BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 031057-EI

DIRECT TESTIMONY OF JAMES N. HELLER

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is James N. Heller. I am currently President of Hellerworx, Inc. at 4803 Falstone Avenue, Chevy Chase, Maryland 20815.

Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE?

A. I have prepared Exhibit JNH-1, which describes my education and experience. By way of background, I received a Bachelor of Science degree in electrical engineering from Northwestern University in 1970. I was a member of the Eta Kappa Nu and Tau Beta Pi engineering honorary societies. In 1972, I received a Masters in Business Administration from the Harvard Business School.

Upon graduation, I began work with the U.S. Environmental Protection Agency's Office of Water Quality, Planning and Standards in Washington, D.C. While at EPA, I was responsible for the development of industrial water pollution control effluent guidelines. I served as Section Chief of a group responsible for the review of these guidelines and for the development of computer-based tools to assist management in the analysis of progress in the water pollution control programs.

In 1975, I joined Energy and Environmental Analysis, Inc., in Arlington, Virginia, a firm that provided consulting services primarily to agencies of the Federal government. I became Director of Management Studies, and was responsible for conducting a wide range of analyses in areas relating to air and water pollution control, automobile energy consumption, energy conservation, coal markets, and rail transportation. Clients served included the U.S. Department of Energy, U.S. Environmental Protection Agency, Executive Office of the President, President's Commission on Coal, U.S. Congress' Office of Technology Assessment, and various coal producers.

In 1980, I joined Teknekron, Inc. of Berkeley, California as a senior analyst. I was responsible for performing a number of coal market and transportation studies for both railroads and coal producers. These studies included evaluation of the coal market implications of the merger of the Norfolk & Western and Southern Railways, and a number of market evaluations for potential coal property acquisitions.

After leaving Teknekron in 1981, I formed the Fieldston Company, Inc., and began providing consulting services for energy producers, shippers, utilities, and government agencies. Fieldston participated in numerous studies on matters related to energy markets, plant-siting studies, all forms of transportation, production costs, port studies, and government policy development.

Fieldston also developed a publications business centered on the coal and railroad industries, and environmental compliance. Publications included the Coal Transportation Report, the Fieldston Coal Transportation Manual, Coal Daily, Rail Business, Clean Air Compliance Review, Air Daily, and Intermodal Business.

My personal publications include Coal and Profitability: An Investor's Guide, published by McGraw-Hill, which I co-authored in 1979 with Charles A. Mann. In 1984, I authored the book Coal Transportation and Deregulation: An Impact Analysis of the Staggers Act, a book jointly published by Serif Press and the Energy Bureau. I speak frequently at conferences on coal transportation and supply matters.

In November 1998, I sold Fieldston Company to Hagler Bailly, Inc., a publicly traded, international consulting firm. Hagler Bailly maintained the consulting business of Fieldston and sold the publications business. In July of 2002, I resigned from PA Consulting and continued my consulting activities under Hellerworx, Inc.

I had also co-founded Fieldston Transportation Services Company (FTS) in 1995 providing railcar management, leasing and maintenance services to shippers and short line carriers. In 1998, we sold FTS to Detroit Edison (DTE).

I have worked as a consultant in the energy, environmental, and transportation industries for more than 25 years. Through my professional experience, I have become knowledgeable about fuel markets, fuel contracts, fuel transportation agreements and power markets among other subjects. My clients have included numerous electric utilities, including Progress Energy, energy producers, transportation companies, various government agencies and the Electric Power Research Institute. I have presented testimony on a number of occasions before regulatory commissions, state and federal courts, and arbitration panels in the U.S. and abroad. I have been accepted as an expert in matters related to energy and transportation markets and have offered testimony a number of times.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I have been asked by Progress Energy Florida, Inc. (PEF) to address the question of what policies and procedures Progress Fuels Corporation (PFC) should follow in soliciting and evaluating bids for waterborne coal transportation services (WCTS).

