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ORIGINAL



April 18, 2000

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0870

Dear Ms. Bayo:

RE: Docket No. 991779-EI

Enclosed are an original and fifteen copies of the rebuttal testimony of Mr. M. W. Howell on the behalf of Gulf Power Company to be filed in the above docket.

Sincerely,

Susan D. Ritenour
Assistant Secretary and Assistant Treasurer

AFA	<u>Level</u>	
APP	_____	Enclosures
CAF	_____	
CMU	_____	
CTR	_____	cc: Beggs and Lane
EAG	_____	J. A. Stone, Esquire
LEG	<u>1</u>	
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04783 APR 19 8

FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Review of the appropriate application)
of incentives to wholesale power sales by)
investor-owned electric utilities)
_____)

Docket No. 991779-EI

Certificate of Service

I HEREBY CERTIFY that a true copy of the foregoing was furnished by hand delivery or the U. S. Mail this 18th day of April 2000 on the following:

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AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 991779-EI

Before me the undersigned authority, personally appeared M. W. Howell, who being first duly sworn, deposes, and says that he is the Transmission and System Control Manager of Gulf Power Company, a Maine corporation, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

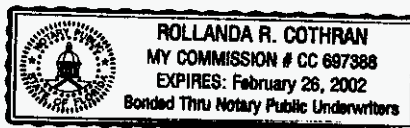
M. W. Howell
M. W. Howell
Transmission and System Control
Manager

Sworn to and subscribed before me this 18th day of April, 2000.

Rollanda Cotheran
Notary Public, State of Florida at Large

Commission No.

My Commission Expires



ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 991779-EI

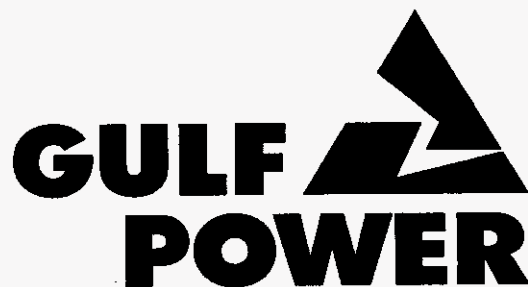
**REVIEW OF INCENTIVES FOR WHOLESALE
SALES BY INVESTOR-OWNED UTILITIES**

PREPARED REBUTTAL TESTIMONY

OF

M. W. HOWELL

APRIL 19, 2000



A SOUTHERN COMPANY

DOCUMENT NUMBER DATE
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FPSC REGULAR REPORTING

1 Q. What is a significant area that needs to be addressed in
2 rebuttal?

3 A. Witness Dismukes is proposing that this Commission
4 accept the troubling thesis that the 20% shareholder
5 incentive currently associated with economy energy sales
6 does not provide an inducement or incentive for
7 utilities to continue their efforts to maximize economy
8 sales. This thesis is in conflict with a basic
9 characteristic of human nature. An incentive is just
10 that - a motivation to produce certain behavior.
11 Incentives are effective mechanisms to encourage the
12 performance of desired actions.

13

14 Q. Is his thesis flawed?

15 A. Yes. Witness Dismukes has confused the concept of an
16 incentive and would have the Commission believe that as
17 long as a utility is interested in keeping its rates to
18 retail customers low, additional direct incentives
19 supporting the goal of lowering customer costs are
20 inappropriate. The fallacy in this thesis is that it
21 deems the general motivation to keep rates low to be
22 equivalent in impact to the more focused incentive
23 provided by the 20% shareholder incentive currently
24 associated with economy energy sales.

25

1 Q. Do utilities have an incentive to keep rates low?

2 A. I certainly agree that utilities today have an incentive
3 to keep rates as low as reasonable. But if an
4 additional incentive is provided, certainly companies
5 will respond positively to that incentive whenever they
6 have the opportunity. In the case of the 20%
7 shareholder incentive associated with economy energy
8 sales, the response takes the form of increased effort
9 to maximize these sales. Conversely, removal of an
10 existing incentive will send a signal that utility
11 resources devoted to this activity are not as important
12 to the Commission today as they once were, and they
13 should be shifted to other activities. We do not
14 believe that this is the signal that the Florida
15 Commission wants to send to the market.

