

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition on behalf of Citizens of
the State of Florida to require
Progress Energy Florida, Inc. to
refund to customers \$143 million

DOCKET NO. 060658

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CONFIDENTIAL
DIRECT TESTIMONY
OF DONNA M. DAVIS
ON BEHALF OF
PROGRESS ENERGY FLORIDA

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**IN RE: PETITION ON BEHALF OF CITIZENS OF THE
STATE OF FLORIDA TO REQUIRE PROGRESS ENERGY
FLORIDA, INC. TO REFUND CUSTOMERS \$143 MILLION**

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DIRECT TESTIMONY OF

DONNA M. DAVIS

1 **I. INTRODUCTION AND QUALIFICATIONS**
2 **BACKGROUND, EMPLOYMENT, AND PFC RESPONSIBILITIES**

3
4 **Q: Please state your name and business address.**

5 **A: My name is Donna M. Davis. My business address is 100 East Davie Street,**
6 Raleigh, North Carolina 27601.

7
8 **Q: Ms. Davis, by whom are you currently employed?**

9 **A: I am currently employed by Industrial Staffing through Comensura**
10 (“Comensura”) as a Mines Controller for Progress Fuels Corp. (“PFC”) in
11 Raleigh, North Carolina.

12
13 **Q: How long have you been employed by Comensura?**

14 **A: Since December 1, 2005. I became an employee of Comensura, providing**
15 services to PFC upon my retirement from PFC.

16

1 **Q: Please explain how you provide services to PFC as a Comensura**
2 **employee.**

3 **A:** My understanding is that Comensura is a vendor management company. It
4 handles payroll, withholding taxes, and other employee related administrative
5 matters. The only company to whom I provide services is Progress Fuels.

6
7 **Q: What are your current responsibilities as a Mines Controller?**

8 **A:** I am responsible for the financial supervision of the PFC coal mines and
9 oversight for the third party synfuel plants, as well as general accounting
10 activities, as needed.

11
12 **Q: You indicated that prior to becoming employed by Comensura you were**
13 **employed by PFC. For how long were you employed by PFC?**

14 **A:** I was employed by PFC for about 21 years, from December 3, 1984, until
15 November 30, 2005.

16
17 **Q: Was Progress Fuels Corp. previously known by another name?**

18 **A:** Yes, until approximately December 2001 it was known as Electric Fuels
19 Corp. In this testimony I refer to both Electric Fuels Corp. and PFC as "PFC"
20 for convenience.

21
22 **Q: Before becoming employed by PFC how were you employed?**

23 **A:** I was employed by Tampa Electric Company or "TECO" from 1970 until
24 1984 in a number of accounting capacities. While I cannot recall all the

1 positions I held with TECO in my initial years of employment, I eventually
2 became the Supervisor of Special Accounting.

3
4 **Q: Would you please summarize your responsibilities at TECO?**

5 **A:** My accounting responsibilities involved general fuel accounting and financial
6 and data filings with the Florida Public Service Commission ("FPSC") and
7 the Federal Energy Regulatory Commission ("FERC"), as well as regulatory
8 audits of that information. This included, among other responsibilities, the
9 preparation of TECO's Form 423 filings with the FERC and any audits of
10 those filings. Form 423 filings provide information as to the prices paid by
11 regulated electric utilities for fuel used in generating electricity, including
12 purchases of coal. As I indicated, I ultimately became Supervisor of Special
13 Accounting. In that position I had overall supervisory responsibility for those
14 filings and audits, among other general accounting responsibilities.

15
16 **Q: What is your educational background?**

17 **A:** I have a BA from the University of South Florida and an MBA from
18 Tampa University in Tampa, Florida.

19
20 **Q: Please summarize the nature of the responsibilities you held at PFC
21 during the course of your employment.**

22 **A:** Generally stated, from 1984 to 2005 I held positions involving the accounting
23 and reporting of PFC's regulated business and the reporting of fuel costs to
24 the Florida Public Service Commission and FERC. In 2004 I also became

1 responsible for the accounting of PFC's non-regulated coal activities. During
2 the period 1996-2002, which is the period covered by this testimony, I held
3 the position of Director of Regulatory and Administrative Services.

4
5 **Q: Describe your responsibilities at PFC during the period 1996 through**
6 **2002, when you held the position of Director of Regulatory and**
7 **Administrative Services.**

8 **A:** During that time period, in which I was based in St. Petersburg, Florida, I had
9 overall supervisory responsibility for all regulatory filings by PFC at the
10 FPSC relating to fuel costs and fuel cost recovery. I was responsible for, and
11 had supervisory authority over, the contract administration, financial
12 accounting and regulatory reporting and auditing for all PFC coal
13 procurement contracts and coal transportation and delivery for regulated
14 entities such as Progress Energy Florida ("PEF," previously known as Florida
15 Power Corp.). This included coal procurement for Crystal River Units 1, 2, 4
16 and 5 ("CR1," "CR2," "CR4," "CR5"). I participated in all quarterly and
17 other briefings of the FPSC Staff concerning coal procurement and coal
18 transportation and delivery during this time frame. I also oversaw all
19 regulatory audits and audit inquiries by the FPSC involving PFC's coal
20 procurement practices, including PFC Requests for Proposals ("RFPs") for
21 coal supply, as well as PFC's spot purchases of coal.

22
23 **Q: During that same period, did you regularly interact with Dennis G.**
24 **Edwards?**

1 A: Yes. Mr. Edwards was PFC's Vice President for Coal Procurement. He was
2 the person primarily responsible for coal procurement and related
3 transportation and delivery for PFC. I worked closely with Mr. Edwards,
4 spoke with him regularly, and was routinely copied on his communications
5 with PFC management concerning coal procurement and coal transportation
6 and delivery.

7
8 **Q: As a result of your responsibilities during that period and your working**
9 **relationship with Mr. Edwards, are you personally familiar with the**
10 **business procedures, practices and routines used by PFC and Mr.**
11 **Edwards in the procurement of coal for CR1, CR2, CR4, and CR5**
12 **during that period?**

13 A: Yes, I am. I worked closely with Mr. Edwards as he was the PFC buyer for
14 the coal and transportation purchased for delivery to Crystal River. Those
15 costs would be accounted for by myself and my staff, and we were
16 responsible for reporting those costs to PEF as well as the FPSC and FERC.
17 Mr. Edwards and I constantly reviewed the coal costs of other utilities using a
18 data base provided by RDI, which compiled costs reported by FERC and the
19 public information filed by the utilities in Florida to the FPSC. Any cost
20 procurement and transportation that was to be passed on to PEF and
21 ultimately to the ratepayer from PFC was reviewed by both Mr. Edwards and
22 myself, and I reviewed any other accounting cost that would be charged such
23 as payroll and other overhead. Mr. Edwards and I would discuss his

1 selections of coal and transportation suppliers and he copied me on all coal
2 and transportation purchases.

3
4 **Q: Are you familiar with the business records generated by Mr.**
5 **Edwards and PFC relating to coal procurement during that period?**

6 **A:** Yes.

7

8 **Q: Is Mr. Edwards still employed by PFC?**

9 **A:** No, he retired in early 2003.

10

11 **Q: What period of time does your testimony primarily address?**

12 **A:** My testimony primarily addresses the period 1996 through the end of 2002,
13 before Mr. Edwards retired from PFC, and primarily the coal procurement
14 decisions for CR4 and CR5 since those decisions are the subject of this
15 proceeding. Other witnesses address fuel procurement in the period from
16 2003 on.

17

18 **II. SUMMARY OF TESTIMONY**

19

20 **Q: What is the purpose of your testimony?**

21 **A:** My testimony has four principal purposes.

22 First, I will explain the PFC coal procurement process and resulting decisions
23 affecting Crystal River Units 4 and 5 during the period 1996 through the end
24 of 2002 when I was Director of Regulatory and Administrative Services and

1 worked with Mr. Edwards. An accurate understanding of the process used
2 and the decisions made will demonstrate that PFC and PEF acted reasonably
3 and prudently in their coal procurement decisions under the circumstances
4 existing at the time.

