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May 3, 2004

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COMMISSION CLERK

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

Re: Review of Tampa Electric Company's waterborne transportation contract with
TECO Transport and associated benchmark; FPSC Docket No. 031033-EI

Dear Ms. Bayo:

Enclosed for filing in the above docket on behalf of Tampa Electric Company are the
original and fifteen (15) redacted versions of the prepared rebuttal testimony and exhibits of Joann
T. Wehle, Brent Dibner, Paula Guletsky and Frederick J. Murrell.

Tampa Electric is submitting under a separate cover letter a single confidential version of
each of these rebuttal testimonies and exhibits with the confidential information highlighted in
yellow or printed on yellow paper stock. That confidential filing is accompanied by a Notice of
Intent to Seek Confidential Classification.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this
letter and returning same to this writer.

Thank you for your assistance in connection with this matter.

Sincerely,

[Handwritten signature of James D. Beasley]

James D. Beasley

Wehle - 05105-04
Dibner - 05106-04
Guletsky - 05107-04
Murrell - 05108-04

- JMP
COM 5
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OPC Enclosures
MMS
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05105 MAY-3

FPSC-COMMISSION CLERK



TAMPA ELECTRIC

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 031033-EI

IN RE: TAMPA ELECTRIC COMPANY'S
2004-2008 WATERBORNE TRANSPORTATION
CONTRACT WITH TECO TRANSPORT
AND ASSOCIATED BENCHMARK

REBUTTAL TESTIMONY AND EXHIBIT
OF
JOANN T. WEHLE
ON BEHALF OF TAMPA ELECTRIC COMPANY
REDACTED VERSION

DOCUMENT NUMBER DATE

05105 MAY-3 3

FPSC-COMMISSION CLERK

Table of Contents

Background	6
Coal Transportation Procurement Process	9
CSXT's Rail Proposals	20
Tampa Electric's Coal Supply and Coal Transportation	24
Tampa Electric's Evaluation of CSXT's Rail Proposals	29
Tampa Electric's Storage & Blending Capabilities	34
Rebuttal Specific to CSXT's Testimony	38
Rebuttal Specific to OPC's & FIPUG's Testimony	52
Rebuttal Specific to Dr. Hochstein	56
Coal Transportation Benchmark	59
Exhibit JTW-2	66

1
2 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

3 PREPARED REBUTTAL TESTIMONY

4 OF

5 JOANN T. WEHLE

6 ON BEHALF OF

7 TAMPA ELECTRIC COMPANY
8

9 Q. Please state your name, business address, occupation and
10 employer.

11
12 A. My name is Joann T. Wehle. My business address is 702 North
13 Franklin Street, Tampa, Florida 33602. I am employed by
14 Tampa Electric Company ("Tampa Electric" or "company") as
15 Director, Wholesale Marketing & Fuels.
16

17 Q. Are you the same Joann T. Wehle who filed direct testimony
18 in this proceeding?

19
20 A. Yes I am.
21

22 Q. Please describe how Tampa Electric's rebuttal testimony is
23 presented.
24

25 A. I am one of four witnesses submitting rebuttal testimony on

1 behalf of Tampa Electric. My rebuttal testimony addresses
2 the numerous inaccuracies and false allegations made by
3 Messrs. Michael Majoros, Jr. and H.G. Wells testifying on
4 behalf of the Office of Public Counsel ("OPC") and Florida
5 Industrial Power Users Group ("FIPUG"), Dr. Robert Sansom
6 and Messrs. John Stamberg and Robert White testifying on
7 behalf of CSXT and Dr. Anatoly Hochstein testifying on
8 behalf of nine residential customers. Mr. Brent Dibner, who
9 also filed direct testimony in this proceeding, addresses
10 inaccuracies and deficiencies in the assertions and
11 conclusions made by Dr. Hochstein and Mr. Majoros regarding
12 the waterborne transportation market. Mr. Frederick Murrell
13 rebutts certain aspects of CSXT's testimony specific to the
14 waterborne coal solicitation, projected coal transportation
15 costs when compared to CSXT's two proposals and the
16 benchmark that was established for Tampa Electric in 1988.
17 Finally, Paula Guletsky from Sargent and Lundy ("S&L")
18 supports the study which Tampa Electric relied on in
19 evaluating CSXT's rail proposals. She also rebuts specific
20 inaccuracies made by CSXT's witnesses Sansom and Stamberg.

21
22 Tampa Electric's rebuttal testimony comprehensively
23 addresses the assertions and allegations of witnesses for
24 FIPUG, OPC, CSXT, and the nine residential customers. In
25 summary, Tampa Electric has conducted itself in an

1 absolutely prudent manner under this Commission's policies.
2 Tampa Electric's contract with TECO Transport is priced at
3 or below market and its customers continue to receive the
4 most efficient and cost-effective services for coal
5 transportation services.

6
7 **Q.** What are your general impressions of the intervenors
8 testimony?

9
10 **A.** The Florida Public Service Commission's ("FPSC" or
11 "Commission") existing policy relied on and followed by
12 Tampa Electric was established in Order No. 20298. It has
13 guided and directed Tampa Electric's actions with respect to
14 its affiliate, TECO Transport, since 1988. Tampa Electric
15 has consistently complied with the letter and spirit of that
16 order since it was issued. The Commission has reviewed and
17 approved the prices paid by Tampa Electric to its affiliate
18 TECO Transport in hearings held each year in the fuel
19 adjustment proceeding.

20
21 Intervenors, on the other hand, have completely ignored
22 these existing policies by criticizing the content of Tampa
23 Electric's June 27, 2003 Request for Proposal ("RFP") when
24 the Commission's current policy clearly does not expect or
25 require that an affiliate contract be subject to any bid

1 process at all. Moreover, intervenors have not presented
2 any facts sufficient to change the Commission's policy set
3 out in Order No. 20298 or to show that any of Tampa
4 Electric's actions which were guided by that policy were
5 imprudent. Intervenor's testimony, in fact, supports the
6 appropriateness of the pricing of the waterborne contract
7 with TECO Transport by conceding that: 1) there is a market
8 for coal transportation services; 2) waterborne
9 transportation service is cheaper than rail transportation
10 service; and 3) TECO Transport has the largest and most
11 efficient waterborne fleet available to serve Tampa
12 Electric. Furthermore, no intervenor has provided testimony
13 that utilizes a model supported with documented market
14 information that contradicts Mr. Dibner's recommended market
15 rate.

16
17 The intervenors have presented very broad but extremely
18 shallow and unsupported or grossly inaccurate theories and
19 calculations. Through their theories, intervenors reach
20 outrageous conclusions such as TECO Transport may be
21 overcharging Tampa Electric for waterborne transportation
22 services by as much as \$40 million a year. To put into
23 perspective how outrageous these allegations are, according
24 to TECO Energy's 2003 Annual Report, TECO Transport's total
25 net income for 2003 was only \$15.3 million and revenues from

1 Tampa Electric accounted for about 38 percent of the
2 business' total revenues.

3
4 No intervenor has provided relevant information that
5 demonstrates TECO Transport's rates under the contract for
6 2004 through 2008 for transportation services for coal from
7 the Midwest to Tampa are above market rates. This is
8 especially true today, just four months into the contract,
9 when ocean rates alone have almost tripled.

10
11 No intervenor has offered any credible evidence warranting a
12 change to the existing benchmark methodology defined in
13 Order No. 20298. Intervenors have only sought to have Tampa
14 Electric rebid a service which under this Commission's
15 existing policies does not require a bid solicitation in the
16 first place. The Commission explicitly recognized in 1988
17 that affiliate contracts are not required or expected to be
18 bid. The Commission instead established a market-based
19 price benchmark to be used as an upper limit to affiliate
20 pricing of coal transportation services. Tampa Electric has
21 been consistently below the benchmark year after year.
22 Intervenors, in effect, seek a retroactive application of a
23 new and yet undefined policy as it relates to a contract
24 entered into under the policies established in Order No.
25 20298.

1 Q. Have you prepared an exhibit in support of your rebuttal
2 testimony?

3
4 A. Yes. Exhibit No. ____ (JTW-2), consisting of seven
5 documents, was prepared under my direction and supervision.
6 Document No. 1 is entitled "Excerpts from Order No. 20298";
7 Document No. 2 is correspondence dated July 16, 2003 from
8 Ms. Dee Brown to Mr. Tim Devlin; Document No. 3 is entitled
9 "Articles about CSXT's Poor Service Levels"; Document No. 4
10 is entitled "Evaluation of Rail vs. Water Delivery Economics
11 for Western Kentucky Coal"; Document No. 5 is correspondence
12 dated April 21, 2004 the Petroleum Coke Management Company
13 to Ms. Joann Wehle; Document No. 6 is a graph showing
14 Columbian and Venezuelan Spot Price Volatility; and Document
15 No. 7 is a comparison of TECO Transport's rates compared to
16 the coal benchmark.

17
18 **BACKGROUND**

19 Q. Please describe the facts and circumstances which caused
20 TECO to develop an affiliated waterborne coal transportation
21 system.

22
23 A. During the 1940's and early 1950's all electric generation
24 in peninsular Florida was powered by oil. Steam generating
25 units used residual oil while many small municipal systems

1 relied on diesel engines and No. 2 distillate oil. While
2 Tampa Electric did have oil supply contracts in those days,
3 there was no real competition and all such contracts were
4 related to prices posted in the world petroleum market. In
5 view of this fact, Florida fuel prices for utilities
6 appeared to be relatively high as compared to other areas of
7 the country where other fuel types were available to
8 electric utilities.

9

10 For these reasons, TECO management investigated the
11 availability of other fuels for the company's then new
12 Gannon Station when planning for this new station began in
13 the early 1950's. Both coal and natural gas were
14 considered.

15

16 Coal's principal disadvantage was transportation costs.
17 Rail rates to Florida from northern coal fields were so high
18 that coal was not competitive with oil. Water
19 transportation systems from the same areas were nonexistent.
20 Obviously, some new means of transportation had to be
21 developed if coal were to become a viable alternative.

22

23 TECO's CEO William MacInnes met with oil company
24 representatives to attempt to work towards a solution. The
25 oil companies did not take his concerns and efforts

1 seriously. He ignored them and a water transportation
2 system was created which could transport coal southward to
3 Tampa. The barges in the initial fleet were old converted
4 oil tankers of about 14,000 dry weight tons and tug-barge
5 units of about 19,200 short tons. This fleet has been
6 continuously upgraded with larger faster vessels and
7 facilities which are finely tuned to Tampa Electric's
8 transportation service needs. All of the additional
9 investment in TECO Transport's improved fleet has been
10 through acquisition of equipment which has improved the
11 economies of scale and efficiency of this system to very
12 effectively compete in the market for Tampa Electric's coal
13 transportation service needs.

14
15 Once this transportation system went into operation, rail
16 rates into Florida began to drop almost immediately. It has
17 been conservatively estimated that the transportation system
18 has saved Tampa Electric's customers over \$500 million in
19 transportation costs alone during the years that it has been
20 in operation. The lowering of rail rates in response to the
21 competition of water transportation has benefited and
22 continues to benefit ratepayers throughout Florida because
23 rail carriers compete with waterborne carriers for the
24 delivery of coal.

25

1 As I will discuss later in my testimony, rail rates are an
2 effective gauge of the upper limit of the market for
3 transportation of coal and are now and have been an
4 effective market-based price benchmark used to determine the
5 reasonableness of prices charged by TECO Transport to Tampa
6 Electric. The existence of a market for the delivery of
7 coal to Tampa is confirmed by CSXT's interest and
8 intervention in this proceeding. An appropriate analysis
9 comparing CSXT's offer to provide rail service with the
10 contract entered into by TECO Transport and Tampa Electric
11 shows, without a doubt, that by fair comparison, contract
12 prices under the new contract, which went into effect
13 January 1, 2004, are below CSXT's proposals. I will
14 demonstrate in my rebuttal testimony that the charges made
15 by OPC, FIPUG, CSXT, and Dr. Hochstein are patently
16 incorrect and unsubstantiated.

17
18 **COAL TRANSPORTATION PROCUREMENT PROCESS**

19 **Q.** Under the Florida Public Service Commission's Order No.
20 20298, is Tampa Electric obligated to issue an RFP for coal
21 transportation services with its affiliate, TECO Transport?
22

23 **A.** No. In 1988, as part of resolving a contested proceeding,
24 Tampa Electric and OPC entered into a settlement with the
25 approval of the Commission's Staff and the acquiescence of

1 FIPUG, which is now embodied in Order No. 20298. The order
2 is the policy of this Commission and it plainly states:

3
4 "Tampa Electric may negotiate its contracts
5 with its affiliate in any manner it deems
6 reasonable."

7
8 The order is attached as Document No. 1 in my direct
9 testimony and pertinent excerpts from the order are in
10 Document No. 1 to my rebuttal exhibit. Intervenors have
11 fundamentally failed to acknowledge the Commission Order and
12 policy.

13
14 **Q.** If Tampa Electric was not required to issue an RFP, then why
15 did it do so?

16
17 **A.** Tampa Electric decided to issue an RFP as part of its good-
18 faith efforts and at the urging of the FPSC Staff to obtain
19 the most relevant and timely waterborne transportation
20 market data available. Tampa Electric's expert witnesses
21 Dibner and Murrell have provided rebuttal testimony that
22 demonstrates Tampa Electric's RFP process was fair and
23 appropriate.

24
25 **Q.** Under the Commission's Order No. 20298, is Tampa Electric

1 obligated to negotiate with its affiliate at "arms length"
2 as suggested by Mr. Majoros on page 17 of his testimony?

3
4 **A.** Order No. 20298 states Tampa Electric shall "be free to
5 negotiate its contracts with its affiliates in any manner it
6 deems to be fair and reasonable." This Order also plainly
7 states:

8
9 . . . the typical affiliate contract is let
10 without the benefit of competitive bidding.
11 Instead, confident that the contract will be
12 given to the affiliate, representatives of
13 the two companies negotiate the rate at
14 which the product or service will be
15 purchased.

16
17 Tampa Electric went well beyond the requirements of the
18 Commission's policies by conducting the RFP and strictly
19 followed these policies in arriving at a contract price
20 which is at or below the market price for coal
21 transportation services.

22
23 Dr. Hochstein urges the Commission to order a rebid, wrote
24 Order No. 20298 when he was a staff attorney for this
25 Commission. Not only did Tampa Electric test the market

1 through an RFP, it hired Mr. Dibner to assist in the RFP
2 review process, analyze the solicitation results, and
3 develop a comprehensive market pricing model which took into
4 account current waterborne transportation market conditions.
5

6 **Q.** According to Mr. Majoros, the RFP was designed to only
7 benefit TECO Transport but was not sufficient to elicit
8 bids. How do you respond?
9

10 **A.** Tampa Electric's RFP was designed to clearly identify and
11 solicitation responses that met the company's needs and
12 preferences for the continuation of low cost and reliable
13 waterborne transportation services for its coal supply to
14 the generating stations. The RFP was similar to ones used
15 in the past but contains modifications that the FPSC Staff
16 acknowledged as improvements. As confirmed by Messrs.
17 Dibner and Murrell, the RFP specifications and evaluation
18 process were reasonable, fair and consistent with that of
19 the industry.
20

21 **Q.** OPC/FIPUG witness Wells at page 6 of his testimony is
22 critical of the company for failing to address the
23 Commission Staff's suggested changes to the RFP. Did Tampa
24 Electric consider the changes that Staff suggested?
25

1 A. Tampa Electric carefully evaluated and considered Staff's
2 suggestions and took the actions it deemed most appropriate
3 and consistent with this Commission's existing policy. This
4 consideration is documented correspondence sent from Ms. Dee
5 Brown, Tampa Electric's Vice President of Regulatory
6 Affairs, to Mr. Tim Delvin of the Commission Staff. I have
7 attached the letter as Document No. 2 of my exhibit.

8

9 Q. Is the right of first refusal provision in the contract an
10 industry standard and would you expect that it was known by
11 potential respondents to the RFP?

12

13 A. Given the length of time that Tampa Electric and TECO
14 Transport have maintained a contractual relationship, one
15 could expect that a right of first refusal clause would be
16 in the current contract. Any long-standing relationship
17 with a supplier who has invested significant capital in
18 providing a service, affiliated or not, warrants the
19 consideration of a right of first refusal in order to
20 encourage that supplier to continue to invest capital to
21 improve its service to that customer.

22

23 A right of first refusal clause is common in the coal and
24 coal transportation industry. This was confirmed in the
25 fall of 2003 during a deposition of Mr. Herbert Ball, Fuels

1 Manager for Gulf Power Company. He acknowledged that Gulf's
2 unaffiliated barge carrier, Ingram Barge Line, has the
3 opportunity to match other bidders' rates. (Deposition
4 Transcript, Ball, Pg 17-18) I am also aware of other
5 companies that recently negotiated contracts with right of
6 first refusal clauses. They include Georgia Power, Alcoa
7 Generating, First Energy and Kentucky Utilities.

8
9 **Q.** Did Tampa Electric's undisclosed right of first refusal
10 contract provision adversely impact the RFP process?

11
12 **A.** No. Because the contract terms provision were strictly
13 confidential and by not disclosing the right of first
14 refusal contract provision, the bid prices for
15 transportation and terminal services were reflective of the
16 market and not unduly impacted by external circumstances.

17
18 **Q.** Dr. Hochstein also suggests, on page 5 of his testimony,
19 that there were numerous conditions in the RFP that are non-
20 standard and unreasonable such as the range of volume,
21 demurrage and storage volume requirements, and certain
22 payment requirements, to name a few. How do you respond?

23
24 **A.** The conditions and requirements included in the RFP are very
25 similar to those used in Tampa Electric's prior waterborne

1 transportation RFP. Tampa Electric's witnesses Dibner and
2 Murrell agree with me that these provisions are typical,
3 reasonable requirements and conditions necessary to ensure
4 that the services Tampa Electric receives under the contract
5 are the services it requires to reliably serve its
6 customers.

7
8 **Q.** Was Tampa Electric's range of volume required in its 2003
9 RFP a standard and reasonable requirement?

10
11 **A.** Yes. It was not only standard and reasonable, it was
12 absolutely necessary to ensure Tampa Electric received the
13 service it requires. The requested tonnage for each segment
14 is a percentage of total solid fuel burn requirements. The
15 river and terminal minimums were set to be 50 to 60 percent
16 of projected burn through 2008, thereby allowing Tampa
17 Electric to maintain flexibility regarding where it can
18 procure coal, and secure the base portion of river
19 transportation capacity. This same methodology was used for
20 ocean tonnages, although a higher percentage was specified
21 to consider Texas petroleum coke ("pet coke") and foreign
22 coal deliveries.

23
24 **Q.** On page 20 of his testimony, Dr. Hochstein states that the
25 RFP payment schedule requirement is not a standard agreement

1 and it is not reasonable. How do you respond?
2

3 **A.** The RFP stated Tampa Electric's preference. Tampa Electric
4 was willing to consider any alternatives that were proposed.
5 Furthermore, in [REDACTED] bid
6 response, the only bona fide bid received, they agreed to
7 the payment schedule requirement.
8

9 **Q.** Was Tampa Electric's RFP requirement for weight measurement
10 a standard and reasonable requirement?
11

12 **A.** Yes, it is standard that origin weights at river barge
13 loading govern. Coal suppliers are unwilling to take the
14 risk of weights when they do not have control over the
15 transportation service provider.
16

17 **Q.** Was Tampa Electric's inclusion of a cargo loss requirement
18 in its RFP an industry standard and was it reasonable?
19

20 **A.** Yes. This is a standard industry practice that Dr.
21 Hochstein seems to confuse with inventory shrinkage. The
22 cargo loss requirement relates to the carrier's insurance
23 coverage in the event that the barge or vessel cargo is lost
24 as a result of accidents, storms, etc. and it protects a
25 shipper like Tampa Electric.

