

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 070108 - E

APPROVAL OF THE ELECTRIC FUEL SUPPLY CONTRACT AND  
RELATED TERMS AND CONDITIONS BETWEEN GULF POWER  
COMPANY AND FLORIDA PUBLIC UTILITIES FOR THEIR  
NORTHWEST DIVISION (MARIANNA) BEGINNING 2008

Direct Testimony of

Robert J. Camfield

On Behalf of

FLORIDA PUBLIC UTILITIES COMPANY

1 Q. PLEASE STATE YOUR NAME AND ADDRESS.

2 A. My name is Robert J. Camfield, and my business address is 4610 University  
3 Avenue, Madison, Wisconsin 53705.

4

5 Q. WITH WHOM ARE YOU EMPLOYED AND WHAT IS YOUR  
6 POSITION?

7 A. I am employed by Christensen Associates Energy Consulting, LLC, where I  
8 serve in the position of Vice President.

CMP \_\_\_\_\_

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10 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

11 A. For the consideration of the Florida Public Service Commission, the testimony  
12 reviews Florida Public Utilities Company's ("FPUC" or "Company") long-term  
13 arrangements for wholesale power supply for its Northwest Division. The  
14 Company has executed a new agreement for power supply ("Agreement") that

1 succeeds the Company's current contract for power supply, and begins in 2008  
2 and extends through 2017. The testimony discusses several related elements  
3 associated with the new Agreement including FPUC's wholesale market context  
4 and situation with a focus on transmission and transmission accessibility, the  
5 Company's procurement process, and the results of that process including the  
6 implications for retail electricity consumers of the Northwest Division.

7  
8 As I stated in previous testimony before this Commission (Docket 060001-EI),  
9 the process of power procurement of Florida Public Utilities Company for the  
10 Northeast and Northwest Divisions during 2005 and 2006 proved to be  
11 unusually arduous, primarily because of ramifications of the transmission issues  
12 associated with service to the Northeast Division. However, transmission  
13 service for the Company's Northwest Division is fairly straightforward, and the  
14 Company could thus proceed to negotiate a power supply agreement for  
15 generation services with the selected service provider, following the conclusion  
16 of the Company's power procurement process.

17  
18 **Q. WOULD YOU BRIEFLY DESCRIBE YOUR BACKGROUND AND**  
19 **PROFESSIONAL EXPERIENCE?**

20 A. Yes. I joined the Michigan Public Service Commission in 1976 as a staff  
21 economist. During my tenure with the Michigan Commission, I was involved  
22 in several retail electricity and natural gas pricing issues, and I testified in rate  
23 case proceedings regarding cost of capital and retail gas tariff design. I joined

1 the New Hampshire Public Service Commission in 1979 as the Senior  
2 Economist, and held the position of Chief Economist beginning in 1981. As  
3 Chief Economist, I was responsible for the administration of the economics  
4 department of the Commission staff. I oversaw the analysis of regulatory  
5 issues, the coordination and guidance of staff participation in regulatory  
6 proceedings, the preparation and development of testimony, and I provided  
7 policy advice to the Commission on a variety of issues such as construction  
8 work in progress, financial planning, and the determination of PURPA Section  
9 133 rates. I joined Southern Company in 1983, and held positions in several  
10 departments including Pricing and Economic Analysis at Georgia Power  
11 Company, Costing Analysis of Southern Company Services, and Southern  
12 Company's Strategic Planning Group. In 1994, I joined Laurits R. Christensen  
13 Associates, Inc. ("Christensen Associates") as a senior economist, and currently  
14 hold the position of Vice President with Christensen Associates Energy  
15 Consulting LLC., a subsidiary consulting group of Christensen Associates.  
16  
17 My experience covers a gamut of issues facing regulated industries. I have been  
18 involved in the negotiation of power supply contracts and the terms of franchise  
19 licenses. My overseas assignments are several, and I have managed a large  
20 market restructuring project in Central Europe. I have served on national and  
21 regional advisory panels, and I have advised integrated electric utilities,  
22 independent power producers, transmission and distribution companies, utility  
23 associations, offices of consumer advocate, and regulatory agencies on

1 numerous policy and technical issues. Innovations include two-part tariffs for  
2 transmission services, web-based self-designing retail electric products,  
3 marginal cost-based cost-of-service methods, and principles for efficient pricing  
4 of distribution services. I have published chapters in technical books, reports,  
5 and articles in noted journals such as *The Electricity Journal*, *IEEE*  
6 *Transactions on Power Systems*, and *CIGRE*. Currently, I serve as Program  
7 Director of the Edison Electric Institute's Market Design and Transmission  
8 Pricing School.

9  
10 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY**  
11 **PROCEEDINGS?**

12 A. I have represented regulatory Commission staff, consumer advocates,  
13 generation companies, distribution companies, transmission companies,  
14 integrated utilities, and utility associations in proceedings before a number of  
15 regulatory agencies regarding a host of issues including cost of capital,  
16 performance assessment and benchmarking, electricity forecasting, retail rates,  
17 cost-of-service allocation, generation expansion planning, and transmission  
18 issues.

19  
20 **Q. COULD YOU DESCRIBE THE ELECTRIC SERVICE TERRITORY OF**  
21 **FLORIDA PUBLIC UTILITIES COMPANY?**

22 A. Florida Public Utilities Company is a small diversified distribution utility  
23 providing electricity, natural gas, and propane services in the State of Florida.

1 The Company's electric operations consist of two divisions in northern Florida,  
2 referred to as the Northeast and Northwest Divisions. These two divisions  
3 provide bundled retail services to residential, commercial, and industrial  
4 consumers in two non-contiguous service territories. During 2006, the  
5 Northeast Division, also known as Fernandina Beach, served 15,372 customers  
6 with gross electricity sales of 516,962 MWh, while the Northwest Division, also  
7 known as Marianna, served 15,264 customers with gross electricity sales of  
8 361,910 MWh. The Northeast Division is interconnected with the JEA  
9 (previously referred to as Jacksonville Electric Authority) transmission network  
10 at one delivery point with 150 MVA of transformer capability and 138 kV  
11 primary feeders. The Northwest Division interconnects with Southern  
12 Company's (Gulf Power Company) transmission network at six delivery points  
13 with a total of 130 MVA of capability and 12.5 kV primary feeders.

