BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of : DOCKET NO. 970171-EU

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

---

FIRST DAY - AFTERNOON SESSION

VOLUME 2

Pages 125 through 294

PROCEEDINGS: **HEARING**

BEFORE: CHAIRMAN JULIA L. JOHNSON
COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER DIANE K. KIESLING
COMMISSIONER JOE GARCIA

DATE: **Wednesday, June 11, 1997**

TIME: Commenced at 9:30 a.m.

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

REPORTED BY: ROWENA NASH
Official Commission Reporter
(904) 413-6736

APPEARANCES:

(As heretofore noted.)

WITNESSES

EXHIBITS - VOLUME 2

P R O C E E D I N G S

(Hearing reconvened at 12:55 p.m.)

(Transcript follows in sequence from Volume 1.)

CHAIRMAN JOHNSON: We're going to go back on the record. Mr. McWhirter.

MR. McWHIRTER: Yes, ma'am. I'm tuning in right now.

JOHN B. RAMIL

resumed the stand as a witness on behalf of Tampa Electric Company and, having been previously sworn, testified as follows:

CONTINUED CROSS EXAMINATION

BY MR. McWHIRTER:

Q Mr. Ramil, if would you direct your attention, once again, to FIPUG Exhibit 3, which is the annual report, and look at the last page in that exhibit. And under "Tampa Electric" look at the line that says "Net System Capability in Megawatts." The number "1996," that's your total installed capacity excluding Hardee power plant?

A I'm not sure whether that includes Hardee or not.

Q Would you agree then, subject to check, that it does not?

A Subject to check, yes.

Q All right. In 1996, your peak demand was 3349 megawatts.

MR. WILLIS: Excuse me, Madam Chairman. Mr. McWhirter is questioning Mr. Ramil about something that he has not testified to. He has placed this material in the record, it's been officially recognized, it speaks for itself, there's no need to continue this line of questioning.

MR. McWHIRTER: Madam Chairman, the rationale for the line of questioning is that we're trying to determine who gets the benefits of the wholesale sale, and I plan to tie this line of questioning in with the ultimate conclusion that TECO Energy gets the benefit of the sale because it will enhance the opportunity to sell power from the Hardee power plant.

CHAIRMAN JOHNSON: You were starting to testify in providing your explanation. What was your question?

MR. McWHIRTER: Well, the question was the peak demand on the system, part of the annual report, and if he doesn't know what the peak demand on the system is, he can say no.

CHAIRMAN JOHNSON: Mr. Willis.

MR. WILLIS: I was just pointing out that he has gone afield from Mr. Ramil's testimony, and that it's 1:00 in the afternoon, we are on the first witness, and he should stick to what Mr. Ramil has testified to.

CHAIRMAN JOHNSON: And your point with that this wasn't a part of his testimony and, therefore, it's irrelevant and outside of the scope?

MR. WILLIS: No, it's not something that Mr. Ramil has presented testimony on, these numbers.

CHAIRMAN JOHNSON: Mr. McWhirter.

MR. McWHIRTER: And my position on that is the basis of his testimony is that the retail customers benefit from this sale. FIPUG's contention is that TECO Energy benefits from the sales and it would be to the detriment of the retail customers and he is the one that's sponsored for demonstrating the benefit. And if the sale is not beneficial to the retail customers because of the limit in the amount of available reserve margin, then that would be impugning the nature of his testimony.

And so it deals with his direct examination, and the purpose of it is to impeach what he is saying in direct examination.

MR. WILLIS: Commissioner, I'll just

withdraw my objection, but the point is we need to direct questions to the witness that's testified on the various matters and get on with the hearing.

CHAIRMAN JOHNSON: Mr. McWhirter, we'll allow the question, but Mr. Willis is correct, it is already 1:00, and we are still on our first witness. I want to give you every opportunity to ask all the relevant questions that are necessary to develop your case and conduct your cross examination, but I caution you that you need to stay on point and be as specific and succinct in your answers as possible -- or your questions as possible.

COMMISSIONER KIESLING: I think you were right the first time.

MR. WILLIS: You were correct the first time. (Laughter)

MR. McWHIRTER: I will do my very best, Madam Chairman.

Q (**By Mr. McWhirter**) Do you recall the pending question?

A Regarding the Hardee power station?

Q Yeah.

A I really don't know if it's in here or not. If you want to know about does a TECO -- does a Tampa Electric affiliate benefit through running the Hardee

Power Station more, I might be able to save us all a lot of time if you just want to ask me about that.

Q Go to it.

A The answer to that, by Tampa Electric making more sales, does the TECO affiliate, TECO Power Services that owns the Hardee power plant that the output is shared by Seminole and Tampa Electric, make more money, the answer is no. And the answer is not in the annual report. But if you look at the FERC docket approving that transaction after the Commission approved the need for that plant, you'll find that the regulated -- the FERC regulated return approved in that docket is captured through the capacity charge to Seminole and Tampa Electric. So increase in generation from the Hardee Power Station does not increase the profitability of TECO Power Services.

Q The questions I want to address with respect to Hardee Power Station has to do with the retail fuel clause. And the price that Tampa Electric pays to Hardee Power Station, as opposed to the cost of running installed capacity. And are you confident to testify in that area?

A I think so if you are talking about how things are done in general principles.

Q All right. I'd like you -- Ms. Kaufman is going to distribute an exhibit which is part of the Exhibit No. 1, Madam Chairman, but for purposes of this I would like to call it Exhibit 4. And it's an excerpt from the FERC Form 1 pertaining to Hardee Power Station.

CHAIRMAN JOHNSON: We'll identify it as Exhibit 4.

(Exhibit 4 marked for identification.)

Q **(By Mr. McWhirter)** Mr. Ramil, this is a two-page exhibit, and Page 1 is the '96 · or the '95 annual report. And Page 2 is for the year ending December 31, 1996. And Line 8 of that exhibit shows the plant capability of Hardee Power Station, it's 295 megawatts.

A Excuse me, are you on December 31, '95, or '96?

Q In both of them, it's the same number.

A Okay.

Q And the peak demand on the plant is higher than that on Line 6. And is that the winter peak demand -- or winter capability of the plant?

A The number "6," I think, is the actual loading of the plant during the winter. And, yes, I believe that's correct, because of the cold atmosphere you can get more megawatts out of the plant in the wintertime.

Q And on Line 12, the net generation of that plant is 662,000-megawatt hours, correct?

A Correct.

Q Can you quickly calculate for us the load factor at which that plant is operating?

A Do you want me to base it upon the peak demand on the unit?

Q Base it on the 295, which is the summer peak, or summer capability.

A I just calculated about 26%.

Q And now calculate it based on the winter capability.

A About 23%.

Q Now make the same calculations for the year 1996.

A Okay. I calculated 20% for the 295 rating and 17% for the 356 rating.

Q So in 1996, the load factor has deteriorated?

A The load factor -- this is a plant so it's capacity factor, not load factor. It's lower in '96.

Q And the sales have dropped off by some 20% if you compare Line 12 on '95 and '96?

A Correct.

Q In the 1993 case, Tampa Electric Company committed to purchase 40% of the capacity of that plant in the summertime. What is that commitment?

A Tampa Electric is paying 40% of the capacity charges on the plant for use throughout the entire year.

Q And what is that amount of money?

A I believe it's about $12 million a year.

Q Or is that 12 million every six months?

A No, I believe it's a year.

Q The cost of that plant, according to this, is $206 million?

A That's what this indicates, yes.

Q And what would be the annual carrying cost on that kind of investment if you tried to get 15% before taxes?

A Are you asking me to make a specific calculation?

Q Yes, sir.

A What is that? 15% fixed charge rate?

Q Before taxes, a 15% return on a $206 million investment.

A Before taxes?

Q Before taxes --

A So when you take the --

Q -- at the 15% return to enable you to get something less after taxes.

A Okay. What do you want me to calculate?

Q 15% carrying cost on $206 million.

A Okay. So 15% times $206 million is what you want me to do?

Q Yes.

A That's $31 million.

Q Is it fair to make an assumption that that is the carrying cost on that investment from that plant?

A I don't know. It's fair under the assumptions that you've made that would be the carrying cost.

Q Does Tampa Electric have a published assumption that it's trying to reach on that plant, or return it's trying to reach on that plant?

A No. Tampa Electric doesn't have any ownership of the plant.

Q TECO Energy, do you know what its desired return is on that plant?

A The rates were set in the FERC proceeding, and that's what they are. I don't know what that is.

Q All right. In 1995 the average fuel per unit is $2.73 -- no, it's $2.30 -- no, it's $23 a megawatt hour, Line 42.

MR. WILLIS: What is your question, Mr. McWhirter?

Q **(By Mr. McWhirter)** Am I correct that on Line 42, the average cost of fuel burned in the Hardee plant is $23 a megawatt hour?

A Yes. This shows 2.3 cents per kilowatt-hour, that would be $23 per megawatt hour.

Q And in 1996 that price was $32 a megawatt hour?

A Correct.

Q When Hardee Power sells electricity to Tampa Electric Company, what does it charge for the energy charge?

A The energy charge is an O&M expense charge based on actual expenses at the plant driven by the formula in the contract.

Q I see. And that would be the fuel price of 23, or 30, plus something else?

A Okay. You asked me energy. Fuel --

Q Yeah.

A -- would be the average fuel cost for the plant.

Q And then on top of that it would charge Tampa Electric an O&M charge?

A Yes, based upon the actual O&M expenses at the plant.

Q Does it make any other charges to Tampa Electric?

A Well, the capacity charge you mentioned earlier.

Q And that's, what, a million dollars a month or something like that?

A That's my recollection.

Q All right. Now, is the price for fuel and O&M recaptured from Tampa Electric's retail customers through the fuel clause?

A I believe the fuel cost is.

Q But not the O&M charge?

A I don't recall on the O&M charge. It may be in the capacity clause.

Q But you don't know?

A Yes, I don't know.

Q If the fuel reports show that the sum charged to Tampa Electric for energy purchased from this plant exceeds $23 in 1995 or $32 per megawatt hour in 1996, would it be fair to conclude that something else is being included in that cost, or would there be another rationale for the price differential?

A Well, you have to remember two things; one is the O&M charges on the plant, the other is that this plant is shared between Tampa Electric and Seminole Electric. And it depends upon who calls on it exactly what it is charged in a given month. The costs are allocated between the two utilities depending on how much they used the plant during a given month. If, say, fuel prices happen to be higher in one month than another, or higher than the average for the year, but one utility took more of its energy during that month, then the fuel charges would reflect the actuals for that month, and you might not be able to compare it to the annual average.

Q If we were trying to ascertain what Tampa Electric was paying for in the charge that was made that's carried in the fuel clause, how would we figure that out?

A If you wanted to figure out? I mean, if you wanted to audit the number in the fuel charge?

Q Yes.

A I think you'd ask about that number in the fuel adjustment hearings.

Q I'm not asking when to ask about it, I'm asking what you would ask for.

A I don't know what you are asking me to answer.

Q Is there a kilowatt-hour charge, and in that charge there's a component of fuel and maybe some other things, where would you find the information as to what the other things in addition to fuel would be in the filings that Tampa Electric makes?

A It would be in what's requested and filed in the fuel adjustment hearings, just like any other purchase that we make.

Q Do the forms that you presently file include an explanation of the components of the charge that's made to Tampa Electric by Hardee Power Partners?

A I don't know.

Q For the future you indicate that customers will be kept whole in this case because incremental costs will be fully recovered and credited to the fuel charge. And that incremental cost is composed of what?

A The incremental cost is composed of the specific cost of fuel to serve the incremental sale.

Q So if any time Hardee power plant is on line and serving -- is selling electricity to Tampa Electric, and then Tampa Electric resells that power to FMPA, the price that appears in the FMPA charge would be the same as Hardee Power charges Tampa

Electric?

A No, you've gone making up a deal that doesn't exist.

Q Okay. Tell me what the deal is.

A We talked for a long time this morning about how the charges of the contract are structured to FMPA, the FMPA.

Q I'm not talking about that. I'm talking about what's credited to the fuel charge.

A No, no, you just talked about it. And the charges under the contract for fuel for FMPA are based upon the units specifically identified in the contract. Okay?

Now, the way this analysis was done looking forward and each and every hour that we are making the sale to FMPA, we'll look at what the incremental cost to the system to serve the sale is. And to use your Hardee Power Station example here, if Hardee Power Station is indeed the incremental fuel source, the incremental generation source serving the sale, then the costs associated with that energy purpose will be credited to the customer clauses so that customers see no additional expense as a result of making these sales.

Q All right. If I understand you then, you're saying the total price paid by Tampa Electric Company to Hardee Power for the energy charge will be the total credit retail customers receive in the fuel costs for that sale that hour?

A For the scenario I described, yes.

Q Now you mentioned "fuel" and I'm talking about the total price, which includes fuel and maybe something else.

MR. WILLIS: Excuse me, Mr. McWhirter, just ask a question.

MR. McWHIRTER: All right.

COMMISSIONER CLARK: Mr. McWhirter, let me ask him something.

MR. McWHIRTER: Yes.

COMMISSIONER CLARK: I'll tell you what the answer sounded like to me.

WITNESS RAMIL: Okay.

COMMISSIONER CLARK: That under the basis of you buying -- Hardee power plant is not owned by Tampa Electric Company.

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: And when you buy from them, you are going to be paying average fuel costs?

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: And when Tampa Electric sells under this, the customers are going to get the benefit of incremental fuel, but they are going to be paying average fuel.

WITNESS RAMIL: Which customers?

COMMISSIONER CLARK: Tampa Electric customers are going to be paying average fuel when the Hardee power plant is being used.

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: So they'll get the benefit of incremental, but they will be paying average.

WITNESS RAMIL: They'll be paying average, which includes whenever the Hardee Power Station was run for the Tampa Electric retail customers.

COMMISSIONER CLARK: All right. So if it isn't needed to be run for the retail customers, but it is needed to run FMPA, what happens?

WITNESS RAMIL: Good question. What happens in that case is that's calculated every hour, and the fuel cost of running the Hardee for that hour is noted as a cost of this sale. And the revenues for this sale will then be credited to fuel adjustment so that to the retail customers it looks like it never happened, and they have no fuel cost impact from it.

COMMISSIONER CLARK: Okay.

Q (By Mr. McWhirter) Assume hypothetically then that the Sebring plant has a cost of $236 a megawatt hour for every hour it operates. Are you saying that any time the Sebring plant operated, the charge made --

MR. WILLIS: Excuse me.

CHAIRMAN JOHNSON: Mr. McWhirter, there's an objection.

MR. WILLIS: I object to the line -- that question on the grounds that it's irrelevant to this proceeding and that it's beyond the scope of this witness' testimony.

MR. McWHIRTER: The whole essence of this proceeding, Madam Chairman, is that the fuel clause will be credited with the incremental cost of fuel. My question is if the incremental cost of fuel from Sebring is $236 a megawatt hour, will FMPA be charged -- or will the fuel clause be credited with that $236 as though it was a sale to FMPA?

CHAIRMAN JOHNSON: Mr. Willis.

MR. WILLIS: Commissioner, I think that it's time to admonish all of us that the hour is now 1:30, we are still dealing with things that are far beyond this witness' testimony, I don't believe have any relevance to the proceeding, and that we need to ask the questions that are relevant so we can handle the other witnesses. We've got several others that are here to testify today, and we need to move forward.

MR. McWHIRTER: This answer calls for a yes or no answer. It could have been given, and we'd have been done three minutes ago, Madam Chairman.

CHAIRMAN JOHNSON: Mr. McWhirter, I appreciate that, but I do believe it's outside the scope of his testimony. Perhaps it's relevant to some other witness, but I believe it may be outside of the scope of his direct testimony and the issues that he's been testifying to.

MR. McWHIRTER: Madam Chairman, I respectfully suggest to you that he's dealing with incremental cost and that is an incremental cost of fuel to Tampa Electric Company. And all I wanted to know was is that incremental cost going to be charged to the fuel cost on FMPA's account. That's a simple question, and it deals exactly with his testimony and no one else's.

CHAIRMAN JOHNSON: The objection was sustained.

Q **(By Mr. McWhirter)** Mr. Ramil, would it be fair to say that what you want is an even playing field in the wholesale market that you will be able to compete equally with independent power producers and other investor-owned utilities that are trying to make wholesale sales?

A I think when you compete you always want an even playing field. And what we are looking for is that when we have an opportunity to make wholesale sales that produce net benefits to the system, that we understand it's our burden of proof to come in and demonstrate to the Commission that they are benefits, and I believe we've done that. And then the Commission should give us fair and reasonable treatment on the retail side, how we are going to deal with that sale.

Q Your answer is, yes, you want an even playing field?

A In what respect?

Q That you can compete competitively in price with other sellers?

A Yes.

Q And you don't want to get a subsidy from your retail customers to enable you to compete unfairly with other investor-owned utilities and other independent power producers, do you?

A The term "subsidy" has been used so loosely in this and other dockets related to wholesale sales that it's impossible to ask that question. If you look at it in terms of what are the retail customers paying right now and you look at it in terms of the two specific contracts before this Commission for review right now, you look at the incremental cost of making those sales, and you look at the incremental revenue of making those sales, you get the $10 million benefit. And I submit to you that there's no subsidy going on because if the contracts aren't there, the customers are paying the same prices they are paying right now.

Q I was asking you for a company policy, and you don't wish to say whether the company wants an unfair trading advantage?

A Well, if you want a company policy, I gave it to you earlier. It's, like, if you want directions to the cafeteria, you go straight that way. I could also tell you to go around five blocks and get to that cafeteria.

The company policy is given wholesale sales opportunities and given that we had the resources to make them and given that the customer wants to buy from us, that we're competitive, if we can produce a transaction that produces incremental revenue greater than incremental costs, we should do it. If we don't do it, then we would have missed an opportunity. That's the policy. You don't have to get into subsidies; that's the policy.

Q All right. Hardee Power makes sales in the wholesale markets, or is it fully subscribed?

A Hardee Power can only provide power to Seminole and Tampa Electric.

Q It can't sell to anybody else?

A Correct.

Q So who are the 8% of other sales that are referred to in Exhibit 3?

A Those are broker sales that have been made from the station of which all the benefits flow back to Seminole and to Tampa Electric.

Q So your first statement was incorrect, you can sell to persons other than Seminole and Tampa Electric?

A No, my first statement was correct, you've just changed the question. You asked me if Hardee Power could sell to others, and I told you no. Seminole and Tampa Electric can use the Hardee Power Station under their entitlements to sell to others.

COMMISSIONER GARCIA: So that I understand, the same way you would answer that the Big Bend unit can only sell to Tampa Electric, is that the type of answer you are giving? I just want to understand.

WITNESS RAMIL: Nc, it's a little bit different, but it's a good question, and it gives me another idea. The Hardee Power Station cannot sell to Florida Power & Light, for instance. But if Florida Power & Light is quoting to buy power on the broker, either Seminole or Tampa Electric can use the Hardee Power Station for it to sell to Florida Power & Light.

