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April 19, 2000

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Ms. Blanca S. Bayo, Director  
Division of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

Re: Review of the appropriate application of incentives to wholesale power sales by investor-owned electric utilities; FPSC Docket No. 991779-EI

Dear Ms. Bayo:

Enclosed for filing in the above docket, on behalf of Tampa Electric Company, are fifteen (15) copies of Prepared Rebuttal Testimony of W. Lynn Brown.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning same to this writer.

Thank you for your assistance in connection with this matter.

Sincerely,

James D. Beasley

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04797 APR 19 8

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1 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2 PREPARED REBUTTAL TESTIMONY

3 OF

4 W. LYNN BROWN

ORIGINAL

5  
6 Q. Please state your name, address, occupation and employer.

7  
8 A. My name is Lynn Brown. My business address is 702 North  
9 Franklin Street, Tampa, Florida 33602. I am employed by  
10 Tampa Electric Company ("Tampa Electric" or "company") as  
11 Director of Wholesale Marketing and Sales.

12  
13 Q. Are you the same Lynn Brown who submitted testimony in  
14 this proceeding on March 1, 2000?

15  
16 A. Yes, I am.

17  
18 Q. What is the purpose of your rebuttal testimony?

19  
20 A. The purpose of my rebuttal testimony is to point out that  
21 certain positions advanced by the Office of Public  
22 Counsel's witness David E. Dismukes regarding incentives  
23 and his alternative recommendation are flawed and fail to  
24 recognize the overall benefits of incentives to  
25 ratepayers of Florida utilities.

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FPSC-RECORDS/REPORTING

1 Q. Have you prepared an exhibit supporting your testimony?

2

3 A. Yes. My Exhibit No. 1 (WLB-2) consists of one document  
4 entitled "Excerpts from the Prepared Rebuttal Testimony  
5 of Thomas L. Hernandez filed in Docket No. 990001-EI."

6

7 Q. What is the first issue in Dr. Dismukes' testimony that  
8 you would like to discuss?

9

10 A. On page 2, lines 6-7 of Dr. Dismukes' testimony, he  
11 states "no utility today can afford to not participate  
12 aggressively in wholesale markets." Further on page 2,  
13 lines 11-14 he states "incentive-based regulation can be  
14 an effective tool for regulators. However, incentive  
15 based regulatory mechanisms should be placed upon  
16 decisions that can be both influenced and measured."  
17 Finally he states that such a mechanism that is not tied  
18 to a decision that is within the utilities' control is  
19 unproductive. Tampa Electric agrees with these points.  
20 The company has invested resources to participate in the  
21 volatile non-firm, wholesale power market. Tampa  
22 Electric's participation has provided benefits to retail  
23 customers in the form of economic power purchases and  
24 off-system sales revenues. Further, the level of a  
25 seller's participation in the market at any given time is

1 influenced by its operating decisions, market forecasting  
2 capabilities, generation cost, and innovativeness.  
3 Incentives have also influenced seller's participation in  
4 the market.

5  
6 **Q.** Are there related points regarding market influence that  
7 Dr. Dismukes makes that you do not agree with?

8  
9 **A.** Yes. On page 2, lines 14-15 of his testimony, Dr.  
10 Dismukes states "Economy sales are clearly one area where  
11 a utility has little ability to influence decisions,  
12 especially in the very short run." On page 3, lines 20-  
13 22, he states "it is a questionable proposition as to  
14 whether utilities can strategically (and consistently)  
15 manipulate their economy sales for profit." Although Dr.  
16 Dismukes never defines "economy sales," Tampa Electric  
17 has defined them to mean Schedules "C" and "X"  
18 transactions that are cost-based and offer equal benefits  
19 to the buyer and seller. It is true that utilities  
20 cannot "manipulate" the price of a cost-based product.  
21 However they can modify their operations to maximize  
22 sales volume when product demand is high. Factors such as  
23 robustness of market activity, incremental cost of  
24 generation, transmission system constraints, and weather  
25 influence the market price at any given time. Utilities

1 certainly cannot control the weather but they do  
2 influence these other factors.

3  
4 **Q.** Please comment on the three incentives that Dr. Dismukes  
5 claims exist in Florida's wholesale market "without an  
6 additional incentive adder."

7  
8 **A.** On page 4, lines 2-8 of Dr. Dismukes testimony, he  
9 describes three incentives for Florida utilities to  
10 participate in the current wholesale market. Tampa  
11 Electric agrees with Dr. Dismukes that all utilities  
12 should strive to provide their customers with quality  
13 electric service at a reasonable price, however,  
14 incentives have proven to encourage certain behavior and  
15 such incentives can benefit both customers and companies.  
16 Tampa Electric has proposed that the current 20 percent  
17 incentive (applied only to economy sales) also be applied  
18 to other non-firm, non-separated sales. This proposal  
19 will encourage Florida utilities to maximize sales of  
20 their available energy in the market place without any  
21 reduction in retail customer reliability. In fact, Tampa  
22 Electric's proposal for incentives should result in  
23 increased market participation which will provide  
24 economic benefits to all Florida retail customers.

