BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of : **UNDOCKETED**

Undocketed merchant plant study

VOLUME 2

PROCEEDINGS: **WORKSHOP**

BEFORE: CHAIRMAN JOE GARCIA
COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER JULIA L. JOHNSON
COMMISSIONER E. LEON JACOBS, JR.

DATE: **Thursday, May 13, 1999**

TIME: Commenced at 10:10 a.m.
Concluded at 4:40 p.m.

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

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I N D E X

P R O C E E D I N G S

(Hearing reconvened at 12:40 p.m.)

CHAIRMAN GARCIA: Let's start again. Maybe if you notice I have been trying to ask as few questions myself because I want to hurry along. But, of course, Commissioner Clark's have all been very relevant and so we want to continue that.

If you can, cut your presentations down a little bit. It will be helpful because we're less than a quarter of the way through it, and we're almost halfway through the day.

The next presentation is Dynegy. Go right ahead.

MR. CRUTHIRDS: Dave Cruthirds, Senior Director and Regulatory Counsel of Dynegy. And it's no "r" in Dynegy. D-Y-N-E-G-Y. Today I'm accompanied by Ben Trammell, Senior Director of Project Development at Dynegy.

I'm not sure how familiar you are -- or the people in the audience are about Dynegy. We're not a household name, but those within the industry, people are very familiar with us. NGC Corporation was our former company. We changed our name last summer to the Dynegy. We're in the top five wholesale power marketing, gas marketing and natural gas liquids in

North America. We had $14.5 billion of revenue last year. Publicly traded. We're a sizeable company as an independent power producer. We're one of the leading developers right now. We've got -- 6800 of megawatts on the ground operating right now, and with the number of plants that are being contemplated, we've got three that's announced in SERC, and we are looking at sites in Florida.

We welcome the opportunity to be here. We have provided comments. Hope those have been read. We're certainly happy to answer any questions on that.

I'd also like to make an appearance today for -- Dynegy is a member of National Energy Marketers Association, NEMA, which represents producers of oil and gas marketers throughout the country. They have authorized us to indicate that NEMA has subscribed to the comments Dynegy has submitted in the proceeding.

We took a different approach, and I'm sure quite different from some of the comments that we had seen provided early on. And we didn't go through and answer all of the exact questions and get immersed in that.

One of the things that we were, I guess, startled by is the approach that the commenters and most of the dialog was all looking at -- and you do have a practical problem; you do have statutes and laws on the books today that you have to deal with. But what we would encourage the people to understand that competition is coming, wholesale competition; while it's quite imperfect and we need some progress both at federal and state level to improve the wholesale market, wholesale competition is here. Retail competition is kind of one way or the other, and we don't know when, exactly what flavor, but it is coming.

So we would prefer that the parties and Commission approach the matter from a perspective of competition is coming. How do we get there? What do we -- like Commissioner Clark's question, what do we do to get there?

Rather than we have the existing regulatory paradigm that we're dealing with, and grapple and get -- you do have to deal with it, but try to get stuff out of the muck and examine the issues and look at them from that perspective.

So that's how we provided our comments. We did provide a set of principles that we think have very solid foundation and would be very appropriate for the Commission to consider, and certainly you won't adopt them verbatim the way we provide them, but we certainly think it would be a good starting point.

One of the questions that came up, Commissioner Clark, you were looking at how do we assure reliability and reserves. And the analogy that I was thinking of -- a lot of us here, competitive power producers, came out of the gas industry, natural gas. There is no federal or state reserve requirement on natural gas reserves. You have a fairly well functioning natural gas market. People depend on natural gas in winter in Boston and winter in New York and winter in Chicago, they depend on natural gas for their lives just in the same way you would depend on air conditioning on the 4th of July in Florida.

In a competitive market you have -- it's Economics 101: Law of Supply and Demand. You're not here -- you don't obviously have that market here in Florida, but we would certainly like you to view it, understand the laws of the economics and approach the merchant plants and see their role and see how the wholesale market operates within that.

COMMISSIONER CLARK: Let me interrupt you for just a minute. Are you suggesting that we not set a margin of reserve even for utilities that have the obligation to serve load and that we simply let the market determine what the appropriate reserve is?

MR. CRUTHIRDS: Eventually, yes. You do have a transition problem where right now you're -- you call it half pregnant -- you're half regulated, half unregulated; maybe a little different percentage here in Florida. But eventually you will be in a situation where the Commission's role will be considerably reduced in terms of the need determination, you know, for what capacity is need.

Now, clearly do have --

COMMISSIONER CLARK: Is it your position that the market should determine how much capacity should be built to serve retail customers in Florida ultimately?

MR. CRUTHIRDS: Yes, it is.

COMMISSIONER CLARK: Okay.

MR. CRUTHIRDS: Looking at the analogy on the gas side, you have price signals that are transmitted to the Chevrons, the Exxons, BP, Amacos, the producers, who see the prices, they look at the forward price curves, the gas equivalent as Mr. Green explained, and they decide when to go out and when it's in their economic interest to produce and go out and explore and develop a field. And an offshore production platform is not unlike the size of investment that a major electric generation plant would be. And they're competing with other producers. They don't get together and say, "Well, okay, Shell, you're going to build the next plant, you're going to drill the next platform, and Chevron, you'll do the next one. They are all at risk and they're competing with each other. But from a macro viewpoint, you do end up with a supply and demand curve. As supply is shrinking -- right now you're seeing in the gas industry people are talking about "Natural gas suppliers, the bubble is over. You may have tighter gas prices in the next three, four years." Well, you can bet the producers are out there looking at that and saying, "We need to step up production," even though prices are low today. And I think you'll eventually have -- if you do have an open competitive power market, you'll have the exact same dynamic where it may be a Duke will say, "Okay. I'm the one today." Tomorrow it may be Dynegy. Tomorrow -- you know, Enron may build the next increment. And we will be the ones that will be essentially at risk for that investment.

I endorsed the comments that were made today by Constellation and Duke in terms of their explanation of the competitive market.

But in terms of -- from the reliability

perspective, we do see if allowed to work and if those price signals are allowed to get through to producers, they will build the appropriate number of power plants.

COMMISSIONER DEASON: Let me ask a question in that regard.

Do you see that there would be risk placed upon ratepayers in the sense that if there is inadequate capacity or there's capacity that is put on the grid only when there's an emergency situation or reserves are tight and prices go up, that there's risk being placed on the ratepayer that they are going to be confronted with prices higher than what we've seen in the past, and the reason, because in the past, is that our incumbent utilities are cost-based regulated and they have to have reserves. And when the capacity is needed, they have to generate. And all they get is what it cost them to generate. It's part of the regulatory impact. Do you see any potential conflicts or risk movement in that regard?

MR. CRUTHIRDS: I think there are some short-term risks.

The laws of supply and demand don't work perfectly. You will see imbalances of supply and demand occur periodically. Look, for example, at the price spikes that occurred in the Midwest this past summer. There were some structural problems with the operation of the grid, people didn't have some capacity on line. But the market -- the prices came through and the market has responded. People are -- including Dynegy, we have a plant, we're looking to put one in Chicago; Reliant has announced a plant in Chicago. There's people tripping all over themselves trying to get capacity down to -- in response to that price signal.

And one of the points we made in our comments, in our principles, is that you may have a short-term price spike that may be in total cost to consumers, less cost than building a new 400-megawatt generation peaking capacity. You look at maybe a $400 million investment to build a new plant and your total cost of the price spike to consumers may be 100 million or 50 million. While prices for a few days may have gotten very high, the total cost to the system -- that may be the appropriate response. And if you don't -- and the other side is if you don't allow the prices to get transmitted -- as sent by supply and demand and get transmitted to the marketplace -- say if you put a price cap -- well, we think that, you know, $50 is all that people should be able to receive -- then you're going to mute the incentive of a Dynegy or a Duke or an Enron to come in and build in that market and provide supplies if they don't see that they're going to be -- they are going to take all of the risk -- their prices might be $5 but there's no opportunity for them to receive the reward on the upside.

CHAIRMAN GARCIA: Any other questions? Thank you very much.

MR. CRUTHIRDS: Thank you.

MS. PAUGH: Enron.

MR. BASFORD: Dick Basford representing Enron. This is Cathy Giddings, our attorney.

In order not to be redundant, a lot has already been said and we agree with that.

Merchant plants are more efficient than much of the existing capacity in the state. The result of that is you're going to have lower cost to the consumer because merchant plants are going to sell wholesale energy to load-serving utilities. Merchant plants are going to be cleaner than much of the generation in the state. They're going to increase the air quality in the state using merchant plants. This has already been discussed.

We do believe that there's no need to cap the amount of merchant plant capacity. The critical thing is no one is going to come to Florida and spend $200- $300 million if they have not already determined that they can produce energy and sell it in the state of Florida.

If we -- if a merchant plant wanted to sell power in Georgia, it would build the generation in Georgia. It is much easier to build generation in Georgia or Alabama or Mississippi than it is in Florida. So there's no incentive to build generation in Florida and sell power out of the state.

So I'm just repeating and recapping what Rick and Mike have already said. We endorse that. We think that merchant plants are important to the state. And we believe that the Commission should proceed with their workshops and make determinations of how best to incorporate merchant plants into the mix of generation in Florida.

CHAIRMAN GARCIA: Any questions?

COMMISSIONER CLARK: Let me ask you a question with respect to having -- continuing to have a regulated retail market and a wholesale competitive market.

One way it could work is that you require the utilities who have an obligation to serve as retail, carry enough capacity to serve that at peak periods plus a margin of reserve, and then allow a certain amount of merchant capacity? Do you think there should be a cap on that, or do you think the market should decide how much extra capacity?

MR. BASFORD: I think the market should decide. As Mike Green said, the market is going to examine what is in Florida and they are not going to make an investment here. We alluded to the example of McDonalds. If you get a proliferation of McDonalds and Burger Kings and Taco Bells, what they do in order to get business is they get promotions and they cut prices and they do things that ultimately is to the benefit of the consumer. The same thing will happen with merchant plants except you're dealing with a much larger investment. They are going to make sure -- merchant plant developers are going to make sure that before they make the investment, that their ability to sell energy competitively in Florida is better than what the traditional utilities can do with their older generation that will be replaced by the new merchant plant generation.

And by the way, it wasn't in our comments and I haven't heard it said, but we don't have a problem with traditional utilities in the state building merchant plants if they are not in the rate base. If Florida Power and Light or TECO or Florida Power Corp want to build a merchant plant and compete in the wholesale market and not put it in the rate base, there's absolutely nothing wrong with that, in our opinion.

COMMISSIONER CLARK: What about the plants that are in retail rate base, shouldn't they be allowed to compete in the wholesale market?

MR. BASFORD: Well, they do.

COMMISSIONER CLARK: My question is should they continue to be? Is it fair -- you know, what's been represented to me it wouldn't be fair to have the ratepayers subsidize that plant and then it can be -- whatever extra they get in the wholesale market is gravy to them and you have to cover all your costs.

MR. BASFORD: That's true. And that's probably something that should be addressed during the docket.

The situation, as I understand it now, is that if a utility, investor-owned utility builds generation in Florida, he puts it in the rate base but has excess capacity in that plant, they can sell it in the wholesale market and I don't know how they divvy up those revenues between shareholders and ratepayers.

I don't know how that works.

COMMISSIONER CLARK: Mr. Cresse can tell us that. I can't -- it's on a cost basis and it's on a split the savings between the buyer and the seller, and then I think it's a 20/80% split between the ratepayers and the stockholders. It's been a while.

MR. BASFORD: And perhaps that should be addressed, that a portion of a plant could be merchant and the other portion be regulated, and that portion that is merchant falls outside of the regulation.

COMMISSIONER CLARK: Well, what would be your reaction to letting plants that are in the rate base be bid into the wholesale market?

MR. BASFORD: If they can bid into the wholesale market competitively, I think they should be allowed to do it.

COMMISSIONER CLARK: If they can come in at the lowest price, they should be able to do that.

MR. BASFORD: Yes, ma'am.

COMMISSIONER CLARK: Okay.

CHAIRMAN GARCIA: Any questions?

COMMISSIONER CLARK: Let me just ask one other question.

If we determine that for environmental reasons we did not want a proliferation of merchant plants -- to meet other state policy objectives we thought the amount of merchant plants should be limited, and I think Staff has suggested there should be a cap -- how would we determine what should be the criteria for determining who gets to build the merchant plant? Do you have an open season and you compare the plants to each other or is it a first-come-first-serve basis?

MR. BASFORD: First, I don't believe there should be a cap. But given there is a cap, I would say that that first-come-first-serve probably would be the way to go. I wouldn't hold out part for somebody down the road to come in and fill.

On the other hand, if you decide to put a cap, you may want to then look at the efficiency of one unit versus the other and where that unit is going to be located. All of those things would come in if you're going to narrow the margin of how much merchant plant capacity -- you may want to start considering those other things as not different than what you consider in a utility's need hearing.

COMMISSIONER JACOBS: Can I ask a question similar to that.

One of the assumptions for the successful operation of merchant plants is that the principle of supply and demand operate in the wholesale market. If you don't have a cap, aren't those principles distorted? It would appear to me that you're going to always have supply driving the curve because you're going to probably have more than enough applicants of capacity than what you presently have demand for.

MR. BASFORD: I think you want the supply driving the curve. The more liquidity you have, the lower the cost to the ultimate consumer. If you put a limit, you may be reducing the amount of energy available to lower the cost to the load serving entity.

COMMISSIONER JACOBS: Okay. If you have -- if you have those circumstances, it appears to me ultimately then you're going to arrive at a place where the costs are not going to be truly -- I'm sorry, the cost -- the prices are not going to be truly reflected. How do you avoid that? Let me ask that question. How to you avoid that?

MR. BASFORD: The price may not be truly reflective of the cost. And if Duke's unit has to sell energy lower than his cost, he may have to do that.

COMMISSIONER JACOBS: Sounds like a good proposition. I don't see you guys building those size plants if that scenario exists though.

MR. BASFORD: I don't think so either. When a developer looks at Florida they are thinking of several things. The load growth here in Florida is very rapid. The second is the declining amount of capacity ratio to the load. We know our capacity ratio to load is declining. So we need new capacity. We see load growth. There's much of our existing capacity that's old; it's inefficient. Obviously, you look -- a merchant is going to look at those things, they're going to look at the demographics of the state. The -- all of that is taken into consideration. And, again, these folks are not going to invest \$100-, \$200-, \$300 million if they don't truly believe that their sale potential here is going to give them the return on those investments.

COMMISSIONER JACOBS: And, I guess, what I'm beginning to understand is the answer to me we is: It's not so much new demand. Your objective is really to replace -- I think you said that already -- you're going to be replacing the existing demand -- I'm sorry. You're going to be serving -- you're going to bring new generation supply to serve existing demand and whatever growth that occurs.

MR. BASFORD: Exactly. Exactly. And many units that operate in Florida are 40 years old. They have heat rates that are 11,000. These new combined cycle units have heat rates at 7500, and are much more economically friendly, and there's nothing wrong with closing down those old units, or at least letting the energy out of new merchant plants replace the energy out of those old plants even if we don't want to retire them. There's nothing wrong with that.

COMMISSIONER JACOBS: So then building upon the scenario described by Commissioner Clark, as opposed to simply reserving some part of reserve margin for merchant plants, you would argue we should dig in a little bit into our demand to find some part of that existing demand that should be replaced, i.e. the aging plants that we should be replacing with merchant capacity as well. Is that a fair statement?

MR. BASFORD: I think that will be a natural result. I don't think the Commission will have to do anything to make that happen. As number generation comes on line, whether it's merchant or whether it's typical traditional utilities, the difference is so staggering between the cost of energy produced on these new combined cycle and the old fossil units -- that difference is so staggering that it just makes sense. That's what's going to happen. I think that business will take care of doing that; that a lot of that old capacity will be retired.

COMMISSIONER CLARK: Let me ask one other question. Do you think he we need to worry about fuel diversity?

MR. BASFORD: Well, that's a question that doesn't have much to do with merchant plants, but fuel diversity certainly is important -- and you can deal with that in several ways. If you're talking about fuel diversity at a plant, whether it's a dual fuel plant, I think the answer to that is yes. That we should consider that plants should have the ability to have a primary and an alternate fuel. If you're talking about as far as within the state, gas versus coal versus oil, while that's important, I don't believe you're going to see anybody building any coal plants in the state. They are just not economically competitive with the other plants.

At some point in time, if we project and forecast that there's going to be -- that the reserves in the natural gas are going to decline, it may force us back to coal plants. But I don't see coal plants having much opportunity of being built in Florida now. So there's two pieces to diversity: The overall state and --

COMMISSIONER CLARK: I'm talking about the overall state. And you say it doesn't have anything to do about merchant plants. But I think it does to the extent you're indicating that the merchant plants, which presumably at this point will be all gas-fired, if your scenario is true -- it will probably backout some coal-fired plant.

MR. BASFORD: It could in the long term. Of course, coal-fired is much more economical than the old oil units. We still have a lot of this around.

COMMISSIONER CLARK: My question is -- one of the reasons we were concerned about diversity was the Arab oil embargo, and more recently we had lightning strike the only pipeline serving the peninsula, or the southern part of the peninsula anyway, and we were in danger of not meeting load because that gas wasn't there. So there are public safety reasons to be concerned about fuel diversity.

Is it your position that the market would take care of that too? That we shouldn't -- don't need to worry about having coal-fired units, having nuclear units, having gas. We have all gas; if that's what the market says, that's fine?

MR. BASFORD: I think that question should always be before the Commission and you should not ignore it. And we're talking about diversity. Are we talking about method of supplying pipeline or are we talking about the commodity itself? I think the commodity is one issue. The pipeline is another issue.

COMMISSIONER CLARK: Okay.

CHAIRMAN GARCIA: Okay. Thank you.

