BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Complaint and petition by Lee County Electric Cooperative, Inc. for an investigation of the rate structure of Seminole Electric Cooperative, Inc.

Docket No. 981827

Filed: July 17, 2000

REBUTTAL TESTIMONY

of

MARTIN J. BLAKE

on behalf of

LEE COUNTY ELECTRIC COOPERATIVE, INC.

I. INTRODUCTION

Q. Please state your name, address and occupation.

A. My name is Martin J. Blake. My business address is 6711 Fallen Leaf, Louisville, Kentucky 40241. I am a member and principal of The Prime Group, L.L.C.

Q. Have you previously filed testimony in this docket?

A. Yes. I filed direct testimony in this docket on May 30, 2000 in support of the Complaint and Petition by Lee County Electric Cooperative, Inc. for an Investigation of the Rate Structure of Seminole Electric Cooperative, Inc.

II. PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. My testimony rebuts the testimony filed in this proceeding by Seminole witnesses James P. Duncan, Trudy S. Novak, and Timothy S. Woodbury.

Q. Please summarize your rebuttal testimony.

A. My rebuttal testimony: (1) explains why a democratic process does not guarantee just and reasonable rates; (2) explains why the Florida Public Service Commission ("Commission") should assert jurisdiction over and review Seminole's rates; (3) demonstrates

that Seminole's main reason for the new rate design was to kill "behind the meter" generation, which also has the effect of negatively impacting load management, energy conservation and economic development; (4) demonstrates the incorrect pricing signals caused by a ratchet that reaches back 4 years; and (5) demonstrates how Seminole did not properly implement marginal cost pricing principles in developing Rate Schedule SECI-7 and SECI-7b.

III. A DEMOCRATIC PROCESS DOES NOT ENSURE FAIR, JUST AND REASONABLE RATES NOR DOES IT BAR THE COMMISSION FROM EXERCISING JURISDICTION OVER SEMINOLE'S RATE STRUCTURE

Q. On Page 2, lines 19-23 of his testimony, Mr. Duncan argues that the Commission should defer to the judgement of Seminole's Board of Trustees because a democratic process was used to develop Rates SECI-7 and SECI-7b. Do you agree with his analysis?

A. No. I see no logic in Mr. Duncan's position that a democratic rate approval process guarantees fair and reasonable rates.

Q. Please explain.

A. "Fair" and "reasonable" are standards by which the rates of electric utilities in Florida are evaluated by the Commission. Mr. Duncan is confusing a process for developing rates with a standard for reviewing the appropriateness of the rates that were developed. To

my knowledge, the Commission has never found that any rate development process guarantees that the rates that are developed meet the fair and reasonable standard.

In fact, the process used by Seminole's Board to approve rates for its member systems does not represent an unbiased process for setting rates. Unlike the Commission, the Seminole Board is not an objective, dispassionate, independent tribunal that can approve rates without the influence of self interest. We understand the passion that Mr. Duncan has for looking after his own self interest, but it is the pursuit of self interest that makes a purely democratic process problematic. The self interest of the majority can trample on the interests of the minority. This potential "tyranny of the majority" is precisely the reason that it is necessary for an independent tribunal to have jurisdiction over the rates charged by Seminole.

Unlike a decrease in the revenue requirement, which would benefit all members, a change in the rate design produces winners and losers. This does not mean that a rate design can never be changed. It can, but only where there are solid justifications for such change. The fact that the change benefits the majority of members is not a sufficient justification. As a matter of public policy, an independent tribunal like the Commission is simply in a better position to judge whether there are sufficient reasons to support a change in rate design.

Q. On page 6, lines 21-26 of his testimony, Mr. Woodbury explains that the Seminole Board fixes rates subject to written approval by the Administrator of the RUS. Is the RUS approval process an objective and independent review of the fairness and reasonableness of Seminole's rate structure?

A. No. The RUS review is simply designed to ensure that the new rates will provide sufficient revenue for repayment of RUS loans. It is a review of the revenue requirement, or the amount of money raised by the rates. The RUS does not review rate design, and thus does not address how the revenue requirement is collected from the various customers.