16
17 Q. Has Witness Dismukes properly characterized the
18 relationship of incentives to the competitive market?

19 A. No. Witness Dismukes has either misunderstood or
20 mischaracterized the relationship of today's more
21 competitive market with the need for an incentive. His
22 testimony asserts that the more competitive market
23 negates the need for an incentive. I submit that the
24 opposite is true. The primary reason a more competitive
25 wholesale market exists today is that the sellers have a

1 direct incentive to make these sales. That direct
2 incentive is the opportunity to make a profit. In fact,
3 for any of the new non-utility players in the wholesale
4 arena, profit is the only driver behind these sales.
5 They certainly are not motivated to keep prices low
6 simply for the sake of low prices.

7 I assert to you that if these new players knew
8 they would not make any profits from their efforts, they
9 clearly would not be in the game. The primary driving
10 force behind the more competitive market in Florida
11 today is the opportunity for increased profits. If
12 profits are okay for non-regulated players who find ways
13 to increase sales, then it hardly seems fair to deny a
14 portion of the profit margin to regulated utilities.
15 And it is not only unfair to the utility, it also is not
16 good for the customer, considering that most of the
17 additional profits go to him.

18
19 Q. What is missing from Witness Dismukes' proposal to do
20 away with the incentive mechanism?

21 A. Witness Dismukes carefully avoids any mention of the
22 fact that if utilities have any added incentive to make
23 sales, it will be just that - an added incentive, which
24 will increase sales, and likely provide lower rates to
25 the retail customer. Giving the customer 80% of a

1 larger pie is better than 100% of a smaller pie. In
2 fact, if the existing direct shareholder incentive were
3 removed, then utilities facing an immediate need to
4 control costs would have an incentive to shut down bulk
5 power marketing departments and avoid these
6 "unproductive" costs. This is clearly an example of how
7 the general motivation to keep rates low is not
8 necessarily equivalent to the direct incentive
9 associated with the opportunity to share the profits on
10 economy sales. The benefits associated with short-term
11 economy sales may be lost to ratepayers due to the
12 change in focus that would come with the loss of the
13 direct shareholder incentive.

14
15 Q. Are you saying that if the direct shareholder incentive
16 were removed, a utility might stop making these sales?

17 A. Absolutely not. Clearly, a utility has a motivation to
18 keep rates low, and it will certainly pursue some level
19 of sales absent a direct shareholder incentive. But
20 today's market requires knowledge of market prices and
21 conditions that only comes from experience. It requires
22 money and effort to acquire that knowledge. Without the
23 direct incentive, a utility is not encouraged to spend
24 the money and develop the resources to more aggressively
25 pursue sales. Without the existing direct incentive,

1 utilities are essentially being encouraged to reduce
2 their efforts to further control costs for the benefit
3 of shareholder and ratepayers alike. This is not a
4 desirable situation when we are in competition with
5 players who keep all the profits. It becomes
6 increasingly difficult to justify programs when only
7 indirect incentives are associated with successful
8 efforts.

9
10 Q. Do you believe Witness Dismukes' testimony correctly
11 portrays a utility's ability to control economy sales?

12 A. No. Witness Dismukes states that "[e]conomy sales are
13 clearly one area where a utility has little ability to
14 influence decisions," implying that a utility has little
15 ability to affect the level of economy transactions.
16 His testimony then goes on to quote two witnesses out of
17 context from a previous docket in an effort to support
18 his contention. It is true that both witnesses were
19 making the point that utilities who make economy sales
20 have very little ability to unilaterally affect the
21 market price or increase the demand for economy energy.
22 Witness Dismukes completely missed the point, in full
23 context, that without knowledge of the market, utilities
24 cannot take advantage of the opportunities that do
25 exist.

1 Q. What is the correct portrayal?

2 A. Clearly, the inability to reliably forecast gains does
3 not diminish the need for incentives. To the contrary,
4 this inability is the very reason this Commission
5 instituted the incentive mechanism. Witness Dismukes
6 has confused an inability to forecast what opportunities
7 will occur in the market with the need to provide an
8 incentive to learn the market and take advantage of the
9 opportunities. Simply stated, we cannot change the
10 opportunities that do exist, but we can change how much
11 of these opportunities we take advantage of if we have
12 the market knowledge.