14

15 **Q. DOES FPUC GENERATE ANY OF THE POWER WHICH IT SELLS TO**  
16 **RETAIL CUSTOMERS IN THESE TWO SERVICE DIVISIONS?**

17 A. No. The Company is a distribution utility, and purchases all generation and  
18 transmission services from regional wholesale power and transmission service  
19 providers.

20

21 **Q. WHAT ARE THE COMPANY'S CURRENT ARRANGEMENTS FOR**  
22 **POWER SUPPLY FOR THE NORTHWEST DIVISION AND PLANS**  
23 **FOR THE FUTURE?**

1 A. The Company purchases bundled generation and transmission services under a  
2 long-term supply contract with Gulf Power Company that dates from 1997, and  
3 is scheduled to expire on December 31 of 2007. The Company's current  
4 contract with Gulf Power Company provides full requirements service including  
5 energy and reserve services, and also covers transmission services.

6

7 **Q. WHAT ARE THE POWER PROCUREMENT OBJECTIVES OF**  
8 **FLORIDA PUBLIC UTILITIES COMPANY?**

9 A. The Company's power supply objectives align with its longstanding goal of  
10 providing, over the long term, high quality service at favorable prices to its  
11 retail customers. The Company's underlying power procurement objectives are  
12 to obtain long-term power supply at favorable terms and prices, while assuming  
13 an acceptable level of risk. To this end and as I have documented elsewhere  
14 before this Commission (Docket 030438-EI), Florida Public Utilities Company  
15 is currently a low-priced service provider within the region, with very favorable  
16 retail electricity prices. The Company's costs of generation and transmission  
17 services, as provided under the Company's current wholesale supply contracts,  
18 are very low with reference to wholesale power prices within the region. In  
19 addition, the Company provides comparatively low-cost distribution services  
20 and has realized substantial gains in productivity in distribution services over  
21 recent years.

22

1   **Q.   WHAT POWER PROCUREMENT STRATEGIES DID THE COMPANY**  
2   **CONSIDER FOR POWER SUPPLY BEYOND 2007?**

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3   A.   In view of the pending expiration of the Company's current supply contracts,  
4       Florida Public Utilities Company engaged in a deliberate process that began by  
5       exploring alternative procurement approaches. The Company initiated an open  
6       solicitation for power supply, referred to as a Request for Proposal ("RFP"),  
7       during 2005. Specifically, the Company released a formal *Request for*  
8       *Proposals to Provide Wholesale Power Supply* on April 21, 2005 ("2005 RFP").

9  
10       An open solicitation for supply is one of several procurement formats that are  
11       potentially available to the Company. Alternative formats were initially  
12       explored by the Company including sequential short-term purchases that could  
13       involve contract laddering, as well as self-supply where FPUC owns and  
14       operates generation resources. Because power generation resources are sizable  
15       facilities involving large investment in specialized capital, self-supply would  
16       likely involve a jointly owned facility. In addition, the Company could engage  
17       in several forms of bilateral contracts including, for example, a tolling  
18       agreement with a power generation entity where the Company would purchase  
19       primary fuels that would then be transformed into electricity and transmitted to  
20       the Company's designated delivery points (points of withdrawal of power from  
21       transmission networks). The contractual arrangements for power supply under a  
22       tolling agreement would involve three separate contracts covering primary fuel  
23       inputs, power transformation, and transmission services.

1 The solicitation of power supply by others can be approached in a variety of  
2 ways, and several formats are possible. As mentioned, FPUC currently takes  
3 power under two bundled power supply contracts covering full requirements  
4 generation services (energy and reserves) and transmission services.

5 Alternative solicitation formats include the two general categories of sealed bid  
6 and auction procedures. In the case of a so-called sealed bid solicitation, the  
7 solicitation—which can be as simple as a one- to two-page letter requesting  
8 power services or a formal RFP process that is highly specific as regards to  
9 information requirements including but not limited to pre-qualifying,  
10 engagement rules, and timetable—can involve a limited number of pre-  
11 identified potential suppliers, or can be an open invitation seeking offers from  
12 interested parties.

13  
14 Auctions for electric power supply first appeared, at least in recent years, within  
15 the unbundled wholesale markets of California (CAISO), PJM, and New York  
16 (NYISO). Auctions are, literally, markets that operate under highly specific  
17 rules. For electricity, auctions can be organized as short-term sequential or  
18 simultaneous market procedures involving related services such as energy and  
19 reserves which are provided over same-day and day-ahead timeframes. These  
20 short-term auctions can include pay-as-bid and uniform-price auction formats.  
21 Because these auctions are repeated with high levels of frequency, they are  
22 organized electronically as a matter of necessity. Auctions for standard offer  
23 service (“SOS”) have recently been organized in the Eastern and the Midwest



1 regions of the U.S. (e.g., New Jersey, Maryland, Ohio, and Illinois). In these  
2 auctions, pre-qualified candidate bidders provide offers to serve load shape  
3 shares. A type of auction recently implemented in wholesale electricity markets  
4 is referred to as a declining clock auction, where the market price follows a  
5 schedule of pre-defined decrement steps at periodic intervals (rounds) over the  
6 course of the auction. Electricity auctions usually cover very large loads, enjoy  
7 wide participation by many candidate suppliers, and can involve numerous  
8 auction rounds (e.g., 50 iterations or more).

