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State of Florida

Public Service Commission

-M-E-M-O-R-A-N-D-U-M-

DATE: October 14, 2003

TO: Kay Flynn, Division of the Commission Clerk and Administrative Services

FROM: Jennifer Rodan, Office of the General Counsel JAR

RE: Docket No. 030001-EI - Fuel and Purchased Power Cost Recovery Clause with Generating Performance Incentive Factor

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Please find attached for filing in the above-referenced docket an original and seven copies of each of the following:

10024-03 1. Direct Testimony of William B. McNulty, on behalf of Staff (Redacted Version)

10025-03 2. Supplemental Direct Testimony of Joseph W. Rohrbacher, on behalf of Staff (Redacted Version)

10026-03 10027-03 Also attached for filing in the above-referenced docket are the confidential versions of the Direct Testimony of William B. McNulty and the Supplemental Direct Testimony of Joseph W. Rohrbacher. The confidential information in these documents is highlighted and should be protected from disclosure to allow the affected utilities the opportunity to request confidential classification for this information.

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DOCKET NO.: 030001-EI - Fuel and Purchased Power Cost Recovery Clause and Generating Performance Incentive Factor

WITNESS: **Direct Testimony of William B. McNulty,** Appearing on Behalf of the Staff of the Florida Public Service Commission.

DATE FILED: October 14, 2003

Q. Please state your name and business address.

A. My name is William B. McNulty. My business address is 2540 Shumard Oak Boulevard Tallahassee, Florida 32399-0850

Q. By whom are you employed and in what capacity?

A I am employed by the Florida Public Service Commission as a Public Utility Supervisor in the Division of Economic Regulation.

Q. Please give a brief description of your educational background and professional experience.

A. I graduated from the University of Florida in 1981 with a Bachelor of Science degree in Psychology. I graduated from the University of Central Florida in 1989 with a Master of Business Administration degree. In that same year, I began employment with the Florida Public Service Commission as a Regulatory Analyst. In May 1998, I was promoted to Regulatory Analyst Supervisor in the Division of Research and Regulatory Review. I was promoted to my current position in May 2000.

Q. What are your present responsibilities with the Commission?

A. My responsibilities include assigning, directing, and supervising the activities of the Cost Recovery Section of the Bureau of Electric Reliability and Cost Recovery. Section activities include the development and presentation of analyses and recommendations to the Commission primarily related to cost recovery of various clause-related expenses (fuel, purchased power, and environmental), as well as to petitions/motions for territorial agreements and disputes and to reviews of reports of electric distribution reliability and related rulemaking. I also assign, direct and supervise the processing of customer complaints concerning distribution reliability and quality of service that may be assigned to the Division of Economic Regulation.

Q. Have you previously testified before the Commission?

A. No.

Q. What is the purpose of your testimony?

A. My testimony addresses the following two issues which have been identified by staff as preliminary issues in this docket.

1. Is the waterborne coal market price proxy that was established in Order No. PSC-93-1331-FOF-EI, issued September 13, 1993, in Docket No. 930001-EI, still a relevant and sufficient means for assessing the prudence of transportation costs paid by Progress Energy Florida to its affiliate, Progress Fuels?

2. Should the Commission modify or eliminate the method for calculating Progress Energy Florida's market price proxy that was established in Order No. PSC-93-1331-FOF-EI?

First, I will describe Progress Energy Florida, Inc 's (PEFI) domestic and foreign market price proxies which were approved by the Commission in 1993 and 1994, respectively. Then I will present a brief review of the Commission's recent regulatory decisions and activities related to waterborne coal transportation service (WCTS) provided by Progress Fuels Corporation (PFC, formerly Electric Fuels Corporation, or EFC) for PEF (formerly Florida Power Corporation, or FPC) I will show that the growth rate of the Domestic WCTS market price proxy during the first five years it was implemented was not representative of the growth rate of market prices nationally. In addition, I will show that PEFI's WCTS market price proxies, including both the domestic market price proxy and foreign market price proxy, were not representative of the costs incurred by PFC to provide WCTS during 2002 Then I will present my arguments for eliminating PEFI's market price proxy for all components of waterborne coal transportation except for any component for which the utility is unable to obtain one or more competitive bids for such service. For any such component, I will explain why the Commission should establish a new market price proxy based on carefully determined base price, escalators, and weightings. Finally, I will present an administrative process whereby the Commission can transition away from the use of the current WCTS market price proxies for PEFI to the proposed regulatory prudence review explained above