Q. Mr. Duncan and Mr. Woodbury both assert that the Commission does not have the authority to review and approve Seminole's rates. Do you agree?

A. No, I do not. It is undisputed that Section 366.04(2)(b), Florida Statutes expressly states that the Commission has the power " [t]o prescribe a rate structure for all electric utilities," without exception. Furthermore, Seminole has specifically admitted that it is an "electric utility" as that term is defined in the Florida Statutes. [See Seminole's Admission No. 4 in response to LCEC's First Request for Admissions served on June 5, 2000.] Accordingly, the Commission has the authority to prescribe a rate structure for Seminole, just as it does for all other electric utilities.

Q. Does the Wholesale Power Contract between LCEC and Seminole prohibit LCEC from petitioning the Commission for rate structure relief?

A. No. Although the Wholesale Power Contract could have included such a provision, the Wholesale Power Contract between LCEC and Seminole does not in any way prohibit LCEC from petitioning the Commission for rate structure relief.

Q. Do you agree with Mr. Duncan that if the Commission determines that it has jurisdiction over Seminole's rate structure, it should limit its review to determining whether Seminole adhered to the internal rate approval process set forth in the Wholesale Power Contract with LCEC?

A. No. As I have previously testified, the Commission should not abdicate its responsibility to ensure that Seminole's rates are fair and reasonable simply because the process used by Seminole to adopt those rates may have been a democratic process.

Q. Why doesn't the use of a democratic process to develop rate design bar the Commission from independently evaluating the fairness and reasonableness of the rate design?

A. In urging the Commission not to assert its jurisdiction over Seminole's rate structure, Mr. Duncan argues that:

> The Commission should recognize that these are not rate schedules imposed on us by some impersonal utility from

> which we need protection. They are rate schedules that we adopt ourselves through a democratic process in which every rate paying member has one representative on the Rate Committee and two representatives on the Board of Trustees. (Duncan Testimony, p. 6, lines 2-6).

However, Mr. Duncan provides no evidence or statutory support for his position that the Commission can choose not to assert jurisdiction over Seminole's rates if they are adopted using a democratic process. Indeed, there have been several instances where the Commission has disapproved settlements even though those settlements represented a consensus among the parties to which there was no dissent. See In re: Petition for expedited approval of settlement agreement with Lake Cogen, Ltd., by Florida Power Corporation, 97 F.P.S.C. 11:202, Docket No. 961477-EQ, Order No. PSC-97-1437-FOF-EQ (Nov. 14, 1997); In re: Complaint of Jesus Fernandez against FLORIDA POWER AND LIGHT COMPANY regarding Current Diversion/Meter Tampering Rebilling for Estimated Usage of Electricity, 92 F.P.S.C. 6: 516, Docket No. 910670-EI, Order No. PSC-92-0566-FOF-EI (June 24, 1992); In re: Objection by ST. JOHNS NORTH UTILITY CORP. to Notice of Intent by GENERAL DEVELOPMENT UTILITIES, INC. to Amend Certificate Nos. 451-W and 396-S and Application for Amendment, Docket No. 880207-WS, Order No. 19676 (July 14, 1988). In those cases a consensus of the parties did not dissuade the

Commission from exercising the jurisdiction and applying the standards charged to it by the Legislature.

In short, the "democratic nature" of arriving at a rate has not prevented the Commission from asserting jurisdiction and disapproving uncontested agreements in the past, and it should not prevent the Commission from asserting jurisdiction and reviewing Seminole's rate structure in this proceeding.

Q. Mr. Duncan and Mr. Woodbury both suggest that Rate Schedules SECI-7, SECI-7a and SECI-7b represent a consensus position to which the Commission should defer. Do you agree?