5 Second, I will explain the processes and decisions involved in PFC
6 purchasing synfuel for CR4 and CR5 during that time frame. An accurate
7 understanding of those processes and decisions will demonstrate that PFC's
8 purchases of synfuel were not driven by a desire to generate federal income
9 tax credits for what Mr. Sansom calls "affiliates" of PFC, but to purchase the
10 lowest cost fuel available for CR4 and CR5, and thus for PEF's ratepayers,
11 which is what we did.

12 Third, I will discuss and illustrate how PFC's coal (and synfuel)
13 procurement decisions during this time were regularly discussed with FPSC
14 Staff, OPC, and the Florida Industrial Power Users Group ("FIPUG"), and
15 that PFC's records concerning all such procurement processes and decisions
16 were maintained as an "open book" available to the FPSC for review and
17 audit.

18 Finally, I will discuss and refute Mr. Sansom's assertion that TECO
19 was purchasing Powder River Basin ("PRB") coal during this time period at a
20 lower cost than the cost for bituminous coal incurred by PFC for CR4 and
21 CR5.

22
23 **Q: Please give a brief summary of your testimony.**

1 A: Although my testimony covers more than this summary, I would summarize
2 the principal points as follows.

3 *First*, throughout the period 1996 through the end of 2002 PFC's
4 practice was to first evaluate for purchase the coal meeting PFC's quality
5 specifications that was offered at the lowest delivered cost. That is the cost to
6 purchase the coal together with the cost to transport it to the Crystal River
7 Energy Complex. This is the cost passed directly on to ratepayers in the fuel
8 adjustment proceedings, and keeping this cost as low as possible was a major
9 PFC priority.

10 *Second*, PFC purchased coal throughout this period using a
11 competitive solicitation process and by spot purchases in which the delivered
12 cost of all coal offers were compared.

13 *Third*, sub-bituminous coal, including PRB coal, was always included
14 in our RFP solicitations, of which there were three solicitations (1996, 1998,
15 and 2001) for CR4 & CR5 during the time period covered by my testimony.
16 PFC's RFP specifications included specifications for sub-bituminous coal as
17 well as bituminous coal. Sub-bituminous producers would have been
18 considered had they offered coal to PFC on the spot market, but to the best of
19 my knowledge none did so.

20 *Fourth*, PFC would also compare coals using an "evaluated cost"
21 (sometimes called a "busbar cost") basis when coals that had not been
22 previously used at CR4 and CR5 (such as sub-bituminous coal) were offered
23 and presented either the lowest delivered cost or appeared to be potentially
24 cost competitive. The evaluated cost analysis used a computer model that is

1 widely used in the electric power industry. The model evaluates the probable
2 cost impact on the utility plant of burning a specified type of coal compared
3 to a coal whose cost impact on the plant is known. Such an analysis was not
4 generally a factor when the only competitive offers were for the type of
5 bituminous coal with which CR4 and CR5 had long experience. Those were
6 the coals against which other coals were modeled. In addition, bituminous
7 coal does not generally vary significantly in quality.

8 *Fifth*, sub-bituminous coal was not the lowest cost coal offered on a
9 delivered or evaluated cost basis and was generally not even competitive.
10 The one occasion in which sub-bituminous coal was arguably competitive
11 was in May 2001 when PRB sub-bituminous coal was the lowest cost coal on
12 an evaluated cost basis, but even then only for contracts of durations different
13 from that which PFC ultimately contracted.

14 *Sixth*, PFC examined the use of sub-bituminous coal regularly,
15 including an ongoing comparison of PFC's costs to those of TECO, which
16 burned such coal at its Gannon plant. PFC determined that TECO was
17 paying more for sub-bituminous coal than for bituminous coal and therefore
18 inferred that TECO was purchasing sub-bituminous coal for reasons other
19 than minimizing the delivered cost of coal. Further, PFC determined that
20 CR4 and CR5 regularly generated electricity at a lower cost per mmBtu and
21 per Kwh than the TECO plants that were burning sub-bituminous coal.

22 *Seventh*, contrary to Mr. Sansom's testimony, PFC never favored
23 synfuel producers or marketers in which PFC held a financial interest. Like
24 all other types of coal, when synfuel was the lowest cost coal product offered

1 it was purchased from the entity making the lowest offer. The fact that PFC
2 purchased synfuel with some frequency from companies in which PFC had
3 an interest is explained by the fact that those companies were the largest
4 producers of synfuel in the country, frequently made the lowest cost offer,
5 and on a number of occasions provided the *only* offer, despite wide
6 publication of PFC's interest in receiving proposals to purchase coal and
7 synfuel. PEF's ratepayers benefited from purchases of the lowest cost
8 synfuel. We saw no reason to avoid purchasing from whatever supplier
9 offered the lowest cost synfuel simply to avoid purchasing from entities in
10 which PFC had an interest. This was consistent with my understanding of
11 with the FPSC's policies concerning purchases from affiliated entities as
12 well.

13 *Finally*, PFC met frequently with the FPSC Staff, FIPUG, and OPC
14 to brief them and answer questions from them concerning our coal
15 procurement policies. All of our records of coal procurement were always
16 open to the FPSC and OPC and were subject to audit. Given the level of
17 information PFC provided them, I believe the fact that the Staff and OPC had
18 no issues with our coal procurement actions during this time period reflects
19 that they properly regarded those practices as reasonable and prudent, which
20 they were.

21
22 **Q: Are you sponsoring any exhibits with your testimony?**

23 **A:** Yes, I am. First, I am sponsoring all of Mr. Edwards' monthly reports on
24 coal procurement in Composite Exhibit No. ____ (DMD-9) to this testimony.

1 This composite exhibit represents business records prepared at or near the
2 time of the events recorded in the records, which records it was a regular
3 practice for Mr. Edwards to keep to perform his and my responsibilities. I
4 am also sponsoring the following exhibits, which I discuss in my testimony,
5 that were prepared by me or under my supervision or control, or they
6 represent business records prepared at or near the time of the events recorded
7 in the records, which records it was a regular practice for me or those who
8 worked with me to keep to perform our responsibilities:

- 9 • Exhibit No. ____ (DMD-1); which are the coal procurement policies
10 applicable to coal procurement decisions for CR4 and CR5 during the period
11 of time addressed in my testimony;
- 12 • Exhibit No. ____ (DMD-2), which is a typical PFC bidder list from 1996 to
13 2002;
- 14 • Exhibit No. ____ (DMD-3), which is a typical RFP for CR4 and CR5 from
15 1996 to 2002;
- 16 • Exhibit No. ____ (DMD-4), which is the estimated Powder River Basin
17 Origin Transportation Market cost;
- 18 • Exhibit No. ____ (DMD-5), which is a composite exhibit of the 1998 RFP
19 response list and Kennecott's declination letter in response to that RFP;
- 20 • Exhibit No. ____ (DMD-6), which is the May 2001 RFP;
- 21 • Exhibit No. ____ (DMD-7), which is the bidder list for the May 2001 RFP;
- 22 • Exhibit No. ____ (DMD-8), which are the evaluations of the bid responses to
23 the May 2001 RFP;

- 1 • Exhibit No. ____ (DMD-10), which is the report of FERC Form 423 TECO
2 costs for 1996-2005;
- 3 • Exhibit No. ____ (DMD-11), which are cost comparisons with TECO on a
4 generated cost per Kwh basis from 1996 to 2002;
- 5 • Exhibit No. ____ (DMD-12), which are cost comparisons with TECO on a
6 generated cost per million Btu basis from 1996 to 2002;
- 7 • Exhibit No. ____ (DMD-13), which is a 1996 analysis of PRB and
8 bituminous compliance coals;
- 9 • Exhibit No. ____ (DMD-14), which is a February 9, 1998 memo from Dennis
10 Edwards to Mr. Cumbie;
- 11 • Exhibit No. ____ (DMD-15), which is a 1999 estimate of the cost of PRB
12 coal at Crystal River by 2003;
- 13 • Exhibit No. ____ (DMD-16), which are agendas for the meetings between
14 PFC, PEF, the Commission Staff, and other interested parties, including
15 OPC, regarding PFC's coal procurement activities;
- 16 • Exhibit No. ____ (DMD-17), which are outlines for the meetings between
17 PFC, PEF, the Commission Staff, and other interested parties, including
18 OPC, regarding PFC's coal procurement activities;
- 19 • Exhibit No. ____ (DMD-18), which is a composite exhibit of the results of
20 internal audits for the years 1999-2005 with respect to PFC's coal
21 procurement for the Company;
- 22 • Exhibit No. ____ (DMD-19), which is the report of FERC Form 423 PEF
23 costs for 1996-2005; and

- Exhibit No. ____ (DMD-20), which is the Staff comparison of the waterborne costs for PEF, TECO, and Gulf from 1995 to 2000.

