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ORIGINAL
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May 23, 1997

HAND DELIVERED

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

Re: Determination of appropriate cost allocation and regulatory treatment of total revenues associated with wholesale sales to Florida Municipal Power Agency and City of Lakeland by Tampa Electric Company; FPSC Docket No. 970171-EU

Dear Ms. Bayo:

Enclosed for filing in the above docket, on behalf of Tampa Electric Company, are the original and fifteen (15) copies of each of the following:

1. Rebuttal Testimony of Douglas R. Bohi.

2. Rebuttal Testimony and Exhibit (JBR-1) of John B. Ramil.

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

Thank you for your assistance in connection with this matter.

Sincerely,

James D. Beasley

JDB/pp
Enclosures

cc: All Parties of Record (w/enc.)

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing Rebuttal Testimony of Douglas R. Bohi and John B. Ramil, filed on behalf of Tampa Electric Company, has been furnished by U. S. Mail or hand delivery (*) on this 23rd day of May, 1997 to the following:

Ms. Leslie Paugh*
Staff Counsel
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Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Mr. Gary Lawrence
City of Lakeland
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Lakeland, FL 33801-5079

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ATTORNEY

BEFORE THE PUBLIC SERVICE COMMISSION

PREPARED REBUTTAL TESTIMONY

OF

JOHN B. RAMIL

Q. Please state your name, address, occupation and employer.

A. My name is John B. Ramil. My business address is 702 North Franklin Street, Tampa, Florida 33602. I am employed by Tampa Electric Company in the position of Vice President-Energy Services & Planning.

Q. Do you have any exhibits?

A. Yes. I have one exhibit, Document No. 1 of Exhibit (JBR-1), summarizing Tampa Electric's proposal.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to dispel the notion suggested by Messrs. Pollock and Larkin that Tampa Electric's proposed regulatory treatment of the FMPA and Lakeland wholesale contract revenue sales causes retail ratepayers to subsidize wholesale sales transactions. The multiple errors in their respective positions are a function of their fundamental misunderstanding of Tampa Electric's proposal, how it compares to Florida broker transactions, and a disregard of basic economic theory. The fact is that Tampa Electric's proposed treatment of the FMPA and Lakeland sales will yield significant benefits to the general body of ratepayers.

Q. You said that there was a misunderstanding of the proposal. Can you please explain your proposal?

A. Exhibit (JBR-1)___, Document No. 1, illustrates our proposal.

<u>Sharing Under Tampa Electric's Proposal Versus Broker Sharing</u>

Q. Both Mr. Larkin and Mr. Pollock make a comparison of the FMPA and Lakeland sales to the Florida Energy Broker. How would you compare the Lakeland and FMPA sales with economy transactions?

A. The sales revenues associated with economy transactions from the Florida Energy Broker are shared 80/20 with 80% of the revenues credited through the fuel clause to lower retail rates, and 20% credited for the exclusive benefits of shareholders <u>below the line</u>. Tampa Electric's proposed treatment of the revenues associated with the FMPA and

Lakeland sales is to credit 50% of net revenues to retail clauses and 50% to operating revenues above the line after offsetting all expenses. This 50% treatment above the line cannot be compared with the 20% treatment from broker transactions. This is because ratepayers can and will benefit from the 50% above the line in Tampa Electric's proposal, but the 20% allocation in economy sales is exclusively for the benefit of the company's shareholders. In fact, Mr. Pollock goes so far as to say Tampa Electric Company has flip flopped the 80/20 formula to its benefit.

Q. Please elaborate.

A. On page 2 of Mr. Pollock's testimony, he claims 78% of the net benefits are retained by Tampa Electric Company and 22% would flow to retail customers.

Mr. Pollock has misinterpreted the data in these statements. He ignores the fact that Tampa Electric's proposal results in 100% of the sales revenue associated with these sales being either immediately passed through retail clauses or credited to operating revenues above the line and not below the line as in the case of economy broker sales. This above the line treatment serves to defer the need for a general rate increase, or potentially lower revenue requirements in the next general rate adjustment filing. Under Tampa Electric's current rate stipulation, any contribution to operating revenue also contributes to potential additional refunds in 1999 and 2000 beyond the guaranteed $50 million.

