BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

FUEL AND PURCHASED POWER COST RECOVERY CLAUSE WITH GENERATING PERFORMANCE INCENTIVE FACTOR.	DOCKET NO. 060001-EI
PETITION TO RECOVER NATURAL GAS STORAGE PROJECT COSTS THROUGH FUEL COST RECOVERY CLAUSE, BY FLORIDA POWER & LIGHT COMPANY.	DOCKET NO. 060362-EI
PETITION FOR AUTHORITY TO RECOVER PRUDENTLY INCURRED STORM RESTORATION COSTS RELATED TO 2004 STORM SEASON THAT EXCEED STORM RESERVE BALANCE, BY FLORIDA POWER & LIGHT COMPANY.	DOCKET NO. 041291-EI

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VOLUME 5

Pages 658 through 740

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LISA POLAK EDGAR
COMMISSIONER J. TERRY DEASON
COMMISSIONER ISILIO ARRIAGA
COMMISSIONER MATTHEW M. CARTER, II
COMMISSIONER KATRINA J. TEW

DATE: Tuesday, November 7, 2006

DOCUMENT NUMBER-DATE
10323 NOV-8 8
FPSC-COMMISSION CLERK

TIME: Commenced at 9:30 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
Official FPSC Reporter
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PARTICIPATING: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:	ID.	ADMTD.
50, 51 & 52		676
18 & 19		709

P R O C E E D I N G S

(Transcript follows in sequence from Volume 4.)

CHAIRMAN EDGAR: We will go back on the record and give everybody a moment to get comfortable again.

And then, Captain Williams, I'm going to look to you. You had an objection. Would you like to speak to it again?

CAPTAIN WILLIAMS: My objection was to these documents that Doctor Goins has never seen before. We don't know how it was complied (sic). We don't know what witness formulated these, if the information contained in them is actually true, they don't seem to be -- they are not going to be presented into testimony, so we will never have an opportunity to cross-examine on it, and Doctor Goins has no personal knowledge of these.

MR. ANDERSON: Chairman Edgar, to abbreviate the proceedings, these documents, of course, are true and correct FPL business records, but I'm just going to ask some different questions not involving that particular document, if that is all right.

CHAIRMAN EDGAR: Okay.

Mr. Anderson, we will move along. Thank you.

DENNIS W. GOINS

continues his testimony under oath from Volume 4:

CONTINUED CROSS EXAMINATION

BY MR. ANDERSON:

Q Doctor Goins, will you please direct your attention to Page 9 of your prefiled testimony. Do you have that in front of you?

A I do.

Q Do you see the first question and answer at the top of the page?

A Yes.

Q There you state that FPL can interrupt the load when necessary to alleviate a power supply or transmission emergency condition or capacity shortage, right?

A Correct.

Q And to keep FPL from operating its generators above their continuous rated output, right?

A Correct.

Q Your testimony here today is you have no idea how frequently or infrequently CILC is called upon for interruption, is that what you are saying?

A My testimony is that in preparation for this case, I did not attempt, make any attempt to identify either the frequency, the duration over any specific time period in which CILC customers have been interrupted. I did so simply because it is irrelevant as to the value of interruptible service under the CILC rate. Since it was irrelevant, there was no purpose in doing it.

Q So the answer to my question was yes, you just don't know how often it has been used, right?

A The answer is I did not do any analysis of the issue, so I don't know what particular time period you're asking about, any particular day. I have done no analysis of it.

Q Have you done any analysis of your client, the Federal Executive Agencies, compliance with providing curtailment upon request in connection with the load control event?

A No, I did not.

Q So you don't know whether the federal agencies when called upon to curtail in an emergency, whether they provided that curtailment or did not provide, you just don't know?

A That's correct.

Q You felt that wasn't important to your analysis either, right?

A It is.

Q It is important to your analysis?

A No, it is not important in terms of the testimony that I have given in this case. I'm not testifying about a specific CCR factor applicable to the Federal Executive Agencies. I'm testifying about the CCR factors for customers served under FPL's CILC rate.

Q The Federal Executive Agencies receive benefits in terms of reduced rates in consideration of providing interruption when requested, right?

A You call it a benefit, I call it a reduced price for a less reliable lower quality of service that's provided by FPL.

Q Your clients accept that reduced price, they accept that bargain, right?

A Yes, they do.

Q But you didn't consider it relevant whether your client actually honors that commitment?

A For purposes of this testimony, absolutely not.

Q Do you agree that the level of discounts for CILC customers should take into account the incentive needed to take nonfirm service?

A I'm not sure what you mean by the incentive needed.

Q Whether the amount of benefit or cost reduction is sufficient to elicit the amount of committed demand reduction?

A Well, I don't agree with that specific phrasing of the issue. I believe that the prices for interruptible service should reflect FP&L's cost of serving interruptible load. I believe that an evaluation whether interruptible service is offered can be evaluated in the context of whether the cost of implementing the program are outweighed by the benefits to the general group of ratepayers in terms of the avoided costs that are created by the interruptible service.

Q There are about 500 customers on rate CILC?

A Approximately.

Q It has been a closed rate for a number of years?

A Yes.

Q There has been no increase or change in the amount of discounted price for those customers?

A That I can't say, since the rate is fairly old and I haven't made a year-by-year comparison of what the prices of firm versus interruptible were.

Q There has been almost no attrition of customers from rate CILC once they are on, right?

A Apparently not. That wouldn't be surprising at all.

Q The fact that there is no attrition from the rate tends to show that the rate is compensatory in terms of getting people to promise to provide interruption that's required?

A No, it doesn't. It doesn't show that at all.

Q Under basic pricing theory, if it wasn't worth it to those customers, wouldn't they just say no?

A Well, it depends. Because one of the requirements for being under the CILC rate is that customers qualify for it by installing backup generation. As I said in my summary, those customers incurred million of dollars of expense in doing so, and they entered into many of these agreements with the FPL energy service company in which FPL was trying to get customers to install backup generation for both business purposes, apparently, and for meeting Commission conservation DSM goals.

Now, once those commitments were made, and those costs were sunk, the customers are then essentially on the hook on their books to recoup the costs of those investments, so that whether a price of interruptible service changes in a minor fashion or a large fashion is not going, since the rate is closed, to have a determination on any new customers that come on, but will, in fact, affect whether a customer, even if it believes the price for interruptible service is too high, given the customer is trying to recoup those costs that were sunk into the backup generation, they simply can't take a walk on those costs. It's not as simple as you make it out to be.

Q Doctor Goins, isn't it a fact that installing backup generation is not a requirement at all to be eligible for rate CILC service?

A It is one of two options that one has to qualify for service.

Q It's a choice a customer can make, but it's not required for CILC, isn't that right?

A Yes. It was a choice that customers who do have the backup made, many in conjunction with working with FPL.

Q Customers do not have to have backup generation to qualify for CILC, right?

A No. But about two-thirds of them apparently -- or at least two-thirds of the load served under CILC is backup generated or is for customers with backup generation. Again, many of whom, at least in the case of FEA in particular, customers who entered into those deals at the direct request and in business dealings with FPL in the mid-90s.

Q I would like to direct your attention again to Page 9 of your testimony. Do you have that still there?

A I do.

Q Do you see that quotation of Professor Bonbright, the first sentence?

A Yes.

Q It says interruptible service has been used by both gas and electric companies for peak shaving, right?

A That's right.

Q Are you aware that CILC is not used to interrupt customers solely for economic reasons?

A Yes, but I don't see how that's related to this quote.

Q During normal system conditions, rate CILC is not used to avoid making purchases of power to serve all customers, including CILC customers, isn't that so?

A Pardon me. I missed the first part of your question.

Q I'll restate it for you.

During normal system conditions, by that I mean not emergency conditions, rate CILC is not used to avoid making purchases of power to serve customers, including CILC customers?

A In non-emergency conditions your dispatchers will simply make a decision, I assume, based on the economics of the transactions involved, including whether the rate payments from CILC customers will compensate the company for any off-system purchases that are made during, as you call it, normal operating conditions.

Q FPL does not use CILC to interrupt customers prior to purchasing power, right?

A I don't know how your dispatchers operate in terms of the rules of engagement in the market that they make.

Q In non-emergency conditions purchased power is obtained to serve CILC customers like all other customers, correct?

A Again, I don't know how your dispatchers operate in making decisions on purchases, in particular on a nonfirm short-term basis.

Q So your testimony is you don't know.

A Well, my testimony is that I would think your company is imprudent if you're going out and making firm capacity purchases on a long-term basis to serve interruptible load during normal conditions, if, in fact, the compensation that the company receives is insufficient to recover those costs.

Q Doctor Goins, do you know how much firm capacity FEA contracts for?

A I did, but I can't recall it right now.

Q Do you recall roughly what proportion?

A It was probably on the order of 30 or 40, between 20 and 40 percent, I would say, for the basic facilities, but I'm not sure. I shouldn't even say that.

Q Will you accept, subject to check, it's about 70 percent firm?

A I have no idea. But if you say it is -- I knew the answer two years ago, I don't know it now.

MR. ANDERSON: We have no further questions.

CHAIRMAN EDGAR: No questions? Okay.

Mr. Twomey.

MR. TWOMEY: Thank you, Madam Chair, Commissioners.

CROSS EXAMINATION

BY MR. TWOMEY:

Q Good afternoon, sir.

A Good afternoon. Morning. Afternoon.

Q Doctor Goins, I'm Mike Twomey and I represent the AARP in this docket.

Are you aware that the AARP claims to have 2.7 million members in the State of Florida?

A It wouldn't surprise me at all.

Q Would you agree with me that individual AARP members in the state of Florida, irrespective of their number, are more likely to be members of a residential customer class than members of the CILC class?

A That I would agree with.

Q I believe I heard you say there were approximately 500 members in the CILC class, is that correct, or you agreed with Mr. Anderson there were about 500?

A Yes, I agreed with Mr. Anderson. Approximately.

Q If you know, how many are represented by the FEA?

A At least three.

Q Beg your pardon?

A Of those CILC customers, at least three.

Q Three out of the 500?

A Yes.

Q Now, I came in a little bit late at the beginning of Mr. Anderson's cross-examination of you, but I believe I heard him say, or in connection with reading the testimony, that there is -- there is some -- let me find the number.

Currently, you are paying, the class is paying or getting a discount that he calls it, which you object to, you are making payments of $19.3 million, is that correct?

A Under the CILC or the CCR factor.

Q Right. Those are the payments. And as I understand the gist of what you want to do, is that you would reduce those payments for the class to something in the order of $2.9 million, correct?