III. APPROPRIATE POLICIES AND PROCEDURES FOR SOLICITATION AND EVALUATION OF COAL TRANSPORTATION BIDS

Q. WHAT SHOULD BE PFC'S APPROACH TO WCTS CONTRACTING?

A. Mr. Pitcher describes the approach that the company intends to follow in conducting the upcoming solicitations.

The parameters in the RFP will specify PFC's volume, flexibility and service requirements, so the responses should provide sufficient information for PFC to distinguish among the offers. The pricing, service provisions, equipment, staff capabilities, and financial condition of each offer will be evaluated. The solicitation process and evaluation criteria should be comprehensive and transparent so that the results will be viewed as reasonable regardless of the outcome. To this end, my testimony discusses the processes used by others for developing and disseminating RFPs; screening and evaluating bids; and, selecting the successful bidders. Mr. Pitcher describes the specific PFC strategy and processes.

Q. WHAT METHODOLOGY DID YOU FOLLOW IN DETERMINING WHAT CONSTITUTE REASONABLE PROCEDURES FOR SOLICITING AND AWARDING BUSINESS FOR THE WATERBORNE ROUTE?

A. As part of my ongoing work, I have developed, evaluated or analyzed the policies, procedures and RFPs used by other companies to solicit bids for coal transportation services (e.g. rail, transloading, barge and ship). I have also discussed the processes for soliciting and evaluating bids with various coal transportation providers and electric generators, including studies conducted in the coal transportation area for the Electric Power Research Institute (EPRI). Based on this information and experience I have recommended processes for soliciting and evaluating bids for WCTS for PEF.

Q. WHAT DO YOU UNDERSTAND TO BE THE PFC FUEL PROCUREMENT POLICY REGARDING WCTS?

A. PFC is tasked with transporting an adequate supply of fuel that meets all legal and environmental requirements to Crystal River at the lowest cost consistent with PEF's obligation to provide adequate and reliable service to its customers. Mr. Pitcher discusses the review and approval mechanisms that PFC intends to follow in collecting and evaluating bids. These processes allow for sufficient oversight and review by parties outside the fuel department to ensure that bids will be evaluated reasonably and fairly.

Q. WHAT PROCESSES WILL PFC USE TO SECURE WATERBORNE TRANSPORTATION SERVICES?

A. Most companies use formal solicitations and informal bid and negotiation processes to secure the lowest possible transportation costs. In this case, PFC intends to use a formal solicitation process consistent with the recommendations of the FPSC staff. To maximize competition, the bid process will allow vendors to bid on any or all of the parts with no preference for an integrated bid. The process will also allow venders flexibility in the bid options to ensure that PFC can take advantage of

opportunities to minimize delivered fuels prices while maximizing system reliability and flexibility.

IV. PROCEDURES

Q. HOW SHOULD THE COMPANY DETERMINE THE QUANTITIES OF COAL TO BE OFFERED UNDER THE WCTS SOLICITATION?

A. Typically the generating company will forecast its range of unit burn requirements for multiple years. The fuels group will then match current and projected coal and transportation contract commitments to a range of burn requirements, identify the uncommitted tonnage and develop a plan to fuel the units reliably at the lowest delivered coal price.

PFC's dilemma is how to build sufficient flexibility into its transportation agreements so as not to commit to and pay for transportation services it may not use, while at the same time to obtain firm commitments from the transportation vendors to ensure that adequate transportation capacity is available to transport all of the required coal to the units. Solving this dilemma is essentially a risk allocation matter where PFC attempts to develop contracts that provide for sufficient flexibility so that tonnage levels can vary over a wide enough range to meet the potential needs of the units while minimizing the costs to be paid for that flexibility.

PFC operates a complex coal supply transportation network aimed at serving a single plant site. PFC must coordinate rail and water deliveries from multiple US and foreign sources. PFC must also ensure that coals are properly blended, and that inventories are maintained at remote terminals in addition to the plants site. The transportation system involves the coordination of inland river tugs and barges, cross-

Gulf tug-barge sets and oceangoing vessels. The water transportation system, therefore, must be capable of handling substantial volume fluctuations.