MS. PAUGH: Florida Industrial Cogeneration Association.

CHAIRMAN GARCIA: Are they here?

MS. PAUGH: I don't believe so. I was not certain.

CHAIRMAN GARCIA: Okay. We're making great time.

MS. PAUGH: Florida Power Corporation is next.

MR. SASSO: Good afternoon. Gary Sasso for Florida Power Corporation, and with me again is Vinney Dolan, also with Florida Power Corporation.

We'd like to begin by mentioning, of course, that we're not here to talk about the legal issues associated with the Duke case or the appeal, but obviously the outcome, the ultimate outcome of those issues will have a significant impact on where we go from here, and, in fact, on what we're attempting to accomplish with this workshop and any successive workshops.

For example, we've already heard that at least certain of the developers are operating on the assumption that we're here to talk about the implementation of that Duke decision, and, of course, that presents a distinct set of issues.

In the Staff workshop, Joe Jenkins mentioned that perhaps in the event the Duke decision were reversed, the workshop might serve the purpose of providing a means to gather information to make recommendations to the Legislature. Of course, if that's the purpose, we think the discussion would take on a wholly different character, beginning with the determination whether there's anything wrong with the status quo? And we believe that that would have to be demonstrated after a thorough on-going investigation of the existing generation system in Florida, and, frankly, we don't think that has occurred.

Commissioner Clark has asked the question, in the course of today's workshop, what should the law be? Well, of course, in some sense that may presume -- I don't think she meant to presume -- that the law should be changed. But from our point of view the law should be what the law is, or at least what it was before the Duke decision, absent some demonstrated reason to change it, and we don't think one has been shown.

But having said that, let me turn to some of the issues that we have raised in our submissions for today's workshop.

As a threshold matter, we have had the concern, which actually predates the Duke ruling, of what is the impetus behind the interest of the Commission and its Staff in merchant plants and it's been apparent for some time that there's been an interest on the part of -- at least the Commission Staff and merchant plants.

Now, the developers who have participated in this workshop have indicated that the impetus should be to seize opportunity; that we shouldn't need to identify a problem. We should be talking about seizing an opportunity. But we have two responses to that. First, we have some difficulty in seizing the opportunity. We think there has been a false premise to many of the assertions made about the advantages of merchant plants, those fictions being that merchant plants are going to bring the state cleaner and more efficient plants. Well, that's a false premise because what we're doing is we're taking a snapshot at time at what new construction will look like in the state of Florida. And the fact is whether merchants build new power plants or the investor-owned utilities build new power plants, they are all going to be state-of-the-art. They are all going to be more efficient. They are all going to be cleaner. And the issue isn't whether merchants are going to contribute a different kind of plant but whether they are going to displace utility plants.

We have a bid rule in the state that works quite well in our view in providing a reasonable balance between the interest of independent power producers and entering the state and competing for opportunities within the state. And in the interest we have heard discussed today about reliability; ensuring that capacity that's built in the state is committed and will be available to the retail utilities when they need it.

The second thing we would say in response to the argument what we're about here is to seize an opportunity, again, we must return to the fact, as we see it, that the statutes in Florida currently do not provide for the construction of new plants based on economic opportunity.

That's fundamentally at odds with FEECA and the Siting Act, as we see them, which embody the legislative policy of restraint. You build a plant as a last resort after you've shown you've exhausted conservation measures. You don't build a plant because there may be an economic opportunity for the developer to build a plant. So the question in our mind is what need --

COMMISSIONER DEASON: Let me ask a question in that regard.

MR. SASSO: Yes.

COMMISSIONER DEASON: Do you interpret the statutes to allow an incumbent utility to come forward with a determination of need, not for reliability purposes, but because that utility can reduce its overall cost by building a new state-of-the-art plant and having it in its dispatch as opposed to older less efficient plants?

MR. SASSO: Yes. I hesitate to give a definitive yes to that because there are a whole variety of considerations that a retail utility takes into account in building a new plant.

One of them would be efficiencies to be gained with the construction of a new plant. But unlike a merchant plant developer who may be looking the a stand-alone opportunity, the utility is looking at its entire fleet, its overall needs, reliability issues, as well as economic issues. But certainly a retail utility should be able to come forward and seek to build a plant based on opportunities to lower cost.

COMMISSIONER DEASON: Would you agree that the retail utility not only has that opportunity but has an obligation --

MR. SASSO: Yes, sir.

COMMISSIONER DEASON: -- to look at what its ratepayers are paying and to put the most cost-effective efficient fleet of plants out there?

MR. SASSO: In fact, that's our point. We don't think that merchant plants are offering the state something that doesn't already exist in terms of the prospect for new construction.

Now, in that connection, trying to identify what the impetus behind this issue is, a couple of factors have emerged in discussions with Staff and in the Staff workshops and so on. And one that is -- that the Staff or the Commission may have a concern about reserve margins in Florida, and the other is that there may be a concern about how to make an appropriate transition to a deregulated environment.

In taking the second one first, if what we're talking about is the best way to transition to a deregulated environment, we're on record as saying -- and we believe -- that it is inappropriate to do this in a piecemeal fashion. That one has to take a comprehensive look at the all of the cross impacts and related issue.

CHAIRMAN GARCIA: You want us to open up a docket to look at those things and make a suggestion to the Legislature?

MR. SASSO: I don't think we're there yet. Again, you may have been out of the room, but we began by saying -- the first step is to conduct an investigation of the existing generation market. Determine if there's anything broken with it. We think it's been operating quite well.

CHAIRMAN GARCIA: Assume then the rest of the nation is broken and so they are fixing it.

MR. SASSO: Well, in some instances that's true. And Mr. Dolan can address the issues in other states. New England, for example, had very high prices and they had to respond to that. The Florida system has been operating quite well, and as I understand it, the prices have been fairly reasonable. Reliability has been fairly strong.

So we just don't think we're there yet. And if we're talking about that type of transition, we have a concern about doing it in a piecemeal manner.

Alternatively, if the Commission perceives that there's an issue associated with reserve margins in the state that gives rise to other questions. First, is there, in fact, a problem? Second, is there a factual basis to conclude that existing Ten Year Site Plans and FRCC methodology are inappropriate or inadequate? Third, if the Commission does have a concern, what is the most appropriate and direct means to address it? Isn't one way to deal with it to review the Ten Year Site Plans that will be filed by the utilities this year in the normal course and work through those issues, determine whether the Commission is satisfied, has concerns; and if there's any residual questions, then think about addressing those through some appropriate docket or other means.

The Staff has suggested, and we've heard discussion today, about a possibility that, "Well, maybe we'll just leave the utilities alone. Let them have their 15% reserve margin, however they define it, however the FRCC deals with it. We won't second-guess their Ten Year Site Plan submissions and we'll deal with any concerns we have on reserve margin by adding a 10% merchant fringe." We've heard that suggestion.

But the problem with that is merchant plant developers will not construct new plants to leave them idle. They're not going to build them to hold them in reserve in the event we need them. So what they are contemplating is that they will build them to run to displace current utility generation capacity. And so what is the impact of that on utility construction? Are utilities expected then to go ahead anyway and build a redundant fleet of new gas-fired combined cycle plants even though the merchants are doing it?

By hypothesis what we're talking about is adding more capacity to serve the same load -- if you're talking about adding to reserves or additional capacity for reserve purposes -- and so that means that if we're expected to buy from the merchants, that means that existing plants are not going to be running fully; they're not going to be dispatched. Are we to put in mothballs old units that would otherwise be replaced in the state by more efficient units constructed by utilities? And if so, is that a net benefit or a net detriment? If utilities, in fact, are going to be asked to shoulder this additional burden of maintaining reserves, while they are still expected to buy from these merchant plants, who is going to pay for that? In effect, isn't that asking the utilities to increase their reserves at some cost?

CHAIRMAN GARCIA: Clarify for me what you mean by expected to buy this merchant plant. Tell me what you mean by that.

MR. SASSO: Who is going to purchase the energy from the merchants that we're talking about having to build plants in the state. They are proposing to you and representing to you that they are going to sell to the utilities. They are telling you that by rule, you shouldn't require utilities to buy from them, but you should second-guess and inspect any utility purchases under a prudency standard to make darn sure they buy from the merchants.

CHAIRMAN GARCIA: Are you worried about the prudency standard? Are you worried that you can't compete with them?

MR. SASSO: We're concerned about what this all means. The existing frame work worked quite well. If a utility needed new capacity, they would build a new plant themselves or they would issue an RFP, or they would accept proposals. They would be able to do a cost-effectiveness valuation; enter into a contract; they knew where they stood.

CHAIRMAN GARCIA: But, Mr. Sasso, that's a good example. You came in here -- I don't know if you did -- someone from your company came in here a few months ago and said, "No, we shouldn't put up something for bid because we can beat it," even before you had taken bids.

MR. SASSO: That's true.

CHAIRMAN GARCIA: If the existing system worked and I've yet to see the existing system even run its full course.

MR. SASSO: The existing system does provide for a waiver if the applicant can demonstrate that it's warranted. And the Commission reviewed that, as is its right and prerogative, and denied the waiver. That's part of the existing system.

CHAIRMAN GARCIA: Within that existing system, you're saying where in that existing system are you or your company required to purchase the power that is produced, for example, by Duke?

MR. SASSO: That remains to be seen. Frankly, that remains to be seen. Because what we're being told --

CHAIRMAN GARCIA: That remains to be seen. The next question will be where in the existing system is there anywhere that ratepayers of Florida are going to be on the hook for Duke's construction?

MR. SASSO: One after the other the developers have come in here and told us that they intend to enter into the contracts with the utilities. When they negotiate those contracts, they are going to be trying to cut the best deal they can for their shareholders and shift the risk to the utilities.

CHAIRMAN GARCIA: I hope you will be doing the same for your shareholders.

MR. SASSO: Absolutely.

COMMISSIONER CLARK: Mr. Sasso, how does the shift the risk to the utilities? It strikes me that it shifts it to the customers.

MR. SASSO: The customers are the utilities, and ultimately to the ratepayers of the utilities.

COMMISSIONER CLARK: Yeah. It shifts it not to the utilities but the ratepayers.

MR. SASSO: Exactly.

COMMISSIONER CLARK: But it would seem to me that your obligation is to run the cheapest power at any time, and that doesn't mean if the power plant from your plant that's in rate base -- you're not going to get the return on your investment and of your investment even when it's not running.

MR. SASSO: There are two issues, and that is, what's going to be the cheapest available power. And by hypothesis it's going to be coming from these new plants, whether they are built by merchants or they are built by the utilities.

COMMISSIONER CLARK: And if it is, shouldn't the utilities be buying from them?

MR. SASSO: And the utilities will be buying from them. And now the question is what does this mean for their reserve margins? Are they still expected to maintain a 15% reserve margin even though they're buying a lot of their energy needs from uncommitted merchant plants? Doesn't that suggest that the utilities are going to be expected to keep idle existing plant and equipment and to maintain that; maintain plants that would otherwise be replaced by new gas-fired efficient utility plants?

These are unanswered questions in our mind because to us, the idea of having a 10% merchant fringe to enhance reserve margins in this state is an oxymoron because merchant capacity does not count toward reserve margin, so they cannot enhance reserve margin.

COMMISSIONER CLARK: Just so I'm clear, you're saying that because these merchant plants might come in -- and if they provide cheaper power, you would buy from them. Whereas, otherwise, you might have taken your plant out of service and put in the cheaper plant yourself?

MR. SASSO: That's one possibility.

COMMISSIONER CLARK: Why aren't you doing it now?

MR. SASSO: Pardon me?

COMMISSIONER CLARK: Why aren't you doing it now?

MR. SASSO: We are proposing to do it now. The Ten Year Site Plans of the utilities show that 8,000 megawatts of capacity of new construction would be added over the ten year planning horizon, which is the same amount we've heard from the developers that they would like to add on the ground in Florida. That's our point. What they are proposing to do is not offer a new opportunity to the state, but to displace one that already exists and that would be provided by the utilities.

CHAIRMAN GARCIA: They haven't built anything. They are not displacing a thing. This is new generation which you say you're going to bring to the state. We're not displacing your generation. We're just simply saying there's new generation in the state, and, obviously, they want a piece of that.

MR. SASSO: Let's suppose by hypothesis they are right and we're right in that 8,000 megawatts are needed. Then the question is are they going to build eight and we're going to build eight? And what's the cost to the environment? How is that reconcilable?

CHAIRMAN GARCIA: In our rule, if you beat them -- if you beat them every time. If every time you need an another four or five hundred megawatts, or a thousand megawatts, you put it out to bid and they can't compete, I expect you to build it. But I'll tell you what, if they come in here and they say to us, "We're going to give FPC a five-year contract. We're going to sell it at $22 a megawatt," I don't know. I'd question whether you could beat that. But if you could beat it, and the ratepayers of Florida were protected, why not?

MR. SASSO: Aren't they circumventing the bid rule? Currently, a utility first identifies its need and then puts out an RFP to satisfy that need.

What we've seen instead is proposals to put plants on the ground without any demonstrated need, hoping to one-up the utilities or get there ahead and essentially position themselves to avoid the bidding process.

COMMISSIONER DEASON: I'm sorry. How do they avoid the bidding process? They have to submit a bid and you have the responsibility and the obligation to evaluate it and make a determination is it the least-cost alternative to meet your demonstrated need.

MR. SASSO: Yes, sir. But they avoid the bidding process in this sense. Conventionally, and prior to the Duke decision, the horse was before the cart. First, there would be a demonstrated identified need by the utility. We'd issue an RFP. Then there would be proposals. And the winning proposal would build the plant.

Now what we're talking about is putting a lot of plants on the ground before we know they will be under contract or what those contracts look like.

COMMISSIONER DEASON: How are you, you being Florida Power Corporation, and your stockholders harmed by that if they build a plant, and they come in and submit the bid and it's the lowest alternative, well, then that's good because it's the lowest alternative. If they come in and they submit a bid for your need and it's not, and you build the plant yourself, that's good too; that benefits the customers. And Duke and their stockholders are on the hook if they cannot dispatch that plant, either with an account or else dispatch it in the wholesale market.

MR. SASSO: There are a whole variety of issues, Commissioner Deason. In any isolated case you can say there's no harm to a utility if they enter into a contract with one plant. And that was, in some sense, the fiction of the Duke proceeding. We were ostensibly talking about one plant. But what we've seen since then, and in the comments submitted to the Commission today, is we're talking about a proliferation of plants; not just one plant.

COMMISSIONER DEASON: What if there are a hundred plants out there and you submit -- open up an RFP and you get a hundred bids and none of them are the least cost; you're the least cost and you build it.

MR. SASSO: Again, on one transaction basis there may be no harm. But the question is what impact is this going to have on our reserve margins? I mean, there have been a number of proposals floating around and we're not sure we understand them. We're not sure we understand how we're --

CHAIRMAN GARCIA: You're setting up, though, this scenario. You're setting it up for us. You've taken us here. Now we're standing here. And let's take that scenario.

There's hundred plants on the ground that were built and you didn't contract with them because you beat them every time. What do I care? I might care -- an environmentalist might care because we have a hundred plants in the state, although, I doubt that that would ever happen, as I'm sure that you know that that would never happen. So why does that put you at risk?

MR. SASSO: I'm sorry. I don't agree with that premise, that that will never happen. What we've been told repeatedly by the developers in the written comments submitted here today is that they want that to happen. They want to encourage a proliferation. They want these plants to be as prevalent as the ubiquitous McDonalds. And we're not talking just about a stand-alone facility. We're talking about transmission lines, gas pipelines. And you recall Dr. Nesbitt's testimony in the Duke case about how Louisiana is made of steel. You can't dig down in that state without hitting steel from a gas pipeline. They want the market to decide this.

You know, in the Duke proceeding we heard how the Commission will have a meaningful role to play. But now the Commission is being told time and time again in all these written comments just please stand out of the way. You really can't meaningfully be involved in this process. This is a market issue. You can't mix regulation and market decision-making.

They've told you that repeatedly in these comments.

So we have some very fundamental questions about where this is going to end up. If we're going to mix deregulation with regulation and we're going to be expected to maintain reserve margins, which are calculated based on committed capacity, at the same time as all of these new plants are being built by the market, and we're under nonmarket restrictions, what impact is this going to have on us, on our ratepayers? Are we going to be expected to maintain our own plants --

CHAIRMAN GARCIA: Why don't you --

MR. SASSO: -- just to have them there?

CHAIRMAN GARCIA: Why don't you tell me what impact you see it having on your ratepayers. Let's get to that.

MR. SASSO: Well --

CHAIRMAN GARCIA: I mean, I don't want to cut you off. But what I'm saying is you're alluding that there's a hurt somehow created here to Florida ratepayers.

MR. SASSO: Yes, sir. We did go through this in sort of a microcosm in the Duke proceeding, and Mr. Dolan is anxious to say something, so I certainly want to let him have the opportunity to.

MR. DOLAN: Well, one issue, I think, was addressed already: The current system, the incremental sales that utilities make, we talked about earlier, flow back to ratepayers. That's going to go away. And on the broker sales they are shared 80/20. But on as-available sales off-broker, it's 100% of that that comes out of utility generation, goes back to retail ratepayers.

I think the other dynamic that's changing here is what is going to be the framework that we're going to decide how the price risk is going to transfer to the customer? If we sit here and say that we are going to build -- when we evaluate building a power plant -- this is not about -- the dynamics of the market aren't about long-term planning. If we have to make decisions on an as-available basis, we have to somehow think about how the market is going to make those decisions. Right now all plants don't run at 100% capacity; different plants dispatch at different rates.