Q. What is the domestic waterborne coal transportation service (Domestic WCTS) market price proxy?

A. Approved by this Commission on September 13, 1993, in Docket No 930001-EI per Order No PSC-93-1331-FOF-EI, the Domestic WCTS market price proxy is the annually-adjusted price PEFI pays for waterborne transportation of coal from multiple points on the Mississippi/Ohio River System, to the Crystal River plant site. The Domestic WCTS was based on the charges EFC paid to its transportation suppliers, or vendors, for waterborne coal transportation in 1992. This base cost ($23.00) was approved as the rate for 1993 and has been adjusted annually by a set of five cost indices, including:

CPI-U (the Consumer Price Index-Urban)

PPI (the Producer Price Index)

No 2 Diesel Fuel Index

AHE (Average Hourly Earnings)

RCAF-U (Rail Cost Adjustment Factor-Unadjusted

The weighting of each of the indices is [redacted] percent, except for [redacted], which is [redacted] percent. Thus, ninety percent of the base price is inflated according to the individual weightings of five indices. The remaining ten percent of the base price is fixed. Any governmental impositions placed on vendors of EFC after 1992 which the vendors choose to pass on to PFC are then added to the index-adjusted price. The escalators, weightings, and development of the Domestic WCTS market price proxy appears in confidential audit workpapers attached to staff Witness Rohrbacher's Direct Testimony of October 14, 2003 in this docket.

Q What is the foreign waterborne coal transportation service (Foreign WCTS) market price proxy?

A In Order No. PSC-94-0390-FOF-EI, issued April 4, 1994, in Docket No. 940001-EI, the Commission approved a counterpart to the Domestic WCTS market price proxy for foreign coal transportation for all shipments of coal received "freight on board" (F.O.B.) at the International Marine Terminal (IMT) in New Orleans. The Foreign WCTS market price proxy was determined to be a price equal to 50.2 % of the Domestic WCTS market price proxy. It was established on the basis of the proportion of EFC's transloading and Gulf transport barging costs to EFC's total 1992 waterborne transportation costs. Arithmetically, the resulting market proxy price is the same as simply multiplying the combination of the 1992 transloading and Gulf transport barging costs ($11 56) times the same composite index used to escalate Domestic WCTS for each year.

Q. What are the components of PEFI's Domestic WCTS?

A. The components are presented here according to the journey of the coal from mine to the Crystal River plant:

(1) Upriver transport (moving the coal from the mine to the river, such as the Kanawha, Big Sandy, and Ohio Rivers),

(2) Upriver terminal (the transloading of coal to river barges at the Kanawha River Terminal or Pen Dock),

(3) River transport (moving the coal by barge down the Ohio and Mississippi Rivers to New Orleans via MEMCO, the river transport company),

(4) Gulf terminalling (the transloading of coal for storage and blending purposes in New Orleans via International Marine Terminal, or IMT), and

(5) Gulf transport (moving the coal by ocean tug/barge across the Gulf to the Crystal River plant, including assist tug and demurrage, by Dixie Fuels Limited, or DFL)

Q. Is waterborne transport the only mode used by PEFI to transport coal to its Crystal River plant site?

A No In fact, rail transportation of coal is, and has been for many years, PEFI's primary means of coal transportation. Each year the utility transports approximately [redacted] to [redacted] percent of its coal requirements by rail; the remaining [redacted] to [redacted] percent is moved by barge. The utility states that it maintains dual modes of transport in order to bring price pressure to bear on CSX, its rail transport vendor.

Q Did the Commission preclude the possibility of either modifying or replacing the WCTS market price proxy at some later date when it was adopted by the Commission?