A Well, no, the class is currently -- the reduction would be a reduction of approximately, under my proposal, $15 million or 16.

Q 16.3 approximately, right.

A Although the company has correctly pointed out that in my calculation I did not separate the firm and interruptible demands because it simply wasn't included in the filing at which time we had to file. So when the rates are recalculated, if the Commission adopts my proposal, that number will drop. It will drop by the order of around -- to around 12 million is my guess.

Q So it would only -- it would only be 12 million versus 16?

A Right.

Q So instead of you -- under your proposal, as I read your testimony, you would go from $19.3 million to 2.9 which would result in your class only paying about 15 percent of what it was currently paying, correct?

A If your number is right, that's correct.

Q Now you're saying that under this recalculation, it wouldn't be quite that large drop in what was paid, correct?

A That's correct.

Q Do you know what the percentage would be?

A No, I do not.

Q It would still be a significant reduction in what your class pays versus what it is currently required to pay under existing practice?

A It would be a reduction relative to both the existing CCR factor and also to that that FPL has proposed in this docket.

Q Now, I believe I heard you respond to Mr. Anderson, and correct me if I'm wrong, when I was walking in, I apologize, again, for coming in late, that you didn't expect Florida Power and Light to eat the difference, if you will, to absorb the difference between what your class CILC currently pays versus what they would pay if your proposal was adopted by the Commission. Was I correct in hearing that? You don't expect the company to lose that money, you expect that it will go someplace else, correct?

A I have not recommended that the company lose anything relative to what it has proposed for recovery, if that's what you're asking.

Q Yes, is that correct?

A That is correct.

Q So then for ratemaking purposes, wouldn't it be kind of like a balloon, if you can imagine that we have a balloon here and the part that Florida Power and Light is getting from the CILC class is squeezed so that it is reduced by 16 million or even 12 million has to expand over in this other part, right?

A Yes, and that is reflected in the proposal that I have made in my testimony.

Q And my client's members are in that other part. Would you acknowledge that?

A They are part of the other part, a big part of it.

Q So of necessity if the Commission adopts your proposal on behalf of the FEA's three members that are part of this larger class of 500, that transfer of revenue responsibility would leave them and go to this bigger body which includes all the residential customers, including my client's members, correct?

A Yes. My estimate is that the impact would be less than 20 cents a month. It would be on the order of about $2 or less a year for a customer, a typical thousand kilowatt hour customer.

Q I'm going to assume you haven't taken any poll that resulted in an opinion on behalf of the residential customers that they didn't care about that. Would I be correct?

A You would.

Q Now, you would acknowledge, would you not, that what you're asking the Commission to do here, these five Commissioners, is to change a longstanding, the longstanding status quo of how purchased power cost is recovered through this clause, is that correct?

A That's correct.

Q Do you, in fact, know how long the status quo has been in effect?

A More than ten years.

Q How much more, do you know?

A No.

MR. TWOMEY: That's all I have, Madam Chair. Thank you.

Thank you, sir.

CHAIRMAN EDGAR: Other parties with questions on cross for this witness? No.

Are there questions from staff?

MS. BENNETT: No questions from staff.

CHAIRMAN EDGAR: Commissioners?

Captain Williams, do you have redirect?

CAPTAIN WILLIAMS: Just one minute. May I have one minute in place?

CHAIRMAN EDGAR: You may. (Pause.)

CAPTAIN WILLIAMS: Okay, ma'am, just briefly.

REDIRECT EXAMINATION

BY CAPTAIN WILLIAMS:

Q I think it was Mr. Butler -- no, it was Mr. Anderson. I'm sorry about that.

MR. ANDERSON: Quite all right, Captain.

Q -- asked you about interruption and CILC customers. Do you know whether or not the value of the CILC rate differs based on whether or not there is an interruption or not an interruption?

A No, the value to FPL and to the system as a whole is the ability of FPL to call on interruptible load to be interrupted during the conditions of either system emergencies or lack of power supplies. And whether the CILC class is interrupted one time a year or 25 times a year is, in effect, irrelevant with respect to identifying whether the interruptibility and the interruptible service is a value and a significant value to FPL.

To assume that the value of interruptibility is based on how many times customers are interrupted is similar to saying, for example, that a utility that requests a huge hurricane storm reserve in anticipation of future storms, even though those storms may never occur, once that reserve is created it's there to call on. So the analogy would be similar to the interruptibility. If you have got the interruptible load there to call on, it is similar to buying insurance as you would through building up a storm reserve.

CAPTAIN WILLIAMS: Nothing further.

CHAIRMAN EDGAR: Captain Williams, do you want to enter Exhibits 50, 51, and 52 into the record?

CAPTAIN WILLIAMS: We do, ma'am.

CHAIRMAN EDGAR: Any objection?

Seeing none, Exhibits 50, 51, and 52 will be entered into the record.

(Exhibits 50, 51, and 52 admitted into the record.)

CHAIRMAN EDGAR: I think it is time for lunch. We will come back at 1:30. We are on lunch break.

(Lunch recess.)

CHAIRMAN EDGAR: We will go back on the record.

And, Mr. Anderson, I believe it's your witness.

MR. ANDERSON: Yes, Chairman Edgar.

Florida Power and Light Company will call as its next witness Doctor Rosemary Morley.

Doctor Morley, have you been sworn as a witness yet?

THE WITNESS: No, I have not.

CHAIRMAN EDGAR: Okay. Then we will do that. If you would, please stand and raise your right hand.

(Witness sworn.)

ROSEMARY MORLEY, D.B.A.

was called as a witness on behalf of Florida Power & Light Company, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. ANDERSON:

Q Doctor Morley, will you please state your name and your business address?

A Rosemary Morley, 9250 West Flagler, Miami, Florida.

Q By whom are you employed and in what capacity?

A I am the rate development manager at Florida Power and Light.

Q Have you prepared rebuttal testimony dated

October 6th, 2006, consisting of ten pages of typewritten questions and answers?

A Yes, I have.

Q Have you submitted two documents, Numbers RM-5 and RM-6, which have been preidentified as Exhibit Numbers 18 and 19?

A Yes, I have.

Q Focussing on your rebuttal testimony, do you have any changes, additions, or corrections to your rebuttal testimony?

A No, I do not.

MR. ANDERSON: Florida Power and Light requests that Doctor Morley's rebuttal testimony be inserted into the record as if read.

CHAIRMAN EDGAR: The prefiled rebuttal testimony of the witness will be inserted into the record as though read.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF ROSEMARY MORLEY

DOCKET NO. 060001-EI

OCTOBER 6, 2006

Q. Please state your name and business address.

A. My name is Rosemary Morley. My business address is 9250 West Flagler Street, Miami, Florida, 33174.

Q. By whom are you employed and what is your position?

A. I am employed by Florida Power & Light Company (FPL or Company) as the Rate Development Manager in the Rates & Tariffs Department.

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for developing electric rates at both the retail and wholesale levels. At the retail level, I am responsible for developing the appropriate rate design for all electric rates and charges. I am also responsible for proposing and administering the tariff language needed to implement those rates and charges.

Q. Please describe your educational background and professional experience.

A. I hold a bachelor's degree in economics from the University of Maryland and a master's degree in economics from Northwestern University. I was awarded a doctorate in business administration from Nova Southeastern University in 2005. Since joining FPL in 1983 I have held a variety of positions in the forecasting, planning, and regulatory areas. I joined the Rates and Tariff Department in 1987 as a Senior Cost of Service Analyst and was subsequently promoted to Supervisor of Cost of Service. I have held the position of Rate Development Manager since 1996.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring an exhibit consisting of two documents which are attached to my rebuttal testimony. They are as follows:

- Document No. RM-5, Non-Firm Electric Service Report
- Document No. RM-6, FAC Rule 25-6.0438

Q. What is the purpose of your rebuttal testimony?

A. In my testimony I will address the proposal by FEA witness Goins that no demand-related purchased power costs be allocated to the Commercial Industrial Load Control (CILC) rate classes for the purpose of determining the capacity cost recovery (CCR) factor for those classes. I will show that this proposal would be unfair to FPL's other customers and is inconsistent with the Commission's rules and practice for non-firm service.

Q. How does FPL allocate the costs recoverable through the CCR clause in this proceeding?

A. FPL has consistently used the 12 CP and 1/13th methodology. This methodology classifies 12/13ths, or 92%, of costs on the basis of coincident peak demand ("CP") and 1/13th, or 8%, of costs on the basis of energy. The portion classified on demand is allocated to the individual rate classes based on their 12 CP contributions, adjusted for losses, while the portion classified on energy is allocated based on the kWh sales, adjusted for losses. As a result, all rate classes that utilize and benefit from purchased power are allocated a share of the cost of that power based on their 12 CP contributions.

Q. What does witness Goins propose in his testimony?

A. Rather than following the 12 CP and 1/13th methodology, witness Goins maintains that one set of customers, those in the CILC rate classes, should be excluded from the allocation of all demand-related purchased power costs and proposes an "Alternative Approach" to reflect his recommended treatment (DWG Direct Testimony, page 13, line 9 to page 14, line 11). The result of his alternative approach is to drastically reduce the cost allocation to the CILC rate classes at the expense of the general body of electric customers.

Q. What is the impact of witness Goins' alternative approach on the remaining customers?

A. As shown in Exhibit DWG-2, $2,923,136 would be allocated to the CILC rate classes compared to FPL's filing of $19,309,158, which results in $16,386,022 of unrecovered purchased power costs that would have to be collected from the remaining customers. This would be an inappropriate and unfair subsidy of the CILC customers by the remaining customers.

Q. Why would the $16.4 million reallocation of costs proposed by witness Goins be unfair and inappropriate?

A. The most significant problem with FEA's proposal is that it is inconsistent with Florida regulations governing the discounts utilities can provide to non-firm service customers. In addition, FEA's proposal is inconsistent with how production costs in general, and the CILC rate classes, in particular, would be treated in a base rate proceeding. Lastly, even the mechanics of what FEA is proposing are flawed. Their method incorrectly assumes that customers under the CILC rate are 100% interruptible.

Q. Why does witness Goins contend that CILC classes should be exempted from paying their share of allocated costs based on the 12 CP and 1/13th methodology?

A. Witness Goins argues the CILC rate classes should not be allocated any demand-related purchase power costs because they receive non-firm service.

