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September 24, 2001

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VIA HAND DELIVERY

Blanca S. Bayo, Director
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4075 Esplanade Way
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Re: Docket No.: 010283-EI

Dear Ms. Bayo:

On behalf of Florida Industrial Power Users Group (FIPUG), enclosed for filing and distribution are the original and 15 copies of the following:

- The Florida Industrial Power Users Group's Post Hearing Statement of Issues and Positions and Post Hearing Brief.

Please acknowledge receipt of the above on the extra copy of each and return the stamped copies to me. Thank you for your assistance.

Sincerely,

Vicki Gordon Kaufman

Vicki Gordon Kaufman

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Calculation of gains and appropriate regulatory treatment for non-separated wholesale energy sales by investor-owned electric utilities	))))))	Docket No. 010283-EI Filed: September 24, 2001

THE FLORIDA INDUSTRIAL POWER USERS GROUP'S

POST HEARING STATEMENT OF ISSUES AND POSITIONS

AND POST HEARING BRIEF

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PRELIMINARY STATEMENT

Pursuant to rule 28-106.215, Florida Administrative Code, the Florida Industrial Power Users Group files its Post-Hearing Statement of Issues and Positions and its Post-Hearing Brief.[1]

INTRODUCTION

Conditions today in the electric market are very different than they were in the 1970s and 1980s. Today retail customers find themselves in a situation where capacity is tight and monopoly utilities are able to take advantage of higher wholesale pricing in a larger geographical area (including selling out of state). (Tr.167-168). Thus, it is more important than ever that the Commission appropriately monitor off-system wholesale sales to ensure that any such sales being made are in the retail ratepayers' best interest.

As this Commission is well aware, FIPUG has long opposed the payment of "incentives" to utilities for engaging in behavior which they should be pursuing because it benefits the ratepayers who are responsible for the costs of the plants in retail rate base. However, in the matter at issue in this docket, the Commission has decided otherwise and has determined that it will pay utilities an incentive for engaging in such behavior. The point of this case, as discussed in more detail below, is that ***such incentives surely should only be paid for behavior which benefits retail ratepayers***. If a utility engages in a transaction which results in a ***loss***, it would be entirely inappropriate for the utility to be ***rewarded*** for such behavior. And FIPUG wants to be clear on this point--what it suggests is not that the utility be penalized for its wrong decision, but simply that ***it not be rewarded***

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[1]The following abbreviations are used in this brief. The Florida Industrial Power Users Group is called FIPUG. The Florida Public Service Commission is referred to as the Commission. Florida Power & Light Company is designated FPL. Florida Power Corporation is called FPC. Tampa Electric Company is referred to as TECo. Gulf Power Company is called Gulf.

when retail customers are required to pay more because the utility is buying and selling simultaneously in the wholesale market.

The issue of whether or not utilities should receive an incentive for engaging in behavior which is beneficial to ratepayers is a debate which has been ongoing for some years before the Commission. In the predecessor to this docket (Docket No. 991779-EI), the Commission considered the question of whether it should eliminate the incentive paid to utilities for engaging in non-separated off-system sales made using retail ratepayer assets at times when there is excess capacity. FIPUG and Staff argued that no such incentive was necessary or should be paid but, after a hearing, the Commission decided to continue the incentive, although the manner in which it was to be calculated was changed slightly. That final decision is set out in Order No. PSC-00-1744-PAA-EI.

The decision on continuing the incentive was included in that Order as final action because it was the result of an evidentiary hearing. However, the Order also contained a Proposed Agency Action (PAA) portion (Part III) which dealt with the calculation of the gains and appropriate regulatory treatment. FIPUG protested this portion of the order because there had been no hearing on the calculations themselves and what types of transactions would or would not be included in such calculations.

The PAA portion of the order found several things. First, it found that not all utilities were calculating total gains in the same way for similar sales and FIPUG agrees that there needs to be uniformity among the utilities in making the gains calculation. Second, the Order found that in measuring the costs, the costs should be measured on an incremental basis. Third, the Order found that utilities should measure the gain on these sales by subtracting incremental cost from revenue received.

