

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Complaint of Allied Universal)
Corporation and Chemical Formulators,)
Inc. against Tampa Electric Company)
for violation of Sections 366.03,)
366.06(2) and 366.07, Florida Statutes,)
with respect to rates offered under)
Commercial/Industrial Service Rider tariff;)
petition to examine and inspect confidential)
information; and request for expedited)
relief.)
_____)

Docket No. 000061-EI

REBUTTAL TESTIMONY

OF

DR. CHARLES F. PHILLIPS, JR.

ON BEHALF OF

ALLIED UNIVERSAL CORPORATION

AND

CHEMICAL FORMULATORS, INC.

January 22, 2001

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FPSC-REG-REG. REPORTING

1 **Q.** Please state your name and give your business address.

2 **A.** My name is Charles F. Phillips, Jr. My business address is 414 Morningside
3 Drive, Lexington, Virginia 24450.

4 **Q.** What is your occupation?

5 **A.** I am the Robert G. Brown Professor of Economics at Washington and Lee
6 University, where I have been teaching since the fall of 1959. My teaching
7 duties include courses in macro- and micro-economics, industrial
8 organization, economic regulation, and the corporation and society.

9 **Q.** What is your educational background?

10 **A.** I received my B.A. in Economics from the University of New Hampshire in
11 1956 and my Ph.D., also in Economics, from Harvard University in 1960.

12 **Q.** What is your experience in the area of public utility economics?

13 **A.** In addition to my teaching responsibilities at Washington and Lee University,
14 I have taught at several company-sponsored executive development programs
15 (e.g., American Electric Power System, InterNorth, Inc., Panhandle Eastern
16 Pipe Line Company) and have given papers on various regulatory issues at
17 numerous conferences and symposiums (e.g., American Bar Association,
18 Great Lakes Conference of Public Utilities Commissioners, Public Utilities
19 Reports, Inc.). For many years, I was a faculty member of the "Public Utility
20 Executive Program," held annually at The University of Michigan, and took
21 part in the semi-annual public utility financial seminars sponsored by the
22 Irving Trust Company (now The Bank of New York).

1 My published research in the area of public utility regulation includes *The*
2 *Economics of Regulation* (1965; revised edition, 1969) and *The Regulation of Public*
3 *Utilities* (1984; second edition, 1988; third edition, 1993), nine edited volumes, and
4 over a dozen journal articles. I have done consulting work for over four dozen public
5 utilities, and for oil pipelines, the State of Alaska, the Virginia State Corporation
6 Commission, and the Wisconsin Public Service Commission. I have testified before
7 Federal and state regulatory commissions in over 195 cases, primarily on cost of
8 capital or rate structure issues. I have previously testified before the Florida Public
9 Service Commission on behalf of Tampa Electric Company ("TECO").

10 A more complete description of my background and experience is set
11 forth in Exhibit No. __ (CFP -1), Pages 1-4.

12 **Q. On whose behalf are you testifying in this proceeding?**

13 A. I am testifying as a consultant on behalf of Allied Universal Corporation
14 ("Allied") and its affiliate, Chemical Formulators, Inc. ("CFI").

15 **Q. What is the purpose of your testimony?**

16 A. The purpose of my testimony is: (1) to identify and attribute economic values
17 to the differences in TECO's responses to the requests of Allied/CFI and of
18 Allied/CFI's business competitor, Odyssey Manufacturing Company
19 ("Odyssey"), for rates under TECO's Commercial/Industrial Service Rider
20 ("CISR") tariff; (2) to identify the economic consequences of those
21 differences to Allied/CFI, to Odyssey, and to TECO's ratepayers; and(3) to
22 determine whether Allied/CFI and Odyssey were similarly situated with

1 respect to their requests for CISR tariff rates, within the meaning of TECO's
2 fundamental obligation as a public utility to avoid undue discrimination.

3 **Q. Do you agree with the statement of TECO witness William R. Ashburn**
4 **(at page 3, lines 16-17 of his direct testimony) that TECO's offers to**
5 **Allied/CFI and to Odyssey were not substantially different?**

6 **A.** No. In fact, the two offers were substantially and significantly different.