The complete and full entitlement of any of the output for the Hardee Power Station is totally to Seminole and to Tampa Electric. Hardee Power Station, the owners of Hardee Power Station, cannot go out and sell that power to others. It's to the complete and full entitlement of Seminole and Tampa Electric.

COMMISSIONER GARCIA: Just to make sure I understand where you are going. Just like Polk 1 would be only to Tampa Electric, they can sell that output to somewhere else, but it would only be to Tampa.

WITNESS RAMIL: Polk is owned by Tampa Electric.

COMMISSIONER GARCIA: Right.

WITNESS RAMIL: Hardee Power Station is owned by TECO Power Services. And one of the requirements of the FERC transaction was that all of the entitlement to that plant went to Seminole and to Tampa Electric. The owners, TECO Power Services, the owners of Hardee Power Station, cannot go out and make separate deals to sell output from the Hardee Power Station to others. Does that help?

COMMISSIONER GARCIA: I think so.

Q (By Mr. McWhirter) And that's a requirement of law?

A No, that's the transaction.

Q And can you explain to us the rationale underlying the necessity to route the power sales through Tampa Electric as a broker, as opposed to dealing directly with other IOUs or wholesale customers?

MR. WILLIS: Objection, irrelevant.

CHAIRMAN JOHNSON: There is a relevancy objection.

MR. McWHIRTER: He's objected to the question?

CHAIRMAN JOHNSON: Yes, sir, on --

MR. McWHIRTER: And what were the grounds for the objection?

CHAIRMAN JOHNSON: Relevancy.

MR. McWHIRTER: Well, the witness has just testified that all sales must be routed through, and it's his testimony. And I'm only asking him a question about his testimony, Madam Chairman. I don't see why it would be irrelevant if he put it in the record.

MR. WILLIS: You can't make the question relevant by asking the question to start with. I mean, we're trying to be patient and let Mr. McWhirter finish his cross examination, but I think that it's time that you should limit the amount of time that he has to presume his cross examination. He's had an ample opportunity to ask questions, he's chosen to ask things that are not relevant to this case.

MR. McWHIRTER: Madam Chairman, I'll make a deal with you. If he'll answer this question, it will be the last one I ask. (Laughter)

CHAIRMAN JOHNSON: He didn't withdraw his objection.

COMMISSIONER KIESLING: That's a pretty attractive offer.

CHAIRMAN JOHNSON: I know. (Laughter)

MR. WILLIS: I accept.

WITNESS RAMIL: Thank you.

CHAIRMAN JOHNSON: The objection was withdrawn. You can answer the question.

WITNESS RAMIL: The transaction that was made --

COMMISSIONER GARCIA: I'm sorry. Could you give us the question again, Mr. McWhirter, since it's your last one?

MR. McWHIRTER: Would you read the question back?

(Thereupon, the question appearing on Page 149, Lines 10 through 14, was read back by the reporter.)

WITNESS RAMIL: The transaction, the way that transaction is set up is the Hardee Power Station output, the complete entitlement of the output, is purchased by both Seminole and Tampa Electric. Seminole and Tampa Electric have the means and wherewithal to sell economy power on the broker as part of their regular business. And they have the full entitlement to sell that.

Hardee Power Station, the owners of Hardee Power Station, as I mentioned -- as I tried to mention to avoid a lot of this question 30 minutes ago, has a requirement to keep the unit available. That's because Tampa Electric and Seminole use it for peaking purposes and the value of having it there is for availability. The output, the number of megawatt hours of sales made, has no bearing on TECO Power

Services return on the plant. They earn no more money, no more or less money, if a lot of sales are made or a few sales are made. And the full entitlement of the sales goes to Tampa Electric and to Seminole.

So when it's not being used by either of the two facilities -- the two utilities, and then, are opportunities to sell that on the broker, one of the two utilities do it and then the two utilities share the broker margin on it.

MR. McWHIRTER: I'm done, Madam Chairman.

CHAIRMAN JOHNSON: Thank you.

CROSS EXAMINATION

BY MS. PAUGH:

Q Mr. Ramil, my name is Leslie Paugh, we haven't had the pleasure of meeting before, but I'm sure this will be memorable.

A Good afternoon.

Q Good afternoon. I have a couple of things that I would like to clear up from your summary and your exchange with Mr. Howe from the Office of Public Counsel. Was it your testimony -- I believe it was in your summary -- that these sales improve the company's ability to earn a rate of return; is that correct?

A I think it was it improves our chances of, our opportunity to earn our allowed return.

Q I believe it was also your testimony that you, therefore, receive a higher margin; is that correct? I'm just clarifying my understanding of your testimony. It's not a trick question.

A I understand, but you said "therefore." Are you tying that to the first question?

Q Uh-huh, inartfully perhaps. Was it your testimony that you receive a higher margin because of these sales?

A My testimony is that we believe in the period of time that we have contracted for these sales, particularly the FMPA sales, we receive a higher margin than if we sold the same coal-fired energy on the broker.

Q Thank you. If you receive higher margins on these sales, why do you need to share any of the net benefits from these sales as you have proposed in these proceedings?

A Well, we have proposed a distribution of the benefits back to customers and the balance, after keeping all the clauses to the customers neutral, being credited to operating revenues. Is that what you mean by sharing?

Q Yes. The sharing of the profits that you propose in these proceedings, the green area on your chart, does that help?

A Yes. I guess I'm asking who are we sharing them between.

Q Between the company, company shareholders or shareholder, and the ratepayers. The proposal is for a sharing mechanism. If you receive a higher margin, why are you asking for a sharing mechanism?

A Well, the margin we receive should be looked at independent of any of the mechanism for the treatment of the sales. The margin we receive has bearing on our reason for making the sales. We think we can get higher margins on these sales than on broker sales. Okay? And that's our reason for entering into the agreements and wanting to make the sales.

Q Correct.

A And now that we have done this to capture the higher margin, what happens to the benefits? And what we've proposed is a total above-the-line treatment of benefits with -- with after keeping the clauses whole and no cost to ratepayers, crediting money back to ratepayers through the fuel clause and leaving the balance as operating revenue. We are not proposing in this treatment to share any of the revenue below the line directly with the shareholders as is the case with our broker incentive.

Q I understand that. It just didn't make sense to me that if you have higher margins you would want to share that, but --

A Well, if we have higher margins on the sale, and then what do we do with that margin? If you have that margin, and then given the proposed average separation, you take two or three times that margin away from the shareholders because of that accounting treatment, there's a loss. There's a loss in making the sales.

Q Okay. With that understanding, why don't you credit all the benefits through a clause instead of just as you've proposed?

A Because it creates kind of a gap in the incentives for optimizing the system in bringing in wholesale revenues. The company, by moving in the direction of making these sales and capturing the higher margins and net benefit for the system, is forgoing it's 20% margin that goes below the line on the broker. And the customers are forgoing their 80% share of that margin. And if we do as you suggest, 100% of the higher margin all goes to the ratepayers, and you have an incentive that's set up so that the company wouldn't be incentived to make the higher margin sales, but wait for the lower margin sales on the broker. And it kind of doesn't match.

Q I see.

COMMISSIONER CLARK: Well. Wait a minute. I don't -- on the broker system, what comes back to you all is a splitting the saving; is that correct?

WITNESS RAMIL: 20% of the savings below -- I'm sorry.

COMMISSIONER CLARK: Let me start. When a broker sale is made, there is a split the savings between the buying utility and the selling utility; is that right?

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: And then that measure of profit that you get as the selling utility, then goes the 20/80 split; is that right.

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: So that margin is after you cover your fuel, SO2 variable, O&M and transmission, right? I guess what I'm trying -- that margin is the same thing as what's up there; is that right?

WITNESS RAMIL: Yes.

COMMISSIONER CLARK: Why is it

appropriate -- and when you assure yourselves -- you have said that you believe your margin, you have secured higher margins by not using the broker system. Why isn't it appropriate to continue the 80/20 split? Why isn't that enough incentive to you to make that kind of contract?

WITNESS RAMIL: Well, that's an alternative treatment, but it's not there now. I mean, right now in what was mentioned earlier, just flowing all the benefit back, there is no 80/20 sharing on this type of transaction.

COMMISSIONER CLARK: I guess you proposed a sharing up at the top; is that right?

WITNESS RAMIL: Yes, but the difference is -- and I think one of the things that a lot of the discussion has fallen into between the parties among the docket, in the docket, is sharing here and sharing in the broker is not the same.

COMMISSIONER CLARK: Well, I guess, I'm trying to figure out why it isn't. In your sharing you are suggesting in this instance that the shareholders get 80 and the stockholders get 20; is that correct?

WITNESS RAMIL: I'm sorry, the shareholders get 80 and the stockholders get 20?

COMMISSIONER CLARK: Yeah. What is the --

WITNESS RAMIL: Did you mean to say the customers? I'm sorry, I should have asked you what your question was.

COMMISSIONER CLARK: Yes, you are right, shareholders and stockholders are probably the same then, right?

WITNESS RAMIL: Yes.

COMMISSIONER CLARK: Looking up there, what is the percentage in the green box?

WITNESS RAMIL: The percent in the green box from our estimates right now out of the whole 10 million is 2.4 million.

COMMISSIONER CLARK: Okay. So what percentage is that?

WITNESS RAMIL: That's a little over 20%.

COMMISSIONER CLARK: And who gets the other 8 million?

WITNESS RAMIL: The other 8 million is a credit to operating revenues.

COMMISSIONER CLARK: Do the shareholders or the ratepayers get the benefit of that?

WITNESS RAMIL: It goes to contributing to the company's overall operations. And in the stipulation that we are under, if we are above the midpoint of our allowed return, there's the sharing mechanism and dollars go to the deferred account for potential future refunds.

COMMISSIONER CLARK: Okay.

WITNESS RAMIL: If we go above our allowed return, it all goes into that pot. And the difference -- I mean, you're right on the issue here and that's those two very top boxes is equivalent to the margin on broker sales, okay? If you'll accept that for a moment.

Now if we were sitting here and that bar represented a broker sale, then 80% of that, that top slice, would go to the customers, and 20% would go directly to the shareholders below the line.

COMMISSIONER CLARK: Okay.

WITNESS RAMIL: Okay? The difference here is that the sharing is between immediate return to the shareholders and leaving the rest within the company's operating revenue.

COMMISSIONER CLARK: Okay.

WITNESS RAMIL: And the company's upside here in this is an improved chance of earning its allowed ROE within the stipulation. If these sales were to be enormously successful and our operating revenue was to be so high that we would be, you know, earning higher allowed ROEs, the stipulation takes care of that. And we can't earn any more than what that stipulation already allows with this all above-the-line treatment that we've proposed.

COMMISSIONER CLARK: Okay.

Q **(By Ms. Paugh)** Just to follow up on that, is it fair to say that -- or aren't the higher margins and affiliate profits enough an incentive for Tampa Electric Company without this sharing mechanism?

A If the higher margins all go back to the retail ratepayers, there's nothing for Tampa Electric as an incentive, nothing. Plus, the opportunity to instead of doing these contracts just let the power be sold on the short-term economy broker, the 20% below-the-line incentive is gone as well. So there's nothing in it as an upside for Tampa Electric.

With respect to the affiliates, we've talked about TECO Transport & Trade, we've talked about coal, and most recently we've talked about Hardee. There's no opportunity for any increase in transportation. There's no opportunity for increase in coal purchases. And Hardee Power Station owners, TECO Power Services, is as indifferent with respect to profitability to the amount of power that Tampa Electric takes from that plant, so there's no upside with respect to any of those affiliates.

Q Mr. Ramil, if I understand your answer, the comparison is as between these contracts and broker sales; is that correct?

A I'm trying to make that comparison in response to Commissioner Clark's question, yes.

Q What is the year ending date of these two contracts, please?

A The FMPA sale ends in the third month in 2001, but there are some things that happened that it can end by the year 1991 -- 1999, I'm sorry. The Lakeland contract, I believe, goes to 2006, but there is a provision that it could end if Tampa Electric desires so in 2001, I believe.

Q Mr. Ramil, if Tampa Electric Company does not get the treatment that it's requesting in these proceedings, are you going to go out and call FMPA and Lakeland and cancel these contracts the next day?

A FMPA and Lakeland are here listening to all this, and we are going to talk to them. And we are going to look at all the options under that contract, and we'd rather not have to do that, we'd rather get the fair treatment that we are going to seek, and we'll look at all remedies under that contract. Certainly, we are not going to do any new ones and try to capture these benefits.

I think just -- the issue of whether Tampa Electric is saddled with these contracts or not shouldn't have a bearing on what the fair treatment is.

COMMISSIONER CLARK: Mr. Ramil, you are talking about incentives, and you would agree that we don't need to incent you into entering into the existing contract because you already did?

WITNESS RAMIL: Correct, Commissioner Clark.

COMMISSIONER CLARK: And what you are talking about is your incentive to continue to do that kind of contract.

WITNESS RAMIL: We entered into the contract with -- and, granted, we're here and we took a risk, but we took the risk that we would get fair treatment. And we also know, and it's well documented in many of our own rate case orders, that the Commission encourages bringing in this additional revenue through wholesale sales.

COMMISSIONER CLARK: Yes.

WITNESS RAMIL: And we are in a situation here where if we could have made these sales at full average embedded costs -- and, you know, you do the separation and the revenue from the sale covers the cost and all that, we would go ahead and do these sales because we have an incentive. If we go to the other end, if we go to the other end of kind of the wholesale sales spectrum to the economy market, we make a sale, we have a 20% below-the-line incentive. I mean, we can earn our full ROE and get that incentive on top of it, it's never capped.

COMMISSIONER CLARK: Let me interrupt you. I understand all that. I just want to be clear that as a result of what happens here, you are not going to renege on your contracts, you are going to fulfill those contracts, aren't you, the two that are the subject of this hearing today?

WITNESS RAMIL: Not necessarily, Commissioner Clark.

COMMISSIONER CLARK: Okay.

Q (**By Ms. Paugh**) I believe it was your testimony that revenues will be credited above the line; is that correct?

A Correct.

Q Is it true that in the short term -- and I'm referring to monthly surveillance reports here -- the treatment TECO has proposed for crediting above the line increases the company's earnings?

A It can increase the company's earnings within its allowed range of allowed earnings and subject to all the conditions of the stipulation.

Q And by that you mean the refund stipulation?

A Correct.

Q The refund in those stipulations is not a guaranteed refund, is it?

A No, it's not a guaranteed refund, but the chances of the refund being there are increased to the extent that the company is successful in increasing its operating revenues which is where we are proposing to put these benefits.

Q Is the refund subject to a number of variables which can impact earnings?

A What do you mean?

Q Variables other than just shear dollars in. Are there dollars out of operating revenues that could reduce the likelihood of the refund, for example?

A Yes.

Q Thank you. If I understood your testimony with Mr. Howe -- and correct me if I'm wrong -- you state that the asset costs to make these sales are presently being borne by the retail ratepayers. Is that a correct statement?

A Yes.

Q Is that to say that currently TECO is not

separating these wholesale long-term Schedule D sales?
A These two that we are talking about in this docket?
Q Yes.
A No, of course, not. That's why we're here.
Q What is your understanding of the Commission policy relative to long-term firm wholesale sales vis-a-vis separation or nonseparation?
A The Commission policy is to separate those sales at system average costs with the opportunity for more flexible treatment if it's demonstrated that there are ratepayer benefits.
Q And TECO is not currently separating; is that correct, the FMPA and Lakeland sales?
A Yes, we have not currently separated them.
Q Thank you. Mr. Ramil, where is TECO recording the O&M and transmission expenses?
A I don't believe there are any transmission expenses. The O&M expenses are being recorded above the line.
Q Are you certain about that transmission answer?
COMMISSIONER CLARK: That's got to make you feel uncomfortable. (Laughter)
MS. PAUGH: That's not my intent.

WITNESS RAMIL: Did you mean to say revenues or expenses?

Q **(By Ms. Paugh)** Is it your testimony that there are no transmission expenses?

A There are nil -- there are no new transmission expenses associated with making these sales.

Q Are there transmission expenses attributable to these sales?

A It depends upon how they're treated.

Q How does Tampa Electric propose to treat transmission expenses attributable to these sales? That's really my question.

COMMISSIONER CLARK: Mr. Ramil, let me ask. Maybe I can ask it a different way. You have to transmit this energy to FMPA and to Lakeland.

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: And transmission assets are either allocated to the retail side or to the wholesale side, right?

WITNESS RAMIL: Correct.

COMMISSIONER CLARK: And we have jurisdiction, at least currently we have jurisdiction, over the retail transmission, and FERC has jurisdiction over the wholesale. And I would assume that when FERC approved this contract, there was some -- part of it covers transmission costs. When you figured out what it's going to cost -- what you would sell it for, you would include transmission costs in there, right?

WITNESS RAMIL: There are transmission prices included in our pricing under the contract.

COMMISSIONER CLARK: Okay.

WITNESS RAMIL: Okay? That doesn't necessarily mean that we incur additional transmission expenses.

COMMISSIONER CLARK: I don't think we are talking about additional expenses. There's been an allocation of transmission assets between the wholesale and the retail market; is that right?

WITNESS RAMIL: For those sales that the Commission has separated an average for Tampa Electric, there has been an allocation for the -- there's another category for the transmission sales that -- the transmission wheeling we are providing to third parties. The Commission, I believe, has treated that as a credit to revenue requirements for retail.

COMMISSIONER CLARK: Okay.

WITNESS RAMIL: And what we are proposing to do here with the revenue that's specifically identified for the transmission is consistent with the treatment of transmission service or wheeling for third parties, because that's what FERC asks folks to do in 888, treat yourself as a third party.

For instance, we have cogenerators that we provide transmission wheeling to. And in our last rate case, the Commission reduced the retail revenue requirements by the estimated amount of that transmission revenue. If we happen to get more in a given year, that's more money that's above the line in operating revenue. Or if we give less -- if we happen to get less in a given year, that's less available as operating revenues. We propose to treat the transmission we get from this transaction the same way.

COMMISSIONER CLARK: So the retail asset, it is a retail asset in this instance not -- if it's not separated out.

WITNESS RAMIL: No, it's not separated out.

COMMISSIONER CLARK: Because it's not treated as a wholesale sale. I mean, it's not treated as separated, therefore, there's no reason to separate it out from the retail rate base.

WITNESS RAMIL: That's what we are suggesting with our proposal.

COMMISSIONER CLARK: But in terms of estimating the expense for the transmission, you are using the wheeling rate you charge to your cogenerated power.

WITNESS RAMIL: Correct. It's actually our new FERC file tariff under 888.

COMMISSIONER CLARK: Okay.

Q (By Ms. Paugh) Does TECO intend to book the revenue related to the O&M and transmission as a revenue or as an offset to expense?

A I believe as a revenue, but I'm not an accounting expert.

Q Is TECO considering any other contracts similar to those that which are the subject of these proceedings for which it will seek similar regulatory treatment?