A. No. Mr. Woodbury's own testimony reveals that there was never a consensus or even a strong majority regarding the design of Rate Schedule SECI-7, SECI-7a and SECI-7b. On page 19, line 12 of his testimony, Mr. Woodbury notes that the SECI-7 rate structure was originally approved by Seminole's Board by an 11 to 7 vote. Mr. Woodbury goes on to note on page 23, lines 20-22 of his testimony that revised rate SECI-7a was passed on a vote of 9 to 8. These votes do not represent a consensus on the new rate design and, in my opinion, are slim rather than strong majorities.

IV. TRUE MOTIVATION FOR RATE DESIGN IS TO KILL "BEHIND THE METER" GENERATION

Q. What is your understanding of Seminole's motivation in adopting the rate design that is incorporated in Rates SECI-7 and SECI 7b?

A. Starting on page 10 of his testimony, Mr. Woodbury cites three motivating factors which led to Seminole modifying its wholesale rate structure:

- Members actively becoming involved in installing "behind the meter" generation to be used, in part, to reduce capacity purchases from Seminole under the Wholesale Rate Schedule;
- Members being approached by other power suppliers offering to sell capacity and energy to the Members at market-based rates;
- The desire on the part of the Members for Seminole to attempt to find consensus on modifications to Seminole's Wholesale Power Contract to provide the Member Systems with flexibility relating to the obligation to acquire future capacity resources only from Seminole ("Member Choice Program"). (Woodbury Testimony, p. 11, lines 1-10).

Q. Please evaluate these three reasons for altering Seminole's wholesale rate design.

A. The second reason does not provide a sound basis for altering wholesale rate design because it makes no difference who approaches the members offering to sell capacity and energy. Members are tied to purchasing electric power from Seminole through long-term, all requirements contracts. The Member Choice Program, cited by Mr. Woodbury as the third reason for altering

the wholesale rate design, has not been approved by the Board even though it has been under consideration since 1998. It is not necessary to change wholesale rate design to accommodate a program that has not yet been, and may never be, approved. Having eliminated two of the reasons as not providing a sound basis for altering wholesale rate design, the only remaining motivation for the change in rate design seems to be that Seminole introduced the new rate design to kill "behind the meter" generation by customers of the member systems. Although killing "behind the meter" generation was the intended target, Seminole's new rate design also negatively impacts load management programs, energy conservation and economic development. In short, the change in rate structure was not a surgical strike that affected only "behind the meter" generation, but a blunt instrument that had a number of unintended side effects as well.

Q. What is the problem with changing a wholesale rate design to kill "behind the meter" generation?

A. In order to kill "behind the meter" generation, Seminole adopted a rate design in SECI-7 that significantly reduced the demand charge over a 3-year period and shifted the unrecovered production fixed costs to a charge allocated based on an average of 3-year historical energy usage. While decreasing the demand charge and increasing the energy charge makes "behind the meter" generation

economically impractical, it also discourages load management and energy conservation.

V. IMPROPER RATCHET AND MARGINAL COST PRICING

Q. Both Mr. Woodbury and Ms. Novak claim that Rates SECI-7 and SECI-7b reflect the incremental cost of capacity and that this provides proper pricing signals to members. Do you agree with their analysis?

A. No. The benefits that Mr. Woodbury and Ms. Novak claim will result from a demand charge for capacity that reflects the incremental price of capacity are really benefits that generally are ascribed to marginal cost pricing. However, the rate design advocated by Mr. Woodbury and Ms. Novak does not properly implement marginal cost pricing principles.

Q. Please explain.

A. The design of SECI-7b does not consistently apply marginal cost pricing principles. Only one element of Seminole's wholesale rate structure is based on what Seminole claims to be a marginal or incremental cost, namely the Production Demand Charge. The Transmission Demand Charge, the Distribution Demand Surcharge, and the Fuel Charge are based on average embedded cost principles. The resulting energy charge is based neither on marginal cost nor average embedded cost principles. Instead, the

energy charge is potpourri composed of average embedded energy costs plus the portion of production fixed costs that are not recovered in the Production Demand Charge. This energy charge is neither marginal nor average embedded and has no counterpart in economic theory. The following table illustrates this by summarizing the consistent application of marginal cost pricing principles and average embedded cost pricing principles and by contrasting these consistent applications to the rate design methodologies utilized in SECI-7 and SECI-7b.