So to the extent we have a plant today that is economical to dispatch at 10% availability, if it's a peaker, and the market displaces that, at some point the overhead for keeping that plant open is going to become uneconomical -- it may not be uneconomical today -- and, therefore, that's the reason that we continue to have those plants available. But if that energy gets displaced by another plant, at some point the plant is going to be uneconomical to keep, and it's going to be stranded and we're going to have to deal with that cost, and that's a current cost in the system. So the plant is either going to get shut down and the cost is going to have to be dealt with, or it's going to stay there and we may, in fact, have duplicate costs for that capacity.

And we heard from Constellation, I think -- we got two definitions floating around about what a merchant plant is.

When merchants enter into contracts, the risk is transferred to ratepayers. To the extent that it's a prudent buying decision, that risk transfers through the utility to our ratepayers. We're talking about moving to a different model. I think we ought to ask ourselves whether we're comfortable with doing that.

CHAIRMAN GARCIA: Isn't that the model, to some degree, we have with you now? The contracts you've entered into with independent power purchasers and the others that require you -- and this Commission, I think, has made several decisions agreeing with you that you have to -- you know, we have to recognize that because it's part of the system we have in place.

MR. DOLAN: I think we have -- if you're speaking about QF contracts, that's approximately maybe 10% of our supply. We have a system today that has some degree of risk taken away from the consumer. We have regulated, levelized pricing. We have reliability standards. And we're hearing a lot of commentary today about shifting the risk of who enforces those standards to the marketplace. Let the market decide what the appropriate amount of capacity is. Let the market decide about how prices are set.

I think, as Mr. Sasso said, before we set out on that course, we ought to ask ourselves is that really what we're setting out to do here? To determine how to set up that type of a marketplace? If we are, I think we ought to stop and question what is it about the existing marketplace that we don't like?

COMMISSIONER CLARK: Let me ask a question. It really sounds to me like what it boils down to, you may lose the opportunity to build and own the plant. That's really what the concern is. Because given the scenario where a merchant plant is built and it is dispatched economically and it has the effect of causing one of your peakers to no longer run, presumably if it is more economic, then it should backout that peaker no matter who owns it. If you had built it, it should back it out. The issue is really do you get cost recovery for that peaker?

MR. DOLAN: I -- certainly that's one of the issues, Commissioner Clark. The other issue is how do we -- do we wait for the market to make that determination for us? How can we sit here today and say that we need to move and replace existing generation when we're operating under a set of rules today that don't contemplate merchant plants?

COMMISSIONER CLARK: I agree with that. But why shouldn't we let the market decide what gets backed out?

MR. DOLAN: Why shouldn't we?

COMMISSIONER CLARK: Yes.

MR. DOLAN: Well, again, that assumes that the model that exists today on how we run this business in Florida today needs to be changed. And I think we struggle with -- we're agreeing that we're saying we ought to move in that direction.

COMMISSIONER CLARK: Well, you know, one of the concerns I have is we've seen utilities cut back significantly on their operating and maintenance and overhead costs as a result of the threat of competition. That indicates to me that the system that was in place, to some extent, encouraged inefficiency. And that by introducing competition into the wholesale market, we may get some more efficiencies. We will require you to be more efficient and those plants that are uneconomic to run will, in fact, be backed out. And if you get appropriate cost recovery for that -- I guess if it is shown that running the new plant and allowing the existing plant to be backed out and costs to be recovered is cheaper than running the existing plant, that's what you ought to do. If that scenario arises, that's what we ought to do. We ought to backout the plant, give you the recovery for that and run the new plant, whoever owns the new plant, so long as it is committed in the sense that they have to run to serve the retail load. What's wrong with that?

MR. DOLAN: I'm not finding any fault with that. If that's the way to deal with that individual issue, I think that's an appropriate way to deal with it. But if you're going to make the changes that we're talking about here, there are a lot of other issues that are going to come with that. I mean, we've talked about a number of them here this morning and this afternoon, and I don't need to repeat those. But we're talking about price volatility, price risk transfer, reliability. There are a number of issues. We don't take them lightly. We think the existing model today deals with them very effectively.

COMMISSIONER CLARK: From my perspective, there were a number of things that were brought up in the Duke plant that caused me to think we ought to look at this because this could be a better way to deliver electricity to the people of Florida.

It's not to say that what currently we had didn't work well. The question is: Can it work better? At least from my perspective it was presented to me that there are some benefits to be gained. And we need to look at those benefits and then we need to decide what's the downside to doing it, quantify that to the extent we can, or at least go into this knowing what the potential downsides are.

MR. DOLAN: Commissioner Clark, I think we agree with that. What I guess what we struggle with a little bit -- let's not call this how do we implement merchant plants; let's call it how do we make the generation system in Florida better. Because it's more than just merchant plants. There's environmental issues. There's price issues. There's bid rules. There's Ten Year Site Plans -- I mean, you can go down the list. We submitted three pages of issues. There are a number of things that we would be concerned about. To the extent we want to look at those comprehensively, and we find there is a net benefit to making changes from today, we support that. We have always supported that, and we will continue to work -- if that's the Commission's desire, we'll work in that direction. But we are going to continue to oppose piecemeal alteration, and we certainly are on record as to how we feel about, you know, the previous decision. And we would be opposed to other piecemeal alterations to whether it's generation or any other part of the business.

MR. SASSO: I'll just add one final comment. We've taken up more than our fair share, I suppose, but there's been another fiction, that merchant developers assume all of the risks of these projects. And when that's being said, we're talking about financial risk. But we're not talking about environmental risk.

The comments repeatedly point out that if a merchant plant fails, they will shut down. It's no big deal. But, of course, it is a big deal. Is this state to be turned into a graveyard for failed speculative merchant plant projects?

FROM THE AUDIENCE: (Unintelligible)

CHAIRMAN GARCIA: How could you say that? That almost -- it boggles the mind that we would make an assertion of that sort.

You actually think that Wall Street would liter Florida with merchant plants because they think it's a good idea and all of this money would show up?

MR. SASSO: The comments submitted by the developers themselves assume the possibility of overbuilding. They say there may be overbuilding; there may be redundancy. And the Commission can look at that after the fact and deal with it. And they contemplate that there may be plant failures. And they say the consequence will be shut down.

And all I point out is that there's more at issue here than economic opportunity; that the existing policies of the state contemplate that plants are not being put on the ground with all their related infrastructure unless they are demonstrably needed. And the excesses of building are not just economic issues; they are environmental issues.

COMMISSIONER CLARK: See, I agree with him to some extent. There's always a risk that these plants will fail and will be stranded. And, you know, the way I have resolved that is you require some obligation of reclamation of the site, just like you all are required to decommission sites; as a condition to building the plant you may require that. That can be addressed. But I agree with you that we need to be clear about the potential environmental impacts so that those entities who are required to look at that can make a judgment as to whether they think the economic benefits that we may believe come about are worth the environmental risks.

MR. SASSO: And it comes down to whether the policy is going to be "more is better" or "less is better," and currently it's, to some extent, less is better.

CHAIRMAN GARCIA: It almost -- it sort of begs the question: Should this state be involved in all sorts of regulation? Should this state control all sorts of aspects just in case we may overbuild, we may overinvest? The natural consequence of letting the market decide these things is, yes, every once in a while we overbid. Yes, as we found in other parts of this country, sometimes there isn't enough, and clearly the prices bring us to that balance. But that balance -- I don't care how good we are as regulators, we're not going to beat the market. And we sit here -- I think in theory we sit here to try to simulate some type of market to bring the best advantages we can to the Florida ratepayers. But if you step back from that, with the technology in place today and we're seeing across the country, where we can allow the market to participate, I would assume that Florida Power Corp and its business entity would like the market to participate. It's a better decider of these things, correct?

MR. SASSO: Fundamentally, it comes down to whether we want to change the existing system. I mean, if that's what we're talking about.

COMMISSIONER CLARK: And I concur, that we ought to -- the way we ought to -- well, I guess maybe you won't agree with it -- I thought what we should do is say here's how it's currently done. Here's one way to do it. Here are the benefits and here are the downsides.

CHAIRMAN GARCIA: I think if the investor-owned utilities want us to open up dockets on those issues -- or any Commissioner wants us to look at those -- that would be fine.

Throughout this process, you know, we want -- we're here, I think -- I hope -- to get a better understanding of where we are. But if that's the issue, and if, you know -- that's fine. I don't disagree with it.

COMMISSIONER JACOBS: Several states were mentioned today that have engaged already in merchant plants. I'd be interested -- if anyone has this information, I'd be interested in knowing what ramifications are evident on the price transfer issue that you talk about, i.e. is there any trend that's becoming evident as to what impact the availability of the extra capacity has ultimately had on the market clearing price?

MR. DOLAN: Commissioner Jacobs, I'll certainly give Mr. Green a chance to answer this as well, but I think if you look at the statistics on merchant plants, I think we will find that the vast majority of those are just existing plants that have changed hands and are now merchants because they are in a different ownership position. There's been some incremental generation built, but I'm not sure that the market is mature enough, you know, with new merchant construction -- you know, there's been discussion, you know, vast expansions up in New England that, you know, have not occurred yet. I'm not so sure that's a result of the merchants' lack of desire to build more so than it is just siting, permitting, transmission studies and the like. But I'm not so sure that we have seen a large incremental amount of merchant that's actually up and running today where we're experiencing the dynamic where we could draw conclusions about price.

I think the markets where we've a lot of merchant -- the California, they have restructured the entire market out there. They have a power exchange, and an ISO and a number of different things, that it would be something that you'd have to look at carefully before you attempt to draw conclusions about the impacts of merchants, new merchants in those particular markets. That's just my opinion. I'm certainly --

COMMISSIONER JACOBS: One of issues that continues to come to mind for me is last summer, while I know that it wasn't just capacity that drove the price spikes, it had a lot to do with transmission and some other things, it would appear to me that if you allow this -- for lack of a better term -- this proliferation of merchant plants, you're going to have a lot of capacity trying to get at wherever new demand shows up.

And you're going to have to have parallel initiatives to deal with those transmission constraints, or else you run the risk of probably some of those same conditions occurring, i.e. the price spike conditions occurring. It was my understanding it wasn't just the capacity. It was the idea that capacity could reach the demand that had a large part in those spikes. How do you avoid that if you are going to allow this new extra demand on the markets? I may be wrong. If I'm wrong in that analysis, I'd be very open to hearing that correction, but it's my understanding that's how some of those spikes occurred.

If that is the case, it would appear to me that by allowing a good bit of new capacity on the marketplace, without addressing some of the transmission constraints, you open up a large risk for those kinds of conditions. Is that a reasonable conclusion?

MR. DOLAN: I'm not sure I'm in the best position to comment on that. I'm not that familiar with the specifics of the situation in the Midwest to say.

COMMISSIONER CLARK: I had understood it to be the function of what was called a "thin market." There was concern that there was not enough capacity out there to serve, and it may have been the effect of not being able to get the capacity where it was or not generating it.

But I have some reason to believe that if you have a robust market, it provides some cushion against volatility. And I know the gentlemen from U. S. Generating is here and probably can answer that question.

MR. HAWKS: The short answer is more is better: More liquidity, more transactions, more buyers and sellers, more products, more day-to-day competition; less volatility.

COMMISSIONER JACOBS: So here's an instance where we have a discrete, very intense demand, okay. And you have this host of potential suppliers out there unrestrained -- essentially unrestrained in what they can do, and they're trying to get at that. And there's this bottleneck. You're saying that there will be no impact on price?

MR. HAWKS: I wouldn't quite look at it that way. If you have this bottleneck demand, all of those purchasers -- and I'm talking about wholesale purchasers.

COMMISSIONER JACOBS: No, the purchaser is probably a few. You have a whole bunch of suppliers trying to reach that purchaser, trying to get through a bottleneck.

MR. HAWKS: It's a buyer's market there. That's going to dampen prices more than anything else if you have a dozen different suppliers chasing a single purchaser.

COMMISSIONER JACOBS: That's what I would have thought in the case of the spike. Where you have these instances where you have a fairly few number of purchases, lost capacity and power marketers -- I may be wrong -- I don't want to defer too long -- but it's my understanding power marketers came into that market. Once they recognized their capacity had been lost, power marketers showed up big time. There was capacity being served to that market.

MR. HAWKS: The power marketers were already there. We're talking about the Midwest spikes, last June 25th.

COMMISSIONER JACOBS: Right.

MR. HAWKS: What happened there was the 15% reserve margin that the Midwest had generally was all wiped out by virtue of planned outages, forced outages, storms; large transmission lines went out. The Cook nuclear power plants in southwest Michigan were out. And there was no reserve margin right there. And then you had the extreme --

COMMISSIONER JACOBS: The power marketers came in, they brought capacity with them, did they not?

MR. HAWKS: No. The power marketers were searching for a capacity and energy at the same time as the utilities.

COMMISSIONER JACOBS: Okay. I thought that was -- outside of that region there were an ample number of potential sellers to that region.

MR. HAWKS: There could have been but there were transmission constraints. That was another problem that --

COMMISSIONER JACOBS: That's exactly my point. Exactly my point.

If you have that scenario exist, do we have the potential for those same results?

MR. HAWKS: Not if you have a generation -- a generating station at the end of that transmission line, you can relieve the constraints by virtue of the additional generation as well as the additional transmission.

COMMISSIONER JACOBS: Okay.

THE REPORTER: Can I have your name?

MR. HAWKS: Oh, I'm sorry. My name is Jack

Hawks. H-A-W-K-S. Vice president, U.S. Generating Company. Should I go ahead and finish the introduction, who we are?

COMMISSIONER DEASON: Are you planning on making a presentation later?

MR. HAWKS: Jon Moyle and I were going to --

MR. MOYLE: We submitted joint comments and I think we're going to be given an opportunity at that time --

COMMISSIONER DEASON: We'll just wait.

MR. MOYLE: -- so we'll just hold it until then.

COMMISSIONER DEASON: Right.

COMMISSIONER JOHNSON: I have a question for Mr. Sasso, and it's following up -- I came in at the tail end of your comments when you said the Commission should consider more than just, I guess, economic impacts. And you talked about if plants were built and abandoned and the impact that that might have on the environment.

And you raised that point, but I don't know if you made a -- therefore we should what? Or is there no process -- process that we have now isn't sufficient to take that into consideration? Is there something more the Commission should be doing here in this process? Is that not handled when you get to the DEP side? Where were you going with that? Because you left it and went into a dialogue, and I didn't hear your wrap-up.

MR. SASSO: It's a complex issue. What I was attempting to address is the assertion that merchant developers are assuming all of the risks of these projects.

What we're talking about is a completely different world from the one that currently exists in Florida. And I understand Chairman Garcia had some difficulty with this idea, but Wall Street has let a lot of banks fail in Florida, savings and loan, after deregulation, which in turn failed because of failures of developers --

COMMISSIONER JOHNSON: I was trying to give you a chance while he was out of the room, darn it. (Laughter)

MR. SASSO: I didn't get it all out. But the point is, Wall Street makes a lot of mistakes. And there may be a certain halo over the market from where the Commission sits, but it's a wild and woolly place out there. And from where I sit, I see failures every day. And that's something that needs to be taken into account.

Whether a plant fails or succeeds, we're talking about additional impact on the environment. But if it fails, yes, there may be a reclamation obligation. But how do you enforce it against a failed corporation which may have been set up just to run a particular plant, which may have no assets or resources?

It's easy to be sanguine about these risks. But we're moving -- we're talking about moving from a regime where we think the Legislature has said these are special kinds of factories with a lot of attendant infrastructure. And we don't want them built unless there's a demonstrable need. They can have an environmental impact every time you put one down. We're talking about moving from that regime to a regime where we're talking about a proliferation -- I mean, those are words that are being thrown around -- and commended by the developers. We're talking about a proliferation, "more is better," of a type of structure and related infrastructure which can have a serious impact on the state.

And I simply meant to say -- without suggesting that there are no solutions -- I simply meant to say that we can't glide by that issue by adopting the mantra that the developers are assuming all of the risks, because they are not.

COMMISSIONER JOHNSON: So you're just asking us in whatever forum we're using that we be cognizant of the fact that there are other risks, and that the developer and shareholders are not assuming all of those risks.

MR. SASSO: Absolutely. I mean, we've talked about the transference of price risk through contracts. I mean, there are a lot of complexities to the economic issues, but there are also environmental issues.

COMMISSIONER JOHNSON: Would you have any solutions -- I mean, particularly now that we've made our primary decision, what could we do to mitigate -- Commissioner Clark talked about one process she might have in mind perhaps we should consider. Are there other things you would suggest that we consider in order to mitigate or balance the risk, or at least acknowledge the risk?

MR. SASSO: Of the Duke decision?

COMMISSIONER JOHNSON: No, the more global issue. What could we change in the process? What would we need to do?

MR. SASSO: I can't possibly answer that, Commissioner Johnson.

Our point is that we're way down the road without perhaps having taken the first step of conducting a investigation of the existing generation system and finding any fault or opportunities for improvement.

I know that Commissioner Clark has said by virtue of her participation in the one proceeding where we heard a few days of testimony from one developer that she saw some benefits. I'm not sure what they are. I fully respect her opinions and her perceptions in that regard, but we're not sure what she has in mind as the benefits.

But to begin the dialogue is to put on the table what we do see as problems, what we do see as benefits, and then talk about maybe the most direct way of addressing them, and I'm not sure we're there.

COMMISSIONER JOHNSON: Okay. Thank you.

COMMISSIONER CLARK: Mr. Sasso, I guess I wonder why do we have to look at the existing system and decide it's not broke to do something else? It strikes me we could say that we think there's room for improvement and we can improve upon it by doing this, and these are the benefits and these are the downsides.

MR. SASSO: Yeah. They may be flip sides of the same coins. But I think that it would be helpful to be specific.

It's very difficult for any participant to take a position on a moving target. And one could identify any aspect of the current system that may be broken or may need improvement or may be just fine where it is -- these are very complex issues. And to address them in a meaningful way, it helps to be specific and identify what we're trying to improve or fix.

