

ORIGINAL



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November 3, 2003

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

COMMISSION
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Re: Docket No. 030001-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket on behalf of Progress Energy Florida, Inc., formerly Florida Power Corporation, are an original and fifteen copies of the Supplemental Direct Testimony of Javier Portuondo.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. A 3½ inch diskette containing the above-referenced document in Word format is also enclosed. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

JAM/scc
Enclosures

cc: Parties of record

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PROGRESS ENERGY FLORIDA

DOCKET NO. 030001-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the Supplemental Direct Testimony of Javier Portuondo has been furnished to the following individuals by electronic mail the 3rd day of November, 2003.

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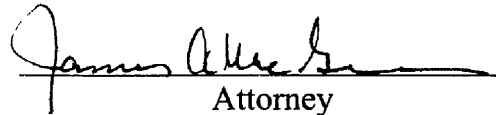
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PROGRESS ENERGY FLORIDA

DOCKET No. 030001-EI

**SUPPLEMENTAL DIRECT TESTIMONY OF
JAVIER PORTUONDO**

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

2 A. My name is Javier Portuondo. My business address is Post Office Box 14042,
3 St. Petersburg, Florida 33733.

4

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

6 A. I am employed by Progress Energy Service Company, LLC, in the capacity of
7 Director, Regulatory Services - Florida.

8

9 **Q. Have your duties and responsibilities remained the same since your**
10 **testimony was last filed in this docket?**

11 A. Yes.

12

13 **Q. What is the purpose of your supplemental testimony?**

14 A. The purpose of my supplemental testimony is to address the last sentence of
15 Staff's position on Issue 30 regarding the methodology for determining the
16 incremental costs of post-9/11 security measures. Because this portion of
17 Staff's position was (a) disclosed to the parties for the first time in the draft
18 Prehearing Order presented at the Prehearing Conference, and (b) unlike the

1 rest of Staff's position, constituted a departure from the well established
2 methodology currently utilized by the Commission that was not supported by
3 Staff testimony or addressed by testimony of the parties, the Prehearing
4 Officer allowed Staff and the parties an opportunity to file testimony limited to
5 this matter. My supplemental testimony is submitted pursuant to this ruling by
6 the Prehearing Officer.

7
8 **Q. What is your overall reaction to Staff's position on the methodology for**
9 **determining incremental costs?**

10 A. With the exception of the last sentence, I am in agreement with the
11 methodology described in Staff's position. While Issue 30 is stated broadly in
12 terms of the incremental cost methodology in general, Staff's position correctly
13 focuses on the aspect of this methodology that gave rise to the issue --
14 identification of the base year expenses reflected in base rates that must be
15 removed in determining incremental costs to avoid the possibility of double
16 recovery. In this regard, I find all but the last sentence of Staff's position
17 consistent with my projection testimony, which addresses the base year issue
18 on pages 27 through 33. The only difference is one of scope. While the
19 relevant portion of Staff's position purports to describe the methodology
20 applicable to incremental security costs, it is equally applicable to the
21 determination of incremental costs in adjustment clause proceedings in
22 general. My projection testimony urges the Commission to recognize the
23 general applicability of this methodology in order to avoid the need to address
24 the same underlying issue on a case-by-case basis in the future.

1 **Q. The last sentence of Staff's position on Issue 30 states: "Once the base**
2 **year costs are determined, the costs would be grossed up (or down) for**
3 **the growth (or decline) in KWH sold from the base year to the recovery**
4 **year." What is your objection to this statement?**

5 A. The preceding portion of Staff's position is a clarification of the current
6 incremental cost methodology that provides a needed elaboration on the base
7 year aspect of that methodology. In contrast, the quoted statement in the
8 position's last sentence represents a significant departure from the current
9 methodology through the addition of a new and, for several reasons, unsound
10 "gross-up" feature

11 In the first place, the gross-up feature fails to recognize one of the basic
12 tenants of ratemaking. When a utility's base rates are set using test year
13 revenues and expenses, all involved understand that the utility's revenues will
14 increase or decrease in subsequent years, primarily as a function of sales
15 growth. However, this, in and of itself, does not indicate the need to adjust
16 revenues, since it is also understood that expenses will likewise vary as a
17 function of inflation and the need to serve the growth in sales. The fact that
18 these variations in test year revenues and expenses have an offsetting effect
19 is the reason base rates often produce earnings that remain within the range
20 of reasonableness well beyond the test year on which the rates were set,
21 absent a major rate base addition. Therefore, if the adjustment for increased
22 revenues suggested in Staff's position were to be made, a corresponding and
23 offsetting adjustment for expense increases would also be necessary.
24 However, this is the slippery slope that can easily transform the fuel
25 adjustment proceeding into a rate case exercise, which would completely

1 defeat the purpose of having two fundamentally different rate-setting
2 mechanisms.

3 Of particular concern to Progress Energy is the inconsistency of Staff's
4 gross-up position with the revenue sharing mechanism contained in the
5 Stipulation and Settlement approved by the Commission in the Company's
6 2002 rate proceeding (Docket No. 000824-EI). Under Staff's proposal, the
7 revenues attributable to the component of security costs reflected in base
8 rates would be grossed up for sales growth since 2002. The effect of this
9 adjustment would be to reduce the incremental security costs recovered
10 through the fuel clause by the amount of the gross-up. However, the revenue
11 sharing mechanism would require that the Company refund to customers two-
12 thirds of the base rate revenues from sales growth above the forecasted
13 sharing threshold. As a result, Staff's proposal would reduce the incremental
14 costs Progress Energy could otherwise recover through the fuel clause
15 because of base rate revenues it did not fully receive. From the customers'
16 perspective, they would receive the benefit of these revenues twice; once
17 through a direct refund and again through a reduction in the incremental costs
18 they would have paid through their fuel charge.

19
20 **Q. Is this the first time Staff has proposed grossing up base year expenses**
21 **when determining incremental costs for fuel clause recovery?**

22 A. No. Staff witness Matthew Brinkley first proposed the gross-up adjustment
23 through testimony submitted in last year's fuel clause proceeding, Docket
24 020001-EI. However, while Staff raised a generic issue and three company-
25 specific issues regarding the recovery of incremental security costs, none of

1 these issues made any reference to the methodology for calculating base year
2 expenses in general or to the gross-up of these expenses specifically.
3 Moreover, Staff's position on these issues did not endorse or even mention
4 the gross-up adjustment described in witness Brinkley's testimony, which had
5 been challenged by rebuttal testimony of three utility witnesses, including
6 myself. The fact that Staff ignored the gross-up adjustment in formulating its
7 positions for the November 2002 hearing, after it had the opportunity to
8 consider the rebuttal testimony, suggests to me that Staff recognized the
9 adjustment was not meritorious. The passage of time has not made it any
10 more so today.

11 Finally, I would note that when the Commission considered the
12 incremental security cost issue at the conclusion of the hearing, it voted
13 unanimously to approve recovery of the individual utilities' incremental costs
14 that were calculated using base year expenses determined in the traditional
15 manner, without a gross-up adjustment. Progress Energy has calculated its
16 incremental security costs now before the Commission in the same manner
17 and urges the Commission to approved the continued use of this
18 methodology.

19
20 **Q. Does this conclude your supplemental testimony?**

21 **A.** Yes it does.

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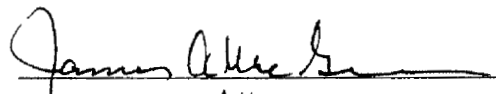
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