

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Determination) DOCKET NO. 991462-EU
of Need for an Electrical Power)
Plant in Okeechobee County) FILED: Oct. 25, 1999
by Okeechobee Generating)
Company, L.L.C.)
_____)

DIRECT TESTIMONY

OF

GERARD J. KORDECKI

ON BEHALF OF

OKEECHOBEE GENERATING COMPANY, L.L.C.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: PETITION FOR DETERMINATION OF NEED FOR THE
OKEECHOBEE GENERATING PROJECT, FPSC DOCKET NO. 991462-EU

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1 Q: Please state your name, address and occupation.

2 A: My name is Gerard J. Kordecki. My business address is
3 10301 Orange Grove Drive, Tampa, Florida 33618. I am self
4 employed as an electric energy and regulatory consultant.

5

6 Q: Please summarize your educational background and work
7 experience.

8 A: I have a Bachelor of Science degree and a Master of Arts
9 degree from the University of Florida. I worked for Tampa
10 Electric Company for 33 years in various capacities
11 involving marketing, conservation, resource planning and
12 rates and regulation. I have participated in the
13 development of, and supervised the preparation of, numerous
14 studies and plans involving conservation goals and
15 programs, cost allocation, rates, load research, and
16 resource allocation.

17

18 Q: Mr. Kordecki, have you previously testified before the
19 Florida Public Service Commission?

20 A: Yes, I have testified regarding the subjects identified in

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1 my preceding answer on more than 36 occasions, including
2 rate cases, determination of need hearings, and various
3 conservation dockets. I have also participated in a number
4 of rule hearings, agenda conferences and Commission
5 workshops.

6

7 **Q: What is the purpose of your testimony?**

8 **A:** My testimony is intended to compare and contrast the
9 revenue allocation effects of new resource additions when
10 comparing electric load-serving utilities versus merchant
11 plants. My testimony briefly describes types of power
12 supply resources, various revenue collection methods and
13 wholesale competition. The comparisons of merchant plants
14 and electric load-serving utilities will be limited to
15 investor-owned utilities. The public power entities
16 (municipal and cooperative utility systems) treat their
17 resources and operating expenses associated with generation
18 in a similar manner to investor-owned utilities. Their
19 oversight activities may vary significantly from
20 organization to organization so comparisons are difficult,
21 whereas the investor-owned utilities are regulated by this
22 Commission. I do believe that least cost principles
23 underlie all the utilities resource additions no matter

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1 what regulatory oversight system is in effect.

2

3 **Q: What is your understanding of the Okeechobee Generating**
4 **Project that is the subject of this need determination**
5 **proceeding?**

6 **A: It is my understanding that the Okeechobee Generating**
7 **Project ("the Project") is a 550 megawatt (nominal) natural**
8 **gas- fired, combined cycle generating unit using two**
9 **combustion turbine generators, two heat recovery steam**
10 **generators, and two steam generators. It is my**
11 **understanding that the Project has been designed to have a**
12 **net annual average heat rate of 6,775 British thermal units**
13 **("Btu") per kilowatt-hour. It is my further understanding**
14 **that the Project is to be developed and constructed by**
15 **Okeechobee Generating Company, L.L.C., using funds provided**
16 **by its investors, and that the Project will not be in the**
17 **rate base of any load-serving utility system that has**
18 **captive customers. Finally, it is my understanding that**
19 **Okeechobee Generating Company intends to operate the**
20 **Project as a "merchant" plant, selling power exclusively at**
21 **wholesale, and that it will not, at least initially, have**
22 **any long-term power sales contracts with any load-serving**

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1 utilities in Florida or elsewhere.

2

3 **Q: Please describe the generation resource alternatives for an**
4 **electric load-serving utility.**

5 A: Generally, resource additions will either be obtained by a
6 firm power purchase or by the load-serving utility
7 constructing a generating unit. The selection from these
8 two alternatives will usually be made on a least cost basis
9 but certain strategic factors, such as fuel diversity,
10 environmental considerations, financing issues, and risk
11 considerations may affect the decision.

12

13 **Q: How are the costs for each of these alternatives collected?**

14 A: Assuming that the additional resource acquisition was
15 prudent, the source of revenues is the same -- the load-
16 serving utility's customers -- but the collection method is
17 different. In the case of a purchased resource, the
18 purchasing utility would collect the costs through the Fuel
19 and Purchase Power Cost Recovery Clause ("Fuel Charge").
20 The request to collect the purchase costs is subject to
21 Commission approval during the Commission's periodic fuel
22 and purchase power cost recovery, conservation cost

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1 recovery, and environmental cost recovery hearings.
2 Normally, the purchase is broken down into two parts, a
3 fixed cost charge per kilowatt which would be collected in
4 the capacity clause and a variable cost component, which
5 would be collected in the Fuel Charge. These contracts may
6 have varying lengths with escalators or other conditions
7 which may be subject to change. The important points are
8 that customers are obligated to pay the prudent costs of
9 these purchases and the collection of these costs is under
10 the scrutiny of the Florida Public Service Commission.