A We think we have some opportunities to do some more. They're going to have to be relatively small because of our need to maintain our reliability criteria.

Q Mr. Ramil, beginning on Page 3, Line 25 of your direct testimony, you state that making cost-effective wholesale sales which provide revenues greater than incremental cost of making such sales is good for the company's retail customers as well as it is for the shareholders; is that correct?

A Which page did you say?

Q Page 3, Line 25.

A Correct, as long as an action like separation at average isn't put into place which would then hurt the shareholders and provide the retail customers even more benefits than what these sales would produce.

Q What do you mean by "put into place"?

A If the Commission would rule that we have to separate these sales at average cost.

Q If you will please turn to Page 11, Lines 10 through 13 of your testimony, I believe it states that TECO would only make wholesale sales when the ratepayers will receive benefits and the stockholders will not be harmed; is that correct?

A Correct.

Q Do you agree that ratepayers would benefit from off system sales if they received all of the revenues whether they were credited through a clause or as TECO proposes?

A Ratepayers would benefit, but stockholders would be harmed.

Q Thank you. How would the stockholders be harmed if all of the revenues were credited through a clause?

A Because the sales could be made through another vehicle, i.e. the Florida energy broker system where the shareholders have an upside.

Q Please turn to Page 4, Line 3 of your testimony. Therein you refer to TECO's 1985 rate case where the Commission reduced retail revenue by 37 million, which TECO was to make up through wholesale sales; is that correct?

A That's correct.

Q Can you tell us why the Commission imputed the 37 million?

A They really didn't impute it. That revenue was being provided by Florida Power & Light under a wholesale contract and that contract stepped down over a period of three or four years. And as that -- they set the retail rates given the level of revenue from FP&L in that contract, in that test year, and then as the sale ramped down and the revenue ramped down from FP&L, said "Go replace that revenue with other wholesale sales."

Q Wasn't it, in fact, because TECO had accessed Big Bend 4 capacity?

A It was because TECO had just added Big Bend 4, a large power plant, which the Commission had determined the need for and reaffirmed that the capacity was needed in the '85 rate case, but because of the block of the capacity put into place as the company grew into that full capacity need, it made good sense to optimize the capacity need with the sales in the interim.

Q How were the revenues received up to the 37 million to be treated in the 1985 rate case?

A I'm sorry, what was the question?

Q The $37 million that were to be imputed in the 1985 rate case, how was that 37 million to be treated?

A The revenue received from the sales was treated as operating revenue to the company.

Q So it all went below the line?

A No, it all went above the line.

Q All right. How were revenues above 37 million to be treated in the 1985 rate case?

A If we had exceeded that revenue target with all that going above the line and went beyond the 37 million, then the same sharing arrangement that exists on the broker went into effect, an 80% share to the customers and 20% to the stockholders.

Q Was TECO successful in meeting that goal of 36 million in wholesale sales?

A No, we could never get that high.
Q If TECO did not reach the target level of 37 million in wholesale sales revenues, how was the difference between the actual revenues and the 37 million accounted for?
A It was less. It was less operating revenue that the company had.
Q So it was taken out of operating revenues?
A No, it wasn't taken out of anyplace, it just didn't company come in because we -- you know, the target was 37 million and maybe we only made 20 million in sales. The difference of 17 million never came in the door.
Q Didn't TECO raise the issue of sharing wholesale sales in its 1992 rate case?
A Yes, we did.
Q And what was the Commission's decision at that time?
A The Commission's decision was to -- the specific sales that we had suggested, the Commission -- the parties agreed to a stipulation which separated those sales at average. Further, for other sales the Commission gave us above a target level an incentive to make sales as an interim incentive. And if you look at the order, it goes on

to speak highly of making -- having incentives to make additional wholesale sales and had suggested that incentive as an interim until they had a docket to examine what a more appropriate long-term incentive would be.

Q What was --

A That docket never happened.

Q I apologize for interrupting. What was the amount of that incentive, or what was the ceiling placed on that incentive in the docket?

A I believe it was $16 million.

Q Did TECO ever reach that ceiling?

A No.

Q Mr. Ramil, are you familiar with the Commission's former oil backout rule?

A Somewhat.

Q Would you like a copy of that rule?

A Sure. (Laughter)

Q This may be subject to review of the document, but I'll ask the question to keep the proceedings moving.

Would you agree that the oil backout rule was designed as an incentive to encourage utilities to convert their oil burning generators to alternative fuels?

A Yes, I think so.

Q Do you agree that according to the oil backout rule TECO was allowed to recover from its ratepayers the greater of imprudently incurred costs or two-thirds of actually experienced fuel savings?

A I don't remember all the details, but I know that a mechanism was in place related to fuel savings.

Q Perhaps you don't recall, but I'll ask this anyway and just tell me if you don't. When two-thirds of the actually experienced fuel savings exceeded prudently incurred costs, didn't the oil backout clause require that the difference be used for accelerated depreciation to shorten the recovery period?

A I don't recall all the details.

Q That's fine.

CHAIRMAN JOHNSON: Did you want this identified?

MS. PAUGH: Yes. We'd like that identified at Staff's Exhibit 1.

CHAIRMAN JOHNSON: We'll identify it as Exhibit No. 5.

MS. PAUGH: I'm sorry.

CHAIRMAN JOHNSON: That's okay. And short title "Copy of Rule 25-17.016."

(Exhibit 5 marked for identification.)

MS. PAUGH: That works.

Q (By Ms. Paugh) Mr. Ramil, did any of the fuel savings get credited to operating revenues as you propose to treat transmission revenues, O&M revenues and 50% of the remaining nonfuel revenues in this case?

A From oil backout?

Q Yes.

A I don't know.

Q Will giving the stockholders 50% of nonfuel revenues reduce regulatory assets?

A Whose proposal is it to give 50% to stockholders?

Q Will your present proposal reduce regulatory assets?

A I don't think so.

Q What plans does TECO have to reduce potentially stranded assets?

A We don't believe we have stranded asset.

Q Are you familiar with the generating performance incentive factor?

A Somewhat.

Q Do you know if there is a limit to the amount of incentive that a company can receive under the GPIF?

A I don't know.

Q Do you know if a company can be penalized under the GPIF?

A Yes.

Q Do you know what amount that is?

A No.

Q Does TECO face any penalty under its current proposal?

A The -- TECO's current proposal aligns the benefit for ratepayers with the company's benefit for shareholders. And to the extent that there's upside or downside, that is shared by both. The customers are getting an immediate benefit through the dollars we have proposed to flow back through the clause, and then the rest of the dollars are recorded above the line as operating revenues inuring to the long-term benefits of ratepayers under the stipulation in deferring future revenue requirements and deferring future rate cases, as is the case with all the other operating revenues in all the other options we have for increasing operating revenues.

Q All right. I have just one more question on your prior testimony.

COMMISSIONER GARCIA: Let me ask before you move on to that.

MS. PAUGH: Sorry.

COMMISSIONER GARCIA: What's the downside for the ratepayers?

WITNESS RAMIL: The downside for the ratepayers? I don't think there is any downside for the ratepayers.

Q **(By Ms. Paugh)** Was it your testimony -- I believe in your summary -- that sunk capital costs should not be considered?

A For what?

Q When you're deciding whether to separate or not separate, I presume, since that's the purpose of this proceeding.

A No, that wasn't my testimony.

Q Oh, I must have written it down incorrectly.

MS. PAUGH: I have no further cross at this point.

CHAIRMAN JOHNSON: Commissioners.

COMMISSIONER DEASON: I have just a few questions. Mr. Ramil, as I understand your testimony, TECO was faced with the opportunity or the question of entering into these contracts or simply to continue marketing on the broker; is that correct?

WITNESS RAMIL: That's correct.

COMMISSIONER DEASON: Now, I understand -- and you also testified that TECO felt that the margins were greater with the contracts and that was one of the considerations of entering into these contracts; is that also correct?

WITNESS RAMIL: That's correct.

COMMISSIONER DEASON: I understand the difference in the margins. Why did TECO choose to enter into these contracts and have all the revenue accrue to the benefit of customers, that being booked above the line, as opposed to continuing with the broker when 20% is guaranteed to go directly to stockholders?

WITNESS RAMIL: Because we think that there's more net benefit under this contract and it's the right business decision to make. We also feel that we want to do two things. And those two things are not necessarily in conflict. We want to keep our retail rates as low as possible to our customers, and we want a fair shot at earning our allowed return. And we saw more benefits to making this sale than to leaving the power on the broker. So that satisfies the better deal side of it.

And we fashioned this proposal, which I think aligns the ratepayer interest and the company shareholder interest together. Let's keep rates as low as we can from where they are now to retail customers and keep the chances as high as we can that we'll be allowed to earn our allowed return.

COMMISSIONER DEASON: Now, in formulating your proposal, all of the revenue in some form is either booked above the line or is flowed through a clause; is that correct?

WITNESS RAMIL: That's correct.

COMMISSIONER DEASON: Okay. Did you consider whether any of those revenues as incremental revenues should be utilized in the form of some type of accelerated depreciation, as opposed to simply including it as revenue above the line?

WITNESS RAMIL: No, we -- I don't recall us considering that.

COMMISSIONER DEASON: Well, in response to a question from Staff, you indicated that it's TECO's position that you do not have any stranded investment or potential for stranded investment?

WITNESS RAMIL: Yes.

COMMISSIONER DEASON: So it's your position then there's no need for any type of accelerated depreciation for generating assets?

WITNESS RAMIL: I don't believe so at this point. I think that one of the things to consider is that with our proposal -- you know, these are very important numbers, but if we look at this, helping to contribute to a larger deferred revenue pot, maybe there's something that could be done with those dollars, I don't know.

COMMISSIONER DEASON: The deferred revenue under the stipulation?

WITNESS RAMIL: Correct.

COMMISSIONER DEASON: That's all.

CHAIRMAN JOHNSON: Any other questions?

COMMISSIONER CLARK: I have a question. Mr. Ramil, when do these contracts end again?

WITNESS RAMIL: The FMPA contract ends in 2001 with some issues with respect to pricing that could have it end at the end of 1999.

COMMISSIONER CLARK: And what is the Lakeland?

WITNESS RAMIL: Lakeland goes through 2006, but that also includes that from 2001 on, every year, Tampa Electric can take a look at it and maybe not continue the contract; we have that option.

COMMISSIONER CLARK: Okay. On what basis can you exercise that option?

WITNESS RAMIL: Look at our costs and see if it's no longer something that we want to keep doing with respect to Lakeland.

COMMISSIONER CLARK: Costs only?

WITNESS RAMIL: Costs only. Because what -- if I could explain a little bit. As we view the market going forward, we've identified another need for capacity, we look around the state. And as we have made these type of sales, which are opportunity-type sales, we don't particularly want to go beyond 2001 or so with this type of sale because somewhere we think a little bit beyond that, capacity is going to get tighter in the state and the market will shift. So we want to make sure that when that happens, if we do have resources to sell, we are getting the market prices which hopefully will be higher, and we won't be sitting here having this issue.

So Lakeland -- I'm sorry, FMPA, because it's a baseload sale and it's around the clock, we don't want to go beyond that with this type of sale and maybe when those margins on the broker turn around, we'd rather go on the broker.

Lakeland is a peaking sale. And as we have looked at, at our incremental costs with respect to that sale, we have set ourselves a higher cost benefit ratio. The cost benefit ratio of the Lakeland sale is almost 3, it's very strong. But there is more risk in projecting the incremental cost or the peaking sale. So we negotiated in that look in 2001 to make sure this still makes sense to us.

COMMISSIONER CLARK: What are the statewide margin of reserves for the '98 through 2006?

WITNESS RAMIL: Statewide?

COMMISSIONER CLARK: Well, let me back it up. What were the margins of reserve you were looking at for those years?

WITNESS RAMIL: They kind of range in the mid teens. They stay pretty steady because -- but that's because people have plans to add new capacity after about 2003. And that's where -- when you start getting into the incremental cost of new capacity, you may start to see that market swing. The FMPA is short of that. The Lakeland, we have the look in 2001 to help us.

COMMISSIONER CLARK: Well, then let me ask you. Do you know what the statewide margin of reserve is currently projected to be for '98, '99, 2000 and 2001?

WITNESS RAMIL: Statewide? No, I don't. My recollection is that it's probably in the mid teens.

COMMISSIONER CLARK: Do we have a rule on what the margin of reserve should be statewide?

WITNESS RAMIL: I think each utility has its own criteria that has been examined in need cases. You have a 15% standard that is used for qualifying for interchange purposes, but I think the Commission made it very clear that that wasn't a standard for reliability to add new capacity.

COMMISSIONER CLARK: But would you say the statewide margin or reserve for the years '98, '99, 2000 and 2001 is around 15?

WITNESS RAMIL: I think so.

COMMISSIONER CLARK: Okay.

CHAIRMAN JOHNSON: Any other questions, Commissioners? Redirect.

COMMISSIONER CLARK: Let me ask one more. Why is it you concluded that the buyer's market will remain for the length of these contracts?

WITNESS RAMIL: The real need for capacity is -- we think is going to be realized by the entire market. Probably a couple of years after the end of the FMPA contract, maybe one year afterwards. So we think it's going to go on for a while.

COMMISSIONER CLARK: Can you explain to me why you believe that? What are the factors you looked at to make that determination?

WITNESS RAMIL: Mainly, when people are starting to add new capacity and all of the existing capacity in the state becomes firmed up, we're starting to see several people come out with requests for proposals for capacity in the 2002 through 2008 time period. Those things tell us that in that period of time people are becoming concerned if there's going to be enough capacity at that point in time.

And we can't tell you exactly what it is, but that's the best indicator that we see right now.

COMMISSIONER CLARK: Is it fair to say that whether or not this is a good deal for the customers depends on you being right that it is in fact -- it will, in fact, remain a buyer's market for the length of the contract?

WITNESS RAMIL: I think that is a part of it. What we have tried to do with our original proposal and what we have done with the suggestion I made this morning for the Commission to consider is to do two things; one is in our basic proposal, with respect to the clauses and keeping those whole as a result of these sales, no impact to the customers.

And, by the way, when we analyze these sales looking forward, included in the cost benefit analysis for the customers we included the lost broker sales, 80%, in that, so we've considered that, and the analysis is conservative from that standpoint. We've got no downside to the customers. What we added this morning was an addition to no downside, a guaranteed $2 million benefit. And we feel that our estimates are good. It's based on good sound data.

As far as the utility projecting, going to about the year 2001, it is not that far away. And what we're doing, we feel confident to the standpoint that of the 10 million in benefits we see in total, we'll guarantee 2 million of them.

COMMISSIONER CLARK: What was the amount of lost broker sales you concluded would likely be lost?

WITNESS RAMIL: I don't know. Perhaps Ms. Branick has that.

COMMISSIONER CLARK: Okay. Thank you.

COMMISSIONER DEASON: When you said there's no downside risk, that's making the assumption that the lost broker sales revenue are less than the benefits derived from your contract sales.

WITNESS RAMIL: In these benefits that we calculated that Ms. Branick and I are testifying too, included in the incremental cost of making the sale we included the 80% that would have gone to the customers through the broker, but will not because the resources are being tied up on this sale. So that's been captured. To the extent --

COMMISSIONER DEASON: So the 9.9 million is net of that?

WITNESS RAMIL: Net of that. To the extent that we were high in our broker margin projections, the benefits will be more; to the extent that we were low in our broker margins, the benefits will be less.

MR. WILLIS: No redirect.

CHAIRMAN JOHNSON: I'm sorry?

MR. WILLIS: No redirect.

CHAIRMAN JOHNSON: Exhibits.

(Witness Ramil excused.)

- - - - -

MR. McWHIRTER: FIPUG offers Exhibits 2 through 4. One is already into evidence.

CHAIRMAN JOHNSON: We'll admit 2, 3, and 4 without objection.

(Exhibits 2, 3 and 4 were received in evidence.)

MS. PAUGH: Staff offers Exhibit 5.

CHAIRMAN JOHNSON: Exhibit 5 will be admitted without objection.

(Exhibit 5 received in evidence.)

MR. WILLIS: Chairman Johnson, in the Prehearing Order it was agreed that Mr. Pollock would testify at such a time as necessary to assure that his testimony is concluded by 5:00. I believe that we ought to take Mr. Pollock now.

MS. KAUFMAN: FIPUG has no objection.

CHAIRMAN JOHNSON: Very well, I think that will be fine. Mr. Pollock.

We'll take a 10-minute break.

(Brief recess.)

- - - - -

CHAIRMAN JOHNSON: We're going to go back on the record. We had a couple of issues, the preliminary issue on the Staff's Motion to Compel. I did have an opportunity to review Staff's motion and also the comments and the initial filing of TECO and the notes from your argument today. I'm going to grant the Motion to Compel. I know that you raise as a procedural matter that you didn't think that this was appropriate, but I can't see any procedural rules that Staff violated. You did have the opportunity today to respond to that. Your response was similar to that which you made earlier, and I believe that was quite adequate as it relates to the issue of relevance.

It appears to me in looking at both the written arguments and listening to the oral debate that has occurred, that TECO refers to the incentives to encourage it to make the wholesale sales and that is an issue that has been raised by TECO. I understand your arguments as it relates to -- that we've now using a market based pricing methodology and that we shouldn't be looking at cost based pricing methodologies, but I don't think that's what Staff is doing through their questioning or how their questioning has been framed. The price that TECO is paying for the coal and transport isn't at issue and that isn't where the question or the interrogatory is directed. But the interrogatory goes to the benefit and the incentive analysis for the shareholders and for the customers, whether there's a need for an incentive and if there are other benefits. I believe that in the context of this proceeding that it is indeed relevant, and it will be useful to the Commission in its analysis of this particular issue.

So with that, you wanted it as a late?

MS. PAUGH: Chairman Johnson, yes, please. Staff would request that that be filed as a late-filed exhibit and part of the record of these proceedings.

CHAIRMAN JOHNSON: I'm sorry?

MS. PAUGH: And part of the record, made part of the record of these proceedings.

CHAIRMAN JOHNSON: Well, then, let's go ahead at this point in time and identify it as -- give me a -- it will be No. 6, but a short title will be TECO's response to Interrogatory -- was it No. 5?

MS. PAUGH: No. 5.

CHAIRMAN JOHNSON: No. 5, and will be marked as a late-filed.

(Late-Filed Exhibit 6 identified.)

MR. WILLIS: Commissioner, we will, of course, comply with your order, but we will request that that exhibit be treated as confidential. And we'll comply with your rules with respect to that.

CHAIRMAN JOHNSON: Thank you. And I think maybe at one of the breaks you can have an opportunity -- I know also in your motion you stated that it might be burdensome and may take you a while to compile that information, if you could then discuss that with Staff and we can talk about how soon you would be able to get that to the Commission.

I think then we are ready for our next witness.

MS. KAUFMAN: FIPUG would call Mr. Jeffry Pollock.

