26, reflect the incremental cost of natural gas or the spot?

A They, in effect, reflect market prices. They are not tied to any existing or proposed contract terms.

Q Would you agree that those are -- those are considered spot prices?

A Yes.

Q At your deposition you indicated that the natural gas fuel price forecast is incremental fuel only. Would you agree that using incremental fuel only equates to a lower fuel forecast?

A No, I would not.

COMMISSIONER CLARK: I'm sorry, Mr. Keating, when you say "incremental," do you mean spot?

MR. KEATING: Yes. I'm using the terms interchangeably.

COMMISSIONER CLARK: Okay.

WITNESS SCHUSTER: Well, I guess, just to maybe pursue that, is lower than what?

Q (By Mr. Keating) Lower than a fuel forecast that relied on firm prices.

A It would depend on what the firm prices were. If they were -- they could be higher or lower than spot, and that would determine the answer to your question.

COMMISSIONER CLARK: You can't say as a definite fact that if you use spot coal prices you're going to come up with a lower forecast than if you use firm?

WITNESS SCHUSTER: No, I can't. And I don't think it would be appropriate to use firm prices in this instance because a firm price relates to a specific contract. For instance, we have a gas contract to supply gas to our cogen plant up at Gainesville, and that price only applies to gas delivered at Gainesville and burned there.

In this instance we're looking at some incremental generation on our system in the future. And since we haven't signed a contract to lock in the price of that gas, it seems that the only reasonable assumption is that it would be based on spot prices until we were to make a decision and make a commitment that would change that.

Q Could you please refer to the exhibit marked LGS-24, which is the other exhibit that we handed out. And if you could refer to Late-Filed Exhibit No. 3 to your deposition that's included in LGS-24. I believe that's on the page marked 7.

A Yes.

Q There are also two tables or two spread sheets that were provided on Pages 8 and 9 of that exhibit. There's on column entitled "Premium Supply Cost," which reflects Florida Power Corporation's 9603 forecast for the years 1997 to 2006. That column -- 73 cents above what appears to be incremental or spot prices in the other column entitled "Supply Cost," in every year shown.

Does that 73 cents represent a premium for firm natural gas? (Pause)

A I'm sorry, I don't recall exactly what that premium is reflective of.

Q Could you check into that for us, and if we could come back to that later in the hearing to find out what the premium --

COMMISSIONER CLARK: Yeah. I think we need an explanation, because as I understand, the premium supply cost is what you, in fact, used in your analysis, right?

WITNESS SCHUSTER: Excuse me. I'm just comparing numbers. (Pause)

I would need to pursue that and find an answer.

In brief, the fuels forecast as prepared by our Fuels Department contains a substantial number of gas forecasts for each of our plants, and on a forward basis for new generation that may be coming on line. What's included in the Ten-Year Site Plan filing is a small subset of that. And I don't have before me here the reconciliation between those two forecasts.

Q If you could refer to -- I think we're on the same exhibit, LGS-24, and turn to Late-Filed Exhibit No. 4. I believe it's following the Late-Filed Exhibit No. 3 we were just on. That exhibit tabulates --

COMMISSIONER CLARK: Mr. Keating, what's the page number down at the bottom?

MR. KEATING: I'm sorry. It's Page No. 10 and Page No. 11.

COMMISSIONER CLARK: Okay.

Q (By Mr. Keating) That exhibit tabulates FCP 9601, 9603 and 9702 natural gas supply and transportation prices separately; is that correct?

A Yes, it does.

Q It appears that by looking at the 9601, 9603 and 9703 natural gas price forecasts, Florida Power Corporation has consistently increased near-term prices while deflating out-year prices. Why have the near-term prices increased in each of the price forecasts provided?

A Well, it's probably a lengthy answer to that question. In brief, it's because of the historical trends and movements in natural gas prices. Natural gas prices have been very nearly flat for almost ten years, 10 to 12 years. And recently over the last couple of years there has started to be more volatility. Some people interpret that volatility, these price spikes we have been seeing up over $3 a millions Btu, as beginning the beginning of a new trend upwards. And other people interpret that as just being a price spike that's going to go away, and we're going to come back down to where we have been for the last ten years.