COMMISSIONER CLARK: I would agree with that. And I think I said to the Chairman I think this is the first step, the workshop, to hear sort of the range of issues that are implicated in deciding to move to a merchant plant.

It's clear that I would have preferred going through those range of options, identifying the impacts, identifying ways to mitigate the impact and drawing an overall conclusion that yes, this is the way we ought to go. Not just look at an individual plant. And I still think that's what we should be doing, and that's my objective here.

And I think we have gotten some -- a range of issues, and they tend to be somewhat pre-formed at this point. But I think after this workshop that those issues can be sort of further clarified and more formed, provided to a subsequent proceeding which deals with the implications of introducing merchant plants into the electric power delivery structure in Florida.

COMMISSIONER DEASON: I have a question. Mr. Sasso, you indicated that FPC opposes the piecemeal alterations to the system, I think was something along those lines.

First of all, what have we done that's piecemeal? And how would you propose that we proceed from this point?

MR. SASSO: Well, again, I don't want to belabor the legal issues. Obviously, we disagree with the decision the Commission reached in the Duke case. And we feel that amounts to a departure from existing law. One piece of it, a significant piece, but one piece in isolation, and we don't expect --

COMMISSIONER DEASON: Let me address that for just a second.

I respect what you're saying. And there is a difference of opinion as to what the current law provides. And, hopefully, we'll get guidance on that and that matter will be settled.

But the Commission interpreted that law a certain way. I know you disagree with that. But with that interpretation of the law, the applicant had a standing to have an application process by this Commission, and we did not have the luxury to say, "Duke, sure you meet -- three Commissioners said you meet the statutory definition of a utility, but we're not going to process your application because we don't want to do this piecemeal. We want to have some widespreading generic docket and invite everybody in the country to participate. And then we may do something from that point. So come back in two years if you still want to do your project."

We, with our -- and perhaps incorrect interpretation of the law -- we did not have that luxury. We had the obligation to proceed. And I believe within that statutory framework, there are time frames within which we must act.

So I disagree to some extent with the characterization that this Commission is trying to formulate policy on a piecemeal when we interpret the law a certain way and we have no alternative but to process that application with that interpretation of the law.

MR. SASSO: I understand that, Commissioner.

And I certainly wouldn't ask the Commissioner, any Commissioner, to agree with our position at this point on the issue. But I guess the disagreement is so fundamental that that explains the difference in opinion or perspective on this point.

If I may, Mr. Dolan had a comment to make in response to your question too.

MR. DOLAN: Commissioner Deason, I think we certainly agree with the position you were in in terms of having to make that decision, and respect that process that had to take place.

I think when we talk about piecemeal, what troubles me a little bit is we spent the lion's share of the time in that proceeding arguing legal issues and a very limited time arguing policy issues. And I think -- with the exception of Florida Power -- we were the only ones that argued policy issues, and I think there are a lot of other stakeholders in this process that have something to say about that. A lot of them are here today: DEP, LEAF. Certainly they have environmental concerns. The developers have their position. And I think what we said is we'll deal with those issues another day.

And if we continue to let them linger and we do this one at a time, at some point it's going to have an impact on how we run our business as these plants come in, if we have a march of these plants into Florida. And I don't think we can ignore those issues. And I think those warrant discussion. And I think it needs to be a comprehensive look.

I think of it in terms of, you know, we have maybe three different points of view in this room. There are a number of folks in this room that would probably argue that the existing system works very well and why should we change it? And that may, in fact, be what our argument might be.

We heard discussion during the course of that proceeding that argued for a hybrid-type situation. Leave the existing retail utilities alone and let's introduce a merchant fringe with a cap. And now we're hearing that that's an unacceptable outcome for the developers. And then there are others in this room that would argue let the market decide it all.

And I think that those are three very different models that bring with them three very different sets of issues. We need to establish what model are we talking about? We keep bouncing back and forth between these different models. And I don't think we're gaining any ground. In the meanwhile we're going to come in one plant at a time and you're going to make one decision at a time, and at some point it's going to have impacts that are going to upset someone -- be it the environmental groups or be it -- we're going to have price spikes or something else, and we haven't really dealt with the issue.

And I would say again, I don't think we should call this a how do we implement a merchant plant docket. I think it's about what do we think is the right way to run the generation business in Florida. I don't think we should presume anything. There's folks today have said we should presume that competition is coming. Should we presume wholesale? Retail? This Commission is on record saying they oppose retail competition. We heard that during the course of the proceeding. I think we should get some clarity about where we're headed here, and then I think we'll have a much more beneficial discussion about the issues.

COMMISSIONER DEASON: One follow-up question.

I believe you filed a letter in support of TECO's letter asking for postponement until after of the Supreme Court rules; is that correct?

MR. DOLAN: Yes, we did.

COMMISSIONER DEASON: And I guess I have a little bit of difficulty reconciling that with your concern about piecemeal policymaking. I guess my concern is this: If we delay everything until the Court rules, we're still subject to someone else coming into this Commission and filing for a need determination, which is going to be another one of these piecemeal problems that you've identified. And under the current Commission's interpretation, most likely that individual, if they are an EWG, probably will be determined to be an electric utility and at least have standing to go forward with that application. Now, whether that determination is granted or not, I guess, rests upon the facts that they present. But if we delay, aren't we subjecting ourselves to further piecemeal interpretation, or at least piecemeal implementation, that's going to, at some point -- under your own terminology -- at some point is going to reach the point to where it is going to have significant impacts; perhaps adverse impacts?

MR. DOLAN: Commissioner Deason, if that's a concern that that's an unreasonable delay if that decision is six to 12 months and we want to proceed now, as long as we establish what the basis is upon which we're proceeding.

What we would object to is that we're

proceeding to solve issues on how to implement merchant plants. I think what we need is to proceed on a much broader basis than that, and that's our point.

COMMISSIONER DEASON: Is that relevant regardless of what the Court rules?

MR. DOLAN: I think merchants are a relevant part of the discussion, absolutely. But I don't think that's at only part of the discussion. That's my point.

COMMISSIONER CLARK: Let me just ask a question.

You say that a question should be what is the right way to run the generation in Florida? How much of that is our call as opposed to FERC's call?

MR. DOLAN: Commissioner Clark, I would say that the lion's share of that is your call today under the existing system.

COMMISSIONER CLARK: I guess I have some concerns that if we take the position that there will be no merchant plants, and that only entities with an obligation to serve can build plants, that FERC may preempt us. They may say that is at odds with our objective of introducing competition into the wholesale market and they'll preempt us if we take that hard line.

MR. DOLAN: Certainly that's possible. I think we're seeing -- facing the same dynamic with transmission. But I think before we make that step we ought to make sure that the benefits outweigh the cost.

CHAIRMAN GARCIA: Any questions? All right.

There being no questions, we're going to take a 15-minute break and then we'll resume with Florida Power and Light.

(Brief recess.)

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CHAIRMAN GARCIA: We're going to get started again.

MS. PAUGH: Florida Power & Light Company is next.

CHAIRMAN GARCIA: Okay. Mr. Childs.

MR. CHILDS: Mr. Cresse is going to be making some comments for Florida Power & Light.

MR. CRESSE: Thank you, Commissioner. My name is Joe Cresse. I'm here on behalf of Florida Power & Light. I'm going to try to keep my comments fairly brief, and I hope, to the point.

I want to make a few observations which I think are relevant to the issue and some conclusions I reached about the advisability of merchant plants. By way of background, I want to maybe remind you why we're here. Why is this an issue? Why was it not an issue 15 years ago?

The reason it's an issue is because of change in technology. You can now build new capacity and sell the output of that new capacity at a rate that could be less than the average embedded cost for some of the existing generating units. If, in fact, new capacity had a higher cost than the average cost of embedded units, we wouldn't be holding this meeting today because nobody could come in and compete with the existing utilities. So we're here primarily because of technological change. And the issue, I think, in the long run is who is going to be the primary beneficiaries of the technology change. Is it going to be all the consumers in Florida or is it going to be some people who are providing electricity in Florida without an obligation to serve Florida citizens?

I want to talk to you a minute about what my definition of a merchant plant is and then I'm going to read from your order. Your order says, "the term merchant plant as used in this order is a power plant with no rate base, no captive retail customers." And

I would add one other thing. And no obligation to provide firm service to a utility or to the citizens of the State of Florida. If it, in fact, has a firm contract with a utility, I don't view that as being a merchant plant.

The other fact that I want you to keep in mind constantly, because it's very important, that a utility's lowest cost generation is reserved for its retail and firm wholesale customers. Excess capacity of a utility is made available to other utilities in the short-term are known for economy sales.

Matter of fact, Joe Jenkins, some 15 years ago, received one of the rarest things the Florida Legislature has ever done. They provided a bonus for him for promoting the broker system and it's brought about many of millions of dollars of benefits to the ratepayers in this state.

And they only let Joe have a $10,000 bonus and I thought the Legislature was pretty cheap in what they did, but notwithstanding that, Joe took the money. (Laughter.)

Another basic point that I think is very important and I hope I could convince you of this, is that the only economic benefit of a merchant plant is if it sells at a cost lower than the incremental cost of an existing utility who would otherwise make the sale.

I want to repeat that because I think it's very important and it's at the crux of whether or not merchant plants are beneficial to the people of this state. In repeating I'm saying, the only economic benefit of a merchant plant is if it sells at a cost lower than the incremental cost of an existing utility who would otherwise make the sale.

COMMISSIONER CLARK: Can I interrupt you?

MR. CRESSE: Certainly. You can always interrupt, Commissioner.

COMMISSIONER CLARK: Isn't it also beneficial if it forces those utilities to operate more efficiently such that they can lower their costs?

MR. CRESSE: Anything that permits or forces or requires a utility to operate more efficiently is beneficial to the general body of customers.

COMMISSIONER CLARK: So it doesn't have --

MR. CRESSE: The benchmark that you use is beneficial.

COMMISSIONER CLARK: Well, it strikes me then, the only economic benefit is if it sells. I don't think that's true. I think the economic benefit is, if it forces all providers to be more efficient and the least cost generation runs.

MR. CRESSE: Could I maybe amend that? Maybe you'd agree with me. Say the only measurable economic benefit. Would that make you happier? I hope it will.

COMMISSIONER CLARK: No. I think there has been a benefit just to the notion of economic plants because the incumbent utilities have been forced to become more efficient and we've seen the benefit of that recently with Florida Power & Light and Gulf Power and TECO.

MR. CRESSE: And probably you've seen the benefit of that, but I don't know that I would contribute all that to the potential competition in the generation of electricity.

COMMISSIONER CLARK: That's fair. But some of it, anyway.

MR. CRESSE: My next proposition is, if utilities -- if existing utilities have adequate reserve margins, by definition merchant plants are not needed for reliability. And they're not needed for economy, unless they sell at less than the displaced seller's incremental cost.

Now, I want to give you some charts. If I can get those charts passed out. They kind of demonstrate to you, I think, what I'm talking about and there's two illustrations and I hope those charts are -- yes, they are.

I'm sure you're familiar with the first chart which has "broker" on the third line of it. This is what happens.

CHAIRMAN GARCIA: Does everyone sort of have this in the audience?

MR. CRESSE: I think we're in the process of passing some out.

CHAIRMAN GARCIA: Why don't you have your assistant put it on the overhead so that people can watch what you're doing. It might make it a little bit easier.

MR. CRESSE: All right. I could put up a larger chart, but probably if it's up there it would be better. Whatever you want to do.

CHAIRMAN GARCIA: I think there everybody would be able to see it. (Pause in proceedings.)

MR. CRESSE: Mr. Chairman, we've handed out 70 copies. If there are more than 70 people here, somebody is going to have to do without.

CHAIRMAN GARCIA: Go ahead, Joe.

MR. CRESSE: At the top of that page if you notice on the left-hand side of the page, we start with the investor-owned utility making the sale and the purchase under the broker system. If Utility A's marginal production cost is $20, and B's marginal cost of production is $30, that sale is made at $25 because they just split the difference. Utility A's gain is $5 and B's gain is $5.

Under an incentive policy adopted years back, 20% of that benefit to the selling utility flows to the shareholders, 80% goes to the customers. The benefit of all Florida customers is $9 from that particular transaction.

On the merchant plant, if it displaces that broker sale, comes in and they offer it at $24, which the purchasing utility would want -- they would want it at $24 because it's less than $25.

Utility B, the purchasing utility, would save $6. The gain above that cost would go to the merchant stockholders. Net benefit to all Florida customers is $6 under that scenario and Florida customers lose the benefit of three bucks.

That's the reason I said that unless a merchant plant sells its product at a cost lower than the incremental cost of the existing utility, there will be no benefit to shareholders in Florida, to customers in Florida and, in fact, would be a detriment.

The second page talks about --

COMMISSIONER DEASON: Mr. Cresse, before you leave that page, let me ask a fundamental question. If there is a robust wholesale market -- and I'm understanding this is the way it worked under regulation and this system has worked extremely well, and I'm not trying to be critical of it. But if there is a robust wholesale market and there is another participant out there whose marginal cost is something less than $25, why isn't it such that the market will work so that Utility A is competing against the merchant plant, and if the merchant plant's marginal cost is $24 and Utility A's is $20, why then wouldn't they just cut a deal to sell it at $23?

MR. CRESSE: If the merchant plant's cost is $24?

COMMISSIONER DEASON: And Utility A's is $23, wouldn't the market work where Utility A would be the one that would sell at $23?

MR. CRESSE: Yes. It would decrease the price that the purchasing utility would have to pay. There's no question about that. I'm not arguing that point.

COMMISSIONER DEASON: And isn't that then beneficial?

MR. CRESSE: There is no benefit to -- there is benefit to the purchasing utility. But there's not as much benefit for the selling utility. There's no benefit at all to the general body of customers of Florida as a whole. It would remain the same.

COMMISSIONER DEASON: Yes, but the ratepayers of the utility who is efficient and has the marginal production cost of $20 and sells it at $23, they benefit a little bit more than under the current broker system, is that correct?

MR. CRESSE: No. If they sold at $20 -- the cost at $20 and they sold at $23?

COMMISSIONER DEASON: No, they would not benefit as much.

MR. CRESSE: They'd lose $2.

COMMISSIONER DEASON: But the utility then that benefits would be the one that was purchasing?

MR. CRESSE: The purchasing utility would benefit. Yes, sir.

COMMISSIONER DEASON: Okay. All right.

COMMISSIONER CLARK: And wouldn't the benefit be exactly the same? Utility A would sell it at $23. Utility B would buy it at $23. They get a benefit of $7.

MR. CRESSE: No. I think -- let me go back to the hypothesis again. You said if the merchant plant would sell at $24. Okay. Well, the merchant plant would not make the sale, and assume that the utility sold at $23, then the utility that sold would make $3 and the utility who purchased would make $7. Benefit would be a little bit different because of the 80% factor. Do you follow that?

COMMISSIONER CLARK: Yes. But how much would it be?

MR. CRESSE: Well, 80% of 3 is 2.4. So the benefit to the consumer in that scenario would be --

COMMISSIONER CLARK: 9.4.

MR. CRESSE: Yes.

COMMISSIONER DEASON: So in that situation, having the merchant plant even there and not making the sale, but just existing, would result in a greater net benefit.

MR. CRESSE: Pardon?

COMMISSIONER DEASON: Under that scenario then, just having the merchant plant existing and being there, able to sell at $24 but not being able to make the sale at $24, and Utility A making the sale at $23, there's a greater net benefit than under the current system, under those assumptions. Maybe my calculation is wrong.

MR. CRESSE: If Utility A, the selling utility, tried to charge more than 24 cents, they wouldn't make a sale.

COMMISSIONER DEASON: We've assumed that they can sell it at $23 and that's what the market comes down to and the sale takes place at $23; because merchant plant is there, his marginal cost is $24. And for Utility A to make this sale he's got to come down in his price from $25 to $23 and he does that and he makes the sale at $23. The net benefit is $9.40 under that scenario.

MR. CRESSE: Yes.

COMMISSIONER DEASON: Okay.

MR. CRESSE: The second chart shows what happens if you have a capacity proposition. And simply put, it's the same thing over again. The sale is made at $29. The benefit entirely flows to the consumer because of the capacity clause, recovery clause, as well as the fuel recovery clause.

I won't take anymore time except as to say that the -- either case, the only benefit to all of Florida's consumers would be if the utility -- if the merchant plant sold capacity at less than incremental cost of the utility selling it.

There's been discussion about old, inefficient plants. Let me remind you --

COMMISSIONER CLARK: Mr. Cresse, these examples suggest to me that the merchant plant has -- in all of these scenarios, has a beneficial effect.

MR. CRESSE: Well, I sure wish I could see it. Could you explain that to me, Commissioner?

COMMISSIONER CLARK: Well, in the first scenario, the existence of the merchant plant was beneficial to the tune of 40 cents.

MR. CRESSE: That's under your assumption as to what the price would be.

COMMISSIONER CLARK: Well, if Utility A's marginal production cost is $20 and the merchant wants to charge $24, I presume if the market is working, it is Utility A that will make the sale, say, at $23.

MR. CRESSE: Yes.

COMMISSIONER CLARK: So in this scenario, it's beneficial to the customers to have the merchant plant to the tune of 40 cents.

MR. CRESSE: Yes, and that's just a split. That's the way the broker works because the split is different on -- the benefit to the purchasing utility is still seven bucks difference between $23 and $7. The total benefit is $10. The difference is that 80%

factor that makes it $9.4.

Let me go to one where the broker is not involved.

COMMISSIONER DEASON: Let's go to the next one, Mr. Cresse.

COMMISSIONER CLARK: Do you agree me that in all scenarios it's beneficial to the customer?

COMMISSIONER DEASON: Let's go to the second one, because I think so.