Q. SHOULD THE CONTRACT TERM BE THE SAME FOR ALL OF THE SOLICITATIONS?

A. Not necessarily. It may be easier to administer agreements and to handle coordination issues if certain parts of the WCTS have matching terms, but not necessarily all. For example, the rates offered by a particular vendor may fluctuate depending upon the vendor's other commitments, or the need to invest in equipment to fulfill this contract. For one vendor a shorter-term contract might yield rates that are more attractive while another vendor might offer more attractive rates for the same service with a longer term agreement.

Q. HOW SHOULD THE COMPANY DETERMINE THE TERM OF THE SOLICITATION?

A. The term of the solicitation typically balances the desire for short-term flexibility and market responsiveness with the economic benefits that may result from a longer-term commitment. For example, to capture anticipated productivity gains, PFC may seek to use a shorter-term contract or a periodic market re-pricing mechanism rather than simply BLS type indices. However, bidders seeking to support new equipment purchases or acquisitions may be discouraged from bidding unless they can be assured of sufficient cash flow to recoup their capital investment under the initial contract term. Contract terms may vary depending upon the bids received and the competitive conditions in the various markets at the time of the solicitation.

Q. HOW SHOULD PFC IDENTIFY POTENTIAL TRANSPORTATION SUPPLIERS?

A. PFC should select potential inland waterway operators based on available lists of companies that have or could reasonably acquire the dry cargo capability and provide the towboats necessary to perform the service between central Appalachian coal docks and Gulf transfer facilities. The names of and information about these operators are available from existing lists maintained by the company, market intelligence, industry publications (e.g. *Sparks Barge Fleet Profile*), and general industry knowledge.

Because of industry consolidation over the past decade, the top three operators now control over 50% of the dry bulk fleet, and one of these, ACBL, is in bankruptcy. PFC will be able to solicit multiple operators; however, it will have a limited number of creditworthy operators capable of handling this business.

With regard to gulf transfer facilities, three terminals in the New Orleans area and one in Mobile have the potential to load jumbo barges, receive Panamax vessels and provide ground storage. In addition, new facilities are being developed in Tampa that could also provide an opportunity for coal transfer and storage.

In New Orleans, TECO Bulk Terminal and IMT were designed to handle the TECO and PEF businesses respectively. The more recently built IC Marine terminal may have the capability to handle all or part of the traffic. McDuffie Coal Terminals in Mobile also provides the potential for gulf transfer depending upon the coal source. McDuffie is well suited for foreign imports, but not for CAPP coals that move by barge on the Mississippi River. In Tampa, Kinder Morgan is developing a new coal terminal, as is Drummond. PFC must consider the necessity of and location for blending CAPP and foreign coals in selecting dock locations.

With regard to cross-Gulf shipping services currently, the two largest providers are Dixie Fuels Ltd, and TECO Ocean Shipping. However, other companies provide ocean shipping services and should be included in a solicitation. PFC should also be open to other creative techniques for meeting the PEF waterborne coal need reliably and at minimum cost (e.g. use of multiple operator and facility combinations). However, new firms may have difficulty penetrating the market because of substantial equipment requirements, the advantage that incumbent operators have because of existing backhaul business, and the channel limitation at Crystal River that precludes use of deep draft vessels. The vessel restrictions at Crystal River that result from the channel depth, channel restrictions and unloading constraints are severe.

Q. HOW SHOULD THE COMPANY CONDUCT THE SOLICITATIONS?

A. Mr. Pitcher describes the manner in which PFC will conduct the solicitations and perform the evaluations. He also describes the proposed time schedule. The approach as described should provide for comprehensive coverage of potential bidders, allow ample notification that allows bidders to respond and assemble equipment if necessary, and provide sufficient guidance so that bidders understand the terms and conditions that PFC seeks.

However, in addition to informing vendors about the process, PFC must convince bidders that PFC is genuinely interested in developing the least cost, reliable transportation system without unduly favoring current vendors or affiliates. A key component of developing that credibility is to follow the transparent evaluation process that the Company has proposed.

