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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED REBUTTAL TESTIMONY

OF

THOMAS L. HERNANDEZ

Q. Please state your name, address, occupation and employer.

A. My name is Thomas L. Hernandez. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am the Vice President of Regulatory Affairs for TECO Energy, Tampa Electric Company's ("Tampa Electric" or "company") parent.

Q. Are you the same Thomas L. Hernandez who submitted testimony in this proceeding on October 1, 1999?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to point out that the positions advanced by FPSC Staff witness Judy Harlow, Office of Public Counsel ("OPC") witness David E. Dismukes, and Florida Industrial Power Users Group ("FIPUG") witness Kent D. Taylor regarding the 20 percent

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1 incentive for economy transactions are flawed and are
2 short-sighted in failing to recognize the overall
3 benefits of the incentive to ratepayers of Florida
4 utilities. I will also point to inaccuracies made by Mr.
5 Taylor in his direct testimony relative to the FMPA
6 wholesale agreement and other wholesale generalizations.
7

8 Incentives

9 Q. What issues do you disagree with in Staff witness
10 Harlow's testimony?
11

12 A. Ms. Harlow accurately acknowledges that changes have
13 occurred in the wholesale market and that making
14 wholesale sales is an important function within
15 utilities' organizations. She also acknowledges that
16 economy transactions have declined over the years as
17 utilities have engaged in more off-broker, non-firm
18 wholesale sales. These sales are entered into with
19 buyers both within and outside Florida. What she fails
20 to acknowledge are the benefits that would accrue if this
21 energy could be retained within the state, especially now
22 during times of potential generation deficiencies within
23 Florida, and that this could be accomplished through
24 incentives. In the past, the broker accomplished this as
25 Florida utilities were encouraged to make economy

1 transactions within the state via appropriately
2 established incentives by this Commission. This
3 certainly does not suggest eliminating incentives; it
4 suggests that incentives may need to be revised and
5 enhanced to keep lower cost energy in the state for the
6 overall benefit of Florida's ratepayers.

7
8 A key point Ms. Harlow argues is that Florida Power and
9 Light Company ("FP&L") and Florida Power Corporation
10 ("Florida Power") treat economy transactions made off-
11 broker differently than Gulf Power Company ("Gulf") and
12 Tampa Electric and, therefore, by eliminating the 20
13 percent incentive, this will eliminate the difference in
14 treatment. Her conclusion is not accurate since she
15 seems to confuse the term "economy" transactions.
16 Economy transactions can be accomplished through several
17 types of transaction schedules. It appears that Tampa
18 Electric and Gulf refer to Schedule C and X transactions
19 as "split the savings" or "economy" transactions whereby
20 FP&L and Florida Power include Schedule OS and J
21 transactions in their definition of "economy"
22 transactions. It appears that all utilities consistently
23 retain the 20 percent incentive on transactions made
24 through the broker. It also appears that all utilities
25 flow gains from Schedule OS and J back to ratepayers at

1 100 percent. The only "economy" transactions that the
2 Florida utilities may be treating differently are
3 Schedule C and X transactions conducted off-broker. In
4 Order No. 12923, the Commission ordered that:

5
6 . . . economy energy sales profits are to be
7 divided between ratepayers and the shareholders
8 on an 80%/20% basis, respectively . . .

9
10 Clearly Tampa Electric's treatment of economy "split the
11 savings" sales is consistent with that ordered by this
12 Commission regardless of how other utilities choose to
13 treat them. To suggest that incentives should be
14 eliminated to ensure consistent treatment between
15 utilities is invalid and unreasonable.

16
17 **Q.** Why should economy transactions made off-broker include
18 an incentive for the seller?

19
20 **A.** As discussed in Tampa Electric witness Brown's and my
21 prefiled testimony, these "split the savings"
22 transactions simply by-pass the automated system and
23 allow the selling utility to obtain the best price for
24 its ratepayers. There are no other differences.

25

1 Q. What do you disagree with in OPC witness Dismukes'
2 testimony?

3
4 A. Mr. Dismukes arguments against the 20 percent incentive
5 are flawed. He argues that "the whole issue of
6 uncertainty associated with forecasting these gains was
7 one of the main reasons for moving their ratemaking
8 treatment from base rate cases to fuel adjustment
9 proceeding." Although it was a consideration in the
10 change of treatment, it was not the main reason for the
11 change. In 1983 when this Commission recognized the need
12 and importance of an incentive for utilities to engage in
13 short-term, non-firm transactions within Florida, one of
14 the main reasons for this action was to encourage
15 utilities to engage in these types of transactions to
16 benefit Florida ratepayers, not simply to change
17 ratemaking treatment because it was difficult to forecast
18 sales.