Q. What is meant by non-firm service?

A. Non-firm service means electric service that can be limited or interrupted. Non-firm service in this context includes interruptible, curtailable, load management, and other types of non-firm electric service offered by the utilities pursuant to tariffs approved by the Florida Public Service Commission. In exchange for providing this ability to limit or interrupt service, non-firm service customers receive a discount on their electric bills. In FPL's case, CILC is one of a number of non-firm service offerings available. Document No. RM-5 provides the most recent non-firm service report provided the Commission.

Q. Has the Commission specified how the discounts for non-firm service customers are to be determined?

A. Yes. Discounts for non-firm service must meet the requirements outlined in Rule 25-6.0438, which is included as Document No. RM-6 in my testimony. One of the rule requirements is a determination of cost effectiveness:

"Cost effective" in the context of non-firm service shall be based on avoided costs. It shall be defined as the net economic deferral or avoidance of additional production plant construction by the utility or in other measurable economic benefits in excess of all relevant costs accruing to the utility's general body of ratepayers.

Q. How does FPL ensure that its non-firm service rates meet this requirement that the benefits of non-firm service to the general body of customers must exceed their costs?

A. FPL uses a two-part rate treatment to ensure that the benefits of non-firm service to the general body of customers exceed their costs. The discounts to non-firm service customers reflect a portion of the cost savings to FPL because specified capacity *additions* can be deferred as a result of the opportunity to limit or interrupt service to non-firm loads. By contrast, the embedded capacity costs are allocated to *all* customers, including non-firm service, in recognition of the fact that FPL actually incurs those costs in order to serve all customers. In summary, the determination of non-firm service rates starts from a baseline that allocates them the costs actually incurred to serve their actual load, and then subtracts from that baseline a discount based on the avoided *additional* costs that FPL would have to incur if those rates did not allow FPL to limit or interrupt service.

Q. Has this two-part treatment historically been used by FPL to calculate the CILC rates?

A. Yes. In a base rate proceeding, CILC customers are allocated production-demand costs using the 12 CP and 1/13th methodology I described earlier, with no adjustment to remove any portion of load that may be interruptible. A separate rate adjustment is then made to reflect the cost effective level of the CILC discount.

Q. Has the Commission reviewed this two-part treatment for the CILC rate classes?

A. Yes. The base rate treatment I described was utilized by FPL in Docket Nos. 050045-EI and 001148-EI. It is also consistent with FPL's treatment of curtailable service in Docket No. 830465-EI. The appropriate level of CILC discounts has been addressed in a separate series of dockets (Docket No. 941170-EG, PSC-95-0865-FOF-EG; Docket No. 881106-EI, Order No. PSC-92-0687-FOF-EI).

Q. Has the Commission approved this two-step process for other utilities?

A. Yes, a similar two-part treatment has been approved for Florida Progress and TECO (Docket No. 910890-EI, Order No. PSC-92-1197-FOF-EI; Docket No. 950645-EI; Order No. PSC-96-0842-FOF-EI; Docket No. 920324-EI; Order No. PSC-93-0165-FOF-EI; Docket No. 990037-EI; Order No. PSC-99-1778-FOF-EI.)

Q. Is FEA's proposal consistent with Rule 25-6.0438?

A. No. FEA is attempting to artificially inflate the discounts to CILC customers by circumventing the requirements under Rule 25-6.0438. FEA wants to include embedded purchased power payments in the CILC discount, contrary to the definition of avoided costs in Rule 25-6.0438. FEA's proposal would increase the cost that the general body of customers would have to bear to support the CILC discounts, with no corresponding increase in benefits. This is clearly contrary to the objective of Rule 25-6.0438, namely to ensure that the benefits of non-firm service to the general body of customers exceed their costs.

Q. How much would FEA's proposal increase the existing level of CILC discounts?

A. Currently, FPL's customers are paying approximately $30 million through the energy conservation cost recovery clause to offset the existing level of discounts to CILC customers. Under FEA's proposal, FPL's customers would pay an additional $16 million to offset a CILC discount through the CCR clause. This amounts to an increase of more than 50%, with no additional benefit to FPL's other electric customers.

Q. Witness Goins appears to assume that the existing discounts are a base rate item and that additional discounts can and should be given to CILC customers through the clauses without regard to Rule 25-6.0438. Do you agree?

A. No. Witness Goins' assumptions are faulty on both counts. First, the avoided costs calculation takes into account total avoided costs, not just avoided base rate costs. Thus, the current level of CILC discounts were deemed to be cost-effective based on avoided base and clause recoverable costs. Second, the Commission recognizes that *any* reduction in charges that CILC customers receive as a result of their interruptibility (whether through base rates or adjustment clause factors) is part of the incentive or discount they receive for taking non-firm service (Docket No. 941170-EG; Order No. PSC-95-0865-FOF-EG). Therefore, any proposed reduction in CCR factors that are charged to the CILC rate classes relative to their firm-service equivalents must be evaluated in light of Rule 25-6.0438.

Q. **Has the Commission previously addressed whether additional CILC discounts through reduced adjustment clause charges are warranted based on Rule 25-6.0438?**

A. Yes. In Docket No. 930759-EG, the issue of whether CILC customers should be excluded from the allocation of conservation costs was addressed. The Commission, in Order No. PSC-93-1845-FOF-EG, issued December 29, 1993, stated as follows:

> If CILC customers were to be excused from paying their share of conservation costs, they would be receiving benefits in excess of those which they provide the system through their willingness to be interrupted [footnote omitted]. As FPL's witness Birkett testified, the cost effectiveness test which was filed to obtain Commission approval of the CILC program yielded a benefit to cost ratio of approximately 1:1. Any additional discount given to CILC customers, whether through excusing them from the payment of ECCR charges *or any other means,* would result in them being overcompensated for their interruptibility.

(Emphasis added.)

Q. Is a formal cost-effective analysis needed in this case to evaluate FEA's proposal?

A. No. The Commission has recognized that, beyond the threshold cost-effectiveness test, the level of discounts should take into account the incentive needed to induce customers to take non-firm service (Docket No. 030051-EG, PSC-03-0322-TRF-EG). This is entirely consistent with the requirement that the benefits from non-firm service *exceed* their costs and that utilities maintain subscribed non-firm loads at or *below* their maximum cost-effective levels. Because the CILC rate classes are closed to new customers, the general body of customers has nothing to gain from higher CILC discounts. No new customers could take service under the CILC rate classes in response to a higher discount. Moreover, there has been virtually no decline in the number of CILC customers since the rate was closed, indicating that the current incentive is adequate to retain existing CILC customers.

Q. What other problems did you find in FEA's proposal?

A. In column (8) of Exhibit DWG-1, the Projected Average 12CP @ Generation is shown as zero for the CILC rate classes. This appears to be based on the faulty assumption that the loads of CILC customers are 100% interruptible.

Q. Please explain why this assumption is faulty.

A. The CILC tariff specifically provides for levels of firm *and* non-firm load for each CILC customer. Witness Goins' elimination of 100% of the 12 CP demand for the CILC rate classes ignores the load characteristics of those customers. Indeed, many CILC customers, including those represented by FEA, have a substantial percentage of firm load. For example, on average over 25% of the CILC-1T loads are firm while some of these large customers have loads that are more than 90% firm. For the reasons discussed earlier in my testimony, the Commission should reject the FEA's proposed reallocation of costs because it is unfair to FPL's other customers and inconsistent with the Commission's rules and practice for non-firm service. However, even if one were to reallocate costs as the FEA proposes, the rates computed by witness Goins improperly overstate that reallocation.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BY MR. ANDERSON:

Q Doctor Morley, do you have a summary to present?

A Yes, I do.

Q Please proceed.

A Good afternoon, Commissioners. Earlier today you heard testimony from FEA proposing a reallocation of costs recoverable under the capacity clause. The purpose of my rebuttal testimony is to explain why their proposal is unfair to FPL's other electric customers and is inconsistent with the Commission's rules and practice for nonfirm service.

FEA proposes to exempt one set of customers, those under the CILC rate classes from any demand-related purchased power costs. Their proposal reallocates $16.4 million away from CILC customers and on to the other electric customers. According to FEA, this dramatic shift in cost assignment is justified because CILC customers receive nonfirm service. The problem with this argument is that the general body of customers is already fully compensating CILC customers for taking nonfirm service. CILC customers already receive a rate discount of over $30 million, and the other electric customers are offsetting the cost of this discount.

Consistent with Commission rules, this $30 million discount reflects the benefit the general body of customers receive from the CILC program. By taking nonfirm service, CILC customers have helped us avoid certain capacity additions, the cost of which would otherwise be borne by the general body of customers. The cost of this avoided generation capacity provides the basis for the rate discount CILC customers are already receiving and which fully compensates them for taking nonfirm service.

In contrast to these avoided costs, the purchased power costs at issue here are incurred in providing service to all customers, including those under the CILC rate classes. FEA states that FPL does not purchase power for CILC customers. Commissioners, this is not true. CILC customers routinely utilize the company's purchased power resources and routinely contribute to our monthly system peaks. The allocation of purchased power costs should reflect this fact and FPL's method does.

FPL follows the approved cost of service methodology and appropriately allocates purchased power costs to all customers, including those in the CILC rate classes. Exempting the CILC rate classes from their share of purchased power costs would over-compensate these customers for taking nonfirm service. Not only would this be unfair to our other customers, it is contrary to the Commission rules limiting nonfirm service discounts to those deemed cost-effective based on avoided costs. In fact, FEA's proposal would increase the cost of CILC discounts borne by the general body of customers by more than 50 percent with no increase in benefits.

Commissioners, for the reasons I have just outlined, FEA's attempt to extract a $16.4 million rate reduction at the expense of all our other electric customers should be rejected.

This concludes my summary.

MR. ANDERSON: Doctor Morley is available for cross-examination.

CHAIRMAN EDGAR: Thank you.

Mr. Twomey.

MR. TWOMEY: Thank you, Madam Chairman, Commissioners.

CROSS EXAMINATION

BY MR. TWOMEY:

Q Good afternoon, Doctor Morley.

A Good afternoon, Mr. Twomey.

Q I'll be brief. You covered a lot of the points I wanted to bring out in your summary. You say at Page 3, Line 8, of your testimony, the result of his alternative approach, meaning Doctor Goins', is to drastically reduce the cost allocation to the CILC rate classes at the expense of the general body of electric customers. Correct?

A Yes, that's correct.

Q Now, excuse me. That necessarily -- you heard my discussion, or my conversation with Doctor Goins, it would necessarily fall on the residential class of which my client's members reside, correct?