All of these exhibits are true and correct.

III. PURPOSE OF PFC

Q: What is the purpose of PFC?

A: During the period covered by my testimony, PFC provided fuel procurement services, among other things, to PEF. These services included the procurement of coal to fuel PEF's coal fired generating plants, including CR1, CR2, CR4, and CR5. PFC contracted directly with coal suppliers and with transportation providers, such as railroads, water transport (barge) companies, and transloading facilities, such as International Marine Terminals (IMT) for transportation services.

Q: Did PFC have objectives that it sought to meet in procuring coal for CR4 and CR5?

A: Yes. We had three principal objectives.

Q: What were those principal objectives?

A: First, to ensure an adequate, reliable supply of coal for the operation of CR4 and CR5. Second, to ensure that the coal supply met the utility's quality specifications. Third, to purchase coal at the lowest cost possible, consistent with achieving the first two objectives.

1 as sulfur content, had to be satisfied on a per shipment basis. Responses to
2 RFPs that did not meet these specifications were disqualified.

3
4 **Q: Did these specifications include bituminous coal?**

5 **A:** Yes.

6
7 **Q: Did the specifications also include sub-bituminous coal?**

8 **A:** Yes, they included separate specifications for sub-bituminous coal.

9
10 **Q: How were the “specs” for bituminous coal developed?**

11 **A:** The “specs” for bituminous coal were based on PEF’s operating experience
12 burning bituminous coal in those units. Those units had operated since their
13 inception in the early 1980’s on Eastern bituminous coal, largely coal mined
14 in the Central Appalachian Region (“CAPP Coal”). The specs described the
15 physical and chemical characteristics that the utility had found from
16 experience would provide the most efficient, highest output operation of the
17 units. I would note that, while CR4 and CR5 are each “nameplate” rated to
18 produce 665 MW of electric energy, in fact they have historically operated on
19 a bituminous coal supply meeting these specs just described to produce
20 approximately 750 to 770 MW a piece.

21
22 **Q: Do you know how the specs for sub-bituminous coal were developed?**

23 **A:** No, although I know that they have been the same since the early 1980’s, so
24 I assume in reviewing the original contract that they were based on the

1 original design of the boiler. I can say that PFC used the sub-bituminous coal
2 specs provided to it by PEF in all RFPs.

3
4 **Q: What specs did PFC use for coal quality in the spot market?**

5 **A:** The same specs as used in RFPs were used to evaluate the potential purchase
6 of bituminous and sub-bituminous coal. Spot contracts were for durations of
7 one year or less.

8
9 **Q: Did satisfaction of the specs by a coal producer ensure that the coal
10 would function in a desirable fashion in the units?**

11 **A:** Yes, as to bituminous coal because those specs were based on long term
12 operating experience with such coal. Bituminous coals that met those specs
13 were very much a "known quantity." The answer was not necessarily "yes"
14 as to sub-bituminous coals, however, since operating experience with such
15 coal at CR4 and CR5 did not exist. The specs used were thought to describe
16 sub-bituminous coal that could be burned as efficiently as possible by the
17 units, but the actual performance of such coals was not known. Because
18 there had been no occasion since the construction of CR4 and CR5 when
19 such coals were cost-competitive, and indeed since sub-bituminous coals
20 were generally not offered to PFC, sub-bituminous coal had not been the
21 subject of actual operating experience or testing in the units.

22
23 *Lowest Cost*

24 **Q: How did PFC achieve the third primary objective?**

1 A: PFC used a competitive RFP and spot purchase process to obtain the lowest
2 cost coal available meeting the utility's quality specifications. There were a
3 number of steps in this process.

4
5 **Q: Did the FPSC establish any requirements or guidelines in this regard?**

6 A: Yes. The FPSC has established by orders that electric utilities' purchases of
7 fuel, including coal, should be made using a "competitive solicitation"
8 process and that spot purchases be made at market price. As I recall, that
9 began with a "generic" order to that effect issued in 1983 Order No. 12645,
10 which applied to all regulated Florida electric utilities. Over the years
11 following 1983 the FPSC issued additional orders tailored to PEF and PFC.
12 We adhered to each of those orders as they were issued. FPSC Order No.
13 13220 (1984); Order No. 20605 (1986); and Order No. 22401 (1990).

14
15 **Q: Did the FPSC dictate exactly how a utility was to go about complying
16 with these directives?**

17 A: No. The FPSC expressly declined to do that, leaving that to the sound
18 judgment of utility management. The FPSC has also declined to dictate what
19 documentation the utility should adopt or maintain concerning that process.
20 The FPSC has found that to be a "utility management decision." Order No.
21 22401.

22
23 **Q: Did PFC adopt any fuel procurement policies directed to the
24 procurement of coal?**

1 A: Yes. PFC established written coal procurement policies and procedures in
2 1987 to comply with the FPSC guidelines and good business practices. Those
3 policies were followed throughout my tenure with PFC and as far as I know
4 are still in place and followed. The policies necessarily included the exercise
5 of judgment at various points; the policies provided an overall framework for
6 analysis and procedures, not a straightjacket for decision making. Those
7 policies are contained in Exhibit No. ___ (DMD-1) to my testimony.

8

9 Q: **Did PFC follow those policies during your tenure at PFC?**

10 A: Yes.

11

12 **VI. HOW THE PROCESS WORKED**

13

14 Q: **Was the coal procurement process at PFC a single step process?**

15 A: No. It involved a number of steps.

16

17 ***Step 1: Identifying Coal Supply Needs.***

18 Q: **Without going into great detail, what was the first step in that**
19 **procurement process?**

20 A: As I indicated earlier, the first step each year was to identify the utility's coal
21 supply needs for CR4 and CR5 for the coming year. In the fall of each year,
22 PEF provided PFC with coal tonnage needs for CR Units 1, 2, 4 and 5 for the
23 coming year. This was based on, among other things, the utility's actual
24 "amount of coal burned" during the preceding year and the expected coal to

1 be burned in the coming year, as well as inventory target levels. We were
2 also kept advised on a monthly basis of the coal burned each month and the
3 expected burn for the following month.

4 All of this information was stated separately for (a) CR4 and CR5 and
5 (b) CR1 and CR2. While all four units are coal fired, CR1 and CR2 burn
6 coal with a higher sulfur content than CR4 and CR5. The latter units are
7 designed to burn coal with lower sulfur content, commonly referred to as
8 "compliance coal."

9
10 **Q: Was that all the information that PFC needed to determine what amount
11 of coal needed to be purchased by PFC in the coming year?**

12 **A:** No. This told us how much coal PEF would need, but we then had to take
13 into account what existing coal supply contracts were already in force that
14 would continue in force in the coming year. The difference between (a) the
15 utility's projected coal needs for the coming year, and (b) the tonnage already
16 under contract for the next year yielded the amount of new coal that PFC
17 needed to procure. As I explained, we also took into account any changes in
18 the amount of coal that the utility desired to maintain in on-site inventory at
19 Crystal River and at IMT in New Orleans. In addition, if the existing
20 contracts had price reopeners, PFC might need to issue an RFP for the same
21 type of coal under contract or initiate a review of market prices for similar
22 coals in order to negotiate the price for the remaining contract term.

23

1 **Q: Can you give us an approximate idea of how much “new” coal needed to**
2 **be procured each year during the period 1996-2002?**

3 **A:** During that period the annual “burns” of coal at CR4 and CR5 were
4 approximately 3.25 million to 3.7 million tons per year. Typically,
5 approximately 2 million to 2.5 million tons were under contract. As a result,
6 the new coal procurement needs for those units on an annual basis ranged
7 between 750,000 tons and 1.7 million tons.