1 Q. Was Tampa Electric's inclusion of a "no-cost expedition of
2 shipment" requirement in its RFP an industry standard and
3 reasonable?
4

5 A. This clause is standard and reasonable given Tampa
6 Electric's obligation to ensure the continued reliability of
7 its generating units. The "no-cost expedition of shipment"
8 requirement simply allows Tampa Electric the ability to
9 request priority handling for specific shipments.
10

11 Q. Why wasn't TECO Transport required to submit a bid along
12 with the other bidders as suggested by Messrs. Wells and
13 Majoros?
14

15 A. As described earlier, the contract between Tampa Electric
16 and TECO Transport contained a right of first refusal
17 clause. With this common contractual right, TECO Transport
18 was not required to submit a bid along with other bidders,
19 another common practice as evidenced by Gulf Power in the
20 deposition I referenced above. If TECO Transport was
21 interested in continuing to perform the services, their
22 obligation was to "meet or beat" the market price for such
23 services.
24

25 Q. OPC/FIPUG witness Wells, on page 7 of his testimony, is

1 critical of the company for not establishing a dialogue with
2 bidders. Why wasn't this done?

3
4 **A.** Tampa Electric did provide bidders with the opportunity to
5 ask questions and to make comments directly to a company
6 representative. Several bidders did avail themselves of
7 this opportunity. The company's practice in procuring such
8 services does not require a formal pre-bid conference. In
9 addition, I am not aware of other utilities holding such
10 meetings for procurement of transportation services. The
11 RFP also invited any bidder to make a presentation of their
12 proposal which would have certainly provided a means to
13 establish dialogue between their company and Tampa Electric.
14 No bidder opted to do so.

15
16 **Q.** Witnesses Wells, Majoros and Sansom have asserted that Tampa
17 Electric should have provided the railroad with a copy of
18 the RFP. Why didn't the company provide them with a copy?

19
20 **A.** The RFP was for waterborne transportation of coal. Tampa
21 Electric provided the RFP to all companies known to Tampa
22 Electric that could provide such services. This did not
23 include CSXT or other rail or trucking companies, since none
24 currently has the facilities to provide the required
25 services. However, once CSXT expressed interest in

1 providing rail transportation services and requested the
2 RFP, it was immediately provided to them and they responded
3 by the stated deadline.
4

5 Q. OPC/FIPUG's witness Michael Majoros, accuses Tampa
6 Electric's waterborne expert, Mr. Brent Dibner of having
7 acted in the best interest of TECO Transport, not Tampa
8 Electric. Did Mr. Dibner act in the best interest of Tampa
9 Electric's customers?
10

11 A. Absolutely. Mr. Dibner was hired by Tampa Electric to serve
12 in a consulting capacity for the RFP review process and to
13 assist in the analysis of the RFP results. Mr. Dibner did
14 not have contact with TECO Transport, divulge any
15 information to TECO Transport nor was he given instructions
16 on how to conduct his modeling or the results it should
17 yield. The final outcome of Mr. Dibner's study was an
18 overall rate reduction of approximately five percent. This
19 could hardly be seen as acting in the best interests of TECO
20 Transport rather than Tampa Electric and its customers.
21

22 Q. Dr. Hochstein contends on page 35 of his testimony that
23 Tampa Electric should issue a new RFP with his recommended
24 changes. How do you respond?
25

1 A. A new RFP is not necessary because the original RFP was
2 sufficient and the bid evaluation process was fair. In
3 addition, due to the extensive media coverage of this
4 process and the scrutiny provided to date, it is doubtful
5 that providers would choose to participate in a second RFP.
6 Also, market prices for ocean transportation services have
7 risen dramatically since the fall of 2003; therefore, one
8 could only expect that RFP responses, if any, would include
9 much higher waterborne rates than those included in the
10 existing Tampa Electric and TECO Transport contract. Both
11 Mr. Murrell and Mr. Dibner address this along with the
12 causes for these market price increases.

13
14 **CSXT'S RAIL PROPOSALS**

15 Q. Describe the circumstances that led CSXT to provide its
16 proposal to Tampa Electric in October 2002.

17
18 A. CSXT met with Tampa Electric in May 2002 after its rail
19 service agreement for rail delivery to Tampa Electric's
20 Gannon Station had expired. While Tampa Electric understood
21 CSXT's marketing strategy and direction from their senior
22 management to make up for lost revenues, Tampa Electric
23 explained its existing waterborne transportation agreement
24 with TECO Transport to CSXT. Under the agreement, the
25 contract would expire year-end 2003. Tampa Electric also

1 pointed out that it did not have appropriate rail facilities
2 to receive coal at either Big Bend or Polk Power stations.
3 Irrespective, CSXT apparently felt compelled to make an
4 unsolicited proposal to Tampa Electric in October 2002.
5

6 **Q.** Did Tampa Electric request that CSXT submit a proposal as
7 stated in a letter dated to you on October 23, 2002 from
8 CSXT's Michael C. Bullock, Director Utility South?
9

10 **A.** No. In fact, after Tampa Electric received the letter and
11 proposal from CSXT, we asked CSXT to change its letter dated
12 October 23, 2002 suggesting the company made such a request.
13 The letter was misleading. Tampa Electric never requested
14 CSXT to submit a proposal.
15

16 **Q.** Was CSXT's proposal a bona fide proposal?
17

18 **A.** Not at all. There were several elements that suggest this.
19 For example:

- 20 1. The proposal was conditioned on CSXT's board approval.
- 21 2. CSXT's cover letter to the proposal acknowledges that
22 the proposal would "serve as the framework for further
23 discussions."
- 24 3. The proposal required that at least 1.8 million tons
25 must be delivered during 2003 even though CSXT knew

1 Tampa Electric had a transportation contract with TECO
2 Transport with minimum annual deliveries through 2003.
3 If Tampa Electric did not take all of the tonnage, it
4 would be subject to dead freight charges of [REDACTED] per
5 ton from CSXT.

- 6 4. The proposal was to become effective in 69 days with
7 minimum tonnage requirements even though no facilities
8 existed for receiving coal.

9
10 The unsolicited proposal had numerous other shortcomings and
11 Tampa Electric did not consider it a serious proposal.

12
13 **Q.** Please address Tampa Electric's operational issues at the
14 time CSXT made its proposal?

15
16 **A.** Although CSXT's proposal was made at a time that was
17 appropriate for its own business needs and direction, its
18 needs did not correspond with Tampa Electric's business and
19 customers' needs. At the time CSXT made its unsolicited
20 proposal, the company was in the process of conducting
21 various evaluations of its generation resources and needs.

22
23 Among other things, Tampa Electric was in the process of
24 making significant decisions about the most prudent means to
25 comply with the U.S. Environmental Protection Agency ("EPA")

1 and the Florida Department of Environmental Protection
2 consent decrees. One key decision being evaluated in late
3 2002 through early 2003 was how much longer its coal-fired
4 Gannon Station could continue to operate safely and reliably
5 given the environmental requirements that Gannon Station
6 terminate its coal operations by December 31, 2004.
7 Depending on the timing of the closure and conditions of its
8 existing coal transportation contract with TECO Transport
9 which had been entered into before the consent decrees
10 existed, the company was facing potential dead freight
11 impacts totaling over \$15 million. Dead freight is a term
12 used to indicate minimum tonnage that is "take or pay" in
13 nature. Tampa Electric was focused on reducing or
14 eliminating this exposure and potential negative customer
15 bill impact.

16
17 Another important issue under consideration in late 2002
18 through early 2004 was the future of burning coal at Big
19 Bend Station, again based on federal and state environmental
20 requirements. According to the consent decrees, Tampa
21 Electric is required to advise the EPA by May 1, 2005
22 regarding its plan for Big Bend Unit 4 and by May 1, 2007
23 with respect to Big Bend units 1, 2 and 3 whether each unit
24 will i) be shut down, ii) be repowered with natural gas as
25 its primary fuel, or iii) continue to be fired by coal.

1 While these issues were under consideration, the company was
2 seriously considering simply extending the terms of the
3 transportation contract for two or three years to meet the
4 committed tonnages for delivery and to gain a better
5 understanding of its future fuel mix and transportation
6 service needs. It was not practical nor prudent for the
7 company to enter into any type of serious discussions with
8 CSXT in October and November 2002.

9
10 **TAMPA ELECTRIC'S COAL SUPPLY AND COAL TRANSPORTATION**

11 **Q.** Please describe Tampa Electric's fuel procurement practices.

12
13 **A.** Tampa Electric's fuel procurement strategy is based on its
14 requirements to generate electricity utilizing fossil fuels
15 including coal, natural gas, oil and pet coke. The
16 company's fuels procurement process is based on an analysis
17 of its generation requirements along with input on fuel
18 pricing, pipeline operations, and market knowledge provided
19 by the Fuels section of the Wholesale Marketing & Fuels
20 Department.

21
22 The company seeks fuel supply contracts that optimize the
23 company's needs. Following are some of the specific factors
24 taken into consideration when procuring coal:

- 25
- Type of coal needed (i.e. low sulfur etc.)

- 1 • Specific burn needs (higher Btu/lb vs. lower Btu/lb)
- 2 • Delivered cost on a cents/MMBtu basis
- 3 • Quality specifications, including sulfur, Btu/lb,
- 4 chlorine, ash content, grindability and fusion
- 5 temperature
- 6 • Reliability of supply
- 7 • Creditworthiness of supplier
- 8 • Source of coal
- 9 • Delivery schedule (location of mine or facility)
- 10 • Payment arrangements
- 11 • Price escalations/re-openers
- 12 • Premium/penalty clauses
- 13 • Discount arrangements

14

15 The above list is not all-inclusive, but represents some of
16 the more common elements considered in the company's
17 procurement strategies.

18

19 **Q.** Would you consider Tampa Electric's coal procurement
20 practices to be prudent?

21

22 **A.** Yes, I would. Our coal procurement practices are cost
23 conscious, proven and efficient. Mr. Murrell, who has had
24 extensive experience in the coal and transportation
25 industries, has confirmed that Tampa Electric's practices

1 are prudent in his rebuttal testimony.

2
3 **Q.** What types of coals are burned at Big Bend Station?

4
5 **A.** Big Bend Station has four units with flue gas
6 desulfurization systems or scrubbers. The design fuel for
7 these units is an Illinois Basin, low ash fusion temperature
8 coal with sulfur limitations approximating a maximum of six
9 lbs. SO₂ /MMBtu.

10
11 Tampa Electric's air permit limitations allow the station
12 only minimal days annually to operate in an "unscrubbed" or
13 de-integrated mode. For these limited time frames, a mid-
14 sulfur Illinois Basin coal or foreign coal is procured based
15 on the best availability and pricing. The station burns
16 approximately five million tons of coal per year.

17
18 **Q.** Is CSXT capable of delivering domestic coal to Big Bend
19 Station?

20
21 **A.** Yes, but with several significant qualifiers. As I have
22 described, there are currently no rail facilities in place
23 to allow for direct rail deliveries. The company has also
24 determined that CSXT's rates are not the most cost effective
25 considering our coal supply portfolio. Finally, even if

1 coal could be delivered by rail to Big Bend, there are
2 certain blending and storage limitations that eliminate rail
3 delivery as a viable option. Having said this and giving
4 adequate consideration to certain reliability and service
5 issues, I assume CSXT would have the capability to deliver
6 coal once facilities are in place. Indeed, CSXT might be a
7 partial transportation solution if they were willing to make
8 an all inclusive legitimate proposal for delivery to Big
9 Bend, and we were able to solve certain blending and storage
10 limitations that I describe below.

11
12 **Q.** What types of coals are burned at Polk Power Station?

13
14 **A.** Polk Power Station is an integrated gasification combined
15 cycle unit ("Gasifier") that effectively turns a coal and
16 pet coke blend into synthetic gas. The fuel blend currently
17 being utilized is 60 percent pet coke and 40 percent coal.
18 This very precise blend must be maintained under the
19 station's stringent sulfur and chlorine requirements.
20 Utilizing the higher amount of pet coke has allowed the
21 station to be Tampa Electric's least fuel cost generator.

22
23 **Q.** Is CSXT capable of delivering pet coke, the predominant fuel
24 source for Polk Power Station to Tampa Electric?

1 A. No. As described in the rebuttal testimony of Mr. Murrell,
2 CSXT is not capable of delivering pet coke directly from
3 either domestic or foreign sources due to its location.
4

5 Q. Dr. Hochstein, is a proponent of foreign coal. Do you agree
6 with Dr. Hochstein's statement on page 61 of his testimony
7 that "Tampa Electric's use of imported coal at Big Bend is
8 very limited, especially in contrast to other Florida
9 utilities?"
10

11 A. Yes. However, it is important to point out that Tampa
12 Electric is one of the few Florida utilities utilizing
13 conventional limestone scrubbers. The other remaining
14 utilities in Florida purchase large amounts of low sulfur,
15 foreign coal because their generating units lack scrubbers.
16 Because Big Bend Station is fully scrubbed, it emits less
17 particulate matter and sulfur dioxide than those units that
18 are not scrubbed. In addition, given the boiler
19 configuration of three of Tampa Electric's Big Bend units,
20 South American coals have limited application in those
21 units. This is due to the low ash fusion temperature
22 requirements. Recent test burns have shown that the maximum
23 amount of South American coals that can be used in the Big
24 Bend boilers is 30 percent. Therefore, purchasing and using
25 large amounts of foreign coal would not be prudent for Tampa

1 Electric.

2
3 Q. Has Tampa Electric received recent bid solicitations for
4 imported coal in the last year? If so, what were the
5 results?

6
7 A. During late 2003, Tampa Electric conducted a bid
8 solicitation for long-term coal supply. The results of that
9 solicitation indicate that foreign coal delivered directly
10 to Big Bend Station was not the lowest cost on a fully
11 delivered cents per million basis when compared to domestic
12 coal. The bid solicitation was made prior to the recent
13 market price run-up in foreign coal and ocean going freight
14 rates, which would make the rates even higher today.

15
16 **TAMPA ELECTRIC'S EVALUATION OF CSXT'S RAIL PROPOSALS**

17 Q. Did Tampa Electric perform an analysis of CSXT's two rail
18 proposals submitted in July 2003?

19
20 A. Yes, as I discussed extensively in my direct testimony on
21 pages 23 through 31, Tampa Electric performed a complete
22 analysis of the CSXT proposals. It also hired S&L to review
23 the proposals and to provide an independent technology
24 screening analysis including cost estimates to retrofit the
25 Big Bend and Polk Power stations to allow for rail delivery

1 of coal. After our evaluation, including Mr. Dibner's
2 detailed market analysis, Tampa Electric concluded that
3 given the significant costs for capital infrastructure and
4 the additional operating and transportation costs that would
5 result from selecting rail transportation, CSXT's proposals
6 were not competitive. I recommended rejecting both
7 proposals.

8
9 **Q.** Please address CSXT's witnesses Dr. Sansom's and Mr. White's
10 criticism that Tampa Electric did not take CSXT's bids
11 seriously.

12
13 **A.** As I explained above, Tampa Electric was not in a position
14 to seriously evaluate CSXT's unsolicited proposal from
15 October 2002. But once Tampa Electric did elect to solicit
16 waterborne transportation bids in June 2003, it issued its
17 RFP. CSXT, certainly not a waterborne transportation
18 company, submitted two bids in response to the RFP. Tampa
19 Electric did take CSXT's bids seriously and even hired S&L
20 to help determine overall costs associated with their
21 proposals. After a complete analysis, we determined that
22 CSXT's bids were not reasonable given the rates, terms, and
23 conditions included in the proposals. This was true even if
24 rail facilities were in place for delivery beginning January
25 1, 2004. In any case, based on the construction and

1 permitting time line, this date was not feasible.

2
3 **Q.** In your opinion, was CSXT's estimate for rail facilities
4 reasonable?

5
6 **A.** No. Based upon the detailed analysis performed by S&L's
7 Paula Guletsky and the assessments made by Mr. Murrell, it
8 appeared CSXT underestimated and understated the capital
9 costs and the time frame necessary for construction of such
10 facilities, including obtaining permits.

11
12 **Q.** Were the rail proposals rejected primarily due to capital
13 costs as asserted by OPC/FIPUG witness Majoros?

14
15 **A.** No. There were several cost related reasons why the rail
16 proposals were rejected, including capital and operating
17 costs that also needed to be considered. As I stated in my
18 direct testimony, some of the reasons included 1) the cost
19 impacts of acquiring coal from different supply locations
20 for rail versus water, 2) the incremental costs for short
21 hauls from the coal mine to rail versus water, 3) costs for
22 environmental impact mitigation, and 4) permitting and other
23 related costs, to name a few. Capital costs were only one
24 of several factors that were considered in the evaluation of
25 CSXT's rail proposals.

1 Q. Please describe some of the other terms and conditions of
2 the proposals that made them unattractive?

3
4 A. There were numerous terms and conditions that made CSXT's
5 proposals problematic. Some of these were:

6 1. The proposals required Tampa Electric to take an annual
7 minimum of one million tons from a CSXT direct rail
8 served rail origin or incur dead freight penalties at
9 [REDACTED]. Besides the penalties, this requirement
10 would dictate limited supply sources and suppliers and
11 would likely drive up coal costs once these conditions
12 were known in the marketplace.

13 2. The proposals required a commitment of 80 percent of
14 Polk Power Station's entire annual receipts. As I
15 previously stated and as Mr. Murrell has testified,
16 CSXT cannot deliver pet coke directly to Polk Power
17 Station. Therefore, Tampa Electric would be paying
18 substantially more for its fuel or be subject to dead
19 freight penalties. Currently, pet coke rates are about
20 67 percent lower than coal rates.

21 3. CSXT offered two options: a "Shuttle Option" and a
22 "Direct Rail Option." The price of the "Shuttle
23 Option" is [REDACTED]/ton higher than Tampa Electric's
24 current trucking rate. The "Direct Rail Option" would
25 all but eliminate the company's ability to purchase

1 less costly pet coke and limit coal supply options.

2 4. The proposals did not include a rate for the delivery
3 of pet coke to Big Bend or Polk Power station. Polk
4 Power Station requires pet coke to optimize dispatch
5 pricing.

6
7 CSXT's proposal was simply unreasonable, incomplete and
8 unfeasible.

9
10 **Q.** On page 25 of his testimony, Dr. Sansom alleges you
11 performed a "fatal mistake" when you evaluated CSXT's bid
12 and compared coal movement from the mine to rail facilities
13 vs. mine to barge facilities. How did you go about
14 determining the incremental costs to move coal from the mine
15 to a rail head rather than mine to a barge dock?