Blake Table 1

Rate Component	Marginal Cost Pricing	Average Embedded Cost Pricing	Seminole Rates SECI-7 and SECI-7b
Capacity	Marginal	Average Embedded	Marginal
Energy	Marginal	Average Embedded	Average Embedded plus portion of fixed production costs
Other Factors	Marginal	Average Embedded	Average Embedded

Q. Please explain how marginal cost pricing should be consistently applied.

A. In marginal cost pricing, all elements of the price should reflect the incremental cost of supplying an additional unit of output, not just one element. Thus, wholesale rates that incorporate marginal cost design concepts would have all of the elements priced marginally, including capacity, energy and other factors.

Q. If marginal cost pricing is to be pursued, please explain why it is important to consistently apply marginal cost pricing principles and to incrementally price all components of the charges for electric service.

A. Incrementally pricing all components of the charges for electric service is essential in order to provide customers with the proper information for evaluating resource alternatives. Different resources have different capacity and variable cost characteristics. For example, gas turbines have a low capacity cost but a high variable energy cost. Hydroelectric generation has a very high capacity cost and a very low variable cost. Other generating technologies generally fall somewhere between these two extremes. Additionally, on-site generation would require no transmission costs, while the use of a central station generating plant would incur transmission costs.

Q. How would properly implemented marginal cost pricing send appropriate pricing signals to customers?

A. Properly implemented marginal cost pricing could provide customers the information necessary to compare among the resource alternatives available to them. For example, if the marginal capacity cost of a gas-fired peaking unit were $8.50/kW-mo., the incremental energy cost were 4¢/kWh, and the incremental transmission cost were $1.50/kW-mo., the customer could compare these costs to its other alternatives, such as load management, on-

site generation, or a curtailment strategy during peaks, to determine which alternative provides the most value. However, Seminole's blending of one marginal element, several average embedded elements and its use of a potpourri in the energy charge does not consistently apply marginal cost pricing principles and does not provide the proper pricing information necessary for such a comparison among alternatives.

Q. What is your understanding of the reason for Seminole's failure to properly apply marginal cost pricing principles?

A. It is important to note that a wholesale rate design that consistently applies marginal cost concepts would not assure that Seminole recovered all of its fixed costs. The reason for inconsistently applying marginal cost pricing in developing SECI-7 and SECI-7b is noted by Ms. Novak on page 20 of her testimony where she states that:

> Once the Production Demand Charge was developed to more closely reflect the incremental cost of capacity, it became necessary to develop a methodology for collecting Seminole's remaining fixed costs. (Novak testimony, p. 20, lines 21-23).

This statement reflects Ms. Novak's recognition that the consistent application of marginal cost pricing would not recover Seminole's remaining fixed costs. She noted that another methodology was needed to recover the fixed costs. The methodology that Seminole employed to recover the remaining fixed costs was not marginal cost pricing, nor was it average embedded cost pricing. The

methodology that Seminole chose to use resulted in an energy charge that combines average embedded energy costs with the portion of production fixed costs that are not recovered through the Production Demand Charge. In essence, Seminole is saying that the pricing of the energy charge really does not matter.

Q. Is it important that Seminole properly price the energy component?

A. Of course it is. The energy charge has a major impact on customer decisions regarding resource use, as demonstrated by Mr. Seelye. However, Seminole does not appear to believe that energy costs matter. In his testimony, Mr. Woodbury states that;

> The Board agreed that in a competitive market not only do Seminole's costs need to be competitive, but also the price signals that effect behavior should, to the maximum extent possible, be tied to marginal costs rather than embedded costs. (Woodbury Testimony, page 12, lines 12-15) (emphasis added).