A Yes. It is a reallocation of about $16.4 million to all of our electric customers and the bulk of that would fall on residential customers.

Q Now, Doctor Goins said that -- I had asked him about the level of reduction that he proposed, which was going from at least in his initial testimony about 19.3 million to 2.9 million, which would leave them with only supplying about 15 percent of what they are currently, and he had a problem with that number because he said it has been revised, is that correct? I mean, do you agree with his revisions?

A I haven't seen his revisions. The $16.4 million is based on Doctor Goins' filed testimony, and I believe when Doctor Goins took the stand he accepted that filed testimony without corrections or revisions.

Q Okay. Now, Page 4. You discussed the fact that you believe the proposal is completely inconsistent with Rule 25-6.0438, is that correct?

A Yes. The FEA proposal is inconsistent with that rule which limits the discounts under nonfirm service to those that have deemed cost-effective based on avoided costs.

Q It strikes me that they should perhaps seek a change in the rule. Would that be another way to address this, do you think?

A I would think that if they disagree -- pardon me, I would think that their proposal is inconsistent with the rule so that their proposal, if they seek to pursue it, would require a change in the rule.

MR. TWOMEY: That's all I have. Thank you.

THE WITNESS: Thank you.

CHAIRMAN EDGAR: Captain Williams.

CAPTAIN WILLIAMS: I just have a few, ma'am.

CROSS EXAMINATION

BY CAPTAIN WILLIAMS:

Q Okay. Doctor Morley, in your summary you said that FPL routinely buys purchased power to serve customers, including interruptible customers. Are you saying that FPL routinely makes firm power purchases to serve interruptible load?

A If I could make a small clarification. I referred to CILC customers, not interruptible customers. With that revision, could you repeat your question?

Q Okay. Was it your statement that you said that FPL routinely buys purchased power to serve customers?

A Yes.

Q I guess you are including in that interruptible, which CILC would fall under that?

CHAIRMAN EDGAR: Excuse me. Captain Williams, I need you to pull the microphone a little bit closer. We are having some difficulty hearing you from here.

CAPTAIN WILLIAMS: I apologize, ma'am.

CHAIRMAN EDGAR: That's okay. Thank you.

BY CAPTAIN WILLIAMS:

Q It was in your summary that you said FPL routinely buys purchased power to serve customers, and I thought you said including interruptible customers, which includes CILC customers. My question is are you saying that FPL routinely makes firm power purchases to serve interruptible load?

A Yes. We make firm power purchases to serve all of our customers, including those under the CILC rate classes.

Q Another question. You would agree that prices for electric service should reflect a utility's cost of service, you would agree with that as a general principle, would you not?

A Yes, I would.

Q And are you familiar with Doctor Goins' testimony?

A Yes, I am.

Q Okay. Do you have that with you?

A Yes, I do.

Q If you could turn to Page 9 of his testimony. And you are familiar with the noted author Professor James C. Bonbright, as well, are you not?

A Yes, I am.

Q And as part of Doctor Goins' testimony he quoted Professor Bonbright, is that correct?

A Yes, he did.

Q And could you read for us the quotation, the last sentence of the quotation which starts, "As a result"?

A "As a result, only the customer cost and energy cost actually incurred and no capacity pricing costs should be included in pricing interruptible service. Of course --"

Q And just to be clear -- that's all I was asking you to read. Thank you.

And Doctor Goins has recommended excluding demand-related capacity costs for CILC customers from the CCR factor, is that correct?

A Yes. That's why his proposal resulted in a reallocation of $16.4 million.

Q I'm sorry, Doctor Goins has recommended excluding demand-related capacity costs for CILC customers from the CCR factors, is that correct?

A Yes, that is why his proposal results --

Q Thank you, ma'am.

A -- in a reallocation of $16.4 million.

CAPTAIN WILLIAMS: We ask the chairperson to strike the part of the testimony that goes beyond yes. It's a yes or no question, and I believe that in the prehearing order it indicated that if a witness can answer with a yes or no that they should.

CHAIRMAN EDGAR: Ms. Helton.

MS. HELTON: Yes. I don't have the prehearing order subject to my memory, but as I recall Commission practice, and hopefully it is in the prehearing order, we do ask that witnesses first start with yes or no. However, we allow witnesses to explain their yes or no answer. So I believe that it is appropriate for Doctor Morley to give a further explanation.

CHAIRMAN EDGAR: Captain Williams, I will allow the witness to briefly elaborate on her answer if it is necessary, in her mind, to clarify her response.

BY CAPTAIN WILLIAMS:

Q You would say, then, that Doctor Goins' recommendation is consistent with what Professor Bonbright states?

A No, I would not agree with that. If you look at Professor Bonbright's full quote, he starts out saying interruptible service has been used by both gas and electric companies for peak shaving. FPL does not use CILC for economic purposes or peak shaving. We use it only in reliability situations. So I don't believe that Professor Bonbright's paragraph here is really applicable to FPL's CILC program.

Q Do you have your testimony in front of you?

A Yes, I do.

Q Okay. Please turn to your testimony. Let's go to Page 5. You know, actually -- let's actually skip that, I'm sorry. Do you have FPL's responses to FEA's interrogatories?

A Yes, I believe we do.

Q Let me ask you to go to, I think it is 5D. If you don't have that, my answer or my question will indicate what we are looking for. FPL's response to that interrogatory, 5D, indicates that two-thirds of the total CILC nonfirm load is backed up with customer-owned generation. Is that true?

A Captain, if you could give me a moment to refer back to the -- if you could repeat your question.

Q FPL's response to that interrogatory, Number 5D, indicates that two-thirds of total CILC nonfirm load is backed up with customer-owned generation. Is that true?

A Yes. CILC customers may elect to have load control equipment or have backup generation. And about two-thirds of our customers have elected to have backup generation.

Q Two-thirds of them have elected for that. And how many customers are on that CILC?

A Approximately 500 customers are on the CILC rate.

Q Okay. And how many megawatts of CILC nonfirm load does FPL currently serve?

A About 500 megawatts of nonfirm load.

Q About 550, 515, is that what I understand from your testimony, your rebuttal testimony?

A Yes, I believe that was in our latest nonfirm service report.

Q Okay. So, two-thirds of 515 megawatts would be around 340 megawatts, is that correct?

A That sounds right. I could verify that calculation, if you would like.

Q Sure.

A It would be about 340.

Q Okay. Now, do you know how many millions of dollars the CILC customers pay to install this 340 megawatts of customer-owned generation?

A No, I do not. As I say, it is not a requirement to be on the rate.

Q It is not a requirement, but you would agree that at least two-thirds did install backup generation, is that correct?

A Yes, that's what the interrogatory response says.

Q And you don't doubt the interrogatories that you have provided us?

A No, I don't.

Q And you don't doubt that it costs more than a couple of dollars to install that backup generation, is that correct?

A I have no idea what it costs these customers to install backup generation.

Q Subject to check, would you say it is at least a million dollars?

A I have no idea what it costs these customers to install backup generation.

Q But you would agree, once again, that there are two-thirds of people who invested in backup generation at least that are on this CILC customers, who are CILC customers?

A Yes, I would.

Q And you would also agree that part of this two-third invested that with FPL, got their generation actually through FPL, is that correct?

MR. ANDERSON: I would just object as to form, because the characterization in the interrogatory is two-thirds of the customer nonfirm load. That is not really a number of customers, so for clarity of the record I would object to form.

CHAIRMAN EDGAR: Captain Williams, can you perhaps restate?

CAPTAIN WILLIAMS: Okay.

BY CAPTAIN WILLIAMS:

Q You would agree that at least a partial number of those who are on backup generation got that backup generation or purchased that through FPL?

A My understanding is customers can select a vendor, and there is a subsidiary of FPL that has worked with some customers in installing backup generation.

Q So that's a yes, that there are some who got their backup generation through FPL?

A Through a subsidiary of FPL, that is my understanding.

Q Do you have the tariff in front of you?

A Yes, I do.

Q And I'm -- let's see, where is this found. I'm looking at the CILC schedule. It looks like it is dated November 15th, 2002. Do you have that in front of you?

A Could you give me the sheet number?

Q I will tell you what, I don't see a -- it looks like it is continued from Sheet 8.650.

A Yes, I have that sheet.

Q You have that? Okay. I am looking at, under the monthly rate, the demand charges and the per kilowatt of load control on peak demand. Do you see where I'm looking?

A Yes, I do.

Q Okay. Underneath the CILC 1 transmission customers, can you tell me -- under that the demand charge for the CILC transmission is $1.05, is that correct?

A Yes, it is.

Q How much of that $1.05 is represented by demand-related production cost?

A How much of the $1.05?

Q Yes.

A Well, the way the CILC works is they are allocated all their base cost, their embedded base cost and then on top of that there is a discount which reduces those charges. So I can't tell you how much is based on production off the top of my head. I can tell you that those charges reflect their embedded base cost with a discount layer on top of that for avoided capacity cost.

Q Could you go back to FPL's responses to FEA's interrogatories, and I want you to look at Question Number 1, Attachment 1 to that.

A Could you repeat?

Q Attachment 1, Question 1A.

A Yes.

Q Now, as I look at this line it talks about base demand, I see -- I'm looking from base demand down to base total. Do you see that under the CILC transmission customers?

A Yes.

Q Okay. And underneath that I see a total of 574. Do you see that?

A Yes, I do.

Q Okay. And I look at the other charges, oil production, coal production, nuclear production, combined cycle gas turbine production, other supplied, and then I come down to transmission costs. Do you see that?

A Yes.

Q As I see it, every one of those has a value to it in this, is that correct?

A Yes.

Q And as I see it as well that if you were to take away the value for the oil production, coal production, nuclear production, combined cycle, gas turbine, and other supplied, what you would have left is pretty close to the $1.05, is that correct?

A Yes, and that is by coincident only. As someone mentioned earlier, I believe Doctor Goins mentioned it, our current CILC rate has been in place awhile. It has not been revised for a recent cost of service. The situation we have now with CILC and a number of other customers is that their base rates are below their base cost of service. And that's why we see in this case, in terms of CILC 1T, the $1.05 they are actually being charged actually wouldn't even recover their transmission cost.

Q I'm sorry, repeat that last part, please?

A The base rate for their load control on peak demand is $1.05, which is below our current cost of service.

Q Okay. One second, please. Looking at your testimony, your rebuttal testimony, Page 5 of that, I'm looking at Lines 10 through 13.

MR. ANDERSON: Counsel, what is the reference again? I'm sorry.