9  
10 **Q. PLEASE DESCRIBE THE COMPANY'S APPROACH AND POWER**  
11 **PROCUREMENT FORMAT.**

12 Of the various alternative procurement formats that are potentially available, the  
13 Company settled on the open solicitation format, where bidders are free to  
14 propose a variety of service arrangements and terms. The open solicitation  
15 approach, when properly conducted and with ample participation by potential  
16 suppliers, can induce a sufficient level of competition to obtain desirable  
17 outcomes for retail electricity consumers and the Company. The open  
18 solicitation format, manifested as the Company's 2005 RFP, sought power  
19 supply for both the Northeast and Northwest Divisions. The 2005 RFP process  
20 was designed in a manner to facilitate (and encourage) participation in order to  
21 increase the level of contestability and supply options available to the Company.

1 **Q. DID THE POWER PROCUREMENT STRATEGY OF THE COMPANY**  
2 **CONSIDER DIVERSIFICATION OF POWER SUPPLY?**

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3 A. Yes. The Company's 2005 RFP provided bidders with options to submit offer  
4 packages with multiple offers covering full requirements, partial requirements,  
5 and energy only services. Energy offers could be submitted for a variety of  
6 timeframes such as, for example, specific hours of weekdays of defined seasons  
7 for individual years. The Company sought offers for a five-year term, although  
8 offers of shorter duration would also be considered. In addition, the Company's  
9 2005 RFP requested ten-year offers as options. Finally, the 2005 RFP provided  
10 bidders with considerable flexibility regarding the proposed commercial terms;  
11 bidders could submit, for example, offers with fixed charges, demand charges,  
12 energy charges, or energy charges indexed to primary fuel prices and wholesale  
13 electricity prices.

14  
15 The open solicitation format provides two main advantages with reference to  
16 other approaches the Company could have pursued. First, multiple offers  
17 covering a variety of forms provide a basis for the Company to potentially build  
18 a portfolio of supply including laddered contracts to hedge risks. Second, by  
19 allowing for a broad range of potential services and structure of terms, the 2005  
20 RFP design, to the extent possible, held to a minimum the level of constraints  
21 and impediments to participation by serious, potential bidders. As a result,  
22 participation by bidders is enhanced thus increasing the potential level of

1 competition and contestability, all in the interest of obtaining the lowest  
2 possible prices.

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3

4 **Q. WOULD YOU DESCRIBE THE IMPLEMENTATION OF THE**  
5 **PROCUREMENT PROCESS?**

6 A. Yes. The Company's 2005 procurement process began with the identification  
7 of power suppliers and power marketing entities operating within the Southeast  
8 and Midwest regions. Potential suppliers situated to the Western area of the  
9 Eastern Interconnection including locations in Kansas, Missouri, and Oklahoma  
10 were also identified. Potential suppliers were then surveyed in order to gauge  
11 their interest in taking receipt of the Company's formal RFP. The 2005 RFP  
12 was released on April 21 to suppliers that expressed interest in participation.  
13 The RFP explicitly defines several procedural steps, and the necessary  
14 information and data to be included in the offer packages submitted by bidders.

15

16 **Q. CAN YOU BRIEFLY DISCUSS THE POWER SUPPLY SERVICES**  
17 **ASSOCIATED WITH THE RFP?**

18 A. Yes. The Company's 2005 RFP process involved generation services including  
19 energy and certain ancillary services. Bidders were free to offer various  
20 bundles of services within offer packages, and could potentially include  
21 transmission services. The implication is that, for example, a selected bidder  
22 could provide a service bundle including energy and load following service,  
23 such that the Company would be required to self-supply or contract for

1 transmission and other ancillary services not covered under the bundle provided  
2 by the generation service provider (winning bidder).

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3  
4 Transmission services could be provided under a contract between the selected  
5 generation service provider(s) on behalf of the Company and the relevant  
6 control areas, or under a contract between the Company and the control areas  
7 directly.

8

9 **Q. BRIEFLY REVIEW THE DATA AND INFORMATION INCLUDED IN**  
10 **THE OFFER PACKAGES OF BIDDERS RESPONDING TO FPUC'S**  
11 **RFP FOR POWER SUPPLY.**

12 A. In addition to the commercial terms and the definition of services, several  
13 information items were requested to be included in the offer packages submitted  
14 by bidders. First, bidders were requested to provide a business overview that  
15 summarizes the bidder's activities in wholesale markets and the generation  
16 technologies available to them. A business overview provides a means to gauge  
17 the full range and extent of the business activities of bidders, as bidders are  
18 often subsidiary organizations within the diversified business activities of very  
19 large firms—for example, a commodity group of an investment banking firm, a  
20 merchant supply business unit of an independent power producer, or an energy  
21 company involved in oil and gas exploration. Where relevant, bidders were  
22 requested to list their wholesale market certification.

23

1 The RFP requested bidders to provide statements of financial condition and  
2 credit worthiness and identified financial surety in the form of letters of credit.

3 The 2005 RFP also imposed non-disclosure obligations and commitments on  
4 bidders including confidentiality agreements and signed submission agreements.

5

6 **Q. PLEASE DESCRIBE THE RFP PROCESS.**

7 A. The RFP identified specific procedural steps with an accompanying schedule, as  
8 follows (original schedule cited). First, *Response Window for Inquiries and*  
9 *Questions* (April 22 – May 16) provided candidate bidders with the opportunity  
10 to obtain additional information to assist them in deciding whether to prepare an  
11 offer package and in the preparation of such packages. Responses to questions  
12 were circulated to all candidate bidders. Bidders were requested to indicate  
13 their *Intent to Submit Offer Packages* on May 17, and *Offer Packages Were Due*  
14 on June 2. The Company would conduct an *Initial Screen of Offers* and  
15 provided *Notice of Status* to bidders on June 22. Specifically, offer packages of  
16 bidders were reviewed for completeness and conformance with the delineated  
17 information requested within the offer packages submitted in response to the  
18 2005 RFP. Bidders were advised of non-conforming conditions of offer  
19 packages, and were provided one week to correct, clarify, or provide additional  
20 information as identified. Under the original schedule of the 2005 RFP process,  
21 the Company would conduct an initial assessment of offer packages, identify  
22 qualifying bids, and notice qualifying bidders by July 29 of their status. While  
23 the schedule was delayed early on to ensure that bidders had adequate time to

1           respond, the Company was nonetheless in a position to interview qualifying  
2           bidders during early September 2005.