13

14 Q. What else has Witness Dismukes offered on this issue?

15 A. Witness Dismukes has, in fact, offered a contradiction
16 within his own testimony. On the one hand, he quotes
17 witnesses out of context in an effort to bolster his
18 assertion that utilities have no control over the level
19 of sales. Yet, on the other hand, he later asserts that
20 there ought to be a penalty if a utility does not
21 achieve an arbitrary level of sales over which they have
22 no control. I assert that such internally conflicting
23 logic should be rejected as a basis for making
24 decisions.

25

1 Q. How does your opinion differ from Witness Dismukes
2 regarding the competitive nature of the wholesale
3 market?

4 A. Witness Dismukes asserts that a more competitive Florida
5 market today sends signals to market participants that
6 should be enough to encourage taking advantage of all
7 available market opportunities. This assertion ignores
8 two important points. First, the market is more
9 competitive because there are now more participants, all
10 of whom are driven by a profit motive. Their incentive
11 to make these sales is profit. They will attempt to
12 maximize that profit by setting as high a price as
13 possible, while still making the sale. It is
14 particularly noteworthy that the non-utility
15 participants keep 100% of the profits for their
16 shareholders, not just 20%.

17 Second, if we remove the incentive that is
18 currently available to utilities to make these sales, we
19 are aggravating an already uneven playing field. This
20 change in policy would serve to discourage regulated
21 utilities from taking reasonable risks in making sales,
22 resulting in lower shared profits for our customers from
23 the sales. Such discouraged participation would reduce
24 the pool of economy energy being sold, thereby placing
25 at risk the benefits from economy purchases that flow

1 entirely to the customers.

2

3 Q. How does competition affect price?

4 A. Increased competition has the effect of driving down
5 prices. As prices drop, so do the profit margins on the
6 sales. If any incentive for regulated utilities to make
7 these sales were eliminated, then utilities would have a
8 counter incentive to not offer sales that might
9 marginally bring a profit, and the customer would likely
10 lose.

11

12 Q. Is Witness Dismukes correct in his discussion of bulk
13 power efficiencies?

14 A. No. His discussion of bulk power efficiencies shows a
15 misunderstanding of system operations and the cost
16 accounting involved in economy energy transactions.

17

18 Q. Please explain why this is true.

19 A. His assertion is that economy sales would have the
20 effect of increasing system operating efficiencies. His
21 testimony then offers no explanation or support as to
22 how this would occur. Witness Dismukes must be thinking
23 along the lines expressed in his filed direct testimony
24 on this issue in Docket No. 990001-EI dated October 18,
25 1999. That prior testimony made this same assertion,

1 then went on to explain how this would be accomplished
2 by reducing average system heat rates. In fact, the
3 opposite occurs. Many economy sales occur when loads
4 are high and capacity is short. It is the more
5 efficient units that operate to serve base load, and the
6 less efficient units that are called on in times of high
7 demand. Increasing the demand on our generating units
8 through economy sales will call on more generation from
9 the less efficient units, raising average system heat
10 rates.

11
12 Q. Are there other flaws in his bulk power efficiency
13 argument?

14 A. Yes. Witness Dismukes makes the remarkable statements
15 that "[t]his efficiency gain . . . will also result in
16 added benefits to utility shareholders", and that ". . .
17 utilities that make additional economy sales have the
18 potential to offer their shareholder higher earnings
19 through increased profits." My response to these
20 assertions is that there cannot be increased profits for
21 the shareholder if, as he proposes, 100 % of the profits
22 are flowed to the customer." I simply don't understand
23 the premise that giving away 100% of profits results in
24 higher earnings.

1 Q. Has Witness Dismukes' testimony in this regard omitted
2 any other significant considerations?

3 A. Yes. What is missing from his discussion is that if
4 utilities have an additional profit incentive to make
5 sales in a competitive market where prices are tight,
6 there is a compelling additional incentive to reduce
7 overall costs to make all generation more competitive.
8 This benefits the customer on every kilowatt-hour
9 generated, not just the relatively small portion that
10 makes up off system sales. In other words, elimination
11 of the direct incentive currently associated with
12 economy sales may result in a reallocation of resources,
13 such that customers lose the savings that the incentive
14 generates.