- - - - -

JEFFRY POLLOCK

was called as a witness on behalf of the Florida Industrial Power Users Group and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MS. KAUFMAN:

Q Mr. Pollock, have been sworn?

A Yes, I have.

Q Would you state your name and business address for the record, please?

A Jeffry Pollock. My business address is Post Office Box 412000, St. Louis, Missouri.

Q On whose behalf are you appearing in these proceedings?

A I'm appearing on behalf of the Florida Industrial Power Users Group or FIPUG.

Q Mr. Pollock, did you file 16 pages of prefiled direct testimony in Appendix A in this docket?

A Yes.

Q And do you have any changes or corrections to that originally prefiled testimony?

A Yes, I do.

Q Would you give us those, please?

A Yes. The first is on Page 2 of the testimony. Line 16, strike the number "78%" and replace it with "80%." Line 17, strike "22%" and insert "20%."

The next set of changes is on Page 5. Line 23, strike "22%" and replace it with "20%." Also strike the number "2.2" and replace it with "2.0." Finally, on Line 25, insert another "0" to the right of the decimal point, so that should read "$0.000014."

Consistent with these changes which, by the way, were prompted by a revision in the cost benefit analysis that Tampa Electric had made, I have some further changes. Page 6 of the testimony, Line 1, again strike "78%" and replace with "80%."

Q Mr. Pollock, let me interrupt you. Your revisions to Pages 6 through 8, those are been made and provided to the parties; is that correct?

A Yes, they have.

MS. KAUFMAN: So that might cut that short. I do have some additional copies if the Commissioners do not have it. Okay.

Q **(By Ms. Kaufman)** Did you also have a change on Page 15?

A Yes. Page 15, Line 10, strike the word "further" and replace it with the word "alternatively."

CHAIRMAN JOHNSON: What was that one?

Q **(By Ms. Kaufman)** Could you repeat that, please, on Page 15?

A Yes. Strike -- on Line 10 of Page 15, strike the word "further" and replace it with the word "alternatively."

Q And finally, Mr. Pollock, did you have two changes on revised Page 6?

A Yes. On Line 13 in the question, strike "22%" and replace it with "20%." And on Line 22, revise the number which currently reads "70.5 million" to "71.5 million."

Q Now with those changes and your revised pages, if I asked you the questions in your prefiled testimony today, would your answers be the same?

A Yes.

MS. KAUFMAN: I'd ask that Mr. Pollock's prefiled direct testimony and his revised pages be inserted in the record as though read.

CHAIRMAN JOHNSON: It will be inserted as though read.

Q **(By Ms. Kaufman)** Mr. Pollock, did you also have an exhibit attached to your testimony consisting of two documents?

A Yes, I do.

Q And did you file a revised Document No. 1?

A Yes.

Q (By Ms. Kaufman) Chairman Johnson, if we could have an exhibit number for those two documents?

CHAIRMAN JOHNSON: Do you want them identified as a composite exhibit?

MS. KAUFMAN: That will be fine.

CHAIRMAN JOHNSON: Exhibit No. 7 and it will be Jeffry Pollock's composite exhibit.

(Composite Exhibit 7 marked for identification.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

JEFFRY POLLOCK

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A My name is Jeffry Pollock. My business address is 1215 Fern Ridge Parkway, Suite 208; St. Louis, Missouri 63141-2000.

Q **WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

A I am an energy and regulatory consultant and a principal in the firm of Brubaker & Associates, Inc. (BAI).

Q **PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A I have a Bachelor of Science Degree in Electrical Engineering and a Masters in Business Administration from Washington University. Since graduation in 1975, I have been engaged in a variety of consulting assignments including energy and regulatory matters in both the United States and several Canadian provinces. More details are provided in Appendix A to this testimony.

Q **ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?**

A I am appearing on behalf of the Florida Industrial Power Users Group (FIPUG). FIPUG members are customers of Tampa Electric Company (TECo). They purchase substantial quantities of electric power and energy under various firm and interruptible tariffs.

Q **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A I shall assess TECo's proposed retail regulatory treatment of its new wholesale sales to the Florida Municipal Power Agency (FMPA) and the City of Lakeland (Lakeland). I have also conducted a limited review of TECo's cost/benefit analysis, even though I firmly believe that such an analysis is irrelevant in determining the appropriate regulatory treatment of the new wholesale sales.

Q **HAVE YOU PREPARED ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY IN THIS PROCEEDING?**

A Yes. I am sponsoring one exhibit consisting of two documents, a copy of which is appended to this testimony. These exhibits were prepared either by me or under my supervision and direction.

Summary and Recommendations

Q **SHOULD TECO'S PROPOSED RETAIL REGULATORY TREATMENT OF THE NEW WHOLESALE SALES BE ADOPTED?**

A No. TECo has not provided any assurances that retail customers will realize benefits that outweigh the costs associated with the new wholesale sales. Under its proposed regulatory treatment, TECo would retain ~~78%~~ 80% of the net benefits, while retail customers would retain only ~~22%~~ 20%. These minimal benefits could easily be offset by higher fuel costs because the dedication of coal-fired capacity to the wholesale market will make it unavailable to retail customers for an extended period. In other words, TECo may have to rely on more expensive resources to meet retail customers' needs.

However, even assuming that the projected benefits to retail customers were to outweigh the costs, the base portions of the transactions should be treated as separated sales for both the adjustment clause calculations and earnings monitoring reports. As discussed in more detail later:

- Retail customers are paying 100% of the embedded costs of the system resources (generation and transmission) being used to support the FMPA and Lakeland sales. Fairness demands that they also receive the benefits derived from the further use of these resources.

- Separation will prevent cost shifting, ensure that competitive wholesale sales are not being subsidized by regulated retail sales and create a more level competitive playing field. A regulated utility should not be permitted to gain a competitive advantage over other wholesale entities which do not have the luxury of using their "captive" customers to subsidize discounted wholesale rates while providing adequate returns to their shareholders.

Finally, as the electric industry becomes increasingly more competitive (both at the wholesale and at the retail level), this Commission should prevent attempts by regulated electric utilities to use their market power to thwart competition. This can be achieved only by requiring utility investors to bear the revenue shortfall between fully allocated embedded costs and the revenues derived from competitive sales.

<u>The Nature of the New Wholesale Sales</u>

Q IS THERE ANY DISPUTE THAT THE FMPA AND LAKELAND TRANSACTIONS QUALIFY AS "SEPARATED SALES" AS THE TERM HAS BEEN PREVIOUSLY DEFINED BY THIS COMMISSION?

A No. Both of the new wholesale sales are long-term (with a duration greater than one year); and according to the Interchange Contracts between TECo and FMPA and TECo and Lakeland, TECo is committing system resources to support these customers' base capacity and energy requirements. For example, under the FMPA agreement:

> Contracted capacity and contracted energy shall be served from all or any combination of the four (4) generating units that comprise the generating resources as long as sufficient capacity and energy is available from those resources that is not subject to existing prior commitments of Big Bend Station and Francis J. Gannon Station coal-fired resources that include the generating resource(s). [TECo Exhibit No. ____ (KAB-1), Document No. 2, Page 5]

Exhibit A of the FMPA agreement identifies the four generating units as including Big Bend Unit Nos. 2 and 3 and Gannon Units 5 and 6.

Supplemental capacity and associated energy will be provided to FMPA and Lakeland on an as-available basis. This portion of the new wholesale sales can be categorized as non-separated sales.

TECo is using its transmission system to deliver the contracted power and energy requirements under both the FMPA and Lakeland agreements. TECo is charging FMPA and Lakeland for the transmission and ancillary services but not sharing the revenue with retail ratepayers.

Q WHAT IS THE COMMISSION'S POLICY REGARDING SEPARATED WHOLESALE SALES?

A The Commission's policy was articulated in Docket No. 970001-EI, Order No. PSC-97-0262-FOF-EI, issued on March 11, 1997. The Commission found that:

> . . . as a generic policy, there shall be uniform cost allocation between the wholesale and retail markets for all prospective separable sales. Thus, we shall impute revenues in the fuel adjustment clause in the event the actual fuel revenues a utility receives from a separable sale are less than average system fuel costs. A utility's shareholders will, in effect, be required to pay for any shortfall associated with fuel revenues if the actual fuel revenues the utility collects are less than the average system fuel costs we impute. Imputation of fuel revenues will protect the retail ratepayer from automatic increases in fuel cost responsibility.

***

> This process protects the retail market from subsidizing the competitive wholesale market.

Id. at 3.

Q WILL THE COMMISSION ALSO CONSIDER ALTERNATIVE REGULATORY TREATMENTS OF NEW WHOLESALE SALES ON A CASE-BY-CASE BASIS?

A Yes. In the aforementioned order, the Commission indicated that, as an exception to the general rule, it would allow a utility to demonstrate ". . . on a case-by-case basis, that each new sale does, in fact, provide overall benefits to the retail ratepayers. (Id. at 4, emphasis supplied). However, it is clear that the utility has the burden to prove that the actual benefits of new wholesale sales would clearly outweigh the costs from the retail customers' perspective.

Cost/Benefit Analysis

Q HAS TECO SUBMITTED A COST/BENEFIT ANALYSIS IN THIS PROCEEDING?

A Yes. This analysis purportedly shows that retail customers would benefit from the new wholesale sales. Therefore, TECo is requesting a variance from this Commission's general practice of treating new long-term firm wholesale sales as separated for adjustment clause and regulatory monitoring purposes.

Q HAS TECO CONCLUSIVELY DEMONSTRATED THAT THE BENEFITS TO ITS RETAIL CUSTOMERS FROM THESE NEW WHOLESALE SALES WILL MORE THAN OUTWEIGH THE ASSOCIATED COSTS?

A No. First, based on TECo's own projections, retail customers would receive only 20% ~~22%~~ of the net benefits derived from the new wholesale sales or about 2.0 ~~$2.2~~ million net present value (NPV) over the duration of the agreements. This would translate into a benefit of only $0.00014 per kWh sold to retail customers. The customers' share of the projected benefits is small compared to the 80% that TECo's shareholders would retain. This sharing mechanism is virtually the opposite of the Commission's longstanding 20/80 sharing of margins from broker sales between the utility and its retail customers, respectively.

Second, and perhaps more importantly, whether any benefits will materialize at all will depend critically on the level of incremental fuel cost associated with the new wholesale sales. As the Commission is well aware, any forecast that depends on projections of fuel costs is speculative at best. It would not be good public policy to approve a proposed retail regulatory treatment for wholesale sales that relies so heavily on projected fuel costs that are subject to extreme fluctuation.

Q **HOW DID YOU DETERMINE THAT RETAIL CUSTOMERS WOULD RECEIVE ONLY ~~22%~~ 20% OF THE NET BENEFITS FROM THE NEW WHOLESALE SALES?**

A The analysis is provided in Exhibit Comp 1 (JP-1), Document No. 1. All of the information presented in this exhibit was derived from TECo Exhibit ____ (KAB-1), Document Nos. 4, 5, 6 and 7. The amounts shown in Document No. 1 are stated on a net present value (NPV) basis.

The starting point for TECo's cost/benefit analysis is the assumption that the new wholesale sales will generate $81.4 million (NPV) of incremental revenues. TECo then proposes to determine the incremental cost of fuel, the cost of additional SO2 allowances consumed, and the variable O&M expense associated with these sales. These incremental costs total about $~~70.5~~ 71.5 million (NPV). Fuel would comprise $65.9 million (NPV), or 93%, of the incremental costs of the new wholesale sales. In addition, because TECo is projecting to add peaking capacity during the duration of the Lakeland agreement, TECo has estimated the incremental cost of these capacity additions to be $0.8 million (NPV).

The total incremental cost of the new wholesale sales is projected by TECo to be $71.5 million (NPV). Thus, TECo would derive $9.9 million (NPV) of net benefits. Stated differently, the new wholesale sales would provide a contribution to fixed costs of $9.9 million (NPV), according to TECo's projections.

Q **WHAT PORTION OF THE $9.9 MILLION OF NET BENEFITS IS TECO PROPOSING TO RETAIN FOR ITS SHAREHOLDERS?**

A TECo is proposing to retain 100% of the transmission revenue ($5.9 million NPV) and 50% of the net non-fuel revenue ($2.0 million NPV). Thus, TECo would retain $7.9 million, or 80% of the $9.9 million of net benefits derived from the new wholesale sales. This inequity is exacerbated by the fact that prior to the wholesale transaction, TECo's holding company, TECo Energy, will derive a profit from the transaction from its coal company, its coal transportation company and its non-regulated generating company. None of these profits will be shared with retail customers.

Q **HOW WOULD RETAIL CUSTOMERS BE AFFECTED IF TECO'S PROJECTIONS OF INCREMENTAL REVENUES AND ASSOCIATED INCREMENTAL FUEL COSTS WERE TOO OPTIMISTIC?**

A The benefits to retail customers could very well disappear if TECo's 10-year forecast projection of profitability either overstates the incremental revenues or understates the corresponding incremental fuel costs associated with the new wholesale sales. As can be seen in Document No. 1, retail customers would receive $2.0 million (NPV) in net benefits based on TECo's projections. These benefits are only 2.5% of the projected incremental revenues and only 3.0% of the projected incremental fuel costs. In other words, if either the projected incremental revenues are overstated by 4.9% and/or the incremental fuel costs are understated by 6.1%, the net benefits to retail customers would disappear.

Q **HAVE YOU HAD AN OPPORTUNITY TO EXAMINE EITHER THE REASONABLENESS OR THE SENSITIVITY OF TECO'S PROJECTIONS OF INCREMENTAL REVENUES AND FUEL COSTS ASSOCIATED WITH THE NEW WHOLESALE SALES?**

A No. I am awaiting receipt of discovery responses to determine the reasonableness and sensitivity of the projected annual costs and benefits, how these sales are being modeled and which resources would operate on the margin.

Q **WOULD A MORE IN-DEPTH ANALYSIS CHANGE YOUR RECOMMENDATIONS IN THIS PROCEEDING?**

A No. First, TECo has the burden of proof to demonstrate that retail customers will gain a real benefit from the new wholesale sales. It has failed to do so. TECo should have provided the Commission with a sensitivity analysis to determine the likelihood that benefits will materialize in each year that the new wholesale agreements are in effect.

Second, even if the sensitivity studies were to demonstrate that retail customers are likely to benefit, TECo has not provided any guarantee that retail customers will save money. Given the speculative nature of any long-term forecast, the Commission should not assume, absent a guarantee from the utility that retail customers will ever see lower rates during the duration of the new wholesale agreements.

In summary, the Commission's policy on the regulatory treatment of separated wholesale sales should not be abandoned based on the results of a highly speculative cost-benefit analysis like the one submitted by TECo in this proceeding.

Regulatory Treatment

Q TECO HAS CHARACTERIZED ITS PROPOSED REGULATORY TREATMENT AS A 50/50 SHARING OF THE REMAINING SALES PROCEEDS BETWEEN TECO AND RETAIL CUSTOMERS, YET YOU HAVE CHARACTERIZED TECO'S PROPOSAL AS A 78/22 SHARING. HOW DO YOU RECONCILE THE TWO POSITIONS?

A TECo is assuming that it is entitled to retain all of the revenues associated with the cost of providing transmission and ancillary services to FMPA and Lakeland. In other words, TECo has characterized these transmission revenues as a cost which it is proposing to charge itself in accordance with its FERC Open Access Tariff.

Q IS IT APPROPRIATE TO CHARACTERIZE THE TRANSMISSION PORTION OF THE REVENUES DERIVED UNDER THE NEW WHOLESALE AGREEMENTS AS A COST INCURRED BY TECO?

A No. To my knowledge, TECo is not incurring any additional generation or transmission investment to provide service to FMPA and Lakeland. In other words, the new wholesale sales represent an incremental use of TECo's transmission system (and generation resources in the case of ancillary services).

The revenues derived from this incremental use of the transmission system, thus, can be used to defray fixed costs. Finally, because the FMPA and Lakeland agreements were consummated subsequent to TECo's last base rate case, none of the transmission-related and ancillary costs now being caused by these customers have been allocated either directly to these customers or to TECo.

For all of the above reasons, it would not be appropriate to characterize the transmission charges as additional costs incurred by TECo when these incremental revenues are clearly available to defray TECo's existing transmission and ancillary service costs. Consequently, the transmission revenues should be treated as net benefits derived from the new wholesale sales.

Q WAS THE ENVIRONMENT IN WHICH TECO NEGOTIATED THE NEW WHOLESALE SALES DIFFERENT FROM ITS NEGOTIATIONS WITH OTHER WHOLESALE CUSTOMERS?

A No. The wholesale market has been competitive for some time now. A good example of the competition TECo has faced occurred in 1991, when TECo participated in a competitive solicitation process for the opportunity to serve the cities of Fort Meade and Wauchula. TECo was ultimately successful in capturing these sales from Florida Power Corporation, and it has been increasing its market share ever since.

Q IS TECO'S PROPOSAL TO SHARE THE BENEFITS DERIVED FROM THE NEW WHOLESALE SALES APPROPRIATE?

A No. The sharing of the benefits associated with long-term firm (i.e., separated) wholesale sales is inappropriate because retail customers are supporting *100%* of the cost of system capacity resources (both generation and transmission) in their base rates and through the various adjustment clauses. The capacity costs associated with TECo's purchases from the Hardee Power Partners, which is owned by a TECo affiliate, TECo Power Services (TPS), are being fully recovered from retail customers in the Capacity Cost Recovery Factor.

Thus, retail customers are entitled to receive all of the benefits associated with the long-term use of the facilities for which they, and they alone, are paying. This means that any benefits derived from these sales should be used to reduce retail rates. To do otherwise would be tantamount to forcing retail customers to subsidize TECo's ventures in the more competitive wholesale market.

Q **IS THERE ANY ISSUE THAT THE NEW WHOLESALE SALES ARE BEING PRICED BELOW TECO'S AVERAGE EMBEDDED COST?**

A No. According to TECo's witness, Mr. John B. Ramil, the fully allocated embedded cost to serve the new wholesale sales will exceed the incremental non-fuel revenues derived from these sales (Testimony at page 11, beginning at Line 21). Thus, the wholesale sales are being priced below TECo's embedded cost.

Q **WHAT ARE THE IMPLICATIONS OF ALLOWING A REGULATED ELECTRIC UTILITY TO SELECTIVELY OFFER BELOW-COST DISCOUNTED RATES TO SOME CUSTOMERS WITHOUT PROVIDING ASSURANCES THAT ITS CAPTIVE CUSTOMERS WILL DERIVE BENEFITS?**

A TECo's proposed regulatory treatment would shift cost responsibility from competitive to regulated operations. That is, retail customers may experience adverse rate impacts as a result of the new wholesale sales. Such cost shifting will stifle competition because the utility, by virtue of forcing captive customers to underwrite its ventures in competitive wholesale markets, will gain an unwarranted competitive advantage over other market participants who do not have the luxury of using their captive customers to offer subsidized rates. Such an outcome, in my opinion, would be contrary to good public policy and to the goal of increasing competition in the electric utility industry.