Mr. Cresse, under the second one, you're assuming that the merchant would sell at $28 because the sale is made at $29 and the assumption you've made for --

MR. CRESSE: Correct.

COMMISSIONER DEASON: -- Utility A and Utility B. I guess my question is, if the market is working, instead of foregoing that sale and foregoing all that benefit, why doesn't Utility A, if their marginal production cost is $20, simply undercut the merchant and sell at $27?

MR. CRESSE: They could do that.

COMMISSIONER DEASON: And then the net benefit is not $10, it's $12. No, I guess it would still be $10. But there is not a loss benefit. The benefit is there because the market has worked and

Utility A has bid down to where they maximize their gain, but they're still the utility that is making the sale because they have the lowest marginal production cost.

MR. CRESSE: If that's what happens, then that is correct.

COMMISSIONER DEASON: Okay.

MR. CRESSE: There was discussion earlier that the existing utilities are operating a lot of inefficient plants and these new plants would bring great savings to the consumers in Florida. I've kind of summarized that discussion.

But the fact of the matter is, if new plants total cost is less than the variable cost of the existing facilities, the utility should replace the existing facilities with a new plant. And the measure is not what the total cost is of the existing facilities, but what the incremental cost is of the existing facilities to produce that electricity. That is what you have to measure against the cost of a new plant, not the total embedded cost.

COMMISSIONER CLARK: Would you say that again?

MR. CRESSE: Yes. There's been discussion, and I've considered some of it criticism, that existing utilities are continuing to operate some old inefficient plants. And my proposition is fairly simple. And that is, unless the existing plants variable cost exceeds the cost of new plant including fuel and O&M expenses and so forth, then the utility should not replace the existing plant because it provides electricity cheaper to its customers than it would if it replaced that plant because you've got that fixed cost that has to be recovered. It's brought great benefits over the years, and any criticism of that nature, I think, is unfounded.

COMMISSIONER CLARK: Well, but I think the point that was of concern to the utilities was if the merchant plant continues to be the least cost unit to run and the incumbent utility finds that their plant is not running because it is not beneficial, then it seems to me the next step to undertake is, is it going to be cheaper to the ratepayers to pay for that power and back out the existing unit and, in effect, recover the undepreciated plant? And if that is cheaper than running the plant, that's what they ought to do.

MR. CRESSE: If they have an alternative that this cheaper than the existing situation, they should adopt the alternative.

COMMISSIONER CLARK: Yes. And, in fact, we have done that.

MR. CRESSE: I don't think anybody would question that. We have mothballed plants, where there's been plants that retired that were no longer efficient, that the incremental cost was greater than the new capacity would be, and we've taken advantage of that. We've tried to certify some orimulsion because it was cost-effective. You certified the need for it.

COMMISSIONER CLARK: Well, I guess my question is then, that should be done whether or not the utility builds it or whether or not a merchant plant steps in and, in effect, becomes the firm capacity for that utility.

MR. CRESSE: Utility should build it or have it under firm contract. And then you know what is cost-effective. You don't know what is cost effective if there is a plant there that is just playing the market. And if it denies a utility some sales that would otherwise in total be beneficial to the consumers of Florida, then that is detrimental if it denies a revenue that would otherwise be beneficial.

CHAIRMAN GARCIA: I'm sorry, Joe. I don't understand. It would be better for Florida to have an inefficient plant run, than to have a least cost provider run?

MR. CRESSE: No.

CHAIRMAN GARCIA: I'm sorry. I lost that last step.

MR. CRESSE: Well, I just repeated what I said from the beginning. If a merchant plant makes a sale that's in excess of the incremental cost of the utility, it charges an excess of the incremental cost of the utility, makes the same sale, that is not beneficial to the citizens of the State of Florida.

COMMISSIONER DEASON: Under what scenario would that happen?

MR. CRESSE: Well, it could happen in sales to a nongenerating utility. It could happen --

CHAIRMAN GARCIA: Why would it happen?

MR. CRESSE: Well, they can sell firm capacity to a nongenerating utility and leave excess capacity with the generating utility. And if I was a nongenerating utility in Florida, I'd be telling you to certify as many plants as you can because that gives me all the options. And the more options I have, the better off I am.

But the purchasing utility is not the only one impacted by these transactions. The displaced utility has a cost that it then has to be recovered from the existing captive customers, using their language.

COMMISSIONER DEASON: But it's already in the rate base. There's no change in that. It continues in rate base. The customers still have an obligation to pay for that investment.

MR. CRESSE: Because you lost a wholesale sale, it increases the cost to existing customers if you have adequate capacity to meet that wholesale sale.

Next point I want to make is merchant plants should not be permitted in the state unless they can demonstrate benefits to the entire state. The theory that just because they propose no obligation for rate base treatment does not necessarily prove they're in the best interest of Florida electric consumers.

Now, I would remind you that Florida has a process -- a competitive process for acquiring any needed new generation and that process has served the state very well. We haven't made the mistakes that many states have throughout the country, both in having unlimited ability to build power plants -- we've had a cap on the capacity that you could build in the state since 1973, 26 years. Some states followed Florida's lead late in life and started having the kind of hearings you have to determine whether or not additional capacity is necessary. But many states didn't have that up until the late 70's, long after Florida established that principle.

So we were out alone when we did that and many states have come to copy it. So it doesn't hurt to be standing alone and not following all the horses running in the race.

I want to close by saying that if merchant plants displaced the short-term economic sales that FP&L made in 1998, it would cost FP&L ratepayers approximately $70 million.

CHAIRMAN GARCIA: How much?

MR. CRESSE: $70 million.

COMMISSIONER CLARK: Say that again.

MR. CRESSE: If merchant plants displaced short-term economic sales that FP&L made in 1998, it would cost FP&L ratepayers approximately $70 million.

COMMISSIONER CLARK: Um --

MR. CRESSE: Now, $50 million of that would say you can't build a plant in Florida and compete and sell in Georgia. $50 million of those sales is out of state.

COMMISSIONER CLARK: Out of state?

MR. CRESSE: Yes.

Another statistic that you need to keep in mind --

COMMISSIONER CLARK: Were they broker sales?

MR. CRESSE: No. The out-of-state sales, I'm sure, were not broker sales, but Mr. Sam Waters is here and he can verify that.

MR. WATERS: Commissioner, good afternoon. My name is Sam Waters from Florida Power & Light. The majority of the sales --

CHAIRMAN GARCIA: Lift the mike.

MR. WATERS: Oh, I'm sorry. I will lean down a little farther. The majority of the sales by far were nonbroker sales. They were what are called opportunity sales or other short-term arrangements.

COMMISSIONER CLARK: How short-term were they?

MR. WATERS: Generally daily. Some hourly. But usually daily. Not much longer than that.

COMMISSIONER CLARK: Okay.

COMMISSIONER JACOBS: Any idea what the numbers are on that?

COMMISSIONER CLARK: He said $70 million.

COMMISSIONER JACOBS: Percentage-wise?

MR. WATERS: I'm sorry. I didn't catch the whole question.

COMMISSIONER JACOBS: What percentage of your sales occur under those contracts?

MR. WATERS: What we're talking about, I guess, to be clear, is the gains on sales rather than just the sales. That's the figure that we're using because that is what would actually be lost. Of the figures that were given, $70 million, probably more than that 90% of that would be nonbroker sales. It would be more the opportunity sales and short-term sales and the minority would be broker-type transactions.

COMMISSIONER DEASON: That's under the assumption that merchant plants would displace 100% of those sales, is that correct?

MR. WATERS: That's 100% of the gain. That's correct.

COMMISSIONER DEASON: In reality though, you would have to compete against those merchant plants and you might make some of those sales and you might not make others, and those that you make may have to be a little bit of a lesser price, but you still may make some?

MR. WATERS: That's true.

COMMISSIONER DEASON: Okay. And then also, offsetting against that would be those times when you find yourselves in a capacity shortfall situation, and you have the capacity from the merchant plant available and you are able to -- since it was there in the market, you could buy it at a lower price than what the otherwise going rate would be and you would need to make an assumption about that and net it against your $70 million to find out if you're a net winner or loser?

MR. WATERS: Well, I guess that's true, Commissioner. We're kind of mixing apples and oranges now because we've taken an actual number and now we're trying to say that under a hypothetical it might change. That's true.

If I'm going to do a hypothetical, I would suggest to you that the merchant plant be in the business of maximizing profit rather than providing aid to the nearest person in need.

If we were the only ones that had a capacity shortage, sure, we'd have to buy from them at whatever price they chose to offer. If there were a shortage in Florida and a shortage in, say, Chicago, similar to the types of things that were going on last summer, then the highest bidder will prevail. I don't think you can presume that we would be the buyer. It would be the highest bidder.

COMMISSIONER DEASON: But you would agree that to the extent that there is another participant in the market, that everything else being equal, that that would have a downward effect on what the then going rate would be when you find yourself in a situation of having to purchase?

MR. WATERS: I think that's right, if there's enough of a market.

MR. CRESSE: Commissioner, my concluding statement is to kind of put this into perspective. If a merchant plant of 484 megawatts sold its entire capacity right at the incremental change, one-tenth of one cent below the incremental cost of the existing capacity, it would save Florida's consumers about $4 million.

If the market is going to be as competitive as they say and they sold at one-tenth of one cent above the next unit, it would save Florida's customers $4 million. That's not a lot of money.

I'd be happy to answer any questions.

CHAIRMAN GARCIA: That's not a lot of money? It's money we don't have to invest. It's money that our ratepayers aren't on the hook for. It's --

MR. CRESSE: That's true. But what I'm trying to get you to understand, Commissioner, is that you have to look at this, and to know what is going to be in the best interest of consumers, you have to have some idea as to what price you're going to have to pay for merchant capacity.

Merchant plants aren't going to come down here and sell their capacity at the incremental cost slightly below what a utility can generate it for. The math don't work at those prices. It just don't work. And they're hoping to anticipate getting more than that. I would bet you if you asked them what their business plan looks like, they would say that the average price is going to be more than the incremental cost of generating electricity in Florida. And if they say they're going to sell at the incremental cost -- below the incremental cost of generating electricity, they ought to sign some contracts to that effect.

CHAIRMAN GARCIA: You all may get an opportunity to do that.

COMMISSIONER JACOBS: This is something that has been of interest to me. One of the witnesses this morning mentioned the idea that -- I think it was one of the first speakers. That assets -- generating assets are being sold at multiples of the book value, or at least above the book value, which implies to me that what you're just saying is that they will be able to sell at above their, I guess, it was variable cost, for that facility somehow, otherwise it would have no value. Nobody would buy it, would they?

MR. CRESSE: I don't think anybody would buy anything unless they thought they could make some money at it, Commissioner.

COMMISSIONER JACOBS: And then what I'm hearing is that -- the premise of a robust wholesale market with merchant plants is that ultimately that whole community of assets will have no use or purpose. There is a disconnect there somewhere. Why in the world are people paying above the value if they're ultimately going to be gone?

MR. CRESSE: I can't answer that question. Somebody else would have to answer that. I have no idea why -- I've read some of the prices that have been paid for existing plants, substantially in excess of what, to a layman like myself, would appear reasonable. But they got the price. There may be some people in the business making bad business decisions or they know more about it.

COMMISSIONER CLARK: Be careful, Mr. Cresse. Remember who your client is.

MR. CRESSE: I understand. I said it may be. But I can assure you that everybody that's in this business or trying to get into this business is doing so because they think they can make more money that way than any other business opportunity they have.

COMMISSIONER JACOBS: Which is why, you know, I know there is going to have to be some equillibrium on the other side. I mean, I can't believe that merchant plants are going to come over here and just drive down market prices to some level and there not be some demand that's going to -- some equillibrium on the demand side. I think we understand that they're expected to replace these plants that are being purchased at above market price. Somewhere the formula is not clicking for me. I know I'm behind the curve. Were you going to -- Susan, were you -- sorry, Commissioner Clark.

COMMISSIONER CLARK: No. I mean, I think you make a good point and I was going to ask that question. With respect to merchant plants I would like to know -- get some information. How much is newly built plant and how much is plant that's been divested? I just -- I'm not clear on that and I'm not sure that that distinction has been made.

I want to follow-up on some questions and you -- the indication is that there may be some wholesale sales that might have been made by a retail selling company that, by making those wholesale sales, you contribute to keeping prices down for the retail ratepayers. And I guess my question is, how much of -- is all of Florida Power & Light's plant in the retail rate base or is there a plant in the wholesale? Is it --

MR. CRESSE: Can I ask Mr. Waters to answer that question? I think there is some in wholesale as well as in retail.

COMMISSIONER CLARK: Okay.

MR. WATERS: I'm sorry, Commissioner. My beeper went off right as you were asking that question.

COMMISSIONER CLARK: What is -- are all your plants in the retail rate base currently?

MR. WATERS: For surveillance purposes, yes, just to make that distinction. I don't think we've gone through a full rate case since several plants have been added. So yes, I believe that's true.

COMMISSIONER CLARK: So that --

MR. WATERS: Now, there's a jurisdiction split --

COMMISSIONER CLARK: The retail ratepayers are carrying the whole load?

MR. WATERS: Well, they're carrying a jurisdiction portion, say 98% for the sake of argument.

COMMISSIONER CLARK: Okay. There is some portion of your plant that is allocated to wholesale?

MR. WATERS: Yes.

COMMISSIONER CLARK: And whether you lose sales in that arena does not impact the retail ratepayers?

MR. WATERS: There are two types of wholesale transactions. The way the jurisdictional split is done is more on firm or long-term commitments, native load-type transactions. Requirements sales is the specific type of transactions we're making the wholesale.

COMMISSIONER CLARK: But if the plant is in -- that portion is allocated to the wholesale sale, whether or not you make a sale out of that plant does not affect the retail rate base, does it?

MR. WATERS: Hourly sales, it does, because the hourly sales are not part of the jurisdictionalization of cost.

COMMISSIONER CLARK: Okay.

MR. WATERS: If we make additional sales beyond what we had anticipated when we did the jurisdictional split -- and that's done on long-term commitments. If we make hourly sales, short-term sales, the benefits of those are credited back to the customers, the retail customers, because they were not -- those sales were not broken out when we did the cost allocation.

COMMISSIONER CLARK: Okay.

MR. WATERS: If I could, while I'm here. On the broker, I think there was a misunderstanding. There was some question about what happens if the broker price moves down to $23 from $25 and so on. I think, to be clear, the broker transaction that we had on the first page is a subset really of the second page. The broker transaction and the rules of a broker transaction are more defined.

If you have an incremental cost of $20 and $30 and they're quoted to the broker, the computer is going to match those up at $25. There's not going to be bidding and counter bidding. So it's -- I think it's kind of a misconception that all of a sudden the benefits will go -- to the customers go from $9 to $9.40. That's not what's going to happen to the broker.

The fact is, there's $10 of total benefits.

The broker happens to split some of those out to shareholders. But ignoring that for the moment, there's always $10 of benefits in those transactions. And if a merchant plant sells for anything more than $20, you've reduced the benefits back to customers. I mean, that's the basic math that we were trying to show.

COMMISSIONER DEASON: If Utility A's marginal cost is $20, why doesn't Utility A bid against to where, if they are the low cost provider, they are the one making the sale?

MR. WATERS: I think they would. They would bid down the price to a point. They want a contribution back to fixed cost, as we all do. They'd bid the price down to about, probably $21. That's the -- one dollar is kind of the break point in today's market.

So, you still have $10 of total benefits. Nine dollars now goes to the buyer instead of the 50/50 split we had before, but it's still $10 total to customers because we're all returning both the gains and the savings to our customers through the clauses.

If the merchant comes in and bids down to $20.50, you know, you can keep going this extension. There's a logical limit to this. But unless -- even if the merchant bids at $20, I guess you could say under the ultimate scenario, there is no gain in benefits to customers. You've just broken even if the merchant sells for $20.

A utility, I'm assuming there that their incremental cost is less than $20 in this example because they are going to maximize their profit. So they won't go down below what they know the competition will go below.

They go down to $20. Customers still have ten benefits -- $10 in benefits. And fine, we've broke even. If they bid $20.50 we only lost 50 cents, but we still -- the customer still lost 50 cents. I mean, I think that's what we were trying to get at.

And the transaction is that both gains and savings now go to Florida's customers. In a merchant scenario, savings go to customers. Gains go to the shareholders of the merchant plant. So the profits that come out of that transaction for a merchant plant are being taken out of the equation and not returned to Florida ratepayers.

COMMISSIONER CLARK: That didn't make sense to me. I think you're going to have to rework your chart. I guess what it suggests to me what the problem is, the broker system requires you to bid in cost as opposed to price.

MR. WATERS: That's basically correct. That's the way it's done today is on incremental cost.

COMMISSIONER CLARK: So it strikes me that one thing you might want to do is change the broker system.

MR. WATERS: Well, what's happening, Commissioner, when I mentioned the $70 million in gains and that most of that is nonbroker sales, well, that is precisely the reason. Everybody is looking to do side deals; whether it's for several -- the broker is also hourly.

If I can sell for four hours -- in the example we said $25 was the strike price in the broker. If I can sell for four hours for $24, I might do that because then I've got four hours worth of sales. The buyer sees a little extra benefit. I see a benefit of a longer sale. I may do that, and that's what is going on in the real market.

COMMISSIONER CLARK: As I understand it, the broker system is no longer working. That sales are being made off the broker system more and more. And in fact, we had Tampa Electric come in and want us to continue to allocate part of a plant to the retail rate base and let them make long-term sales out of it and give them some incentive to make those because it wasn't -- they were concerned that they couldn't maximize the benefit out of the broker system.

MR. WATERS: And that's possible. Each situation may be different. Everybody is trying to maximize the benefits, I think, on both sides.

We're primarily a buyer, frankly, in the overall market, especially off peak, the cheaper economy energy, and we would try and maximize our benefits there, too.