15
16 Q. What is your opinion of the witness' testimony on name
17 recognition?

18 A. Witness Dismukes throws out a novel assertion that
19 increased name recognition will be an incentive for
20 utilities to engage in wholesale sales. This position
21 confuses utilities' efforts at name recognition with how
22 the bulk power market really operates. Any market
23 player is well aware that the Southern Company, FP&L,
24 FPC, and TECO are known by all in the electricity
25 market, with a proven reputation to deliver what is

1 promised. The competitive market for economy energy is
2 interested primarily in only two things - deliverability
3 and price. The Florida utilities have the reputation
4 for deliverability. But if, in any hour, they are not
5 competitive on price, then they do not get the business.
6 The result will be that their customers do not get the
7 80% savings, and every customer in Florida loses to
8 unregulated players who profit from the lost opportunity
9 of the regulated utility.

10

11 Q. What are the fallacies behind Witness Dismukes'
12 alternative recommendation?

13 A. His alternative recommendation is mired in the past and
14 fails to recognize today's energy market. The proposal
15 to limit the incentive to the Florida Energy Broker
16 Network (EBN) discriminates against Gulf for not
17 participating in the EBN. Also, it ignores the reality
18 that all the other Florida companies are now making very
19 limited use of the EBN, since the industry has long
20 since moved to market-based transactions rather than
21 cost matching. Even if the proposal were modified to
22 include other sales, the wide dead band recommended for
23 no shareholder participation simply guarantees that the
24 shareholder will never gain. This is much akin to being
25 on the low end of an unlevel playing field with the deck

1 stacked against you.

2

3 Q. Is Witness Dismukes' comparison of his alternative to
4 the FPSC's approach used in the telecommunications area
5 appropriate?

6 A. No. The telecommunication program was targeted to
7 providing new services and the reduction in costs
8 associated with technological innovation applicable to
9 that industry. When this incentive mechanism created
10 for the telecommunications industry was adopted, it was
11 not used to replace an existing incentive mechanism that
12 was tied to short term non firm opportunity sales for a
13 commodity service such as economy energy sales that has
14 been a part of the business for a long time.

15

16 Q. Witness Dismukes asserts that extending the policy of
17 incentive gains to sales outside the broker system "has
18 a number of very serious policy and jurisdictional
19 issues that the Citizens would recommend the Commission
20 seek to avoid." Is there any foundation for this
21 statement?

22 A. No. Witness Dismukes makes this sensational assertion,
23 and yet he doesn't even list, much less explain, a
24 single one. If he had insight, he should have been open
25 and forthcoming, rather than make such an incredible

1 statement with no attempt at substantiation.

2 In fact, Gulf has applied the 80/20 sharing of
3 gains to economy sales outside the EBN since the
4 inception of the incentive mechanism. Contrary to
5 Witness Dismukes' implication that ratepayers will be
6 harmed, Gulf's ratepayers have benefited handsomely by
7 enjoying 80% of the profits associated with these sales
8 as a direct reduction in their electric service costs.

9
10 Q. Should the Commission eliminate the 20 % shareholder
11 incentive?

12 A. No. The Commission should not take any action to remove
13 or reduce the existing direct incentives to utilities
14 for participating in this market. By establishing the
15 existing 20% direct shareholder incentive in 1984, the
16 Commission recognized the need for and overall benefit
17 of increased sales of economy energy. The competitive
18 market changes that have recently occurred have only
19 increased the importance of this incentive to encourage
20 electric utilities to continue participation in this
21 market, to give Florida's retail customers an
22 opportunity to receive greater short term benefits than
23 if this incentive were removed.

24

25

1 Q. Does this conclude your testimony?

2 A. Yes.

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AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 991779-EI

Before me the undersigned authority, personally appeared M. W. Howell, who being first duly sworn, deposes, and says that he is the Transmission and System Control Manager of Gulf Power Company, a Maine corporation, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

M. W. Howell
M. W. Howell
Transmission and System Control
Manager

Sworn to and subscribed before me this 18th day of April, 2000.

Rollanda Cothran
Notary Public, State of Florida at Large

Commission No.
My Commission Expires