Until retail customers can choose their generation supplier, regulation must remain a surrogate for competition. Thus, retail customers should pay only their fully allocated embedded cost of service and no more.

Q WOULD TREATING THE NEW WHOLESALE SALES AS SEPARATED SALES MINIMIZE SUCH COST SHIFTING BETWEEN COMPETITIVE AND REGULATED OPERATIONS?

A Yes, it would. However, in TECo's case, it would not completely solve the problem. This is illustrated in Document No. 2, which is a comparison between the retail fuel and purchased power costs, the cost of purchased power from the Hardee Power Partners and the fuel cost associated with Schedule D wholesale sales.

As can be seen, the retail fuel adjustment charges (Column 1) are consistently higher than the fuel costs derived from Schedule D sales (Column 3). This result may be primarily attributed to the fact that TECo is dedicating above-contract and spot market coal purchases primarily to its wholesale operations. It is also attributable, in part, to the fact that TECo is purchasing expensive electricity from its affiliate, TPS, and charging the full cost of these purchases to its captive retail customers. The energy portion of these purchases is shown in Column 2 of Document No. 2.

In other words, TECo is purchasing capacity and energy from its affiliate while, at the same time, it is selling system capacity and lower cost energy resources to its affiliate and to other wholesale market participants. This practice might be characterized as a further attempt to shift costs between competitive and regulated operations.

Q **IN A COMPETITIVE MARKET, COULD A SUPPLIER CHARGE DIFFERENT PRICES FOR THE SAME COMMODITY?**

A No. According to the testimony of TECo witness, Dr. Douglas R. Bohi, in a competitive market, ". . . it is not possible to charge different prices for the same commodity because of arbitrage." (Testimony at Page 11, Lines 12-14) On this point, I agree with Dr. Bohi.

Q **ARE YOU CONTESTING THE PRUDENCE OF TECO'S PURCHASED POWER AND SALES AGREEMENTS?**

A No. I am not suggesting that there is any impropriety in either TECo's purchased power or wholesale service agreements per se. What I am suggesting is that the Commission has an important role to play, as a surrogate for competition, to ensure that the dramatically different prices TECo is charging for retail and wholesale generation services is in the best interest of retail customers.

Q **DR. BOHI ASSERTS THAT IF THE INCREMENTAL COST OF WHOLESALE SALES ARE COVERED BY INCREMENTAL REVENUES, RETAIL CUSTOMERS WILL NOT BE SUBSIDIZING WHOLESALE SALES. HOW DO YOU RESPOND TO HIS ASSERTION?**

A Dr. Bohi's assertion is based on an erroneous assumption that a utility having low incremental operating costs is more efficient than a competing supplier that may have higher operating costs but lower total costs. This is reminiscent of the doctor who tells a patient that "you are in great shape for the shape you are in" when in fact the patient may be terminally ill.

Q IS IT APPROPRIATE TO MEASURE EFFICIENCY SOLELY BASED ON INCREMENTAL COST?

A No. A firm may have low incremental costs simply because it has invested capital to offset variable production costs in anticipation of operating at a sufficiently high load factor to earn an adequate return. This is not a measure of efficiency. It is the result of a strategic decision to employ operating leverage.

Electric utilities have chosen to invest (or over-invest as some analysts now contend) in capital because, in a regulated environment, all additions to rate base would produce a higher return for the utility's stockholders. Traditional cost of service regulation rewarded investment because revenue requirements are the sum of return on investment (i.e., profits) and operating expenses (i.e., revenues = profits + expenses). It is wrong to characterize a firm that was incentivized to invest as necessarily being more efficient than another firm that chose instead to minimize *overall* costs.

The regulatory equation is in stark contrast to conditions in a competitive market where profits equal revenues minus expenses. Because price is market determined, the most efficient supplier will have a strong incentive to minimize the *overall* cost of goods sold to maximize the opportunity for profit. No distinction will be made between fixed and variable costs, or between average and incremental costs, as suggested by Dr. Bohi, in determining efficiency.

Q HOW SHOULD THE COMMISSION PROTECT TECO'S RETAIL CUSTOMERS FROM UNWARRANTED COST SHIFTING?

A Any revenue shortfall between the embedded costs associated with the new wholesale sales and the revenues derived from these sales should be borne by TECo at least until such time as TECo is able to demonstrate that, based on actual data, retail customers will be "held harmless."

Therefore, I recommend that there be no sharing of margins from new separated wholesale sales, and that 100% of the non-fuel revenues should be returned to retail customers, including all transmission and ancillary service charges. ~~Further~~ ALTERNATIVELY, TECo should be ordered to perform a jurisdictional separation study in which embedded costs are appropriately allocated to all long-term separated wholesale sales. This jurisdictional separation study should be the basis for measuring the earnings derived from TECo's retail operations. To do otherwise would artificially depress earnings from retail operations and reduce the potential for future refunds under the earnings cap approved in Docket No. 960409-EI.

Q WOULD SUCH A POLICY DISCOURAGE UTILITIES FROM PARTICIPATING IN COMPETITIVE MARKETS?

A No. A prudently managed utility will use its best efforts to market surplus capacity and energy irrespective of whether it receives a specific monetary incentive for doing so. This is because maximizing off-system sales should enable a utility to minimize retail rates and, therefore, protect what many utilities are now realizing is their most valuable asset–their retail customers. Thus, a rate minimization strategy will be critical to the future success of incumbent electric utilities in a fully competitive retail customer choice environment.

Q **DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

A Yes, it does.

Q (By Ms. Kaufman) Mr. Pollock, do you have a summary of your testimony?

A Yes. Thank you and good afternoon, Commissioners. I'm testifying on behalf of FIPUG. Our primary recommendation in this proceeding, which addresses the regulatory treatment of two long term firm wholesale sales is that these sales and the costs be separated at least insofar as the base component. Alternatively, if these sales are not going to be separated, then it's our view that all of the nonfuel revenues, including transmission-related revenues derived from these sales, should be flowed back to retail customers in the form of a credit on their bills.

Our rationale for this position is as follows: First, there's no dispute that retail customers are fully paying the costs of the resources that are being committed to the FMPA and Lakeland sales. Fairness demands that any benefits derived from the use of these retail rate base facilities should flow back to the retail customers in the form of lower rates. And as I included, that's not only the generation component of the revenues, but also the transmission component.

TECO's proposal, basically, according to our analysis, would require that only 20% of the net margins, that is the residual, would be flowed into the ratepayers pocketbooks and that 80% will be retained as operating revenues. Our analysis of this is, is that anytime you retain something in operating revenues, it will simply trickle down eventually to the shareholders in the form of earnings, unless in this case it happened to cause TECO's earnings cap to be exceeded. In other words, their proposal is pay the shareholders first. We disagree with that proposal. We think it causes undue risk for the ratepayers, and the ratepayers should not be put at risk for the performance of these sales.

Until this morning the company had provided no guarantee that any benefits of these sales would flow through to retail customers. It really hinges on whether or not -- at least it did before this morning, on whether the projected revenues would exceed projected incremental costs. And, of course, the largest single element of the projected incremental cost is the cost of fuel. And anytime you make multiyear projections of the cost of fuel, you're inviting problems. Any material change, either in revenues or incremental fuel costs or combination thereof, could very easily eliminate the residual benefit, half of which could flow to retail customers.

The bottom line is that the ratepayers, not the shareholders, would have been completely at risk. Public policy in this instance, I think, demands -- and I think we all recognize that we are in a real extraordinary time period -- a transition to competitive markets in electricity. And given that extraordinary time period, we believe it's the Commission that has to take the kind of extraordinary measures to ensure that the retail ratepayers under its supervision are fully protected.

There's a tremendous temptation on the part of regulated utilities to shift costs from the competitive arm of the utility into the safe harbor of regulation. Because in the safe harbor of regulation, there is an opportunity, although some would say a guarantee, to recover all costs.

You can prevent cost shifting by making sure in this instance that incremental costs are being appropriately defined to ensure that if the company's proposal is implemented, that full incremental cost of fuel is properly calculated. That's something that I have not been able to explore in this case, but it needs to be challenged.

Secondly, I think you need to consider this case from the overall perspective of not where we are today, but how we got there. If a utility is allowed to overbuild and overinvest in capital and then turn around and sell the lowest cost resources to the wholesale market, this is going to leave the retail customers left holding the bag for the high capital costs or possibly even the high fuel costs of the remaining resources. That, too, is cost shifting.

FIPUG appreciates TECO's gesture this morning to guarantee $2 million on a net present value basis as a benefit that would be used to reduce retail adjustment clause revenues, but quite frankly, we view this as too little and too late. As a matter of principle and fairness and consistent with your responsibility, Commissioners, to protect the public interest, it's our view that the stockholders should bear any shortfall between fully allocated costs and the revenues derived from competitive sales. And further, our view is not limited just to the wholesale markets because, as you know, the retail markets are also becoming ever so more competitive. To implement this remedy and to be consistent with the treatment of other similar competitive sales, we request that you require the full separation. Thank you.

Q Does that conclude your summary,

Mr. Pollock?

A Yes.

MS. KAUFMAN: Mr. Pollock is available for cross examination.

MR. HOWE: I have no questions.

CHAIRMAN JOHNSON: TECO.

MR. HART: We have some questions, but since we are the only party that's adverse to this witness, we would like to conduct our cross examination after those in support of this position have completed their questioning.

CHAIRMAN JOHNSON: There's no one else left. Well, Staff?

MR. HART: Staff has taken a position the same as this witness's, and we'd like for them to put on their full case before we cross examine it.

CHAIRMAN JOHNSON: Staff, what's your response?

MS. PAUGH: Staff only has a couple of questions, we are happy to ask it now. It makes no difference to us.

CHAIRMAN JOHNSON: Well, if Staff doesn't object --

MS. PAUGH: We don't object to their going last.

MR. HART: Thank you.

CROSS EXAMINATION

BY MS. PAUGH:

Q Mr. Pollock, my primary question is very simple. In your opinion, does the treatment that Tampa Electric propose have an anticompetitive affect vis-a-vis other wholesale sellers of electricity? And I'm primarily referring to entities such as independent power producers.

A Yes, it's my view that anytime an electric utility that has captive customers can use those captive customers as a base to support earnings, while at the same time is offering discounted rates for competitive sales, has a competitive advantage over other entities, like independent power producers whose shareholders and shareholders alone are at risk for their success or failure.

MS. PAUGH: Thank you. That's all I had.

MR. HART: In view of the summary and the cross examination that's occurred, we have no questions.

CHAIRMAN JOHNSON: You said you have no -- your mike is off, but I think you said you have no questions?

MR. HART: I said in view of the summary and the cross examination that's occurred, we have no questions.

CHAIRMAN JOHNSON: Very well. Exhibits.

MS. KAUFMAN: FIPUG would move Exhibit 7.

CHAIRMAN JOHNSON: That will be admitted without objection. Mr. Pollock, you are excused.

(Exhibit 7 received in evidence.)

(Witness Pollock excused.)

- - - - -

WITNESS POLLOCK: Thank you much.

COMMISSIONER KIESLING: If we keep going like that, we may finish today.

CHAIRMAN JOHNSON: TECO, are we going back then to Douglas Bohi?

MR. WILLIS: Bohi.

CHAIRMAN JOHNSON: And we will be taking Mr. Bohi's direct and rebuttal?

MR. WILLIS: Yes.

MR. LONG: Yes, that's correct.

Chairman Johnson, may I proceed?

CHAIRMAN JOHNSON: Yes, sir. And the witness was sworn this morning, were you not?

WITNESS BOHI: Yes, I am.

DOUGLAS R. BOHI

was called as a witness on behalf of Tampa Electric Company and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LONG:

Q Are you the Douglas R. Bohi who has filed both direct and rebuttal testimony in this proceeding?

A Yes, I am.

Q Do you have any changes or corrections to make to any of your direct or rebuttal testimony?

A I have a few minor typographical errors that I could correct. I'm in my direct testimony on Page 17, Line 14, the word "lead" should be "load."

COMMISSIONER GARCIA: What page are we on?

WITNESS BOHI: Page 17, Line 14.

CHAIRMAN JOHNSON: The word "lead" should be what?

WITNESS BOHI: "Load." So it reads "retail load." In my rebuttal testimony on Page 5, Line 9, the word "that" should be deleted. Page 10, Line 1, the end of that line should read "included in."

COMMISSIONER GARCIA: Page 10, line?

WITNESS BOHI: 1. Page 13, Line 4, the word "utility" should be correctly spelled as I-T-Y.

COMMISSIONER GARCIA: What line on Page 13?

WITNESS BOHI: That is Line 4 on Page 13. And I believe that's it.

Q (By Mr. Long) Dr. Bohi, was this direct and rebuttal testimony prepared by you under your direction and supervision?

A Yes, it was.

Q If I were to ask you the questions that appear in this direct and rebuttal testimony today while you are under oath, would your responses be the same?

A Yes, they would.

MR. LONG: Chairman Johnson, I ask that Dr. Bohi's direct and rebuttal testimony be inserted in the record as though read.

CHAIRMAN JOHNSON: It will be so inserted.

Q (By Mr. Long) Dr. Bohi, with regard to your direct testimony, did you prepare an appendix which contains your experience and publications?

A Yes, I did.

MR. LONG: Chairman Johnson, I ask that the appendix to Dr. Bohi's direct testimony be marked for purposes of identification?

CHAIRMAN JOHNSON: It will be marked as Exhibit 8.

(Exhibit 8 marked for identification.)

BEFORE THE PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DOUGLAS R. BOHI

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Douglas R. Bohi. My business address is Charles River Associates Incorporated, 1001 Pennsylvania Avenue, N.W., Suite 750 North, Washington, D.C. 20004.

Q. By whom are you employed?

A. I am a Vice President of Charles River Associates Incorporated, an economics consulting firm with offices in Washington, Boston, and Palo Alto.

Q. Please describe your educational background and prior work experience.

A. I have been awarded a bachelor of science degree in economics from Idaho State University (1962) and a Ph.D. in economics from Washington State University (1967). Prior positions I have held since receiving my Ph.D. include: Economist in the Office of the Assistant Secretary of Defense for Systems Analysis; Economist for Caterpillar Tractor Company; Professor of Economics and Chairman of the Economics Department at Southern Illinois University; Senior Fellow and Director of the Energy and Natural Resources Division at Resources for the Future, Incorporated; and Chief Economist and Director of the Office of Economic Policy at the Federal Energy Regulatory Commission.

While at Resources for the Future, I concentrated on research that would help explain how energy markets, including electricity markets, behave and how various kinds of government regulation affect market efficiency. I have authored or co-authored eight books and numerous articles on various aspects of energy market behavior and energy policy issues. [My résumé is attached as Appendix 1.]

Q. Have you testified before the Florida Public Service Commission before?

A. No, I have not.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Tampa Electric.

II. **PURPOSE AND SUMMARY OF TESTIMONY.**

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe the basic economic principles that should be used in determining how the revenues and costs associated with the wholesale sales of power to Florida Municipal Power Agency (FMPA) and to the City of Lakeland (Lakeland) should be reflected in the retail jurisdiction. Based on these principles, both transactions are profitable in the sense that the additional revenues received will exceed the additional costs incurred to serve each of the two transactions. Thus, both sales yield net benefits. The Commission should encourage these types of sales and would, in fact, discourage them if the cost of these transactions were imputed at their average cost rather than their incremental cost.

Q. Please summarize your testimony.

A. My testimony uses traditional economic analysis to show that, to maximize economic efficiency for the firm and for society, firms should produce and offer for sale any increment of output where price (or, equivalently, average revenue) at least covers the incremental costs of production, even if the price is less than the average cost of production. Put another way, incremental wholesale sales are profitable as long as they make a contribution to fixed costs. This condition is satisfied by the sale of power to FMPA and Lakeland.

The wholesale market for power in Florida is highly competitive, implying that individual sellers such as Tampa Electric are unable to determine the market price and must be willing to sell at a price that the market will bear. In their assessment of whether each individual transaction is profitable, sellers will determine whether the price covers the incremental cost of production. Market efficiency is achieved if the seller with the lowest incremental cost is the one that makes the sale.

If the Commission requires the imputed cost of wholesale sales to be set at average cost rather than incremental cost, the correct efficiency condition will not be achieved. The firm with the lowest incremental cost for the same service may not be the one making the sale. Moreover, if the Commission applies an inappropriate standard for evaluating the benefits of wholesale sales to firms under its jurisdiction, a distortion will be created favoring firms outside the Commission's jurisdiction. In particular, independent power producers and power marketers who do not have retail customers will be able to sell according to their incremental costs of production. To the extent that their incremental costs are larger than those of jurisdictional firms, the wrong firms will be supplying the market.

When the market is operating less efficiently than it should, electricity prices are higher than they need to be. As a consequence, consumers will ultimately bear the cost of market inefficiency. Importantly, the retail customers of firms that are unable to make wholesale sales because of the imputation of average costs may be harmed as will the ultimate consumers of wholesale sales.

III. ECONOMIC PRINCIPLES.

Q. What types of costs will you be discussing in your testimony?

A. I will be discussing average costs, average variable costs, marginal costs, and incremental costs. Moreover, I will be discussing these costs within the context of a competitive wholesale market.

Q. Why in the context of a competitive wholesale market?

A. Because the transactions at issue are sales in the wholesale power market and, as demonstrated in the Prepared Direct Testimony of Tampa Electric Witness John B. Ramil, the wholesale power market in Florida is very competitive. In particular, this means that Tampa Electric is a pricetaker in the wholesale market, not a price setter. Tampa Electric must be willing to sell in the wholesale market at whatever price the market will bear.

Q. Define what you mean by average costs, average variable costs, marginal costs, and incremental costs.

A. Average cost refers to the cost per unit of producing a particular level of output. It is simply total costs of production divided by the quantity of output. Total costs include fixed costs, which are costs of production that do not vary with the level of output within the time frame under consideration, and variable costs are costs of production that vary with the level of output.

Average variable cost refers to the per unit variable costs of producing a particular level of output. It is simply total variable costs divided by the quantity of output.

Marginal cost refers to the change in total cost that results from an increase of one unit of production. It is equal to the change in total cost divided by the change in output. Since the change in output is one unit, it is simply the change in total cost. Note further that total cost will change only because of a change in variable costs (since fixed costs are fixed). Thus, marginal cost is also equal to the change in total variable costs.

Incremental cost is a term that is used in place of marginal cost when one wants to refer to a change in output larger than one unit. This occurs because the transactions under consideration usually involve more than a single unit of electricity. Incremental cost is calculated by the increase in total cost (or, equivalently, the increase in total variable cost) divided by the increase in quantity of output. Since the increase in total cost is divided by the change in output, the increase is averaged to obtain a per unit measure.

Q. The distinction between fixed costs and variable costs is important in defining these terms. Are some costs always fixed costs and others always variable costs?