11

12 **Q: What happens when the utility decides to build a generating**
13 **unit?**

14 **A:** The size and steam capacity of the proposed unit determines
15 whether a utility is required to seek site certification
16 under the Florida Electrical Power Plant Siting Act
17 ("Siting Act"), including a determination of need from the
18 Commission. Assuming the unit is approved, when it achieves
19 commercial in service status, the utility will add the
20 unit's costs to its rate base and regulatory operating
21 accounts. The costs are of two types: a capitalized cost
22 which represents the outlay to build the unit, which

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1 becomes part of the utility's rate base, and an operating
2 cost. The latter has two major components--a variable
3 operation and maintenance (O&M) and a fuel cost. The O&M
4 becomes part of the annual operating expense but the fuel
5 cost is collected in the Fuel Charge in the same manner as
6 the fuel costs from a purchased resource. If the unit
7 addition's capitalized costs are not significant enough to
8 cause a financial hardship on the utility's earned rate of
9 return, then no further action can be expected at that
10 time. If the capital addition is significant, some type of
11 revenue relief will usually be requested by the utility.
12 This request will begin a process where the utility's total
13 expenditures and rate base will be examined.

14 If there is a unit addition but no rate relief
15 requested, the Commission uses a surveillance report to
16 monitor the load-serving utility's financial condition.
17 Again, the important points to be made are that the
18 ultimate (predominantly retail) customers are responsible
19 to pay for all prudent costs associated with the
20 construction of the new unit, for the life of the unit, and
21 the Florida Public Service Commission maintains oversight
22 of the costs.

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1 Q: Describe what happens when a merchant plant is built.

2 A: After the Commission grants its need determination, and the
3 Siting Board grants the required site certification, the
4 unit is constructed and becomes commercially operational.
5 If there are no firm contracts for sale of part of the
6 unit's output, then the owner must attempt to support the
7 full capital and operating costs of the project through as-
8 available or spot market type sales. These might be
9 hourly, daily or "day-ahead," weekly, or even monthly. (My
10 understanding is that if there is a firm contract for some
11 of the power, then only the remaining power not under long
12 term contract is considered to be the merchant plant or
13 merchant capacity.)

14

15 Q: When will a load-serving utility purchase power, either
16 capacity or energy or both, from a merchant plant?

17 A: There will be times when a load-serving utility will
18 probably make purchases from the merchant plant because the
19 merchant plant's pricing is less than the incremental fuel
20 cost of the load-serving utility. Since the merchant plant
21 purchases are more economical, the utility's customers will
22 be better off financially. At these times it would be

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1 imprudent for the utility not to make the purchases. The
2 costs of these purchases would be submitted by the utility
3 to the Commission in its fuel and purchased power cost
4 recovery filing for approval as wholesale economy
5 purchases. Subject to the Commission's review for prudence
6 and reasonableness, these costs would be recovered through
7 the Fuel Charge.

8

9 **Q: Mr. Kordecki, what do you mean by wholesale competition?**

10 **A:** Wholesale competition in electricity markets generally
11 refers to the presence of competitive, unrestricted,
12 uncommitted sellers of power in a given wholesale market,
13 such as Peninsular Florida. The more sellers (and buyers)
14 of power in a given market, the more robust the
15 competition. Conversely, the fewer the number of sellers,
16 the less effective and robust competition in that market
17 will be.

18 Wholesale competition may also be defined by what it
19 isn't. Perhaps the most important aspect of wholesale
20 competition is that it is exactly that: wholesale, not
21 retail. No retail customers purchase wholesale power. It
22 can only be purchased in Florida by a load-serving utility
23 with an obligation to serve retail customers or purchased

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1 by a utility or marketing entity that will resell the power
2 at the wholesale level. This resale activity may occur
3 more than once for a specific block of power.

4

5 **Q: What agency, if any, regulates these wholesale sales?**

6 A: The Federal Energy Regulatory Commission (FERC) has
7 jurisdiction over the rates, terms and conditions of the
8 sales made by jurisdictional utilities. In Florida this
9 includes only the investor-owned utilities, marketers,
10 exempt wholesale generators, independent power producers,
11 and some cogeneration sales. The FERC does not have
12 authority over the wholesale sales made by any of the
13 cities or generation and transmission organizations. There
14 are some exceptions, but generally this jurisdictional
15 authority description is accurate.