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3

4   **Q.   HOW WERE BIDS SOLICITED AND HOW MANY RESPONSES**  
5       **WERE OBTAINED?**

6   A.   The Company contacted numerous potential suppliers, and thirty-five entities  
7       expressed interest in taking receipt of the 2005 RFP. Nine entities provided  
8       Letters of Intent to submit offer packages following the release of the RFP.  
9       Seven offer packages were submitted.

10

11 **Q.   WITH RESPECT TO THE SUBMISSIONS RECEIVED, WERE THE**  
12 **OFFERS BY BIDDERS TO SERVE ONE OR BOTH DIVISIONS?**

13 A.   Three bidders provided offers to serve either or both electric divisions of the  
14       Company. Other offer packages focused on one of the two divisions.

15

16 **Q.   OF THE OFFER PACKAGES RECEIVED, WERE ANY PACKAGES**  
17 **SUBMITTED BY ENTITIES AFFILIATED WITH FPUC?**

18 A.   No entities providing offer packages, or for that matter participating in the RFP  
19       process, are affiliated with FPUC in any way.

1 **Q. ONCE THE RESPONSES WERE RECEIVED AND QUALIFIED**  
2 **BIDDERS IDENTIFIED, WHAT WERE THE NEXT STEPS?**

3 A. At the time that the RFP was released, the schedule would have placed the  
4 Company in the position to select winning bidders during August and to  
5 negotiate contracts during the September – October timeframe. However, the  
6 overall level of participation in the bidding for both the Northeast and the  
7 Northwest Divisions was greater than anticipated and several viable bidders  
8 were identified. Also, it became evident that, at least potentially, the Company  
9 could induce lower prices through an auction-style market procedure. Thus, the  
10 Company's 2005 RFP concluded with a quasi-auction involving three rounds of  
11 offers, in which bidders were invited to provide revisions to the price terms of  
12 offers. The relative standings of the offers of bidders (but neither the identities  
13 nor the levels of competing offers) were noticed to bidders following the first  
14 and second rounds.

15  
16 **Q. WHAT FACTORS WERE INCLUDED IN THE EVALUATION OF**  
17 **OFFERS?**

18 A. The criteria for evaluation of the offers of bidders, as stated within the  
19 Company's RFP, included overall price level, counterparty risk, environmental  
20 quality of the underlying resources used to provide services, and delivery risks.  
21 Where appropriate, the potential monetary impact of policy actions at the  
22 federal level aimed to internalize the social costs of CO2 emissions were  
23 incorporated into the analyses.

1

2

To the extent possible, the analyses involved quantitative assessment and

3

utilized multi-criteria analysis methods. Particular attention was given to the

4

implied level of price risks, as some of the terms of the offer packages of

5

bidders contained variable price terms. Indeed, one specific offer package with

6

favorable terms stated on an expected value basis, would have involved a

7

contract for differences with a major financial institution in order to hedge much

8

of the inherent price risk associated with the commercial terms of the offer,

9

should the offer be selected.

10

11 **Q. HOW WAS THE EVALUATION CONDUCTED?**

12

A. The evaluation was conducted independent of the Company by Christensen

13

Associates Energy Consulting, and the results of the evaluation were presented

14

to the Company as an outside assessment. The evaluation included unit-specific

15

(\$/MWh) and total bills (total dollar amounts) criteria, where the commercial

16

(price) terms are converted to an equivalent price basis, stated as net present

17

value over the term of the potential contract.

18



1 The evaluation of the final terms of the offers, as obtained during the third  
2 round, was conducted during late 2005. The evaluation of terms, when  
3 combined with the assessment of non-price factors, provided the basis for the  
4 recommendations provided to the Company. The Company selected the  
5 winning bidders, and all bidders were advised of the outcome during late  
6 January 2006.

7

8 **Q. PLEASE IDENTIFY THE SERVICE PROVIDERS SELECTED**  
9 **THROUGH THE 2005 RFP PROCESS.**

10 A. Through the 2005 RFP process, the Company selected Southern Company as its  
11 prospective service provider, including Southern Power Company (“Southern  
12 Power”) to serve the Northeast Division over the 2008 – 2017 period, and Gulf  
13 Power Company (“Gulf Power”) to serve the Northwest Division from 2008  
14 through 2012.

15

16 The prospective contracts with Southern Power and Gulf Power would cover  
17 several key generation services including energy, as well as ancillary services  
18 that in total conform to the well known categories of regulation, imbalance  
19 energy, spinning reserves, and supplemental reserves. The new contracts would  
20 not cover voltage support and reactive power.

21

1 **Q. PLEASE DISCUSS SUBSEQUENT DEVELOPMENTS FOLLOWING**  
2 **THE CONCLUSION OF THE COMPANY'S RFP PROCESS?**

3 A. Two events subsequent to the RFP process are of interest. First, as I alluded to  
4 above, Florida Public Utilities Company was forestalled from completing its  
5 contract with Southern Power Company for generation services for the  
6 Northeast Division because of difficulties associated with obtaining rights to  
7 firm transmission service over the transmission interface that electrically  
8 connects Georgia and the Florida FRCC. As a consequence, the Company thus  
9 negotiated and executed a power supply agreement with the JEA (Jacksonville  
10 Electric Authority) for the Northeast Division for the period 2007 – 2017.

11  
12 Second, the Company explored through discussion with Gulf Power Company,  
13 a ten-year power supply agreement for the Northwest Division, beginning in  
14 2008 in lieu of a five-year contract as originally contemplated. The new  
15 Agreement is for the term 2008 – 2017.