A. No The Commission was silent as to how long the market price proxy should be used as the basis of WCTS cost recovery. Even FPC considered it to be experiment. When asked about the economic implications of replacing cost-plus pricing with market pricing, FPC Witness Karl H. Wieland responded on direct in Docket No. 930001-EI that "there is obviously no way to predict the future outcome of complex economic events and conditions with any confidence". Certainly, the Commission did not close the door to a review of the WCTS market price proxy based on a reasonable argument that it should either be modified or replaced

Q. Why should these issues be considered by the Commission at this time?

A. In Order No. PSC-02-1761-FOF-EI, issued December 13, 2002 in Docket No. 020001-EI, the Commission approved a stipulation among parties that a review of the WCTS market price proxies should take place as part of the fuel and purchased power cost recovery clause proceedings In addition, timing is an important concern because PFC contracts with vendors for WCTS are terminating in late 2004 (river transport and Gulf terminalling) and early 2005 (Gulf transport) PFC is the coal procurement subsidiary of PEFI, charged with arranging all coal purchases and coal transportation. Inasmuch as PFC's existing WCTS contracts are expiring and new contracts are taking their place in late 2004 and early 2005, I believe it is preferable to establish any new requirements and/or changes to the market price proxies the Commission deems necessary as soon as possible. By so doing, PEFI and PFC will be given due notice of any new requirements and proxy modifications prior to these entities signing new WCTS contracts with vendors.

Q What actions have the parties and staff taken to further this review of the WCTS market price proxies to date?

A. Commission staff held a meeting among parties to the fuel docket on January 30, 2003, to discuss the WCTS market price proxy and its continued validity. While the meeting allowed for an information exchange that was productive, staff believed a more complete understanding of the past and current operations of the WCTS market price proxy would best be gained by completing a staff audit of the books and records of PFC. This audit was performed by the Division of Auditing and Safety (Audit Control No. 03-045-2-1). Staff Witness Rohrbacher is testifying about the findings of the audit. In addition, staff has conducted written and oral discovery regarding PEFI's WCTS market price proxy PEFI's Witness Javier Portuondo has also filed direct testimony, dated September 12, 2003 regarding the WCTS market price proxy.

Q. Why is it important that the Commission concern itself with determining the cost of providing Domestic WCTS and Foreign WCTS if the prices that are charged for such services are market price proxies that escalate/de-escalate based on a composite index?

A. According to Order No. PSC-93-1331-FOF-EI, PEFI's Domestic WCTS market price proxy was based on the EFC's 1992 cost of providing WCTS service to FPC. The market price proxy was a "best guess" as to what direction market prices would be for WCTS for PEFI, but it was based on the application of <u>cost</u> escalators that imperfectly gauge market price, especially over long periods of time. The potential has always existed for a significant mismatch between the market price proxy resulting from the application of these cost escalators and the actual WCTS market price. A market price proxy was established based on cost because there was insufficient market information available to set a market price. Thus, I maintain that the Commission should periodically review the costs of providing service for any market price proxy in order to ascertain that the mechanism is not allowing either an significant overrecovery or underecovery of costs.

Q. Does a market exist for PEFI's WCTS?

A. Yes, a market exists for most of the components of WCTS, including upriver transport, upriver terminalling, river transport, and Gulf terminalling. PEFI has identified eighteen upriver terminal companies, five river transport companies, and four Gulf terminal companies capable of providing WCTS in some measure for the utility. Upriver transport is competitively contracted by the upriver terminal or coal suppliers. However, it is unclear whether a market exists for Gulf transport Witness Portuondo's claim in his direct testimony that a market does not exist for Gulf transport begs the question of whether a market could exist if the utility or its coal-procuring subsidiary were to seek a market directly through an open competitive bidding process. I believe it would be premature to conclude that a market for Gulf transport does not exist until the results of a fairly constructed competitive bid process proved the case

Q. What WCTS market price information is available which may be used to assess the market price proxies' relationship to true market prices?

A. The best source of relevant market price information that is lacking at this time is the price information that could be gleaned from fair and open competitive bidding procedures. In November 1983, the Commission issued Order No 12645 in which it stated its policy that fuel transportation expenses which are recovered via the fuel clause should result from "competitive procurement practices" and further recommended that long term contracts be awarded on the basis of a competitive bidding process Unfortunately, neither PEFI nor PFC have solicited competitive bid information through a formalized request for proposal (RFP) for any components of WCTS during the past 10 years. PFC did seek information informally through telephone contacts for certain components judged to be more subject to competition, such as for the upriver terminal. However, for most of the major components, including river transport, Gulf terminalling, and Gulf transport, the utility states that it relied upon market research, experience-based market knowledge, and contract negotiations in order to assess market price rather than competitive bid solicitations.

Second, some data is available regarding WCTS from trade publications and government sources. Trade publications such as <u>Coal Transportation</u> and government sources such as the Energy Information Administration (EIA) provide some price data and analysis.