CAPTAIN WILLIAMS: Page 5 of her rebuttal testimony, Lines 10 through 13.

MR. ANDERSON: I appreciate it. Thank you.

BY CAPTAIN WILLIAMS:

Q You say that nonfirm discounts reflect a portion of the cost savings to FPL. Why do the discounts not reflect all of your FPL cost savings?

A Because under the nonfirm service rule, the intent is that the benefit to the general body of customers exceeds the cost to that general body of customers, including the discounts or incentives they receive. If those two were equal, the general body of customers would be indifferent between having nonfirm service and not having nonfirm service. So under the nonfirm service rule, the idea is that customers get a greater benefit, the general body of customers get a greater benefit than what the programs cost. So, in other words, that is why in terms of doing a cost-effectiveness test, the ratio shows that the benefits must exceed the cost.

Q Ma'am, have you all done a cost-effectiveness test to test Doctor Goins' proposal?

A No, we haven't done a formal test, because under Doctor Goins proposal there is no benefit to the general body of customers. There is only an increase in cost the general body of customers would have to pay in terms of higher CILC discounts.

Q I guess I'm asking -- you said that, I guess, the benefit had to be higher than the cost to the general body, general customers, is that correct?

A Yes, that is a threshold requirement in terms of cost-effectiveness.

Q So as long as that benefit was still greater than the cost to the general body it would still be consistent with whatever rules that you all are going by, is that correct?

A It might be consistent with the rule. However, it would still not be to the benefit of the general body of customers or fair to the general body of customers to make them pay more to offset the cost of nonfirm service and not give them anything in addition.

Q Now, a large part of your argument is fairness to the general body of customers. What part does the fairness to the CILC customers play in that?

A I think CILC customers are being treated fairly. They are getting a significant rate discount which is being offset by all of our other customers, and in exchange for that, we invoke load control events only during capacity emergencies. Not on any routine basis. So I think we are being fair to our CILC customers.

Q But help me out with this. Even though no matter how seldom you invoke these load control programs, would you call them, at least two-thirds of the people in that rate have invested millions in backup generation, is that correct?

A Yes. I don't know -- well, I'm sorry, if I could backup.

I don't know how much they have invested in backup generation. I understand that there are some CILC customers whose have chosen to invest in that. But that was their decision, and in exchange for that they are getting a $30 million reduction in their rates as is.

CAPTAIN WILLIAMS: No other questions, ma'am.

CHAIRMAN EDGAR: Thank you. Any other questions on cross for this witness by any other party? Seeing none.

Are there questions from staff?

MS. BENNETT: Yes, Madam Chair. Just a few.

CROSS EXAMINATION

BY MS. BENNETT:

Q The CILC rate is a nonfirm rate, is that correct?

A Yes, that's correct.

Q And it is an optional rate, meaning that customers choose to select this?

A Yes, absolutely.

Q The CILC rate provides for levels of firm and nonfirm load for each CILC customer, is that correct?

A Yes, that's absolutely true. In fact, some customers under CILC are primarily firm, whereas others may be 100 percent nonfirm.

Q Does FPL offer other nonfirm rate schedules?

A Oh, absolutely. As I think was mentioned yesterday, we have a residential on-call program of over 700,000 participants, and we also offer other nonfirm options to our commercial and industrial customers, as well.

Q And to the best of your knowledge, do other Florida IOUs offer nonfirm or interruptible rate schedules?

A Yes, they do.

Q Do you know if any of the other investor-owned utilities exclude any demand-related purchased power costs when calculating capacity cost recovery factors for their nonfirm rate schedules?

A They absolutely do not. The Commission-approved methodology for allocating CILC capacity clause costs is an allocation based on 12 CP and 1/13th for all customers with no exemptions.

Q CILC customers pay reduced base rates, is that correct?

A That's correct. They pay a lower base demand and a lower base energy.

Q And how is that reduction calculated?

A That reduction is based on the generation unit that has been avoided, the value of that unit. And that unit, that value goes into calculating a reduction in their base charges.

Q So that discount that CILC customers receive in base rates is recovered from the general body of ratepayers through -- is it the conservation cost-recovery clause that it is recovered?

A Yes, it is recovered from the general body of customers through that clause.

Q And FEA's proposal is for CILC customers to receive an additional discount in the capacity clause, is that your understanding?

A Yes, that's correct.

Q I need you to return for a minute to your responses to FEA's first set of interrogatories, and it's Question 1B. In my set of exhibits it's Bates stamped 133. Specifically, it is the rate impact test.

A Unfortunately, my version is not Bates stamped, but I think we can find the page you are referring to.

Q Let me go ahead and ask the question. You may know the answer without referring to the document. There's a cost-effectiveness analysis of the CILC rate and the analysis shows a benefit/cost ratio of 1.02 according to this document. Can you explain what the benefit/cost ratio close to 1 means?

A A benefit/cost ratio close to 1 means that the program is only marginally cost-effective. Meaning if we were absolutely at 1, the benefits and the costs would be in balance, which would mean the general body of customers would be indifferent between having the nonfirm program and building an additional power plant.

Q So if the Commission were to approve FEA's proposal and increase the incentives or discounts provided to CILC customers, would the CILC rate still be cost-effective?

A Oh, absolutely not. What FEA is seeking is a 50 percent increase in their level of discounts, so that would surely result in a reduction of the cost of the benefit/cost ratio to the point where it would be no longer cost-effective to continue the rate.

Q And under FEA's proposal, does FPL's general body of ratepayers -- would they be required to pay an additional 16.3 million in incentives?

A Yes, they would be required to pay an additional $16.4 million through the capacity clause.

Q And this is my last question. Would you agree that the CILC tariff specifically states that customers on this rate can only be interrupted during emergency conditions or capacity shortages?

A Yes, that's exactly what the tariff states.

MS. BENNETT: I have no further questions.

CHAIRMAN EDGAR: Commissioners, any questions? No. Mr. Anderson.

REDIRECT EXAMINATION

BY MR. ANDERSON:

Q Just one question for you, Doctor Morley. Counsel asked you a question a few minutes ago about whether it is reasonable to purchase firm power to serve all customers, including CILC customers. Could you explain to the Commission why it is reasonable to purchase firm power to serve all customers, including CILC customers?

A It's reasonable to do that because in our normal operations we expect to serve all customers, including those under the CILC rate classes.

MR. ANDERSON: That's all we have. Thank you. We would offer into evidence the two exhibits that we mentioned earlier, 18 and 19.

CHAIRMAN EDGAR: The exhibits marked 18 and 19 will be entered into the record.

(Exhibits 18 and 19 admitted into the record.)

MR. ANDERSON: Thank you.

CHAIRMAN EDGAR: And the witness may be excused.

THE WITNESS: Thank you, Chairman.

CHAIRMAN EDGAR: That is our last witness before we begin the GPIF mechanism portion of this evidentiary portion of this proceeding. And, Mr. McGlothlin --

MR. McGLOTHLIN: Chairman Edgar, Joe McGlothlin on behalf of the Office of Public Counsel. The next two issues, 21 and 22, are associated with a petition for modification of the generating performance incentive factor that OPC filed last May. And the prehearing officer ruled that I may tee up the subject with some brief comments before calling our witness.

Before I do that, this might be a good opportunity, since we are changing subjects, to bring up one administrative detail, if I may.

CHAIRMAN EDGAR: Okay.

MR. McGLOTHLIN: It is this. As you will see from the statements, or position under Issue 22, the earliest point in time that any party proposes to apply the proposed modification, if it is adopted, is in 2006. So when the utilities report the actual data for 2006 next April, and the Commission would then act on that the following November.

That being the case, unlike some of the other issues that are before you, there is no urgency for a bench decision today. And because these two issues involve a fairly complex set of facts and policy considerations, we ask the Commission to set a briefing schedule that would allow the parties to brief the evidence and that would also allow your staff in, perhaps, a more orderly and thoughtful way to give you a written recommendation before you vote on these issues.

CHAIRMAN EDGAR: Ms. Bennett? Ms. Helton? Either one.

MS. BENNETT: The staff has no objection to continuing this to the December 19th agenda. There is a briefing schedule set on the CASR, and I will notify the parties in our bench decision portion as to those dates if no other party objects.

CHAIRMAN EDGAR: Are there any concerns with Mr. McGlothlin's request? Commissioners?

Commissioner Arriaga.

COMMISSIONER ARRIAGA: I'm sorry, I was turned around looking for paperwork here. Would you repeat why is it you want the delay, the postponement?

MR. McGLOTHLIN: There is no urgency that would require a bench decision today. And to give the parties a chance to formulate their arguments in a more orderly way and to give your staff an opportunity to prepare a written recommendation that you may consider in a less hectic format, we suggest that Issues 21 and 22 be the subject of a briefing schedule as opposed to a bench decision today.

COMMISSIONER ARRIAGA: Thank you.

MR. BURNETT: Madam Chairman, may I?

CHAIRMAN EDGAR: Mr. Burnett.

MR. BURNETT: I don't specifically object, I would just note that I believe my arguments are factually crystallized at this time, and I would just suggest that the Commission, with all respect, should not preclude their ability to enter a bench decision after hearing the evidence, if they feel that would be appropriate.

CHAIRMAN EDGAR: Okay. Mr. McGlothlin, what I would like to do is we will go ahead and hear your opening statement, we will hear the testimony, we will move through the remaining of the two other dockets that are on. And when we have a recommendation from our staff later on the issues that are before us, we will take the timing on these two issues up then.

MR. McGLOTHLIN: All right.

CHAIRMAN EDGAR: Okay. And are there any other points before I ask you to begin your five minutes of opening statement on this?

MR. McGLOTHLIN: No, that's all.

CHAIRMAN EDGAR: Okay. Then you are recognized.

MR. McGLOTHLIN: Commissioners, the Commission devised the generating performance incentive factor, or GPIF as you will hear it called, as a way to encourage the utilities to improve the thermal efficiency and the availability of their base load generating units. For about 25 years, the Commission has implemented the GPIF in the context of individual projection periods beginning first with six-month periods and later with annual periods. Twenty-five years later, we contend it's time to assess whether looking at the big picture over time the GPIF has been working as it should be, or whether perhaps there are some unforeseen effects, or whether there are otherwise some means of tailoring the GPIF to better match the Commission's policy objective in a way that would be more equitable for ratepayers.

Our witness, James Ross, has conducted a detailed unit-by-unit analysis of the GPIF experience. He will testify that over time the reward payments to utilities have exceeded the penalties by about $120 million, meaning that by and large the utilities set targets for availability and heat rate and more often than not beat those targets and receive rewards.

