



ORIGINAL

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PROGRESS ENERGY SERVICE COMPANY, LLC

October 18, 2004

HAND DELIVERY

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

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Re: Docket No. 040001-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket on behalf of Progress Energy Florida, Inc., are an original and fifteen copies of the Rebuttal Testimony of Samuel S. Waters.

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

Respectfully yours,

Bonnie E. Davis

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**PROGRESS ENERGY FLORIDA**

**DOCKET NO. 040001-EI**

**REBUTTAL TESTIMONY OF  
SAMUEL S. WATERS**

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

2 **A. My name is Samuel S. Waters and I am employed by Progress Energy Carolinas. My**  
3 **business address is 410 S. Wilmington Street, Raleigh, North Carolina, 27601.**

4

5 **Q. Have you previously filed testimony in this docket?**

6 **A. Yes, I have.**

7

8 **Q. What is the purpose of your rebuttal testimony?**

9 **A. I will address several points raised by witnesses Knauth and Vogt on behalf of the Florida**  
10 **Industrial Power Users Group (FIPUG) regarding the proposed purchase of capacity and**  
11 **energy from the Southern Companies by Progress Energy Florida (PEF). Specifically, I**  
12 **will discuss what I consider to be the primary issue in this instance, whether or not PEF**  
13 **should be required to issue a Request for Proposals (RFP) to demonstrate that the purchases**  
14 **from the Southern Companies are the most cost effective alternative available to PEF,**  
15 **which seems to be what is being suggested by both Mr. Knause and Mr. Vogt. I will also**  
16 **address several of the specific allegations made in their testimony.**

17

18 **Q. What do Mr. Knauth and Mr. Vogt suggest with respect to requiring a bidding**  
19 **process to demonstrate the cost effectiveness of the proposed power purchases from**  
20 **the Southern Companies?**

21 **A. Mr. Knauth suggests that:**

1 “With respect to both FPL and Progress Energy, each utility’s witness testifies that, if  
2 the utility were to meet the 2010 need for capacity with units in its generation  
3 expansion plan rather than with the proposed UPS arrangements, it would build a  
4 large combined cycle unit. (Waters, page 6, lines 15-16; Hartman, page 15, lines 10-  
5 12.) I am informed that before either utility could proceed with construction of such a  
6 unit, it would be required by rule to conduct a detailed Request for Proposals, and that  
7 its decision would be reviewed in a Commission proceeding that typically lasts for  
8 several months (and in which bidders routinely participate as parties.) The nature and  
9 significance of the needs that the proposed UPS arrangements are intended to satisfy  
10 are identical to those of the needs that would trigger that scenario of active  
11 competition and detailed review.” (Knauth, page 5, line 22 through page 6, line 9.)

12 Mr. Vogt takes a somewhat lighter approach, acknowledging:

13 “Though the provisions of the “bid rule” do not apply to the UPS PPA’s such  
14 agreements present many of the same policy issues as the addition of generating  
15 capacity.” (Vogt, page 7, lines 16-18.)

16 Both witnesses are clearly suggesting that PEF should conduct an RFP.

17  
18 **Q. Do you agree with that suggestion?**

19 **A.** No. I do agree with Mr. Vogt that the provisions of the bid rule do not apply to this case,  
20 but the primary reason for my belief that an RFP would be inappropriate is that conducting  
21 an RFP would jeopardize PEF’s ability to take advantage of this opportunity.

22  
23 **Q. Please explain.**

24 **A.** Clearly, in the creation of the Commission’s “Bid Rule”, there was recognition that  
25 requiring an RFP process in all instances where the utility is acquiring capacity would

1 restrict a utility's ability to plan its supply system in a flexible and cost-effective manner.  
2 For example, when a utility has identified combustion turbines as its most cost-effective  
3 alternative, there is no requirement for an RFP, allowing the utility to more quickly respond  
4 to needs in the near term. Repowering of existing units is also excluded, encouraging the  
5 efficient use of older generating units. These exemptions result from the clear linkage  
6 between the "Bid Rule" and the Power Plant Siting Act, but they also implicitly suggest that  
7 there are circumstances where bidding may not be appropriate. In this case, where we are  
8 dealing with a contract extension, rather than construction of a new unit, I believe that there  
9 is a great risk of losing the opportunity if PEF is required to proceed with an RFP.