The Order then made four explicit findings about the treatment of these gains. The first finding stated that "each IOU shall credit its fuel and purchased power cost recovery clause for an amount equal to the *incremental fuel cost of generating the energy for each such sale*." The problem with this language appears to be in the way the utilities are interpreting it. Apparently, only in the instance in which power is purchased to cover an emergency situation do the utilities consider that higher cost purchased power to be on the increment. If power is purchased in advance because the utility believes (due to forecasted weather or other conditions) that it will be needed and then finds it has a surplus, so that it must sell that power for less than it bought it for[2], the utility still insists that ratepayers not only pick up the entire tab, but that the utility actually receive an incentive for this behavior. This approach actually ***rewards*** the utility when it makes forecasting errors! Customers bear all of the risk of forecasting errors. There is no disincentive for mistakes. If utilities receive an incentive even when there is a forecasting mistake, the incentive induces overly aggressive rather than prudent wholesale marketing. FIPUG suggests that this is not the signal the Commission wishes to send to utilities. If a utility must purchase power to meet retail demand, the cost of that purchased power must be factored into the calculation of incremental cost; in other words, that high priced purchased power ***is*** the incremental cost.

Further, in the situation where the utility cannot find power to cover both its wholesale commitments and must either interrupt interruptible customers or buy through for them, a credit from the wholesale sale should be given to those retail customers. As Mr. Kordecki explained at hearing,

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[2]The utilities refer to this as "must take" power and argue that if they did not get an incentive to sell it in circumstances where they did not need it, the ratepayers would pick up the entire tab. FIPUG suggests that if this were to occur, the Commission might want to closely scrutinize such behavior.

interruptible customers are in place to help the utility meet the needs of its other ***retail*** customers (and in emergency situations, the needs of other utilities' ***retail*** customers), not to be interrupted so that the utility can pursue off-system wholesale sales.

The other finding which FIPUG believes requires clarification is the finding regarding the calculation of O & M costs on wholesale sales. The Order provides that: "Each IOU shall credit its operating revenues for an amount equal to the incremental operating and maintenance (O & M) cost of generating the energy for each such sale." Because O&M costs are very difficult to quantify, it is FIPUG's position that *all* O&M expense charges (as opposed to just incremental) should be credited back to the appropriate clause to ensure that the utility does not recover these costs twice.

ARGUMENT

ISSUE 1

WHAT IS THE APPROPRIATE REGULATORY TREATMENT FOR SO^2 EMISSION ALLOWANCES ASSOCIATED WITH NON-SEPARATED WHOLESALE ENERGY SALES?

FIPUG's Position: *This issue has been stipulated.*

ISSUE 2

WHAT IS THE APPROPRIATE REGULATORY TREATMENT FOR THE COST OF FUEL AND PURCHASED POWER ASSOCIATED WITH NON-SEPARATED WHOLESALE ENERGY SALES?

FIPUG's Position:* If there are any purchased power costs which are higher than the marginal costs of a utility's own units, such cost should be included in the cost of the wholesale sale. When purchased power cost is the highest cost on the utility's system, it is the incremental cost.*

The question this issue addresses is actually fairly simple: when should utilities receive a reward for engaging in off-system wholesale sales from assets supported by retail ratepayers?

Should they receive a reward any time they engage in such sales or only when the sale results in a benefit to retail ratepayers? The answer should be obvious--the Commission, through the incentive mechanism it has previously approved, wants to encourage behavior that ***benefits*** ratepayers; therefore, the ***only*** type of behavior for which the utility should receive a reward is one that results in benefits for the ratepayers. (Tr. 163). To reach this goal, ***all*** the costs of a wholesale sale must be considered. (Tr 170). When a utility lacks capacity to meet the demand of its retail customers because it has entered into a non-separated wholesale transaction, the cost of replacement power is not to serve retail customers, but must be considered a cost of the wholesale transaction, exclusive of other costs involved in the transaction. (Tr. 170). Therefore, any time power is being purchased to serve retail customers and that cost of such purchase is higher than native generation, that cost ***is*** the incremental cost and must be used in the gains calculation. While there apparently is agreement on this principle in the abstract, the problem arises in its application by the utilities.

There does appear to be at least one scenario as to which all the utilities agree that the cost of purchased power should be used as the incremental cost. When a unit is taken off line due to an unforseen forced outage and the utility must purchase power to serve its retail load, all the utilities agree that the incremental cost is that highest purchased power cost. (Tr. 36). Thus, this scenario should be incorporated into the final order in this case so that it is clear that all utilities must use purchased power as the incremental cost in this situation.