16
17 **A.** As noted in my direct testimony, we made direct inquiries of
18 coal suppliers we had under contract, Dodge Hill and Black
19 Beauty, regarding the incremental costs associated with
20 moving coal from the mine to rail rather than from the mine
21 to barge. The incremental costs would increase the cost of
22 coal by \$2.00 to \$6.00 per ton. These incremental costs
23 cannot be ignored as Dr. Sansom has done in his flawed
24 analysis. His omission substantially understates the actual
25 delivered cost of these fuels and casts doubt on the

1 legitimacy of his analysis.
2

3 **TAMPA ELECTRIC'S STORAGE AND BLENDING CAPABILITIES**

4 **Q.** Both CSXT's witnesses and Dr. Hochstein make certain
5 allegations that Big Bend Station is underutilized for
6 storing and blending coal. Please describe Tampa Electric's
7 policy regarding coal inventory storage.
8

9 **A.** Tampa Electric maintains its coal inventory at levels
10 necessary to protect against potential interruptions in the
11 supply of fuel and to provide for generation contingencies
12 such as unanticipated changes in load. The company also
13 considers supply system reliability, anticipated fuel
14 supply, market conditions, weather and economics.
15

16 **Q.** What has Tampa Electric and the Commission deemed to be an
17 appropriate level of coal inventory?
18

19 **A.** While it may be common for Midwestern utilities to store 30
20 to 45 days of inventory, the Commission determined in Order
21 No. PSC-93-0165-FOF-EI that it is appropriate for Tampa
22 Electric to maintain up to 98 days of system inventory. In
23 making its decision, the Commission recognized the distance
24 between Tampa Electric's generating stations and coalfields.
25 Therefore, the 98 days of system inventory for ratemaking

1 purposes. Furthermore, the Commission has approved the
2 company's *Long-Term Energy Emergency Plan* requires exact
3 actions in the event that system-wide inventory levels dip
4 below a 50-day supply with expected continuing declines.
5 There is a strong relationship between low inventory levels
6 and price volatility. Utilities' low inventory levels
7 certainly contributed to the cost run-ups in the market in
8 late 2000 and 2001. Given these circumstances, Tampa
9 Electric maintains its inventory levels for reliability and
10 to insulate itself from price volatility.

11
12 **Q.** What is Big Bend Station's typical coal storage capacity and
13 how does that translate to days on hand of inventory for the
14 station?

15
16 **A.** Big Bend Station's typical storage capacity is approximately
17 750,000 tons which translates to about 50 days of demand.
18 About 60,000 tons of the coal inventory are stored at Big
19 Bend Station for Polk Power Station that portion needs to be
20 excluded. Additionally, approximately 80,000 tons of medium
21 sulfur coal must be maintained for Big Bend units operating
22 in an "unscrubbed" or de-integrated mode. Once those two
23 amounts are subtracted, the maximum storage of Big Bend
24 Station coal is about 610,000 tons, which equates to about
25 40 days of demand.

1 Q. Are there any concerns with increasing storage at Big Bend
2 Station as suggested by Drs. Sansom and Hochstein?

3
4 A. Yes, there are. While Tampa Electric had, at one point in
5 time, an inventory level at Big Bend Station that approached
6 one million tons, the company encountered numerous
7 environmental problems. The company experienced dusting
8 problems, inability to administer dust suppression to coal
9 piles, and water drainage and runoff issues. Dust
10 suppression is necessary when a power plant such as Big Bend
11 is located in a metropolitan area. Given the operational
12 and the community issues associated with such levels, the
13 company would not, as a norm, allow these levels of
14 inventory.

15
16 Q. Dr. Hochstein states that Tampa Electric's storage volumes
17 at TECO Bulk Terminal with its eight separate piles are not
18 standard or reasonable requirements. Is he correct?

19
20 A. No. This statement makes it apparent that Dr. Hochstein is
21 not familiar with Tampa Electric's coal plant operations.
22 Due to the gasifier at Polk Power Station, Tampa Electric
23 must maintain three separate coal piles at TECO Bulk
24 Terminal to meet the precise blending requirements of the
25 gasifier. In addition, for Big Bend Station, Tampa Electric

1 must maintain a separate pile for "compliance coal"
2 purposes. This coal is utilized when Big Bend is operating
3 in an "unscrubbed" or de-integrated mode. Two standard
4 piles are also maintained that have different Btu values.
5 Typically, the lower Btu coal is used in the shoulder months
6 and the higher Btu coal is used in the summer.
7 Additionally, there is a pile that is utilized for test
8 burns. Therefore, the requirement for up to eight separate
9 piles was reasonable and a necessary requirement based on
10 Tampa Electric's on-going plant operations. Furthermore, in
11 [REDACTED] bid responses, they agreed to not only the eight pile
12 requirement, but also indicated that additional piles and
13 storage capacity could be provided with sufficient notice.
14

15 **Q.** Does Big Bend Station have sufficient storage capacity to
16 take imported coal directly?
17

18 **A.** Yes, but only in limited quantities and with smaller vessels
19 delivering the coal.
20

21 **Q.** Are there coal blending capabilities at Big Bend Station?
22

23 **A.** Yes. As I described in my direct testimony, there are
24 blending facilities at Big Bend Station that are integral to
25 the Big Bend boilers. However, Big Bend Station does not

1 have blending capabilities for Polk Power Station. This
2 precise blend is made at TECO Bulk Terminal where the
3 products are delivered and stored prior to blending. TECO
4 Bulk Terminal has the appropriate equipment to mix the blend
5 to its precise specifications.
6

7 **Q.** Do you agree with Dr. Sansom's conclusion at page 41 of his
8 testimony that Big Bend should replace storage and blending
9 currently performed at TECO Bulk Terminal?
10

11 **A.** No. As I have described above, it would not be reasonable,
12 practical or feasible to increase the storage capabilities
13 at Big Bend Station even if it did have the ability to blend
14 coal for Polk Power Station, which it does not. TECO Bulk
15 Terminal is an essential link in our transportation chain.
16 Besides being needed for coal blending and storage, it is
17 also a necessary coordinating facility that allows river
18 barges to offload onto gulf vessels. Because river barges
19 cannot cross the Gulf of Mexico.
20

21 **REBUTTAL SPECIFIC TO CSXT'S TESTIMONY**

22 **Q.** Has Tampa Electric ever contracted for coal transportation
23 services with CSXT? If so, what were the circumstances?
24

25 **A.** Yes. Tampa Electric has had a long business relationship

1 with CSXT for coal transportation services. CSXT witness
2 White mentions a relationship spanning from 1996 through
3 2001; however, it goes back over 30 years. CSXT delivered
4 coal to Gannon Station for decades. This contract expired
5 once Gannon Station was converted from coal to natural gas
6 and the last rail deliveries by CSXT were in October 2001.
7

8 **Q.** On a qualitative basis, how would you describe the services
9 performed by CSXT?
10

11 **A.** The trade press has recently detailed numerous complaints
12 about CSXT's service levels. These reports are in line with
13 Tampa Electric's experiences. Over the last three years
14 when CSXT was delivering to Gannon Station, the tonnages
15 were declining from approximately 500,000 tons in 1999 to
16 just over 200,000 tons in 2001. During this time, we
17 consistently experienced situations where railcars were
18 missing or diverted. At other times, unscheduled or
19 unexpected railcars would show up with other trains. It
20 became a great administrative burden to investigate and
21 track supply, make associated adjustments to invoices and to
22 decipher related billings. On numerous occasions, Tampa
23 Electric identified billing errors.
24

25 As I stated above, this experience was not unique to Tampa

1 Electric. Document No. 3 of my exhibit includes recent
2 articles about CSXT service problems. For example, on page
3 3 of the Morgan Stanley's April 29, 2004 analysis "CSX
4 Quarterly Performance Measures Going in the Wrong Direction,
5 1Q02-1Q04," graphically depicts "CSX's service woes [that]
6 have dropped to a level where it is meaningfully impacting
7 the carrier's ability to secure additional business and
8 customer rate increases on non-captive business."
9 Additionally, witness Murrell cites in his rebuttal
10 testimony, numerous CSXT customer complaints regarding
11 rates. One interesting correlation to note is that railroad
12 service levels decline in times of pricing volatility.
13 Tampa Electric experienced this in 2001.

14
15 **Q.** Since October 2001, have you taken any coal by rail from
16 CSXT?

17
18 **A.** Yes. In the fall of 2002, Tampa Electric purchased two
19 trains of coal to supplement low inventories at Gannon
20 Station due to geological problems at the Galatia mine and
21 higher than expected demands for electricity. Given the
22 inventory levels and a recent proposal by CSXT, Tampa
23 Electric requested delivery of two trains to Gannon Station
24 through CSXT's Conrad Yelvington transfer facility. The
25 Yelvington terminal took over four weeks to unload the two

1 trains which totaled only 17,224 tons. By the time all the
2 coal arrived at Gannon Station, the inventory levels were
3 back to normal because the geological problems at the mine
4 were resolved and TECO Transport had given priority handling
5 for all shipments of the Galatia coal.
6

7 Q. Based upon Dr. Sansom's use of the term "bi-modal
8 transportation" would you characterize Tampa Electric's
9 approach to coal transportation as a bi-modal approach?
10

11 A. Yes I would. I understand Dr. Sansom's term to describe the
12 utilization and optimization of both rail and water
13 transportation. Tampa Electric has utilized both rail and
14 waterborne transportation to move coal from the mines to its
15 generating stations. Even today, after Gannon Station's
16 conversion, Tampa Electric utilizes rail or truck services
17 for short hauls to move coal from the mine to a dock
18 facility.
19

20 Q. Besides the short rail hauls from coal mines to dock
21 facilities, is it currently feasible for Tampa Electric to
22 adopt Dr. Sansom's general recommendation that Tampa
23 Electric should "exploit all available - here, both water
24 and rail - modes by pursuing bids from alternative
25 transportation service providers?"

1 A. In theory, yes, but in reality, no. Dr. Sansom's testimony
2 is primarily based upon "Monday morning quarterbacking"
3 through the development of a very selective scenario that
4 must include terminating or modifying existing coal
5 contracts in order to justify rail in the bi-modal approach
6 that is cheaper than Tampa Electric's current coal commodity
7 and coal transportation costs. To do this, Dr. Sansom
8 needed to go back into time to a period whereby rail origin
9 coal supplier coal prices were less expensive than Tampa
10 Electric's existing coal contracts and to then suggest that
11 Tampa Electric breach its existing coal contracts which Dr.
12 Sansom knows results in monetary penalties, which are
13 conveniently excluded from his analysis.

14
15 In actuality, Tampa Electric has existing long-, medium- and
16 short-term coal agreements based upon the needs of the
17 company's generating units. These contracts were entered
18 into based upon the company's prudent procurement practices
19 utilizing the best market information available. Tampa
20 Electric's coal contracts were entered into based upon an
21 overall analysis of delivered coal prices. Since there are
22 no rail facilities in place today, the company's contracts
23 are such that river and ocean barges are the most economic
24 modes of transportation. This is precisely the reason the
25 company issued a waterborne transportation RFP. After

1 considering CSXT's proposals, the company determined that
2 the proposals were not reasonable given the terms,
3 conditions, and rates. Based on this, I do not believe it
4 is practical to utilize this rail transportation approach.

5
6 **Q.** What would be the impact to Tampa Electric's ratepayers if
7 Tampa Electric were to prematurely break its existing coal
8 supply agreements as suggested by Dr. Sansom?

9
10 **A.** Even if there were provisions in existing coal contracts
11 that would contemplate a breach, I have not spent much time
12 attempting to quantify the impacts. It is illegal to breach
13 a contract based upon pricing matters and the liquidated
14 damages associated with such actions would be costly and not
15 something the company would consider given its reasonable
16 and prudent approach to coal procurement. Dr. Sansom himself
17 should be aware of the impact that breaching contracts has
18 on a utility's reputation and its ability to construct new
19 contracts on favorable terms going forward.

20
21 **Q.** Please comment on Dr. Sansom's analysis of LG&E, TVA, and
22 Seminole's coal supply and transportation costs compared to
23 Tampa Electric's. Are these appropriate comparisons?

24
25 **A.** No. Dr. Sansom has taken delivered coal information from

1 FERC Form 423s. Delivered coal prices consist of both the
2 price of coal along with the price of transportation. It is
3 important to understand the breakdown of the two along with
4 the specific utility circumstances for which the coal was
5 procured. Dr. Sansom does not do this.

6
7 To compare Tampa Electric's transportation costs, a
8 southeastern utility, to LG&E and TVA, Midwestern utilities,
9 is simply unfair and improper. Obviously these midwestern
10 generating facilities are advantaged by having the coal
11 fields close to their generation, thereby lowering their
12 transportation costs. Seminole maintains a very long-term
13 relationship with its main coal source, the Alliance Dotiki
14 mine. We know that their contract term spans some 20 to 30
15 years. What we do not know is 1) the breakdown of the
16 commodity vs. the transportation, 2) if this is a coal deal
17 vs. a synfuel deal which trades at a discount to coal and 3)
18 if the commodity pricing is based upon the result of a
19 larger settlement. Dr. Sansom conveniently selects
20 advantageous delivered costs that are narrowly defined and
21 beneficial to his argument. He ignores higher priced
22 delivered transportation service into Florida for such
23 intervenors as, Gainesville and and Progress Energy.
24 Document No. 4 of my exhibit corrects numerous errors and
25 assumptions Dr. Sansom made in his Exhibit RLS-6a when

1 evaluating rail versus water delivery for western Kentucky
2 coal. My document demonstrates that once coal rates are
3 adjusted for actual commodity and transportation pricing,
4 the western Kentucky coal delivered by water is as much as
5 [REDACTED] million less expensive than rail.
6

7 **Q.** Please elaborate on your comments about Dr. Sansom's
8 comparison of LG&E and TVA to Tampa Electric.
9

10 **A.** LG&E and TVA are not comparatively situated to Tampa
11 Electric. Their generating facilities practically reside in
12 the coalfield and they may have more opportunity to bring
13 coal to their facilities by a variety of modes such as
14 barge, rail, and truck. Tampa Electric does not have those
15 same opportunities.
16

17 **Q.** On page 15 of his testimony, Dr. Sansom accuses Tampa
18 Electric of purchasing coal from the Alliance Dotiki mine in
19 2002 and 2003 in order to provide TECO Transport with a
20 profitable move. Is he correct?
21

22 **A.** No. Both companies operate independently of each other. I
23 am not privy to TECO Transport's profitable moves.
24

25 Dr. Sansom omits a key piece of information. When the

1 solicitation was issued in June 2001 the coal market had
2 experienced a significant run-up in prices. Coal
3 inventories of all utilities were low. As a result, coal
4 vendors were taking advantage of the low supply in the
5 marketplace by raising prices. When Tampa Electric procured
6 this limited spot order of 400,000 tons, it did so in a
7 solicitation that awarded other barge origin coals as well
8 in order to meet Tampa Electric's inventory needs. The
9 purchase of the Dotiki coal was not related to TECO
10 Transport or its profits; it has however, to do with Tampa
11 Electric's need to increase coal inventories to acceptable
12 levels.

13
14 **Q.** Please elaborate on your comments about Dr. Sansom's
15 comparison of Seminole to Tampa Electric.

16
17 **A.** Dr. Sansom selected Seminole to serve as a contrast to Tampa
18 Electric's delivered coal prices at a time when market
19 conditions were most advantageous to his argument. As I
20 previously stated, Seminole has a 20 to 30 year agreement
21 with the Alliance Dotiki mine. Comparing such a long-term
22 coal agreement with Tampa Electric's agreement is like
23 comparing apples to oranges. Seminole's contract may
24 include volume discounts, synfuel, which sells at a
25 significant discount to coal, or other arrangements which

1 make it less expensive. Because the comparison is for
2 delivered coal prices, one must understand the coal contract
3 much better before jumping to the conclusion that Tampa
4 Electric's transaction with the Alliance Dotiki mine is
5 imprudent or that, in general, Tampa Electric is overpaying
6 by utilizing water rather than rail.

7
8 **Q.** How do you respond to Dr. Sansom's allegation that Tampa
9 Electric paid \$10 per ton more for the Western Kentucky coal
10 than Seminole did in order to shift business to its
11 affiliate to move the coal?

12
13 **A.** Once again, Dr. Sansom has made an error in his evaluation
14 by selecting anomalies in the market. Timing in the coal
15 market, as in any commodity market, is crucial. It is very
16 easy to judge pricing after the fact. He jumps to the
17 conclusion that transportation is what accounts for the \$10
18 per ton difference. This is not necessarily a correct
19 conclusion since the coal and transportation costs are
20 combined for FERC 423 reporting.

21
22 **Q.** Please comment on CSXT's conclusions that Tampa Electric
23 should have bid the NAPP Pitt 8 and the Illinois Basin
24 markets in the second quarter of 2003. What is the
25 relevance of the coal sources? What is the relevance of

1 this time frame?

2

3 **A.** Again, Dr. Sansom uses hindsight to select an ideal time to
4 support his argument. He selects a time when prices were
5 somewhat depressed. If one were to select a different point
6 in time such as now, Pitt 8 prices have experienced a much
7 greater increase than the Illinois Basin markets. Dr.
8 Sansom's argument falls flat.

9

10 Dr. Sansom also ignores the important fact that Tampa
11 Electric did not need the coal he claims should have been
12 procured in 2003 nor did the company have the facilities to
13 receive it. Ironically, on one hand he criticizes the
14 company for having too much inventory, yet he advocates that
15 the company purchase unneeded coal. He also fails to
16 acknowledge that some of the Pitt 8 producers are routinely
17 sold out or the coal is only available in limited supply.

18

19 **Q.** Please comment on Dr. Sansom's assessments that Tampa
20 Electric should have terminated and replaced coal from
21 Ziegler, Illinois Fuels, and Galatia with his preference
22 coal sources from the NAPP Pitt 8 and the Indiana markets.

23

24 **A.** Dr. Sansom appears to suggest or imply that Tampa Electric
25 terminate the Zeigler contract. As I mentioned earlier, Dr.

1 Sansom should know that breach of contract without cause is
2 illegal. Ziegler would not simply walk away from its long-
3 term contract with the company. There were and are no
4 grounds to terminate the Zeigler contract. If Dr. Sansom is
5 suggesting a buy-out or buy-down of the contract, there
6 would be costs associated with this. These costs would be
7 based on the remaining net present value of the contract or
8 the difference between the contract price and what the coal
9 supplier could sell that coal for in the market, if at all.
10 In the unlikely event that the Commission found such a buy-
11 out prudent, these costs, in addition to the new coal
12 contract costs, would be borne by Tampa Electric's
13 customers. Dr. Sansom did not factor this into his scenario
14 exercise.

15
16 As for the Galatia coal, Tampa Electric had the right to
17 terminate the coal contract in July 2002; however, at that
18 time, it was expected that Gannon Station would continue to
19 burn coal into 2004. Therefore, there was no reason to
20 terminate the agreement. The Galatia coal is also burned at
21 Big Bend Station as "compliance coal" for the limited times
22 when the units are operating in an "unscrubbed" or de-
23 integrated mode. Again, simply terminating this contract
24 would result in contract damages that would make other
25 alternative deals much less attractive.

1 Q. Are there non-quantitative aspects to terminating contracts?

2

3 A. Yes. It is essential to consider the impact to the
4 company's reputation when doing as Dr. Sansom suggests.
5 Terminating contracts without cause or due to above market
6 pricing can surely result in the utility acquiring a
7 reputation for such activities and would likely yield either
8 less supply opportunities or higher prices in the long run.
9 It is more than a little surprising to see a witness such as
10 Dr. Sansom seriously suggest contract abrogation as a
11 prudent business path.

12

13 Q. Do you agree with Dr. Sansom that there is a two percent Btu
14 loss of coal that is transloaded for barge shipment due to
15 multiple handling and that there is a 25 cents/ton Btu loss
16 for coal that is transloaded for barge shipment due to
17 moisture?

18

19 A. No. Dr. Sansom's assertions are incorrect. In his
20 testimony he states that "coal is loaded into a railcar or
21 truck and moved to a river dock where it is put in a pile,
22 then loaded on to barges." While this statement is factual,
23 it is irrelevant because the quantity and quality of coal is
24 measured when it is loaded onto a barge. Furthermore, there
25 is no empirical evidence that shows Btu loss and Tampa

1 Electric's experience does not support his assertions. What
2 happens to the coal prior to the point in the delivery chain
3 is not a concern for Tampa Electric. Mr. Murrell also
4 addresses this issue in his rebuttal testimony.