Third, proprietary studies are available with market price information for river transport and ocean transport. Information such as this has been presented in testimony offered by Tampa Electric Company (TECO) in this docket.

Fourth, inter-utility comparisons of WCTS market price are available. The Commission receives relevant WCTS cost data via monthly filings of Florida Form 423 by TECO that would provide some useful inter-utility WCTS market price comparisons. However, this information is classified by this Commission as confidential for a 18-month period based on the potential for competitive harm which may result to the utility and/or its affiliates Such information cannot be shared with PEFI for that reason.

Q. What was the specific market data you reviewed, and what conclusions can be drawn?

A. I reviewed publicly-available information compiled by the Energy Information Administration (EIA). Such information is limited to the first five years that the market price proxy was implemented (1993-1997). My analysis shows that the growth rate of PEFI's Domestic WCTS market price proxy exceeds the growth rate of the market price shown in the EIA data for these years, as depicted in EXH WBM-1. The data shows that the market rate for multimode coal transportation rates decreased in real terms from 1993 though 1997 by an average of 3.50 percent per year, while PEFI's market price proxy [redacted] by [redacted] percent per year when adjusted for inflation on a per-ton mile basis (PEFI's waterborne transport is actually considered "multimode" because it requires upriver transport via truck to get the coal to the river). Unfortunately, the market data for the years following 1997 necessary for a more updated comparison is not available from EIA. The 1992 through 1997 price data comparison shows that the PEFI's market price proxies were not reflective of the market trend during this period and [redacted]

Q. What do you know about the relationship between PEFI's Domestic WCTS market price proxy and PFC's cost to procure Domestic WCTS on behalf of PEFI?

A. Based on the results of staff discovery and staff's audit of PFC's 2002 costs, PFC's 2002 cost of providing Domestic WCTS for PEFI is [redacted] than the 2002 Domestic WCTS market price proxy, as shown in EXH WBM-2. My estimate of PFC's 2002 margin for Domestic WCTS provided on behalf of PEFI is [redacted] percent, or [redacted].

Q. How did you determine the directs, or contractual, costs for Domestic WCTS, which are shown in your margin analysis of PEFI's 2002 Domestic WCTS?

A. This cost estimate was offered by PEFI. While there is outstanding staff discovery on this matter, the utility states that the is known within a range of $1.00 per ton. I have accepted the mid-point of the range offered Thus, the actual number reported by the utility may be either $0.50 per ton greater or lesser than the amount I used, and the resulting impact on the range of the margin is from [redacted] percent up to [redacted] percent.

Q. In your calculation of the margin for Domestic WCTS, did you recognize all of the costs that were identified as recoverable in Order No. PSC-93-1331-FOF-EI?

A. Yes. The margin estimate I have calculated includes not only the eight types of costs explicitly identified in the Order as costs recoverable via the market price proxy, it also includes PFC's General and Administrative (G&A) costs of providing WCTS. The order does not explicitly state whether PFC's G&A costs are recoverable through the market price proxy. Because the Order explicitly identifies eight other recoverable cost items, one could argue that the list of items should be considered complete and exclusive. However, my calculation of the margin estimate includes PFC's G&A costs for two reasons:

(1) Prior to the inception of the market price proxy, such G&A costs were recovered via the fuel clause, and when the market price proxy was implemented, the utility ceased recovering such costs separately through the fuel clause

(2) The language of the Order does not explicit state that such costs should be excluded I have represented the impact of this cost in "indirect costs" as shown in EXH WBM-2.

Q. Does your analysis include costs associated with Dixie Fuel Limited's

(DFL) non-contractual operations and maintenance (O&M) costs?

A. No. My margin analysis excludes such costs. While PEFI claims that approximately $3 M to $4 M of non-contractual O&M costs were incurred in 2002 by DFL, these costs were not included in the contract between PFC and DFL for Gulf transport The Order explicitly states that "the market price [proxy] would also cover, i.e., replace, the return of EFC's investment in IMT and Dixie Fuels currently provided under cost-plus pricing for water transportation." PFC owns a majority of DFL. Recognition of non-contractual O&M costs which may be a substitute for capital investment is counter to the explicit intent of the Order. Thus, there is no reason why these costs should be recognized in my margin analysis of PFC's WCTS.