8 The amount under contract was impacted significantly each year until
9 early 2002 by two long term (20 year) contracts entered into in the early
10 1980’s when long term contract commitments were deemed desirable to
11 ensure the availability of coal supply, particularly for base load plants such as
12 CR4 and CR5. Such a contract duration was a standard term in utility coal
13 contracts at the time. In fact, the Florida Department of Environmental
14 Protection (“DEP”) required proof of the existence of a long term coal supply
15 under contract as part of DEP’s approval of the siting of the units. The
16 Massey contract was submitted to DEP as proof of compliance with that
17 requirement, and DEP approved the siting of the units. The Massey and
18 Powell Mountain contracts were also entered into during a period of coal
19 price stability.

20

21 **Q: What was the tonnage covered by the Massey and Powell Mountain**
22 **contracts?**

23 **A:** Each was a nominal 1 million ton/year contract. Each gave PFC the option to
24 buy 10% to 15% more or less than the nominal tonnage when the contract

1 price differed from the market price. Each of these contracts expired in the
2 spring of 2002.

3 They accounted for roughly 60 to 66% of the annual needs of CR4
4 and CR5, subject to the ability of PEF to purchase 10% to 15% less if the
5 contract price exceeded market.

6
7 **Q: Was assuring an adequate supply of coal that would operate efficiently
8 and as expected in Units 4 and 5 of particular importance?**

9 **A:** Yes. Units 4 and 5 are “base load” plants, meaning they generate electricity
10 around the clock to meet PEF’s constant or “base load” statewide customer
11 needs for electricity. They are not “peakers” or other plants that operate only
12 to meet spikes in demand. Assuring an adequate and reliable performing fuel
13 supply for baseload plants is therefore critical to ensuring that the “lights
14 come on” whenever PEF’s 1.6 million customers “flip the switch.”

15
16 ***Step Two: Balancing Contract Durations***

17 **Q: What was the next step in the procurement process?**

18 **A:** To achieve a prudent mixture of coal supply contracts by having an
19 appropriate balance of long term, medium term, and “spot” supply contracts.
20 This is consistent with FPSC policies and orders.

21
22 **Q: What do you mean by the term “spot” contracts?**

1 A: Within PFC we use the term “spot” contract to describe contracts having a
2 duration of one year or less. This can include purchases for a single month or
3 even a single shipment.

4
5 **Q: Please explain what you mean by having a “balance” of contracts.**

6 A: As is common in the industry, we contracted with various coal consulting
7 services, including EVA, that provided forecasts as to future conditions in the
8 coal markets over various periods of time ranging from the short term to the
9 much longer term. We took those into account in evaluating how much of
10 our coal supply we wanted to be on medium term contracts (such as 18
11 months to three years) and how much we wanted to purchase on a spot basis
12 during a year.

13 For example, if we believed, based on an evaluation of market
14 forecasts, that the price of coal would move downward during a year and coal
15 on the spot market would be abundant, we may opt to maximize our
16 flexibility to take advantage of such drops by entering into fewer contracts
17 for a year or more in order to be able to purchase in the spot market.
18 However, even in such a situation we may choose to hedge against the
19 forecast proving inaccurate by putting some portion of our coal supply under
20 contract. Because, as discussed in more detail later, the coal market was
21 generally soft during the 1990’s and through the year 2000, we issued three
22 RFPs for CR4 and CR5 – in 1996, 1998 and 2001 – during the period
23 covered by my testimony.

24

1 **Q: What was the long term component of the contract mix?**

2 **A:** During the period 1996-2002 the Powell Mountain and Massey contracts
3 provided the long term component of this mixture. No other long term
4 contracts of similar duration were sought or entered into. PEF would
5 exercise its contractual right to purchase the contractual minimum under
6 these long term contracts during periods in which other coal was at a more
7 economical delivered price to CR4 and CR5. During much of the period
8 1996-2002 PFC was purchasing the contract minimums under the Massey
9 and Powell Mountain contracts.

10 Having arrived at a determination of what balance of longer, shorter
11 and spot contracts seem most prudent, PFC would turn to the next step in the
12 process.

13

14 ***Step Three: Creating a Competitive Solicitation Document***

15 ***And List of Recipients***

16 **Q: Please describe this third step in the procurement process.**

17 **A:** Having identified the needed supply of coal from new contract purchases,
18 and if it was determined that an RFP, rather than spot purchases, was
19 appropriate, an RFP was drawn up. A list of potential coal suppliers, usually
20 exceeding 100 in number, was maintained and updated, with coal suppliers
21 being regularly added to the list of prospective proposers. The list was the
22 result of such information as (a) known coal mining companies identified by
23 knowledge of the industry and various industry data, publications and the
24 like; (b) previous responders to an RFP; and (c) entities that had contacted us

1 to express an interest in being included in RFPs. If a company wanted to be
2 added to the list, all that was necessary was for them to contact PFC and
3 request to be added. A typical such list is Exhibit No. ___ (DMD-2) to my
4 testimony.

5
6 **Q: Did PFC send the RFPs to producers of sub-bituminous coal?**

7 **A:** Yes. To the best of my knowledge, during the period covered by my
8 testimony four companies comprised the bulk of the sub-bituminous
9 producers. They were Arch Coal, Peabody Coal, Triton Coal, and Kennecott
10 Coal. Arch later purchased Triton. Those companies were routinely included
11 in all RFPs. A typical bid solicitation sheet showing the producers that were
12 regularly solicited for proposals is Exhibit No. ___ (DMD-2) to my
13 testimony.

14
15 **Q: Was there a way that a coal producer who may not have been sent an
16 RFP could learn of the RFP and make a proposal?**

17 **A:** Yes. Our RFPs regularly appeared in widely read coal industry publications.
18 We affirmatively provided information concerning our RFPs to those
19 publications so as to achieve even broader dissemination of our RFPs than
20 even the lengthy list of producers to whom the RFP went. Coal Outlook, Coal
21 Daily, Energy Argus Daily, US Coal Review and McCloskey Coal Report are
22 just a few of the publications we used and which could have reported our
23 RFPs. It was not unusual for prospective coal suppliers who had not received
24 the RFP from us to contact us, request an RFP, and submit a proposal.

1 **Q: What about spot purchasing? Was there a way in which sub-bituminous**
2 **coal producers could make offers on the spot market to PFC?**

3 **A:** Yes. PFC was a substantial purchaser in the spot market. In our experience
4 most suppliers assumed we were more or less always open to spot purchases.
5 In addition, the same coal industry publications routinely publicized
6 companies purchasing in the spot market, which would have included PFC.

7
8 **Q: Describe the contents of the RFPs that were used.**

9 **A:** We used a relatively standardized form of RFP, although the substantive
10 contents would change with the needs of the company. Examples of the
11 RFPs used by PFC during the period 1996-2002 appear in Exhibit No. ____
12 (DMD-3) to my testimony.

13 Typically, and among other things, the RFP would state:

- 14 • the minimum annual tons desired, delivered in monthly, ratable amounts;
- 15 • the duration of the desired contract, which may include soliciting
16 proposals for more than one time period;
- 17 • “required coal specifications” for *both* bituminous and sub-bituminous
18 coal;
- 19 • that proposers should identify both their “typical” quality compared to the
20 specifications and their “guaranteed” quality;
- 21 • that PFC was “indifferent” as to the origin of the coal;
- 22 • that both rail and barge loading origins would be considered;
- 23 • that rail deliveries were to be quoted FOB the mine loading point; and
24 barge deliveries should be quoted FOB the barge.

1 *Step Four: Evaluating The Responses*

2 *A. Delivered Price*

3 **Q: Once responses to an RFP were received, how were they evaluated?**

4 **A:** Our primary basis for comparison was which proposal, if accepted, would
5 involve the lowest “delivered cost” or “delivered price.” These terms are
6 interchangeable.

7
8 **Q: What do you mean by “delivered cost”?**

9 **A:** “Delivered cost” was the cost calculated by PEF based on (a) the FOB mine
10 price specified in the proposal, plus (b) the cost of transporting the coal to the
11 Crystal River Complex.