16  
17 **Q. IS IT YOUR VIEW THAT, AS A RESULT OF THE 2005 RFP PROCESS,**  
18 **THE SELECTION OF GULF POWER COMPANY TO SERVE THE**  
19 **NORTHWEST DIVISION IS IN THE BEST INTEREST OF RETAIL**  
20 **CUSTOMERS?**

21 A. Yes, the Company's selection of the incumbent supplier, Gulf Power Company,  
22 beyond 2007 is the best power supply alternative known by and available to the  
23 Company. The Agreement that resulted from this decision ensures that the

1 Company's customers of the Northwest Division will continue to receive  
2 reliable power supply at favorable prices over the foreseeable future. The long-  
3 term contract with Gulf Power Company can be considered the best option open  
4 to the Company. The terms of the Agreement are competitive with respect to  
5 alternative offer packages and potential suppliers made available to the  
6 Company through the 2005 RFP process, to contemporary wholesale electricity  
7 prices in the region during late 2005 – early 2006, and to the current long-term  
8 outlook for power supply at the wholesale level in the Southeast Region.

9  
10 Over many years, Gulf Power has proven to be a good business partner,  
11 providing high levels of service reliability to FPUC and the Northwest Division.  
12 In consistent fashion, Gulf Power has responded promptly to various technical  
13 issues with regard to electric services. In addition, Gulf Power has provided  
14 various support services to FPUC in the form of market studies, load data and  
15 information, and analysis of data. This information proves valuable to the  
16 Company for operations and for use in response to regulatory issues and  
17 proceedings.

18  
19 Gulf Power and the parent organization, Southern Company, are well  
20 recognized, established electricity service providers with attending low levels of  
21 counterparty risks. Through conservative resource management and a clear  
22 focus on the markets that they serve, Gulf Power and Southern Company

1 provide very high levels of customer satisfaction to electricity consumers  
2 through high service quality and innovative products at favorable prices.

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3

4 **Q. WILL THERE BE CHANGES IN THE CONTRACTUAL**  
5 **ARRANGEMENTS FOR TRANSMISSION SERVICES FOR THE**  
6 **NORTHWEST DIVISION, BEGINNING IN 2008?**

7 A. Yes. Going forward, arrangements for transmission services will be handled  
8 directly by the Company whereas under its current contract with Gulf Power,  
9 transmission services are bundled together with generation services. Under the  
10 current arrangement, Gulf Power essentially contracts for transmission services  
11 with Southern Company on behalf of Florida Public Utilities Company.

12

13 The Company's Northwest Division is a longstanding native load customer of  
14 Gulf Power. . Under the current contract with Gulf Power Company, FPUC for  
15 has utilized and paid for the generation services provided by Gulf Power and  
16 Southern Company's system-wide generation resources situated at various  
17 locations across Southern's transmission network including, in particular, the  
18 generation resources of Gulf Power Company. This broad base of generation  
19 facilities has utilized Network Integration Transmission Services (NITS) over  
20 many years. The Company is entitled to continued access to the network  
21 integration transmission services and, in support of the new Agreement with  
22 Gulf Power for generation services, the Company will contract for NITS, as

1 currently provided under the current agreement with Gulf Power.

2

3 This means that, in parallel with the new Agreement for generation services, the  
4 Company will assume the position of a direct customer of Southern Company  
5 for transmission services. Under a contract for NITS with Southern Company,  
6 the Company will pay transmission charges monthly for scheduling services  
7 (Schedule 1), voltage control and reactive power (Schedule 2), direct transport  
8 services (transmission), plus a federal regulatory fee. These services are (will  
9 be) defined in the transmission service agreement between the Company and  
10 Southern Company. The charge levels for these services are posted within  
11 Southern Company's Open Access Transmission Tariff (OATT), and are  
12 approved by the Federal Energy Regulatory Commission.

13

14 In addition, the Company will pay for interconnection services, including costs  
15 for dedicated substations (voltage transformation and related equipment  
16 including metering equipment) and metering facilities, where such costs are  
17 based on embedded costs that, as a matter of level, will be very similar to the  
18 charges for interconnection services covered by the current contract with Gulf  
19 Power for generation and transmission services.

20

21 **Q. HOW DOES THE STRUCTURE OF TERMS OF THE NEW**  
22 **AGREEMENT COMPARE WITH THAT OF THE CURRENT**  
23 **CONTRACT?**

1 A. The terms of the Company's current contract with Gulf Power includes charges  
2 for demand that cover transmission services, ancillary services, and generation  
3 services stated as dollars per kW-month; charges for electric energy stated as  
4 dollars per kWh; charges for voltage transformation stated as dollars per  
5 kilovolt-ampere; and charges for delivery services (interconnection) stated as  
6 dollars per month. The current contract includes provision for escalation in the  
7 level of the charges over the life of the contract. The charges for transmission  
8 services and ancillary services under the current contract are defined in  
9 Southern Company's OATT, as mentioned above.  
10  
11 The structure of the commercial terms of the new Agreement beginning in 2008  
12 includes an energy charge (\$/MWh), an environmental compliance charge  
13 (\$/MWh), and a demand charge (\$/kW-month), sometimes referred to as a  
14 capacity payment. The energy and environmental compliance charges are based  
15 on embedded costs, where the cost levels are subject to regulatory review by the  
16 Florida Public Service Commission.  
17

1       **Q. CAN YOU PLEASE HIGHLIGHT OTHER PROVISIONS OF THE NEW**  
2       **CONTRACT?**

3       A. The new Agreement deals more explicitly with contingency events and risks  
4       than previously, which is a natural result of the evolution of the wholesale  
5       power and transmission markets since the mid- to late-1990s. The history of the  
6       electric power industry in general and wholesale energy markets in particular  
7       since 1998 reveals much higher levels of uncertainty and risks. These risks  
8       assume several dimensions, such as high short-term variation in wholesale  
9       electricity prices and primary fuel prices; a higher likelihood of power system  
10      reliability failures; potential for large-scale financial losses incurred by  
11      investors in entities in energy markets; increased frequency of congestion events  
12      across major transmission corridors leading to higher likelihood of transaction  
13      curtailments; uncertainty regarding the direction of environmental policy  
14      initiatives at the federal, regional, and state level; and force majeure events.  
15      These factors pose greater financial risk for participants in wholesale power  
16      markets today, as well as heightened potential for temporary loss of power  
17      supply at considerable cost and inconvenience for retail consumers.  
18      Accordingly, contemporary power contracts, to a much greater extent than in  
19      the past, incorporate provisions to explicitly manage these and other risks.  
20  
21      Accordingly, the new Agreement with Gulf Power is fully consistent with the  
22      current practice of recognizing the realities of contemporary wholesale power  
23      markets, and several elements are worthy of mention. First, the new Agreement