The next scenario the Commission must address occurs when a utility purchases power in advance because it thinks the weather will be hotter than normal or because there is some other forecasted circumstance which it believes will result in the need for additional power. In that situation, which the utilities term "must buy", the forecasted situation may not actually occur. The

utility then finds itself with "excess" power it does not need and should sell that power if it can. When a utility makes a sale in this situation, it often does so at a loss; that is, it sells the purchased power for less than it paid for it. Incredibly, when that occurs, the utilities actually want to receive a ***reward*** for selling the power at a loss! The Commission should reject such a bizarre "incentive" system.[3]

FIPUG does not suggest that the utilities should not engage in the behavior described above. They must plan their system based on their best forecast of upcoming events. However, as everyone knows, sometimes events do not materialize as forecasted--it may rain when hotter weather was previously forecast. In such cases, the utility should not be rewarded for its incorrect choice.[4] It should be made whole, but not rewarded. (Tr. 210). As Ms. Jordan admitted at hearing, this proposal poses ***no risk*** to the utilities (Tr. 237); they are made whole for the transactions. However, when a utility makes a sale under such circumstances, it should not receive an incentive for it. Rewarding a utility for this type of behavior encourages the utility to make very conservative purchases, treat those as zero cost, and then sell the power at a lower cost than the cost of the purchase, thus receiving a larger gain for the transaction. (Tr. 192-193).

The utilities attempt to confuse this issue in two ways. First, they characterize the transaction as a "must take" transaction, meaning that the utility has entered into the transaction and has no choice but to take the power. (Tr. 127-128). FIPUG does not disagree. However, the fact that the

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[3]Even TECo's Ms. Jordan admitted that TECo would make the sale in that situation in the absence of an "incentive." (Tr. 242).

[4]Despite the utilities' claims otherwise, this is ***not*** an issue of prudence or imprudence, but is simply a question of whether the Commission wants to ***reward*** a utility when it makes a purchase that results in a loss to the ratepayer.

utility "must take" the power and then sell it because it does not need it does not mean that selling off that power at a later point in time is the type of behavior that should be "rewarded."[5] It clearly has resulted in a loss to ratepayers.

Second, the utilities confuse "economic dispatch" with the incentive system the Commission put in place in Order No. PSC-00-1744-PAA-EI. How a utility dispatches its systems has ***no*** relation whatsoever to whether it should receive a reward for entering into a particular wholesale transaction. The utilities should, of course, use economic dispatch in running their systems. The use of economic dispatch may result in that "must take" purchase being dispatched earlier in the dispatch order than other resources. However, that does not mean that making that wholesale purchase was the right choice nor does it mean that a reward should be given for a purchase that actually ends up costing the ratepayers more money than if the utility had make the correct choice. In such situations, the higher cost purchased power is the incremental cost and should be used to calculate any gains. (Tr. 177).

Finally, interruptible customers should ***not*** be used as a resource to allow a utility to make an off-system wholesale sale. As admitted by TECo, it interrupts (or buys through) for its interruptible customers while engaging in off-system transactions. It is clear that under certain circumstances, utilities can make much more money selling power on the wholesale market than serving their interruptible customers. While, for example, TECo interruptible customers pay some $30 to $40 per megawatt hour, under certain circumstances, prices in the wholesale market can spike up to several hundred dollars per megawatt hour, (Tr. 112-113); thus, interruptible customers are

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[5]TECo argues that FIPUG's only purpose here is to reduce the size of the incentive for which the utility is eligible. However, FIPUG's purpose is to ensure that any incentive that is paid is appropriately calculated and incents behavior which is beneficial to retail ratepayers.

being interrupted for economic reasons.[6]

Interruptible customers are retail ratepayers; when they agreed to take service on the interruptible rate schedule, they knew that they might be interrupted so that firm service to retail ratepayers could continue in times of emergencies. However, it was certainly not part of the regulatory bargain that they would be interrupted to support a wholesale sale, particularly where the sale is made at a much lower price than the price of the buy through power imposed upon interruptible retail customers. (Tr. 201-02).[7]

ISSUE 3

WHAT IS THE APPROPRIATE REGULATORY TREATMENT FOR THE OPERATION AND MAINTENANCE (O & M) EXPENSES ASSOCIATED WITH NON-SEPARATED WHOLESALE ENERGY SALES?