Q What would your margin analysis show if you allowed PEFI's claim of $3 to $4 M in non-contractual O&M costs incurred by DFL in 2002?

A. My analysis would show a margin of [redacted] percent.

Q. What do you know about the relationship between PEFI's Foreign WCTS market price proxy and PFC's cost of providing Foreign WCTS to PEFI?

A Similar to Domestic WCTS, PFC's 2002 cost of providing Foreign WCTS appears to be substantially lower than the 2002 Domestic WCTS market price proxy, as shown in EXH WBM-2. My analysis is based on the results of staff discovery and Staff's audit of PFC's 2002 costs. My estimate of PFC's margin for Domestic WCTS is [redacted] percent, or [redacted] Also, my comparison of the costs of Domestic WCTS and Foreign WCTS reveals that the ratio of transloading and Gulf transport shipping costs to total domestic costs has [redacted], from 50.2 percent in 1992 to [redacted] percent in 2002.

Q Wouldn't it be important to consider not only the costs incurred by PFC but also the profits that PFC should be allowed to receive in return for the additional risk it assumed when the market proxy mechanism was implemented?

A. Yes, the Commission did allow both profits and losses to accrue to the affiliate, EFC, when it approved the stipulation to implement a WCTS market proxy for FPC. However, most of the risk of cost increases were factored into the market price proxy via the escalators or by insurance coverage carried by EFC's vendors or EFC itself. For instance, the escalators included in the annual calculation of the market price proxy addressed fuel price risk through the application of the No. 2 Diesel Index. In Witness Portuondo's direct testimony, at Page 23, he references the possibility of a catastrophic loss to DFL related to its provision of service to PEFI, such as a vessel lost at sea. However, the cost impact of a lost vessel incident is not compelling. DFL carries vessel insurance, so the remaining risk would be payment of the deductible, which PFC indicates is $1.0 M to $2.5 M. However, even for that potential loss amount, the likelihood of a catastrophic incident actually happening is quite small. In deposition, a long-time PFC employee indicated she was unaware of any catastrophic event involving permanent loss of a facility or vessel having ever occurred in relation to PFC's coal transportation operations in the history of the company. PFC was formed in 1976.

In addition, PFC no longer owns all of the water transportation components that it did own in 1993 when the market price proxy was established, so the risk to PFC for losses associated with those components has been diminished. In 1993, EFC owned virtually every component, either in whole or in part, involved with transporting coal by water on behalf of FPC except for short haul transportation from the mine to the upriver terminal. At this time, PFC maintains a two-thirds ownership in the Gulf transport component, DFL, and PFC owns one of the upriver terminals, Kanawha River Terminal. PFC no longer owns a river transport company or a portion of the Gulf terminal.

Additionally, if PFC incurred costs that exceeded their revenue stream from the market price proxy, it would be within the discretion of PEFI to petition the Commission for relief on behalf of its subsidiary on a going-forward basis by seeking to modify or eliminate the market price proxy.

Thus, EFC's risk premium associated with the imposition of the market price proxy, while unknown, would appear to be small, so any allowance for price margins reflecting the additional level of risk assumed should be relatively small. While I am uncertain the exact definition of what may constitute a "small" price margin, it is clear from a current and historical context that the margins achieved by PFC for Domestic WCTS and Foreign WCTS in 2002 are [redacted]

Q. Do you have any concerns regarding the market price proxies' escalators and the escalator weightings?

A. Yes. PEFI's market price proxies are based on escalators that, in at least one instance, have no bearing on the transportation service provided by PFC. RCAF-U is an market price proxy escalator that provides a measure of changing rail costs, but rail is no longer used by PFC for upriver transport. Also, the escalators' weightings underestimate the level of fixed costs in the industry. As shown in EXH WBM-3, only 10 percent of the total costs are considered fixed costs in the proxy However, in the inland waterway bulk freight industry, approximately 58 percent of costs are fixed, including the cost of capital equipment such as tugs and barges. Thus, the market price proxy contains a bias towards more costs being classified as variable and subject to escalation, thus allowing for a higher escalation of costs than is reflected in the market.

Q What do you conclude regarding the reasonableness of the 2002 market price proxies (domestic and foreign) based on your review of costs of service and profit levels?

A. I conclude that both market price proxies exceeded the costs of providing service and allowed the affiliate, PFC, to achieve significantly more profit than is reasonable for this service given the level of risk assumed. Also, I conclude that the market proxies' escalators and their respective weightings do not reflect the cost structure of the industry.