7 **Q. Please identify the differences in the offers.**

8 **A.** There are three obvious differences. First, Odyssey's initial rate (before taxes
9 and fees) was [REDACTED] MWH, compared with Allied/CFI's proposed initial rate
10 (before taxes and fees) of [REDACTED] MWH. Second, Odyssey's Contract Service
11 Agreement ("CSA") with TECO contained [REDACTED]

12 [REDACTED]

13 [REDACTED] Third, although both
14 Odyssey's CSA and the offer to Allied/CFI state an annual escalation rate of
15 [REDACTED] percent, the escalation rate under Odyssey's CSA was [REDACTED]

16 [REDACTED] while Allied/CFI's offered annual escalation
17 rate was [REDACTED]

18 [REDACTED]

19 **Q. Can you attribute an economic value to each of these differences?**

20 **A.** An economic value can be easily calculated with respect to the first and third
21 differences, but it is more difficult to compute an economic value for the
22 second difference.

1 One consequence of the first difference is that the initial rate is 7.5
2 percent higher for Allied/CFI than for Odyssey. Stated another way, at the
3 very outset, Odyssey enjoys a [REDACTED] percent cost advantage for electricity over
4 Allied/CFI. The Odyssey rate escalates annually at [REDACTED]

5 [REDACTED]
6 [REDACTED]

7 Assuming that both Odyssey and Allied use [REDACTED] over the
8 [REDACTED] of the initial contracts Allied/CFI would pay a total of just over [REDACTED]
9 [REDACTED] more for electricity than Odyssey would pay.

10 Adequate data is unavailable to calculate an economic value for the
11 second difference. However, the fact that these terms of Odyssey's CSA have
12 significant economic value can be seen in the fact that TECO's largest
13 industrial customer requested a special contract rate that would include a
14 [REDACTED] [See, Order No. PSC-
15 01-0104-PAA-EI issued January 17, 2001 in Docket No. 001287-EI, denying
16 approval of special contract between TECO and IMC Phosphates.]

17 **Q. Why did you not use in your comparison of initial rates the [REDACTED] MWH**
18 **rate for Allied/CFI stated in Mr. Ashburn's supplemental testimony?**

19 **A.** The only rate offer communicated to Allied/CFI in the negotiations with
20 TECO was [REDACTED] MWH, as stated in the rebuttal testimony of Allied/CFI
21 witness James W. Palmer. The attempted revision was made in Mr.
22 Ashburn's supplemental testimony one year after TECO's offer was made to

1 Allied/CFI, ten months after Allied/CFI's Complaint was filed, six months
2 after Mr. Ashburn first prepared the rate comparison which is Exhibit A to his
3 direct testimony, and three months after Mr. Ashburn's direct testimony was
4 filed, and was not communicated to Allied/CFI during their negotiations in
5 1999.

6 **Q. What are the economic principles that generally are used to determine**
7 **whether contract or negotiated rates are justified by providing benefits**
8 **to a utility's ratepayers?**

9 **A.** To provide economic benefits to a utility's ratepayers, contract or negotiated
10 tariffs must, "at a minimum, recover all variable and customer-specific fixed
11 costs over the life of the contract. Revenue in excess of direct fixed and
12 variable costs will contribute to the utility's common costs which otherwise
13 would be shared by other ratepayers and shareholders." [Edwin A Rosenberg
14 et al., *Contract Pricing of Electric and Telephone Service: Current Practice*
15 *and Policy* (Columbus, Ohio: National Regulatory Research Institute, 1992),
16 p. 28.]

17 **Q. Do you agree with Mr. Ashburn's statement (at page 4, lines 17-19 of his**
18 **direct testimony) that the electric service retained or attracted by the**
19 **CISR tariff rate must provide benefits to the general body of ratepayers**
20 **and must be determined by TECO to have been truly "at risk"?**

21 **A.** Yes. Those are the two major conditions discussed in the Commission's
22 Order approving the CISR tariff. Order No. PSC-98-1081-FOF-EI, provides:

1 "TECO will conduct specific analyses for each CISR customer to calculate
2 the net benefits to the general body of ratepayers....As long as the revenues
3 exceed the costs, the general body of ratepayers will benefit." The Order
4 further provides: "Customers must make a written request to TECO for
5 service under the CISR and must provide ... documentation demonstrating
6 that the applicant has a viable lower cost alternative to taking service from
7 TECO."