10  
11 **Q. Why do you feel that the opportunity to make this purchase from the Southern**  
12 **Companies would be at risk?**

13 **A.** There are two reasons. To put the risk in context, it is important to recognize that an RFP  
14 process would take on the order of six months to complete, followed by negotiations to  
15 complete a contract for the power to be purchased. Based on this timeframe, the first  
16 reason I believe risk is increased is that Southern is under no obligation to either hold this  
17 offer open or bid into an RFP and wait for the outcome to see if they are the winning  
18 bidder. We are currently negotiating under a series of 30-day extensions to reach  
19 agreement, and there is every reason to believe that Southern will continue to search for a  
20 buyer if we back away from an agreement today. The capacity they are seeking to sell is  
21 "uncovered" by any existing wholesale or retail obligation once our current contracts with  
22 them end. It stands to reason that no owner of a capital intensive asset will take a passive  
23 approach to selling an interest in that asset. We have to ask ourselves, what incentive  
24 would Southern have to wait for us? If the argument is that there are no other potential  
25 buyers, it brings me to my second reason for believing that this deal is at risk by delaying.

1 Not only do I believe that there are potential buyers for this capacity simply looking at  
2 the overall growth in peninsular Florida, but I also believe that at least some of the potential  
3 buyers are not subject to Commission review of the contract for cost recovery, and would  
4 not have to delay a purchase by conducting an RFP process. This would be true for  
5 potential buyers both inside and outside Florida. The only reasonable conclusion is that, at  
6 the very least, there is an increased possibility of this deal being offered elsewhere, in whole  
7 or in part, while PEF goes through an RFP process. Loss of this sale would result in loss of  
8 the advantages I outlined in my pervious testimony, the most important of which, in my  
9 mind, is access to coal energy.

10  
11 **Q. What other benefits in the agreement with the Southern Companies that you feel are**  
12 **unique to this seller?**

13 **A.** There are two main advantages that I see, primarily resulting from the fact that we are  
14 dealing with a seller that has a substantial portfolio of resources, with a variety of fuel  
15 types. First, there is the ability for Southern to maintain an extremely high unit availability,  
16 translating to increased reliability of the supply system, by providing capacity from  
17 alternate resources. Second, there are savings, which have not been quantified, to be  
18 obtained by the ability to provide energy from alternate resources, in place of the Franklin  
19 combined cycle unit. When energy is provided from an alternate resource, it is provided at  
20 a discount below the contract rate for the Franklin unit.

21  
22 **Q. Are these benefits in addition those cited in your direct testimony?**

23 **A.** Yes. To reiterate the benefits I believe that PEF customers obtain from this purchase:

- 1       • Contributes to fuel diversity - A portion of the energy will come from coal-fired  
2       generating capacity, providing low-cost energy and serving to reduce the price  
3       volatility of PEF's fuel mix.
- 4       • Contributes to economy energy availability – Access to the transmission facilities  
5       provided by the agreement will give PEF access to lower cost energy that may be  
6       available within the Southern region, in those hours when the units specific to the  
7       purchase are not scheduled.
- 8       • Contributes to increased reliability - The agreement will maintain a transmission path  
9       to the Southern system, which provides access to a large resource pool and enhances  
10      system supply reliability.
- 11     • Contributes to cost certainty - The purchases come from existing generating facilities.  
12      Utilization of existing resources provides greater assurance of cost and performance  
13      than might be obtained from units that would need to be constructed.

14

15   **Q. How then can the Commission address the cost effectiveness of this proposed**  
16   **purchase from the Southern Companies?**

17   **A.** The Commission has sufficient information available to make an informed decision. We  
18   have presented the economics of the proposed agreements, and the assumptions upon which  
19   they are based, as well as the strategic benefits associated with the purchases. There is  
20   sufficient information to make a judgment on whether or not the purchases are prudent and  
21   cost-effective. Waiting for additional information would put the offer at risk and  
22   potentially lose the benefits of this deal for PEF customers.

1 **Q. Do the projects suggested by Messrs. Knauth and Vogt offer a reasonable basis for**  
2 **believing that there are competitive projects which could take the place of the**  
3 **purchases from Southern?**

4 **A.** No. Mr. Vogt references a coal project in southern Georgia that is currently in the licensing  
5 process (Vogt direct testimony, page 11, lines 20-22). This appears to be the basis for his  
6 statement "... the fact that a new coal unit would still have time to be constructed to meet  
7 an in-service date of June 1, 2010..." (page 8, lines 9-11). The fact is, I have an existing  
8 coal unit to buy from in this deal, and a speculative unit represented as an alternative. At  
9 equal pricing, I'll take the "bird in the hand". Even if it could be shown that the cost of a  
10 new, scrubbed coal facility (my assumption on type) could be offered at a price below an  
11 existing unscrubbed unit (Scherer 3), I would have to weigh the risk of having the unit in  
12 service to meet my need date, the unit performing to the contract specifications, etc. And  
13 let me state very strongly here that the sellers do not bear the risk of non-performance. The  
14 ultimate risk of non-performance is borne by the customer.