5
6 **Q.** Do you agree with Dr. Sansom that there is an additional one
7 dollar cost associated with "extra inventory" required to
8 maintain water deliveries?

9
10 **A.** No. His assertion that there is a cost of \$1.00 for "extra
11 inventory" is irrelevant because Tampa Electric is
12 reimbursed for only the cost of fuel purchased and
13 associated transportation at the time of consumption.

14
15 **Q.** According to Dr. Sansom, Tampa Electric is overpaying TECO
16 Transport by \$11.7 million in 2004, by \$22.5 million in
17 2005, and even more in 2006 through 2008. Do you agree with
18 his assessment?

19
20 **A.** Absolutely not. As I have demonstrated above, Dr. Samson
21 utilizes a very simple methodology of comparing rates
22 established under different agreements to Tampa Electric.
23 He contrives a scenario based on "Monday morning
24 quarterbacking" through the development of a very selective
25 scenario that must include terminating or modifying existing

1 coal contracts in order to justify rail. To do this, Dr.
2 Sansom selected a narrow window back in time where rail
3 origin coal prices were less expensive than Tampa Electric's
4 existing coal contracts. Then, he suggests that Tampa
5 Electric breach its existing coal contracts while ignoring
6 the associated costs. Furthermore, I think Dr. Sansom's
7 suggestion that TECO Transport is overcharging Tampa
8 Electric by over \$22.5 million lacks credibility because
9 when their total net income for 2003 was only \$15.3 million
10 and Tampa Electric only accounted for 38 percent of the
11 revenues.

12
13 **REBUTTAL SPECIFIC TO OPC/FIPUG'S TESTIMONY**

14 **Q.** Mr. Majoros states that Tampa Electric should have presented
15 the proposals to TECO Transport to "meet or beat." Would
16 this have been appropriate?

17
18 **A.** No, it would not have been. Had Tampa Electric presented
19 these bids to TECO Transport, it would have knowingly
20 provided confidential information to a direct competitor.
21 Moreover, with regard to the rail bids by CSXT, Tampa
22 Electric would have been providing a proposal it knew was
23 grossly misleading. With the inland river bid, it would
24 have been providing a bid that was somewhat incomplete,
25 given that the bid was from a company in bankruptcy without

1 the ability to deliver the quantities required under the
2 RFP. Mr. Majoros's statement is totally inappropriate.

3
4 **Q.** Mr. Majoros asserts TECO Transport's rates are overstated
5 annually by \$28 million primarily because Mr. Dibner's model
6 did not account for backhaul when determining market rates.
7 Do you agree?

8
9 **A.** Not at all. As Messrs. Dibner and Murrell address this in
10 more detail, it is totally improper to consider TECO
11 Transport's backhaul activities when setting a market rate
12 for providing Tampa Electric coal transportation services.
13 This Commission has considered backhaul impacts in the past
14 but only in instances when contracts are priced at cost-plus
15 rates, not at market rates. In Order No. 14782 when the
16 FPSC was reviewing Florida Power's cost-based transportation
17 pricing, it recognized that:

18
19 "any profit or loss resulting from the
20 prudent phosphate backhaul operations or
21 other non utility ventures which are
22 intended to reduce the cost of coal to FPC
23 and the utilization of equipment dedicated
24 to the utility's business should be included
25 in the price of coal."

1 At that time, Florida Power Corp.'s transportation contract
2 was priced at cost-plus, not at market.

3
4 **Q.** Mr. Majoros also states that TECO Transport's rates are
5 overstated because Mr. Dibner should not have considered a
6 "preference trade premium" when determining market rates.
7 Do you agree?

8
9 **A.** No. Mr. Dibner addresses this issue in more detail. Mr.
10 Dibner appropriately included this premium when determining
11 market rates for TECO Transport's services.

12
13 **Q.** Mr. Majoros alleges that the terminal services component of
14 the waterborne transportation rate in the current contract
15 should be the same as that in the old contract. Do you
16 think his adjustment is proper?

17
18 **A.** Not at all. Mr. Majoros loosely extends the "meet or beat"
19 market price concept. Under the right of first refusal
20 clause in the prior Tampa Electric and TECO Transport
21 contract, Tampa Electric was required to provide TECO
22 Transport with the current market rate, which TECO Transport
23 had the option to "meet or beat" that price. Mr. Majoros
24 would have you believe that the concept extends to the rates
25 under the prior contract; that is if the market rates

1 established in 1998 were lower than market rates in 2004,
2 TECO Transport should be obligated to the older rates. This
3 is simply absurd.
4

5 Q. At page 27 of his testimony, Mr. Majoros states that because
6 JEA paid \$9.00 per ton for transportation and Mr. Dibner's
7 proposed rate for similar movements is [REDACTED] per ton, Tampa
8 Electric is paying too much. Dr. Hochstein makes a similar
9 allegation. Do you agree with them?
10

11 A. No. The shipments cited by Mr. Majoros regarding TECO
12 Transport shipping pet coke to JEA are spot transactions
13 negotiated by a broker. Spot transaction costs may be
14 higher or lower depending on the circumstances of the deal
15 and the conditions of the market at a given time. For
16 example, on April 21, 2004, I received a letter from
17 Petroleum Coke Management Company, a broker of pet coke that
18 indicated the 2004 rates from TECO Ocean Shipping are
19 [REDACTED]/ton. I have attached the letter as Document No. 5 of
20 my exhibit. This rate is [REDACTED] percent greater than Tampa
21 Electric's pet coke rate. It is not reasonable to compare a
22 spot rate to a five-year contract that ensures
23 transportation services are available as required. Not
24 unlike hourly wholesale purchase power transactions, the
25 rate is determined relative to the spot market only and is

1 good for only a short duration of time. Mr. Majoros'
2 adjustment to the rate is incorrect and inappropriate. Drs.
3 Sansom and Hochstein have reached incorrect conclusions.
4

5 **REBUTTAL SPECIFIC TO DR. HOCHSTEIN**

6 **Q.** On page 5 of Dr. Hochstein's testimony he states "coal from
7 the mid-west fields can only rationally be transported to
8 Tampa Electric's Big Bend station by water" when he attempts
9 to assess the market. Do you agree with his statement?
10

11 **A.** No and it appears that Dr. Hochstein, later in his testimony
12 on page 61, disagrees with his own assertion by stating that
13 as part of a prudent supply strategy, Tampa Electric should
14 develop additional transportation options for domestic coal,
15 such as a rail option. As evidenced by Dr. Hochstein and
16 CSXT's bid to provide coal transportation services to Tampa
17 Electric, rail and water delivery of coal are in direct
18 competition.
19

20 **Q.** Dr. Hochstein states that direct delivery of imported coal
21 to Tampa could save the voyage along the Gulf Coast,
22 resulting in savings of more than \$10.00 per ton. How do
23 you respond?
24

25 **A.** Dr. Hochstein obviously does not understand the types of

1 coal qualities that are required in the company's boilers.
2 Many of the foreign fuels have high ash fusion temperatures
3 which cause operational problems in the Big Bend boilers.
4 In addition, our most recent bid analysis results show that
5 imported coal directly to Tampa's port facilities was not
6 the least cost option. In fact, South American spot pricing
7 has been extremely volatile over the past three and a half
8 years. I have graphed Columbian and Venezuelan spot prices
9 to show this volatility on Document No. 6 of my exhibit.

10

11 Q. Do you agree with Dr. Hochstein's calculation that taking
12 direct delivery of foreign coal, such as the Colombian
13 imports, to Big Bend Station will generate savings of about
14 \$9.35 per ton?

15

16 A. No, I do not. Again, our most recent solicitation conducted
17 in late 2003 for 2005 and beyond showed that Colombian
18 imports direct into Big Bend Station or to other Tampa port
19 facilities were not the cheapest alternative for Tampa
20 Electric. Like Dr. Sansom, Dr. Hochstein selects a narrowly
21 contrived time when South American commodity and transport
22 via foreign vessel was very advantageous to his argument.
23 The market has changed dramatically since these shipments.

24

25 Q. At the time Tampa Electric went out for bid, were other

1 terminals at the Port of Tampa operational and does either
2 facility currently blend coal?

3
4 **A.** At the time of Tampa Electric's waterborne transportation
5 RFP, Marigold/Drummond was planning to build a terminal, but
6 had no permits in place. The Marigold/Drummond Terminal,
7 which received its final permits in September of 2003, is
8 limited to self-unloading vessels that generally charge a
9 significant premium for bulk transportation. Kinder Morgan
10 was operating Pier 219, but was required to offload directly
11 to trucks, which would have made Tampa Electric liable for
12 significant demurrage. Kinder Morgan has since closed Pier
13 219 and is using its Port Sutton phosphate loading facility
14 that was purchased in December of 2003.

15
16 **Q.** Would Tampa Electric consider using the Port of Tampa
17 facilities in the future?

18
19 **A.** Yes. Tampa Electric would certainly consider using the
20 facilities if market conditions and contractual commitments
21 would yield the most reliable, cost effective alternative to
22 Tampa Electric's customers.

23
24 **Q.** Please comment on Dr. Hochstein's conclusion that if Tampa
25 Electric were to modify its transportation pattern by

1 delivering foreign coal directly to Tampa, the savings may
2 be as high as \$40 million.

3
4 **A.** His conclusion is outrageous. Witness Dibner demonstrated
5 that Dr. Hochstein's calculation of freight rates for the
6 ocean segment is replete with numerous errors and, when
7 adjusted, result in increased rates, not reduced rates, to
8 Tampa Electric and its customers.

9
10 **COAL TRANSPORTATION BENCHMARK**

11 **Q.** Explain how the benchmark for Tampa Electric works.

12
13 **A.** This Commission established a waterborne coal transportation
14 benchmark to address this issue. Each year Tampa Electric
15 compares its actual cost for waterborne coal transportation
16 services against the average of the lowest costs paid by
17 Florida municipal utilities for coal deliveries by rail.
18 The comparison is submitted to the Commission for review,
19 and as long as Tampa Electric's actual cost is at or below
20 the benchmark, the cost is deemed reasonable. If Tampa
21 Electric's waterborne transportation costs exceed the
22 benchmark in any given year, the company must justify any
23 costs greater than the benchmark amount before the
24 Commission allows recovery through the fuel clause.

25

1 Q. After reading the rebuttal testimony of OPC/FIPUG, CSXT, and
2 Dr. Hochstein, what is your general assessment regarding the
3 coal transportation benchmark?
4

5 A. It is clear that the witnesses for the intervenors contend
6 that the benchmark is no longer appropriate yet not one of
7 them offers a definitive alternative. It appears they would
8 have the Commission simply ignore the approved benchmark
9 methodology and accept their arbitrary respective approaches
10 to adjusting the overall costs for coal transportation and
11 then accept that as the appropriate amount for cost
12 recovery. I do not believe that is appropriate nor do I
13 believe any of them adequately demonstrated that the
14 benchmark is should be eliminated or modified. Anyone
15 urging a departure from an existing Commission approved
16 methodology should have the burden of demonstrating why the
17 methodology is no longer valid.
18

19 Q. Dr. Sansom concludes that the benchmark has no analytical
20 value based upon 1) his inability to obtain certain
21 information about Lakeland from the FPSC Staff, 2) the
22 backup information the Commission Staff provided him for
23 JEA's actual rail costs only showed non-discounted
24 information, and 3) your calculations, which have been made
25 by the company since the inception of the benchmark are

1 "invalid." How do you respond?
2

3 **A.** Dr. Sansom is wrong. Since the benchmark was first
4 established in 1988, Tampa Electric has provided accurate
5 and complete information as prescribed by Attachment A of
6 Order No. 20298. It appears that Dr. Sansom is challenging
7 the decisions and orders this Commission has issued on the
8 subject for the past 15 years. I find his unsubstantiated
9 conclusions to lack sufficient merit for serious
10 consideration.
11

12 **Q.** What flaws do you see in Dr. Hochstein's assessment of the
13 rail benchmark methodology?
14

15 **A.** It seems that Dr. Hochstein has confused establishing the
16 market rate for coal transportation services with that of
17 establishing a benchmark rate to gauge the reasonableness of
18 the market rate as part of an annual regulatory review
19 process. These are two separate and distinct issues.
20 First, the benchmark is not a factor in the establishment of
21 the market rate. Tampa Electric's determination that the
22 market rate was fair and reasonable was based on the
23 responses to the bid proposals and the market rate analysis
24 of Mr. Dibner, not a comparison to the municipal rail rates
25 as Mr. Hochstein states. Second, the benchmark establishes

1 the upper limit for reasonableness for cost recovery.
2 Unlike Progress Energy's benchmark for similar services,
3 Tampa Electric recovers the lesser of either its actual
4 transportation costs or the benchmark.
5

6 **Q.** Mr. Majoros states in his direct testimony that affiliate
7 transactions are always problematic, particularly when a
8 regulated affiliate like Tampa Electric is making purchases
9 from an unregulated affiliate such as TECO Transport. Do
10 you agree with Mr. Majoros?
11

12 **A.** Absolutely not. TECO Transport offers the most efficient,
13 reliable and cost effective means of transporting coal to
14 Tampa Electric. Even Dr. Hockstein acknowledges this.
15 Recognizing that affiliate transactions require more
16 scrutiny because of critics, like Mr. Majoros, the
17 Commission approved the rail benchmark to serve as an
18 effective ceiling price for cost recovery purposes. Tampa
19 Electric's transportation service costs charged by TECO
20 Transport have consistently been below the benchmark since
21 its inception in 1988.
22

23 **Q.** Mr. Majoros states in his testimony at page 29 that the rail
24 benchmark is clearly out of date and is highly overstated at
25 the present time. Do you agree?

1 A. No, I do not. It is illogical to conclude that because the
2 2002 benchmark was [REDACTED] percent higher than the recent rail bid
3 that the benchmark is not a useful tool. The differential
4 between Tampa Electric's contract rate and the current rail
5 proxy benchmark is about the same as it was in 1988 when the
6 benchmark was first adopted by the Commission. The
7 differentials are graphed in Document No. 7 of my exhibit.
8 This is an indication that conditions today are not
9 significantly different than the conditions in 1988 when the
10 benchmark was developed. It also demonstrates that TECO
11 Transport's rates have continuously, year after year, been
12 considerably below rail rates. Tampa Electric's customers
13 have greatly benefited by TECO Transport's efficient
14 operations.

15
16 Q. Has Tampa Electric conducted itself in a fair manner, from
17 the perspective of its customers, in administering its
18 contractual dealings with TECO Transport under the benchmark
19 approved in 1988?

20
21 A. Yes, we have. As I previously stated, the prices Tampa
22 Electric has paid have been consistently lower than the
23 benchmark price and the contract we entered into for 2004 -
24 2008 has an even lower price than the contract that expired
25 year-end 2003. In a Commission Staff document produced at

1 the request of an intervenor in this case, Staff made the
2 following observation concerning Tampa Electric's affiliated
3 coal transportation payments pursuant to the benchmark
4 methodology:

5
6 "... The settlement allows TECO to pay its
7 affiliate, TECO Transport and Trade any
8 amount up to the cap. In the last decade or
9 so, the amount paid by TECO to TECO
10 Transport and Trade has been about [REDACTED] per
11 ton less than the cap. Multiplying the [REDACTED]
12 per ton by about 4 million tons per year
13 calculates to about [REDACTED] million per year.
14 This means TECO Energy, the parent of both
15 TECO and TECO Transport and Trade, could
16 have increased the amount recovered through
17 the fuel cost recovery by about [REDACTED] million
18 per year. It is a tribute to TECO and TECO
19 Energy that they have not done so.

20
21 Tampa Electric's customers have continued to enjoy similar
22 savings for each and every year since the benchmark was
23 established 1988. It is totally inappropriate to suggest
24 that there should be any modifications to this methodology
25 for determining waterborne transportation cost recovery

1 related to this beneficial transaction between Tampa Electric
2 and TECO Transport.

3
4 **Q.** Does this complete your rebuttal testimony?

5
6 **A.** Yes, it does.

7
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EXHIBIT NO. _____
TAMPA ELECTRIC COMPANY
DOCKET NO. 031033-EI
(JTW-2)
FILED: MAY 3, 2004
DOCUMENT NO. 1

EXHIBIT TO THE
REBUTTAL TESTIMONY
OF
JOANN T. WEHLE

DOCUMENT NO. 1

"EXCERPTS FROM ORDER NO. 20298"

**EXCERPTS FROM ORDER NO. 20298
ISSUED IN DOCKET NO. 870001-EI-A
ON NOVEMBER 10, 1988**

The Staff Counsel identified on the first page of this Order is as follows:

MICHAEL B. TWOMEY, Esquire, Florida Public Service Commission,
Division of Legal Services, 101 East Gaines Street, Tallahassee, Florida
32399-0863
On behalf of the Commission Staff.

Order No. 20298 written by Mr. Twomey for the Commission provides in pertinent part:

SUMMARY

We have determined as a matter of policy that utilities seeking the recovery of the cost of coal purchased from an affiliate through their fuel and purchased power cost recovery clauses shall have their recovery limited by a "market price standard," rather than the "cost-plus" standard now in effect. We also have accepted a Stipulation among the parties to this docket which provides a methodology for implementing the market pricing standard for not only the coal Tampa Electric Company (TECO) purchases from an affiliate, but the transportation and handling services it purchases from affiliates, as well. (Emphasis supplied.)

* * *

We directed our Staff to conduct discussions amongst the affected parties for the purpose of determining how best to establish and implement market pricing mechanisms.

After extensive negotiations, the parties to this docket arrived at a Stipulated Agreement which provided a methodology for establishing "market" price proxies for all of TECO's affiliated fuel transactions. This order describes the TECO hearing in this docket, as well as the Stipulated Agreement, which we accept and approve.

* * *

TECO Transport and Trade

TECO Transport and Trade Corporation, is a subsidiary of TECO's parent company, TECO Energy, Inc. TECO Transport and Trade in turn, has five separate subsidiary operating companies which make up the water transportation system. Except for a small (less than ten percent or about 500,000 tons per year) share of TECO's requirements of Gatliff's sales, which are delivered to Gannon Station directly by rail, all of TECO's coal is delivered to Big Bend and Gannon Stations by barge under the direction of TECO Transport and Trade Corporation.

Mid-South Towing, which was established in 1959, owns or operates ten tow boats and over three hundred river barges. It transports coal from the coal fields near the Ohio River to the Electro-Coal Transfer facility some 40 miles down river from New Orleans.

The Electro-Coal Transfer facility is over 200 acres in size, provides on-ground storage for 4.5 million tons and controls over three miles of riverfront. It was established in the early 1960s and provides a location for river vessels to discharge coal and transfer it to ocean vessels or to ground storage. Bulk products hauled for others are also stored or transloaded by Electro-Coal.

* * *

CONCLUSION

As a result of this hearing and the companion hearing in Docket No. 860001-EI-G concerning Florida Power Corporation, we have concluded that it is desirable, where possible, to gauge the reasonableness of fuel costs sought to be recovered through a utility's fuel adjustment clause by comparison to a standard that attempts to measure what a given product or service would cost had it been obtained in the competitive market through an arm's-length contract with an unaffiliated third party. We believe that limiting cost recovery in this manner will best serve the interests of TECO's customers by insuring that they are not required to pay more than a market price for the fuel component of their electricity because of an affiliation between their utility and a fuel supplier.