I don't think that changes though. If you we threw the broker example out all together and just looked at the other example. The split price falls anywhere between $20 and $30. It doesn't matter where it is. There's $10 dollars of benefits. If somebody is making a profit that's not being returned to customers, that's coming out of the $10. I think that's the only point.

COMMISSIONER DEASON: You lost me on that one. If there is $10 of potential benefit and regardless of who makes the sale, if there is still $10 of benefit, it's still $10 of benefit.

MR. WATERS: Except when the merchant makes the same sale. Let's say it's at $20. Okay. $10 we broke even. There's still $10 of benefit. If they make the sale at $21, the dollar they made, the gain, is not being returned to customers. It's going to their shareholders.

COMMISSIONER DEASON: And you're saying you would be indifferent -- if your marginal cost of production is $20 and the merchant bids it down to $21, at that point, you'd be indifferent whether you made the sale or not?

MR. WATERS: No. I don't think so.

COMMISSIONER DEASON: You're looking for at least a dollar to --

MR. WATERS: Well, we would look for at least a dollar to try and have some contribution back to our customers. But that's the difference. We're looking for a contribution to customers. They're looking for a contribution to shareholders. That dollar, if we sell at $21, there are $10 of benefits to Florida. Not just to us, but to Florida. If a merchant sells at $21, there are $9 of benefit to Florida customers.

COMMISSIONER DEASON: But I don't -- why would you let -- if you're cost is $20, I know you would prefer to have a contribution to fixed cost, but if you're cost is $20, why would you forego that sale and let somebody else sell at $21?

MR. WATERS: Well, there is an ultimate limit. Let's say it's less than a dollar. You're asking, would I go down to $20. There are costs that are not quantified. You know, the additional wear and tear on a unit. There are all sorts of arguments I'm sure you've heard over the years of making additional sales. There is a point below you just don't want to go that. You get too close to your pure incremental fuel cost. There's some unquantified costs and so on.

COMMISSIONER DEASON: Well, then you're saying you're real true marginal cost is not $20. It's something in excess of that?

MR. WATERS: Probably.

COMMISSIONER DEASON: Okay.

MR. WATERS: I think that's true for any generating unit. You know your fuel cost. You can quantify variable O&M to a point. There are other costs you would like to be able to cover. You're just not sure exactly what they are.

COMMISSIONER DEASON: And the merchant plant would have to consider those things as well? They could say, "Well, we'll forego it because we don't want the wear and tear on our plant."

MR. WATERS: Right. The difference is it would be very unlikely they would sell it at incremental cost plus the unknown margin, whatever that is, if they can get higher. I mean, they will push it as high as they can.

COMMISSIONER DEASON: And you would do the same too, if you were the low cost producer. If you were at $20 and a merchant was at $24, you'd want to sell at $23.98 or whatever to get the -- to maximize your profit. I mean, that's the way the market works.

MR. WATERS: Maximize the return to the customers. We don't get any profit on the deal, unless -- a straight broker deal. You know, I've kind of thrown that one out because there is a split there that's been done.

COMMISSIONER DEASON: You maximize your margin?

MR. WATERS: Right.

COMMISSIONER DEASON: And however that margin is utilized, that's a regulatory question.

MR. WATERS: Yes.

CHAIRMAN GARCIA: Any other questions?

MS. PAUGH: Mr. Chairman, Staff has a question of Mr. Waters.

CHAIRMAN GARCIA: Glad he came up for us. Go right ahead then.

MS. PAUGH: Staff is wondering if Mr. Waters knows what the percentage of total revenues is reflected by the broker revenues?

MR. WATERS: Total revenues?

MS. PAUGH: Yes, sir.

MR. WATERS: No, not off the top of my head. The figure that we're working with is the gain.

MS. PAUGH: I'm sorry?

MR. WATERS: The figure we're working with is just the gain on sales, not the -- just the total revenue from the sales.

MS. PAUGH: Okay. Thank you.

MR. MOYLE: Are you entertaining questions from others besides the Commissioners?

CHAIRMAN GARCIA: Sure. But we're running out of time, so I ask that you be brief.

MR. MOYLE: Just a couple of quick questions with respect to the obligation to serve. I think in the comments that that was pointing to is a distinguishing factor. That's a statutory obligation to serve, is that correct?

MR. CRESSE: Is that question to me?

MR. MOYLE: Whoever.

MR. CRESSE: Yes. I think the obligation to serve is both statutory and regulatory.

MR. MOYLE: And if that obligation is not met, are there any monetary penalties that result from failing --

MR. CRESSE: Yes. The Commission has the authority under the regulatory law to take quality of service into consideration in establishing rates. And if you take it -- if they're not providing adequate service, they could penalize them in the status of the rates. It's monetary.

MR. MOYLE: Let me ask you this question. I've been told then, a lot of the long-term contracts and even some of the short-term contracts, which are not statutory obligations but contractual obligations, that they are liquidated damages provisions if you fail to provide, consistent with your contractual obligations. Are you aware if Florida Power & Light contracts for those sales have liquidated damages?

MR. CRESSE: No, I'm not aware.

CHAIRMAN GARCIA: All right. Any other questions? All right.

MS. PAUGH: The joint response.

MR. McGLOTHLIN: Okay. My name is Joe McGlothlin. Duke Energy New Smyrna Beach, Constellation Power Development, Reliant Energy and U.S. Generating Company determined that their positions were aligned with respect to the most fundamental questions that were being presented. That's why they jointly prepared the document that is included in your package.

It represents a basic position paper and my plan was to highlight the document. I'm going to shorten my comments in view of the time that's been spent already because I think it's very important that Mr. Meyer of Reliant and Mr. Hawks of U.S. Gen, have an opportunity to address some of the specific items that have come up today.

But very briefly, in the Duke New Smyrna case the Commissioners recognized that merchant capacity can play a valuable role. In the many issues that the Staff work so hard to categorize, it appeared to us that some of the questions seemed to ask, how can the Commission limit or control or cap the amount of a merchant capacity.

As you hear the presentations today, we urge you to consider which arguments serve ratepayers' interests, consumers' interests. Because if you do that, we think that you'll recognize that the more appropriate question is, what market structure can we facilitate that will maximize the benefits that merchants can provide to ratepayers.

One of the questions posed is the definition of a merchant. And while that's a basic question, I'm glad it's there because we think the answer drives everything that is pertinent to your policy direction.

Specifically, the essence of the definition is that the merchant takes on all the risk, all the investment, business, operating risk. And ultimately the risk the merchant takes is the risk that the merchant will be able to provide the wholesale market what it wants on an economically viable basis. What does a market want? It wants low costs. It wants high reliability. That's why if the merchant succeeds, then ratepayers benefit.

As to the question, what market is necessary to facilitate the integration of merchants in this more competitive market, the market would have these characteristics.

It would have open access -- genuine open access overseen by an independent transmission administrator. It would have ease of market entry. There would be numerous providers and numerous products and price transparency, all of which would lead toward the more competitive wholesale market. And as the questions from the Commissioners have indicated -- have demonstrated that more competitive market will put downward pressure on wholesale prices to the benefit of ratepayers.

To my right is Mr. John Meyer, who's an executive vice president with Reliant. He wants to add his own comments.

MR. MEYER: Today I'd like to address three specific things where Reliant both may differ a little from exact comments in the filing, as well I think we have a unique experience of having operated in a wholesale market for over 15 years in Texas.

Specifically I want to address a lot of the issues we've raised on a wholesale market, as well as a specific stand on reserve margin; and then lastly just answer, I think, Commissioner Clark's question of what is required for a vibrant wholesale market.

First of all, can the coexistence of utilities and EWGs or QFs exist in a wholesale market, and I'd have to answer, certainly, yes.

In the early 80's and mid 80's, in Reliant's service territory about 5,000 megawatts of cogeneration was built. Much of this cogeneration was PURPA put cogeneration which basically means they met the minimum efficiency requirements and had considerable power to sell into the marketplace.

That merchant activity, while at the time we had many battles over it, turned out to be very important to the consumers in Texas. In fact, about 8,000 megawatts of QF power actually got developed in Texas.

Today that represents the reserve margin going into last summer and this summer in Texas. In other words, our reserve margin requirement is also about 15% and almost all of that can be expressed that the QFs that were built provide that.

Now, actually they provide power really more on a higher capacity factor basis and much of the utility generators have that reserve, but the amount is a reserve margin.

And somebody mentioned earlier that Texas even has more merchant activity going on because of this. As Texas goes down the reserve margin -- and it's getting tighter every summer. In fact, in the year 2000 many new plants will start coming on somewhere around 3,000 megawatts, and even though we've seen 20,000 announced, we don't believe more than six or seven will end up getting built. Because simply, it's self-limiting. And I'm going to address that just a little more in the reserve margin requirements.

So, I feel that the merchant plants in Texas are very important to deal with the utilities -- and with the utilities in making reserve margin. Very few plants were built in Texas after this. Reliant built a couple of cogen plants. Also a local industry that did the similar purpose and provided the same efficiencies that ended up going into rate base, but not too many plants were built in rate base with this.

As far as the utilities, can the utility continue to sell it's rate base plants in the wholesale market when merchants start coming in? The answer is definitely yes. I mean, basically you want the wholesale market to be as many buyers and sellers as you can. You want liquidity. In fact, we imported the broker system from Florida some 16 years ago. And that really had a big bearing at the time and it's kind of gone down the same line now as we do it outside the broker typically that sells.

COMMISSIONER CLARK: Mr. Meyer, let me ask you a question. Should the incumbent utility be permitted to bid in its plant -- any of its plants at whatever price it wants to, if it is a plant in rate base?

MR. MEYER: That's a hard question. I think our rule in Texas, and I think probably from a rate base perspective as a consumer, I would want them to bid in such they don't lose money. Because it's my money, it's really my plants they're bidding in, and I expect to get either all the benefit or the majority of the benefit when they're bidding those in.

But I think they should be allowed to bid in. They obviously -- they don't have to recover any fixed costs usually those plants. Except in some states, and Texas isn't one of them, they do include sales as part of the rate base and actually reduce the rate base and then they're under the gun to make these sales.

COMMISSIONER CLARK: Well, they impute the income from them.

MR. MEYER: Right.

Going on, I guess, I want to address a couple of Florida Power & Light's comments.

First of all, they said that if a merchant plant makes sales in Florida nobody benefits, even if they're economic, that the ratepayer loses.

I'm assuming if two utilities get together -- in fact, the broker system insures this -- that they both get about half the difference in their cost if they are good negotiators, if they're equal-type negotiators. If the merchant plant happens to make the sale of exactly the same cost, half of the -- the guy purchasing still gets the benefit, his consumers. The guy selling, he doesn't get that benefit anymore because someone else has it.

Now, the question is, is that fair? The reason that it's fair is because the ratepayers have borne the cost of that plant which the seller's going out of, and a merchant plant, he's bearing none. So in the future, it's very fair.

He also stated that 60% of the sales went to Georgia. Reliant isn't in a position to build plants in Georgia, but I know many others are. Those sales may evaporate anyway, and I think, have nothing to do with the Florida merchant plant question.

As far as a broker, one thing we did change in the broker system when we got it is, we let QFs or IPPs bid into the system also to sell power, which is a little different, because we thought they would be important to include their economic sales in the wholesale market.

Let me move on now. As far as, I think there was a comment made about the -- that when a utility buys from a merchant plant they transfer the responsibility to the ratepayer. Well, that's true once they buy. However, usually those purchases are of a short duration. Whenever a utility builds a plant the ratepayers are on the hook forever in the rate base for that plant or until it's sold to somebody else, which until recently that never really has occurred.

They -- a utility can buy two or three or four or five years from a merchant plant, and yes, during that time the ratepayers are paying it, but we assume that that deal was made as a least cost alternative. In fact, I think in all states it's required the Commission bless those contracts usually anyway. So they have determined, either by the facts of the evidence presented or even a docket, that that's the least cost alternative.

It also gives a utility flexibility two or three years from now. If more plants come on and it gets cheaper, they can buy those instead. They don't have to go back to the same one.

Reliability needs. I think one of the questions that came up -- and this one. What is a PC or the PSC role in this reliability? I think you're very involved in the reliability needs. Merchant plants subscribe to the rules of the road. NERC is very specific on this. Most regional council rules are very specific.

Every interconnection agreement I've signed in about 10 or 12 different states require a merchant plant to meet the needs of the utility or the grid in emergency situations. I know when we had our major freeze in '89 and I was in the control center, our Commission put out a request of all generators and industrials, whether they're utility or not -- utility certainly -- but all the others to also output everything possible and industrials cut back load as much as possible, and they did. Of all the many arguments we had with QFs over pricing, when it came down to we had to have it for liability, they all jumped in and did everything they could to deliver.

Obligation to serve. I think U.S. Gen said a few comments about that. The utility -- I think the -- in a wholesale environment, wholesale market we're talking about, the utility will have the obligation to serve, because he has a monopoly to serve the retail customer in that case. So he should bear that obligation to serve.

When a QF or merchant plant is contracted they take on an obligation to serve during the time of that contract.

Now, I'd like to address a little bit about reserve margin, because I think this question came up and I want to make sure Reliant's view is quite clear here.

I think the PSC has the obligation, as long as you have a wholesale market, to require load-serving entities to have a certain reserve margin. They can set that minimum standard, I think, anywhere they want.

If you had a regional transmission organization, you might even consider deferring to them or you may want to still set it yourself or you may want to set a cap, or I mean a minimum, and let them vary it as needs arise.

As far as setting a cap that deals with reserve margin, Reliant's general position is we don't think caps are necessary. You can look at all the examples. Like if you set a 20% reserve margin and let's say you set a reasonable cap with maybe 40%, I can't think of an example where you'll see 40% overbuild by merchant plant activity. At some point the economics and the financing will not bear it out.

COMMISSIONER DEASON: Let me ask you this.

MR. MEYER: Okay.

COMMISSIONER DEASON: Should merchant plant capacity be included in reserve margin if it is not under contract for a retail utility?

MR. MEYER: You mean to meet the load-serving entity's minimum obligations?

COMMISSIONER DEASON: Right. Assume that the merchant plant is in the state, is generating, but it's just generating without any type of a long-term contract. Should that capacity be figured in the reserve margin calculation?

MR. MEYER: The why I've laid it out where you would require minimum from LSEs, I do not think, if that LSE hadn't contracted for it, it should be counted for that obligation. When you look at the overall regional reliability situation, you look at all generation in that, that goes and sells into the grid. But I mean, those are two different scenarios. One is meeting a statutory obligation or rules obligation, and the other is addressing what you believe the adequacy is like from a NERC or NAERO perspective in a given region.

COMMISSIONER DEASON: So for calculating an individual utility's reserve margin it should not be included, but looking at an entire generating area for reliability purposes, it can be considered?

MR. MEYER: Yes. Definitely.

COMMISSIONER JACOBS: What if -- you have the decision as to whether or not you provide that capacity, correct? It's solely at your discretion?

MR. MEYER: If I don't have any contracts as a merchant plant or an EWG, I have the decision when I run. That is correct. However, I have obligated myself that in an emergency, and then which is usually defined as a threat -- imminent threat to shedding a firm load, that I will come up and run as long as my costs are protected. In other words, I don't necessarily make money, but I'm not going to lose. I'm not going to run for free. I want to have my costs covered, but I will come up and run.

I've made those obligations in all other places and I certainly would make the same obligation here.

COMMISSIONER JACOBS: Let's say in a non-emergency situation, if you use as your discretion not to operate, the theory is that somebody else will fill that slot?

MR. MEYER: Somebody else will fill that slot.

COMMISSIONER JACOBS: Why?

MR. MEYER: Why would I make the decision not to operate? I would make the decision not to operate because the price would be too low. And that is, that I can't generate the power -- my marginal cost to generate would be more than the cost of the energy I'd sell. In other words, my marginal cost may be $16 and the market is $15. I will not run unless I'm required to under a contract or under the obligation I made with the reliability council.

COMMISSIONER JACOBS: And what we're saying is that there will be somebody there who can generate at $15 and make a profit?

MR. MEYER: Sure. Well, either they will make a profit or they're required to by rate base because they're profit has already been paid for. There are times in a Florida market that the -- I'm sure the price is $15, which is probably the price generally of coal resources on a marginal basis.

COMMISSIONER JACOBS: Okay. Thank you.

MR. MEYER: I guess the only other thing I had to add, there was a large consideration. We talked about reserve margin and whether both a utilities unregulated sub could bid on that. And I think I would agree with Enron in general on that, that they should be allowed to bid if they want to. But two things have to happen when that occurs, because we've been in that situation ourselves.

One is, if the unregulated sub of utilities is bidding, it should be in a situation where it does not assign any of the risk associated with that generation back to the ratepayer. And also -- and to do that you have to have a stiff set of codes of conduct and affiliated rulemaking. And those aren't necessarily easy tests to pass.

I think that the load-serving entities should be required to seek proposals to serve their load and I think they could bid on them also. However, I think that they should have to identify who they chose and generally at what price, including themselves. And I'd go a step further and say, if they can't build it for that price, then it shouldn't be at the ratepayer's risk because they made that choice.

That's really a true test then to see that they really evaluated it fully, that they didn't just put in a price and say everybody else lost.

I guess the last question I'd like to address, or one of the thoughts is, what changes would be needed to make a vibrant wholesale market in Florida?

I think Reliant's been involved in many of these things going on now. First of all, I believe there should be an independent planning and scheduling agent that controls or administers a transmission resources, such that a liquid wholesale market would be encouraged.

Also, I think there should be encouragement of merchant plants and the load-serving entities to meet. In fact, I think it's an obligation that they have to meet their demands and reserve margins in the least expensive way to the consumers.

I think the elimination of pancake transmission rates should take place. And by that, that will definitely encourage a vibrant wholesale market. And I think this independent entity or agency or whoever is assigned that, needs to determine incentives that would encourage siting a new generation in the proper locations which would be most beneficial to the consumer.