In addition to this lack of understanding of the general formula proposed by Tampa Electric, Mr. Pollock does not understand how to calculate net benefits to retail customers.

Q. Please elaborate.

A. Mr. Pollock asserts later on page 8, that if incremental fuel costs are understated by 3.3%, the net benefits to retail customers would disappear. This is absolutely incorrect. He has misinterpreted the proposal and misapplied the mechanics of how the benefits are calculated. The system incremental fuel would have to increase over 6.5% before the retail customers' immediate 50% share of benefits disappear. In fact, incremental fuel would need to increase 15% for all benefits to operating revenues to disappear. In Mr. Pollock's example, if incremental fuel is actually 3.3% higher over the term of the sale, the retail customers would in fact still receive

$1.2 million as an immediate benefit under the clauses and a total of $7.7 million net benefit taking into account above the line credits.

Q. Other than the mathematics associated with Mr. Pollock's testimony, do you accept his analysis?

A. No. His approach is too narrow. Weighing benefits and costs is the primary factor in business decision making. When the benefits and costs of the transaction are compared a benefit to cost ratio of 1.8 for the FMPA transaction and 2.8 for the Lakeland transaction is calculated. Any ratio greater than 1.0 demonstrates benefits outweighing cost. The greater the ratio the greater the benefits and less risky the decision. This same approach is used in evaluating conservation programs. Conservation programs which have a benefit cost ratio greater than 1.0 are considered in the best interest of rate payers and are approved. The FMPA and Lakeland sales compare very favorably to this standard.

Retail Ratepayers Fuel Costs Are Unaffected

Q. All of the intervenors express concern about the possibility of the retail customer paying higher rates through fuel due to the understatement of the system incremental fuel in the forecast. Is this concern justified?

A. No, it is not. These witnesses have misunderstood Tampa Electric's proposal to credit the actual system incremental fuel cost to the fuel clause. They have confused this credit with a credit for the fuel revenues collected from the wholesale customers. They have also confused the effects of crediting system incremental fuel costs with system average fuel cost.

Q. Explain the difference between Tampa Electric's proposal and crediting the fuel clause with the actual wholesale fuel revenues received.

A. Tampa Electric's proposal is quite simple, and guarantees that the retail customer will not pay higher rates through the fuel clause.

Revenues equal to actual system incremental fuel cost will be credited to the fuel adjustment clause regardless of the fuel revenues actually collected from the wholesale sales or the projected level of system incremental fuel cost. Revenues equal to system incremental SO_2 allowance cost will also be credited to the environmental clause.

Therefore, retail ratepayers will pay fuel and environmental cost recovery clause rates NO higher than they would have been have had the sales not been made.

Q. Explain next, the difference between crediting to the fuel clause system incremental fuel cost and system average fuel cost.

A. In contrast to Tampa Electric's proposal, if revenues equal to system average fuel cost were credited in connection with these wholesale sales the retail customer would be affected. For example, in the sale to Lakeland, fuel is priced at system average fuel cost. If revenues equal to system average fuel were credited to the fuel clause as is suggested by Mr. Pollock, Mr. Larkin and Staff, the retail customers, would pay 1.0 million net present value more through the fuel clause over the period of this transaction, as shown in Document 5, Exhibit No. KAB-1. Lakeland is expected to be served during the peak periods of Tampa Electric's own native load. While Tampa Electric Company's overall incremental fuel cost is below system average fuel cost, during peak periods they may be higher than system average fuel cost.

Capacity Commitments

Q. Do the wholesale sales to FMPA and Lakeland require the commitment of Tampa Electric generating capacity?

A. Yes. The sale of off-system energy and capacity obviously requires the commitment of generating resources, but as Ms. Branick has explained in her direct testimony, there were no changes to Tampa Electric's expansion plan as a result of serving these two sales. The next planned generation unit is scheduled for the year 2003. The sale to FMPA ends in the year 2001. The Lakeland sale does encompass a period of time during which new capacity will be added. However, expansion planning analysis has shown that the Lakeland sale does not affect the timing of the current Tampa Electric expansion plan. The 2003 planned capacity addition occurs, regardless of including the Lakeland sale or not. In a conservative approach, a cost for new capacity was incorporated in the analysis of the Lakeland sale.