12
13 **Q: Why was this the primary basis for comparison?**

14 **A:** PEF’s ratepayers pay for fuel purchases on a cost pass-through basis under
15 FPSC orders. In the case of coal, the amount that ratepayers pay through this
16 “fuel adjustment” charge is the delivered price of coal. We therefore sought
17 to ensure that PEF’s ratepayers paid for the lowest delivered price of coal by
18 emphasizing lowest delivered price in our coal procurement policies and
19 procedures.

20
21 *B. Mine Price*

22 **Q: Where would PFC obtain the FOB mine price?**

23 **A:** That would come directly from the proposal.

24

1 *C. Transportation Costs*

2 **Q: What were PFC's transportation options for getting coal to Crystal**
3 **River?**

4 **A:** Transportation of coal to Crystal River could be by rail or by water. The
5 complex was served by a CSX rail line. Water deliveries were by barge. The
6 FPSC had directed PEF and thus PFC to maximize the use of rail deliveries.
7 We did this every year. The 1 million (nominal) tons of coal under the
8 Powell Mountain long term contract were delivered by rail. The similar
9 tonnage under the long term Massey contract were shipped by water. I would
10 note that maintaining waterborne transportation provides an alternative
11 transport system in the event of rail strikes or other surface transportation
12 disruptions, as well as providing a means to negotiate the most favorable
13 rates from both forms of transportation. Also in Order No. 21847 (1986) the
14 Commission again reaffirmed the desirability of maintaining alternative
15 transportation routes for the purposes of increasing reliability and enhancing
16 price competition.

17
18 **Q: Can you give us an idea of how important transportation charges were to**
19 **the overall cost of coal procurement?**

20 **A:** Transportation charges were a very significant portion of the total delivered
21 price of coal from all potential sources. In the case of sub-bituminous coal, it
22 was by far the greatest portion of the total delivered price, significantly
23 exceeding the FOB mine price at all times.

24

1 **Q. Did PFC have a preference for whether coal for CR4 and CR5 was**
2 **delivered by rail or by water?**

3 **A.** PFC generally tried to maximize the use of rail transport, as directed by the
4 FPSC. Because CR4 and CR5 burn what is called “compliance coal,” and
5 because it was harder to obtain rail transport for compliance coal, we
6 generally emphasized the use of water for compliance coal for CR4 and CR5.

7

8

(i) Rail

9 **Q: Could all of PEF’s coal for CR4 and CR5 have been delivered by rail?**

10 **A:** No, even if we had wanted to do that, it was neither possible nor desirable
11 from a transportation charge perspective.

12

13 **Q: Please explain.**

14 **A:** CSX Transport, which is also the only railroad company operating in Florida,
15 maintains a single (“one way”) rail line between Dunnellon and Crystal
16 River. As a result, it is not possible to run more than one train at a time
17 between Dunnellon and Crystal River. Moreover, the rail spur at the Crystal
18 River Energy Complex is a loop. This imposes an inherent limitation on the
19 number of train sets that can run into the complex, which makes it physically
20 impossible to meet the transport needs of the complex, or of CR4 and CR5,
21 entirely or principally by rail.

22

23 **Q: What about sub-bituminous coal? What were the transportation options**
24 **for shipping that kind of coal to Crystal River?**

1 A: My understanding was that rail delivery of sub-bituminous coal to Crystal
2 River was cost prohibitive and that the only realistic option was rail transport
3 from the mine to water and then by waterborne delivery to Crystal River. I
4 understand that another witness testifying on behalf of PEF will address this
5 in detail. In my basic working understanding, however, this was a result of
6 (a) the distance from the Powder River Basin in Wyoming and Montana to
7 Crystal River; (b) the fact that no single railroad company could provide rail
8 service from Wyoming and Montana to Crystal River; and (c) the
9 substantially greater amount of sub-bituminous coal that would have to be
10 shipped compared to bituminous coal due to the lower Btu content of sub-
11 bituminous coal.

12
13 **Q: How was the rail transportation cost determined?**

14 A: PFC had negotiated rail rates with CSX, which is the only railroad operating
15 into Crystal River.

16

17 *(ii) Waterborne*

18 **Q: How was the water transportation cost determined?**

19 A: For water transportation, PEF would use (until 2005) the “waterborne proxy”
20 rates established by the FPSC for PEF’s water transportation and water
21 transportation related costs. The waterborne proxy rates included various
22 components, namely (a) truck transportation to an upriver dock, transloading
23 to barges, and river barge transportation rates for transport on the Ohio and
24 Mississippi rivers; (b) transloading costs, for transferring the coal to storage

1 or transferring coal from a river barge to a Gulf barge at IMT in New
2 Orleans; and (c) cross-Gulf barge rates for ultimate delivery to Crystal River.

3
4 **Q: Please explain the waterborne proxy.**

5 **A:** The waterborne proxy was established by the FPSC in order to eliminate the
6 need to thereafter constantly calculate PFC's "actual" waterborne transport
7 charges. The Commission felt that cost-plus pricing had led to lingering
8 suspicions that it resulted in higher cost due to affiliate transactions and that a
9 market proxy could be established. The proxy established in 1993 was based
10 on PFC's actual costs in 1992 and was thereafter annually escalated or de-
11 escalated by FPSC specified indices linked to certain market escalators.
12 Once established by FPSC order, the proxy became the cost that PFC was
13 required to use to calculate waterborne transportation rates. All parties to the
14 FPSC proceeding establishing the waterborne proxy, including the FPSC,
15 understand that by its very nature the proxy may deviate from PFC's actual
16 costs, be the deviation up or down. The proxy was replaced in 2004 by a
17 stipulated charge (which stipulation included OPC), and in 2005 by market
18 based rates to the extent that market based rates existed.

19
20 **Q: How did PFC use the waterborne proxy in calculating the water
21 transportation component of delivered cost for sub-bituminous coal?**

22 **A:** The waterborne proxy was developed by combining the cost of discrete
23 stages of water transportation (e.g., river barge rates from upriver docks to
24 the IMT terminal in New Orleans). This also lent itself to being used to

1 calculate the waterborne proxy rate applicable to each transport stage as
2 necessary to reflect the actual stages involved in particular transports. PFC
3 therefore used the applicable rates from the waterborne proxy for the portions
4 that applied to the route that would be taken to Crystal River by sub-
5 bituminous coal.

6
7 **Q: Has the FPSC recognized such a stage approach in any order?**

8 **A:** Yes, in 1994 the FPSC approved PFC's use of such an approach in
9 calculating the appropriate proxy rate for the shipment of imported coal
10 which might be purchased at IMT, which did not use any part of the river
11 stage of the full waterborne proxy. The FPSC sanctioned the use of 50.2% of
12 the full waterborne proxy to reflect the stages that included transloading at
13 IMT and cross-Gulf transportation from IMT to Crystal River. Although the
14 circumstances that gave rise to the FPSC's order involved imported coal, the
15 actual methodology employed in the order was based on the portion of the
16 waterborne proxy that would be involved in the purchase of any kind of coal
17 at IMT. In 2004 the FPSC approved a waterborne proxy for foreign
18 (imported) coal FOB Barge by calculating the portion of the transport
19 activities included in the waterborne proxy that were actually involved in
20 transporting foreign coal to Crystal River for 2001 to 2003, less the
21 transloading component, which cost the foreign coal supplier absorbed.

22
23 **Q: Can you illustrate how PFC calculated delivered cost for sub-bituminous**
24 **coal?**

1 A: Yes. An example appears as Exhibit No. ___ (DMD-4) to my testimony.
2 This is a calculation of the estimated transportation cost of coal originating in
3 the Powder River Basin in 1997. In this estimate, the three transportation
4 cost components were the mine to the river (here, the Cora dock on the
5 Mississippi), the river dock to IMT, and the movement of the coal from IMT
6 across the Gulf to Crystal River, including all transloading charges.

7 In Exhibit No. ___ (DMD-4), the first leg of the trip was estimated
8 based on information obtained from the marketplace for such mine to river
9 rail costs. The second leg, the trip from the Cora dock on the Mississippi to
10 IMT, is a conservative estimate of the relative percentage of the waterborne
11 proxy for the river to IMT movement to the shorter movement on the river to
12 IMT for PRB coal.