And I think that's the comments that I have to say, if there is no further questions.

CHAIRMAN GARCIA: Yes, sir. There is no questions. Next.

MR. MOYLE: Thank you, Mr. Chairman. Jon Moyle on behalf of U.S. Generating. I want to just take a minute or two and make some general comments and then have Jack Hawks of the company respond to a couple of points that had been raised earlier today.

We've been getting into a lot of detail on this issue and I'd like to just kind of take a step back and look at it from a bit of a broader perspective. Maybe a 10,000-foot view, if you will.

It's been suggested earlier I think that part of the reason that we're here, the impetus for being here, was changes in technology. I would respectfully disagree with that and say that the reason that merchant plants are being discussed and considered in Florida is because, quite frankly, Florida needs the power.

There was discussion about last summer and some price spikes out in the Midwest. I would ask that we not forget that also last summer we had some critical situations in Florida where a lot of big businesses were -- who were on interruptible rates were being denied power, causing them economic damages, sending their workers home and what not.

And that that happened, I think, with IMC Agrico. They were here in an earlier proceeding and testified dozens of times I think in the month of June or July. I may not have the dates correctly. And I'm not sure that it can be disputed that Florida has a need for the power. Just in the past spring when certain plants were down for maintenance we saw that there were some times where interruptible customers had to be called on because there was a need there.

Given that, I disagree, I think, with the statement that has been made that less is better with respect to this. I would argue that more is better. And that if businesses can have the availability of power from merchant plants, that that's a good thing for the state, not a bad thing.

We have a bunch of people who want to come to Florida and invest hundreds of million of dollars into this state to provide power to Florida with no cost to the ratepayers. I didn't say risk. I said cost. They're going to go ahead and invest money into the state to provide that power and it's not going to be at cost to the ratepayers.

I'm not going to belabor all the points I think that have been made about the benefits of merchant plants with respect to providing additional energy and reliability.

More competition in the wholesale market. I think in an earlier comment Florida Power & Light indicated they were primarily a buyer in the wholesale market.

If that's the case and merchants want to come in and participate in that wholesale market, I think that would be a positive thing, particularly given the downward pressure on rates.

We've had discussion about the benefits to the environment as a result of this new, cleaner technology.

So, in my view, it kind of distills down to a fundamental question of, on the one hand, markets and competition; on the other hand, continuing with a monopolistic frame work. And I think, given the course of history, that markets and competition win out in the end. So just a few general comments.

Jack Hawks from U.S. Generating is here to respond specifically to some points that were made and I will turn it over to him.

MR. HAWKS: Thank you, Mr. Chairman. Just as a point of reference, U.S. Generating today has about 5,000 megawatts of merchant power in operation. We've got about 1,100 megawatts of merchant generation in construction and we've got about 8,000 megawatts of merchant generation in development.

I talked a little while ago about -- trying to respond to Commissioner Clark's question, about what is needed to make a competitive wholesale market. Joe McGlothlin elaborated on that. All of those things -- I'm trying also to speak to Commissioner Johnson's question about the global model here.

All of those things we talked about in market structure would constitute a competitive wholesale market. So we don't need to revisit that issue.

Regarding competing against rate based utility generation, I have a little bit stronger view on that. I have no desire to compete against rate based utility generation in the wholesale market unless there are market power mitigation measures taken such as what was done in California, whereby, they created a power exchange that required the utilities to bid their rate based generation and their QF power into the power exchange and accept the price that -- the market clearing price that resulted from the daily activity in the power exchange.

As far as a situation down here, if you moved the rate based generation into the market, and the utilities or their affiliates then went to FERC, applied for market based rate authority, went through the necessary market power mitigation activities to receive market based rate authority, then, of course, we would be more than willing to compete in the wholesale market.

In regards to this issue on risk; yes, it's true that the utilities can build the same types of gas combined cycle generating facilities that we can. Yes, they would be required to adhere to the same permit levels and, yes, --

COMMISSIONER CLARK: Before you go to that, I'm still trying to puzzle through the notion of them needing to bid into the market. They would have to bid all their rate based generation into the market and their customers would have to take whatever the bid price is. Is that right?

MR. HAWKS: Yeah. This is at the wholesale level though. It's not -- their utility customers are still paying their regulated rates for transmission and distribution. We're just talking about the supply component of the bundled rate right now. Not all of it. Just the supply part.

COMMISSIONER CLARK: How much of the supply -- how much of the bundled rate is --

MR. HAWKS: Depends on the utility. Ranges, I don't know, 30% to 40% up to 60% to 70%, depending on the utility, depending on how much the age and the depreciation schedules of the stock of generation --

COMMISSIONER CLARK: Sounds a little bit like virtual divestiture to me.

MR. HAWKS: For what?

COMMISSIONER CLARK: If --

MR. HAWKS: Oh, for what they're doing in California?

COMMISSIONER CLARK: Yes.

MR. HAWKS: They did divest, as you know, their fossil generation, their oil and gas generation. I don't know if I would characterize it as virtual divestiture, but yes, since they went ahead in the California market, when they did their retail restructuring legislation, they also did wholesale legislation in the same bill. And, so yes, they do bid into it.

COMMISSIONER CLARK: Well, but I understand your comments to be that if they want to -- your position would be, is if they want to be in the wholesale market, they have to bid all their generation into the wholesale market.

MR. HAWKS: No. Only if I'm going to be required to compete against it. But if I'm not, you know, what is going to happen here and other regions of the country during the transition period here is that you're going to have a time period whereby, regulated rate based generation will continue to exist. And as a matter of fact, Texas is about to pass a bill that is going to create an unregulated generation affiliate for each of the investor-owned utilities. And that unregulated affiliate then will be competing against us in the wholesale market. The difference is that the Texas bill also is going to have a number of these market power mitigation measures we're talking about, the code of conduct that Jon just mentioned.

There's a lot of safeguards that will occur, such that, we can compete in the wholesale market in Texas.

COMMISSIONER CLARK: Well, but as I understand, your position is that it would be your view that they shouldn't be allowed to compete in that wholesale market, unless --

MR. HAWKS: It depends on how deep -- you're right. Depends on how deep that wholesale market -- that competitive wholesale market is.

Again, here in Florida right now it's a very thin wholesale market. And it will grow depending on the growth and demand, depending on the decisions made by the utilities to look to other supply options other than their own generation, and we'll just have to wait and see how it evolves down here in Florida as to where we end up on how we're competing.

I'm just saying that as a starting point, it's very difficult for us to recover our capital investment, our fuel costs, our operating and our variable costs from the market price when the utilities are only recovering their fuel and variable operating cost. Their fixed costs are being covered in the rate base.

COMMISSIONER CLARK: It represents a barrier to your entry.

MR. HAWKS: Right. It's a barrier to entry, that's correct.

As far as I'm concerned, I was talking about who can build all this new generation. One of the chief benefits that we offer consumers is this risk element. We are assuming all of the development risk, all of the permitting risk, all of the fuel risk, all of the interest rate risk, all of the construction risk, all of the operating risk, and all of the general business risk.

The only risk that's going to be transferred -- that could be transferred to the ratepayer is the difference between the price that we might have under a two-year contract with a utility and what that utility would have to pay if we weren't there, if we didn't perform under our contract. And that small price risk is what could be transferred.

But in any contract that we would sign there would be liquidated damages in the contract such that the -- at least the delta between what the utility would have to -- or I shouldn't say utility -- the wholesale customer would have to go out and find from the next supplier if that's the high price, would certainly be covered in the liquidated damages for not performing under that contract.

So, I did take issue with this -- the point made earlier about all of the risks associated with the development of merchant generation being transferred to the ratepayer, because if we go bankrupt and our plants close down -- it hasn't happened yet, but you could play out the scenario, that the original developer, the original owner is going to take the write-off on the capital investment and that plant will likely be sold to another party and the new owner won't have to recover all of that capital investment -- the original capital investment, the market price, and that plant could continue to then compete and possibly succeed in the marketplace.

Commissioner Jacobs, you asked about market value and about the value and how is it that these acquirers of generation are paying so much more over the value. And the difference is, the book value of the plants under the standard utility accounting practices versus the perceived market value that we as acquirers have ascertained in our own internal market assessments.

In our case, the book value of the roughly 4,000 megawatts of a physical plant we bought in New England was about $1.1 billion. And our bid price, our winning bid was $1.59 billion. So it's about a 45% premium to book.

We, of course, have looked at the New England market, just as FPL has as a matter fact because they did the same thing with the Central Maine Power assets. They took the same view that we did. They bought a very valuable chunk of hydropower up in Maine. And we got a mix of coal, natural gas and hydropower in our acquisition and we determined that we created -- we created forward price curves for as far as we could. And right now you can only do that for a relatively short period of time, couple three years.

But we believed that the market value and the market prices that will occur in New England will sustain our investment in the New England -- in our case, the New England Electric System's generating plants. That's the difference between this. We're talking about two types of value. One is book value and one is market value.

COMMISSIONER JACOBS: And in that instance, you're going to have two different functioning -- two ways the market will function. The price will be driven there by that. It won't be driven by all of this new capacity coming in.

MR. HAWKS: Actually, New England, historically oil has set the marginal price for electricity in New England. Hydro is at the bottom. And you're right, when I say we have 5,000 megawatts of merchant generation in operation, that operation has been occurring for 13 days now. It just started on May 1st. And so every day now we're bidding, and everybody is bidding their assets in and there is different products that you bid for.

I talked about products earlier. Capacity is one product. Energy is another product. You have several different types of ancillary products. You can structure a product with a wholesale customer such that they take the power for five days a week, eight hours a day. That's another product. You can do another one 16 hours a day. There's lots of products that are being created in the wholesale market. All of that is occurring mostly in New England and Pennsylvania, New Jersey, Maryland, Delaware, Washington D.C., that PJM market, and to a lesser extent, the New York power pool. But all of that gives us enough confidence that we can plunk down $200 million, $300 million or $400 million and recover that investment over time.

COMMISSIONER DEASON: Let me interrupt for just a second before you go on to a different point.

You indicated that you opposed the concept of allowing an incumbent utility to bid in the wholesale market based upon just it's variable cost of production. Is that correct?

MR. HAWKS: Yes. We have to recover everything from our bid price into the wholesale market.

COMMISSIONER DEASON: Well, the incumbent utility has an obligation to serve and we make them meet that demand, that requirement, with their least cost generation. So if they have anything to bid it's going to be those plants that are lower down in the dispatch curve. And quite frankly, the investment in those plants is a sunk cost, it's already in the rate base, the ratepayers have an obligation to pay for that.

So it seems to me the ratepayers would be better off if the utility recovers all variable cost and has any contribution whatsoever towards it fixed cost. So why would we want to tie the hand of the utility behind it's back and not let it compete on that basis?

MR. HAWKS: I'm not sure that the customer, the ratepayer, is getting that great of a benefit if once you add that contribution to the fixed side of their investment.

COMMISSIONER DEASON: Isn't any contribution better than none?

MR. HAWKS: Actually, I wasn't sure when the gentleman from FPL came forward. I wondered that too, how much the contribution to fix they were getting out of their current wholesale sales.

I'm just -- our problem is that I'm talking about a completely open wholesale market. And I'm talking about the end state as opposed to where we are now or the transition stage.

Certainly, during the transition we're going to have to make accommodations to get to the end state. I'm just talking about at the end of the day, and the end of the day could be 10 years from now or 12 years from now or 7 years from now, depending -- we're almost at the end of the day in New England because most of the utilities up in New England are divested.

COMMISSIONER DEASON: Let me tell you this.

I don't know what the result of all of this is going to be, but I can tell you this. Most likely, at least coming from one Commissioner, the bottom line test is going to be what's in the best interest of the end consuming customer. It's not what's best for the new entrant. It's not what's best for the incumbents. That's what the test is going to be.

And what I just heard you say, I don't think -- and I have an open mind about it, and if you can convince me otherwise, that's fine. But what I heard you say is not in the best interest of the customer.

MR. HAWKS: Well, if I have a fleet of merchant generation here and if the whole state is -- all the generation in the state is converted to merchant generation, and we're competing against each other on a daily basis, and we have -- we're going to push that wholesale price down every day such that we can be dispatched and --

COMMISSIONER DEASON: But you're not going to push it down any more than you have to and you're going to maximize your profit on that, and if you're forced to, though, you're going to be in a situation where you're going to make the sale as long as it covers all of your variable cost and you get any contribution towards your fixed cost because once you're here in the state and you got that concrete in the ground, that's a sunk cost, just like it's a sunk cost for the incumbent utility.

MR. HAWKS: And I believe that price will be the lowest possible price to the consumers.

MR. MOYLE: I think the point, Commissioner Deason, is long range in terms of if and when you get to the point, if you're competing whereas you have a fixed cost on interest with respect to the assets you have in the ground and the other person does not, well, that is an advantage that the other person has that you don't have. Now, how you got there through the rate base and what not -- but that is, I think, the comment in terms of the long-term view of the world and what's happening in some other states like the New England market.

CHAIRMAN GARCIA: All right. The next presenter is?

MS. PAUGH: Mr. Kordecki.

CHAIRMAN GARCIA: Mr. Kordecki.

MR. KORDECKI: Good afternoon. I will try to be brief. I understand no one is really interested in my comments, just who I'm working for.

Actually I am now an independent consultant.

I have been hired by another consulting firm who has clients who are looking at building -- possibly building some merchant plants or doing some business in Florida and I actually do not know exactly what their relationships are and I cannot divulge any of their names.

COMMISSIONER DEASON: I thought you were here for the Conservation Goals docket.

MR. KORDECKI: Is that hearing still going on?

COMMISSIONER DEASON: It has never ended.

COMMISSIONER CLARK: But, Mr. Kordecki, who is the consulting firm you're working for?

MR. KORDECKI: Please, I prefer not to answer that either.

COMMISSIONER CLARK: Well, you know, that presents some difficulty in sort of understanding any bias you may have with respect to this proceeding.

MR. KORDECKI: Well, my bias, at this point, is towards the merchant plant so I think, take it at face value.

I think the most important thing the Commission can do in the near term is to derive a definition of merchant plants. I've heard a different set of comments. I guess the leanest version would be those plants that require a need hearing who do not have a utility obligation. The broadest definition would be, I think, those plants that are not in the rate base of a load-serving utility who has an obligation to serve. I think in the long-run you're going to want to deal with the latter, not the former.

There are a number of plants right now that do not need hearings and who I personally would consider to be merchant plants; cogenerators. There is some IPPs that may be fully subscribed. These are basically generation operations who are not in anyone's rate base. That is not to say that the Commission, as least as far as investor-owned utilities, doesn't have some jurisdiction over what happens.

You have a fuel clause. You have a capacity clause in the fuel clause. You get to examine those. I guess, is it annually now or semi-annually? So to that extent, those purchases are examined -- are available to you.

They also, if they're long-term, are in the reserve margins, or may be in the reserve margins. But I do not believe merchant plants bring a requirement of a reserve margin. Like I said, that are a number of units that escaped your need hearings;

combustion turbines. I think the first speaker this morning talked about 900 megawatts and CTs, that you will not have, basically, any oversight over.

There are possible steam units under 75 megawatts. I mentioned cogenerators. I guess it could be as narrow as their sales out of units, which are not covered by contract or by, as available power, or it could be as large as a QF itself. And there are existing generating units that have changed ownership and changed relationships.

For instance, Seminole. I believe, Seminole 1, I believe is owned by GE Capital, not by Seminole. In my estimation that's a merchant plant.

Hopefully having dealt with the Commission for over 30 years and taking on a new career, maybe I can bring on a little bit of at least my knowledge of how the Commission functions and the state functions to this topic.

As far as reserve margins, they should reserve only to load-serving utilities. They have the obligation to serve and they should also meet the obligation of the reserves. I don't believe any merchant plant or anyone selling power should be required to support those reserves or count as reserves. In other words, I don't think there is any such thing as a supplemental reserve. That's not to say that they can't be helpful in terms of reliability. To the extent that they are firm sales to load-serving utilities and counted as resources, then they're reserves or counted at least in the reserve calculations.

I do believe there is one area in reliability which I think is paramount in the Commission's mind that is ripe for some discussion and that's on the emergency conditions, and I think there's different feelings about what the merchant plants would like. But I believe that is an area that when there is a state emergency, that there are potential for requirements for merchant plants to sell that power that's not under firm sale conditions to sell into the market.

Now, I understand that there's significant worry about price gouging, particularly under those conditions. One, frequency, obviously, means something. But there's no requirement that merchant plants not have bilateral agreements or couldn't have bilateral agreements with other load-serving utilities for emergency sales.

In fact, load-serving utilities could be supporting merchant plant sales themselves in terms of backup power contracts. So there's no prerequisite that if there's a merchant plant there can't be any type of contractual -- bilateral contractual arrangements between load-serving utilities and merchant plants.

I'm not sure the Commission has jurisdiction over those, but I believe they're there, and I believe under a statewide emergency situation, I think the Commission and the Governor may have a much greater latitude in terms of how those plants are used or may be used.

Like I mentioned earlier, I don't believe the introduction of merchant plants changes any of the obligations of the load-serving utilities. That's in reference to reserve margins. That's in reference to conservation goals. I believe they're just another element that may go into an avoided calculation term of conservation goals.

As far as the problems associated with environmental -- with the environment, I suspect that all merchant plants will, in fact, be meeting whatever appropriate laws there are. To the extent that merchant plants run, and let's say, IOU or other load-serving units in the state don't run, the difference in terms of their output in terms of pollution is going to be the pollution effect.

To the extent that the merchant plants are more benign environmentally, then I suspect you'll see less energy -- less negative environmental effect and converse if they aren't.