Q. What factors were considered in making the determination there was no need to add capacity to serve the FMPA and Lakeland sales?

A. The factors considered were maintaining an adequate reserve margin to serve Tampa Electric's native load and the impact of the FMPA and Lakeland sale~ on that margin. Tampa Electric monitors two criteria to assure reliable and cost-effective electric service for its retail rate payers. These two criteria include a 15% reserve margin and a 1% expected unserved energy guideline. The 15% reserve margin addresses peak load demand.

The addition of these sales does not cause Tampa Electric to fall short of meeting these criteria. Thus, while the total level of reserves are reduced by the addition of these sales, the minimum reserve criteria have not been violated and are not affected. In essence, Tampa Electric has merely maximized the utilization of capacity above the required reserve margin. This utilization contributes to fixed costs thereby benefitting retail customers.

Furthermore, there is no need to find replacement capacity either from the units on the system or through a purchase. It makes no sense to incur additional, unnecessary costs in optimizing capacity.

<u>There is No Subsidy of these Sales by Retail Customers</u>

Q. Both Mr. Larkin and Mr. Pollock express concern that the company is proposing a subsidy by retail customers for wholesale sales. Do you agree?

A. No. If the FMPA and Lakeland sales suddenly went away, the rate paid by retail customers would not suddenly drop, by any supposed "subsidization" amount. Based on this fact, it is clear that the retail customers cannot be subsidizing these wholesale sales and Mr. Larkin and Mr. Pollock have clearly misinterpreted the facts. Specifically, Mr. Larkin's summary of the company's justification for its proposal on lines 24 through 29 on page 3, and lines 1 through 7 on page 4 clearly demonstrates a misunderstanding of the basic economic theory outlined in Dr. Bohi's testimony. The economic theory of making incremental sales from the company's resources as long as incremental costs are covered is not being applied by the company where it has an obligation to serve. It is being applied to sales where there is a choice to serve or not to serve as in the case of wholesale power sales. Dr. Bohi has justified this application in his testimony. I simply want to add that any contribution wholesale sales make to embedded costs lessens the burden of retail customers.

Flaw in Cost-Shifting Argument

Q. Are there flaws in Mr. Pollock's comparison of fuel costs in his Document No. 2 of Exhibit 1 where he claims there is "cost-shifting" between competitive and regulated operations?

A. Yes. Mr. Pollock's conclusion is based on the comparison of three numbers that are not "apples to apples". First, the system average fuel and net purchase power cost is for a system operating at a 60% load factor, compared to the purchased energy payments to Hardee for energy taken at approximately a 6% load factor. Secondly, the system average fuel costs include sunk costs associated with providing service to retail customers while supplemental fuel revenues from sales for resale are based on unit incremental fuel costs. Lastly, the energy component for the Hardee purchase contains the operation and maintenance expense, thereby inflating the value relative to the other two columns which are essentially fuel only.

Mr. Pollock has made an invalid comparison of these rates to conclude "cost-shifting" exists. In following Mr. Pollock's logic further, one could conclude that "cost-shifting" exists since Tampa Electric's retail interruptible customers pay approximately $39/MWh, far less than the average retail rate of approximately $70/MWh. Clearly, this would be an invalid conclusion because of the difference in the basis for the numbers. Further, Mr. Pollock's example is exacerbated by his error of including costs in one set of numbers that are not in the other numbers.

Clearly, Mr. Pollock's attempt to demonstrate "cost-shifting" between competitive and regulated operations must be discarded.

__Incentive vs. Disincentive__

Q. How do you respond to Mr. Pollock's recommendations on the regulatory treatment of these sales?

A. On page 3, line 8, and page 12, line 11, Mr. Pollock argues for separation. On page 15, line 8, Mr. Pollock argues that 100% of the non-fuel revenues from these sales be returned to retail customers.