16

17 **Q: How will the merchant plants be designated?**

18 A: I believe that, in general, they will have exempt wholesale
19 generator ("EWG") status and will also be subject to FERC's
20 regulatory authority as "public utilities" under the
21 Federal Power Act.

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1 Q: What role does the Florida Public Service Commission have
2 in wholesale transactions?

3 A: For sales made by investor-owned utilities, the Commission
4 will determine the treatment of revenues. In the case of
5 firm sales, the Commission must decide whether to
6 jurisdictionally separate the sales or flow back the
7 proceeds as credits against retail customers' cost
8 responsibility and, if so, how the proceeds will be flowed
9 back (e.g. to a fuel clause). In the case of non-firm
10 sales and short term firm sales, how the proceeds will be
11 handled must be decided.

12 For purchases made by jurisdictional utilities, these
13 expenditures will be examined in the fuel adjustment
14 hearings for prudence.

15

16 Q: Mr. Kordecki, will the merchant plants be competing for all
17 of these types of sales?

18 A: If the merchant plants are defined as including only the
19 output or capacity for which there is not a long term firm
20 contract, then the wholesale competition will be limited to
21 as available economy sales for which purchases are
22 normally made as a substitute for the purchasing utility's

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1 higher-cost generation resources. If a broader definition
2 of merchant plants is used, encompassing medium-term or
3 even long-term firm sales, then merchant plants might be
4 said to compete for all such wholesale sales.

5

6 Q: There have been claims that the introduction of merchant
7 plants as competitors to the incumbent utilities will hurt
8 their wholesale sales activities, thereby reducing the
9 revenues which these utilities are flowing back to their
10 customers. What is your reaction to these statements?

11 A: I believe that these assertions are at best narrow, self-
12 serving statements that attempt to minimize and detract
13 from the real, tangible benefits provided by merchant
14 plants. While it may true, at least hypothetically, that
15 merchant entry will reduce the profitability of the
16 incumbent utilities' wholesale activities, the Commission's
17 focus should be on the broad interests of all Florida
18 electric customers. Because merchant power plants
19 (especially of the efficient technology type planned for
20 the Okeechobee Generating Project) will only operate when
21 they are the lower cost resource, the conclusion that their
22 entry will result in lower total electric costs for

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1 Florida, considered as a whole, is predictable. This is
2 because no utility is obligated to buy from Okeechobee
3 Generating Company or any other merchant plant, and because
4 the merchants will only operate when their incremental
5 production costs are less than the incremental operating
6 costs of other power plants in the Peninsular Florida
7 generating fleet.

8 Competition will often provoke hostile or negative
9 reactions by incumbents, particularly if the incumbents'
10 market is somewhat protected against entry from new
11 participants. In the first place, even without new
12 entrants such as merchant plants, load-serving utilities
13 are building new units and making other contractual
14 resource agreements which will change market shares or
15 pricing or both. If we go back 10 or 20 years, the
16 wholesale market was significantly different than it is
17 today. The cities and the generation and transmission
18 organizations have added or contracted for significant
19 resource additions. More recently there has been more
20 interest in selling non-firm power outside the Energy
21 Broker Network. I believe that the volumes and margins on
22 the Broker have been shrinking.

23 Maximizing the revenues from wholesale sales and

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1 flowing back the profits may be a laudable goal for the
2 utility but it may not equate to the lowest cost per
3 kilowatt-hour for all customers, which should be the
4 Commission's goal.

5

6 **Q: Please explain.**

7 **A:** If efficient and cost-effective plants such as the
8 Okeechobee Generating Project are not allowed to be built
9 to exclusively serve the wholesale market, the consequences
10 will almost certainly be higher costs for Florida
11 ratepayers than if such projects are allowed to enter the
12 market. The construction of competitive, low-cost
13 generation capacity will increase the number of wholesale
14 resource options available to utilities. Many times, these
15 units will be able to provide power into the Peninsular
16 Florida market at lower cost than the marginal unit then
17 operating in Peninsular Florida and therefore, will be the
18 supplier of economy-type power.

19

20 **Q: Are merchant plants likely to provide any other benefits to**
21 **Florida electric customers?**

22 **A:** Yes, plants such as the Okeechobee Generating Project can

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1 participate as competitors for long-term, firm sales which
2 can be used by load-serving utilities as generating
3 resources. Increasing the number of long-term resource
4 options available to load-serving utilities should put
5 downward pressure on the pricing of new resources and on
6 long-term power supply costs.