Since capacity cost is the only component of SECI-7 and SECI-7b that Seminole attempted to price marginally, it can be inferred from the above quote that none of the other elements of price provide signals that "effect behavior." Seminole uses the energy charge as a catch-all or dumping ground for any costs that aren't recovered elsewhere. The lack of importance that Seminole places on a properly constructed energy charge also can be seen in Ms. Novak's statement that:

> Seminole considered and rejected using any demand based allocation, as it would send improper price signals and defeat

> the strategic goal of pricing demand based upon the incremental cost of capacity. (Novak Testimony, p. 21, line 24 through p. 22, line 2).

This demonstrates Seminole's focus on incremental pricing of capacity and its total lack of concern for properly pricing the energy component.

Q. In her testimony on page 15, lines 16-18, Ms. Novak accuses LCEC of cherry picking the one aspect of rate design with which it is unhappy, while accepting the benefits of the other parts of the rate design to which it agrees. Is there merit to Ms. Novak's contention?

A. No. The fact that LCEC has challenged specific elements in Rate Schedules SECI 7 and SECI-7b (i.e., the Production Fixed Energy Charge and the associated ratchet) does not constitute "cherry picking." Rather it is pointed criticism of two fundamentally flawed elements of Seminole's wholesale rate structure. In my judgment it is Seminole, not LCEC, that is cherry picking by selecting <u>one</u> marginal component, and blending it with several average embedded components and an energy charge that is a potpourri of average embedded energy and production fixed demand costs.

Q. Are there other elements of the rate design incorporated in SECI-7b that send incorrect price signals?

A. Yes. The use of a ratchet that is based on an average of 3 years of historical energy usage and calculated after a one year lag produces

an allocator that reaches back over 4 years for allocating the portion of production fixed costs not recovered through the Production Demand Charge. If a customer reduces its usage through load management or energy conservation measures, it would not begin to see this reduced usage reflected in the Production Fixed Energy Charge portion of its monthly bill for about 2 years and would not see the full effect for over 4 years.

Q. Is this use of a ratchet that reaches back over 4 years inconsistent with marginal cost pricing?

A. Yes, I believe that it is. It is inconsistent to insist that one piece of fixed production costs must reflect the incremental cost of capacity on a forward-looking basis, while the other piece of fixed production costs is allocated based on a ratchet that reaches back into time over 4 years. For Seminole to wax eloquent about the need to incrementally price generating capacity to send proper pricing signals, while at the same time incorporating what is effectively a 4 to 5 year ratchet on the approximately $54,000,000 in generating costs (Novak Testimony, p. 21, line 13) that go unrecovered by the "marginal capacity charge," seems at best to be inconsistent with marginal cost pricing principles and at worst disingenuous.

Q. Are there other problems that would be caused by the use of a more than 4 year ratchet for allocating the Production Fixed Energy Charge?

A. Yes. Because LCEC would continue to incur a share of the Production Fixed Energy Charge for almost 5 years if a customer chose to manage load, conserve energy or install on-site generation, it would be forced to file tariffs that mirror Seminole's ratchet that reaches back more than 4 years. LCEC does not want to adopt a ratchet that reaches back more than 4 years in its rates and does not feel that this is a prudent way to prepare for a competitive environment. However, in order for LCEC to protect its financial interests, it will be necessary for LCEC to pursue this course of action if the Commission approves Seminole's existing Rate SECI-7b .

Q. What has been the Commission's policy with respect to ratchets?

A. As noted in my direct testimony, the Commission has historically eliminated ratchets from electric utility rate structures because they are a disincentive to conservation. See In re: Petition of Florida Power Corporation to increase its rates and charges, Docket No. 820100-EU, Order No. 11628 (Feb. 17, 1983). Therefore, Rate SECI-7b, which incorporates a ratchet that reaches back more than 4 years, should be disapproved by the Commission.

Q. On page 7 of her testimony, Ms. Novak characterizes LCEC's position as protesting the collection of production fixed

costs through any rate component that is not based upon kW peak demands. Does Ms. Novak accurately characterize LCEC's position?