A. No. What is a fixed cost or a variable cost depends on the time frame under consideration, and the variability of cost within that time frame. For example, capital costs are commonly called fixed costs, but within a very long time frame where expansion plans are being considered, these costs are variable. Similarly, fuel costs are commonly thought of as variable costs, since more fuel must be burned to increase output, but certain types of long-term contracts for fuel purchases may actually make some fuel costs fixed within the time frame set by the fuel contract.

Q. What time frame are you using for your testimony?

A. The time period of relevance for my testimony is determined by the length of time needed to complete the wholesale power transactions with FMPA and Lakeland. The FMPA transaction is for baseload capacity that grows from 35 MW starting December 16, 1996 to 150 MW by March 15, 2001. The Lakeland transaction is for 10 MW of peaking capacity that extends from November 4, 1996 through September, 30, 2006.

As indicated in the Prepared Direct Testimony of Tampa Electric Witness Karen Branick, the FMPA transaction does not require an increase in Tampa Electric's system capacity to satisfy the transaction, nor does the transaction force an expansion in Tampa Electric's system capacity to satisfy retail customers or any of Tampa Electric's other contractual obligations. In short, Tampa Electric's capacity requirements are the same whether the sale to FMPA is consummated or not. Thus, all capacity costs are fixed for the purpose of evaluating this transaction. Incremental costs are therefore measured by changes in fuel costs and variable O&M costs.

The Lakeland transaction involves 10 MW of peaking capacity that extends beyond Tampa Electric's next planned expansion. The testimony of Tampa Electric Witness Karen Branick indicates that there is uncertainty about whether additional peaking capacity is required to meet the Lakeland obligation. Consequently, incremental costs are calculated with and without a capacity charge, plus additional fuel costs and O&M costs.

Q. Based on these definitions, at what level of output should a firm produce?

A. The firm should continue to increase production as long as the price received for each increment of output covers the increase in cost required to produce that level of output, as long as price covers average variable costs of production.

Q. Please explain.

A. The firm should produce each increment of output that increases its profits or reduces its losses. Since the firm will incur its fixed costs of production no matter how much it decides to produce, the production decision is based on variable costs. The correct level of output can be determined by applying a simple rule to each increment of production under consideration. Each increment should be produced as long as the price received for that increment more than covers its incremental costs of production. As long as this rule holds, each additional sale contributes some amount to fixed costs and the firm is better off. In other words, if the firm is making profits before the sale, the sale will add to total profits; if the firm is making losses before the sale, the sale will reduce total losses.

Q. Do you mean that different transactions may be charged different prices because incremental costs change with the number of transactions?

A. Not necessarily. In a competitive market, all transactions of a similar nature and entered into at the same time would be charged the same price. This is best illustrated in the case of a wholesale spot market for electricity, where there may be several buyers of the same commodity at the same time. If incremental costs rise with the number of such transactions, the price charged for all of the transactions should cover the highest incremental cost incurred. Indeed, in a competitive spot market it is not possible to charge different prices for the same commodity because of "arbitrage." The customer receiving a lower price could resell to a customer that is charged a higher price, thus earning a profit, and reducing the market share of the original seller. Such arbitrage activities in competitive markets ensure that price discrepancies cannot persist for very long.

The same argument does not apply as easily in the case of contract sales, because contracts tend to specify unique commodities and because contracts tend to be negotiated at different points in time.

Q. Why would prices vary for different services or for the same services arranged at different times?

A. Different services may involve different costs, in which case they warrant different prices. One example is the spot sale of energy versus a contract sale of capacity. Another example is the difference between a contract sale of 10 MW of baseload power and a contract for 10 MW of peaking power. The latter example indicates why the pricing of baseload power for FMPA differs from the pricing of peaking load for Lakeland.

In the case where the same services are arranged at different times, prices may vary because costs of production change. For example, fuel prices can change over time so that the incremental cost of different transactions will change. Even if fuel prices do not change, the fuel costs of plants in the dispatch order required to serve peak loads will typically be higher than the fuel costs at off-peak times of day.

Q. What is the significance of average costs in this analysis?

A. The relationship between price and average cost is important for determining whether to produce at all, but it does not determine how much to produce. If the average revenue earned from all sales is below average cost, the firm is incurring losses and may eventually be forced to shut down. However, as long as the firm must pay its fixed costs and if its price is above the variable costs of production, it pays the firm to continue operating in order to pay for some of its fixed costs.

Thus, the relationship between price and average cost determines whether to produce, while the relationship between price and incremental cost determines how much to produce.

In a regulated context, the firm's average costs are covered by revenues from retail sales and the issue is whether to produce an additional amount for sale into the wholesale market. If incremental costs of wholesale sales are covered by incremental revenues, retail customers will not be subsidizing wholesale sales.

Q. Would a requirement that all utilities price their wholesale sales at average costs, rather than incremental costs, have negative implications for the efficiency of the electric industry in the state of Florida?

A. Yes. As I have explained, firms should determine how much they produce according to their incremental costs, not their average costs. If decisions about which firm supplies the wholesale market are determined by average costs rather than incremental costs, it is possible that the firm with higher costs would be supplying the market, and that the wholesale price of electricity would be higher than necessary. Excessive prices in the wholesale market ultimately mean that retail prices will be excessive as well. The negative effects of excessive electricity prices go beyond the reduction in welfare of consumers to include more general adverse implications for employment and productivity in the state of Florida.

For example, suppose that Firm A has lower average costs than Firm B, but higher incremental costs. If wholesale transactions are to be evaluated on the basis of relative average costs, Firm A would supply the market; if, however, incremental costs were compared, Firm B would supply the market. Such a comparison would be possible if Firm B's average costs include larger fixed costs than Firm A's average costs. But differences in fixed costs are irrelevant for determining which firm should supply the market since fixed costs will be incurred whether the sale is made or not. The comparison should be made on the basis of the incremental costs incurred and, on this basis, Firm B should supply the market. The profit (or contribution to fixed costs) resulting from the sale made by Firm B would be larger than the corresponding amount resulting from the sale made by Firm A.

If Firm A supplies the market rather than Firm B, the price of wholesale electricity in the state of Florida would be higher than necessary. The price of electricity paid by retail customers would also be higher than necessary. By choosing an inappropriate criterion for determining who can make the sale, therefore, the electric industry is forced to operate less efficiently than it otherwise could and consumers are forced to pay higher prices than are necessary.

Q. If some firms must impute their costs for wholesale sales at average costs, while other firms may use incremental costs, is there likely to be an uneconomic bias against those using average costs?

A. Yes. Suppose I.O.U.s in the state of Florida must evaluate decisions to sell in the wholesale market on the basis of average costs, while independent power producers and marketers are allowed to make the evaluation on the basis of incremental costs. As indicated in the example above, the incremental costs of the I.O.U.s may be relatively lower, while the average costs may be relatively higher, than the independent power producers and marketers. This can happen because the I.O.U.s have higher fixed costs, but fixed costs are irrelevant to the decision to make the wholesale sale. Thus, the I.O.U.s may be unable to compete in the wholesale market even though the I.O.U.'s incremental costs for the same service may be lower than competing incremental costs. Not only is market efficiency harmed, but the I.O.U.s are unfairly treated relative to other wholesale competitors.

IV. APPLICATION OF THE ECONOMIC PRINCIPLES TO TAMPA ELECTRIC'S SALES TO FMPA AND LAKELAND.

Q. What are the incremental costs that are incurred by the FMPA transaction?

A. The incremental costs of supplying the FMPA transaction are given in the Prepared Direct Testimony of Tampa Electric witness Karen Branick. Document 4 in Exhibit KAB-1 of Ms. Branick's testimony gives the cumulative present value of incremental costs and revenues over the five-year period in which the transaction would last. The incremental cost to

Tampa Electric's system for producing and transmitting the amount of power called for by the contract with FMPA are separated into fuel costs and non-fuel costs. There are no capacity charges included with non-fuel costs. This is appropriate, as noted earlier, because the FMPA sale does not require Tampa Electric to increase capacity to accommodate the sale. The only non-fuel costs are SO2 allowance costs and variable O&M costs.

As noted in Ms. Branick's testimony, these incremental costs are calculated at the margin for Tampa Electric's system. In other words, the dispatch order for the quantity required to serve the FMPA sale comes after the retail ~~lead~~ loAD is served. This means that the incremental costs of serving FMPA are higher than the incremental costs of serving retail customers. For this reason, it may be concluded that incremental costs of serving FMPA are larger than Tampa Electric's average variable costs.

Q. What are the revenues to be earned from the FMPA transaction?

A. Document 4 in Exhibit KAB-1 also gives the incremental revenues to be earned from the FMPA transaction. If these revenues are divided by the quantity to be sold, one derives the average revenue, or price, of the transaction.

Q. What may be concluded about the profitability of the transaction?

A. Since the incremental revenues from the transaction exceed the incremental cost of the transaction, the transaction is profitable. Since the sale is beneficial, the Commission should follow a policy that encourages rather than discourages such a sale.

Q. Does Tampa Electric's wholesale power sale to FMPA benefit FMPA's retail customers?

A. Yes. Tampa Electric was awarded the contract by FMPA because it was the cheapest source of the additional power required by FMPA. If Tampa Electric does not supply the power, FMPA will be forced to purchase from a higher-priced alternative supplier. FMPA's customers would have to pay higher prices as a result.

Q. What are the incremental costs and revenues of Tampa Electric's proposed sale to Lakeland?

A. The incremental costs and revenues of Tampa Electric's proposed sale to Lakeland are given in Document 5 in Exhibit KAB-1 in Ms. Branick's testimony.

In this case, incremental costs may include a charge for new peaking load capacity to service the Lakeland transaction. Whether capacity charges are included or not, the incremental costs are evaluated at the margin for Tampa Electric's system, so that the incremental costs for new peaking capacity exceed the average costs of peaking capacity.

Q. What may be concluded about the profitability of the transaction?

A. Since incremental revenues are larger than incremental costs, the transaction is profitable. The same arguments given above in connection with the sale to FMPA apply equally to the sale to Lakeland.

Q. Should the Commission encourage the FMPA and Lakeland sales?

A. Yes. These sales have been evaluated according to established economic principles and have been found to be profitable. Thus, these sales should be encouraged by the Commission. To provide the proper encouragement for such sales, the Commission should ensure that incentives are in place that will cause firms to seek out this business.

Q. Does this conclude your testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

PREPARED REBUTTAL TESTIMONY

OF

DOUGLAS R. BOHI

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business Address.

A. My name is Douglas R. Bohi. My business address is Charles River Associates Incorporated, 1001 Pennsylvania Avenue, N.W., Suite 750 North, Washington, D.C. 20004.

Q. Are you the same Douglas R. Bohi who submitted Testimony in this proceeding on April 25, 1997?

A. Yes. My educational background and work experience are described in that testimony.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Tampa Electric.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain why the testimony of Mr. Hugh Larkin, Jr. and Mr. Jeffrey Pollock reflects a serious misunderstanding of basic economic principles and, therefore, should not be the basis for a Commission decision in this proceeding.

Q. Please summarize your testimony.

A. My testimony responds to three erroneous arguments presented by Mr. Larkin and Mr. Pollock that, through repeated assertion in various ways, forms the basis of their direct testimony. First, they assert that firms (regulated or unregulated) should not make sales decisions on the basis of incremental costs of production. However, in any line of business where the firm is free to choose to make a sale, the firm should base that sales decision on whether incremental revenues exceed incremental costs. In contrast to service provided to retail customers, decisions to make wholesale sales are at the discretion of Tampa Electric. In making these decisions on the basis of incremental costs, the company is following sound economic principles.

Their second erroneous argument is that Tampa Electric's proposal to credit retail customers according to incremental fuel costs represents a cross-subsidy from retail customers to wholesale customers. This argument ignores the fact that Tampa Electric's proposal to credit retail customers an amount equal to system incremental fuel costs will cover fuel costs incurred to serve wholesale sales.

The third erroneous argument is that Tampa Electric does not require an incentive to make wholesale sales. I show why Tampa Electric requires an incentive to engage in discretionary wholesale sales, and that proposals aimed at reducing this incentive run the risk of reducing both the amount of wholesale sales and the amount of benefits that flow to retail customers. For this reason I conclude that the arguments put forth by representatives of retail customers to reduce Tampa Elecric's incentives are not in the best interest of those customers.

III. SHOULD INCREMENTAL COSTS BE USED TO MAKE SALES DECISIONS?

Q. What is Mr. Larkin's argument regarding the decision to make sales on the basis of incremental costs?

A. Mr. Larkin (p. 3 lines 8-9) argues that sales decisions made on the basis of whether incremental revenues cover incremental costs would not "be applied by any business in completing sales to its customers." He makes two observations to support this contention. The first is that if this theory were followed, every customer of Tampa Electric which entered the system after the establishment of base rates would pay only the incremental costs associated with that customer's addition to the system. The second is that, in a competitive business or one that is an oligopoly such as the automobile industry, prices of products are not established in this manner. He claims that automobile manufacturers, as do all manufactures, establish a price and generally maintain that price for all customers.

Q. What is wrong with the first assertion?

A. It assumes that the seller is setting the sales price on the basis of incremental costs, and that the seller may offer different prices to different customers because the seller's incremental costs will differ. This view lacks understanding of the basic economic principles involved. To begin with the seller does not set the price. In the regulated electric retail market in Florida the Commission sets the price and the company has no choice but to serve all customers at that price. In a competitive market such as the wholesale market in Florida, the seller likewise does not set the price. The market sets the price and the company has a choice whether to sell or not. Buyers have several alternative sources of supply and will choose the cheapest alternative. This has the effect of limiting the price that any seller can receive. Accordingly, a competitor may choose to beat the ~~that~~ price and make the sale, or choose to forego the sale.

The question at this point is the criterion the seller should use to decide whether to make the sale or forego it. Established economic principles are clear on this point and may be verified in any introductory economics textbook; the seller should not make the sale unless incremental revenues are larger than incremental costs. If incremental revenues are larger than incremental costs, the sale is profitable and the seller must decide whether the risks and other disincentives are large enough to discourage making the sale.

The rule does not say that the seller should sell at a price equal to incremental costs, nor does the rule say that the seller should sell at different prices to different customers because the incremental cost of serving different customers will vary. The price is determined by the market and, in a competitive market, the seller should sell at whatever the price the market will bear. If, for example, market demand rises and causes the price to increase, the seller should sell at the higher price. Conversely, if demand falls and causes the price to fall, the seller will be forced to sell at a lower price, unless the seller chooses not to sell at all.

Under no circumstances should the seller sell at a price below incremental costs. As long as the price is above incremental costs, then the costs incurred in making the sale are covered and a net return is earned that will either help pay for fixed costs or add to net profits. The main point is that the costs incurred are covered.

Q. What is wrong with the second observation put forth by Mr. Larkin that, in a competitive business or one that is an oligopoly such as the automobile industry, prices of products are not established in this manner?

A. This argument reveals a serious misunderstanding about the way manufacturers behave with regard to prices and incremental costs. Manufacturers commonly establish list prices for their products, and may determine those prices on the basis of average costs of production, including a margin for profit, and the expected level of demand. Nevertheless, the actual selling price at any time will be determined by the level of demand for the product at the time and the prices at which competitors are willing to sell. If demand is strong and competition is weak, a manufacturer may unilaterally increase its list price. If, on the other hand, demand is weak and competition is strong, the manufacturer may decide to sell at a discount from the list prices.

This type of behavior is particularly common in the automobile sector, as anyone who has shopped for an automobile under different market conditions can attest. Manufacturers increase the prices they charge dealers for popular models and dealers add on special charges to customers. When manufacturer and dealer inventories rise because of a weak market, however, manufacturers are willing to offer special incentives to dealers, and dealers are willing to offer discounts to customers. Actual selling prices will vary with different customers, different locations, and different times. The seller will try to obtain the highest price possible, and will be acutely aware of the minimum price necessary to make the sale profitable. The minimum price will be determined by incremental costs of production.

I have personal experience with the way manufacturers make sales decisions from my earlier employment with Caterpillar Tractor Company. As in the case of auto manufacturers, Caterpillar sells its products through a worldwide network of dealers. Suggested list prices are published, which are subject to change, and discounts from the price list are common depending on market conditions and the size of inventories. In cases involving large sales and the offer of a significant discount, dealers would ask the company to review the offer and decide whether the discount is acceptable. In making the decision, the company is acutely aware of its incremental costs. These costs establish the price floor. How far the price has to be above incremental costs to make the sale depends on market conditions, as discussed above.

Q. Mr. Pollock (p.14, lines 4-23) argues that it is inappropriate to measure efficiency solely on the basis of incremental cost. Do you agree with his argument?

A. No. Mr Pollock argues that a firm that has low incremental costs may have high capital costs and is not necessarily "more efficient than another firm that chose instead to minimize overall costs." Earlier (p. 13, line 19 to p. 14, line 3), Mr. Pollock states that it is "an erroneous assumption that a utility having low incremental costs is more efficient than a competing supplier that may have higher operating costs but lower total costs."

These arguments are wrong. The most efficient firm for producing a given increment of output is the firm that can produce that increment at the lowest cost. The firm that can produce the increment at the lowest cost can also accept the lowest price to sell the product.

Q. Mr. Pollock is concerned about how capital costs fit into the determination of the most efficient firm. What is your response?

A. The magnitude of capital costs does not change the rule that sales decisions should be made on the basis of incremental costs, not on average costs. However, as I explained in my Direct Testimony, in some cases capital costs should be included in incremental costs and in other cases they should not. If capital costs are variable to a production decision, they should be included in incremental costs; if capital costs are fixed with regard to a production decision, they should not be included in incremental costs.

The situation where capital costs are variable in the production decision arises in the case of the sale of peaking power to the City of Lakeland. As indicated in the Direct Testimony of Ms. Karen Branick, the analysis of the Lakeland sale found that the sale would not necessarily increase capital requirements. To be conservative, however, the sale is treated as if additional capital were required. Accordingly, the incremental cost of the sale includes a component to cover these additional capital costs as well as the cost of fuel and O&M.

In the case of the sale of power to FMPA, the production decision does not require additional capital investment and capital costs are fixed. In this case, incremental costs do not include capital costs; rather, incremental costs include only the additional costs incurred in making the sale. Capital costs must be paid whether the sale is made or not and, as a result, they become irrelevant to the decision to make the sale. The decision to sell is determined by whether incremental revenues are larger than incremental costs. By selling at a price above incremental costs, at least some amount is earned to help pay for capital costs. If the sale is not made, capital costs must still be paid, but there is less revenue to make the payment, and the firm is worse off. Again, incremental costs is the appropriate basis for making the decision to sell.

Q. Mr. Pollock's example (p. 13, line 19 to p. 14, line 23) compares two electric utilities that choose different investment approaches: one has high capital costs and low operating costs and the other has low capital costs and high operating costs. Which one is the most efficient?