1 incorporates credit worthiness standards, and provisions that identify how the  
2 cost impacts of potential changes in the business environments confronting the  
3 counterparties to the Agreement, Florida Public Utilities Company and Gulf  
4 Power Company, are to be managed. Specifically, the Agreement incorporates  
5 a *Change in Law* provision to manage the cost impacts associated with potential  
6 policy actions by legislative and regulatory authorities.

7  
8 Second, the Agreement includes a provision to accommodate renewable  
9 resource requirements that potentially may be imposed on the Company in the  
10 form of a renewable portfolio standard mandated by federal or state legislation,  
11 or by regulatory policy rule. Third, the new Agreement incorporates a provision  
12 that protects Florida Public Utilities Company and its Northwest Customers by  
13 explicitly defining the responsibilities of the supplier, Gulf Power Company,  
14 should the organization of wholesale power markets in the Southeast region of  
15 the Eastern Interconnection undergo a major market design change—*e.g.*, the  
16 formation of a Regional Transmission Organization. A more detailed  
17 assessment of risks and the provisions of the new Agreement to manage risks  
18 will be provided later in the testimony.

19



1       **Q. CAN YOU PLEASE REVIEW THE RELATIVE PRICE LEVELS FOR**  
2       **GENERATION SERVICES IMPLIED BY THE COMMERCIAL TERMS**  
3       **OF THE COMPANY’S NEW AGREEMENT WITH GULF POWER**  
4       **COMPANY?**

5       Yes. The RFP-obtained offer prices submitted by bidders for the Northwest  
6       Division, as estimated for the standard suite of generation services identified  
7       above, average \$67/MWh for the period 2008 through 2012. The all-in prices  
8       of the new Agreement for services for the Northwest Division beginning in  
9       2008, as executed by the Florida Public Utilities Company and Gulf Power  
10      Company, are estimated to approximate this level. Taken as a whole, the  
11      overall price level and attending risks associated with the executed Agreement  
12      between the Company and Gulf Power Company are competitive.

13  
14      Wholesale electricity prices and primary fuel prices have eased somewhat since  
15      the late-2005 – early-2006 timeframe and, as a consequence, it is useful to  
16      consider how the estimated prices of the new contract compare to estimates of  
17      wholesale prices in the Southeast region. Because of lower levels of market  
18      liquidity in the Southeast particularly within the FRCC region, however,  
19      wholesale market benchmarks over several years ahead are not readily  
20      observable. Thus, price benchmarks must be developed, either directly by  
21      projecting wholesale electricity price for the region with computer simulation  
22      techniques, or by inferring future wholesale prices from historical experience.  
23      In the latter approach, observed short-term prices over past years for

1 commercial hubs within the Eastern Interconnection (including the Southeast  
2 region) are used in conjunction with forward power contracts for selected hubs,  
3 to develop projections of prices over longer-term forward periods in the  
4 Southeast—for example, for three years ahead.

5  
6 Once developed, the wholesale price benchmark then serves as a basis to gauge  
7 the estimated price level implied under the new Agreement. Here, the approach  
8 taken is to use inferred wholesale electricity prices as the benchmark.

9  
10 The analysis indicates that the estimated prices under the new Agreement are  
11 consistent with expected wholesale electricity market prices in the Southeast  
12 over the next several years, and align well with what wholesale power buyers in  
13 the market today would expect to pay, at the least, for power over the next few  
14 years. Projections of wholesale electricity prices stated on a per-MWh basis for  
15 the Southeast region, not including reserve services, are estimated at \$62, \$68,  
16 and \$66 for the years 2008 – 2010, respectively. These results closely  
17 approximate the results of the RFP process, suggesting that expectations of  
18 future wholesale market conditions have not materially changed from  
19 late-2005 – early-2006. Furthermore, references from industry media indicate  
20 that, in some cases, contract prices for power supply in the South Central region  
21 have reached over \$80 per MWh.

22

1 In summary, projected regional prices align with the estimated prices under the  
2 new Agreement. Also, it is important to note that the projected regional prices  
3 cited above do not cover reserve services. Over the ten-year contract term, the  
4 prices for generation services implied by the Agreement are likely to escalate at  
5 annual rates of change approximately equal to overall inflation, though the  
6 change in prices of any one year, either up or down, can deviate substantially  
7 from overall inflation for the year.

8  
9 It is perhaps useful to mention that the commercial terms of the current contract  
10 between the Company and Gulf Power are unusually favorable to retail  
11 consumers, with commensurate economic losses for Gulf Power, Southern  
12 Company, and Southern Company shareholders. For years, the current contract  
13 has provided overall prices covering energy, reserve services, and transmission  
14 services for prices of \$39 to \$41, stated on a per-MWh basis. These contract  
15 prices contrast sharply with the corresponding average day-ahead prices for  
16 2004 – 2006 of \$66, \$60, and \$55, also stated on a per-MWh basis, for regional  
17 hubs referred to as Instate Florida, Florida-Georgia Border, and Into Southern  
18 Company, respectively. For 2006, the benchmark wholesale prices are \$72,  
19 \$67, and \$61 for Instate Florida, Florida-Georgia Border and the Southern-  
20 SERC areas, respectively. Again, these market benchmark prices do not cover  
21 reserve and ancillary services.