In terms of gas price forecasting, that's, I guess, what I call the $64 question. And the forecasts reflect that uncertainty. We have moved up in the near-term because we've seen upward movements in gas prices in the near-term, and we need to reflect that.

However, the long-term forecast needs to look at the long-term trends that we've had over time, and that seems to suggest moderation in gas prices.

Q Could you please refer to now to Column 4 of -- I believe it's your Exhibit 7 to your prefiled testimony.

A Yes.

Q Referring to that column, is it correct that the values are based upon your estimate of what it will cost to build a combined cycle unit to replace the power that the contract would have provided in the years 2014 to 2023?

A Yes.

Q I'm sorry, I think I've referred you to the wrong spreadsheet. If you could give me just a second.

COMMISSIONER CLARK: Okay. Mr. McGee, I don't know if it applies to anyone else, when you have exhibits, if you're going to offer them as a composite, which we usually do, you might number them consecutively.

We were on Exhibit 7; is that right? We still need to be there? Mr. Keating?

MR. KEATING: Excuse me?

COMMISSIONER CLARK: All right.

MR. KEATING: I'm sorry. I had referred you to the wrong exhibit.

Q (By Mr. Keating) Could you please refer back to Exhibit LGS-24 that was handed out just a minute ago. And turn to Page 18. It contains Late-filed Exhibit No. 8. Are you with me?

COMMISSIONER CLARK: Page?

MR. KEATING: Page 18.

COMMISSIONER GARCIA: Page 18 of -- I'm sorry, Page 18 of the composite -- Staff composite exhibit?

MR. KEATING: Yes. It's the exhibit previously identified as LGS-24 that's now part of Staff's composite exhibit.

Q If you could turn to Page 3 of that exhibit, of that spreadsheet. Is it correct that Columns 18, 19, 21, 21 and 22 show your calculations on how you arrived at the estimates in Column 4 on Page 1 of the spreadsheet?

A Yes.

Q Okay. Would you please briefly explain how these calculations work to arrive at an estimate of future construction costs?

A Yes. The forecast is what I would characterize as a market price for combined cycle capacity costs in the sense that we have assumed that price will change each year and escalate according to the change in the cost of capacity from a combined cycle unit.

Just by way of example, the alternative would be to assume that you build a discrete unit in 2014, and then begin to depreciate it, and you would base your cost over that ten-year period based upon a discrete unit that's built at a discrete point in time. We felt that it was more conservative and reasonable to use a market price concept for capacity in this analysis. And what we've done, basically, is to forecast the cost of a combined cycle unit each year and then convert that over to a fixed charge rate, dollars per kW a month, that would be the price for the capacity charge from that type of capacity.

Q Referring now to Column 18 titled "Cost Inflation Rate Percent." That's on Page 3 of your spreadsheet.

A Yes.

Q Is it correct that this column contains the escalation rates of DRI's GDP Fixed Investment Equipment Price Index?

A Yes.

Q Okay. Is this the price index that you selected to estimate future costs?

A Yes.

Q Is it correct, then, that your net present value savings estimate is based upon an assumption that construction cost will escalate by, roughly speaking, one-half of 1% per year?

A Subject to check, yes.

Q Referring to Exhibit LGS-6 to your testimony, could you please explain what that exhibit is or what that shows?

A Well, that exhibit contains a cover letter and a response that was provided to Judy Harlow of the Commission Staff late last year in response to questions that she gave to Florida Power.

Q Is it correct that that's a copy of a spreadsheet submitted in November of 1996 showing an estimate of net present value savings for this buyout?

A Yes.

Q Okay. In that analysis did you base your construction cost escalation rates on a price index different than the one you used to create your Exhibit LGS-7?

A Yes.

Q Is it correct that the index you used to create Exhibit LGS-6 to your testimony grew at an average rate of a little more than 5% per year? I'm sorry, 3% per year?

A Once again, subject to check, yes.

Q What has happened since you originally performed your analysis to lead you to believe that the appropriate escalation rate is roughly a half percent per year rather than a little more than 3% per year?

A Well, two things have happened: The first thing is that the forecasting methodology has changed. During 1996 Florida Power prepared for the very first time a forecast of the market price of generation out into the future, and when our original petition was filed with the Commission on October 1st, 1996, we based our projections on that market price projection.