19
20 Mr. Dismukes inaccurately concludes that since Florida
21 utilities have protested "competitive wholesale merchant
22 facilities" proposed to be built within the state, they
23 are contradicting themselves by suggesting incentives
24 remain appropriate. He ignores the fact that until the
25 capacity is committed on a firm basis to serve Florida

1 ratepayers, the merchant energy could be exported and
2 sold without any benefit to Florida's ratepayers while
3 using Florida's natural resources, utilizing allocated
4 imported fuels, and impacting the state's environment.

5
6 Another inaccurate conclusion by Mr. Dismukes is that
7 increased economy sales yield increased overall system
8 capacity utilization which yields lower heat rates which
9 yields higher earnings for shareholders. It is clear by
10 these statement that Mr. Dismukes does not fully
11 understand Florida broker and economy transactions. To
12 enter into an economy transaction, both seller and buyer
13 must have the capacity available since the transaction is
14 non-firm and immediately recallable upon notice.
15 Therefore, the capacity factor, or utilization, of the
16 aggregate system is unchanged. On page 6, lines 7 and 8
17 of his testimony, Mr. Dismukes makes a broad
18 generalization that "increased capacity utilization will
19 increase overall operating efficiencies by reducing
20 average system heat rates." Once again, he confuses
21 theory with practical applications. The economy
22 transaction is based on incremental costs for both buyer
23 and seller. These costs are determined using the product
24 of incremental, not average unit heat rates and fuel
25 prices, to determine the energy costs. Therefore, a

1 generating unit with a lower fuel price but higher heat
2 rate (i.e. less efficient) could displace a generating
3 unit that is more efficient but higher cost to operate
4 due to higher fuel prices. In addition, the most
5 efficient (thermal) operating point for numerous
6 generating units is not at the maximum capacity factor.
7 Therefore, further loading of these units could result in
8 operating inefficiencies. What he ignores is that
9 economy wholesale transactions generally yield the lowest
10 margins for utilities.

11
12 In his testimony, Mr. Dismukes infers that Florida
13 developed a broker system as a means, in part, to improve
14 reliability. Given the dynamics of an economy
15 transaction and in the absence of an incentive for the
16 selling utility, there is no reliability benefit. As
17 discussed earlier, economy transactions are capacity
18 neutral in that both seller and buyer must have the
19 capacity available to enter into the transaction. In
20 other words, a potential buyer, in the absence of
21 available capacity under a "split the savings"
22 transaction, must purchase power under a different
23 schedule at a higher cost. The selling utility, in the
24 absence of incentives, is likely to manage firm reserve
25 margins to minimize as-available capacity to keep base

1 rates as low as possible. Incentives encourage utilities
2 in the state with the obligation to serve its customers
3 to carry additional capacity reserves that provide
4 opportunities to make energy transactions that benefit
5 the ratepayers of both seller and buyer. These
6 additional capacity reserves are also helpful in
7 mitigating the use of non-firm load resources during
8 weather extremes and/or system power supply
9 interruptions.

10
11 Another inaccurate conclusion by OPC's witness is that
12 utilities should be motivated by name recognition, not
13 profitability for both ratepayers and shareholders. He
14 suggests that utilities can simply "point to their
15 expertise and historic participation in the Florida
16 broker system" and this serves as an intangible
17 incentive. Tampa Electric is not driven to "name
18 recognition" but it is driven to providing reliable
19 electric service to its ratepayers and to providing a
20 fair return to its shareholders. This balance is
21 supported by incentives like those currently provided by
22 the Commission-approved 20 percent incentive on economy
23 transactions. Incentives such as these are important to
24 encourage benefits to ratepayers and should not be
25 eliminated.

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Both Staff and OPC argue that utilities should be motivated to reduce rates by crediting the fuel clause with 100 percent of economy sales gains. Tampa Electric has taken many actions to keep its rates competitive well beyond what the parties are now suggesting. The company does not agree that the removal of incentives is appropriate since this action would be shortsighted and fails to weigh overall benefits of economy transactions.

Q. What do you disagree with in FIPUG witness Taylor's testimony regarding incentives?

A. Mr. Taylor concludes that because there are no risks to utilities relative to economy sales, there should not be a "reward." Although risks for economy transactions are not as significant as other types of wholesale transactions, the conclusion that there are no risks and therefore utilities should not be allowed a return to shareholders is erroneous. The seller does in fact incur additional costs and face alternatives that, without the appropriate incentive, could lead both the seller and buyer to conclude that to enter into economy transactions is too risky from a reliability and competitive perspective. FIPUG's conclusions ignore, as do Staff's

1 and OPC's, the importance of retaining a competitive
2 wholesale market within Florida by incenting capacity and
3 energy to remain within the state for the benefit of all
4 ratepayers.

5
6 **Wholesale Agreements**

7 **Q.** What other observations does Mr. Taylor make about
8 wholesale sales, in general, that are inaccurate?