8 **Q. Did Odyssey meet the second requirement by demonstrating that it had**
9 **a viable lower cost alternative to taking service from TECO?**

10 A. No. The deposition testimony of Odyssey witness Stephen W. Sidelko and
11 the rebuttal testimony of Allied/CFI witness Peter DeAngelis reflect that
12 Odyssey had not considered any viable lower cost alternative to taking
13 service from TECO.

14 **Q. Has TECO's offer of CISR tariff rates to Odyssey provided economic**
15 **benefits to TECO's ratepayers?**

16 A. Presumably, yes. The offer made to Odyssey resulted in TECO attracting what
17 is described in the deposition testimony of Odyssey witness Patrick Allman
18 (at pages 23-24) as an ideal customer with a large steady load. According to
19 Mr. Ashburn's supplemental direct testimony, the benefit-to-cost ratio
20 ("BCR") of Odyssey's CSA is [REDACTED] A BCR greater than 1.0 reflects TECO's
21 determination that a negotiated CISR tariff rate is beneficial to TECO's

1 ratepayers, as stated in an internal TECO memo dated May 6, 1999, a copy of
2 which is attached to my testimony as Confidential Exhibit __ (CFP-2).

3 However, I do not have sufficient information from TECO to verify
4 their calculation of the BCR for Odyssey because the information necessary
5 for that calculation has been ordered to be withheld from disclosure to
6 Allied/CFI. In particular, values for [REDACTED]
7 [REDACTED]
8 [REDACTED]
9 [REDACTED] and values for TECO's actual versus its estimated fuel
10 costs, would be necessary.

11 Additionally, there is some question concerning the values placed on
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]

18 **Q. Has TECO's offer of CISR tariff rates to Allied/CFI provided economic**
19 **benefits to TECO's ratepayers?**

20 **A. No. The offer to Allied/CFI failed to attract what would have been a second**
21 **ideal customer with a large steady load, and thereby denied TECO's ratepayers**

1 the presumed economic benefits that would have been provided if the offer
2 had been acceptable to Allied/CFI.

3 **Q. What offer would have been acceptable to Allied/CFI?**

4 A. It is my understanding that the offer to Allied/CFI of the identical rates, terms
5 and conditions in Odyssey's CSA would have been acceptable to Allied/CFI.
6 At least by all accounts, that is the offer that Allied/CFI's Mr. Namoff
7 repeatedly requested.

8 **Q. Would the offer to Allied/CFI of the identical CISR tariff rates, terms and**
9 **conditions offered to Odyssey have provided economic benefits to**
10 **TECO's ratepayers?**

11 A. Again presumably, yes. There is a caveat stated in one of the TECO
12 documents, in a handwritten note apparently made by Mr. Rodriguez in
13 connection with a presentation to members of TECO's Allied/CFI project
14 team, that reads: "Discrimination-Had capacity Bleach 1-may not here." A
15 copy of that document is attached to my testimony as Confidential Exhibit
16 (CFP-3). If TECO could not achieve a BCR of greater than 1.0 for service to
17 Allied/CFI's proposed new plant on terms as stated in Odyssey's CSA, e.g.
18 because it did not have the capacity to meet Allied/CFI's service requirements,
19 then the rate offered to Allied/CFI would have to be increased to achieve a
20 BCR greater than 1.0. However, I have seen no evidence that suggests that
21 TECO could not have achieved a BCR of greater than 1.0 for service to
22 Allied/CFI's proposed new plant on the same terms as those agreed to with

1 Odyssey. As between two business competitors such as Allied/CFI and
2 Odyssey who are similarly situated with respect to their service requirements,
3 TECO's rates for electric service should differ only by the absolute amount of
4 the difference in TECO's incremental cost to serve the two customers. [See,
5 *In re Electric Restructuring* (Nevada Public Service Commission 1996), 172
6 PUR 4th 35, 39.]