That was the escalation rates that you referred to in the attachment to Judy Harlow's letter.

Q So is it your belief now that the GDP Fixed Investment Equipment Price Index is the most appropriate index to use to estimate future construction costs for a combined cycle unit?

A Well, let me -- excuse me. Let me finish my answer.

Q I apologize. I didn't mean to interrupt you.

A And I apologize for it being such a long answer, but the first point is the methodology change.

The basis for the filing on October 1st was that this market price forecasted generation which was prepared, I believe, in May of 1996. That forecast was not repeated or updated in the same form that it was done in May of 1996, so as we move forward in time, in order to update our analysis of the OCL buyout, we had to do something different. And in doing something different, I restructured the analysis and went back to the DRI and selected what I felt was an appropriate index to use for the purposes of the OCL buyout.

So I guess in terms of a methodology change, what I would -- the way I would describe it is that we have moved from a generic index that was used for generation cost forecast in 1996 to a more specific and a more appropriate index that I selected specifically to be applied to the OCL buyout. That is the first cause for the change.

The second cause for the change is just the simple passage of time and the fact that even if the exact same index had been used from the beginning to end, the forecast would, in all likelihood, have changed.

Q Mr. Schuster, Staff is going to pass out a -- hand you a copy of what's identified as LGS-26. It contains DRI's business fixed investment data.

COMMISSIONER CLARK: Do you need an exhibit number?

MR. KEATING: Yes, we'd like that marked for identification.

COMMISSIONER CLARK: All right. Let's label it Exhibit 5.

(Exhibit 5 marked for identification.)

Q (By Mr. Keating) This page shows at the top DRI's projections for entire category of GDP investment expenditures labeled "Nonresidential Fixed Investment." And down towards the middle of the page it shows the price indices for those same expenditures. Do you see that?

A Yes.

Q Now, is it correct that these investment expenditures and their associated price indices reflect DRI forecasts for the different types of fixed business investment?

A Yes.

Q Is it correct that the price index you used to estimate future construction costs is the one marked with arrow entitled, "Producer's Durable

Equipment?"

A No, I don't believe it is.

Q Which of the price indexes did you use?

A I believe we kind of had this same conversation in my deposition, and I used an index from a different page in the DRI manual that was provided in a response to an interrogatory as a late-filed exhibit.

Q Were the numbers the same in that index?

A No, they were not.

COMMISSIONER CLARK: Mr. Schuster, do you know what interrogatory it was you answered that had the table?

WITNESS SCHUSTER: I'm looking for it right now. Okay. You just have a subset of the late-filed deposition exhibits.

MR. McGEE: If you would refer to your Late-Filed Deposition Exhibit No. 9, I think that will get you close.

WITNESS SCHUSTER: Thank you. (Pause)

My late-filed exhibit No. 9 refers to Page 137 of DRI's May 1997 projection data, and it shows the components of the gross domestic product implicit price deflators.

The index that I used was a fixed investment equipment index.

COMMISSIONER CLARK: Where is that, Mr. Schuster?

Q (By Mr. Keating) Is that the index on Page 24? It's about four rows up from the bottom?

A Yes, it is.

Q If you look at Page 23 of that same exhibit, that starts your Late-filed Exhibit 9, you've got -- it states, "Provide the data resources reference for the cost inflation rate in Column 18 of the base case net present value analysis of customer benefits from the OCL ten-year contract buyout." And I believe that that Column 18 is Column 18 of your Late-filed Exhibit 8 on Page 20 of this exhibit. (Pause)

It doesn't appear to me that the numbers that were used -- numbers that you referenced in your Late-Filed Exhibit No. 9 on Page 24 of the fixed investment equipment category, or index, are the same numbers in Column 18 titled, "Cost Inflation Rate Percent" on your Late-Filed Exhibit No. 8 on Page 20 of this exhibit.

A No, they are not. They are the same concept and they are the same index, but they are taken from two different forecasts. The footnote on Late-filed Exhibit No. 8 for Column 18 shows that that's coming from the August DRI review and Late-Filed Exhibit No. 9 is from the May review.

COMMISSIONER CLARK: Why are they different? I mean, is it just -- why did you use one addition for answering No. 9 and another for answering No. 8?