25

1 In his rebuttal testimony filed on November 1, 1999 in  
2 Docket 990001-EI and attached as my exhibit, Tampa  
3 Electric witness Thomas L. Hernandez directly addressed  
4 two of the three incentives listed by Dr. Dismukes. Mr.  
5 Hernandez accurately assesses why reduced rates and  
6 increased name recognition are important but do not  
7 mitigate the need for appropriate incentives.  
8

9 **Q.** Do you believe, as Dr. Dismukes does, that Tampa Electric  
10 and other Florida IOUs have contradictory points of view  
11 when it comes to merchant plants?  
12

13 **A.** No. Dr. Dismukes states on page 5, lines 8-12 that  
14 Florida's IOUs are asking for incentives while opposing  
15 merchant plants within the state. Florida IOUs have  
16 expressed their desire to continue participating in  
17 Florida's wholesale market. Dr. Dismukes fails to  
18 acknowledge that merchant plants are incented to make  
19 wholesale sales. Merchant plant owners don't simply  
20 retain 20 percent of the profits, they retain 100  
21 percent. In fact, merchant plant owners are anxiously  
22 anticipating lucrative sales opportunities in Florida.  
23 From time to time, Florida utilities experience a loss of  
24 generation, which can effectuate escalated market prices.  
25 Merchant plants stand to take advantage of these

1 situations and retain 100 percent of the wholesale  
2 transaction profits.

3  
4 Another important consideration is that merchant plants  
5 do not contribute to Florida's planning, operating or  
6 spinning reserves requirements unless the host control  
7 area includes an obligation to serve these requirements  
8 in their operating agreement. Merchants are not required  
9 to serve Florida retail customers but are free to market  
10 their power without constraint. In contrast, a Florida  
11 utility's primary obligation is to serve Florida's retail  
12 customers. Incentives that encourage wholesale power  
13 transactions above this basic obligation are appropriate.

14  
15 **Q.** Please comment on Dr. Dismukes' alternative  
16 recommendation.

17  
18 **A.** Dr. Dismukes describes an alternative incentive  
19 recommendation that includes a "dead band" benchmark  
20 accompanied by incentives and penalties for performance  
21 levels that are over/under the benchmark. The benchmark  
22 is based on a five-year moving average of sales made on  
23 the Florida Energy Broker Network ("EBN"). There are  
24 several flaws in his recommendation.

25

1 Dr. Dismukes apparently is unaware that the Florida EBN  
2 has recorded little activity over the past year.  
3 Furthermore, this cost-based, split-the-savings matching  
4 program was discontinued on March 20, 2000. Most  
5 wholesale sales are off-broker, non-firm, non-separated  
6 energy transactions. The EBN now includes numerous out  
7 of state participants and is principally market-based  
8 transactions. Products are offered both at the Florida-  
9 Georgia border and in-state.

10  
11 Dr. Dismukes argues that "the whole issue of the  
12 uncertainty associated with forecasting these gains was  
13 one of the main reasons for moving their ratemaking  
14 treatment from base rate setting to fuel adjustment  
15 proceedings." I agree with Mr. Hernandez's analysis of  
16 this issue in his rebuttal testimony from Docket No.  
17 990001-EI, that although it was a consideration in the  
18 change of treatment, it was not the main reason for the  
19 change. One of the main reasons for incentives was to  
20 encourage utilities to engage in economy transactions to  
21 benefit Florida ratepayers, not simply to change  
22 ratemaking treatment because it was difficult to forecast  
23 sales.

1 Q. Do you have any other comments regarding Dr. Dismukes'  
2 alternative proposal?

3  
4 A. Yes. Dr. Dismukes advocates that risks and rewards  
5 should be symmetrical. Tampa Electric believes the  
6 Commission's current process along with the company's  
7 proposal is fair and symmetrical. If a utility pursues  
8 opportunities and is able to effect incremental economy  
9 sales, the utility currently retains 20 percent of the  
10 gain. If this utility is complacent and foregoes sales  
11 that might otherwise have been attainable, the utility's  
12 shareholders lose their 20 percent share of the foregone  
13 gain. This incentive is symmetrical and avoids the  
14 pitfalls previously recognized by the Commission,  
15 associated with any attempt to project an optimal or  
16 appropriate level of economy sales.

17  
18 Tampa Electric's proposal of a 40 percent shareholder  
19 incentive for in-state sales and a 20 percent shareholder  
20 incentive for out-of-state sales encourages more energy  
21 to be made available to in-state buyers thereby  
22 increasing in-state market liquidity which benefits  
23 Florida retail customers. This simple, straightforward  
24 proposal does not depend on historical benchmarks, dead  
25 bands or annual deviations from a benchmark. It provides

1 encouragement for non-firm, non-separated off-system  
2 sales.

3

4 Q. Does this conclude your testimony?

5

6 A. Yes, it does.

7

8

9

10

11

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25

EXHIBIT NO. \_\_\_\_\_ (WLB-2)  
TAMPA ELECTRIC COMPANY  
DOCKET NO. 991779-EI  
WITNESS: L. BROWN

TAMPA ELECTRIC COMPANY  
EXHIBIT OF W. LYNN BROWN

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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.

1 Both Staff and OPC argue that utilities should be  
2 motivated to reduce rates by crediting the fuel clause  
3 with 100 percent of economy sales gains. Tampa Electric  
4 has taken many actions to keep its rates competitive well  
5 beyond what the parties are now suggesting. The company  
6 does not agree that the removal of incentives is  
7 appropriate since this action would be shortsighted and  
8 fails to weigh overall benefits of economy transactions.  
9

10 Q. What do you disagree with in FIPUG witness Taylor's  
11 testimony regarding incentives?  
12

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

1            wholesale market within Florida by incenting capacity and  
2            energy to remain within the state for the benefit of all  
3            ratepayers.  
4