15 Mr. Knauth offers an existing facility, but it is not available until 2012 (Knauth direct  
16 testimony, page 11, lines 18-20). He goes on to say that "Conceptually, it is possible for a  
17 utility to structure short-term arrangements at the outset of the period in order to avail itself  
18 of a wholesale source that is available later in the period." (page 12, lines 15-17), and "A  
19 competitive opportunity could also lead Vandolah to consider converting a portion of its  
20 capacity to a combined cycle configuration for the purpose of this proposal" (page 12, lines  
21 19-21). It is hard to argue with conceptualls, but here we have a completely hypothetical  
22 project, consisting either of a short-term purchase (which I assume would have to come  
23 from an RFP, per Mr. Knauth) plus a later purchase from the existing facility, or,  
24 conversion of the facility to combined cycle, which again introduces risks associated with  
25 schedule and performance that I do not have with the existing facility. Moreover, Mr.

1 Knauth simply ignores the key question of how I would replace the coal energy provided in  
2 the Southern agreement.

3

4 **Q. Mr. Knauth states that “Committing to the transaction years prior to the time it is**  
5 **necessary to do so would increase the exposure to that risk” (page 10, lines 14-15),**  
6 **referring to the risk of “a significant increase related to changes in environmental**  
7 **requirements.”(lines 11-12). Do you agree?**

8 **A.** No. To be clear, he is raising the issue with reference to the term sheet for the Scherer  
9 power purchase that makes PEF responsible for cost changes resulting from a “change in  
10 law”. This is something of a red herring, since there are only two ways to approach the  
11 uncertainty associated with changes in environmental regulation; the way it’s been handled  
12 in the proposed agreement, which is to deal with it as it occurs, or to attempt to price the  
13 changes into the agreement up front. If the Southern Companies, or any party, were to  
14 agree to bear this risk as seller, there is no doubt they would price the power to ensure that  
15 they were covered in the event of a substantial change. However, compare the situation  
16 under the proposed agreement, where we have a known asset with known operating  
17 parameters and known costs, with uncertainty over future environmental costs, versus a  
18 proposed facility with contractually guaranteed, but nevertheless less certain costs and  
19 operating parameters, and that same environmental risk. Since the construction of a new  
20 facility presents more risk compared to an existing facility, it stands to reason that the  
21 additional risk will be reflected in the price offered if it is assumed by the seller through  
22 contractual guarantees. Therefore, I continue to believe that this purchase from the  
23 Southern Companies contributes to cost certainty.

24

25 **Q. Would you please summarize your rebuttal testimony?**



1 A. The testimony of Messrs. Knauth and Vogt, presented on behalf of FIPUG, presents policy  
2 issues beyond the scope of this docket, policy issues that have been dealt with on two  
3 occasions in creating the current “Bid Rule”. I believe that an RFP process is not in  
4 customers’ best interests under the circumstances presented here, because the delay created  
5 by the process would put the proposed deal at risk. In addition, they are asking me to risk  
6 this “bird in the hand” for their conceptual “birds in the bush”, and they have not provided  
7 compelling arguments that that risk on customers behalf is warranted.

8 The proposed purchases from the Southern Companies offer a unique opportunity to  
9 **obtain coal energy, access** a broader southeastern market, and defer the need for new  
10 **capacity in Florida. I continue** to believe that approval of this purchase is in the best  
11 interest of PEF customers.

12

13 **Q. Does this conclude your testimony?**

14 **A. Yes.**

**PROGRESS ENERGY FLORIDA**

**DOCKET NO. 040001-EI**

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a true copy of the Rebuttal Testimony of Samuel S. Waters on behalf of Progress Energy Florida has been furnished to the following individuals by regular U.S. Mail the 18<sup>th</sup> day of October, 2004.

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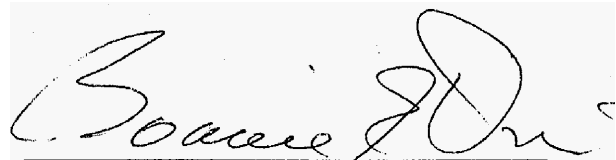
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