WITNESS SCHUSTER: Well, at the deposition I was asked whether -- well, we talked about many of the assumptions in the analysis, and I was asked to update as many of those assumptions as there was more recent information available.

COMMISSIONER CLARK: Okay.

WITNESS SCHUSTER: In the deposition, at that point in time, the most recent was the May data.

COMMISSIONER CLARK: All right. And No. 9 was -- what data did you rely on?

WITNESS SCHUSTER: And No. 9 was updated at the specific request of Staff as a result of the deposition.

Q (By Mr. Keating) Is it correct that these investment expenditures -- I'm sorry. Let me refer you back to the exhibit that was handed out identified as LGS-26. We pointed out at the top of the page that the DRI's projections for the category GDP investment expenditures labeled "Nonresidential Fixed Investment," and at the bottom of the page was, or towards the middle of the page, the price indices for those same expenditures.

A Yes.

Q Okay. Looking at the top of the page, do you know notice that the category called "Nonresidential Fixed Investment" is broken down into two subcategories, one called "Producer Durable Equipment," and one called "Nonresidential Structures?"

A Yes.

Q Do you agree that the values in these two categories add up to the total values in nonresidential fixed investment?

A Subject to check, yes.

Q Do you also see that these two subcategories are broken down further into smaller groups and that these smaller groups become more specific as to the types of business investments being projected?

A Yes.

Q Okay. Now, looking at the Producer's Durable Equipment category, further down the page, is it correct that this category is broken down into separate investment expenditures for automobiles, office equipment and a group called "other"?

A Yes.

Q Is it correct that the group called "other" contains expenditures for the types of machinery that you believe would be found in a combined cycle power plant?

A Yes.

Q And would you agree that the group called "office equipment" includes things like personal computers, copiers, fax machines and telecommunications equipment?

A Yes.

Q Would you agree that the group called "autos" contains items such as automobiles and trucks?

A Yes.

Q Is it correct that there are price indices for each of these groups shown further down the page?

A Yes.

Q Do you know notice that the price index for the office equipment group declines at roughly 12% per year over the forecast period, while the other two groups increase by about 2% per year?

A Approximately, yes.

Q Looking at the Producer's Durable Equipment Price Index, do you agree that this price index includes changes in forecasted prices for all three groups of durable equipment expenditures?

A Yes.

Q Would you agree that this aggregate price index, because it contains the office equipment price index, is lower than the other durable equipment category which you say contains the costs of the types of machinery used to build a combined cycle power plant?

A Yes, the percentage changes are lower and in some cases negative.

Q If you believe that the other category is more closely associated with the cost of building the plant, why didn't you use that price index instead of an aggregate index that is based in part on the cost of personal computers, copiers, fax machines and telecommunications equipment?

A That would have been an option to take it to on finer level of detail and use a more disaggregated index. There's a trade-off in going to a more detailed index. I think that to the extent that the office equipment index includes computer-type equipment, electronic type equipment, there's a substantial amount of that in a combined cycle plant in the controls. Not the exact same thing; it's more of an industrial type of equipment as opposed to an office piece of equipment, but it would reflect the cost trends of electronic equipment.

One of the things I was concerned about is that if you -- when you go to a more detailed index, sometimes it becomes more difficult to forecast and from one forecast to the next you see greater changes. So there's -- it's kind of a trade-off to use a mid-range index that might cover more of the things that you're trying to measure and cover them in a more stable fashion.

Q Do you see the investment category called "nonresidential structures" contained in the group "buildings and other mining and petroleum and public utilities" further down this page?

A Yes.

Q Did you consider using the Public Utilities Price Index in your calculations?

A Yes, I did.

Q Why did you choose not to use that?

A Well, for two reasons: One is because it is a subcategory of nonresidential structures, and it has the trade-off of accuracy and stability that I mentioned in my last response.

The second is that if you look at the cost breakdown for the construction of a combined cycle plant, only approximately 10% of the total cost of the plant is in structures. The balance of the 90% is almost entirely in categories that would be included in the equipment index.

Q Given the index that you used, are you saying that as a whole you expect there to be years when the cost of the combined cycle unit should be deflated?