Q. HOW MUCH TIME SHOULD BE ALLOWED FROM THE TIME THAT THE RFPS ARE SENT UNTIL THE SUBMISSIONS ARE DUE?

A. Typically, the time to respond to an RFP may range from two to eight weeks depending upon the complexity of the request and the prior familiarity of the suppliers with the bid requirements. This bid request should probably allow eight weeks for the cross-Gulf response given the magnitude and complexity of the requirement. Less time should be required by those bidding on the terminal and barge segments because these bid requirements are less unique.

Q. HOW SHOULD PFC EVALUATE THE RESPONSES?

A. PFC should strive to make the bidding and evaluation processes as transparent as practicable. In conformance with FPSC guidelines and its own fuel policies, PFC should clearly present its solicitation process and evaluation criteria. Evaluation criteria should include price package, operational capability, safety record, environmental record, financial stability, reliability, past performance, flexibility, and management integrity. To the extent that evaluation criteria involve quantitative responses, the process may be viewed as more objective; however, some parameters will be inherently difficult to quantify. As a practical matter, PFC may adjust prices and renegotiate terms as part of the final negotiations with the successful bidder or bidders to obtain the best possible deal.

Q. WHAT KEY TERMS AND ELEMENTS WOULD YOU EXPECT TO BE INCLUDED IN THE BARGE AND OCEAN TRANSPORT CONTRACTS?

A. I would expect the following terms to be included:

- Shipper – state guarantor, if any.
- Recitals/Intent – state the intentions of each contracting party and purpose/need for the contract agreement.

- Commodity/Annual Tonnage – state whether tons are fixed and if not, state nature of shipper's commitment, e.g. requirements, and the basis for the estimate of tonnage; also prepare "what ifs" referencing the potential for tonnage changes during each specified period or during the term of the contract. The "dead freight" issue is particularly important. If PFC makes a minimum annual volume commitment and then fails to meet those minimums, it is likely to be assessed a charge for freight it does not ship.
- Services contracted for – state specific jobs define locations and job performance tolerances; possibly identify remedial obligations.
- Area-to Area – state principal origins and destinations; identify any changes that may occur during the contract term and under what permissible circumstances; ensure that additional points can be covered.
- Shipping schedule/Service schedule and frequency – specify tons per month, level shipments, ratability, frequency of regular services, and requirements for special or non-routine activities.
- Operating assumptions – specify barge or equipment type, dedicated/ exclusive use equipment, unit tows, and backhaul involvements.
- Performance obligations – specify for each party to include loading/unloading facilities, personnel responsible, etc. Also, determine ability to use subcontractors.
- Demurrage terms – specify use of credit system or payments for delay, and number of free days allowed.

- Term & Termination conditions - specify extendibility terms and/or renewal options.
- Prices/pricing/rates - specify whether using flat or incentive rates. Pricing should consider the value of using marginal pricing on incremental tonnage after meeting baseload tonnage requirements.
- Price Adjustments – specify permissibility of adjustments under specified conditions, time frequency, notification requirements, approval requirements, and nature of pricing caps if any. If formula or index adjustments are used, specify the basis and if any portion is to be held fixed.
- Payment terms –specify methods allowed (e.g. electronic).
- Cancellation & Default – identify permissible actions and conditions for implementation of default or cancellation.
- Insurance – specify indemnification, requirements and damage responsibility.
- Force Majeure – identify circumstances/causes excusing performance and obligations to mitigate, whether makeup is required, and financial obligations while force majeure exists, including notice requirements, etc.
- Weight Determination/Service performance criteria – state methods for determination and obligations for inadequate performance; consider incentives for excellence.
- Exclusivity – identify supplier's rights including whether this is the sole service provider or carrier; identify non-exclusivity if that is the case.
- Guarantees – state any guarantees for performance of service or tonnage; corporate parent or fiduciary involvement if necessary.

- Indicate any other material or unusual information to be included in the contract.