* * *

Irrespective of whether any imprudence or unreasonable expenses are found and disallowances made, we agree with the parties to this case that a change from cost-plus pricing is warranted. While we believe that the current system has been generally successful in allowing only reasonable

and prudent costs to be passed through the utilities' fuel adjustment clauses, we concur with TECO's position that it has been administratively costly, caused unnecessary regulatory tension, and left the lingering suspicion that it has resulted in higher costs to a utility's customers.

Implicit in cost-plus pricing is the requirement that one is capable of conducting a cost-of-service analysis of a business to determine that its expenses are both necessary and reasonable. This is a methodology that is demanded for monopoly utility services, and which usually proves to be complex, expensive and time consuming. It is a methodology which requires a high degree of familiarity with the capital requirements and expenses necessitated by the operation of the business being reviewed. Cost-of-service analysis of affiliate operations places additional demands upon the regulatory agency in terms of time, expense and acquiring additional expertise. All come at some additional cost that must eventually be borne by the ratepayers, either in his role as a customer or as a taxpayer. Furthermore, there seems to be no end to the types of affiliated businesses that we are expected to become sufficiently familiar with so that we might judge the reasonableness of their costs on a cost-of-service basis.

Cost-of-service regulation for public utilities is necessitated by their monopoly status and the attendant lack of significant competition, if any, for their end product. Cost-of-service regulation exists as the proxy for competition to insure that utilities provide efficient, sufficient and adequate service and at a cost that includes only reasonable and necessary expenses. Cost-of-service regulation of some type is essential when there is no competitive market for the product or service being purchased; it is superfluous when such a competitive market exists.

There is another reason for switching to a market pricing system that was alluded to in TECO's statement that the current system, no matter how outstanding the results, left lingering suspicions that it resulted in higher costs. That this might be true may be seen by contrasting affiliated and non-affiliated contracts. The latter, with few exceptions, are characterized by arm's-length transactions entered into in the competitive marketplace. Typically, the contracts result from competitive bidding systems in which the contract is awarded to the qualified bidder submitting the lowest bid. In any event, the utility's negotiator has clearly defined loyalties and knows whose interests he or she is to protect. In contrast to this, the typical affiliate contract is let without the benefit of competitive bidding. Instead, confident that the contract will

be given to the affiliate, representatives of the two companies negotiate the rate at which the product or service will be purchased. (Emphasis supplied.)

PROPOSED STIPULATION AGREEMENT

In accordance with our directions at our September 6, 1988 Agenda Conference, our Staff, the Office of Public Counsel and TECO met to discuss the methods by which market pricing could be adopted for the affiliated coal and coal transportation transactions between TECO and its affiliates. As a result of numerous and lengthy negotiations, the parties have arrived at a Stipulation (Attachment A to this Order) which they have submitted for our approval. (Emphasis supplied.)

According to the Stipulation, TECO shall be free to negotiate its contracts with its affiliates in any manner it deems to be fair and reasonable. TECO agrees to prudently administer the provisions of its contracts. Furthermore, TECO agrees to report to the Commission the actual transfer prices paid by it to its affiliates under the contracts in the normal course of the fuel adjustment proceedings. (Emphasis supplied.)

* * *

Pursuant to the Stipulation, the parties agreed that the record in this proceeding indicated that the prices currently paid by TECO to TECO Transport and Trade are reasonable. Notwithstanding this, TECO agrees to the establishment of a benchmark price for coal transportation services to be used prospectively for regulatory review purposes. While TECO stated that it will execute its new contracts with TECO Transport and Trade at approximately the currently existing rates, which are less than current rail rates between the same points, the reasonableness of its actual transfer price for all of the transportation and transportation-related services from mine to generating plant would be compared to a coal transportation benchmark price. As shown on Attachment 3 to the Stipulation, the transportation benchmark would be calculated by averaging the two lowest comparable publicly-available, rail rates (in cents per ton-mile) for coal to other utilities in Florida and then multiplying that average times the average rail miles from all of TECO's coal sources to TECO's generating plants. The product would then have added to it the costs of privately-owned rail cars on a per ton, per trip basis. The total would be the coal transportation benchmark price. The actual transportation transfer price paid by TECO to TECO Transport and Trade, pursuant to its contracts, would be recoverable through the fuel

adjustment clause, as long as it was equal to or less than the benchmark price. Any excess above the benchmark would be disallowed for cost recovery unless justified by TECO. (Emphasis supplied.)

* * *

In his letter forwarding the Stipulation, counsel to TECO represented that he had supplied counsel to the Florida Insutrial Power Users Group (FIPUG) [the only other party to the proceeding] with a copy of the Stipulation and had been advised that FIPUG had no objection to the commission's final action on it. (Emphasis supplied.)

We believe that the proposed Stipulation meets our policy guidance and is in the public interest and shall, therefore, approve it.

* * *

If one considers the objective of coal transportation services to be the movement of the coal from the mine to the generating plant, then rail service and the total waterborne system are not only comparable, but competitive to a large degree, as well. We believe using the average of the two lowest publicly available rail rates for coal being shipped to Florida will provide a reasonable market price indication of the value being provided by TECO's affiliate waterborne system.

The Stipulation Agreement which is attached to and made a part of Order No. 20298 provides in pertinent part:

1. At the Commission's Agenda Conference on September 6, 1988, the Commission reviewed the affiliated cost-plus fuel supply relationships between Tampa Electric Company ("Tampa Electric") and its affiliates, Gatliff Coal Company ("Gatliff") and TECO Transport and Trade ("TTT"), and determined that cost-plus pricing should be replaced with market pricing for fuel supply relationships of Tampa Electric wherever possible.

2. In accordance with the Commission's direction, Staff, Office of Public Counsel ("OPC") and Tampa Electric have met to discuss the methods by which market pricing can be adopted for the affiliated coal and coal transportation transactions between Tampa Electric and its affiliates. As a result of these discussions, Staff, OPC and Tampa Electric agree as follows:

3. Public Counsel and Staff agree that the specific contract format, including the pricing indices which Tampa Electric may include in its contracts with its affiliates, are not subject to this proceeding and Tampa Electric may negotiate its contracts with its affiliates in any manner it deems to be fair and reasonable. Tampa Electric agrees to prudently administer the provisions of such contracts.

4. The transfer prices paid by Tampa Electric under contracts with its affiliates shall be reported to this Commission in the normal course of the fuel adjustment proceeding.

* * *

TECO Transport & Trade

8. The parties agree that the record in this proceeding indicates that the prices currently paid by Tampa Electric to TTT are reasonable.

9. Tampa Electric, however, agrees to the establishment of a benchmark price to be used prospectively for regulatory review purposes.

10. The coal transportation benchmark price will be the average of the two lowest comparable publicly available rail rates for coal to other utilities in Florida. This rail rate will be stated on a cents/ton-mile basis representing the comparable total elements (i.e., maintenance, train size, distance, ownership, etc.) for transportation. The average cents per ton-mile multiplied by the average rail miles from all coal sources to Tampa Electric's power plants yields a price per ton of transportation. The result will become the "benchmark price" as shown on Attachment 3.

a. The benchmark price will be used to evaluate water transportation of coal services provided by TTT to Tampa Electric.

b. The price paid for water transportation of coal by Tampa Electric above the benchmark price would be disallowed for cost recovery unless justified by Tampa Electric.

* * *

13. The parties hereto shall not unilaterally recommend or support the modification of this Stipulation or discourage its acceptance by the Commission.

14. The parties hereto shall not request reconsideration of or appeal the order which approves this Stipulation.

15. The parties urge that the Commission take final agency action at the earliest possible Agenda Conference approving this Stipulation.

* * *

17. While Staff for internal reasons prefers to signify its agreement with this Stipulation by writing a Staff memorandum recommending approval of the Stipulation, the Electric and Gas and Legal Staff of the Florida Public Service Commission has reviewed this Stipulation simultaneously with the signing; has given its approval of the specific language contained herein; and has committed to submit its recommendation requesting approval of this Stipulation by the Commission; and has committed not to unilaterally recommend or support the modification of this Stipulation or discourage its acceptance by the Commission.

EXHIBIT NO. _____
TAMPA ELECTRIC COMPANY
DOCKET NO. 031033-EI
(JTW-2)
FILED: MAY 3, 2004
DOCUMENT NO. 2

EXHIBIT TO THE
REBUTTAL TESTIMONY
OF
JOANN T. WEHLE

DOCUMENT NO. 2

"CORRESPONDENCE DATED JULY 16, 2003
FROM MS. DEE BROWN TO MR. TIM DEVLIN"

AUSLEY & McMULLEN

ATTORNEYS AND COUNSELORS AT LAW

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EXHIBIT NO. _____
TAMPA ELECTRIC COMPANY
DOCKET NO. 031033-EI
(JTW-2)
FILED: MAY 3, 2004
DOCUMENT NO. 2

July 16, 2003

HAND DELIVERED

Mr. Wm. Cochran Keating, IV
Senior Attorney
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

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

Dear Cochran:

This letter will serve as Tampa Electric Company's ("Tampa Electric's" or "the company's") responses to the following requests for documents and data to TECO Energy, Inc. and its affiliates, put forth in your letter to me dated July 14, 2003:

Staff Request No. 1

Please provide all materials that TECO Energy, Inc. or any affiliate thereof has provided to any potential buyer(s) of TECO Transport in order to provide information concerning TECO Transport and/or its potential sale.

Tampa Electric's Response: Tampa Electric has verified, and I am authorized to confirm on the company's behalf, that only one document was provided to potential purchasers of TECO Transport. A copy of that document, prepared by Merrill Lynch and circulated by that organization to entities it believed might have an interest in TECO Transport, is attached hereto as Exhibit "A".

Staff Request No. 2

Please describe TECO Energy's current plans with respect to the potential sale of TECO Transport.

Tampa Electric's Response: In April of this year, TECO Energy announced that TECO Transport and certain other assets have been identified as valuable non-

Mr. Wm. Cochran Keating, IV
July 16, 2003
Page Two

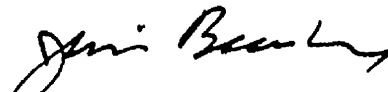
EXHIBIT NO. _____
TAMPA ELECTRIC COMPANY
DOCKET NO. 031033-EI
(JTW-2)
FILED: MAY 3, 2004
DOCUMENT NO. 2

core assets that could be considered for sale to enhance the corporation's liquidity position. Currently, however, TECO Transport is not for sale.

In providing the above responses, Tampa Electric has not raised an issue as to the relevance of the requested information or as to whether it is the type of information intended to be addressed by Section 366.05(9), Florida Statutes. Instead, the company has provided its responses in an effort to be cooperative and to accommodate Staff's request for responses at the earliest possible time. The company's willingness to accommodate the Staff in this regard is not intended to effect, nor should it be construed to serve as, a waiver of its right to raise such issues by way of objection in response to any future requests, which right is hereby reserved.

I trust the foregoing satisfies the Staff's requests set forth in your July 14 letter.

Sincerely,


James D. Beasley

JDB/pp
Attachment

cc: All Parties of Record
Division of Commission Clerk and Administrative Services (Docket File)

h:\jdb\rec\030001 keating ltr 7-2003.doc

EXHIBIT NO. _____
TAMPA ELECTRIC COMPANY
DOCKET NO. 031033-EI
(JTW-2)
FILED: MAY 3, 2004
DOCUMENT NO. 3

EXHIBIT TO THE
REBUTTAL TESTIMONY
OF
JOANN T. WEHLE

DOCUMENT NO. 3

"ARTICLES ABOUT CSXT'S POOR SERVICE LEVELS"

Still a Long Way to Go to Justify Current Valuation

Company Description

CSX Corporation, headquartered in Jacksonville, Florida, is a transportation company offering rail, intermodal, trucking and terminal services.

CSX reported 1Q04 EPS of \$0.31, which was better than our and consensus estimates of \$0.27 per share, however, it's probably worth noting that entering the quarter our EPS estimate stood at \$0.36, and consensus was at \$0.40. The upside from our estimate was driven by better-than-forecast cost control, which was partially aided by two favorable one-time items, \$8 million in fuel recovery (\$0.02 per share), and a \$6 million recovery on buildings rents (\$0.02 per share), which was partially offset by \$10 million in higher-than-forecast other expense (\$0.03 per share). We are raising our 2004 EPS estimate by \$0.05 to \$2.10 (largely to account for the upside in the quarter), and our 2005 estimate by \$0.05 to \$2.55. Management did not provide any earnings guidance but we would assess the tone of its remarks made during its conference call as cautiously optimistic.

Summary and Investment Conclusion

We continue to rate CSX Underweight as we found very little in the quarter to change our thinking towards our March 24th downgrade of the stock from Equal-weight. We remain concerned that the turnaround story is taking longer to unfold (a point that management largely confirmed during its call), and revenue risks are increasing as its service gap relative to competitor NSC grows. While we have not seen outright signs of a dramatic market share shift to NSC, the results from our March 25th *Freight Pulse VI* shipper survey indicates that customer service levels at CSX continue to deteriorate, whereas they continue to improve at NSC (shippers ranked NSC best of the rails on the measure of on-time delivery, whereas CSX was the worst). We

believe that NSC is likely to gain small, but important amounts of market share with service-sensitive shippers that typically move at higher margin levels. We believe this trend will gain increasing amounts of momentum the longer it takes CSX to return its operations to more competitive levels.

Buying into the CSX turnaround at current price levels requires significant conviction that its operational problems will be soon resolved followed by stronger-than-expected earnings improvement, two assumptions that we believe will be tough to accomplish in 2004. The stock is currently trading at 14.1x our twelve-month forward estimate (well above the stocks historical 11.8x average), largely due to its depressed level of earnings (keep in mind the stock at one time earned close to \$4 per share), which makes CSX the richest rail stock in our universe. Even assuming 21% EPS growth in 2005, the stock is still trading at 12.4x our \$2.55 estimate, above the current group average of 11.9x. We believe that investors buying the stock at current levels must look out to at least 2006, assume that management flawlessly executes on its plan, and rebuilds earnings to the \$3 level. Applying the industry's average multiple of 12x to \$3 of earnings yields a \$36 fair valuation, or 13% upside, 20 months from now. Given the risks that it: 1) may lose a very large terminal contract with Maersk at the end of 2004 (we estimate worth \$25 to \$30 million of operating income, or \$0.08 to \$0.09 of EPS), 2) hits a few rough spots on its road to recovery (typical in a railroad turnaround), 3) realizes a lower quality of revenue growth due to its service gap with NSC, or 4) sees its multiple contract due to a tightening Fed policy, suggests to us that the limited potential upside does not justify the number of risks at this time (granted this last point would impact all railroads, but we sense investors are buying CSX for absolute return).

Exhibit 1

Current Railroad Stock Valuations

Stock	Market	28-Apr	EPS Estimates			Absolute P/E Ratio			6-Yr Hist.* Absolute P/E on 12-Mo. Fwd EPS			Relative P/E Ratio			6-Yr Hist.* Relative P/E on 12-Mo. Fwd EPS						
			12-Mo.	2003A	Fwd. 2004E	2005E	2003A	Fwd. 2004E	2005E	Trough	Avg.	Peak	2003A	Fwd. 2004E	2005E	Trough	Avg.	Peak			
BNI	O	\$12,080	\$33	\$2.09	\$2.65	\$2.56	\$2.85	15.6	12.3	12.7	11.4	8.0	11.4	13.5	76%	71%	72%	68%	30%	68%	76%
CNI	O	\$11,020	\$39	\$2.50	\$2.99	\$2.67	\$3.23	15.5	13.0	13.5	12.0	8.0	12.5	14.0	76%	75%	76%	72%	33%	70%	78%
CP	E	\$3,555	\$22	\$1.48	\$1.81	\$1.71	\$2.00	15.1	12.4	13.1	11.2	8.0	11.5	13.0	74%	71%	74%	67%	33%	65%	78%
CSX	U	\$6,824	\$32	\$1.91	\$2.25	\$2.10	\$2.55	16.6	14.1	15.1	12.4	9.0	11.8	14.0	81%	81%	85%	74%	35%	71%	85%
NSC	O	\$9,517	\$24	\$1.36	\$1.90	\$1.80	\$2.10	17.9	12.8	13.5	11.6	9.0	12.5	14.0	87%	74%	78%	69%	45%	79%	97%
UNP	U	\$15,461	\$60	\$4.14	\$4.28	\$4.05	\$4.75	14.5	14.0	14.8	12.6	8.5	12.5	14.0	70%	80%	83%	75%	38%	73%	131%
TOTAL:		\$59,324	Average:			15.9	13.1	13.8	11.9	8.4	12.0	13.8	77%	78%	78%	71%	36%	71%	82%		

Source: Morgan Stanley Research

79

CSX Corporation - April 29, 2004

Please see analyst certification and important disclosures starting on page 17.

Indeed, the lack of any operational improvement in the quarter causes us to question whether the 1Q04 results mark a turnaround in the story, or is better explained as a benefit of very easy year-over-year comparisons. Keep in mind that we came away from a December 2003 meeting with management stating that CSX's turnaround efforts will likely take longer than we previously expected, a finding that the 4Q03 and 1Q04 results confirmed (see our December 12th report "Tempering Our Turnaround Timeline Following Meeting With Management" for additional thoughts towards the stock). We continue to believe that CSX has the potential to regain its earnings growth momentum, but with the market willing to discount nearly a year's worth of earnings improvement and limited execution risk at this juncture, we believe other transportation stocks likely provide a better risk/reward for investors seeking cyclical exposure (BNI, CNI and NSC).

call that service issues have restrained its ability to participate in the surging domestic intermodal market, as this freight tends to be among the most service sensitive freight handled by the railroad.

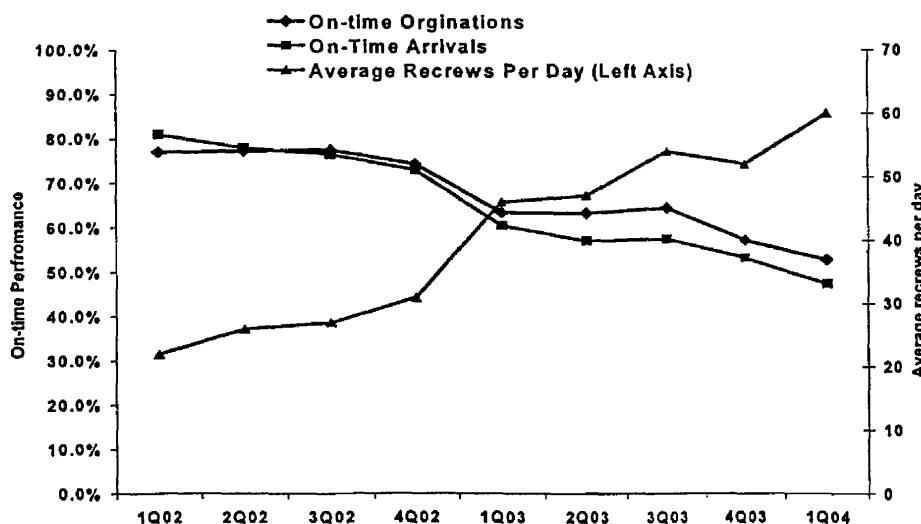
New COO debuts turnaround plan, but don't look for near-term inflection point. New Chief Operating Officer Tony Ingram debuted his "CSX One" plan, a longer-term, two phase program to improve operations. Phase 1 scheduled be rolled out in early July and completed by late September will focus on road trains and moving freight from hub yards to processing yards, with Phase 2, focusing on integration of yard operations to local delivery scheduled to begin at the end of 1Q05. While we are optimistic these programs will eventually have positive impacts on CSX's operations we caution investors that railroad turnarounds take time, and that management indicated that it will likely be 1Q05 before we see significant improvement in CSX's operations. In the short-term Ingram plans to focus on improving safety and on-time train originations. While safety is usually a high priority for all railroads, we believe the degradation in CSX's operations is also impacting its safety performance, witness its 22% increase in train accident frequency. We are mildly concerned that further deterioration in its safety record could prompt additional oversight from Federal regulators and an increase in its casualty and insurance costs.