Now, so far that sounds like good news, but Mr. Ross's analysis also discloses that notwithstanding the payment of substantial rewards that exceed penalties over time, the GPIF has not led to a pattern of sustained improvements in individual unit availability and individual unit heat rates. Instead, at the unit level, efficiency of the base load units involved in the GPIF program has fluctuated all over the map.

The idea of paying $120 million in rewards and receiving no discernible pattern of long-term improvements strikes us, and we predict will strike you, as counterintuitive. We think there is a serious disconnect between the rewards being paid and the results shown by the data.

How could this happen? Well, because of time constraints I'm going to preview only a couple of Mr. Ross's points. But bear in mind, as he will say, the GPIF contemplates that the next period's targets will be a function of the units most recent experience. That means that if a unit has declined in performance, the target of so-called reasonable expected improvements will be based on that recent experience even if that recent experience has been disappointing. This means literally that a unit can move from poor to mediocre and qualify for a reward as the GPIF is currently devised.

Let me use a homely illustration. Let's say a high school student falls from a B-plus in math to a D. The following semester the same student moves from a D to a C-minus. Relative to the D, the C-minus is an improvement, but should that student expect to see an increase in his allowance? That's the flavor of what can and at times has happened in the GPIF.

More fundamentally from the standpoint of your policy objectives, as well as fairness to the ratepayers, this means that if a utility can score millions in rewards by a performance that is only marginally better than the past, even when the past is poor, then this is proof that the current GPIF doesn't set the bar high enough to provide a true incentive to improve over long-term.

Mr. Ross proposes to modify the existing GPIF by adding one more step to the existing calculation. Nothing else would change, he would add one step. The step would be the addition of a dead band around the points that are used to quantify a reward or penalty. The current GPIF sets a scale of 10 points on either side of the target. If the score is positive by any amount, the utility earns a reward. Mr. Ross proposes to require a utility to show improvement of at least five points or receive no reward.

The reason for this measure is simple and is the essence of our position. Already a utility has an obligation to be efficient. Ratepayers should not be required to pay the utilities extra dollars for simply doing their job. Rewards should be reserved for exemplary performance, and that is what Mr. Ross's proposal is designed to accomplish.

Today you will hear the utilities try hard to hang on to the status quo. Some of them will even say that the Commission should focus only on whether they beat their targets in a given projection period and not concern themself with whether the GPIF leads to long-term trends of improvement. This defines the chief difference between our position and theirs.

We want you to look at -- get up from the individual projection periods and look at the big picture. They say the big picture is irrelevant as long as they are meeting the targets. Their position is understandable. Why wouldn't they take this view? Under the existing GPIF, they have the opportunity to collect millions of extra dollars for performance that is only marginally better than the past.

There is no better way, we contend, to stifle the incentive to improve or to create complacency than to allow the utilities to continue to make a profit center out of business as usual. And with that, we will call Mr. Ross.

MR. BUTLER: Madam Chairman?

CHAIRMAN EDGAR: Mr. Butler.

MR. BUTLER: I'm sorry, is it possible for those of us opposing this issue to have a brief opportunity to provide an opening on this issue to the Commissioners at this point?

MR. McGLOTHLIN: I would object to that because I have heard the utilities do just that in the first round of opening comments.

MR. BUTLER: You didn't hear me do it.

CHAIRMAN EDGAR: Ms. Helton.

MS. HELTON: Madam Chairman, Mr. McGlothlin has given his opening statement pursuant to arrangements that were made with the prehearing officer at the prehearing conference a couple of weeks ago. I believe I heard some of the other utilities avail themselves of opening statements concerning GPIF, even if Mr. Butler didn't, and I don't believe that that was what was contemplated when the prehearing officer made his ruling.

MR. BUTLER: I would simply observe it seems a little bit imbalanced and certainly defer to the Commission for its ruling on the subject. But we are here at a point a day and a half into the hearing just about to talk about the subject of GPIF. You have heard Mr. McGlothlin's slant on it. I'm sure you won't be surprised to know it is different than ours. But if you are interested, I would be happy to give a very brief response. But, if not, that's fine.

MR. McGLOTHLIN: I'm sure Mr. Butler won't mind if I disagree with the characterization of a slant, but the fact remains that the utilities had their full increment of opening statement opportunity earlier in the case.

CHAIRMAN EDGAR: Mr. Butler, I, and I think we are always eager to hear from all parties, but in this instance to me the prehearing officer's order as reflected in the prehearing order is very clear on this point, and we did have the opportunity for discussion on this in opening statements only yesterday morning. Although it does seem like awhile ago, it was only yesterday morning. So I appreciate your enthusiasm again, but we are going to go ahead and move into the witnesses.

Mr. McGlothlin.

JAMES A. ROSS

was called as a witness on behalf of the Citizens of the State of Florida, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. McGLOTHLIN:

Q Please state your name and business address.

A My name is James A. Ross. My business address is 500 Chesterfield Center, Suite 320, Chesterfield, Missouri 63017.

Q By whom are you employed, sir?

A Regulatory and Cogeneration Services.

Q And what is your position in that firm?

A I am vice-president of the firm.

Q Mr. Ross, did you prepare on behalf of the Office of Public Counsel direct testimony dated May 30th, 2006?

A Yes, I did.
Q Do you have that before you now?
A I do.
Q Do you have any changes, additions, or corrections to make to the prefiled testimony?
A I do not.
Q Do you adopt the questions and answers contained in this document as your testimony here today?
A I do.
MR. McGLOTHLIN: With that, Chairman Edgar, I ask that the prefiled direct testimony of Mr. Ross be inserted into the record as though read.
CHAIRMAN EDGAR: The prefiled direct testimony of the witness will be entered into the record as though read.
MS. BENNETT: Madam Chair, I may have missed it, but did we confirm that this witness has been sworn?
MR. McGLOTHLIN: He has been sworn.
THE WITNESS: I have, yes.
CHAIRMAN EDGAR: Thank you, Ms. Bennett.
BY MR. McGLOTHLIN:
Q Mr. Ross, I now direct you to what has been marked as Appendix A and Exhibits JR-1 and JR-2. Were those prepared by you or under your supervision?
A Yes, they were.
Q Do you have any corrections or additions to make to

those documents?

A No, I do not.

MR. McGLOTHLIN: If I understood my conversation with staff counsel earlier, Chairman Edgar, I believe we need hearing exhibits assigned to these documents, hearing exhibit numbers.

MS. HELTON: I believe they have already been assigned Number 54 and 55 in the composite exhibit.

CHAIRMAN EDGAR: That's the way it looks to me, Mr. McGlothlin.

MR. McGLOTHLIN: Thank you.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 060001-EI

DIRECT TESTIMONY OF
JAMES A. ROSS

INTRODUCATION AND SUMMARY

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

A. My name is James A. Ross. I am a member of the consulting firm of Regulatory & Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. My business address is 500 Chesterfield Center, Suite 320, Chesterfield, Missouri 63017. A statement of my qualifications is attached as Appendix A (Exhibit ____).

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. RCS was engaged by the Florida Office of Public Counsel to evaluate whether, from the perspective of the electric utilities' ratepayers, time and experience have proven the Generating Performance Incentive Factor (GPIF) mechanism, adopted by the Florida Public Service Commission (Commission) in 1980, to be effective and equitable and, if not, to recommend steps needed to ensure the GPIF operates in a manner that is consistent with ratepayers' interests. The purpose of my testimony is to convey my conclusions and my recommendations.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATION.

A. My conclusions and recommendations are summarized as follows:

- In general, the investor-owned utilities on a whole have received significantly more rewards than penalties. The cumulative **net** payments (i.e., rewards less penalties) to Florida Power & Light Company (FP&L), Progress Energy Florida, Inc. (PEF, formerly Florida Power Corporation or FPC), and Gulf Power Company (Gulf) have, for the period April 1983 through December 2004, been about $120 million.

- The publicly available data indicate that, despite the incentive mechanism that resulted in the payment of (net) $120 million over time, the GPIF process has not prompted universal improvement in individual unit performance or in system-wide performance. The most striking example is the decline in TECO's system availablilty and heat rate performance for the period October 1989 throught December 2004.

- A review of the publicly available individual unit data for each of the utilities indicates that individual unit performance varies from year to year. The actual availability and heat rate performance for the individual units for the most part shows mixed improvement and, in some circumstances, degradation over time. The data also indicate that the availability and heat rate performance for many units was higher in past periods than in more recent periods.

- Fundamentally, a regulated utility has an obligation to operate efficiently. Any incentive mechanism should take this tenet into account, and reward only performance that demonstrates material and meaningful improvements. Importantly, the incentive mechanism should not result in rewards for performance that shows no exemplary gains or even long-term declines.

- Based on my review of publicly available data, I recommend that the Commission revise the GPIF process to treat ratepayers more equitably. This can be accomplished by imposing a Generating Performance Incentive Points (GPIP) dead-band. Establishing a GPIP dead-band for effectuating rewards and penalties is a modification that will require only minimal changes to the GPIF methodology as a whole.

- The GPIP dead-band would simply be applied in the last step of the GPIF methodology; thus, all other aspects of the current GPIF would be unaffected. In other words, the utilities would continue to calculate the GPIF components as currently defined in the methodology, including the GPIP.

- In addition to the GPIP dead-band modification, the Commission can address the problem of a consistent decline in system performance over time (as in the case of TECO) by establishing absolute system weighted EAF and HR numbers that would preclude any reward payment for actual performance below these established minimum performance levels.

BACKGROUND

Q. WHAT IS THE GENERATING PERFORMANCE INCENTIVE FACTOR?

A. The Generating Performance Incentive Factor, or GPIF, is a reward/penalty mechanism that the Commission prescribed in 1980. The stated purpose of the Generating Performance Incentive Factor is to encourage utilities to improve the productivity of their baseload generating units.

Q. HOW DOES THE GPIF ASSESS THE EFFICIENCY OF GENERATING UNITS?

A. The GPIF focuses on two aspects of generating efficiency over which the Commission has determined the utilities can exercise some control.

The first aspect is the "heat rate" of a generating unit. The heat rate quantifies the amount of fuel that must be consumed to produce a unit of electricity and is expressed in British thermal units (Btu's) per kilowatthour (kWh). A reduction in the heat rate of a unit signifies an improvement in efficiency, because the generating unit requires less fuel to generate a kilowatthour of electricity.