Q. WHAT KEY TERMS AND ELEMENTS WOULD YOU EXPECT TO BE INCLUDED IN THE TRANSLOADING CONTRACTS?

A. I would expect the following terms to be included:

- Shipper – state guarantor, if any.
- Recitals/Intent – state the intentions of each contracting party and purpose/need for the contract agreement.
- Commodity/Annual Tonnage – state whether tons are fixed and if not, state nature of shipper's commitment, e.g. requirements, and the basis for the estimate of tonnage; also prepare "what ifs" referencing the potential for tonnage changes during each specified period or during the term of the contract.
- Services contracted for – state specific jobs, define locations and job performance tolerances; possibly identify remedial obligations.
- Terminal equipment to be used in this movement – this would include loading and unloading equipment for barges and ships, mobile equipment, reclaim equipment, number of berths and minimum draft.
- Shipping schedule/Service schedule and frequency – specify tons per month, level shipments, ratability, frequency of regular services, and requirements for special or non-routine activities.
- Ground storage – specify availability and possible dedication. Also, specify number of piles and maximum storage allocation for this movement.
- Sampling equipment – specify availability for testing inbound and outbound coals and for monitoring during loading and unloading.

- Fleeting capability - include fleet locations, availability of barge storage space, availability of harbor boats.
- Performance obligations – specify for each party to include loading/unloading facilities, personnel responsible, etc. Also, determine ability to use subcontractors.
- Demurrage terms – specify use of credit system or payments for delay, and number of free days allowed.
- Term & Termination conditions - specify extendibility terms and/or renewal options.
- Prices/pricing/rates - specify whether using flat or incentive rates. Pricing should consider the value of using marginal pricing on incremental tonnage after meeting baseload tonnage requirements.
- Price Adjustments – specify permissibility of adjustments under specified conditions, time frequency, notification requirements, approval requirements, and nature of pricing caps if any. If formula or index adjustments are used, specify the basis and if any portion is to be held fixed.
- Payment terms –specify methods allowed (e.g. electronic).
- Cancellation & Default – identify permissible actions and conditions for implementation of default or cancellation.
- Insurance – specify indemnification, requirements and damage responsibility.
- Force Majeure – identify circumstances/causes excusing performance and obligations to mitigate, whether makeup is required, and financial obligations while force majeure exists, including notice requirements, etc.

- Weight Determination/Service performance criteria – state methods for determination and obligations for inadequate performance; consider incentives for excellence.
- Exclusivity – identify supplier's rights including whether this is the sole service provider or carrier; identify non-exclusivity if that is the case.
- Guarantees – state any guarantees for performance of service or tonnage; corporate parent or fiduciary involvement if necessary.
- Identify any other material or unusual information to be included in the contract.

Q. DO YOU HAVE ANY OTHER COMMENTS REGARDING THE PROCESS THAT PFC SHOULD USE IN SOLICITING BIDS?

A. Yes. While I understand that the FPSC would like PEF to switch to market rates as soon as feasible, I think that PFC management should be given discretion over timing to ensure that market conditions are most favorable for PFC at the time of the solicitation. Central Appalachian coal prices are at historically high levels as shown in Exhibit JNH-2. Compliance coal prices spiked in 2001 and then declined though not to the pre-2001 levels. Currently, market prices have again hit historically high levels, and there is considerable difference of opinion about how long prices will remain at current levels. Ocean shipping rates are also at historically high levels as shown in Exhibit JNH-3 and expected to come down only gradually.

The high central Appalachian coal prices are a function of a number of factors including reserve depletion, environmental restrictions that have delayed new mine openings, and high natural gas prices that have increased coal burns. The high ocean freight rates are driven largely by Chinese demand for ocean freight to provide inputs for their rapidly growing steel industry coupled with a lack of new vessel builds.

Changes in market factors can occur suddenly (as shown in the 2001 coal price spike) and PFC management should have discretion to approach the market when they deem it to be most appropriate.