A. The decision rule based on incremental costs still applies. For any increment of output, the firm with the lowest incremental costs is the most efficient for producing that output. If all such decisions are made in the context of fixed capital costs, then capital costs are irrelevant to the determination of which firm is the most efficient for producing a given increment of output.

I can illustrate my argument by returning to Mr. Pollock's example. Suppose Utility A has high capital costs and low operating costs while utility B has low capital costs and high operating costs. Further suppose that the two utilities are competing for sales in the wholesale market.

If the market price were greater than ~~utiltiy~~ utility A's incremental costs and lower than utility B's incremental costs, it would make sense for utility A to make the sale but not utility B. Utility A would make a profit on the sale that would help pay for its (high) capital costs, while utiltiy B would take a loss on the sale, which would make it more difficult for utility B to pay for its (low) capital costs. Utility A is clearly more efficient than utility B in making this sale.

Indeed, if we extend the example to suppose that utility A has lower incremental costs than utility B for every increment of output they can produce, and that the two are in direct competition for all sales, then utility A would be able to make every sale at a lower price than utilty B. Having lower capital costs will not help utility B compete with utility A.

Q. What happens in the last example if ~~utiltry~~ utility A captures all of the business and still does not cover all of its fixed costs?

A. The simple answer is that the market does not value this product enough to cover the cost of producing it and, thus, production should cease. The more involved answer depends on how fixed costs are financed. For capital that is financed with debt instruments, debt payments must be made or creditors will force the firm into bankruptcy. Since in our example the revenues to ~~utility~~ utility A were covering at least part of its fixed costs, debt payments may be covered. For capital financed by equity investment, a shortfall of revenues would lower dividends below the market rate of return.

IV. DOES THE TAMPA PROPOSAL IMPLY A SUBSIDY TO WHOLESALE SALES?

Q. Mr. Larkin, Mr. Pollock, and staff witness David P. Wheeler argue that Tampa Electric's proposal means that retail customers are subsidizing wholesale customers. What does it mean to say that one customer is subsidizing another?

A. Retail customers may be said to be subsidizing wholesale customers if retail customers are paying some of the costs incurred in supplying electricity to wholesale customers.

Q. Why do Mr. Larkin, Mr. Pollock, and Mr. Wheeler believe that retail customers will be subsiding wholesale customers?

A. Their testimony incorrectly argues that a subsidy occurs because Tampa Electric's proposal would credit retail customers through the fuel adjustment clause an amount equal to actual system incremental fuel costs rather than system average fuel costs.

Q. Does the difference between actual system incremental and system average fuel costs constitute a subsidy from retail to wholesale customers?

A. No, The amount that should be credited to retail customers to ensure that they are not adversely affected by wholesale sales is the increase in total fuel costs caused by the wholesale sales. Average fuel costs do not measure the increase in total fuel costs caused by wholesale sales; rather, the increase in total fuel costs is measured by incremental costs.

V. DOES TAMPA ELECTRIC NEED AN INCENTIVE TO MAKE WHOLESALE SALES?

Q. Should Tampa Electric receive an incentive to make wholesale sales?

A. Yes. The service provided to wholesale customers is entirely discretionary. Tampa Electric can choose whether to sell to wholesale customers, can choose how much it will sell and for how long, and can determine a variety of other terms and conditions that affect the cost of service. In making the sales decision, Tampa Electric must be satisfied that the sale will improve rather than detract from earnings. Unless earnings are improved, there is no reason to undertake the risk and cost of making the sale.

Q. Will any such incentive be inconsistant with the principles of rate making?

A. No. The regulatory model has always contained incentives to both the retail and wholesale jurisdictions. The purpose of these incentives, regardless of their form, ~~have~~ has been to encourage behavior that benefits ratepayers.

Q. Will Tampa Electric's proposal be consistent with the interests of the retail customer?

A. Yes. I can understand that representatives of retail customers might try to collect more of the benefits from wholesale sales in order to lower retail rates, but I cannot understand why the same persons would be prepared to argue that no incentive should be provided to encourage Tampa Electric to seek business that benefits ratepayers.

Q. Mr. Larking (p. 20, lines 1-18) and Mr. Pollock (p.3, lines 1-20) argue that regulated electric utilities are merely using their retail customers to gain a competitive advantage over other wholesale entities "which do not have the luxury of using their `captive' customers to subsidize discounted wholesale rates." How do you respond to this argument?

A. I would agree with the argument if the premise were true; that is, if the costs of serving wholesale customers were in fact shifted to retail customers. Since the premise is not true for Tampa Electric's proposal, I do not agree with the conclusion.

On the contrary, the solution suggested by Mr. Larkin and Mr. Pollock to require Tampa Electric to credit retail customers on the basis of average embedded costs for any wholesale sale, will tend to drive regulated utilities out of the wholesale market. The reason is that nonregulated entities will make decisions to sell in the wholesale market on the basis of their incremental costs, not their average embedded costs. These entities will be able to under-price regulated utilities, even when their incremental costs are above those of regulated utilities. This will allow them to capture a disproportionate share of the wholesale market. Consequently, a Commission decision that regulated utilities must credit the costs of wholesale transactions at average embedded costs, while competing suppliers have the freedom to make sales decisions on the basis of incremental costs, will severely bias the competitive equation against regulated utilities.

An unfortunate result of this outcome is that the lowest cost, most efficient producers will not necessarily be supplying the wholesale market. Wholesale prices will be higher than they should be, yet fewer profits earned from wholesale sales will flow back to the benefit of retail consumers. Thus, ratepayers of regulated utilities will be worse off, the shareholders of regulated utilities will be worse off, and the ultimate consumers of wholesale power will be worse off. The only beneficiaries of such a misguided policy will be the shareholders of the nonregulated entities. I suspect that enhancing their profits will not serve to benefit the people in the state of Florida, however.

Q. Does this conclude your testimony?

A. Yes, it does.

Q (By Mr. Long) Dr. Bohi, would you please summarize your direct and rebuttal testimony?

A Yes, I will, thank you. Good afternoon, Commissioners. I appreciate the opportunity to be here in order to respectfully suggest that it is critically important for this Commission to apply several key economic principles in its deliberations concerning the regulatory treatment to be afforded the FMPA and Lakeland sales.

First, as a matter of basic economic theory, sound business judgment, and effective public policy, discretionary incremental wholesale sales should be evaluated by both the company and this Commission on the basis of incremental cost, not average cost. This principle holds true whether incremental costs are above or below average costs. The point is fixed costs must be made whether or not the incremental wholesale is made. Therefore, the decision to make incremental wholesale sales must be based on a consideration of the new or incremental costs which would be incurred, not the preexisting fixed costs which are sunk costs.

Second, in view of the discretionary nature of wholesale sales, if the revenues from an incremental sale are greater than the incremental cost incurred in making the sale, then the sale will produce net benefits and should be encouraged. Any incremental contribution to preexisting fixed costs will serve either to reduce losses or increased profits.

Third, retail ratepayers who initially are responsible for 100% of the fixed costs attributable to making new wholesale sales are better off after the sale is made since the resulting net benefits will serve to reduce their preexisting fixed cost burden. Under these circumstances, it should not be asserted that retail customers are somehow subsidizing wholesale customers by merit of the fact that wholesale customers are not paying average costs. Whether wholesale customers are paying a price that is more or less than average cost is an outcome that is determined by the wholesale market not by Tampa Electric. The choice in this situation is between making a sale and enjoying some positive benefit or not making the sale and receiving no benefit.

Fourth, the imputation of average cost to incremental wholesale sales will result in significant market inefficiencies in the loss of net benefits to ratepayers if, as a result, utilities are disincented to make such sales. To the extent that the firm with the lowest incremental cost is prevented from making a given wholesale sale, market efficiency is degraded. To the extent that jurisdictional IOUs are disincented from making wholesale sales, the net benefits which would have accrued to IOU ratepayers would instead flow to ratepayers of IOUs in other states or to the shareholders of unregulated power marketers.

Fifth, it is as matter of simple arithmetic that average fuel costs will remain unchanged if the fuel clause is credited with system incremental fuel costs for a new wholesale sale, just as the company proposes in this proceeding.

Opposition to Tampa Electric's proposal is grounded in a misunderstanding of the economic principles which I've just described. This misunderstanding should not lead the Commission to a policy decision which may well harm ratepayers in the final analysis. Such a decision would be to attribute average cost to these sales when, in fact, they are incurring incremental costs. Thank you.

MR. LONG: Chairman Johnson, Dr. Bohi is available for cross examination.

CHAIRMAN JOHNSON: Thank you. Ms. Kaufman.

MS. KAUFMAN: FIPUG will defer to Mr. Howe to go first.

CHAIRMAN JOHNSON: Mr. Howe.

CROSS EXAMINATION

BY MR. HOWE:

Q Hello, Dr. Bohi. I'm an attorney with the Public Counsel's office. I have just a few questions. I noticed you said in your summary, I believe, that fixed costs must be paid. And I believe you also said that the retail jurisdiction is currently responsible for 100% of the fixed costs; is that correct?

A That's correct.

Q If this Commission were currently involved in a rate case involving -- or conducting a rate case involving Tampa Electric Company, and all the assets devoted to wholesale sales were going to be set aside outside the retail jurisdiction, and let's assume further that they set aside those assets as portions of Big Bend 2 and 3 and Gannon 5 and 6 that would be devoted to the FMPA sale, would the revenues Tampa Electric is receiving from that sale to FMPA cover its costs?

A I could not say for sure.

Q Why could you not say for sure? Is the question -- you know, what's the value of the assets that would be devoted to the wholesale jurisdiction?

A I don't know what the average embedded costs of those units are that you're talking about.

Q Well, let's just use some numbers. If the average --

MR. LONG: Chairman Johnson, I'm sorry, I would like to object to this line of questioning. Dr. Bohi's testimony deals with the economic theory as applied to these sales. The specifics of these sales and the ratemaking for Tampa Electric was clearly within the purview of Mr. Ramil, and the details in terms of the ratemaking are the substance of Ms. Branick's testimony.

MR. HOWE: If I might respond? Just to pick one reference in Dr. Bohi's testimony, Page 17, prefiled direct, Line 7, "The only nonfuel costs are SO2 allowance costs and variable O&M costs." I'm testing that statement. I'm testing to see if there's another element of cost. That, being the capital cost, the return on assets that is also a matter of ratemaking and a cost that would necessarily have to be covered by revenues from the wholesale jurisdiction.

MR. LONG: I understand that, Chairman Johnson, but the point is that those costs were analyzed by Ms. Branick and Mr. Ramil. Dr. Bohi is merely referring to their testimony, what's established in their testimony. He is not the witness for that information.

MR. HOWE: Well, then, I would suggest that I would move to strike any reference Dr. Bohi makes as a fact that the only nonfuel costs to be considered by Tampa Electric or by this Commission in evaluating Tampa Electric's proposal are SO2 allowances and variable O&M.

MR. LONG: Well, Chairman Johnson, Dr. Bohi is entitled to rely on the testimony of Tampa Electric's other witnesses. I see no basis for striking his testimony simply because he's been relying on what other witnesses in this proceeding have sponsored in their testimony and are here to address under oath.

MR. HOWE: Chairman Johnson, I would just ask then that Mr. Long identify where in Dr. Bohi's testimony he states that he's drawing conclusions only from Ms. Branick's testimony. I don't believe it exists.

MR. LONG: Well, Chairman, I'm not under oath, but the witness is; I think that's an appropriate question.

MR. HOWE: Chairman Johnson, Tampa Electric's witness doesn't tell me what questions to ask.

CHAIRMAN JOHNSON: Mr. Howe, I'm going to allow your question. But to the extent that the witness does not know the answer or does not feel qualified to answer, you can state that.

Q **(By Mr. Howe)** Dr. Bohi, you were once employed by the Federal Energy Regulatory Commission, were you not?

A That's correct.

Q Are you familiar with the jurisdiction of the Federal Energy Regulatory Commission?

A Yes.

Q What regulatory agency has the authority to allow a return on assets committed to wholesale sales under the jurisdiction of the Federal Energy Regulatory Commission?

A The assets are under the jurisdiction?

Q No. I asked what regulatory agency has jurisdiction to allow a return to a public utility on assets committed to wholesale sales under the jurisdiction of the Federal Energy Regulatory Commission.

A That is an ambiguous question because there's occasions where the assets are under the jurisdiction of the Federal Energy Regulatory

Commission, and there are occasions where they're under the jurisdiction of the state regulatory authority.

Q My question deals with assets committed to wholesale sales under the jurisdiction of the Federal Energy Regulatory Commission.

A Well, if they are under the jurisdiction, the assets, then the Federal Energy Regulatory Commission will set those returns.

Q Dr. Bohi, also, with assets under the jurisdiction of the Federal Energy Regulatory Commission, assets devoted to a wholesale sale, is an element of cost to be covered by wholesale rates the return on those assets?

A Not necessarily. After all, FERC regulations are changing, and in some cases prices are market-determined. Returns to the asset itself may be truly a function of market-determined outcome and that there are FERC jurisdictional assets in which there is no reason to inquire about their cost of production.

Q Are you suggesting that an electric utility might choose to set wholesale rates at such a level -- I'm sorry. Are you suggesting that an electric utility might submit to FERC a contract for approval at prices which do not allow for a return on the assets committed to that wholesale contract?

A I'm suggesting that in the wholesale market, in specific occasions, and more generally now, it's the market determines the price; the utility does not set the price. And if it earns a profit, that's fine; if it doesn't, it doesn't. And it has nothing to do with its embedded costs at all.

MR. HOWE: No further questions.

CHAIRMAN JOHNSON: Ms. Kaufman.

MS. KAUFMAN: Thank you, Chairman Johnson.

CROSS EXAMINATION

BY MS. KAUFMAN:

Q Dr. Bohi, I'm Vicki Kaufman on behalf of the Florida Industrial Power Users Group. I think we met by telephone.

A Right.

Q Dr. Bohi, could you turn to Page 4, Line 16 in your prefiled direct testimony?

A Page 16, Line 4?

Q No, Page 4, Line 16. And on Line 16 and 17, you are talking about market efficiency. Do you see that?

A I will eventually. Yes.

Q In that sentence there you are referring to the wholesale market, are you not?

A That's correct.

Q If you'll turn to Page 5, Line 9.

A Yes.

Q In the last clause there, you say, "The wrong firms will be supplying the market." Do you see that?

A Yes.

Q And you are referring to the wholesale market there, are you not?

A That's correct.

Q And on Line 11, you say, "When the market is operating less efficiently." Do you see that?

A Yes.

Q And, again, you are referring to the wholesale market, are you not?

A That's correct.

Q Dr. Bohi, can the Florida Public Service Commission direct Tampa Electric at what price they should sell in the wholesale market?

A Not that I'm aware of, no.

Q Now the wholesale market that you are referring to on Page 5, Lines 11 and 12, is it your opinion that that is a competitive market?

A Essentially competitive, yes. Workably competitive, I would think.

Q I'm sorry, what was --

A Workably competitive.

Q And it's your testimony, isn't it, that a competitive market brings with it certain efficiencies?

A Yes.

Q Now it's true, isn't it, that in the retail market here in Florida, Tampa Electric is a monopoly; is that correct?

A That's correct.

Q Would it be your view that that market would be more efficient if it was competitive?

A Not necessarily, no.

Q So you think that the wholesale market is more efficient because it is competitive, but that would not necessarily be the case in the retail market?

A Well, it depends upon how it was restructured.

Q Could you turn to Page 14, Line 10. And I think we discussed this sentence somewhat at your deposition where you talk about the negative effects of excessive electricity prices. Do you see that sentence?

A Yes, I do.

Q Am I understanding your testimony in that sentence that begins on Line 10 that if the Commission does not adopt the approach that Tampa Electric has suggested in this case, that we are going to see adverse implications for employment and productivity in our state?

A The recommendation that I make is that the Commission --

MS. KAUFMAN: Excuse me, Chairman Johnson, could --

MR. LONG: Counsel, would you allow the witness to answer the question, please?

MS. KAUFMAN: Chairman Johnson, I was just going to request that the witness be directed to give a yes or no answer and then explain.

MR. LONG: Well, Chairman, this is an expert witness, and an expert witness is entitled to offer an opinion.

CHAIRMAN JOHNSON: We will allow the expert witness to offer his opinion, but for purposes of the Commission, and it helps the Commissioners, if you would just start off by answering yes or no and then following up with an explanation. We'll allow you that time to provide your explanation.

WITNESS BOHI: Could you say the question again, please?

Q (By Ms. Kaufman) Yes, I'll try. I'm just trying to understand if it's your testimony on Page 14 there that if the Commission does not adopt the proposal that Tampa Electric has set forth here for the treatment of these two wholesale sales, that we are going to see adverse implications for employment and productivity in our state?

A Yes.

Q It's true, isn't it, Dr. Bohi, that you have not done any studies specific to Florida in this regard, have you?

A That's correct.

Q Would you turn to Page 15, please, in your prefiled direct. And the question that begins on Line 17 and then going over -- your answer goes over to Page 16. It's my understanding that the concern you are expressing through that question and answer is that --

A Excuse me, could I interrupt you a minute? You went on to another question, and I was to be given the opportunity to elaborate on my yes or no answer the last time.

Q Well, I think if your counsel thinks that appropriate, they can do it on redirect.

CHAIRMAN JOHNSON: Well, I'm going to allow him because I probably confused him. But if you want to expound, make sure that you let us know before the counsel goes on to the next question. But I'm going to allow you a little latitude now because you weren't aware of our process.

WITNESS BOHI: Yeah, thank you. My recommendation was that inappropriate decision rules for evaluating wholesale sales could lead to excessively high prices in the wholesale market. If that's the case, then prices to consumers are ultimately going to be higher as well. Not only the retail consumers of the utilities who aren't allowed to make those sales, but the retail consumers of the buying utilities who are paying higher wholesale prices than necessary.

And while it is true that I haven't conducted a study specific to the state of Florida about the adverse employment and productivity implications of higher than necessary electricity prices, numerous such studies have been made. I am aware of them, and that this is a general sort of economic relationship when you increase the cost of producing other goods and services, you are going to have adverse economic implications. That's simply what this refers to. I think it's a general proposition that deserves to be recognized.

Q Does that conclude your answer?

A Yes.

Q That's a general proposition that is not based on any Florida-specific studies; is that correct?

A Not on a Florida-specific study, but on studies having to do with the relationship between prices, cost of production and what those do to productivity and employment in numerous -- not only other locations in this country, but numerous other countries in the world. It's hardly a controvertible fact.

Q But it's not based on any Florida-specific studies; is that correct?

A That's correct.

Q Thank you. Let's turn back to the bottom of Page 15 and the top of Page 16. And let me see if I can paraphrase the concern that you are addressing in that question and answer. Am I right in understanding that your concern that Tampa Electric might be at a disadvantage in the wholesale market vis-a-vis, say, independent power producers, or other people selling in that market, if they have to impute at average system costs; is that correct?

A That's correct.