A Yes. I wouldn't be surprised if that were the case. And I'll make two points, if I may. One is that I'll be the first one to describe what I did as a -- what I feel is a reasonable forecasting approximation in terms of projecting the cost of the combined cycle plant. In terms of using a different index or using a weighting of several indexes or using a more detailed index, I just tried to strike a compromise that I felt was accurate and reasonable.

Secondly, based on some of the prior conversation here, in my cross examination, I would compare a combined cycle power plant, as it is a maturing technology, one that's entering the marketplace, compare it to computers. And I think anybody who has bought a computer knows that the prices on computers can go down from month to month and year to year. We have seen that in the marketplace where foreign vendors of combined cycle plants and equipment will drop their price in order to enter the marketplace. So we have seen instances where the price does go down.

Q If what you just told me was the case in November when you did your previous analysis, then why did the cost escalation rates change?

A I thought that I answered that question previously. Should I answer it again?

Q Yes, if you could please briefly answer it.

A Okay. Two reasons. One is the change in the methodology, the forecast that was prepared last fall was based on the generation cost forecast that was prepared in May of last year. And it was the very first time that that type of forecast had been prepared using that methodology. It was not repeated or updated. So when we came into 1997 and continued to respond to Staff's request to update the assumptions for this analysis, I selected an updated index, first from the May DRI review and then from the August review, which I felt fairly reflected the specific escalation of a combined cycle power plant.

So to summarize, the differences are the change in the index, which I would describe as a methodology change, and the passage of time which has resulted in a more recent forecast.

MR. KEATING: Staff is going to hand out a copy of a exhibit identified as LGS-28. That exhibit contains Florida Power Corporation's response to Staff's Interrogatory No. 4, a portion of Florida Power Corporation's response to Staff's request for production of documents No. 1B, an excerpt, Column 17 through 22 of your Late-Filed Deposition Exhibit No. 8.

COMMISSIONER CLARK: We'll mark it as Exhibit 6.

Do you have any more exhibits for this witness?

MR. KEATING: Yes, I do.

COMMISSIONER CLARK: Does it make any sense to hand them out at the same time so we don't take time passing them out and stuff? How many more do you have?

MR. KEATING: Just a few more.

COMMISSIONER CLARK: All right. We'll go ahead and just do it the way we're doing it, but in the future we might want to try and get it done all at once. All right. It's Exhibit 6.

(Exhibit 6 marked for identification.)

Q (By Mr. Keating) If you could please refer to your response to Staff's Interrogatory No. 4 on the first page of that exhibit. Is it correct that in your response you stated that the original October 1996 cost-effectiveness analysis was based on quote/unquote "judgment capital cost inflation assumptions that reflected the currently depressed state of the combined cycle unit prices."

A Yes, that's correct.

Q Could you turn to your response to -- I'm sorry. Could you turn to your response to Staff's Request for Production No. 1B. It begins on the second page of that exhibit. Specifically, if you could refer to the last page of the November 8th, 1996, letter to Judy Harlow contained in that exhibit? Could you briefly explain the contents of this document?

A I'm sorry. I'm not with you yet. You're in LGS-24?

Q I am in LGS-28 that was just handed out.

MR. McGEE: The exhibit that I received is marked LGS-27.

MR. KEATING: I apologize. We will hand out LGS-28. (Pause)

COMMISSIONER CLARK: LGS-28 entitled -- well, it's the response to Staff Interrogatory 4, a portion the response to Staff's POD Request 1B and columns 12 through 22, Lee Schuster Late-Filed Deposition Exhibit 8 will be marked as Exhibit 7.

(Exhibit 7 marked for identification.)

MR. KEATING: Am I correct that the exhibit hand add out was mistaken was LGS-24?

MR. McGEE: That was LGS-27.

MR. KEATING: 27. Okay.

Q (By Mr. Keating) If you could please refer to your response to Staff's Interrogatory No. 4 on the second page of Exhibit LGS-28.

A Yes.

Q Is it correct that in your response to Staff's interrogatory you stated that the original October 1996 cost-effectiveness analysis was based on quote/unquote, "judgmental capital cost inflation assumptions that reflected the currently depressed state of combined cycle unit prices?"

A Yes.