Q. What regulatory action, if any, should be taken for 2002, 2003, and 2004 on the basis of your analysis of PEFI's market price proxies?

A. No action should be taken regarding the current market price proxy mechanism as it applies to 2002, 2003, and 2004. It would be inappropriate for the Commission to apply a new WCTS cost recovery method on a retroactive basis to 2002. Neither would it be appropriate to use a new WCTS cost recovery method for 2003 and 2004 because PFC and PEFI have relied upon such regulatory treatment in contracting for services in the near term

Q. What regulatory action, if any, should be taken on the basis of the cost comparisons presented above and apparent lack of market price information for the years following 2004?

A. The Commission should move expeditiously to eliminate PEFI's market price proxies and replace them with a requirement that PEFI justify its projected

WCTS cost recovery upon the basis of a fair and complete competitive bid procedure for each component of WCTS. The Commission should establish a market price proxy for particular components of WCTS only in the event that PEFI and PFC are unable to procure a competitive bid from one or more qualified vendors after administering a fair and complete competitive bid process.

Q Why should the current market price proxies be eliminated?

A. I recommend the elimination of the current market price proxy methodology for these reasons:

(1) Competitive markets already exist for most of the components of WCTS included in the market price proxies, so there is no reason why the Commission cannot avail itself of the most direct market information from PEFI or PFC based on their efforts to competitively bid the various components of WCTS.

(2) The market price proxies have worked to the detriment of PEFI's ratepayers by exceeding both the cost of service and the market price of WCTS.

(3) PEFI's market price proxies are based on escalators that in some instances have no bearing on the transportation service provided by PFC, and the weightings on the escalators underestimate the level of fixed costs in the industry, and

(4) The Foreign WCTS market proxy is completely obsolete at this time because it is based on a ratio of Gulf transport costs to total costs that existed 10 years ago but that has [redacted] since that time. It is particularly important that the Commission eliminate or replace the Foreign WCTS market price proxy because PEFI's foreign coal purchases are expected to increase significantly in 2004 and 2005 The increase in coal delivered via

Foreign WCTS is expected to replace much of the coal delivered via Domestic WCTS

Q. Wouldn't a competitive bid procedure subject both the Commission and parties to the fuel docket to excessive administrative costs and regulatory tension?

A. No. As a point of clarification, the regulatory method that I am recommending is not a return to cost-plus pricing. The Commission can avoid the administrative cost and the potential for regulatory tension associated with a cost-plus pricing methodology by instead determining the recoverable market price based upon review of competitive market response documentation. Such a standard avoids the need for detailed cost analysis and the need for the Commission to maintain expertise regarding the costs for each of the various components that comprise WCTS.

While the Commission should not mandate PEFI to provide specific documentation, the Commission should direct PEFI to maintain as much detail as necessary to allow the Commission to fairly evaluate the bid process, including the RFP instrument, the criteria for selection, the solicitation schedule, the evaluation and screening process, and the selection decision. The Commission should require PEFI to provide staff written notification of the availability of such documentation 90 days prior to the November fuel hearing in the year prior to the expiration of the current contract in question. Such regulatory intervention can hardly be considered excessive or burdensome considering PEFI's aggregate cost of WCTS ([redacted] in 2002).

Q. What specific guidance should the Commission give PEFI and PFC regarding the competitive bid procedure for the Gulf transport component of WCTS?

A. The two-thirds ownership that PFC has in DFL would indicate the need for closer involvement by the Commission in the review of the competitive bid procedure for Gulf transport service. The Commission should strongly encourage PEFI and PFC to meet once or more with staff and the affected parties to discuss the formation of the bid proposal and the process by which the utility will conduct the bid procedure at least a month in advance of issuing the proposal. The Commission should encourage PEFI and PFC to consider carefully the input of the participants of such meeting or meetings.

Q. How should the Commission judge the prudence of PEFI's WCTS costs if a fair and complete competitive bid process fails to produce one or more competitive bids from qualified bidder(s), despite the best efforts of PEFI and PFC?