13 The ratio of the miles from the Cora dock to IMT to the miles from
14 the Ceredo dock to IMT ($995 \div 1564$) was multiplied times the original
15 waterborne proxy rate from the Ceredo dock (\$7.71), which is the further
16 river dock from IMT under the waterborne proxy, to provide an "implied"
17 original Cora waterborne proxy rate (\$4.97). To arrive at the escalation of
18 this rate from the origin of the waterborne proxy in 1992 to get a 1997
19 "market" rate, the percentage escalation from the original total base river
20 waterborne cost (which was the average of the costs from all docks from
21 which PFC purchased coal plus the waterway user tax) of \$7.32 to the 1997
22 river waterborne proxy rate of \$8.30 was first determined (13.4%). This
23 percentage increase was then applied to the "implied" Cora to IMT 1992

1 river rate of \$4.91 to get the 1997 Cora to IMT implied waterborne proxy rate
2 of \$5.57.

3 Once the river part of the waterborne proxy was determined, it was
4 added to the market estimate of the mine to river cost plus transloading costs
5 (\$14.00) and the estimated IMT and Gulf waterborne proxy rates (\$12.70) to
6 obtain a total estimated transportation cost from the PRB to Crystal River of
7 \$32.27/ton. To get the delivered cost number, the dollar per ton price FOB
8 mine must be added to the \$32.27/ton estimated transportation cost.

9
10 ***B Evaluated Cost/Busbar Cost***

11 **Q: Was any cost basis other than delivered cost ever used to compare and**
12 **evaluate responses to RFPs?**

13 **A:** Yes. We would employ what we called the “evaluated cost” of coal, which
14 was sometimes also referred to as the “busbar cost.”

15
16 **Q: Explain what you mean by an “evaluated” or “busbar” cost.**

17 **A:** The physical and chemical characteristics of coal can have an impact on the
18 operation of the boilers and other operating aspects of the utility plant in
19 which it is burned. This impact can add an operating and maintenance
20 expense and capital costs that will ultimately be passed on to ratepayers
21 during rate adjustments, apart from the fuel adjustment charges that are
22 periodically passed through. The “evaluated cost” or “busbar cost” analysis
23 was a way of estimating such costs.

24

1 **Q: By the way, could you explain the reference to “busbar” as used in**
2 **“busbar cost.”**

3 **A:** Yes, although I am not an expert in how it is calculated. My working
4 understanding is that the busbar is essentially the physical point in the utility
5 generating plant that marks the end of the generating system and the
6 beginning of the transmission system. The term “busbar cost” is, in my
7 understanding, used to describe what cost impact certain coals will have on
8 the cost of burning the coal and thus ultimately generating electricity up to
9 the point at which the generation system ends. I understand that other
10 witnesses may address the calculation of this cost more knowledgeably.

11

12 **Q: Who performed the evaluated cost or busbar cost analysis?**

13 **A:** When we requested such an evaluation, our request went to the utility, which
14 then performed the evaluation with us and produced the results. The results
15 were expressed as a cost in ¢/MM Btu higher or lower than (or the same as)
16 the historically established and known cost impact on the plant of coal
17 meeting the utility’s “ideal” physical and chemical specifications.

18

19 **Q: You indicated that you are not an expert in how evaluated or busbar cost**
20 **is determined, but that you have a working understanding of it. What is**
21 **your understanding of how it is done?**

22 **A:** My understanding is that it was done using a computerized model created by
23 the Electric Power Research Institute’s (“EPRI”) model. We used the results

1 provided by the utility in comparing the evaluated or busbar cost of various
2 proposals.

3
4 **Q: Was it always necessary to calculate an evaluated cost or busbar cost in**
5 **comparing responses to RFPs?**

6 **A:** No, not always. If the “short list” of proposers was comprised of suppliers
7 with whose coal we had substantial experience or on which we had
8 previously done a busbar analysis, it was generally unnecessary.

9
10 **Q: What kind of situations would provide a reason to believe that using an**
11 **evaluated or busbar cost comparison would provide additional cost**
12 **information that would be useful in evaluating proposals?**

13 **A:** It was most commonly used when we received proposals for coals of a type
14 that the utility had not previously used and which had different chemical or
15 physical properties from the coal with which the utility had extensive,
16 historic operational experience (CAPP coal). When the only proposals
17 received were for types of coal, typically CAPP coal, with which the utility
18 had such extensive historic experience, there was no need to go beyond
19 determining the delivered cost since the evaluated costs were known. It was
20 also not necessary to do such additional evaluations when non-CAPP coal
21 was already highly non-competitive on a delivered cost basis. In such
22 situations there was no reason to believe that further evaluations using the
23 evaluated or busbar cost would affect which proposal was the lowest cost
24 proposal.

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Q: Can you give us an example of a type of coal that as to which an evaluated cost or busbar cost analysis could provide important information?

A: Yes. Sub-bituminous coal is such a coal.

Q: Were evaluated or busbar cost comparisons done on spot purchases?

A: No, it was not practical to subject short term spot purchases to such modeling. One reason for this is that the tonnage had an impact on the busbar costs – the more tons the facility has to handle and operate with, the higher the cost typically. Spot purchases generally involved lower tonnage and shorter time periods than contract purchases.

Q: Can you give us an idea of how many responses to RFPs PFC might get from sub-bituminous coal producers during the time period covered by your testimony?

A: Yes. It is first important to keep in mind that the only RFPs that PFC issued for CR4 and CR5 during the time period covered by my testimony were in 1996, 1998 and May 2001. At all other times PFC met the tonnage needs of CR4 and CR5 (above that already under contract) by purchases in the spot market. In response to the 1998 RFP Kennecott, a major PRB coal producer, expressly declined to make a proposal, and we received no proposals from any other sub-bituminous coal supplier. Please see Composite Exhibit No. ____ (DMD-5) to my testimony, which includes the 1998 RFP response list

1 and Kennecott's declination letter. In the May 2001 RFP proposals were
2 received from two sub-bituminous producers (Triton and Arch), each of
3 which was the lowest evaluated cost proposal for certain possible contract
4 durations but not others. This is discussed later in this testimony.

5
6 **C. Short Listing**

7 **Q: Now, once the responsive proposals were examined on a delivered or**
8 **evaluated cost (where used) basis, what did PFC do?**

9 **A:** The initial evaluation resulted in the creation of a "short list." This was
10 usually the 3 to 5 proposals with the lowest delivered cost, or lowest
11 evaluated cost if calculated. Bidders who did not make the short list were
12 notified and advised that we would include them on future proposals and
13 welcomed their continued interest. The short list proposers were then the
14 group with whom PEF negotiated to obtain the best price. The contract was
15 then eventually entered into with the proposer(s) offering the best lowest
16 ultimate price.

17
18 **VII. SUB-BITUMINOUS COAL EVALUATIONS 1996-2002**

19
20 **Q: During 1996-2002 was sub-bituminous coal competitive with other types**
21 **of coal on either a delivered or evaluated cost basis?**

22 **A:** No. During this period the FOB mine price for sub-bituminous coal was
23 substantially lower than that of bituminous coals, including CAPP coal.
24 However, the transportation cost for getting such coal to Crystal River from

1 the mine, typically located in Wyoming, was the vast bulk of the delivered
2 cost and rendered it non-competitive on a delivered cost basis. Sub-
3 bituminous proposals, when made, typically did not make the "short list,"
4 except arguably in the May 2001 RFP. I would note again that Kennecott, a
5 sub-bituminous producer, expressly declined to bid for our business in
6 response to the 1998 RFP, and that we received no bids from other PRB
7 producers in response to that solicitation. I can recall receiving no sub-
8 bituminous coal proposal in response to an RFP prior to 2001.

9
10 **Q: What about spot purchases?**

11 **A:** To my knowledge during the 1996 through 2002 time period we never
12 received an offer for a spot sale of sub-bituminous coal.