Since it appears that costs to the customer over the duration of the contract may be higher than if the solicitation were conducted under more stable market conditions, FPSC should give PFC management sufficient latitude as to when the solicitation is conducted to achieve the most favorable results.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

EXHIBIT JNH-1

RESUME OF
JAMES N. HELLER

HELLERWORX, INC.
4803 Falstone Avenue
Chevy Chase, Maryland 20815

Current Position

Jamie Heller is the founder and president of Hellerworx, Inc. Hellerworx was developed to provide strategic and economic consulting services to electric generators, energy producers and transportation companies. Mr. Heller is an expert in fuel, energy, environmental and transportation issues. His specialties include fuel market analysis, transportation market analysis, electric utility planning and electric power market analysis, analysis of environmental compliance options, utility fuel procurement, energy property valuation, and litigation support. Mr. Heller has served as an arbitrator, and as an expert witness before various state commissions, federal district and state courts, arbitration panels in the U.S. and overseas, the Surface Transportation Board and the Federal Energy Regulatory Commission. He has made numerous speeches and presentations before various conferences and seminars in the U.S. and abroad. His comments have appeared in various trade publications.

Consulting Specialties

Strategic planning. Estimating fuel production and transportation costs. Fuel price and transportation rate forecasting. Negotiating fuel and transportation agreements. Evaluating alternative Clean Air Act compliance strategies. Siting new energy facilities. Transportation procurement planning. Transportation management studies. Providing litigation and regulatory support. Conducting market assessments and forecasts. Performing reserve acquisition analyses. Evaluating equipment purchases. Energy supply planning.

Prior Professional Experience

- **PA Consulting (October 2000-July 2002). Senior Partner.** As Senior Partner within the PA Management Group worked on launching the Environmental and Resource Analytics practice within PA. The practice provided strategic and analytical services to clients in the electric generation, fuel and transportation markets; performed various studies and modeling activities related to compliance with environmental regulations; and conducted environmental risk assessments. The principal areas of focus were environmental compliance with Clean Air Act standards, providing fuel and environmental analyses in support of electric generating unit asset acquisition and financing activities, and a major effort to support Firestone Tire in its dispute with Ford Motor Company and NHTSA.
- **Hagler Bailly (October 1998-October 2000). Senior Vice President.** Served as head of Hagler Bailly's fuels and environment practice area and an expert in coal, energy, and transportation issues. His activities supported the firms forecasting and analysis of electric power, fuel and transportation markets and various clean air compliance issues. In October 2000, PA Consulting purchased Hagler Bailly.

- **Fieldston Company, Inc. and Fieldston Publications, Inc. (1981-1998). Founder and President.** Founded The Fieldston Companies in 1981 to provide energy and transportation consulting services to the energy supply, transportation and electric utility sectors. The 60+ person staff provided expert assistance to the fuels supply, transportation and electric generation industries in hundreds of commercial matters. The publication staff developed and published leading business periodicals in the coal, rail transportation and environmental fields. A joint venture company, Fieldston Transportation Services, provided rail transportation and railcar maintenance services to various shippers and short line rail carriers. In 1998, Mr. Heller sold the consulting and publishing companies to Hagler Bailly, and the transportation services company to DTE.
- **Teknekron, Inc. of Berkeley, Calif. (1979–1980). Senior Analyst.** Strategic planning, market analyses, rail merger studies, transportation market analysis and rate estimation, plant siting, and public policy development.
- **Energy and Environmental Analysis, Inc. (1975-1979). Director of Management Studies.** Directed coal market and transportation studies for railroads and coal producers. Conducted economic evaluation of air and water regulations. Developed energy efficiency plans. Clients included U.S. Department of Energy, Executive Office of the President, U.S. Presidential Commission on Coal, U.S. Congress Office of Technology Assessment, and various coal producers.
- **Office of Water Quality Planning and Standards (U.S. Environmental Protection Agency) (1972–1975). Section Chief.** Developed and promulgated industrial water pollution control guidelines.

Books

James N. Heller and Charles A. Mann. *Coal and Profitability: An Investor's Guide.* McGraw-Hill, 1979.

James N. Heller. *Coal Transportation and Deregulation: An Impact Analysis of the Staggers Act.* Serif Press and the Energy Bureau, 1984.