A. No. LCEC is concerned that production fixed costs are being split into two pieces: one which is being allocated based on kW peak demands, and one which is being allocated based on a ratchet that reaches back more than 4 years and is calculated based on historical kWh usage data. LCEC believes that splitting fixed production costs into these two components and allocating them in this manner is inconsistent with both marginal cost pricing and with average embedded cost pricing principles. Both the use of a ratchet that reaches back more than 4 years and the fact that the ratchet is calculated using historical kWh are concerns that LCEC is protesting.

Q. In your opinion, what rate design would you recommend as being fair and reasonable to Seminole's member systems and their customers?

A. I, and my colleague Mr. Seelye, would recommend a rate design where the production fixed costs: (i) were not separated into two components, and (ii) were allocated based on peak kW demand using traditional average embedded cost design principles. This would remove the production fixed costs from the energy charge, thus having the energy charge reflect the average embedded cost of energy. The demand charge would include what are now called the

Production Demand Charge and the Production Fixed Energy Charge and would reflect the average embedded cost of production capacity. This would result in a rate design that consistently applied average embedded cost pricing principles. As an alternative, Seminole could utilize a rate design that would consistently apply marginal cost pricing principles. However, this would require a time differentiated energy charge.

Q. On page 24, lines 9-10 of her testimony, Ms. Novak says that "Dr. Blake is incorrect when he states that generating capacity is not constructed to serve off peak kWh." Did Ms. Novak correctly summarize your testimony?

A. No. This is the classic example of creating a straw man argument that is easier to defeat rather than addressing the real argument that is considerably more difficult. I simply did not say, nor is it my argument, that generating capacity is not constructed to serve off-peak load. If I had, this would be a rather easy argument to defeat. Contrary to Ms. Novak's testimony, what I said was that Seminole does not incur additional fixed production costs as a result of kWh sales made during off-peak periods. This is consistent with what Mr. Madulla presented to the LCEC Board, as noted in Mr. Seelye's testimony. Thus, allocating a portion of fixed production costs on the basis of total kWh usage, without regard to whether the usage occurred during off-peak periods, penalizes customers that efficiently utilize service by purchasing energy during times when it

is beneficial to the system for them to do so. An energy charge constructed using average embedded cost rate design concepts already averages on-peak and off-peak energy prices, thus understating on-peak energy prices and overstating off-peak energy prices. This use of average embedded cost rate design is common in the industry and was a feature of Rate SECI-6. However, to add $54,000,000 annually to the energy charge through the Production Fixed Cost charge would add significantly to the already overstated off-peak energy prices and would penalize off-peak users of the system. LCEC has no problem with time differentiated rates that better reflect cost causation, and would support seasonally differentiated demand charges as well as time differentiated and seasonally differentiated energy charges as long as either marginal cost pricing principles or average embedded cost pricing principles are consistently applied.

VI. OTHER RATE DESIGN ISSUES

Q. On page 15 of her testimony, Ms. Novak claims that "moving from the rate structure incorporated in Rate Schedule SECI-6b to the current rate structure incorporated in Rate Schedule SECI-7b did not harm LCEC." Do you agree with her assessment?

A. No. On page 15 of her testimony, Ms. Novak states that:

> In fact, LCEC was slightly benefited by the new rate design, as average rates for 1999 were lower under Rate Schedule SECI-7 by 0.07 mills per kWh as compared to the average rates for LCEC under the rate structure underlying Rate Schedule SECI-6b. (Novak Testimony, page 15, lines 4-7).