13
14 **Q: You mentioned an occasion in which sub-bituminous coal was arguably**
15 **competitive. Please explain.**

16 **A:** In May of 2001 we issued an RFP that went, as usual, to many coal
17 producers, including sub-bituminous producers. There was a major upward
18 spike in coal prices after two decades or more of highly stable prices, and we
19 wanted to try to lock in our coal contracts earlier in light of these
20 uncertainties. A copy of the May 2001 RFP and the bidder list is Exhibit No.
21 ____ (DMD-6) and Exhibit No. ____ (DMD-7) to my testimony, respectively.

22 PFC was attempting to evaluate what this market situation indicated,
23 if anything, in terms of longer term price increases or instability. We
24 therefore requested proposals for contracts of 1, 2, 3 and 5 years so that we

1 could examine different scenarios as we evaluated the unusual situation and
2 possible future market conditions.

3 We received proposals from sub-bituminous and bituminous coal
4 producers, as well as for South American coal. We did an evaluated cost
5 analysis on all proposals. The results of those analyses appear in Exhibit No.
6 ____ (DMD-8) to this testimony.

7 Sub-bituminous coal proposals were not the lowest on an evaluated
8 cost basis for the 1 year and 3 year analyses. A PRB response (Arch Coal)
9 was the only one proposing a 2 year contract. Two PRB proposals (both
10 from Triton coal, for different Btu PRB coals) were the lowest on an
11 evaluated cost basis for a 5 year contract.

12 PFC did not ultimately deem a 5 year agreement prudent. Although
13 the coal markets had undergone an abrupt spike in prices in 2001, PFC was
14 not comfortable signing a contract of such duration in light of the uncertainty
15 as to what the 2001 market conditions indicated, if anything, for the future
16 direction of the market. PFC therefore negotiated with the lowest cost
17 proposer for a 3 year contract, which was a proposal for high Btu imported
18 coal, which negotiations ultimately resulted in a one year contract with that
19 proposer.

20
21 **Q: Just so we are clear, PFC signed a one year contract for imported**
22 **bituminous coal in May 2001?**

23 **A: Correct.**
24

1 **Q: Was sub-bituminous proposal the lowest proposal on an evaluated cost**
2 **basis for a 1 year contract?**

3 **A:** No.

4
5 **Q: Do all the PFC records reflecting the details of the evaluations done on**
6 **responses to RFPs in the 1996-2002 time period still exist?**

7 **A:** No, some were discarded well prior to the commencement of this proceeding
8 (and anything remaining we found after the proceeding commenced was
9 maintained), and in the absence of any indication that there was any potential
10 for a question to arise as to the fuel procurement decisions made under those
11 RFPs. These materials were destroyed within time frames consistent with
12 PFC's records retention policy.

13
14 **Q: Does the fact that those particular documents are no longer available**
15 **affect your testimony?**

16 **A:** No, it does not. First, they involve only the three RFPs issued during that
17 time period, in 1996, 1998 and 2001, which were the only RFPs issued
18 during the 1996-2002 time period. Second, we have the key document for
19 the 2001 RFP, which is Exhibit No. ____ (DMD-8), which shows that no sub-
20 bituminous coal was the lowest cost offer for the 1 year contract period
21 selected by PFC. Finally, my recollection of the events to which I testify
22 herein is not dependent on having such records, but is an independent
23 recollection. While having the actual records might permit me to add

1 additional detail, I have no reason to believe it would materially affect my
2 testimony or contradict it.

3
4 **Q: Before moving to the next topic, could you describe the nature of the coal
5 market generally during the 1990's and how it generally affected PFC's
6 procurement environment?**

7 **A:** Generally speaking the 1990's were characterized by a "soft" coal market,
8 meaning coal was abundant and relatively inexpensive. It was basically a
9 "buyer's market." In addition, those producers who responded to our RFPs
10 tended to respond with bituminous coal with high Btus and high quality
11 specifications. As a result, PFC tended to utilize more short term and spot
12 purchases as a strategy for maximizing our ability to purchase high quality
13 coal at low prices. The general nature of the market and PFC's strategy and
14 responses to it are reflected in the monthly reports provided by Mr. Edwards
15 to his superior(s). Those reports are contained in Composite Exhibit No.
16 ____ (DMD-9) to this testimony.

17
18 ***C. Monitoring PRB Usage By Others And Forecasting Its Eventual***

19 ***Competitiveness***

20 **Q: Did PFC familiarize itself with PRB usage by other Southeastern
21 utilities?**

22 **A:** Yes. Through the period 1996 through 2002 PFC was aware that TECO, our
23 most geographically proximate "competitor," and The Southern Company
24 were using sub-bituminous PRB coal in some plants.

1 **Q: Why did PFC look at such information?**

2 **A:** Whenever we saw a generating utility in our region using such coal, we
3 attempted to determine why such coal might make economic sense for them
4 to use, even though it did not appear economic for PEF. It was a means of
5 quality assurance, if you will, to make sure we were not missing something,
6 even though we had no reason to think we were.

7
8 **Q: What did you conclude as to TECO?**

9 **A:** We could find no basis to believe that TECO's purchases of PRB coal were
10 based on purchasing the lowest cost coal. This is borne out by data reported
11 by TECO on FERC Form 423. This data shows that TECO's purchases of
12 PRB coal were never the cheapest, and often among the most expensive, coal
13 TECO purchased on a delivered cost basis to the transfer facility. This is
14 illustrated in Exhibit No. ____ (DMD-10) to this testimony, which contains
15 that FERC information.

16 Our assessment was that even though PRB coal was not the lowest
17 cost coal available to TECO, TECO was purchasing such coal for emissions
18 control purposes in order to address specific emissions needs of TECO and
19 Hillsborough County where TECO's Gannon plant is located. At that time
20 there was a considerable amount of press coverage regarding TECO's SO₂
21 emissions and Hillsborough County being (or being in danger of becoming) a
22 "non-attainment" area for SO₂ emissions. My non-expert understanding of a
23 non-attainment area is that it is an area that has been designated by the

1 federal Environmental Protection Agency as consistently failing to meet
2 federal air quality standards for particular substances, such as SO₂.

3
4 **Q: Did PFC collect or generate any other data that bears on this
5 conclusion?**

6 **A:** Yes. We also regularly compared PEF's and TECO's coal costs, measured
7 on a generated cost per Kwh basis, using information reported by both
8 utilities to the FPSC for fuel adjustment purposes. On this basis PEF's costs
9 were consistently lower than those of TECO during the period 1996-2002.
10 This information appears in Exhibit No. ___ (DMD-11) to this testimony.

11 We made a similar comparison using a generated cost per million Btu
12 basis. PEF's coal costs measured on this basis also compared favorably, and
13 were frequently lower than, those of TECO during the period 1996 to 2002.
14 This information appears in Exhibit No. ____ (DMD-12) to this testimony.

15
16 **Q: What did PFC conclude as to what all this information indicated?**

17 **A:** Basically, we never found a basis for concern that we were not procuring coal
18 on a lowest cost basis.

19
20 **Q: Are there other indications that PFC was evaluating potential purchases
21 of sub-bituminous coal during the 1996-2002 time period?**

22 **A:** Yes. Even though sub-bituminous coal had not proved itself competitive
23 economically, PFC continued to monitor it for potential future use. This is
24 illustrated, for example, in a 1996 exercise done by Mr. Edwards (Exhibit

1 No. ____ (DMD-13)) which estimated (among other things) the delivered
2 cost of 8,800 Btu PRB coal through McDuffie Terminal in Mobile, Alabama.

3 In addition, Exhibit No. ____ (DMD-4), created in 1997 or 1998,
4 illustrates PFC's attempts to fairly estimate the cost of transporting PRB coal
5 to Crystal River using the waterborne proxy rates, coupled with estimated rail
6 charges from the Western mines to the Mississippi River.

7 Also, in Mr. Edwards' February 9, 1998, memo to Mr. Cumbie
8 (Exhibit No. ____ (DMD-14)), Mr. Edwards discussed his thoughts on the cost
9 of switching all "compliance" (so called "D" coal) to rail delivery and all
10 non-compliance ("A" coal) to water delivery. In that memo Mr. Edwards
11 observes that:

I believe we should recognize that we will, in all likelihood, be using Powder River Basin coals at [CR] 4 & 5 by about 2000 (my guess.) Since those coals, and others like South American, best move to Crystal River by water and are generally "compliance" grade, we would likely switch back to "D" water at this time in any event.