The second aspect that the GPIF mechanism takes into account is the availability of a unit. A unit is deemed available if it is able and ready to generate electricity when called upon. If a unit is unavailable at a time when it would be the most economical unit to operate, the utility must operate a more expensive unit and incur higher fuel costs. An increase in a unit's availability rating signifies an improvement in unit performance.

Q. DESCRIBE HOW THE GPIF MEASURES HEAT RATE AND AVAILABILITY FOR THE PURPOSE OF ESTABLISHING REWARDS AND PENALTIES.

A. The generating units that are the subjects of the mechanism are identified at the outset of the period during which performance will be measured. For each such unit the utility owner submits, for Commission approval, targets for heat rate and availability that will be effective during a projection period. At the end of the period, the actual operating data are compared to the utility's targets. The comparisons are translated into a score measured in terms of Generating Performance Incentive Points (GPIP). If a utility earns a positive score (between 1 and 10 GPIP), it receives a reward. If the utility's score is negative, it is penalized.

Q. HOW DOES THE GPIF QUANTIFY THE POSSIBLE RANGE OF REWARDS AND PENALTIES?

A. The maximum reward or penalty is measured in terms of 25 basis points on the utility's average equity for the period. These limits become the extreme points of the scale that is divided into 10 positive GPIP points and 10 negative GPIP points.

Q. PLEASE ILLUSTRATE THE CALCULATIONS NECESSARY TO DETERMINE THE REWARD OR PENALTY THAT A UTILITY RECEIVES UNDER THE GPIF.

A. The calculation of the maximum reward/penalty allowed in the GPIF methodology is illustrated hypothetically in Schedule 1 of Exhibit______ (JAR-1). Page 1 of Schedule 1 shows that the maximum allowed incentive is a function of the revenue associated with 25 basis points (0.25%) return on average jurisdictional common equity for the evaluation period. The calculation of the GPIF requires complex simulations of the utility's system dispatch. It also involves and a projection of an individual generating unit's overall availability, after taking into account full and partial planned and unplanned outages (equivalent availability factor, or EAF), and average heat rate (i.e., the determination of specific "targets"). For each unit, a target and a maximum reasonable attainable range of potential improvement (as well as provision for degradation) is determined, along with a "weighting factor" to reflect the percent contribution to total system fuel savings. Page 2 of Schedule 1 illustrates the results of this aspect of the calculation for a typical evaluation period.

As illustrated on Page 3 of Schedule 1 to Exhibit______ (JAR-1), the individual unit data are consolidated to generate a utility system reward/penalty table associated with the Generating Performance Incentive Points (GPIP) ranging from -10 to +10. At the end of the evaluation period, actual unit EAF and average heat rates are compared to the pre-established targets. Based on this comparison, a total system GPIP is determined which corresponds to a monetary reward/penalty based on the deviation of individual unit performances from their targets.

Q. WHAT GOVERNS THE CALCULATION OF THE GPIP?

A. The Commission prescribed the methodology in the form of a formula, which appears in the GPIF manual that accompanied the order adopting the GPIF. The formula for computing the GPIP is presented below:

4.2.3 <u>Generating Performance Incentive Points</u>

$$GPIP = \sum_{i=1,n} \left[a_i EAP_i + e_i AHRP_i \right]$$

Where:

GPIP = Generating performance incentive points

a_i = Percentage of total system fuel cost reduction attributed to maximum reasonably attainable equivalent availability of unit i during the period

e_i = Performance of total system fuel cost reduction attributed to minimum reasonably attainable average heat rate of unit i during the period

EAP_i = Equivalent availability points awarded/deducted for unit i

$AHRP_i$ = Average heat rate points awarded/deducted for unit i

Q. FOR WHAT PERIODS DOES THE COMMISSION REVIEW GENERATING PERFORMANCE FOR PURPOSES OF THE GPIF?

A. Initially, the Commission determined that the utilities' GPIF's would be subject to six-month review periods. These six-month periods ranged from April through September in a given calendar year and from October in one calendar year through March of the following calendar year. Thus, the review period and subsequent Commission GPIF determinations reflected six-month reward/penalty data and six-month individual unit data for the periods "April through September" and "October through March".

This six-month review was continued until 1999. Beginning with calendar year 1999, each utility's GPIF review was performed on a calendar year basis. Data from Commission decisions and utility filings with the Commission beginning in calendar year 1999 forward are presented on a 12-month calendar year basis. (The Commission determined that since performance targets are set prospectively, the GPIF methodology allows for adjustments to the EAF and HR performance indicators where such adjustments are determined to be appropriate by the Commission.)

Q. PLEASE DESCRIBE YOUR REVIEW OF THE GPIF DATA.

A. I reviewed publicly available utility reward/penalty data, individual unit target performance data, and individual unit adjusted actual performance data that was obtained from Commission decisions and GPIF data filed with the Commission. The reward/penalty data was obtained for the period April 1983 through December 2004. Individual unit data was obtained for the period October 1989 through December 2004. This represents the most comprehensive period for which data was obtainable from the public record, although there is a limited amount of data during these periods could not be gleaned from the documents.

Q. DID YOU ADJUST ANY OF THE DATA THAT YOU RECEIVED?

A. Yes. Due to the nature of utility operations (e.g., planned maintenance), the comparison of both individual unit and system performance data over time is best evaluated on a 12-month basis. Accordingly, I annualized the six-month data for reward/penalty and unit performance. In general, I annualized the reward/penalty data by combining (i.e., adding) the six-month period "April through September" with the six-month period "October through March" for an annualized "April through March" period. (Some deviation from the general application was necessitated by differences in individual utility data availability and the transition to calendar year GPIF reviews beginning with calendar year 1999.)

With respect to the individual unit performance data, the annualized data was calculated by combining (i.e., averaging) the six-month EAF and HR data for only those units that were included in two consecutive six-month periods beginning with the period "October through March" (i.e., resulting in a consecutive 12-month period of "October through September"). For purposes of trend analysis, units with less than three annual periods of data were also excluded from the unit database.

Additionally, I developed system target and actual EAFs and HR's for selected annual periods. The system weighted performance data was calculated by normalizing the EAF and heat rate weighting percentages and applying those normalized percentages to calculate a weighted system EAF or heat rate number. For periods prior to the "calendar year GPIF reviews" (i.e., calendar year 1999), the system weighted EAF and heat rate numbers reflect an average of the two six-month weighted system numbers.

Q. WHAT DID YOU LEARN REGARDING THE REWARDS AND PENALTIES THAT HAVE BEEN PAID/IMPOSED OVER TIME?

A. In general, the investor-owned utilities in the aggregate have received significantly more rewards than penalties. The cumulative **net** payments (i.e., rewards less penalties) to Florida Power & Light Company, Progress Energy Florida, Inc. , and Gulf Power Company, for the period April 1983 through December 2004, totaled approximately $120 million.

Schedule 2 to Exhibit __ (JAR-1) presents the annualized reward/penalties for FP&L, PEF, Gulf and TECO for the period April 1983 through December 2004. Each of the investor-owned utilities has been assessed different rewards/penalties under the GPIF methodology. Each individual utility's reward/penalty is detailed in following sections of the testimony.

Q. HOW HAS FPL FARED UNDER THE GPIF?

A. On an absolute dollar basis, FPL has received the greatest monetary reward. FPL received a cumulative **net payment** on the order of $92 million during the period. Page 1 of Schedule 2 to Exhibit __ (JAR-1). presents the FPL reward/penalty beginning with April 1983 and concluding with calendar year 2004 (note that the graph excludes the period April 1997 through September 1997 for FPL because this information was not obtained). The FPL reward/penalty presented on Page 1 of Schedule 2 demonstrates that FPL has consistently received rewards in excess of penalties during the period evaluated.

Q. PLEASE DESCRIBE PEF'S HISTORY OF GPIF-RELATED REWARDS AND PENALTIES.

A On an absolute dollar basis, PEF is a distant second behind FP&L in receiving net monetary rewards under the GPIF methodology. PEF received a cumulative **net payment** on the order of $27 million. Page 2 of Schedule 2 to Exhibit ___ (JAR-1) shows this information in table format.

Q. PLEASE PROVIDE CORRESPONDING INFORMATION FOR GULF POWER.

A. Gulf received a cumulative **net payment** on the order of $3 million. Page 3 of Schedule 2 presents the Gulf reward/penalty beginning with April 1983 and concluding with calendar year 2004.

Q. PLEASE TURN TO TECO.

A. Page 4 of Schedule 2 to Exhibit __ (JAR-1) shows (Column 2 at Line 22) that TECO is the only utility that has experienced a cumulative **net penalty** under the GPIF methodology for the period annualized. TECO's cumulative **net penalty**, however, is only about $2.3 million. The penalties incurred by TECO in calendar years 2002 and 2003 were significant in comparison to past annualized periods. Nevertheless, Page 2 of Schedule 2 shows, at Line 20, that even factoring in the calendar year 2002 penalty, ratepayers had made a cumulative net payment to TECO through year 2002.

Q. WHAT IS THE SIGNIFICANCE OF THIS OBSERVATION?

A. As discussed in more detail below, the publicly available data indicates that TECO's system-wide performance has been on a declining trend since the 1990's.

Thus, any assumed correlation between enhanced system performance and the GPIF incentive is, at best, suspect.

Q. WHAT DID YOU CONCLUDE FROM YOUR ANALYSIS OF HISTORICAL DATA?

A. A review of the publicly available data indicates that the GPIF process has not prompted universal improvement in individual unit performance or in system-wide performance.

The most striking example is the TECO system EAF and HR performance, shown graphically in Schedule 3 to Exhibit __ (JAR-1) Figure 1 of Schedule 3 shows the system-related target and actual EAF for the period October 1989 through December 2004. The actual EAF linear trend line presented in this exhibit shows a significant downward trend in the EAF, which indicates a decline in performance.

Similarly, Figure 2 of Schedule 3 presents the system-related target and actual HR for the period October 1989 through December 2004. The linear trend line presented on Figure 2 shows a significant upward trend in the HR, which indicates a decline in performance (i.e., the higher the average heat rate, the more fuel consumed, and the greater the cost to generate a kWh of electricity). In short, over a period when the EAF and HR performance has declined, the utility continued to receive rewards under the GPIF.