7 **Q. Would the offer to Allied/CFI of the CISR tariff rates, terms and**
8 **conditions offered to Odyssey have provided economic benefits to**
9 **Allied/CFI?**

10 **A.** Yes. By offering the same terms to Allied/CFI as those which had been
11 negotiated with Odyssey, the two companies would have been placed on an
12 equal footing with respect to electricity costs. Such a result is critical because
13 the two companies are competitors and because electricity represents nearly
14 one half of their operating costs. Put another way, TECO would have been
15 neutral with respect to the two competitors if it had offered each an identical
16 CISR tariff. By negotiating a lower initial rate with Odyssey, TECO was
17 placing Allied/CFI at a competitive disadvantage.

18 **Q. As between TECO's ratepayers, Allied/CFI, and Odyssey, which parties**
19 **received an economic advantage and which parties received an economic**
20 **disadvantage from TECO's offer to Allied/CFI?**

21 **A.** Odyssey is the only party that received any economic advantage from TECO's
22 offer to Allied/CFI. TECO's ratepayers and Allied/CFI received economic

1 disadvantages from TECO's offer to Allied/CFI. The economic disadvantage
2 to Allied/CFI begins with the fact that TECO's offer put Allied/CFI at a
3 significant cost disadvantage relative to Odyssey, with the result that the plant
4 was not built. The disadvantage to TECO's ratepayers resulted from the lost
5 benefits they would have received if TECO had attracted Allied/CFI's at-risk
6 load. Additionally, consumers of Allied/CFI's and Odyssey's products were
7 disadvantaged by the discrimination in TECO's offer to Allied/CFI, although
8 I understand that this issue is not before the Commission.

9 **Q. As between TECO's ratepayers, Allied/CFI, and Odyssey, who would**
10 **have received an economic advantage and who would have received an**
11 **economic disadvantage if TECO had offered the same CISR tariff rates,**
12 **terms and conditions to Allied/CFI in June 1999 that TECO had agreed**
13 **to with Odyssey in September 1998?**

14 **A.** None of the three parties would have received any economic disadvantage if
15 TECO had offered the same terms to Allied/CFI as it had agreed to with
16 Odyssey. TECO, moreover, would have been neutral with respect to granting
17 an economic advantage to either one of the two competitors and would have
18 had two "ideal" CISR tariff customers.

19 **Q.** **Were Allied/CFI and Odyssey similarly situated with respect to their**
20 **requests for CISR tariff rates?**

21 **A.** Yes. It is my understanding that such factors as the service requirements and
22 load profiles of the two plants, TECO's incremental cost to serve the two

1 plants, and the potential revenues to TECO for service to Allied/CFI's plant
2 on the same terms as those agreed to with Odyssey, were essentially identical.
3 Of critical importance is the fact the two companies are business competitors
4 with respect to their customers, products and markets, such that TECO's
5 discrimination in favor of one and against the other would be expected to put
6 the disfavored company at a competitive disadvantage.

7 **Q. Do contract or negotiated tariffs, such as TECO's CISR tariff, raise**
8 **questions of undue discrimination?**

9 **A.** Yes, such tariffs always raise such questions, which is why they have been
10 used sparingly. Whenever one or more companies are removed from a general
11 rate category and special rates are negotiated, the potential for discrimination
12 arises. Many commissions, in approving similar tariffs, have acknowledged
13 that fact. The issue was of concern to Commissioners Clark and Garcia in
14 Docket No. 951161-EI. [See In re Petition for approval of proposed optional
15 Commercial/Industrial Service Rider by Gulf Power Company, March 7,
16 1996, pp. 89-96.] However, the tariffs have been found by these commissions
17 to be "in the public interest" since they promote specific economic and/or
18 social objectives (*i.e.*, prevent loss of load, promote economic development).

19 **Q. Do you agree with the statement in Mr. Ashburn's direct testimony (at**
20 **page 7, lines 307) that TECO is under no obligation to provide the same**
21 **CISR tariff rate offer to two customers in the same industry?**

1 A. No. His position, I believe, is poor public policy because it ignores the
2 fundamental obligation of a public utility to avoid undue discrimination
3 between its customers. In the present instance, the disparity in the initial rates
4 and escalation terms offered to Odyssey and to Allied/CFI places Allied/CFI
5 at a competitive disadvantage with respect to the cost of its most essential
6 input, with a total value of those two differences alone over the [REDACTED]
7 periods of the contracts of approximately [REDACTED] No public utility
8 should have that authority or power. Indeed, economic regulation was
9 undertaken in part to prevent just such price discrimination. [See, Charles F.
10 Phillips, Jr., The Regulation of Public Utilities (3rd Ed. 1993) p.69-70.]
11 Because the two companies are similarly situated with respect to their requests
12 to TECO for CISR tariff rates, TECO should be prohibited from negotiating
13 two different CISR tariff rates and, thereby, favoring one competitor over the
14 other.