FIPUG Position: *The Commission should not permit double collection of costs. No O & M costs collected from wholesale customers should be kept by the utility when those costs are already part of base rates. No revenue recovered as O & M costs should be considered part of the gain but should be flowed back to ratepayers.*

Several things became very obvious at hearing regarding the utilities' calculation and collection of O & M costs related to a wholesale sale. First, none of the utilities are calculating O & M expenses in the same way. (See Exhibit No. 2.) And some utilities, such as FPC, do not track them at all. (Tr. 37-38). Second, and related to the first point, is that the amounts the utilities assess

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[6]While TECo said it would not interrupt an interruptible customer to make a nonfirm sale, it admitted that it was aware of no tariff or law that would be violated if it did so. (Tr. 123). However, TECo information as to how it deals with such transactions is not available for examination to verify TECo's claims. (Tr. 124125). TECo also has the curious situation of selling power to its affililate, Hardee Power Partners, at $32.76/megawatt hour while purchasing power from Hardee at $53.82/megawatt hour. (Tr. 152).

[7]The customers affected by this policy are not only interruptible customers, but all nonfirm customers. (Tr. 203).

as being associated with O&M expenses vary vastly between the utilities. For example, FPL, by far the largest of the four utilities, had no such expenses in 1998 and only $951,765 worth of such expenses in 2000. In contrast, TECo recorded $1.3 million of such expenses in 1998 and an astonishing $3.4 million in 2000. (Exhibit No. 2.) Whether TECo's higher O&M cost is a result of the fact that TECo is more aggressive in making wholesale sales than the utility which is four times larger or whether TECo charges a greater sum for O&M attributable to each MWH sold is not the question. The appropriate action for the Commission is to set up a uniform system of accounting for O&M and require utilities to bear the burden of proving that the costs are actually incurred to make the wholesale sale. Failure to develop such a requirement will open a wide portal for potential abuse.

Third, the Commission must recognize that when a utility credits O & M costs to operating revenue, retail ratepayers see no benefit from such crediting in between rate cases. (Tr. 181). It is simply a mechanism by which the company is able to retain additional cash between rate cases.

As Mr. Kordecki testified, O & M costs are very difficult to quantify and it is even more difficult to identify O & M costs which are not already included in rate base items. Therefore, all O & M expenses charged to a wholesale sale should be credited back 100% to the appropriate clause (Tr. 180) unless the utility supports the charge as a cost ***incremental*** to the costs being collected through base rates. Clearly, the burden to do this rests with the utility. (Tr. 180-181). Unless the utility carries this burden, no costs should be assessed to retail ratepayers so that the Commission can ensure that there is no double recovery.

ISSUE 4

HOW SHOULD THE COMMISSION IMPLEMENT PART II OF ORDER NO. PSC-00-1744-PAA-EI, IN DOCKET NO. 991779-EI, ISSUED SEPTEMBER 26, 2000, CONCERNING THE APPLICATION OF INCENTIVES TO WHOLESALE ENERGY SALES?

FIPUG Position: * The Commission should ensure that the clarifications set out in Issues 2 and 3 above are included in the incentive calculation so that the calculation is made uniformly and fairly.*

In Issues 2 and 3 above, FIPUG has set out the changes which should be made to the methodology the Commission ultimately adopts to implement its incentive earlier incentive decision. Such changes are necessary to ensure that the incentive mechanism is appropriately applied and that a utility is not rewarded when its behavior results in a loss to retail ratepayers.

CONCLUSION

The Commission should clarify its PAA order to ensure that utilities receive an incentive ***only*** for behavior which benefits retail ratepayers. If the Commission fails to do so, it will be encouraging utilities to engage in behavior that actually ***harms*** ratepayers; FIPUG believes that this is certainly not the Commission's intent. Thus, when a utility purchases higher priced power on the wholesale market to serve retail ratepayers, the cost of such power should be deemed the incremental cost and included in any calculation of gains. As to O & M costs of wholesale transactions, the burden must rest with the utility to demonstrate that there are incremental O & M costs from a particular wholesale transaction. Unless this heavy burden is met, the utility should flow all O & M expense charges back to retail ratepayers through the appropriate recovery clauses in order to protect

retail ratepayers from a double recovery of the same costs.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing the Florida Industrial Power Users Group's Post Hearing Statement of Issues and Positions and Post-hearing Brief has been furnished by (*) hand delivery, or U.S. Mail this 24th day of September, 2001, to the following:

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