Q. WHAT DID YOU OBSERVE REGARDING THE SETTING OF TARGETS OVER TIME?

A. A review of recent calendar year TECO system weighted EAF and HR data shows a decline (reduction in required performance) in the performance targets. Less demanding targets allow poorer system performance to either receive reward payments or incur reduced penalties relative to targets requiring better performance. Schedule 4 of Exhibit______ (JAR-1) shows the TECO target and actual adjusted EAF and HR data for calendar years 2001 through 2004. Note that the EAF target in 2004 reflected a 4.49% lower performance than the 2001 target, and the decline (deterioration) in the HR target for the same period was 2.66%. The result is that in calendar year 2004, TECO received a $729,534 reward payment from ratepayers for actual adjusted EAF and HR performance that was 2.21% and 1.21% poorer, respectively, than calendar year 2001 (a period for which TECO received a $831,029 **penalty**).

Q. IS THIS PHENOMENON UNIQUE TO TECO?

A. No. The circumstance of receiving a reward in a year where the system performance declined from that exhibited in an earlier year is not limited to TECO. A review of recent calendar year data shows that PEF also had declining target standards such that poorer performance resulted in rewards in comparison to a period where the system exhibited higher performance. Schedule 5 of Exhibit __ (JAR-1) compares the actual adjusted EAF, HR and reward data for calendar years 2001 and 2002. The actual adjusted EAF and HR performance for calendar year 2002 shows a decline in performance of 2.19% and 2.93%, respectively, from calendar year 2001. Nevertheless, PEF was awarded $2,781,223 in 2002 compared to $608,057 in 2001.

Q. WHAT ABOUT GULF POWER?

A. Schedule 6 of Exhibit______ (JAR-1) presents a similar example of two recent calendar years where a decline in Gulf's system performance in comparison to a prior year still resulted in a $441,988 reward.

Q. IN YOUR REVIEW, DID YOU DETECT AN OVERALL PATTERN TO THE PERFORMANCE DATA OF INDIVIDUAL UNITS?

A No. There was a general absence of sustained trends of improvement. The individual unit performance data for each of the utilities vary from year to year. Based on the historical range of variation, there is no indication that the prospect of GPIF rewards has universally resulted in significant and sustained improvements in unit performance. My review included a comparison of individual unit targets with individual unit actual data for all four utilities over time. The actual EAF and HR performance for the individual units, for the most part, show mixed results. The data also indicate that the EAF and HR performance for many units was higher in past periods than in more recent periods. The data for individual units over time are presented in Exhibit_____ (JAR-2).

The example of FP&L helps make the point. FPL has the highest number of generating units in its GPIF calculation. Only a relatively small percentage of the total FPL units in the program show linear trend improvements in both the EAF and HR annualized performance. This phenomenon is illustrated in Schedule 7 of Exhibit______ (JAR-1). The analysis includes the linear trend for each unit's EAF and HR for annualized data during the 15–year period October 1989 through December 2004, and also the six-year most recent calendar year 1999 through 2004 period. The information in Schedule 7 shows that, of the 27 units evaluated, only 59.3% had EAF trending improvements over the 15-year period. Moreover, of the

16 units which showed trending improvements during the 15-year period, only 6 of those 16 (or about 38%) also showed trending improvements over the more recent six-year period.

The HR data exhibits even lower performance improvement trends. Of the 27 units evaluated, only 29.6% had HR trending improvements over the 15-year period. Moreover, of the 8 units which showed trending improvements during the 15-year period, only 2 of those 8 (or about 25%) also showed HR trending improvements over the six-year period. Finally, only 5 units (18.5% of the 27 units evaluated) showed both EAF and HR trending improvements over the 15-year period.

Q. HOW IS IT POSSIBLE FOR A UTILITY TO EARN A POSITIVE REWARD CONSISTENTLY, WHEN UNIT PERFORMANCE FLUCTUATES SO WIDELY OVER TIME?

A. This seemingly counterintuitive result is possible because the GPIF mechanism contemplates that a unit's "performance target" for a given projection period will be based largely on the unit's recent performance, even if the recent performance data reflect a deterioration in efficiency. Accordingly, a unit with a significant decline in recent performance can contribute toward a reward in the current period by merely returning to or forward a previously achieved performance level.

Q. WHAT CONCERNS DO YOU HAVE WITH THE PRESENT GPIF REWARD/PENALTY MECHANISM?

A. Fundamentally, a prudent utility having an objective to provide economical service should strive to maintain and operate generating units as efficiently as possible. This objective is particularly true for major baseload generating units. Accordingly, the Commission should expect sustained high equivalent availabilities and low (efficient) heat rates for baseload generating unit as the rule rather than the exception. To reward utilities for performance that fails to accomplish meaningful enhancements to availability and/or heat rate, or that even reflects deteriorating performance, is counterintuitive and at odds with the utility's obligations to customers. Contrary to regulators' logical expectations, the data demonstrate that, under the current GPIF mechanism, customers can be required to pay monetary rewards to utilities when performance does not improve—in fact, when efficiency actually declines over time.

Q. DO YOU HAVE ANY RECOMMENDATIONS?

A. Yes. The Commission should revise the GPIF process to treat ratepayers more equitably. The Commission should "raise the bar" with respect to ratepayer-funded GPIF rewards. Specifically, I recommend that the Commission should place a "dead band" on the GPIP, so as to require a meaningful degree of system improvement before granting a reward.

Q. PLEASE DESCRIBE THE "DEAD BAND" CONCEPT YOU HAVE IN MIND.

A. The utilities would continue to calculate the GPIF components as currently defined in the methodology including the GPIP. However, the current "Generating Performance Incentive Factor Reward/Penalty Table" would be modified such that unless the total system GPIP is in excess of a pre-determined level no reward would be due the utility. The GPIP dead band would simply be applied in the last step of the GPIF methodology; thus, all other aspects of the current GPIF would be unaffected. Schedule 8 of Exhibit __ (JAR-1) illustrates this modification. Ratepayers currently fund rewards for utility achievement over forecasted targets based upon a linear scale of 0 to 10, with 10 being the maximum achievable reward. Assuming, for purposes of illustration, that the adopted "GPIP dead band" ranges from a -3.0 to +7.0, the reward and penalty determination phase of the current GPIF methodology would be modified such that a GPIP total of +6.0 would result in no reward under the modified methodology (Column 3 at Line 5 of Schedule 8). In contrast, the current method would have required a reward payment of $6,644,554 (Column 2 at Line 5 of Schedule 8). On the other hand, a GPIP total of +8.0 would yield the utility the same $8,859,405 reward as the current methodology (Line 3). The penalty for poor performance would be similarly determined. For example, a GPIP total of -2.0 would result in no penalty under the modified methodology (Column 3 at Line 13 of Schedule 8). In contrast, the current method would have assessed a penalty of $2,214,851 (Column 2 at Line 13 of Schedule 8). On the other hand, a GPIP total of -.0 would assess the utility the same $4,429,702 penalty as the current methodology (Line 15). The upper limit on the dead-band should be no less than +5.0 and may be as high as +7.5 depending on further analysis of the GPIP that has resulted in rewards to the utilities. The lower limit on the GPIP dead-band could range between -3.5 and -2.5.

Q. HOW CAN THE COMMISSION ADDRESS THE PROBLEM OF RATEPAYER FUNDING OF REWARDS DURING A PERIOD OF SUSTAINED DETERIORATION IN UTILITY SYSTEM PERFORMANCE?

A. In addition to the "GPIP dead band" modification, the Commission can address the problem of a consistent decline in system performance over time (as in the case of TECO) by establishing absolute system weighted EAF and HR numbers for each utility that would preclude any reward payment for actual performance below these established minimum performance levels.

Q. WHAT WOULD BE INVOLVED IN ESTABLISHING EACH OF THESE MEASURES, AND HOW WOULD THE EFFORT NEEDED AFFECT THE TIMING OF IMPLEMENTATION?

A. Incorporating a "dead band" would not require the utilities to do anything differently. It could be implemented without delay. Because the establishment of minimum scores to serve as prerequisites to rewards would involve a review of each utility system's characteristics and capabilities, it would be necessary to gather and analyze system-specific information before developing these criteria. Accordingly, it would be implemented as a second phase of the applied remedy.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BY MR. McGLOTHLIN:

Q Mr. Ross, have you prepared a summary of your direct testimony?

A Yes, I have.

Q Please proceed.

A Good afternoon. The generating performance incentive factor, or GPIF, is a reward/penalty mechanism that the Commission prescribed in 1980. The stated purpose of the GPIF is to encourage utilities to improve the productivity of their base load generating units. The GPIF focuses on two aspects of generating efficiency. First is the heat rate, which is the amount of fuel that must be consumed to produce a unit of electricity.

The second is the availability of the unit. For each unit in the GPIF, the utility submits targets for heat rate and availability that will be effective in a projected period. At the end of the period, the actual data are compared to the targets and translated into a score called generating performance incentive points, or GPIPs. If a utility scores positive by any amount it receives a monetary reward measured on a sliding scale. If the GPIP score falls below its target by any amount, it receives a penalty.

The GPIF was fashioned, as I stated earlier, in 1980. OPC engaged me to review its results over time and to see if, as implemented, it is equitable to ratepayers. My review of the data reveals that even though the utilities have been paid net bonuses of more than $120 million over time, this has not lead to sustained increases in unit efficiency. My exhibits illustrate this conclusion in detail. In fact, the data proved that utilities have been able to earn bonuses consistently at the same time performance has fluctuated up and down.

Having reviewed both the patterns of the utility performance and the bonuses earned under the GPIF, I conclude that the GPIF as presently structured needs modification to be more equitable to ratepayers. Currently a utility can earn a reward for performance that is not exemplary. In my view, ratepayers should not pay rewards for the utility just doing its basic job when the level of performance is not exemplary. Rewards should only be for performance that is exemplary.

Basically, the problem is that the current GPIF sets the bar too low. I recommend that a dead band be placed about the GPIP score so that a reward will be paid only when a utility's performance is significantly greater than the target. A utility has a fundamental obligation to improve efficiency. This tenet should be reflected in the way the dead band is set. I recommend that rewards begin at a minimum positive score of no less than 5, and that a penalty be assessed if the negative score is 2.5 points or more. My recommendation would not change the way the current GPIF works. The dead band would be implemented at the last step of the current process.

As a second phase designed to address the possibility of bonuses earned during periods of degraded performance, I suggest that the Commission evaluate the possibility of an absolute minimum performance standard that a utility would have to beat to qualify for a reward.

Thank you.

(Transcript continues in sequence with Volume 6.)

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Hearing Reporter Services Section, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 8th day of November, 2006.

Jane Faurot

JANE FAUROT, RPR
Official FPSC Hearings Reporter
FPSC Division of Commission Clerk and
Administrative Services
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