I think the Commission has made some findings relative to environmental equipment and those findings specifically were that it's devoted to energy -- environmental equipment has been devoted to energy. That's how it's dealt with rate base-wise, and to the extent that it's collected on energy. So I think primarily it's driven by energy.

So because you have more merchant plants does not mean there is going to be more load in the state. The state load will stay the same, all things being equal, or relatively the same depending on the economic effects of the pricing. And to that extent it's just going to be the difference between what now runs and what is being sold versus what is not running. I don't see where there's a great windfall of significant pollution in terms of detriment to the environment.

Earlier there was some questions about market power issues and I believe that market power issues are primarily a FERC jurisdictional issue. To the extent that an incumbent utility is in the merchant function and wants market base rates, which I think is the market power issue, they are required to file their -- either a mitigation if they do have market power or prove that they do not have market power in order to charge market power rates.

I think there may be some misunderstanding. There are utilities in the State of Florida who can charge market power rates. I believe every municipal G and T co-op can charge market based rates. And I believe TECO has filed for them. I don't know if they've gotten a ruling yet.

Only Power and Light Incorp. cannot charge market base rates in the State of Florida. To my knowledge can only charge it outside the State of Florida. And I believe they stipulated to that in their filing with FERC. So to that extent I don't think there is a market power issue in terms at this juncture.

I believe that in the space of time, I will conclude my remarks.

COMMISSIONER JOHNSON: What do you mean by TECO can charge market power rates?

MR. KORDECKI: I think they filed to charge market base rates for wholesale transactions. I don't know if it's been ruled on or not.

COMMISSIONER CLARK: Mr. Kordecki, if I understand you correctly, then what was passed out to us by Florida Power & Light, they could not -- they would have to -- they would have to use the broker system and bid it in at $20 and the sale would be made at $25 and there would not be the opportunity for the utilities to negotiate on a price less than $25, is that correct?

MR. KORDECKI: No. I believe that's not correct. I mean, if they're selling in the -- quoting into the broker, I believe that's correct. But I think the preponderance for sales now in the State of Florida that are nonfirm are not broker sales. I believe they're opportunity sales or "J" sales, basically other nonfirm sales.

COMMISSIONER CLARK: And what is the -- what can they charge for those opportunity sales?

MR. KORDECKI: I think outside the State of Florida they can charge whatever they want.

COMMISSIONER CLARK: All right. Inside the State of Florida.

MR. KORDECKI: Inside the State of Florida, I believe they have a tariff. You'd have to ask them. I think they have a tariff that has a cap.

COMMISSIONER CLARK: So you would not be able to, unless you are permitted to charge market base prices -- what is it -- you have to go to FERC and get an approval to charge a certain rate? Okay. So you could not simply meet whatever the merchant plant is bidding without going to FERC and getting approval of it?

MR. DOLAN: Commissioner Clark, in the case of Florida Power Corp., that's correct. We do not have authority for market based rates in Florida.

COMMISSIONER CLARK: Neither does FP&L, is that right?

MR. DOLAN: That's correct. And given -- and it's unlikely that we would get them given our current understanding of the FERC rules.

COMMISSIONER CLARK: What about Tampa Electric?

UNIDENTIFIED SPEAKER: I think we have filed for them.

COMMISSIONER CLARK: You have filed for market based rates on the theory that you don't own enough transmission to be --

MR. DOLAN: Enough generation.

COMMISSIONER CLARK: Enough generation. Okay.

MR. KORDECKI: I think most of the comments about market based rates go to the fact that people will sell above cost, not so much that they will sell below cost. I think FERC couldn't care less if you wanted to give it away.

COMMISSIONER CLARK: Well, I think they do care in the case --

MR. KORDECKI: No. As long as it's not subsidized by ratepayers, I don't think they care.

COMMISSIONER CLARK: It seems they care if they have market power.

MR. KORDECKI: Well, I think if they have market power, they don't have market based rates, they just have a tariff of some sort that -- either an interchange agreement with another utility or some type of capacity tariff.

COMMISSIONER CLARK: I think that's my point. FERC does care if they have market power.

MR. KORDECKI: Yes, but what I alluded to is I don't think FERC cares if they sell below cost as long as it's not a cross subsidy to regulate utilities. In other words, the difference being a burden to other regulated utilities.

COMMISSIONER DEASON: But isn't the assumption that if they can sell below cost for them to be viable and stay in business they're getting a subsidy from somewhere?

MR. KORDECKI: In the short run they could eat it out of their pockets because they want market shares. That's what a lot of, I think, utilities with market based rates, EWGs, merchant plants, whatever, may actually sell at cost -- at below the variable cost for a short period of time to derive a market share. That's what airlines do. I mean, it's not an uncommon thing.

MR. VILLAR: Commissioner, my name is Mario Villar, Florida Power & Light Company. I wanted to clarify, for FPL we do have a floor which is our marginal cost, and a ceiling, which is a cost-based ceiling. We can negotiate a price somewhere in between the two.

CHAIRMAN GARCIA: Okay.

COMMISSIONER DEASON: Could you -- you cannot go below -- obviously, you cannot go below your floor. That's why it's defined as a floor. So you cannot exercise market power to the detriment of competitors?

MR. VILLAR: Correct.

CHAIRMAN GARCIA: Thank you. Any other questions?

COMMISSIONER CLARK: It strikes me we wouldn't really want them to make the sale if it violated that floor.

CHAIRMAN GARCIA: Okay. Thank you.

MS. PAUGH: Mr. Willis has indicated that. Tampa Electric will pass on making a presentation. Our next presenter would be Mr. Kammer of IBEW, if he wishes to present.

CHAIRMAN GARCIA: Leslie, how many more do we have after this? Two after this? LEAF and --

MS. PAUGH: And Florida Wildlife Federation.

CHAIRMAN GARCIA: Very good. Go right ahead, Mr. Kammer.

MR. KAMMER: Terry Kammer with IBEW Council U4. As others have said, I will be brief, but I will be.

Our main concern in this whole area, of course, is employment. One of the questions in the presentation is employment enhancement and creation. Looking at the power industry as itself we feel that this would not create jobs, it would take jobs away.

On the global view where, if indeed the power was cheaper and we brought industry to Florida, that may actually occur. Our members, we have approximately 9,000 to 10,000 workers in bargaining units throughout the state with the various utilities and municipalities. We're paid a fair wage. We have fair benefits. We're not sure that will happen with merchants.

Constellation in Brevard, according to the paper there, 12 employees for 900 megawatts, which means to me they're going to have operating employees. The maintenance will be contracted out. That may come from Georgia, Alabama, Florida, wherever. I have no idea.

We have a real concern with the jobs in Florida that do pay well. They're getting fewer and fewer and our concern is that, and we want to stay at the table with this issue as it goes along. Thank you.

CHAIRMAN GARCIA: Very well. And I think you have been at the table as this issue has been developing. All right. Good. Thank you. Next presenter.

MS. PAUGH: Ms. Kamaras with LEAF.

MS. KAMARAS: Thank you, Commissioners, for affording me the opportunity. I know it's late in the day and my comments are brief.

The Commission suggested a cap on plants based on the number of proposed megawatts of solar photovoltaic capacity as one of its items in the Duke order.

LEAF, of course, is pleased to see the Commission give recognition to the value of solar generation and the need to incorporate mechanisms to encourage it. However, we don't see a particular rationale to treat one power plant different from another in this regard. If the Commission is going in this direction, then any new power supply, merchant or utility, should be held to that same standard.

Likewise, with the suggested criteria for review based on the efficiency ratings of new plants it should apply across the board if it is to be used at all.

The Commission also expressed concerns about the potential impacts of merchant plants on the environment, and particularly, the use of ambient air pollution increments and the use of plants sites and other finite resources. I think the air pollution increment was addressed earlier today.

Again, LEAF is pleased to see the Commission's environmental concern, but suggests that to some extent it is misdirected. As you know, LEAF has a deep concern regarding air pollution and we would prefer to see nonpolluting resources, including energy efficiency, over any polluting ones.

However, the most damaging power plants are the ones that are already here, many of which are operating far beyond their design life.

Finally, the Commission expressed concern about the potential impacts of merchant plants on conservation goals and plans. LEAF believes that the availability and cost of merchant plants applies, and should be taken into account the same as any other supply option by utilities in assessing the need for conservation. We recognize that if those supply costs are lower than other utility options, that less DSM may become cost-effective.

However, how and what the Commission decides concerning DSM cost-effectiveness is a subject of another docket. So, we won't belabor it here. Thank you.

CHAIRMAN GARCIA: Thank you.

COMMISSIONER CLARK: Just so I understand. You're comfortable with the notion that merchant plants may have the effect of driving down the cost of electricity which may back out some demand side conservation measures?

MS. KAMARAS: I'm not comfortable with it, but I think it may be a fact as power plants -- whether merchant or otherwise, if they are lower in cost to build, there is a relationship there and we must, obviously, recognize that relationship.

COMMISSIONER CLARK: Okay.

MS. PAUGH: The Florida Wildlife Federation.

COMMISSIONER CLARK: I think he left.

CHAIRMAN GARCIA: We will let nature speak for itself. That is it, correct?

MS. PAUGH: As far as I know, yes, Mr. Chairman.

CHAIRMAN GARCIA: Okay. All right. Is there anything you want to announce or anything?

MS. PAUGH: No. I suppose the next step is to decide what the Commission wishes Staff to do with respect to this issue.

CHAIRMAN GARCIA: Right. I think we've got to digest what we've gone through today. FPC wants us to do more to study this issue. FPL doesn't think we need to do anything at all, and everyone else thinks we're doing just fine. So we'll think about it and then I hope that Staff will think about it and meet with the Commissioners and get some feeling or consensus on where we need to go next and what issues fall out from what we've discussed here, and maybe some specific areas where there may be some trouble if the Court does rule in our favor, that we should at least some idea or maybe a few more workshops to hash that out. And I know Commissioner Clark is interested in exploring some of those things, so I would assume that we will let her take the lead here.

COMMISSIONER CLARK: Mr. Chairman, it seems to me that there have been some issues that have been raised and maybe some of them have been answered, too. But, I guess, I think it's important for us to make some inquiry into what it does mean for planning purposes. What it means for -- well, should we have some set aside in merchant plants for a specific kind of plant? Should there be a cap on merchant plants or should we let competition dictate how much is fair?

I think we have to look at those issues and make some recommendations on them. And to that extent, you know, I think what would be appropriate is to work with Staff and develop, I guess, it would be a generic docket.

CHAIRMAN GARCIA: All right. Well, why don't we --

COMMISSIONER DEASON: Well, let me, I guess, put in my comments. I think that to the extent that we have any priorities it should be on reserve margins and get that matter considered. I'm not opposed to going forward. I think that should be the higher priority. I think there is some merit to the argument that we just need to wait and see what the Court is going to do. And I'm not opposed to that either. But I make that statement with some caution, and that caution is, those entities who think that we're doing piecemeal policymaking here, realize that if we delay this and don't go forward with opening a docket on this, and we get another application, we are going to have to process it. We don't have the liberty to tell an applicant or anyone else that we're going to put it on hold because we want to conduct a generic investigation after the Court rules. So that's where I am on it.

CHAIRMAN GARCIA: Okay.

COMMISSIONER JACOBS: In deference to that concern though, I think that it's very valid, that we will have to deal with all the applications, but I think it's a very valid concern that we take a very deliberate approach to addressing these issues. Not just to solve the question of whether merchant plants will be here, but to make sure they fit into the public policy paradigm that exists and that we're following what's called for.

CHAIRMAN GARCIA: Commissioners, from my point of view, I think we should -- I mean, clearly there's some issues that have come up today, and I guess I don't feel committed either way. But I think Susan does make some good points. There is some issues here that are out there, and I think Commissioner Deason is echoing them to some degree that we need to work on because when someone applies we still have to process that application.

And understanding that, we want to make sure that when we process that application it's not to the detriment of Florida's ratepayers and if, you know, anywhere that Staff finds that there may be a problem in, then that's an area we need to address now. It may be work for naught if the Court rules against this Commission. That being the case, you know, so it was work for naught. But --

COMMISSIONER CLARK: See, I don't necessarily think it's work for naught because, obviously, the Duke decision wasn't just because they were allowed to be an applicant. It was the conclusion of this Commission that they should -- there was a need for it, too.

CHAIRMAN GARCIA: Right.

COMMISSIONER CLARK: And, it strikes me that there are implications of allowing merchant plants into the generation market in Florida and we need to go forward and identify those and reach some conclusions as to whether the current law needs to be changed to accommodate those plants or if -- you know, there is a dilemma because we already made the decision that they should be part of it.

COMMISSIONER DEASON: I think that there's a very valid point that's been made here today in that I don't think the focus of this should be merchant plants per se. I think that it is a question as to how we -- if we're going to have a competitive wholesale market, how that entire matter is going to be structured and that there are relevant questions that involve our incumbent utilities just as much as it does merchant plants.

And one of my bottom-line concerns is that if we are going to have competition, I want to see competition. I don't want there to be any advantages to the new entrants. I don't want there to be any disadvantages to the new entrants. And probably more importantly, I don't want to see our incumbent utilities somehow advantaged in the wholesale market because they are incumbent. But just as important, I don't want them to be disadvantaged because they've got certain requirements, like having an obligation to serve and those types of things and we're going to have to weigh all of that out.

For there to be a viable wholesale market, we're going to have to weigh all of those things, and there are some very serious questions that are going to have to be answered in that regard.

One of those questions is, is that if this Commission is upheld at the court, it seems to me that we're going to have to be upheld on our finding that Duke, as an EWG, is an electric utility. That was one of the fundamental decisions that we made. And if we are upheld, well, then that means they're an electric utility. Do we have the authority then to somehow treat them differently than we do our other utilities to put a cap on that type of generation?

And squarely -- obviously, it's not in our statute to do that. We just -- we have requirements that apply to utilities. We do have certain classes of utility, some are rate base regulated, we set the retail rates and those types of things, which certainly would not apply to merchants.

There are a lot of questions that are going to have to be answered and I certainly -- I can't sit here today and tell you I know all of the answers, but there are a lot of questions.

COMMISSIONER CLARK: I just think we need to move forward regardless of where we are with the court case. And Commissioner Deason, you mentioned the margin of reserve, and I guess, there is -- I tried to resolve, which is the thing you should do first. Should you do the marginal reserve or should you look into what is the right way to run the generation market in Florida? I think that's really the correct identification of what we want to do.

And, you know, my thought was kind of, you would sort of make a conclusion that those retail -- those entities required to serve load, in order to assure reliability, you might require them to reach a -- to maintain capacity to serve that plus a certain margin. And then you will go to the -- the next step would be to determine what that margin would be.

COMMISSIONER DEASON: Well, I don't necessarily disagree with that. I'm not sure that's the answer, but I'm not making a judgment on that today. It seems to me that regardless of who is going to be generating in this state, whether that mix includes merchants or not, we know that we've got to answer the very critical question as to what we want to do from a policy perspective as to reserve margins. And we know that's a question we've got to answer. And it seems to me that it's very critical and extremely high priority, and that's where I think we need to devote our resources and our time and put our priority there.

If we need to review that issue in terms of two scenarios; one being how do we do reserve margins if merchants are in the mix, and how do we do reserve margins if merchants are not in the mix, so be it. I don't see how we can avoid that.

But to look at restructuring the wholesale market when we don't even know how the Court is going to rule, knowing that we've got the task in front of us concerning reserve margins, I just think that needs to be the little higher priority.

COMMISSIONER CLARK: Well, you know, I think that implicit in this Commission's decision with respect to the merchant plant was it was a good thing and regardless of how the Supreme Court rules, I would assume that we would be -- if they say they are not -- can't be an applicant, we would be over in the Legislature saying they should be an applicant.

COMMISSIONER DEASON: Well, I don't know as I agree with that. You're taking that decision much further than what I decided in my one vote, one out of three.

I voted that they met the definition and in applying the statutory criteria to them, they meet that criteria and that they passed the test. We granted the determination. I did not make any prevailing policy statement that we need to be endorsing merchant plants and that we need to do everything we can, over advocating the Legislature, whatever, to have merchant plants in this state.

That was not -- the issue of merchant plants was not the issue in the need determination docket to me. It was simply, we had one entity who expressed that they felt they met the statutory definition of a utility and that they had a proposal and they wanted to know if their proposal met the test within the statute. I said yes to both of these questions, but I didn't answer anything more other than that.

I can only speak for myself. You know, I don't think it was a question of -- merchant plants were not on trial. It was one application from one entity who wanted to build a merchant plant.

CHAIRMAN GARCIA: All right. Staff, you try to figure a consensus from that and I think we'll get together again. We may have some issues that we need. Maybe we'll set up some more workshops to hash out some of these issues and maybe we can do some of those in internal affairs and make a decision from that point of view.

Again, if a Commissioner wants to open a docket --

MR. JENKINS: In the meantime, we are moving ahead with the reserve margin docket without the consideration of the merchant plant option or cushion in it.

CHAIRMAN GARCIA: Well, I think Commissioner Deason just made a good point. I know we're a little bit down the road from there. But I think it's a good point. Maybe we should discuss it.

MR. JENKINS: All right.

CHAIRMAN GARCIA: All right. Thank you. Thank you very much. Thank you for coming.

(Thereupon, the workshop concluded at 4:40 p.m.)

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STATE OF FLORIDA)
: CERTIFICATE OF REPORTERS
COUNTY OF LEON)

We, JOY KELLY, CSR, RPR, Chief, Bureau of Reporting and KIMBERLY BERENS, CSR, RPR, Official Commission Reporter,

DO HEREBY CERTIFY that the Undocketed Workshop was heard by the Florida Public Service Commission at the time and place herein stated; it is further

CERTIFIED that we stenographically reported the said proceedings; that the same has been transcribed by us; and that this transcript, consisting of 259 pages, constitutes a true transcription of our notes of said proceedings

DATED this 21st day of May, 1999.

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