Education

Harvard Business School — Master of Business Administration, 1972

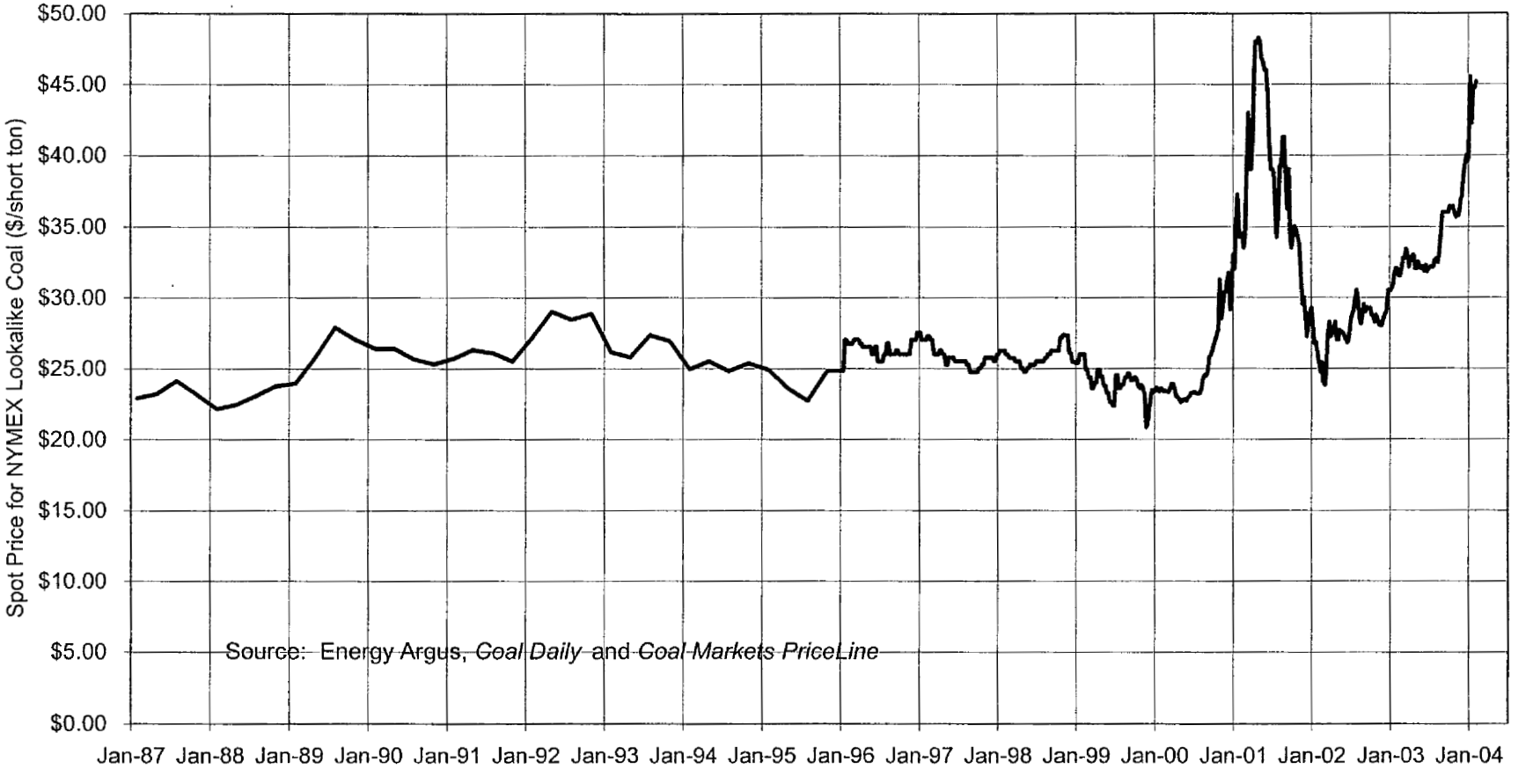
Northwestern University — Bachelor of Science, Electrical Engineering, 1970

Honors

Member, Eta Kappa Nu and Tau Beta Pi Engineering Honorary Societies

Exhibit JNH-2

Central Appalachian Coal Prices
NYMEX Coal 1987-2004)



Handymax Historical and Forecasted Rates