7
8 **Q: Is there any way to ensure that Florida electric customers**
9 **are receiving the benefit of the lowest cost per kilowatt-**
10 **hour from wholesale sales transactions?**

11 **A:** Ensure in an absolute way, no, but the encouragement of new
12 entries into the wholesale generation market through new
13 merchant plants will promote wholesale sales competition.
14 This competition will put downward pressure on wholesale
15 prices. Coupled with the Commission's general authority to
16 review fuel and purchased power costs for cost recovery
17 purposes (based on prudence and reasonableness principles),
18 merchant entry can reasonably be expected to result in
19 lower power supply costs for Florida electric customers
20 than if entry is denied. This market driven approach to
21 wholesale competition would, in no way, change the
22 requirements for adequate installed and operating reserves

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1 (either contracted or self-built) for the load-serving
2 utilities Their retail service obligations remain the
3 same.

4
5 **Q: Would the Okeechobee Project provide any reliability**
6 **benefits to Peninsular Florida?**

7 **A:** Yes. The Okeechobee Plant would be similar to any other
8 generating plant in Florida, in that it could -- and would
9 be expected to -- be made available to load-serving
10 utilities during times of shortage to help serve peak
11 demands.

12
13 **Q: Can the capacity of the Okeechobee Generating Project be**
14 **included in calculating Peninsular Florida's reserve**
15 **margins?**

16 **A:** Yes, since this capacity can be required under a statewide
17 emergency to be sold into the grid, it is appropriate that
18 this capacity be used in calculating the aggregate reserve
19 margin for Peninsular Florida. In addition, this capacity
20 is at least as likely to be available to serve loads in
21 Peninsular Florida during peak conditions as additional

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1 import capacity whereas anything coming across the
2 interface would depend on its availability.

3

4 Q: Mr. Kordecki, some opponents of merchant power plants have
5 argued that merchant plants are not required to sell into
6 the grid during power shortages. What is your reaction to
7 these assertions?

8 A: This non-participation during times of generation shortages
9 is an argument of little merit from any realistic
10 standpoint. Frankly, it appears to be a roadblock
11 argument. The idea that a merchant utility, having entered
12 the Florida market to make wholesale sales in that market,
13 would refuse to sell into the grid when prices are the
14 highest makes absolutely no sense to me. The owners build
15 the plants to sell energy at the wholesale level. Selling
16 power generates revenues; withholding power does not.
17 Also, it is my understanding that under a statewide
18 emergency, the Governor could require any utility with
19 generation to supply into the grid. Lastly, a merchant
20 plant can, under FERC jurisdiction, have bilateral
21 interchange agreements or contracts with other generators

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1 which might accommodate individual utility generation
2 resource shortages.

3

4 **Q: What about the argument that merchant plants will sell out**
5 **of state and the local utility customers will not receive**
6 **the benefits from the sales?**

7 **A: I do not believe that any significant amount of merchant**
8 **power would be sold outside Florida for a variety of**
9 **reasons. I don't believe that sales across the Florida-**
10 **Georgia interface played any role in the financial analyses**
11 **used to evaluate the viability of this project. The value**
12 **of power here in Florida is generally significantly greater**
13 **than in Georgia. A geographical location in South Florida**
14 **wouldn't be the most favored site if sales into or through**
15 **the SERC Region were important. If some sales do take**
16 **place, they will probably be insignificant in the overall**
17 **economic effect on Florida ratepayers. Of course during**
18 **periods of out of state sales, other generation will become**
19 **available to replace higher cost power within the state.**

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1 Q: Are there any other benefits?

2 A: Yes. Florida ratepayers will not have to bear the costs of
3 the Okeechobee Project in the rate base of their local
4 utility. If their utility makes a firm purchase from the
5 Okeechobee Plant in lieu of building generation, it will
6 presumably be because it represents the least-cost option
7 for the utility and therefore, will reduce the costs
8 associated with increased generation resources. The
9 presence of merchant plants with uncommitted capacity may
10 provide enhanced competition, and thus lower costs, when
11 load-serving utilities solicit bids for new power supplies,
12 thus enhancing the operation of the Commission's "Bidding
13 Rule."

14
15 Q: Please summarize your testimony.

16 A: The Florida Public Service Commission by certifying the
17 Okeechobee Generating Project, could take another step in
18 increasing wholesale market competition, which, in turn,
19 can be expected to help reduce ultimate consumer
20 electricity costs. A positive decision would not require
21 electricity consumers to be directly responsible for the
22 cost of the Okeechobee Project. This plant will contribute

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1 to the overall state reliability since it will generally be
2 available (subject to outages like any other power plant)
3 to be sold into the state grid in times of individual
4 utility or statewide generation needs.

5

6 **Q: Does this conclude your direct testimony?**

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