A. Gulf transport is the most probable transportation component for which no qualified bid may be received in response to a fairly constructed and administered request for proposal. In that circumstance, the Commission should require the utility to bring forth a petition that would essentially propose a new market price proxy specific to the component of WCTS for which one or more competitive bids from qualified vendors were not received. Any petition for a market price proxy should include a base price for the projected period that is built upon the most recent actual costs with pro-forma adjustments as appropriate. Annual cost escalators should reflect the costs of the waterborne coal industry Weightings for each variable cost escalator should be applied based upon the percentage of related costs to total costs of the service for that component. The proposal should include both direct contractual costs as well as PFC's G&A expense specific to the component in question so that the full cost of the service for that component is represented The Commission should require a petition to be filed no later than three months prior to the November fuel hearing in the year prior to the contract taking effect so that it can be fairly reviewed and properly deliberated before implementation. For instance, if PEFI and PFC were unsuccessful during the first half of 2004 in generating competitive bids for 2005 Gulf transport service, a market price proxy petition they submitted in August 2004 would reflect pro-forma 2005 costs for PFC's Gulf transport service. Such costs would be based on 2003 actual costs and 2005 pro-forma adjustments.

Q. Under your regulatory proposal, how should the Commission determine the prudence of costs for existing contracts that are not expiring during the next year and a half, such as upriver terminalling?

A. The Commission should determine that existing contractual costs for contracts that are not expiring are reasonable upon proper execution of the contract until such time that the contract in question terminates or reaches a renewal period. When that time approaches, the regulatory mechanism would change to either competitive bidding, if such bidding is successful, or a new market price proxy based on a petition filed by PEFI.

Q. If a new market price proxy is established for one or more components of WCTS, how often should the Commission revise such market price proxy(ies), and how should it do so?

A The Commission should limit the effective term of every new market price proxy it develops to four to five years. The Commission should require PEFI to file a petition for a cost and market review of the market price proxy based on the same filing schedule as when the original market price proxy was initiated. Four years is within a reasonable range of the length of many WCTS contracts. If the contract underlying the market price proxy would expire in the fifth year, then PEFI would be relieved of filing for a new price proxy that year and its market price proxy would be extended an additional year in order to allow PEFI the opportunity to competitively bid that component of WCTS.

Q. Can you summarize your testimony?

A. Yes. In my testimony I have addressed two preliminary staff issues distributed to parties in the fuel docket. The first issue asks whether the PEFI's WCTS market price proxy is still a relevant and sufficient means for assessing the prudence of costs paid by PEFI to PFC, its subsidiary, and the second issue asks whether the market price proxy should be modified or eliminated. Based upon my review of both market information and recent cost information, I have concluded that the current market price proxies for both domestic and foreign coal transportation are no longer relevant and sufficient for the purpose of assessing cost prudence. The margins PFC has achieved for providing domestic and foreign waterborne coal transport are excessive given the relatively small additional risk PFC has incurred. Additionally, the growth rate of the Domestic WCTS market price proxy has not reflected the growth rate of the waterborne coal transportation market In addition, the application of the proxy escalators and their respective weightings yield inaccurate estimates of the market price because they do not reflect the prevailing cost changes in the industry. The Commission should eliminate the use of the current market price proxy mechanism wherever possible and replace it with a more market-oriented approach. Competitive bid solicitations should provide the foundation for prudence review for each component which can be successfully bid. In those instances where competitive bids cannot be obtained, the market price proxy for that component of WCTS should be developed based upon updated actual costs and relevant escalators weighted to reflect the level of variable costs of providing the service. If a market price proxy is necessary for any component of WCTS, that component should be reset in either four years or five years depending upon the expiration of PFC's related contracts with transportation vendors.

Q. Does this conclude your testimony?

A. Yes, it does.

Comparison of Average Annual Growth Rates of PEFI DWCTS Market Price Proxy versus Multi-mode Coal Transportation Market
Years 1993-1997

A Year	B* PEFI's Market Price Proxy ($/ton	C** Mileage Adjustment	D CPI-U Average Annual Growth Rate	E PEFI's Market Price Proxy Growth Rate (adjusted for mileage and CPI-U)	F*** Avg Rate Per Ton-Mile Multi-mode (mills in1996 $)	G Avg Rate Per Ton-Mile Multi-mode Growth Rate
1992	$23.00				13 7	
1993	$[redacted]	0 8%	2 99%	[redacted]%	13 1	-4.38%
1994	$[redacted]	0.8%	2.56%	[redacted]%	13.2	0 76%
1995	$[redacted]	0.8%	2.83%	[redacted]%	12.0	-9.09%
1996	$[redacted]	0.8%	2.96%	[redacted]%	11 1	-7.50%
1997	$[redacted]	0.8%	2 29%	[redacted]%	11.4	2.70%
Average Growth Rate, 1993 to 1997				[redacted]%		-3 50%