Q Now, if you could turn to your response to Staff's Request for Production of Documents No. 1B and that's the second page of this exhibit. Specifically, if you could turn to the last page of the November 8th, 1996, letter sent by you to Judy Harlow of the Commission Staff. Could you briefly explain the contents of that document?

A I apologize. I'm not with you yet. What is the front page of the document you're referring to?

COMMISSIONER GARCIA: He's in the same exhibit we were on before. Just flip one more page.

MR. KEATING: The exhibit LGS-28 that was handed out consists of your response to Staff's Interrogatory No. 4, a portion of the response to Staff's Request for Production of Documents No. 1B and Columns 17 through 22 of your Late-Filed Deposition Exhibit 8. I'm referring to the second to the last page now of this exhibit. And that page is part of your response to Staff's Request for Production No. 1B.

WITNESS SCHUSTER: Okay. This is Page 3 of 5, or 2 of 5? Or --

Q (By Mr. Keating) It's the page that in the bottom right corner the number is 9:26.

A Okay. I think I'm with you.

Q Could you briefly explain the contents of this document?

A Well, this is a development of the replacement cost capacity charge for the OCL buyout transaction. It shows the assumptions and the progression of calculations to get to a capacity cost on a dollar per kW month basis.

Q Is Column 1 on this page the forecast you were referring to when you responded to Staff's Interrogatory No. 4?

A Yes, it is.

Q How did the capital cost escalation rates shown in response to Staff Interrogatory No. 4 compare to those in your Late-Filed Deposition Exhibit No. 8?

A They are different, and the more recent assumption is lower.

Q What is the replacement capacity cost that was projected for the year 2023 in your analysis in your response to Staff's Request for Production No. 1B? And, again, that's the fourth page of this exhibit.

A You're referring to the $84.81 number?

Q I'm referring to the $144.90 figure under Column 5.

A Oh, okay. I'm with you.

Q Is it correct that in your response to Staff Interrogatory No. 4 you stated that you believe that combined cycle unit prices were depressed to the point that you increased them by 15% in the year 2004?

A No. I reported that as being the assumption and the basis for the assumption made by our Power

Marketing Department that did that forecast. That was not my personal belief. I was explaining the forecast and the 15% increase in the year that it occurred in response to the interrogatory question.

COMMISSIONER CLARK: Mr. Keating, how much more do you have?

MR. KEATING: Probably about half an hour.

COMMISSIONER CLARK: I'll tell you what, we're going to go ahead and take a lunch break now. Just a minute. Mr. Keating, is this a convenient point to break? Or do you have a few more?

MR. KEATING: I really just a couple more questions in this line of questioning.

COMMISSIONER CLARK: All right. You finish that, and let me know. Then we'll see how long, we'll take a break.

Q You did state in your response to Staff Interrogatory No. 4, though, that the inflation rate of 15% for 2004 was a judgmental adjustment included in the forecast to represent an eventual firming up of prices of combined cycle units from near-term price levels that were believed to be depressed; is that correct?

A Yes.

Q Okay. And is it correct that in your

Late-Filed Deposition Exhibit No. 8 you decreased the projected replacement capacity cost by $60 per kilowatt a year in the year 2003? And that is a decrease as compared to what you provided in response to Staff's Request for Production No. 1B?

A Yes.

Q Do you now believe that your original estimates were unreasonable?

A Well, no, I don't. I wouldn't describe them as unreasonable. They were not my original estimates. The original forecast was prepared by another person in another department, really, for another purpose. It was a market price forecast of generation that was to be used by our power marketing group, and it was used in the original OCL buyout analysis because it was believed to be reasonable and was current at that point in time.

What I've done more recently is to do an updated analysis using what I believe to be reasonable assumptions and the most current data that's available.

MR. KEATING: I think that wraps up this line of questioning and this would be a good time for a break.

COMMISSIONER CLARK: Okay. What I'd like to do is just reconvene at 2:10.

And I'd like to ask you, Mr. McGee and Mr. Childs and Mr. Howe, think about what you're going to do on redirect timewise, and what you might have by way of cross examination for the other witnesses and just tell me an estimate of time so we may decide if we want to go late or if we have to come back tomorrow. All right? Thank you.

(Lunch recess.)

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(Transcript follows in sequence in Volume 2.)