There are two problems with Mr. Pollock's proposal. The first problem is an internal inconsistency. If wholesale sales are separated at average embedded cost, the revenues will not be available to the retail jurisdiction for flow through to retail customers because they will have been allocated to the wholesale jurisdiction.

The second problem is that there will be NO revenues to allocate to either jurisdiction because there will be NO wholesale sales under prevailing market conditions.

Q. It appears all of the intervenors question the validity of an incentive for the company to make these types of sales. Basically, they say that a prudently managed utility should use its best efforts to market power irrespective of an incentive. How do you respond?

A. The Florida Energy Broker is a very good analogy here. The broker is a voluntary system representing a real market based on incremental pricing and incentives. As mentioned earlier, the benefits to the customer are that 80% of the sales revenues are credited through the fuel clause. Significantly a 20% incentive exists that is credited below the line for the exclusive benefit of shareholders. I believe all parties would agree that the broker system has provided tremendous benefits, in excess of $800 million, to retail ratepayers in Florida. The 20% incentive to stockholders has been a key to this record. We should learn from this success and recognize that the desirability of an incentive as presented in this proceeding.

Q. Some intervenors have argued that an incentive would result in a double recovery to Tampa Electric. How do you respond?

A. These arguments reduce to an issue of allowed returns. They both ignore the fact that Tampa Electric's proposal credits all of the wholesale revenues to retail customers through "pass-through" clauses or above the line to operating revenues. Thus, there is no opportunity for Tampa Electric to earn an excessive or double return. Its incentive is limited to an improved chance to earn its allowed rate of return. As previously pointed out, moreover, the retail customer will benefit from these wholesale sales.

Q. What will be the effect of rejecting Tampa Electric's proposal?

A. The company will be disincented to make wholesale sales like FMPA and Lakeland where there are more benefits to be captured for the retail customer than in economy broker sales. This is so because the company will be incented to forego these types of sales in favor of broker transactions and thereby deny customers the benefit of selling capacity in addition to energy.

Q. Is the concept of generating additional revenue from wholesale sales to minimize retail rates new?

A. No. As I just pointed out this Commission recognized the benefit of such activity when the energy broker and the associated revenue treatment policies were set. More specifically for Tampa Electric, in a 1985 rate order, the Commission provided for the company to aggressively market wholesale power and achieve revenues (retained 100% as operating revenues above the line) so that retail rates could be minimized.

Q. What was the result of this action?

A. The result of this Commission action was to spark an entrepreneurial spirit among the company employees to achieve additional revenues through the aggressive marketing of wholesale power. The Company has entered into good business transactions producing the best possible margins allowed by the competitive wholesale market. These margins help minimize retail prices.

Moreover, in introducing this entrepreneurial spirit into the Company, our employees have sought many ways to increase revenue through other means, resulting in less cost burden for our retail customers. For example, the Company aggressively markets steam from generating units, training programs developed for its T&D employees and premium lighting to new and existing electric customers.

Q. How does Tampa Electric's proposal for the treatment of the FMPA and Lakeland wholesale sales revenue compare with the existing regulatory treatment of these other revenue generating activities which help to lower retail electric prices?

A. Tampa Electric's proposal compares favorably and is totally consistent with the regulatory treatment of other sources of additional revenue. For example, the revenues from the activities listed in my previous example are credited 100% above the line.

When Tampa Electric's proposal is viewed in this context, it is readily evident that Commission approval would be totally fair to all involved and consistent with existing revenue treatment. The intervenors have strived to create an illusion that "wholesale" sales carries with it severe complications and the need for extraordinary review. To our retail customers it is simply another source of revenue from a third party that helps to minimize their rates.