Ms. Novak is confusing the impact of a reduced revenue requirement with the impact of a changed rate design or structure. Rate Schedule SECI-7b made two changes as compared to Rate Schedule SECI-6b. First, the revenue requirement in Rate Schedule SECI-7b is lower than the revenue requirement in Rate Schedule SECI-6b, which benefits all Seminole members including LCEC. The other difference between these two rates is the rate design methodology employed and the resulting rate structure. Rate Schedule SECI-6b employs a traditional average embedded cost rate design methodology while Rate Schedule SECI-7b radically departs from the traditional design concept and instead consists of a capacity charge based on a marginal cost rate design, several components based on average embedded cost rate designs and an energy charge that is a potpourri of elements and which reflects neither marginal cost pricing nor average embedded cost pricing principles. For any given level of revenue requirement, the rate design reflected in Rate Schedule SECI-7b does harm LCEC, contrary to Ms. Novak's assertion. If the revenue requirement were the same for Rates SCEI-6b, SECI-7 and SECI-7b, the rate design incorporated in Rate SECI-7 would produce higher delivered cost per kWh for LCEC than would SECI-7b, and both SECI-7 and

SECI-7b would produce higher delivered cost per kWh for LCEC than SECI-6b. Thus, Ms. Novak's statement that LCEC is benefited by the new rate design is incorrect.

Q. Describe the member support for the new, lower revenue requirement and contrast this with the support for the new rate design?

A. Mr. Woodbury's testimony provides an indication of the difference in member support for the new, lower revenue requirement as compared to support for the new rate design. The vote on the rate design or rate structure in SECI-7 passed by a vote of 11 to 7 (Woodbury Testimony, p. 19, line 12) and the vote on the rate structure in SECI-7a passed by a vote of 9 to 8 (Woodbury Testimony, p. 23, line 21). This indicates a slim majority for the rate design change when considered alone. However, when the reduced revenue requirement and the changed rate design are bound together in Rate SECI-7, the new rate passed with only 2 negative votes. I would interpret this as considerable enthusiasm for the new revenue requirement and lukewarm enthusiasm for the new rate design.

Q. Ms. Novak claims that Rate SECI-7b is not that much different than SECI-6b. Do you agree with her analysis?

A. No. Ms. Novak tries to give the impression that the changes between Rate Schedule SECI-6b and SECI-7b are minimal and that

adopting Rate SECI-7b was no big deal. However, Rate SECI-7b recovers about $54,000,000 in production fixed costs through an energy charge and incorporates a flawed rate design methodology that misapplies marginal cost pricing and average embedded cost pricing concepts. Rate SECI-7b also introduces a ratchet that reaches back 4 years for allocating the Production Fixed Energy Charge. This ratchet utilizes historic energy usage for allocating capacity related costs. Regardless of the size of the change, the change moves Seminole and its member companies in the wrong direction to prepare for competition.

Q. Please explain.

A. By increasing, rather than reducing, the rate tilt, the subsidy paid by large customers and received by small customers will increase under rate SECI-7b relative to SECI-6a due to the recovery of additional fixed costs through every kWh that customers purchase. Thus, LCEC will be in a worse position to retain and attract large, high load factor customers. The competitive battles are likely to be fought over high load factor customers with large kWh purchases, not over small usage customers with low load factors. Increasing the subsidy paid by high load factor customers with large kWh purchases is not a prudent way to prepare for competition and increases the likelihood of losing such customers to alternative energy suppliers. Furthermore, after increasing the risk of losing customers, the ratchet that reaches back more than 4 years ensures

that the financial impact of this loss will be principally borne by LCEC and the other member systems. By way of comparison, the rate design in SECI-6b would not increase the risk of losing high load factor customers with large kWh usage and would not shift the financial burden of losing a customer from Seminole to LCEC.

Q. What course of action do you recommend that the Commission pursue in this proceeding?

A. I recommend that the Commission assert authority over Seminole's rate structure. I also recommend that, the Commission should disapprove rate SECI-7b and require Seminole to implement a rate design that would recover all production fixed costs through the Production Demand Charge and eliminate the Production Fixed Energy Charge. This would make Seminole's rate design consistent with average embedded cost pricing principles. Alternatively, the Commission should disapprove the rate design contained in Seminole's SECI-7b and should order Seminole to file a rate design that consistently reflects marginal cost pricing concepts. However, as I have stated, a rate design based on marginal cost pricing will require a time differentiated energy charge.

Q. Does this conclude your rebuttal testimony?

A. Yes.

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