Q Wouldn't it be true, Dr. Bohi, that if captive customers, in this case Tampa Electric's retail ratepayers, cover their fixed costs, that it's Tampa Electric that's going to have the competitive advantage over those independent power producers who have to cover their fixed and variable costs in the wholesale market?

A No, not necessarily. No.

Q Do you disagree that, for example, an independent power producer that doesn't have a captive retail base has got to cover his fixed and incremental costs in order to make a profit in the wholesale market?

A That's correct.

Q I'm sorry, my statement is correct?

A Yes. They have to cover their cost to stay in the business.

Q And they don't have a captive base of customers that are going to cover their fixed costs, do they?

A What I would suggest is that the --

Q I'm sorry. Again, if you could just answer yes or no and then explain?

A This is not a yes or no question.

MR. LONG: Madam Chairman, the witness answered the question a couple of times, and he's trying to explain. I ask that he be given an opportunity to do that briefly.

CHAIRMAN JOHNSON: Ms. Kaufman.

MS. KAUFMAN: Chairman Johnson, I think it was a yes or no question. I just asked him if it was the case that independent power producers, for example, do not have a captive customer base to cover their fixed cost. I think that can be answered with a yes or no and an explanation if he feels it's appropriate.

WITNESS BOHI: By definition, they have no retail customers. So, no, they don't have anybody to cover any of their costs, other than who they sell their power to.

What I would add to that is that the decision rule that an independent power producer will use to decide whether it makes a sale or not is its incremental cost and its incremental revenues. And that the same decision rule ought to apply to a regulated utility as well.

Q **(By Ms. Kaufman)** Dr. Bohi, I'm going to assume -- let me ask you. You're familiar with the proposal that Tampa Electric has made in this case; is that correct?

A Yes, that's correct.

Q And you understand how they are proposing to credit the revenues from these two wholesale sales?

A Generally, yes.

Q Would you turn to Page 17 of your direct testimony, please?

A Yes.

Q Lines 12 to 18. You say there that it's your opinion that the incremental cost of serving FMPA is higher than the incremental cost of serving TECO's retail customers; is that correct?

A That's correct.

Q Do you know what the components are of the retail fuel charge in Florida?

A I'm sorry, the components?

Q The components.

A Of the retail --

Q -- fuel charge.

A I would assume it's the cost of fuel.

Q Do you know whether there are any other components, other charge -- the retail fuel charge, other than the cost of fuel in Florida?

A No.

Q Let me ask what your understanding is of how Tampa Electric is going to credit system incremental fuel if its proposal is adopted in this case?

A It's probably a question best asked of Mr. Ramil.

Q Well, why don't we see what we can do here. You did testify that you understood Tampa Electric's proposal and that you support it, did you not?

MR. LONG: Madam Chairman, I object. The witness answered that he had a general understanding, and it's also clear that is the substance of Mr. Ramil's testimony. I think that it's inappropriate to question this witness about Mr. Ramil's testimony. He's given his understanding, and he's indicated that the witness who knows the answer to this question is another Tampa Electric witness.

CHAIRMAN JOHNSON: Ms. Kaufman.

MS. KAUFMAN: Madam Chairman, Tampa Electric has put this witness on in support of their proposal in this case. Mr. -- excuse me, Dr. Bohi has testified that he is familiar with how incremental costs are proposed to be credited. I think it's appropriate to explore his understanding of how that's going to be done through Tampa Electric's proposal.

CHAIRMAN JOHNSON: And what was your last question? What was your question?

MS. KAUFMAN: Let's see if I can recall. I was going to begin to explore with him his understanding of how that's going to happen. I don't know that there was a question pending.

CHAIRMAN JOHNSON: Okay. I'm going to allow you to ask the question so I can better understand where we're headed with the issue. If the witness doesn't know the answer, you can state that.

And you'll have to take the answer as you find it.

Q **(By Ms. Kaufman)** Dr. Bohi, is it your understanding that Tampa Electric proposes to credit system incremental fuel to the retail fuel clause?

A That's my understanding, yes.

Q Now, is it your understanding that that would mean that when TECO is operating -- let's just use a hypothetical -- is operating an expensive unit during an hour on its system, does that mean that the cost, the fuel cost of that most expensive unit, would be credited to the retail clause during that hour?

A That's my understanding, yes.

MS. KAUFMAN: I want to distribute an exhibit now. If I can have a number for that, Madam

Chairman? This is a composite exhibit and it's excerpts from some of Tampa Electric's fuel filings that you have already taken official recognition of, but if we could give it a number.

MR. LONG: Again, Chairman Johnson, this is not material the witness has sponsored. If he has some knowledge, I have no objection to his answering. But I would object to asking this witness about material that he has not prepared and has not filed.

CHAIRMAN JOHNSON: Ms. Kaufman, and I'll wait on you to ask the question, but to the extent that you are starting to get into a greater level of specificity, this probably is not the appropriate witness. But I will allow you to start the language.

MS. KAUFMAN: Thank you, Chairman.

CHAIRMAN JOHNSON: We'll mark this as Exhibit 9. And short title?

MS. KAUFMAN: "Tampa Electric's Fuel Filing Excerpts."

CHAIRMAN JOHNSON: "Tampa Electric's fuel filing" --

MS. KAUFMAN: -- "Excerpts."

CHAIRMAN JOHNSON: "Excerpts," okay.

(Exhibit 9 marked for identification.)

Q **(By Ms. Kaufman)** Do you have a copy of what's now been marked as Exhibit 9, Dr. Bohi?

A Yes, I do.

Q If you would look behind Tab No. 3, and the page number stamped at the bottom is Page 17. And the name of the schedule is "System Net Generation and Fuel Cost, actual for the period March 1997." Do you have that?

A I haven't located that. Where is that on the page?

COMMISSIONER GARCIA: Ms. Kaufman, where are you?

MS. KAUFMAN: Okay, behind Tab 3 of Exhibit 9, it's stamped Page 17 at the bottom. But the actual heading of the schedule is "System Net Generation and Fuel Cost."

COMMISSIONER KIESLING: That's where I'm having a problem.

WITNESS BOHI: I don't find that.

COMMISSIONER CLARK: Mine doesn't say that, mine says "Power Sold Tampa Electric Company estimated for the period" --

MS. KAUFMAN: I'm sorry, I've directed you to the wrong tab. It's behind Tab 2, excuse me.

COMMISSIONER KIESLING: Thank you.

Q (By Ms. Kaufman) We'll see if that works better, Dr. Bohi. Are you with me now, sir?

A Yes.

Q Okay. And let me represent to you, subject to Ms. Branick's verification, that this is an excerpt from Tampa Electric's fuel filing for the March 1997. If would you look about midway down right near where their Page 17 is, you will see an entry for Sebring and it's abbreviated S-E-B. Do you see that?

A Yes.

Q And I'm looking at the line that says "SEB-Phillips total." Do you see that, sir?

A Yes.

Q Okay. If you go all the way across to the very last column, it's Column N. It's headed "Cost of Fuel Dollars Per Unit." And just to make this easier for us, I'm talking about the "23.23" number.

A Yes.

Q But I'd like to talk about that in megawatt hours. So that would be $232 in megawatt hours; is that correct?

A I'm not sure.

Q Well, wouldn't you just move the decimal place over one to convert it to megawatt hours?

A Well, the heading of the column says "Dollars Per Unit," so I don't know what the units are.

Q Okay. Let's look at cents per kilowatt-hour, which is the $3.68 figure there. Do you see that?

A Yes.

Q So we would move the decimal place over to talk about megawatt hours there, would we not?

A If you say so.

MR. LONG: Chairman Clark, I would renew my objection. Counsel is basically testifying here. She hasn't established any foundation as to whether the witness has any familiarity with this document or understanding of its origins or the numbers that appear on the page. And without that foundation, I don't understand how this is proper cross examination.

CHAIRMAN JOHNSON: Ms. Kaufman.

MS. KAUFMAN: Chairman Johnson, this is Tampa Electric's fuel filing. I mean, if they're saying that these numbers aren't correct, I'll have to change my cross examination. But I'm using this for illustrative purposes to establish his understanding of how these fuel costs are going to be credited. I'm not asking him to tell me whether or not he believes these numbers are correct. You've taken official recognition of this document, and it's a Tampa

Electric filing with this Commission.

MR. LONG: Well, Madam Chairman, Tampa Electric files a great many things, all of them correct; that doesn't mean they're relevant to this proceeding. And that's the basis for my objection.

CHAIRMAN JOHNSON: I'm not certain if the document is relevant or not, but it's clear that this witness is not familiar with this particular document and doesn't go to the accuracy of the document itself. That concerns -- you haven't asked him a question yet, though.

MS. KAUFMAN: I was just trying to direct him to the right number to be looking at, which is confusing on these schedules. But I will ask my ultimate question, and if counsel wants to object, then you can rule on it then if that will be all right.

CHAIRMAN JOHNSON: Certainly.

Q **(By Ms. Kaufman)** Dr. Bohi, all I'm trying to establish here or to ask you if it's your understanding is: Would it be your understanding that, for example, when the Sebring unit is operating at a cost of $3.68 a kilowatt-hour, if that's the most expensive unit on Tampa Electric's system, would that be --

A I --

Q I said if it is. -- would that be the incremental system fuel cost that Tampa Electric proposes to credit?

A I don't know the answer to that question.

Q And without knowing the answer to that question, it's still your testimony that crediting of the system incremental fuel is appropriate?

A Yes. That is a concept. Conceptually, that's correct. Whether this number reflects anything in particular having to do with the system incremental cost is another question; I can't testify to that.

Q Dr. Bohi, have you done any analysis at all of how Tampa Electric defines "a system incremental cost"?

A I've had discussion with staff at Tampa Electric about the appropriate economic principles involved and what they mean as far as calculating numbers, yes.

Q If it was demonstrated in this proceeding that Tampa Electric has understated its incremental cost, would you agree then that the sale in question was being subsidized by the retail jurisdiction?

A If costs were being understated, would they be subsidizing -- would retail customers be subsidizing, is that the question?

Q Yes, sir. If the way Tampa Electric was defining "incremental costs" was understated, then would it be your testimony that the sale in question was being subsidized by the retail jurisdiction?

A Possibly, yes. I would define "a subsidy" as retail customers paying the cost of supplying wholesale customers. Whether that always is true by your definition, I don't know.

Q And I'm correct that you've done no independent analysis, but you've relied on Tampa Electric's representations to you?

A Of the --

Q Of the incremental costs.

A Of the numbers, you are talking about now?

Q Yes, sir.

A As opposed to the concepts?

Q Yes, sir.

A As to the numbers, yes, I rely on Tampa Electric.

Q Would you turn to Page 8, Line 13 -- I'm sorry, Page 18, Line 13. And the question that is asked and answered there is whether FMPA's retail customers are benefiting from this sale. And you say that they are; is that correct?

A That's correct.

Q And I think you've already testified, haven't you, that Tampa Electric's retail customers are 100% supporting these assets that are being used to make the sale?

A Before the sale, yes.

Q Now the FMPA retail customers are not retail customers of Tampa Electric, are they?

A No.

Q Dr. Bohi, a lot of your testimony deals with the fact that you believe that Tampa Electric needs some incentives to engage in these wholesale transactions; is that right?

A Well, as an economist, the concept of incentives is an essential part of economic behavior. I would attribute that importance in any walk of life, economic life.

Q But the point of your testimony is that you've testified that Tampa Electric needs some incentives to engage in this process?

A I would agree, yes.

Q Are you aware, Dr. Bohi, that Tampa Electric has some sister or affiliate companies that are engaged in coal supply and coal transport?

A Yes, I'm aware.

Q And you've been here during the testimony today, have you not?

A Yes.

Q Would it be your opinion that those companies would benefit from these transactions?

A It would be my opinion that it's irrelevant.

Q Would it be your opinion that those companies will benefit from these transactions?

A I have no idea, but it's still irrelevant.

Q Well, do you remember us discussing this issue in your deposition?

A The issue of affiliates?

Q Whether the affiliate companies would benefit from these sales?

A Vaguely, yes.

Q And do you recall stating in your deposition that you thought the affiliates would benefit?

A No, I don't recall.

Q Okay. Well, let me read you the question and answer and see if that refreshes your recollection.

MR. LONG: Madam Chairman, perhaps it would be more efficient to allow the witness simply to review the transcript language and refresh his own recollection.

CHAIRMAN JOHNSON: Ms. Kaufman.

MS. KAUFMAN: Chairman Johnson, it's just one question and answer. I think it would be sufficient for me to read it, but whatever you prefer.

MR. LONG: Well, I think it's important for the witness to be able to read whatever statement is there in context, as opposed to taking it out of context.

MS. KAUFMAN: It's fine if Dr. Bohi would like to read the question and answer into the record. I have no objection.

CHAIRMAN JOHNSON: Okay.

MS. KAUFMAN: May I approach the witness?

CHAIRMAN JOHNSON: Yes.

Q **(By Ms. Kaufman)** Dr. Bohi, if you would just read that question and answer into the record, I think that would be sufficient.

A The question starting at the bottom of the previous page?

Q The question that's got the yellow highlighting around it.

A I would prefer to start at the previous one because I answer that by saying "I'm sorry, I don't know. I didn't have any real knowledge of those subsidiaries and the profitability of them."

Q Okay. Could you continue with the question that's highlighted, please?

A "Dr. Bohi, let's take this question on a theoretical or a hypothetical basis. If a utility has integrated fuel supply and transport businesses and there are increased sales resulting from wholesale sales under this treatment, would Tampa Electric's integrated businesses benefit?"

My answer is "Well, I would hope that they are rational economic business people and that they only engaged in a transaction that makes the benefit. So it's a, yes, I believe they are rational, they are aren't out to lose money, so that they should benefit."

Q Dr. Bohi, do you know if all utilities define incremental cost in the same way that Tampa Electric is defining them in this case?

A I cannot say what other utilities do.

Q Do you know if when a utility generates electricity for its incremental load, as we are discussing here, and fuel is burned in the process, does it incur costs to handle the fuel to get it to the plant?

A I would assume so, yes.

Q Do you know if Tampa Electric is including those fuel handling costs in its definition of "incremental fuel"?

A I would assume so, but I do not know for sure.

Q It would be appropriate for them to include it, would it not?

A I would think so, yes.

Q I just have a few questions on your rebuttal question, Dr. Bohi. If you turn to Page 5, Line 19. And in that passage it actually begins on Page 7 on Line 17. You are talking about the seller deciding whether the risks of the sale are -- you're saying that the seller should consider the risks involved in the sale.

A That's correct.

Q You have not included the risk of interruption in your analysis of risk there, have you?

A This statement doesn't refer to risks of interruption, it refers to business risks associated with a particular sale.

Q On Page 14 of your rebuttal testimony, Line 10, you say there that the amount that should be credited to retail customers to ensure they're not adversely affected by wholesale sales is increased in total fuel costs caused by the wholesale sale?

A That's correct.

Q Is the reverse of that statement also true? And that is, that if customers are credited with less than system incremental, they will be adversely affected, retail customers?

A Generally, yes, but not necessarily.

Q Why would -- you said generally the answer would be yes, but not always. Why would that be?

A Well. I think crediting at system incremental costs sometimes is going to overstate the amount of fuel costs that's actually incurred by a utility to make a particular sale. There are going to be occasions where the actual fuel cost is going to be substantially less, and it could be even close to zero.

MS. KAUFMAN: That's all we have, Chairman Johnson.

CHAIRMAN JOHNSON: Staff.

CROSS EXAMINATION

BY MS. PAUGH:

Q Dr. Bohi, I believe in your summary that you stated that as long as incremental fuel cost is covered, then the fuel cost paid by the retail ratepayers will be unchanged; is that correct?

A That's correct.

Q Does that assume that incremental fuel cost is determined appropriately?

A Of course.

MS. PAUGH: Thank you.

CHAIRMAN JOHNSON: Is that it?

MS. PAUGH: Yes, Chairman Johnson.

CHAIRMAN JOHNSON: Redirect? Or Commissioners?

COMMISSIONER DEASON: I have a few questions. Dr. Bohi, I know you have extensive experience in the electric industry. Are you familiar with the current changes that are taking place in the telephone industry?

WITNESS BOHI: From an outsider's perspective, yes.

COMMISSIONER DEASON: Are you aware that the Telecommunication Act and the FCC decisions and, in fact, decisions of this Commission require incumbent telephone companies to make available to competitors components of their system at incremental cost?

WITNESS BOHI: I'm not familiar with the details of that, no.

COMMISSIONER DEASON: Is it your opinion that is the appropriate thing to do, or you don't have the experience to say one way or the other?

WITNESS BOHI: I feel like I'm out on a slippery edge here. I'm not sure I should venture a statement about that.

COMMISSIONER DEASON: Well, I guess I can't help when I sit here and listen to testimony about incremental cost, I can't help but draw an analogy to the telecommunication industry, especially since we're -- have been engaged in that process for some time. And incremental cost is a very fundamental part of the concept of trying to foster a competitive market in what heretofore -- the "fore" has been a monopoly market. And we are trying to introduce competition. And to the competitors we are saying -- we are saying to the incumbents, which are the incumbent monopolists who are having competition forced upon them, we are saying that you have to make part of your system, components of your system, to potential competitors at an incremental cost.

This is the standard, and it seems to be accepted. There's some debate as to how you actually calculate incremental cost, but as far as the concept that seems to be where we are.

Now, as I understand some of the positions that are being taken by some of the parties here is that I can't help but draw an analogy that TECO should be required to provide or to sell at average embedded cost, and I'm having a difficulty meshing the two. And it seems to me it would be synonymous with telling the incumbent telephone companies why you have to make systems, your components of your system, available to competitors at incremental; to compete for those same customers, you're going to have sell your services at average embedded, regardless of what the market is.

And now my question to you, do you see any similarity between what's being argued here and what's being required in the telephone industry?

WITNESS BOHI: It sounds a bit similar, yes. And I would assert that the same decision rule that applies to the competitive newcomer ought to be applied to the incumbent as well, depending upon other structural matters in this particular industry. But in the case of electricity, I think it's a matter of seriously biassing the competitive equation between entities which have the freedom of making the decision on the right grounds, the right decision rule, which is incremental, rather than on a basis of average.

CHAIRMAN JOHNSON: Any other questions? Redirect.

MR. LONG: Chairman Johnson, I have no redirect.

CHAIRMAN JOHNSON: Exhibits.

MR. LONG: Yes, Chairman Johnson, I ask that Exhibit No. 8 be moved into evidence.

CHAIRMAN JOHNSON: It will be admitted without objection.

(Exhibit 8 received in evidence.)

MS. KAUFMAN: Chairman Johnson, I think we'll wait to move Exhibits No. 9 until Ms. Branick takes the stand.

CHAIRMAN JOHNSON: Very well. Dr. Bohi you are excused and we are going to take a 15-minute break.

(Witness Bohi excused.)

(Brief recess.)

\- - - - -

(Transcript continues in sequence in Volume 3.)