Q. Does this conclude your testimony?

A. Yes, it does.

Revenue Treatment Under Proposal

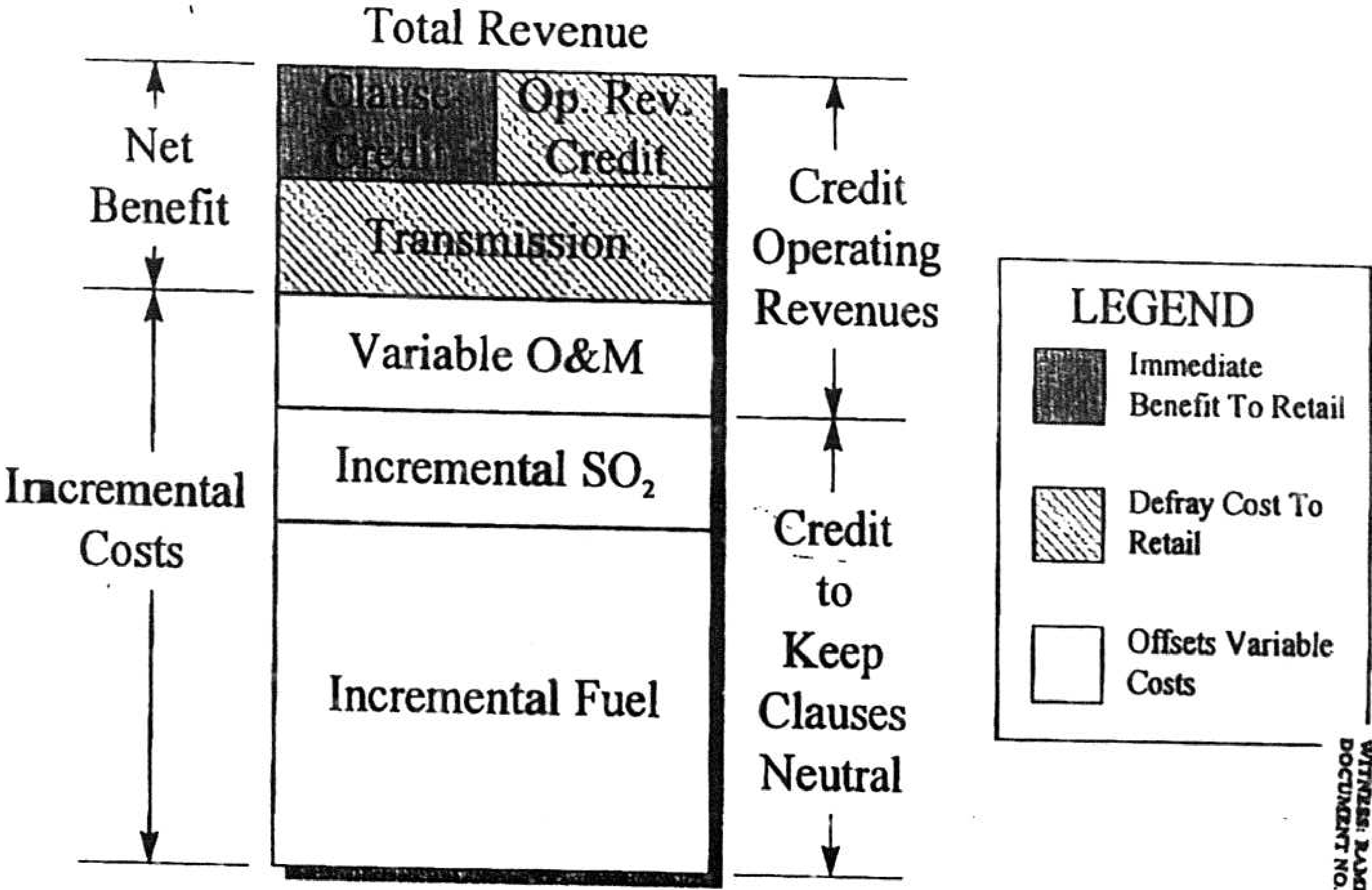

EXHIBIT NO.____
TAMPA ELECTRIC COMPANY
DOCKET NO. 970171-EU
WITNESS: RAMIL (JBR-1)
DOCUMENT NO. 1