9
10 **A.** Mr. Taylor's suggestions in his testimony on page 11,
11 line 11 through page 12, line 5 are contradictory and
12 undermine the very premise of non-firm load resources
13 such as interruptible service and load management
14 programs. The value of non-firm load resources is
15 predicated on the value of deferral or avoidance of
16 constructing generating plant or purchasing firm power.
17 This same "avoided cost" value is the basis for load
18 management program credits and discounted rates for those
19 non-firm customers on an interruptible rate. In fact, if
20 there were no non-firm load resources on our system, the
21 associated increase in firm load and energy would require
22 Tampa Electric to build or acquire additional supply-side
23 resources to reliably meet the higher firm system
24 requirements. These same supply-side resources would
25 then be available to be used in the as-available economy

1 market or spot market when not utilized for retail
2 customer needs.

3
4 On page 12, lines 2 through 4, Mr. Taylor erroneously
5 refers to a 15 percent reserve margin relative to total
6 system demand when in fact the 15 percent reserve margin
7 applies only to firm supply-side resources and firm
8 system demand. Non-firm supply resources are excluded
9 and non-firm load resources are included due to the
10 economic benefits for both participating customers and
11 general body of ratepayers as I stated earlier.

12
13 **Q.** Do you disagree with FIPUG witness Taylor's comments
14 related to the regulatory treatment requested by Tampa
15 Electric in this proceeding for the FMPA wholesale
16 agreement?

17
18 **A.** Yes. There are numerous inaccuracies and allegations
19 made by Mr. Taylor that are biased and untrue. On page
20 9, line 7 of his testimony, Mr. Taylor infers that
21 utilities sell capacity in the wholesale market at less
22 than cost. This is simply untrue. This Commission has
23 long held and Tampa Electric supports the concept that no
24 sales should be made below incremental cost. Therefore,
25 any revenues in excess of the incremental costs to serve

1 a wholesale transaction, either firm or non-firm, create
2 benefits to both ratepayers and shareholders. It is the
3 allocation of the benefits in dispute, not the concept of
4 selling above incremental cost. This same concept
5 dispels Mr. Taylor's notion of "predatory pricing in the
6 wholesale market to kill off competition." A utility
7 that develops and maintains a cost-effective balance of
8 supply-side and demand-side resources to reliably meet
9 the needs of its retail customers is likely to be
10 positioned to sell capacity in the wholesale market at
11 prices above its incremental cost.

12
13 On page 9, line 22, Mr. Taylor incorrectly refers to the
14 FMPA agreement as being backed up by "1486 MW of TECo's
15 most efficient generating units." Based on average heat
16 rates, Polk Unit One is the most efficient unit on Tampa
17 Electric's system and Big Bend Units 1 and 4 are more
18 efficient than Gannon Units 5 and 6. In addition, no
19 more than 150 MW will be sold to FMPA at any one time.

20
21 On page 10 of his testimony (lines 1 through 5), Mr.
22 Taylor notes that the cost of the energy sold to FMPA is
23 less than the price the company charges its interruptible
24 customer. The FMPA sale was priced using capacity and
25 energy in excess of Tampa Electric's reserve margin

1 criteria and above incremental costs to serve the load.
2 Since the total revenues exceed the total incremental
3 costs to serve the sale, economic benefits are realized.
4 However, interruptible customers, by definition, do not
5 require capacity support yet are served by the company's
6 supply-side resources for most of their energy
7 requirements at a discounted rate. While neither the
8 FMPA sale nor interruptible customers require additional
9 supply-side resources, the duration of the commitments to
10 serve differs significantly. The FMPA sale began
11 December 15, 1996 and ends March 15, 2001 with less than
12 15 months remaining at the start of the projection
13 period. In contrast, the bulk of the interruptible
14 customers have been on the discounted rate since 1986 and
15 require a minimum of five years written notice to
16 transfer from a non-firm to firm rate.

17
18 On page 11, lines 3 and 4, Mr. Taylor incorrectly asserts
19 that the third-party purchases for FMPA in 1998 and 1999
20 impacted Tampa Electric's native load customers. As
21 shown in the company's monthly fuel filings, no costs
22 associated with the third-party purchases were included
23 for cost recovery.

24

1 Finally, Mr. Taylor's assertion that the FMPA transaction
2 should be studied in a separate docket is unwarranted.
3 This Commission thoroughly reviewed the transaction in
4 1997 and found that the total revenues exceeded
5 incremental costs and that the sale provided significant
6 economic benefits. Since the company is proposing to
7 credit 100 percent of the revenues for the remaining
8 months of the transaction, there is no need to have a
9 separate proceeding. Even isolating the last 14 ½ months
10 of the four-year transaction, there are benefits
11 attributable to the sale as shown in the exhibit in my
12 direct testimony. The company's projected cost recovery
13 clause factors in this proceeding for the year 2000
14 reflect those benefits. Deferring a decision would only
15 defer the benefits to the company's ratepayers.

16
17 Q. Does this conclude your testimony?

18
19 A. Yes, it does.
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