22

1       **Q. PLEASE REVIEW SPECIFIC RISKS INHERENT TO THE**  
2       **COMPANY’S EXECUTED AGREEMENT WITH GULF POWER.**

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3       A. The expiration of the Company’s current contracts and its 2005 power  
4       procurement process coincide with an unusually difficult and challenging time  
5       for power markets, and energy markets more generally. Currently, primary fuel  
6       supplies at the national level are relatively tight based on historical standards, a  
7       direct consequence of high worldwide demand for fuels and fairly high levels of  
8       uncertainty in several dimensions including weather-induced supply disruptions  
9       such as that associated with Hurricane Katrina in the case of natural gas and oil  
10      supplies, and rail line failures in the case of Powder River Basin coal supplies.  
11      Accordingly, wholesale electric prices have reached historically high levels and  
12      remain sensitive to unplanned events. These events and other risks mentioned  
13      earlier have affected the commercial terms of power supply contracts generally.  
14      It is useful to review the implied risks, as they are significant, and how the new  
15      Agreement manages these risks.

16  
17      Because the commercial terms of the Agreement including fuel and  
18      environmental charges are based upon embedded costs, the contract prices are  
19      likely to have greater stability than short-term wholesale electricity prices.

20      Second, the tariff prices for generation services under the Agreement are likely  
21      to vary in similar fashion to the costs of generation services implicitly within  
22      retail prices charged by Gulf Power. The contract prices are likely to remain  
23      below the charges for generation services implicit in retail tariffs charged by a

1 number of incumbent service providers within the State of Florida, though not  
2 necessarily with respect to retail service prices within the Southeast region as a  
3 whole.

4  
5 Moreover, annual changes in the contract prices will to a substantial extent  
6 follow primary fuel prices, particularly coal prices. As with electric utilities  
7 generally, Gulf Power's embedded fuel costs are sensitive to changes in market  
8 prices for fuels experienced nationally. Because fuel charges are directly  
9 reflected in both the retail charges to Gulf Power's retail customers and  
10 wholesale charges under the Agreement, the charges for services paid by FPUC  
11 for the Northwest Division will, to a substantial extent, follow Gulf Power's  
12 charges to its retail consumers.

13  
14 Primary fuel prices including natural gas and coal have risen substantially in  
15 recent years, particularly during late 2005 and continuing through the second  
16 quarter of 2006, though they have declined somewhat recently. Over the  
17 foreseeable future, fuel prices are not likely to fall back to the levels seen in the  
18 period 2000 to 2004. Moreover, the prices for these two major fuel types  
19 appear to be more highly correlated currently than in past years, a natural result  
20 of the increased substitution of fuels for electric power generation, in the short  
21 run. Since early 2005, the sharp increases in electric prices nationally are  
22 attributable in part to much higher costs for fuels. While short-run primary fuel  
23 prices can vary greatly, the contract terms for fuel costs are likely to reveal

1 substantially less variability, thus implying lower risks for the Company and  
2 retail customers with respect to spot markets for fuels.

---

3  
4 As mentioned, another risk factor arises through potential costs of  
5 environmental compliance, as the Company is subject to future environmental  
6 charges through the Change in Law provision of the Agreement. Of particular  
7 concern under this provision is future restrictions imposed by federal legislation  
8 on CO2 emissions associated with fossil fuels, and the resulting impacts on  
9 electricity service providers and retail electricity prices. While CO2 compliance  
10 costs will be borne by all electricity generators, compliance costs are likely to  
11 be uneven across utilities. Indeed, restrictions on CO2 emissions will favor  
12 natural gas-fired generators and, to the degree that natural gas is increasingly  
13 “on the margin,” regional wholesale prices are likely to increase relatively less,  
14 with respect to the embedded cost impacts on electric utilities like Gulf Power  
15 Company that predominantly employ coal-fired generation. In short, the  
16 implication is that, in the face of restrictions on CO2 emissions—which could  
17 be implemented in the form of a so-called *cap and trade* market scheme such as  
18 that currently in place to manage SO2 emissions or a direct tax on emissions—  
19 Gulf Power and many incumbent utilities in the Southeast region are  
20 comparatively disadvantaged. Because the Northwest Division’s costs and  
21 retail prices for services under the Agreement are wedded to Gulf Power’s  
22 potential compliance costs for CO2 compliance, the Company’s costs may also  
23 be comparatively disadvantaged with respect to regional wholesale prices. It is

1 likely, however, that should CO2 policy initiatives be implemented, such policy  
2 would be phased in over a number of years. Second, the burden on customer  
3 bills as a result of potential CO policy would be borne approximately equally by  
4 the customers of the Company and of Gulf Power. Third, and most importantly,  
5 the implementation of CO2 policy would tend to reduce the absolute and  
6 relative price for coal, as coal users substitute away from coal in order to  
7 mitigate the cost impacts associated with CO2.

8  
9 Other dimensions of risk covered by the Company's new Agreement with Gulf  
10 Power are noteworthy. Specific events under the Agreement with potential  
11 price impacts include: 1) declines in the future level of electricity consumption,  
12 2) the impact of storms in the Gulf region resulting in long-term power outages,  
13 and 3) change in the structure of wholesale electricity markets. Each is  
14 reviewed below.