Insights from the quarter

CSX's operational struggles continue to worsen in the quarter. As depicted in Exhibit 2, CSX's on-time originations and arrivals were both at three-year lows in the most recent quarter hovering near 50%. We believe that CSX's service woes have dropped to a level where it is meaningfully impacting the carrier's ability to secure additional business and customer rate increases on non-captive business. Management confirmed on its conference

Exhibit 2

CSX Quarterly Performance Measures Going in the Wrong Direction, 1Q02-1Q04



Source: CSX reports
CSX Corporation - April 29, 2004

Management restructuring plan complete: On Tuesday, CSX completed its management restructuring plan announced in November 2003. The restructuring eliminated approximately 900 management positions within CSX, and will result in annual cost saving of approximately \$90 million. The restructuring modestly benefited 1Q04 results, but we expect to see a more meaningful impact from the plan in CSX's 2Q04 results. We caution that higher pension expense and incentive compensation could offset up to \$50 million of the savings in 2004. During the quarter, CSX incurred a \$59 million charge related to restructuring, and expects to occur an additional \$5-\$10 million in charges related to the program in 2Q04.

Coal volumes surge, but CSX having less success than NSC increasing coal rates. CSX reported a 10.2% increase in coal revenue which was driven by 9.1% increase in volumes and a 1% increase in yields. CSX management confirmed that it's now booking revenue for movement to Duke power at the new, 50% higher rail tariff rate level. The benefit is approximately one-third that of NSC given the smaller number of tons shipped on this contract by CSX. Removing this benefit from CSX's and NSC's 1Q, we believe coal yields were flat at CSX, and increased 4.6% at NSC. While part of CSX's lower yields is the result of shift towards shorter-haul traffic, we still believe that NSC is currently having more success increasing coal rates than CSX. We expect coal pricing to improve in the coming quarters as CSX indicated it secured significant rate increases on contracts renewing in 1Q04 and expects this trend to continue in 2Q04. However, we caution investors that only 10% of CSX's coal contracts come up for renewal in 2004, and 15% in 2005, and therefore the trend of

improving Eastern coal pricing is likely to take some time to play out.

Weakness in autos expected to continue into 2Q04. Auto volumes declined 2.9% year-over-year in 1Q04, which was driven by a 4.6% drop in auto loadings (auto was the only commodity group to report down revenue in 1Q04), as CSX suffered from plant shutdowns along its lines. CSX indicated that it expects auto revenue to decline year-over-year in 2Q04 as auto inventory levels remain elevated despite increased incentives. It's worth noting that CSX is the second railroad (CP is the other) that has taken a cautious stance with regards to 2Q04 auto volumes.

Fed Tightening A Developing Concern

We believe that investors are becoming increasingly preoccupied with the likelihood of a Fed tightening sometime in 2H04, which historically has negatively impacted railroad valuations (the S&P rail index underperformed the S&P 500 Index by 1,200 basis points during the 1994-95 tightening and by 3,900 basis points in 1999-2000 when merger congestion issues and the tech stock boom coincided with the most recent Fed tightening - see Exhibit 4). While we do not intend to fight history on this issue, we would suggest that the direct earnings impact to the rails this time is minimal, and we believe that we can see clearly to sustained double-digit EPS growth in '05 for many rails (we assume a 22% at CSX) even with a more mild 3% GDP assumption. We believe that the railroads with fluid networks and more visible earnings growth (including CNI, NSC and BNI) will likely outperform other freight transportation stocks, especially those with near-term operational issues.

Exhibit 3

Key 1Q04 Operating Results (for the railroads that have reported thus far - sorted by improvement in operating ratio)

	YEAR-OVER-YEAR PERCENT CHANGE (EXCEPT O.R.)						LABOR		
	VOLUME	RPU	OPERATING			EPS	LABOR EXPENSE	COST PER PERSON	
			REVENUE	EXPENSES	INCOME				RATIO
NSC	6.6%	1.7%	8.5%	1.3%	49.8%	-560	84.9%	3.6%	5.4%
CNI *FX	-3.5%	7.6%	4.1%	0.1%	16.3%	-290	15.9%		
CNI	-3.5%	-1.0%	-3.9%	-7.0%	5.6%	-250	5.7%	-7.7%	-7.0%
CSX	4.3%	0.1%	4.3%	2.8%	20.7%	-140	58.8%	2.7%	5.3%
BNI	8.0%	2.9%	11.6%	10.3%	18.5%	-100	30.2%	9.6%	7.9%
CP *FX	10.7%	-1.3%	7.6%	7.3%	9.4%	-20	9.7%	12.2%	13.2%
CP	10.7%	-7.6%	2.3%	1.3%	-1.6%	30	1.2%	7.7%	8.6%

Sorted by improvement in operating income. CP *FX-adjusted for the impact of changing exchange rates Source: Morgan Stanley Research



COAL TRANSPORTATION REPORT

Volume 23 No. 8 argusonline.com April 12, 2004

CSX Service Issues Hitting Utilities

Continued service delays on the CSX rail system are causing headaches for utilities and are impacting the coal markets, with utilities seeing delays amid unwillingness by the railroad to add new equipment in the face of a surge in the system's export business.

The carrier's average train velocity, considered a key measure of rail efficiency, decreased 6 pct from 22.5 mph in 2002 to 21.1 mph in 2003, and the latest figures suggest 2004 service is only getting worse (see chart, page 6).

For the past five weeks, average CSX train velocity has ranged from 20.1 mph to 20.7 mph, compared to the 20.4 mph average seen in February.

Among CSX coal trains, velocity has ranged from 15.9 mph to 16.4 mph the past five weeks, compared to the 16.5 mph average seen for coal trains in the first quarter of 2003, and the 16.2 mph average of February.

Other figures confirm CSX's service problems have mounted over the past year. The carrier's average system dwell time, which measures the amount of time between car arrival and departure from yards, increased 9 pct from 2002 to 2003, and is up roughly 12 pct between the third quarter of 2003 and Q1 2004.

CSX executives acknowledge that the railroad's service levels are not where they need to be, and the carrier has attempted to address shipper concerns. Among its largest moves, the carrier hired a new chief operating officer away from competitor **Norfolk Southern (NS)** in March, launched a major management restructuring plan and brought on rail consulting firm **MultiModal Applied Systems** to help revitalize its network operations.

With MultiModal's help, the railroad is implementing its "CSX One" plan, designed to simplify and optimize its operating network through reduced terminal handlings and more efficient routings.

(continued on page 6)

Coal Contracts

Shippers Seek Answers To UP Pricing Plan

The utility industry continues buzzing about **Union Pacific's (UP)** decision in early March to install a public pricing format for its coal division, and many coal users remain confused and apprehensive about the new plan.

"Concern is the word. There's really not a full understanding [of the program] by railroads' heavy-haul customers," said Tom Canter, executive director of the **National Coal Transportation Association (NCTA)**. UP representatives are planning to discuss the pricing matter with NCTA members next week, during the association's spring conference in Arizona.

"We're expecting to get some better explanations in Tucson," Canter

(continued on page 4)

This Issue

News

CSX working to improve service	1
UP pricing plan draws more reactions	1
STB adds pro-shipper fees	3
Coal shippers ask for congressional help	5
PRB improvements should increase capacity	7

Briefs

Colombia port gets expansion funds	2
NS posts record February	2
Great Lakes shipments resume	2
NCTA conference in Tucson	3
AAR Coal Carloading Data	3
March Port Loading Data	8

CSX Service..from page 1

Utilities Grumbling

Still, these efforts have done little to assuage anxiety among utilities, some of which were seeing March deliveries of January trains.

At the same time, coal market players caution that finger-pointing could be a mask for underlying problems with producers, some of which have double-sold their coal production, once into the steam market, and then a second time into the metallurgical market with the expectation of using spot purchases to meet steam coal contracts if needed.

Transportation delays and the export movement of coal have supported the market for CSX-delivered coal, which has surged in the first quarter. Prices for prompt-quarter CSX-delivery are up 49 pct since the end of December.

The railroad understands that it has problems with its customer deliveries and is working hard to address them, said CSX spokesman Gary Sease. "Service is an issue and has been an issue in the past couple of months," he said, adding that the company is accelerating planned purchases of new locomotives and hiring additional crews.

Meanwhile the boom in U.S. exports has forced the railroad to shift more rail capacity into steel and coal exports, even as low producer inventories also undercut the system's loadings, Sease said.

"CSX's operating issues appear to have been a function of strong demand as well as systemwide inefficiencies in rail network operations," said a recent Bear Stearns research report.

MultiModal Hope

The key to a turnaround for the carrier appears to rest in its recent partnership with MultiModal, a Princeton, N.J.-based supplier of scheduling and planning software.

The consultant's products have been used by a majority of the Class I freight railroad industry. Most noticeably, MultiModal was hired by CSX's Eastern competitor, NS, in 2001, to help the carrier implement its scheduled railroading program.

Implementing new traffic routing, blocking and classification strategies, NS was expected to see operational savings in excess of \$200 million a year, the consulting firm claimed. Financial analysts have credited the company with helping greatly improve the carrier's system optimization, particularly during the past two years.

CSX also recently named a key NS executive, Tony Ingram, as its chief operating officer in a bid to improve the company's performance. Ingram was previously senior vice president for transportation network and mechanical at the CSX rival.

Power Constraints

The efforts by CSX to improve service to utilities are running up against power constraints, with the railroad in a replacement-centric mode instead of adding equipment to expand capacity despite the surge in exports, one utility source said.

The coal industry is not alone in its complaint about the availability of locomotive power, with grain shippers seeing similar problems in the upper Midwest on BNSF and CPR lines, they say.

To improve its power availability, CSX executives have said that they are evaluating the lease or sale of up to 3,000 miles of its non-core network, which would allow CSX to

return approximately 50 locomotives to its core network.

Despite its varied restructuring plans, officials for the carrier say they are unsure when service levels or earnings will begin to improve. Changes "can't happen quick enough," Oscar Munoz, CSX's new chief financial officer, said in February, "but we can't predict when the turnaround will take hold."

If CSX's actions mirror those taken by NS, analysts believe that some operational improvements may be seen in the last quarter of 2004, with a more meaningful impact occurring the following year. Other Class I railroads saw as much as a 3 pct improvement in their operating ratios from MultiModal's work, Munoz noted.

	Feb. 2004	Q1 2003 (*Q4 02)	Pct. Change
BNSF coal trains	19.5	20.9	-6.7%
<i>BNSF all trains</i>	23.9	25.5	-6.3%
CSX coal trains	16.2	16.5	-1.8%
<i>CSX all trains</i>	20.4	21.6	-5.6%
NS coal trains *	14.6	16	-8.8%
<i>NS all trains *</i>	22.1	23.4	-5.6%
UP coal trains	22.6	24.2	-6.6%
<i>UP all trains</i>	22.1	24.8	-5.6%

Source: AAR

Tips, leads, comments . . . we'd love to hear them. Please give COAL Transportation Report editor Mark Mueller a call at (202) 349-2863.

COAL & ENERGY

Energy Publishing, LLC
Volume 6, No. 45
March 10, 2004
Price Report

Market Commentary

Still lots happening and mainly in the Southeastern rail marketplace...

South Carolina Public Service Authority (Santee Cooper) apparently received less than 10 responses – “extremely light,” one source said – to its recent RFP and maybe even had some of those proposals pulled off the table after subsequent deals were made with other utilities.

(Continued on page 4)

Eastern Rail OTC Coal (12,500 Btu/lb.)				
Term	Vol	Price	Product	Sulfur
Q105	1T	\$50.25	CSX-BS	< 1%
Q105	1T	\$51.00	CSX-BS	< 1%
C1,205	1T	\$49.50	CSX-BS	< 1%
Q204	1T	\$58.20	NS	COMP

OTC NYMEX Coal (12,000 Btu/lb., 1% sulfur)				
Term	Vol	Price	Bid	Offer
104	5B		\$52.25	\$53.25
04	5B		\$52.50	\$53.50
204	5B		\$52.50	\$53.50
304	5B		\$53.750	\$54.750
3,404	5B	\$54.50		
404	5B		\$53.75	\$54.75
105	5B		\$50.50	\$51.50
205	5B		\$47.50	\$48.50
Y05	5B		\$47.50	\$48.50
CY06	5B		\$47.00	\$48.00

OTC PRB 8800 at 0.8 lbs. SO2				
Term	Vol	Price	Bid	Offer
H04	1T		\$6.40	\$6.60
J04	1T		\$6.45	\$6.65
Q204	1T		\$6.45	\$6.65
Q304	1T		\$7.65	\$7.85
Q404	1T		\$7.70	\$7.90
Q105	1T		\$7.65	\$7.95
Q205	1T		\$7.70	\$8.00
CY05	1T		\$7.70	\$8.00
CY06	1T		\$7.80	\$8.10

OTC PRB 8400				
Term	Vol	Price	Bid	Offer
H04	1T		\$5.50	\$5.70
J04	1T		\$5.50	\$5.70
Q204	1T		\$5.50	\$5.70
Q304	1T		\$6.50	\$6.70
Q404	1T		\$6.55	\$6.75
Q105	1T		\$6.50	\$6.80
Q205	1T		\$6.55	\$6.85
CY05	1T		\$6.55	\$6.85
CY06	1T		\$6.65	\$6.95

Eastern railroads attract verbal daggers as Tidewater turnaround teases

In the East, rail issues continue to dominate discussion. Recognize this, Powder River Basin guys? The railroads apparently are pushing for prorated shipments.

The carriers figure that utilities should complain less about service if they aren't willing to take more coal in the shoulder months and less in the winter and summer, high-demand periods.

In any case, the railroad issue in the East is “very real,” a source said.

“Most people are complaining about railroad performance right now,” he said.

Where CSX is concerned, at least, complaints aren't confined to the utility sector.

“I've heard two coal companies complaining about it now,” a source said.

“I don't know that we can get the rail equipment in here to get everything shipped that we've got sold,” one coal supplier told Coal & Energy Price Report.

Continued on page 2)

Hill Daily Index*			
Quality	Hill Price	Hill Index	Last Trades
NYMEX Current Quarter, Plus One	\$53.50	223.38	3/5/04
NYMEX Current Quarter, Plus Two	\$54.50	227.56	3/9/04
NYMEX Next Calendar Year	\$47.97	198.33	2/27/04
PRB 8,800 Current Quarter, Plus One	\$6.40	143.50	3/3/04
PRB 8,800 Current Quarter, Plus Two	\$7.75	173.77	3/5/04
PRB 8,800 Next Calendar Year	\$7.40	165.92	12/26/04
PRB 8,400 Current Quarter, Plus One	\$5.25	151.73	11/4/03
PRB 8,400 Current Quarter, Plus Two	\$6.00	173.41	1/09/04
PRB 8,400 Next Calendar Year	\$5.25	149.55	10/8/03
CSX <1% sulfur Current Quarter, Plus One	\$52.63	202.42	3/1/04
CSX <1% sulfur Current Quarter, Plus Two	\$60.13	231.27	3/4/04
CSX <1% sulfur Next Calendar Year	\$50.06	192.54	3/9/04
CSX compliance Current Quarter, Plus One	\$36.55	140.57	1/06/04
CSX compliance Next Calendar Year	\$38.65	148.65	1/05/04
NS <1% sulfur Current Quarter, Plus One	\$34.25	131.73	5/14/03
NS <1% sulfur Next Calendar Year	\$46.50	178.85	2/13/04
NS compliance Current Quarter, Plus One	\$58.20	223.85	3/9/04
NS compliance Next Calendar Year	\$38.30	147.31	12/10/02

All prices are based exclusively on actual trades (no mid-market indicators are employed) and are indexed against market as of 12/28/99, when NYMEX-spec coal had been traded most recently at \$23.95/ton, 8,800 Btu/lb Powder River Basin coal at \$4.46/ton and 8,400 Btu/lb PRB coal at \$3.46/ton. The eastern rail index is measured against an arbitrary price of \$26.00/ton. “Hill Index” reflects weighted average of prices recorded on most recent trading day. On days when no trades occur, published index remains at previous level.

No Duplication of This Report in Whole or in Part is Permitted Without Express Written Consent

Non-OTC Utility Current Coal Price Marker*		
PRB		\$/Ton
8,400 Btu/lb. FOB mine		\$5 55 (Q2)
8,800 Btu/lb. FOB mine		\$6 40 (Q2)
8,800 Btu/lb. premium sulfur FOB mine		\$7 50 (Q2)
CENTRAL APPALACHIA		
12,500 Btu/lb. 1.2 lbs SO2 FOB rail	\$54.00 (CSX), \$54.25 (NS)	
12,500 Btu/lb. 1.6 lbs SO2 FOB rail	\$52.25 (CSX), \$52.50 (NS)	
12,000 Btu/lb. 2.0 lbs SO2 FOB rail	\$44.75 (CSX)	
12,000 Btu/lb. 1.2 lbs. SO2 FOB barge	\$49.85 (Big Sandy)	
11,500 Btu/lb. 1.6 lbs. SO2 FOB barge	\$40.00 (Big Sandy)	
NORTHERN APPALACHIA		
13,200 Btu/lb. 2.5 lbs SO2 FOB rail	\$45.75	
13,000 Btu/lb. 3.6 lbs SO2 FOB barge	\$40.00	

NYMEX Futures						
Term	Last	Open High	Open Low	Most Recent Settle	Prev Day Total Volume	
Natural Gas (Henry Hub)						
H04	5.420	0	0	5.438	0	
J04	5.500	0	0	5.513	0	
Crude Oil						
HO4	36.35	0	0	36.28	0	
JO4	35.51	0	0	35.45	0	

Emissions Markets Prices for 2/25/04	
	Ton Units
NOX OTC Allowances	
Vintage 2004 Bid/Ask	\$2200 X \$2350
Vintage 2005 Bid/Ask	\$3500 X \$3700
Vintage 2006 Bid/Ask	\$2750 X \$3100
SO2 OTC Allowances	
Vintage 2004 Bid/Ask	\$269 X 271

COAL & ENERGY Price Report

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Terms and Definitions: The information included in Coal & Energy Price Report is derived from conversations with a variety of industry sources and through other intelligence. Data represents our best estimates. The Daily Trading table on page one includes the number of trades made for NYMEX quality coal during the period shown, along with the weighted average price of the coal traded. The OTC price boxes show trades made the day previous to the report, along with updated estimates of current trader offers to buy or trade the particular quality of coal. The Utility Coal Price Marker is our estimate of the price to which producers are willing to bid their products to electric utility consumers. It does not necessarily coincide with trader pricing. In the OTC (Other Eastern Coals) block, rail coal trades and offers are presented by freight district. Barge coal trades and offers are presented by origin river.

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Month Codes					
JAN	FEB	MAR	APR	MAY	JUN
F	G	H	J	K	N
JUL	AUG	SEP	OCT	NOV	DEC
N	Q	U	V	X	Z

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Eastern railroads attract verbal daggers...

One complaint that keeps getting repeated: Export business is being served by the eastern railroads while the utilities make do with less power and arguably less efficient service than has been enjoyed in the past.