* Source Staff Audit WP-81
** Source. Florida 423 Forms, 1992 and 1997 (tons, counties), coal industry transportation maps (various)
*** Source Energy Information Administration, "Average Utility Contract Coal Transportation Rate per Ton-Mile by Transportation Mode, 1979-1997 (Mills in 1996 Dollars); http://www eia.doe.gov/cneaf/ctrdb/tab37.html, printed 10/10/2003

PFC'S 2002 DOMESTIC AND FOREIGN WCTS MARGINS
(FOR COAL TRANSPORT ON BEHALF OF PEFI)

Domestic WCTS Margin

A	B	C
	Per Unit Analysis ($/ton)	Total Revenue and Cost Analysis (B x 2002 domestic tons) (4)
Market Price Proxy (1)	[redacted]	$[redacted]
Direct Costs (2)	[redacted]	$[redacted]
Indirect Costs (3)	$0 37	$656,608
Total Costs	[redacted]	$[redacted]
Margin	[redacted]	$[redacted]
Margin Percentage	[redacted]%	[redacted]%

(1) Source Staff Audit Workpaper WP-82
(2) Source PEFI Response to Staff Interrogatory No. 16. See also 10/10/03 deposition of PEFI Witness Javier Portuondo - specifically, his estimated correction (midpoint) to the interrogatory response
[redacted] Direct Costs less ($2 00 + $3,00)/2 Correction = $[redacted]
(3) Source Indirect Costs based on deposition of PEFI Witness Javier Portuondo and Interpretation of Order No PSC-93-1331-FOF-EI Estimate doesn't recognize Dixie Fuel Lines O&M costs but does recognize PFC's G&A costs; ($.75M G&A x[redacted]%total tons)[redacted] domestic tons = $0 37/ton
(4) Tonnage per PEFI response to Staff Interrogatory No 15

Foreign WCTS Margin

A	B	C
	Per Unit Analysis	Revenue and Cost Analysis (B x 2002 foreign tons) (4)
Market Price Proxy (1)	[redacted]	$[redacted]
Direct Costs (2)	[redacted]	$[redacted]
Indirect Costs (3)	$0.37	$103,525
Total Costs	[redacted]	$[redacted]
Margin	[redacted]	$[redacted]
Margin Percentage	[redacted]%	[redacted]%

(1) Source Staff Audit Workpaper WP-82
(2) Source: PEFI Response to Staff Interrogatory No 16 See also 10/10/03 deposition of PEFI Witness Javier Portuondo
(3) Source. Indirect Costs based on deposition of PEFI Witness Javier Portuondo and Interpretation of Order No PSC-93-1331-FOF-EI. Estimate doesn't recognize Dixie Fuel Lines O&M costs but does recognize PFC's G&A costs, (($ 75M G&A x[redacted]% total tons)[redacted]tons =$0 37/ton
(4) Tonnage per PEFI response to Staff Interrogatory No 15

Comparison of PEFI Market Price Proxy Escalators to Barge Industry Cost Profile

Row		PEFI's Escalators, WCTS (1)	PEFI's Weightings, WCTS (1)	REEBIE BCAM Cost Percent (2)	REEBIE BCAM Cost Descriptors
1	Fixed Costs		10%	58%	Towboat and Barge
2		Sum of Fixed Costs	10%	58%	
3					
4	Variable Costs				
5		Average Hourly Earnings	[redacted]%	11%	Wages
6		Consume Price Index-U	[redacted]%	9%	Overhead
7		Produce Price Index	[redacted]%	1%	Fleeting
8		Rail Cost Adj. Factor-U	[redacted]%	NA	
9		No 2 Diesel	[redacted]%	16%	Fuel
10			NA	5%	Profit
11		Sum of Variable Costs (Rows 5-10)	90%	42%	
12					
13	Total, Fixed and Variable Costs		100%	100%	

(1) 'Source' Staff Audit WP-81

(2) Source' REEBIE Barge Transportation Cost Model Webpage http.//www.reebie.com/images/BCAM htm