15  
16 Possible Declines in the Future Level of Electricity Consumption: Growth in  
17 electricity sales of the Company's Northwest Division has been within the range  
18 of 1.5 – 2.0% in recent years, although year-by-year change in retail sales are  
19 quite sensitive to weather and the resulting demand for space conditioning. One  
20 can realistically anticipate that sales will advance at annual rates of change that  
21 approximate historical patterns, though perhaps somewhat more slowly.  
22 Nonetheless, there is the possibility that sales could decline. The price risks  
23 attending the decline in retail sales levels are a direct result of the structure of

1 the commercial terms of the Agreement regarding capacity purchase, which are  
2 manifested as demand charges. Specifically, the demand charges contain a  
3 ratchet provision, where the minimum level of demand charges is based upon  
4 the level of peak demand (MWs) observed when the contract is initiated.  
5 Demand charges are not harmful to retail consumers in terms of impact on the  
6 overall prices for services, unless the level of demand declines fairly  
7 significantly over the term of the Agreement. For example, declining future  
8 retail sales levels of the Northwest Division could potentially result from the  
9 combined impact of a slowdown in the growth of long-term economic activity  
10 for the territory covered by the Northwest Division, coupled with aggressive  
11 electricity conservation policy. The likelihood of rising overall contract prices  
12 as a result of declining sales levels is small and, should it occur, the impact on  
13 the overall price level appears to be comparatively modest (less than 5 mills).

14  
15 *Storm Activity and Supply Interruptions:* The Force Majeure provisions of the  
16 new Agreement excuse the payment by the Company of demand charges in the  
17 case of transmission interruptions, but not in the case of power interruptions at  
18 the distribution level. This means that the Company will continue to be  
19 responsible for monthly demand charges for up to 90 days. The reasoning  
20 underlying this provision is that the capital charges incurred by Gulf Power  
21 Company on generation resources committed to serving the Company and its  
22 retail customers continue unabated regardless of the occurrence of storm-related  
23 events. Nonetheless, the provision puts the retail customers and the Company at



1 risk in the case of a natural disaster that results in an extended loss of power at  
2 the distribution level. As a practical matter, the likely impact of this contract  
3 provision, stated in money terms is small, for two reasons. First, the Northwest  
4 Division is substantially inland from the Gulf Coast, and thus likelihood of  
5 large-scale loss of power from storm activity is small. Second, it is highly  
6 likely that the damage to the Company's distribution system in the Northwest  
7 Division, in the event of serious storm activity, can be repaired with expedience.  
8 In brief, the likelihood and magnitude of burdensome demand charges resulting  
9 from power outages at the distribution level due to storms is small.

10  
11 *Change In the Structure of Wholesale Markets:* As mentioned earlier, the new  
12 Agreement covers generation services and the Company must purchase and  
13 arrange for transmission services in order to transport generation services from  
14 points of delivery in the transmission network to the Company's Northwest  
15 substations where power is delivered. The prices and charges for transmission  
16 services for the Northwest are based on the embedded costs of transmission  
17 facilities, as reflected in Southern Company's OATT. These OATT prices are  
18 based on contract path principles, which do not recognize the true underlying  
19 economic costs of transmission services, which are highly locational. The risks  
20 here arise from the possibility that the Southeast region, as a result of federal  
21 mandate or for other reasons, implements locational pricing principles, and that  
22 the relevant delivery points designated by Gulf Power under the Agreement  
23 change in a manner that is unfavorable to the Company. As a consequence,

1 transmission charges under a locational pricing regime could potentially  
2 increase dramatically.

3

4 The risks of this event are very small. First, it is highly likely that the transition  
5 to a locational pricing framework would involve the grandfathering of existing  
6 transmission rights, where Financial Transmission Rights (FTRs) are granted in  
7 lieu of the contract path-based physical transmission rights that the Company  
8 purchases under Southern Company's OATT. This means that the Company  
9 should be fully protected from locational congestion charges. Second, it is  
10 likely that, should Gulf Power Company designate new delivery points, such  
11 points would not, relatively, disadvantage the Northwest Division as the  
12 Division resides within Gulf Power's service territory.

13

14 Nonetheless, risks exist that a change in delivery points could cause increases in  
15 transmission charges for the Company in two ways: First, following the  
16 implementation of locational pricing, a change in delivery points involves the  
17 substitution of one set of FTRs for another. Second, locational pricing could  
18 involve the incorporation of a price component that accounts for marginal losses  
19 not covered by FTRs; the level of marginal line losses tends to be roughly twice  
20 that of average losses. Given the current direction in the structure of wholesale  
21 markets and the inherent protections obtained through the grandfathering of  
22 rights as discussed above, the risks are small.

1 Q. WILL CUSTOMERS IN THE NORTHEAST DIVISION EXPERIENCE  
2 ANY CHANGES IN 2008, AS A RESULT OF THE NEW AGREEMENT  
3 WITH GULF POWER FOR SERVICE TO THE NORTHWEST?

4 A. No. Retail customers of the Company's Northeast Division will experience no  
5 change in the level of customer bills during 2008 as a result of the recently  
6 executed Agreement with Gulf Power Company.

7  
8 Q. IN YOUR PROFESSIONAL OPINION, IS THE COMPANY'S  
9 AGREEMENT WITH GULF POWER COMPANY FOR POWER  
10 SUPPLY FOR THE NORTHWEST DIVISION THE MOST PRUDENT  
11 ARRANGMENT FOR RETAIL CUSTOMERS OVER THE SHORT-  
12 AND LONG-TERM?

13 A. Yes, the new Agreement with Gulf Power Company for generation services for  
14 the Northwest Division is the best long-term power supply option and choice  
15 available to the Company and its retail customers at this time.

16  
17 The commercial terms of the Agreement with Gulf Power are based largely on  
18 embedded costs and, while the prices will follow charges for primary fuels and  
19 environmental costs, such prices are likely to demonstrate reasonably high  
20 levels of stability. The outlook for the overall level of the contract prices appear  
21 to be competitive though it is possible that future wholesale electricity prices  
22 within the region may vary from the prices projected under the terms of the new  
23 Agreement. Gulf Power and Southern Company are well established,

1 financially sound partners and have historically provided high levels of reliable  
2 power supply and service quality to the Company and its customers over many  
3 years. Gulf Power and Southern Company have high levels of credit  
4 worthiness. Gulf Power has a well balanced generation mix, particularly with  
5 participation within Southern Company's pool, which draws upon a substantial  
6 amount of coal-fired resources and nuclear power complemented by gas-fired  
7 generation for peaking capability.

8

9 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 A. Yes, it does.