Certainly, the railroads must be ecstatic that the lucrative export moves lost in the latter part of the Nineties have returned. High-vol coking coal business to Hampton Roads has been gone since 1998, when the "market just evaporated," a source noted.

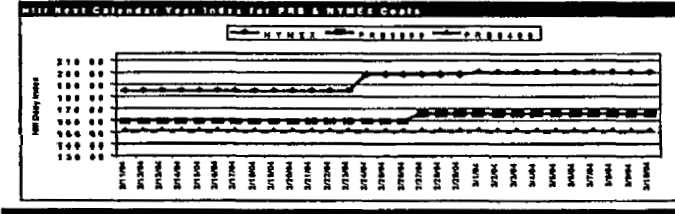
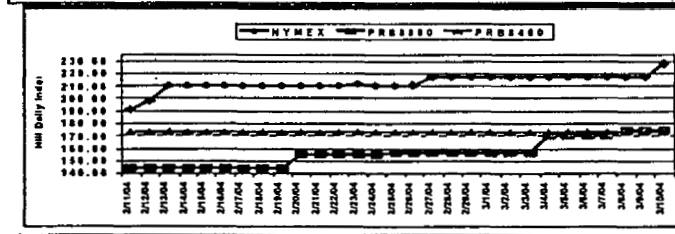
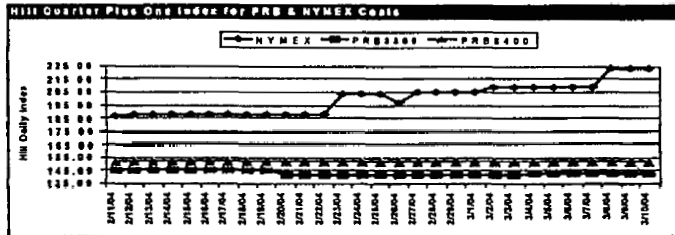
And by all accounts, that business was very profitable for the carriers, probably substantially more profitable than the lion's share of utility business.

"Now it's back," a source said of the Hampton Roads business.

"They don't have the people or the equipment to handle it." If you're the railroads: "You're glad to have the best of both worlds, but you can't do both efficiently like you could before."

One source theorized that the railroads are doing their best to manage the situation by serving the profitable export market aggressively and by staying in close contact with the utilities to make sure that no particular plant actually finds itself in a dire circumstance.

(Continued on page 3)



OTC Broker Index				
March 9, 2004				
	NYMEX	CSX 12,500	PRB	PRB
	look-alike	-1% sulfur	8,400	8,800
Prompt Month	52.69	57.94	5.48	6.44
Prompt Quarter	53.00	58.00	5.56	6.53

Indices compiled courtesy of Argus Media, Inc.

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Eastern railroads attract verbal daggers...

The railroads are maybe asking themselves: "Where are we getting the most revenue?" the source said. Certainly, they have made no secret of their need – a need they have characterized as critical – to generate additional revenue.

A source said he figures the railroads might be finding it sensible to mount this strategy: "Let's just manage it as we go and make sure nobody runs out of coal."

Or maybe there simply is a shortage of power, crews and equipment.

But a source said that's hard to swallow given this reality: "If production continues to slide, why wouldn't you have enough power to supply it? The railroads have been supplying utility demand (from Central Appalachia) for umpteen years. Production is going down. Something would have had to change in the transportation system to say, 'We can't supply it now.'"

AEP set to meet market need by broadening East specs, upping PRB burn

Look for American Electric Power to increase its Powder River Basin coal burn, if it hasn't already.

"If they haven't, they're making those plans right now," a source told Coal & Energy Price Report.

Some subtle but important differences in AEP's current RFP for coal to supply the Big Sandy generating station are one "sign they're trying to diversify supplies," a source said.

AEP's machinations aren't confined to Big Sandy, a source said.

"They're expanding the sulfur they will buy out of Central App, and I'd imagine they'll burn as much PRB coal as they can," a source said. "I don't think there's any doubt about that."

PRB coal pricing "compared to \$54 rail... that spread is blown out," the source said. "You've got to maximize and maybe trickle some of that PRB to plants that traditionally just dabbled in it."

One mitigating circumstance: Given its size and total annual coal burn, AEP doesn't "have a huge open position in '04," a source said.

Skeptics doubt PRB able to meet lofty yield expectations published by BLM

Will new demand emerge? Will it be logistically feasible?

Those are a few of the questions posed by power producers responding to a recent federal Bureau of Land Management report that projected a potential increase in Powder River Basin coal production to 646 million tons/year by 2020. Sources question whether the railroads can handle the additional load even with new lines and also wonder who the potential buyers would be for the new supply.

BLM officials cautioned that the figure is an ambitious forecast that represents the highest possible rise in production over the specified time period, but said they aren't ruling out an 80 percent increase over the next 16 years. Consumers believe the figure is way out of line with reality.

"The current rate is about 350 million tons without any other lines out there," an official with a utility said. "I think it's a very high number. There will be more coal burned, and eastern mines are pretty much at capacity. The reserves are there (in the PRB), but can it be physically moved without more infrastructure? That's the \$64,000 question. I don't think the number is doable even with more tracks."

While utilities burning eastern coal continue to look at PRB coal as an alternative, the number of new users isn't likely to grow to a level that justifies such an enormous increase in production, a source said.

"I am not sure what the demand growth will be, but I don't think it will be 300 million tons," the source said. "You can only get so much out at a time. If it does grow, it will probably be by about 100 million tons."

Even with its low-sulfur content and attractive price, PRB coal isn't for everyone, a source said.

"If you can use that quality, fine. But not everyone can use it," he said. "Btu of 8,400 to 8,800 is not a cure all because of the different characteristics. Are they saying that everyone will switch to PRB and eastern coal will no longer exist? Things will get tighter in the East, but it can't all be picked up by the West. That will never happen."

Another source echoed that sentiment.

"If it was that easy to use more PRB coal, the utilities would be doing it," he said. "They are not doing that. PRB hasn't moved much in price. You also have to blend it. I'd like to know where that demand will come from."

CONSOL able to report narrower loss as a result of year-end tax accruals

Year-end tax accruals enabled CONSOL Energy to narrow its reported net loss to \$7.8 million, or 10 cents per diluted share, instead of a net loss of \$11.8 million, or 14 cents per diluted share, reported previously in the company's Securities & Exchange Commission Form 8K filing.

The change did not affect the pre-tax loss previously reported.

CONSOL expects to file its Form 10K with the SEC March 12.

(Continued on page 4)

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COAL & ENERGY

Energy Publishing, LLC
Volume 6, No. 52
March 19, 2004
Price Report

Market Commentary

While the Central Appalachia market seems to have moderated a bit in recent days, excepting the fact that prices haven't really dipped, a veteran of the region told Coal & Energy Price Report that he expects **greater volatility this summer.**

"Market prices were up, according to my estimation, about \$13 in 30 days," the source said. "That's CSX rail." Weather this winter "wasn't severe, and we've got people scrambling for coal."

The second quarter will arrive in less than two weeks, "and we still have prompt (Continued on page 4)

Eastern Rail OTC Coal (12,500 Btu/lb.)

Term	Vol	Price	Product	Sulfur
Q3,404	1T	\$56.05	CSX-BS	< 1%

OTC NYMEX Coal (12,000 Btu/lb., 1% sulfur)

Term	Vol	Price	Bid	Offer
J04	5B		\$50.00	\$52.00
K04	5B		\$51.00	\$52.50
Q204	5B		\$51.00	\$52.50
Q304	5B		\$51.50	\$53.00
Q404	5B		\$51.50	\$53.00
Q105	5B		\$48.50	\$50.00
Q205	5B		\$46.00	\$47.50
CY05	5B		\$46.00	\$47.50
CY06	5B		\$44.50	\$46.00

OTC PRB 8800 at 0.8 lbs. SO2

Term	Vol	Price	Bid	Offer
J04	1T		\$6.55	\$6.75
K04	1T		\$6.60	\$6.80
Q204	1T		\$6.60	\$6.80
Q304	1T		\$7.55	\$7.95
Q404	1T		\$7.55	\$7.95
Q105	1T		\$7.60	\$8.00
Q205	1T		\$7.60	\$8.00
CY05	1T		\$7.60	\$8.00
CY06	1T		\$7.80	\$8.10

OTC PRB 8400

Term	Vol	Price	Bid	Offer
J04	1T		\$5.50	\$5.70
K04	1T		\$5.55	\$5.75
Q204	1T		\$5.55	\$5.75
Q304	1T		\$6.50	\$6.90
Q404	1T		\$6.50	\$6.90
Q105	1T		\$6.50	\$6.90
Q205	1T		\$6.50	\$6.90
CY05	1T		\$6.50	\$6.90
CY06	1T		\$6.65	\$7.05

Eastern railroads still taking verbal beating for priority shipments, delays

Coal consumers continue to complain that the eastern railroads are not providing adequate service. Buyers are especially incensed that service allocations have tended to penalize utilities that have kept their coal inventories in solid shape.

"The railroad is literally allocating (service) based on sheer need," a source said. "What's your inventory? You go to the top of the food chain."

So who's getting service first? "The credit challenged companies who can't afford inventory, obviously," a source said.

One buyer told a Coal & Energy Price Report source: "We've got the coal. There's not enough equipment coming in now to make all our shipments."

A utility source said his people are getting "mixed information from those guys." Part of the problem is said to be equipment displacement and delivery schedules that simply got "out of synch" due to severe winter weather.

"I think there is a power issue, and I think there is a manpower issue," the source said. Service has gotten "slightly better" recently.

(Continued on page 2)

Hill Daily Index

Quality	Hill Price	Hill Index	Last Trades
NYMEX Current Quarter, Plus One	\$51.75	216.08	3/17/04
NYMEX Current Quarter, Plus Two	\$51.88	216.62	3/17/04
NYMEX Next Calendar Year	\$47.97	198.33	2/27/04
PRB 8,800 Current Quarter, Plus One	\$6.60	147.98	3/10/04
PRB 8,800 Current Quarter, Plus Two	\$7.75	173.77	3/5/04
PRB 8,800 Next Calendar Year	\$7.40	165.92	12/26/04
PRB 8,400 Current Quarter, Plus One	\$5.25	151.73	11/4/03
PRB 8,400 Current Quarter, Plus Two	\$6.00	173.41	1/09/04
PRB 8,400 Next Calendar Year	\$5.25	149.55	10/8/03
CSX <1% sulfur Current Quarter, Plus One	\$55.70	214.23	3/17/04
CSX <1% sulfur Current Quarter, Plus Two	\$56.05	215.58	3/18/04
CSX <1% sulfur Next Calendar Year	\$50.06	192.54	3/9/04
CSX compliance Current Quarter, Plus One	\$36.55	140.57	1/06/04
CSX compliance Next Calendar Year	\$38.65	148.65	1/05/04
NS <1% sulfur Current Quarter, Plus One	\$55.75	214.42	3/16/04
NS <1% sulfur Next Calendar Year	\$44.83	172.42	2/11/04
NS compliance Current Quarter, Plus One	\$59.75	229.81	3/10/04
NS compliance Next Calendar Year	\$38.30	147.31	12/10/02

All prices are based exclusively on actual trades (no mid-market indicators are employed) and are indexed against market as of 12/28/99, when NYMEX-spec coal had been traded most recently at \$23.95/ton, 8,800 Btu/lb Powder River Basin coal at \$4.46/ton and 8,400 Btu/lb PRB coal at \$3.46/ton. The eastern rail index is measured against an arbitrary price of \$26.00/ton. "Hill Index" reflects weighted average of prices recorded on most recent trading day. On days when no trades occur, published index remains at previous level.

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Non-OTC Utility Current Coal Price Marker*		
		\$/Ton
PRB		
8,400 Btu/lb. FOB mine		\$5 70 (Q2)
8,800 Btu/lb. FOB mine		\$6 70 (Q2)
8,800 Btu/lb. premium sulfur FOB mine		\$7 70 (Q2)
CENTRAL APPALACHIA		
12,500 Btu/lb. 1.2 lbs SO2 FOB rail	\$59.50 (CSX)	\$59.75 (NS)
12,500 Btu/lb. 1.6 lbs SO2 FOB rail	\$57.80 (CSX)	\$58.05 (NS)
12,000 Btu/lb. 2.0 lbs. SO2 FOB rail		\$49.75 (CSX)
12,000 Btu/lb. 1.2 lbs. SO2 FOB barge		\$53.75 (Big Sandy)
11,500 Btu/lb. 1.6 lbs. SO2 FOB barge		\$44.00 (Big Sandy)
NORTHERN APPALACHIA		
13,200 Btu/lb. 2.5 lbs SO2 FOB rail		\$45.75
13,000 Btu/lb. 3.6 lbs SO2 FOB barge		\$40.00

Eastern railroads still taking verbal ...

While increased export demand is partly responsible for the slowdown, utility inventory buildup has played a larger role, a source said. "We have a huge sponge sitting in the Carolinas called the Carolina utilities," the source said. "There are more trains going out of the Big Sandy region than can be reasonably handled. I think there's just a big

Utilities hankering for suppliers to add production should live for tomorrow

If utilities want more coal introduced to the stream, they're going to have to forget that old Grassroots song: "Sha la la la la, live for today." Coal companies, like Leon, can't do it all alone. "Assuming we have the equipment and labor, and we could produce more tons, it's not a 30-60 day process," one major supplier told Coal & Energy Price Report. "It's a six-month process." People are willing to pay for term to get 2004 tons, the source said, but they want to begin getting those tons immediately. A coal producer can't make immediate delivery from a mine that is still in the developmental process. "If a utility were to give you, say, 40,000 tons/month at \$45, and tell you: 'I'll give you six months before you have to deliver the first tons,'" a new or re-opened mine might be justified, the source said. "You have a timeline that's not immediate." In times like these, though, when coal is scarce, so is patience.

NYMEX Futures					
Term	Last	Open	Open	Most	Prev Day
		High	Low	Recent	Total
Natural Gas (Henry Hub)					
J04	5.625	5.630	5.630	5.631	0
K04	5.699	0	0	5.663	0
Crude Oil					
J04	37.91	0	0	37.93	0
K04	37.36	37.32	37.32	37.39	0

Emissions Markets Prices		Ton Units
NOX OTC Allowances		
Vintage 2004 Bid/Ask		\$2000 X \$2300
Vintage 2005 Bid/Ask		\$3000 X \$3300
Vintage 2006 Bid/Ask		\$2700 X \$3000
SO2 OTC Allowances		
Vintage 2004 Bid/Ask		\$282 X 288

COAL & ENERGY Price Report

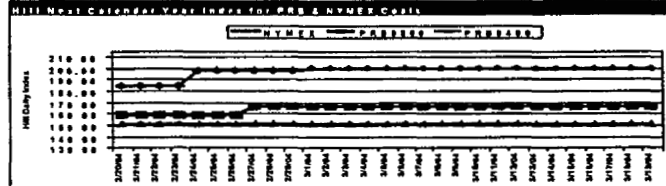
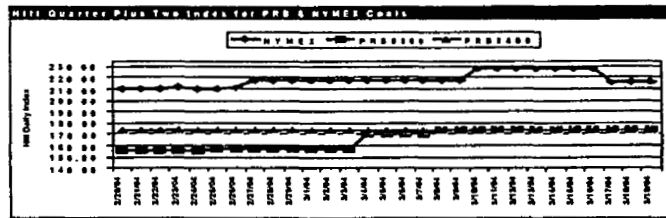
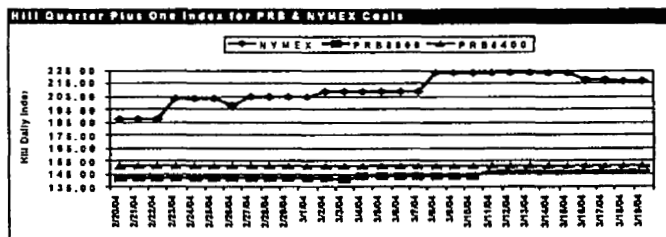
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Month Codes					
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N	Q	L	V	X	Z

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OTC Broker Index				
March 18, 2004				
	NYMEX	CSX 12,500	PRB	PRB
	look-alike	-1% sulfur	8.400	8.800
Prompt Month	51.25	55.08	5.50	6.55
Prompt Quarter	51.92	55.73	5.67	6.67
Indices compiled courtesy of Argus Media, Inc.				

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Peabody shares offered at \$45...

Gross proceeds to Peabody and selling shareholders total \$754.5 million, excluding the over-allotment option. The selling shareholders are Lehman Brothers Merchant Banking Partners II L.P. and its affiliates, who have now eliminated their ownership interest in the company.

The offering is being made through a group of underwriters led by Morgan Stanley & Co. Incorporated and Lehman Brothers Inc., who served as joint book-running managers.

North Carolina's top cops bids to force emissions cuts in 13 other states

North Carolina Attorney General Roy Cooper has requested that the Environmental Protection Agency require coal-fired power plants in 13 states to reduce emissions that he claims are harming air quality in the state, a request that covers the greater part of the fleet of coal-fired generators in the Midwestern and Eastern U.S.

The plants named in Cooper's petition are located in Alabama, Georgia, Illinois, Indiana, Kentucky, Maryland, Michigan, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia and West Virginia.

The pollution from sources outside of North Carolina has hampered the state's ability to meet national air quality standards, according to Cooper.

Cooper said the petition would force the EPA to determine whether the power plants named in it are significantly contributing to North Carolina's difficulty in maintaining clean air standards.

Air quality in several North Carolina counties currently falls short of national standards.

All 2004 NYMEX prices remain above \$50 after painfully slow futures week

There were no changes in settlements on the Central Appalachian Coal contract at the New York Mercantile Exchange March 18, making the week one of the slowest, in terms of price movement, in some time.

Activity for April, May and June:

Month	Settle	Change
April	\$51.75	—
May	\$52.10	—
June	\$52.50	—

The latest settlement prices...

Contract	Month	Settlement Price
April 04		\$51.75
May 04		\$52.10
June 04		\$52.50
3rd Quarter 04		\$53.00
4th Quarter 04		\$53.00
1st Quarter 05		\$49.00
2nd Quarter 05		\$47.80

Market Commentary...

(Continued from Page 1)

months trading in the mid-\$50s," another source said. "Wait until the first hot spell."

Relative inactivity, recently, is a product of "utilities scared to buy high in a market that traditionally corrects itself," the first source said. Since producers are unwilling to sell pure spot coal anywhere below exorbitant, and since utilities are "hesitant to buy term, they've left that position open," the source said, referring to 2005 tonnage.

A spate of RFPs for 2005 likely will arrive in supplier mailboxes "in September and October, and in a constrained market, it might be earlier," the source said.

He figures there are more 2005 tons open at this point than is typical for spring of the year preceding delivery, largely because new contract signings have been delayed.

Further, the source said: "There are still open tons for '04, even from the people who solicited. Nobody wants to touch the Q3, Q4 - no buyers, no sellers. It's such a volatile commodity right now."

As market conditions moderated late in 2001, many of the tons "that trickled into the market were bought from trading companies," the source said. "Trading companies aren't offering coal right now."

Most, he figures, do not have exceptionally long positions.

Merchant generators unable economically to maintain high inventories still are scouting pretty heavily for CSX coal, a source said. Mirant, NRG Energy and Dynegy were among the generators he cited. National Energy & Gas Transmission also has been casting its net for Central App coal to supply the Brayton Point and Salem Harbor generating stations, according to the source.

He thinks the latter company is short international coal and is looking to buy CSX coal to fill in its requirements.

Buyers might be feeling "a false sense of security," a source said. "Demand is brewing. I'm a big buyer of 'You ain't seen nothing yet.'"