15 **Q. If TECO has the obligation to avoid undue discrimination in offering**
16 **CISR tariff rates as between two similarly situated competitors in the**
17 **same industry, does this obligation impair TECO's ability to negotiate**
18 **CISR tariff rates with any other qualifying applicant?**

19 A. No. TECO is under no obligation to offer the same CISR tariff rates to two
20 qualifying applicants who are not business competitors of each other,
21 regardless of the similarity of their service requirements, because the

1 consequence of TECO's discrimination in the rates offered would have no
2 effect on competition for the companies' products.

3 **Q. Does this obligation compromise TECO's ability to maintain the**
4 **confidentiality of information submitted by the applicants demonstrating**
5 **their qualifications for CISR tariff rates?**

6 A. No. A qualifying applicant would have no standing to challenge the
7 confidentiality of information submitted by another qualifying applicant
8 unless the two applicants were business competitors and the second qualifying
9 applicant was not offered non-discriminatory rates compared to the rates
10 accepted by the first.

11 **Q. With respect to Issue 1 in this proceeding, is it your opinion that TECO**
12 **has acted in violation of its CISR tariff, Commission Order No. PSC-98-**
13 **1081A-FOF-EI, and those sections of the Florida Statutes which prohibit**
14 **undue discrimination by a public utility, in TECO's response to**
15 **Odyssey's request for CISR tariff rates?**

16 A. Yes. The evidence is that Odyssey had not qualified for the offer of CISR
17 tariff rates because it had not demonstrated that it had a viable lower cost
18 alternative to taking service from TECO.

19 **Q. With respect to Issue 2 in this proceeding, is it your opinion that TECO**
20 **has acted in violation of its CISR tariff, Commission Order No. PSC-98-**
21 **1081A-FOF-EI and those sections of the Florida Statutes which prohibit**

1 undue discrimination by a public utility, in TECO's response to
2 Allied/CFI's request for CISR tariff rates?

3 A. Yes. TECO's response to Allied/CFI's request for service to what was
4 essentially an identical second and ideal customer, clearly was in violation of
5 TECO's obligation to avoid undue discrimination.

6 **Q. With respect to Issue 3 in this proceeding, is it your opinion that the**
7 **differences between the rates, terms and conditions stated in TECO's**
8 **letter of October 18, 1999, to Allied and those agreed to between TECO**
9 **and Odyssey constitute a violation of relevant Florida Statutes, the**
10 **requirements of Commission Order No. PSC-00-1081A-FOF-EI, or the**
11 **CISR tariff?**

12 A. Yes, for the reasons I have stated above.

13 **Q. In your opinion, what actions should the Commission take with respect**
14 **to Odyssey, Allied/CFI and TECO?**

15 A. The Commission should suspend Odyssey's CSA based on its noncompliance
16 with the CISR tariff requirements, and should order TECO to offer to
17 Allied/CFI CISR tariff rates, terms and conditions appropriate to the service
18 requested by Allied/CFI. At a minimum, TECO's offer to Allied/CFI must not
19 place Allied/CFI at a competitive disadvantage to Odyssey with respect to the
20 cost of electric service.

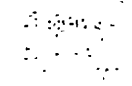
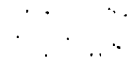
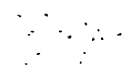
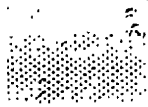
21 **Q. Does this complete your rebuttal testimony?**

22 A. Yes, it does.

Allied/CFI
Docket No. 000061-EI
Prefiled Rebuttal Testimony of Dr. Charles F. Phillips, Jr.
Confidential Exhibit __ (CFP-2)

1095-0

Allied/CFI
Docket No. 000061-EI
Prefiled Rebuttal Testimony of Dr. Charles F. Phillips, Jr.
Confidential Exhibit __ (CFP-3)



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