Page 1 of 3

COAL & ENERGY

Energy Publishing, LLC
Volume 8, No. 55
March 24, 2004
Price Report

Market Commentary

One veteran supplier told Coal & Energy Price Report he figures he can write a buyer's speech that will be recited often during the next few weeks, at least through the end of the shoulder months.

(Continued on page 4)

Eastern Rail OTC Coal (12,500 Btu/lb.)

Term	Vol	Price	Product	Sulfur
Q204	1T	\$56.50	CSX-BS	< 1%
Q3,Q404	1T	\$57.00	CSX-BS	< 1%
Q3,Q404	1T	\$57.55	CSX-BS	< 1%
Q105	1T	\$51.00	CSX-BS	< 1%
Q105	1T	\$51.25	CSX-BS	< 1%
Q105	1T	\$51.50	CSX-BS	< 1%
Q105	1T	\$51.75	CSX-BS	< 1%

OTC NYMEX Coal (12,000 Btu/lb., 1% sulfur)

Term	Vol	Price	Bid	Offer
J04	5B		\$50.50	\$52.00
K04	5B		\$51.50	\$53.00
Q204	5B		\$51.50	\$53.00
Q304	5B		\$52.50	\$53.50
Q3,Q404	5B	\$52.20		
Q3,Q404	5B	\$53.25		
Q404	5B		\$52.50	\$53.50
Q105	5B		\$49.50	\$50.50
Q205	5B		\$48.00	\$49.50
CY05	5B		\$47.50	\$48.50
CY06	5B		\$44.50	\$46.50

OTC PRB 8800 at 0.8 lbs. SO2

Term	Vol	Price	Bid	Offer
J04	1T		\$6.50	\$6.70
K04	1T		\$6.55	\$6.75
Q204	1T		\$6.55	\$6.75
Q304	1T		\$7.55	\$7.95
Q404	1T		\$7.55	\$7.95
Q105	1T		\$7.60	\$8.00
Q205	1T		\$7.60	\$8.00
CY05	1T	\$7.75	\$7.60	\$8.00
CY05	1T	\$7.75		
CY06	1T		\$7.80	\$8.10

OTC PRB 8400

Term	Vol	Price	Bid	Offer
J04	1T		\$5.50	\$5.70
K04	1T		\$5.50	\$5.70
Q204	1T		\$5.50	\$5.70
Q304	1T		\$6.50	\$6.90
Q404	1T		\$6.50	\$6.90
Q105	1T		\$6.50	\$6.90
Q205	1T		\$6.50	\$6.90
CY05	1T		\$6.50	\$6.90
CY06	1T		\$6.65	\$7.05

Eastern railroad service still subject of great frustration among coal buyers

The eastern railroads continue to attract greater criticism than coal producers. Most utilities appear to be having some degree of concern with rail service.

"I know both of them are struggling," a source said of CSX and Norfolk Southern. "It seems like the NS is struggling more. Trying to get bottom dump equipment is a real fight."

Shippers report that the railroads have attributed most of their delivery problems to inadequate crews and power. The reasons behind such inadequacy are less apparent.

"I think it's several issues," a source said. "I think the export thing is obviously an issue. They're trying to have their cake and eat it too."

Exports to the East Coast once formed a profitable route that was "pretty much snuffed out" during the past six years, a source said. "That really hit (the eastern railroads) in the pocketbook."

"You've had a tremendous surge in exports recently, and my guess is that the railroads are looking at moving coal to the piers to meet boats that have huge demurrage as opposed to moving coal to a utility that has 30 days in the ground," another source said.

(Continued on page 2)

Hill Daily Index ^o			
Quality	Hill Price	Hill Index	Last Trades
NYMEX Current Quarter, Plus One	\$51.75	216.08	3/17/04
NYMEX Current Quarter, Plus Two	\$52.73	220.17	3/23/04
NYMEX Next Calendar Year	\$47.97	198.33	2/27/04
PRB 8,800 Current Quarter, Plus One	\$6.60	147.98	3/10/04
PRB 8,800 Current Quarter, Plus Two	\$7.75	173.77	3/5/04
PRB 8,800 Next Calendar Year	\$7.75	173.77	3/23/04
PRB 8,400 Current Quarter, Plus One	\$5.25	151.73	11/4/03
PRB 8,400 Current Quarter, Plus Two	\$6.00	173.41	1/09/04
PRB 8,400 Next Calendar Year	\$5.25	149.55	10/8/03
CSX <1% sulfur Current Quarter, Plus One	\$56.50	217.31	3/23/04
CSX <1% sulfur Current Quarter, Plus Two	\$57.28	220.31	3/23/04
CSX <1% sulfur Next Calendar Year	\$51.38	197.062	3/23/04
CSX compliance Current Quarter, Plus One	\$36.55	140.57	1/06/04
CSX compliance Next Calendar Year	\$38.65	148.65	1/05/04
NS <1% sulfur Current Quarter, Plus One	\$55.75	214.42	3/16/04
NS <1% sulfur Next Calendar Year	\$44.83	172.42	2/11/04
NS compliance Current Quarter, Plus One	\$59.75	229.81	3/10/04
NS compliance Next Calendar Year	\$38.30	147.31	12/10/02

All prices are based exclusively on actual trades (no mid-market indicators are employed) and are indexed against market as of 12/28/99, when NYMEX-spec coal had been traded most recently at \$23.95/ton, 8,800 Btu/lb Powder River Basin coal at \$4.46/ton and 8,400 Btu/lb PRB coal at \$3.46/ton. The eastern rail index is measured against an arbitrary price of \$26.00/ton. "Hill Index" reflects weighted average of prices recorded on most recent trading day. On days when no trades occur, published index remains at previous level.

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Non-OTC Utility Current Coal Price Marker*

PRB	\$/Ton
8,400 Btu/lb. FOB mine	\$6 70 (Q2)
8,800 Btu/lb. FOB mine	\$7 75 (Q2)
8,800 Btu/lb. premium sulfur FOB mine	\$8 75 (Q2)
CENTRAL APPALACHIA	
12,500 Btu/lb. 1.2 lbs. SO2 FOB rail	\$57 50 (CSX), \$58 00 (NS)
12,500 Btu/lb. 1.6 lbs. SO2 FOB rail	\$55.75 (CSX), \$56 25 (NS)
12,000 Btu/lb. 2.0 lbs. SO2 FOB rail	\$47.75 (CSX)
12,000 Btu/lb. 1.2 lbs. SO2 FOB barge	\$53 25 (Big Sandy)
11,500 Btu/lb. 1.6 lbs. SO2 FOB barge	\$51.75 (Big Sandy)
NORTHERN APPALACHIA	
13,200 Btu/lb. 2.5 lbs. SO2 FOB rail	\$48 75
13,000 Btu/lb. 3.6 lbs. SO2 FOB barge	\$42 00

NYMEX Futures

Term	Last	Open High	Open Low	Most Recent Settle	Prev Day Total Volume
Natural Gas (Henry Hub)					
J04	5.510	0	0	5.530	0
K04	5.597	5.611	5.611	5.626	0
Crude Oil					
J04	37.11	0	0	37.11	0
K04	37.64	0	0	37.45	0

Emissions Markets Prices

	Ton Units
NOX OTC Allowances	
Vintage 2004 Bid/Ask	\$2000 X \$2250
Vintage 2005 Bid/Ask	\$3000 X \$3450
Vintage 2006 Bid/Ask	\$2600 X \$3000
SO2 OTC Allowances	
Vintage 2004 Bid/Ask	\$282 X

COAL & ENERGY Price Report

Daily to your e-mail account at an annual rate of \$950 00 (add \$150 00 for fax service) Or subscribe today to get six months of Coal & Energy Price Report for \$550 00 (add \$75 00 for fax service)

Terms and Definitions: The information included in Coal & Energy Price Report is derived from conversations with a variety of industry sources and through other intelligence. Data represents our best estimates. The Daily Trading table on page one includes the number of trades made for NYMEX quality coal during the period shown, along with the weighted average price of the coal traded. The OTC price boxes show trades made the day previous to the report, along with updated estimates of current trader offers to buy or trade the particular quality of coal. The Utility Coal Price Marker is our estimate of the price to which producers are willing to bid their products to electric utility consumers. It does not necessarily coincide with trader pricing in the OTC (Other Eastern Coals) block, rail coal trades and offers are presented by freight district. Barge coal trades and offers are presented by origin river.

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Month Codes					
JAN	FEB	MAR	APR	MAY	JUN
F	G	H	J	K	M
JUL	AUG	SEP	OCT	NOV	DEC
N	Q	U	V	X	Z

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Eastern railroad service still subject...

For now, he said, the railroads will "try to take care" of utilities that have low inventories. Others might not be as near the front of the line as usual. "If you're a little better off than your brother, you might not get a train," the source said.

The railroads have been forced to make personnel cuts since the high-vol export market declined, and that probably has caused legitimate concerns as the market unexpectedly rebounded.

"I think that's caught up with them," a source said.

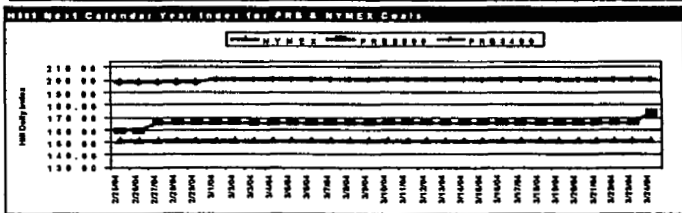
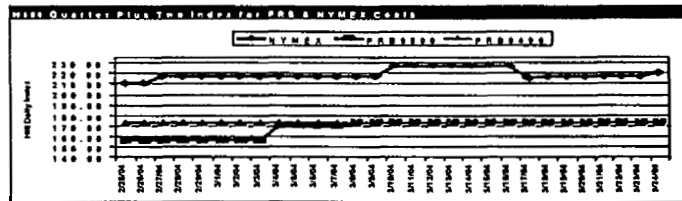
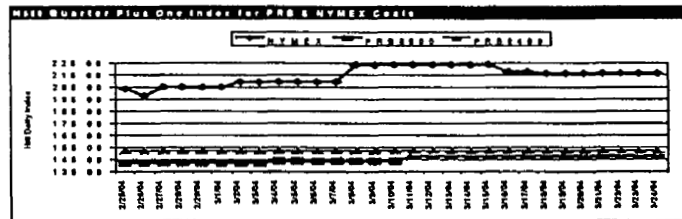
The new export business might be creating greater strain for NS than for CSX, a source said, noting that the latter railroad's unit trains can dump at DTA and at Pier IX for a rather rapid return to the coalfields, while the Lamberts Point terminal doesn't boast as much room for stockpiles.

The revival in the export market probably isn't alone in creating problems for the railroads.

"Here recently, people have had to reach farther for coal," a source said. Given longer transit times and a greater number of non-routine movements, a situation has developed that "has tied them up some."

Don't look for things to get much better in the near term. The lake-shipping season will begin in the middle to the end of the month, creating new thirst for rail equipment.

(Continued on page 3)



OTC Broker Index

	March 23, 2004			
	NYMEX	CSX 12,500	PRB	PRB
	look-alike	-1% sulfur	8,400	8,800
Prompt Month	51.58	56.08	5.50	6.48
Prompt Quarter	52.12	57.08	5.62	6.62

Indices compiled courtesy of Argus Media, Inc.

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Eastern railroad service still subject...

"That's going to put more pressure on them," a source said. "I think they've got a lot of different things they're grappling with them right now."

As for the utilities: "Whoever's in the worst shape is getting the best treatment," a source said. "I don't care whether it's on the East Coast or just over to Chattanooga, everybody's got an issue with rail service right now."

Values high at SO2 emission allowance auction, but lower than expected

Private citizens, brokers and power plants bought and sold 250,011 tons of sulfur dioxide at the 12th annual acid rain allowance auction March 22 at the Chicago Board of Trade.

American Electric Power was the big buyer in the auction, garnering 75,000 allowances in the spot auction and 124,950 allowances in the seven-year advance auction. AEP paid \$20.8 million for spot auction allowances and \$15.9 million for seven-year advance auction allowances.

The highest bid price in the spot auction was \$300.00. The clearing price was \$260.00. In the seven-year advance auction, the highest bid was \$129.11, and the clearing bid price was \$128.00.

In the spot auction, other top buyers were Morgan Stanley Commodities Group (25,000 allowances), Edison Mission Energy (10,481), PSEG Energy Resources (7,500), Cantor Fitzgerald Brokerage (5,000) and Indianapolis Power & Light (1,500).

"The prices actually were a little lower than what was expected," said Peter Zaborowsky, managing director of Evolution Markets' Environmental Markets Brokerage Services. "It's a sealed bid auction due on the 16th. The last trade as bids were due was at the \$275.00 level. Conventional wisdom was that it would probably fall in a minus-five, plus-seven range. We had it bracketed probably at \$270.00-280.00. The average was \$272.00. That's a downtick from where the market had been trading the last couple of days.

M "The last trade we did before the results came out was \$285. It traded up between the day bids were due and the day of the auction. That meant the market was anticipating a strong auction result.

"The market feels it was a non-event. It would have been much more of an event if one buyer took everything, especially a non-traditional participant. On the flip side, if it had been a lot of smaller utilities with needs of (5,000) to 10,000 allowances, it might have been a bearish signal, but it didn't pan out."

Zaborowsky said he expected a larger number of participants.

"I'm surprised we didn't have more bids," he said. "It's a function of the fact that we are at a pretty high prevailing price. Maybe the smaller buyers felt there are no bargains to be had anymore. That might have diminished the participation."

As for the impact the auction pricing will have on coal burns, Zaborowsky expects it to be minimal.

"I don't think it will affect that," he said. "I still think coal has a significant delivered price advantage over gas and oil. If you look at the production cost impact, I don't think even \$300.00 would change that dramatically."

The vintage credits for 2011 came in at a lower-than-expected price.

"We thought that would be higher," Zaborowsky said. "It's always lower because of the seven years of carry, but if \$128.00 is the average price and you bring it out seven years, you've got \$180.00 as the equivalent future value price.

"I thought it was a relative bargain considering that the EPA is proposing to cut the SO2 cap in half. I thought there would be more interest. Maybe there aren't enough companies well positioned enough to spend money now for the future."

Bush folks look to go just a bit lower on mercury given technology limits

The Bush administration is likely to adopt the second of two mercury emissions reduction options, favoring a plan that would require power plants to cut emissions to 15 tons by 2018 by phasing in lower ceilings on each plant's emissions, according to the Associated Press.

The industry-endorsed strategy would allow plants that cut mercury emissions below a yet-to-be-determined cap to sell credits to plants that are above the ceiling.

A second option offered by the Environmental Protection Agency several months ago centered around reducing mercury through short-term technology. But studies by the Department of Energy and the utility industry revealed that there is no existing technology to remove mercury equally well from various types and grades of coal.

EPA officials say that makes the option to reduce mercury to 34 tons by 2008 less feasible.

"The debate is what's the best option, given the available technology," EPA spokeswoman Cynthia Bergman told the AP. "And we think that, given the state of technology, cap and trade is better – and we are leaning that way."

The Bush administration ruled in December that mercury should not be regulated as a toxic substance requiring maximum pollution controls, reversing a Clinton administration ruling. The EPA must come to a final decision by the end of 2004 to meet a court-ordered deadline in a lawsuit brought by the Natural Resources Defense Council.

While some industry experts, including former EPA administrator Carol Browner, believe technology is available to reduce mercury emissions to 34 tons by 2008, utility leaders prefer the idea of trading emission rights.

(Continued on page 4)

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"COLUMBIAN AND VENEZUELAN SPOT PRICE VOLATILITY"

COLOMBIA AND VENEZUELA SPOT PRICES
 Prices shown are FOBT US\$/tonne at the Ports

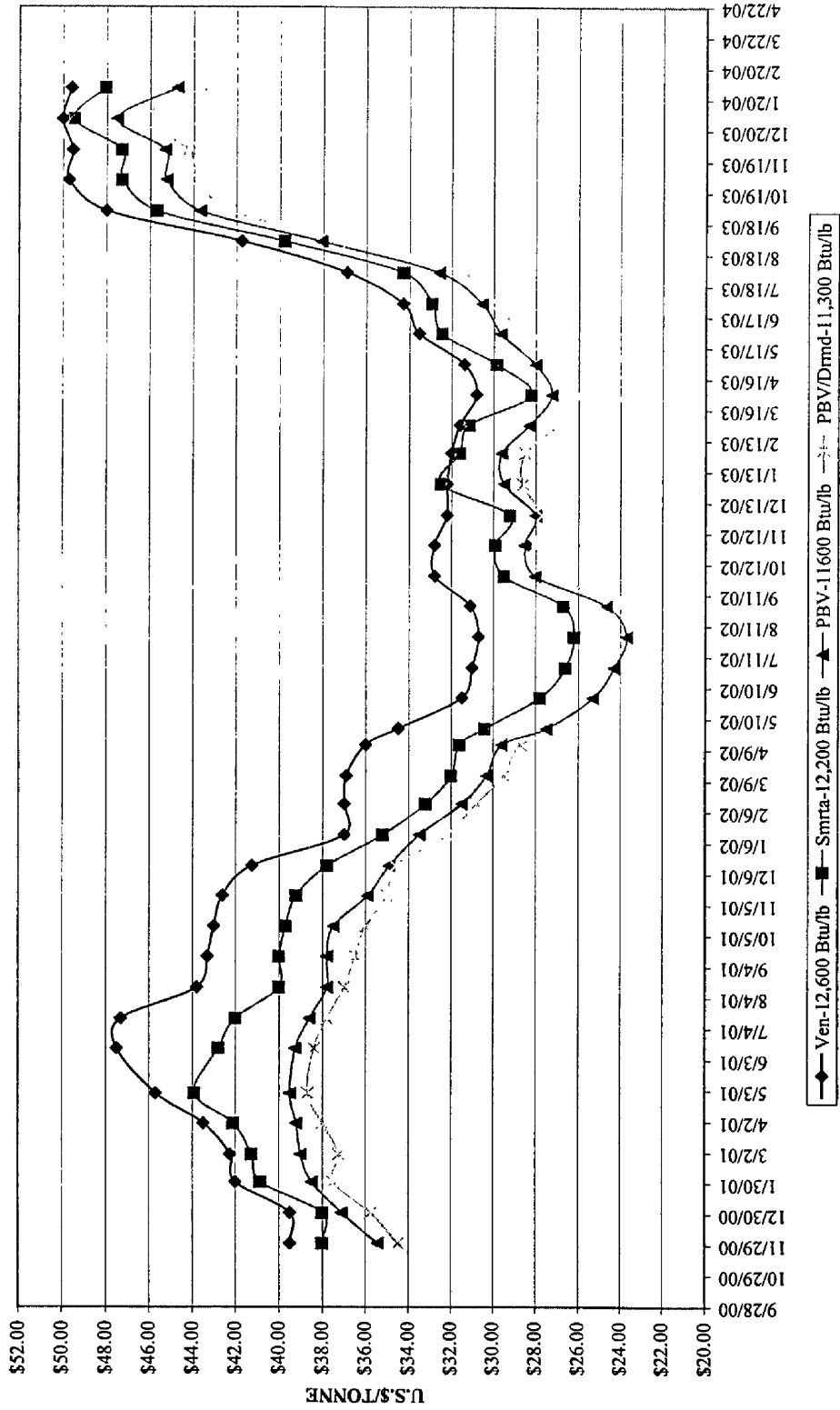


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"COMPARISON OF TECO TRANSPORT'S RATES
COMPARED TO THE COAL BENCHMARK"

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