12 That memo is Exhibit No. ____ (DMD-14) to this testimony.

13 In 1999 PFC estimated that PRB would potentially be the lowest cost
14 coal, using a 50/50 CAPP/PRB blend, by 2003. See Exhibit No. ____ (DMD-
15 15) to this testimony.

16 These all illustrate that PFC was very open to the idea that at some point
17 in the next several years PRB coal may become the coal of choice on a lowest
18 cost basis. I would also note that the last mentioned exhibit (Exhibit No. ____
19 (DMD-15)) further indicates that PFC was well aware of the original boiler
20 design for CR4 and CR5.

1 *D. Previously Untested Types of Coal.*

2 **Q: Had sub-bituminous coal been the lowest cost coal on an evaluated cost**
3 **basis, what policies or practices would PFC have employed before**
4 **contracting for it?**

5 **A:** As I have discussed, sub-bituminous coal had not previously been burned in
6 CR4 and CR5. As a result, PFC's and PEF's standard procedures would have
7 required that the coal offered be subjected to a "test burn" before a contract
8 was finalized. This did not occur during the period 1996-2002 because sub-
9 bituminous coal was not the lowest priced coal and therefore the need to
10 conduct such a test evaluation was never presented.

11
12 **Q: Wasn't the purpose of the evaluated cost calculation done with the EPRI**
13 **model to determine the impact of the coal on the cost of operating the**
14 **plant?**

15 **A:** Yes, but the evaluated cost calculation done by the EPRI model is still only a
16 computer model that is useful to give an indication of the *estimated* impact.
17 My understanding is that before a previously unused coal would actually be
18 contracted for, the utility would desire to test it to confirm, with actual field
19 experience, the effects on the operation of CR4 and CR5.

20
21 **Q: What function did the evaluated cost analysis and EPRI modeling serve**
22 **then?**

23 **A:** Had they suggested that sub-bituminous coal was the lowest cost coal on an
24 Evaluated Cost basis, the model would have served the purpose of placing

1 that coal into active contention for testing and eventual purchase. It did not
2 so indicate during the period covered by my testimony, however.

3

4 **Q: Can you point to any example of such a process being followed during**
5 **your tenure at PFC?**

6 **A:** Yes. This was the procedure followed in evaluating whether to purchase
7 "Petcoke" in 1999 and synfuel in the late 1990's. In both instances, when it
8 appeared that these fuels, previously untested at CR4 and CR5, were
9 potentially the lowest cost coals, PFC and PEF arranged for test burns to
10 determine the actual field performance of these new fuels.

11

12 **Q: What is your understanding of what occurred concerning sub-**
13 **bituminous coal after 2002?**

14 **A:** My understanding is that beginning in late 2003 to early 2004, PRB coal
15 began to emerge as the lowest, or potentially lowest, cost coal, and that PEF
16 began testing it in accordance with the policies and practices I just described.
17 I recall that as a result Mr. Pitcher began actively considering sub-bituminous
18 coal, preparing to test burn such coal, and directing others to evaluate
19 transportation costs for sub-bituminous coal.

20

21 **VIII. SYNFUEL**

22

23 **Q: Did PFC purchase synfuel purchases for CR4 and CR5 during your**
24 **tenure?**

1 A: Yes.

2

3 **Q: How did PFC evaluate whether to purchase synfuel and from what**
4 **supplier?**

5 A: PFC evaluated synfuel on the same basis as all other coal offers. That was to
6 determine what the lowest delivered cost and evaluated cost offers of coal,
7 including synfuel, were and to purchase fuel meeting the utility's
8 specifications at the lowest such cost. As I have indicated, in the case of
9 synfuel, the utility also tested synfuel before authorizing substantial
10 purchases.

11

12 **Q: Are you familiar with the testimony of Mr. Sansom in this proceeding in**
13 **which he contends that PFC favored the purchase of synfuel from**
14 **producers in which EFC had a financial interest?**

15 A: Yes, I have read his testimony.

16

17 **Q: Is he correct in this regard?**

18 A: No he is not.

19

20 **Q: Did PFC favor or give preference to synfuel produced or marketed by**
21 **companies in which PFC (or EFC before it) had an equity interest?**

22 A: No, it did not.

23

1 **Q: Are you aware that Mr. Sansom asserts that it is “statistically**
2 **impossible” for PFC to purchase as much synfuel as it did from such**
3 **companies absent such favoritism?**

4 **A:** Yes, I have read his testimony.

5
6 **Q: Is there an explanation for the amount of synfuel that PFC purchased**
7 **from such companies?**

8 **A:** Yes. It was not unusual for PFC to purchase synfuel from entities marketing
9 synfuel produced by companies in which PFC had some equity interest for
10 the simple reason that those companies were by far the largest producers of
11 synfuel in the country. In fact, on a number of occasions such companies
12 were the *only ones offering* synfuel on a spot purchase basis. Therefore, but
13 for them PFC would have had to purchase coal at a higher cost to ratepayers
14 than the synfuel it purchased.

15
16 **Q: How did synfuel prices compare generally to coal prices?**

17 **A:** Generally, synfuel was priced \$1 to \$2 per ton below the market price of
18 bituminous CAPP coal, yet it had an equivalent heating value.

19
20 **Q: How did this impact PEF’s ratepayers?**

21 **A:** Obviously, it benefited them. They paid in effect \$1 to \$2 less per ton
22 through the fuel adjustment proceedings.

23

1 **Q: Just to be clear, did PFC also purchase synfuel from other synfuel**
2 **suppliers having no direct or an indirect connection with Progress**
3 **Energy?**

4 **A:** Yes, as I said we purchased from the proposer, be it synfuel or coal, offering
5 the lowest price and which met the utility's quality specifications. As a
6 result, we purchased synfuel from producers having no connection with PFC
7 when producers in which PFC had a financial interest were not the lowest
8 cost product offered.

9
10 **Q: How does the amount of tax credits generated for Progress Energy, the**
11 **holding company for PFC, by sales of synfuel to PFC compare to**
12 **Progress Energy's overall tax credits from synfuel sales to others?**

13 **A:** The tax credits from synfuel sales to PFC for Crystal River were minimal
14 compared to the tax credits generated from sales of synfuel to other utilities
15 and industrial customers. This is because tax credits were not available on
16 sales from a company with a majority equity position in a synfuel producer to
17 an affiliated company. The synfuel producers in which PFC held a majority
18 equity position sold their synfuel coal product to utilities other than PEF and
19 industrial customers.

20 New River Synfuel LLC, the synfuel producer that sold 80 percent of
21 the synfuel purchased for CR4 and CR5 between 2000 and 2005, is a synfuel
22 producer in which PFC held only a 10 percent equity position. Even New
23 River Synfuel LLC, however, sold more synfuel to other utilities and
24 industrial customers than it did to Crystal River. The total tax credits claimed

1 by New River Synfuel LLC for the period 2000 to 2005 for all synfuel sales
2 to all utilities and other customers were \$67,549,000. The total tax credits
3 claimed by New River Synfuel LLC for the same period for synfuel sales to
4 Crystal River were \$10,546,000, with operating losses of \$6,583,000, for a
5 net total tax credit claim of \$3,962,000.

6 When the \$3,962,000 net tax credit claimed on New River synfuel
7 sales to Crystal River from 2000 to 2005 is compared to the \$1.25 billion
8 value of all synfuel tax credits claimed on all synfuel sales by Progress
9 Energy over the same time period --- which Mr. Sansom says at page 26,
10 lines 9-10 of his testimony was reported by Argus Coal Daily --- the
11 insignificance of the tax credits on synfuel sales to Crystal River is self
12 evident. They account for less than 3 percent of the total tax credits. As a
13 result, there is no basis in fact for anyone to suggest that synfuel tax credits
14 influenced in any way the purchasing decisions for CR4 and CR5.

15
16 **Q: Are you familiar with something referred to as “twist” arrangements**
17 **involving synfuel?**

18 **A:** Yes. A “twist” arrangement is where PFC has stepped into the middle of a
19 coal contract. Someone has a contract for coal and PFC steps in the middle
20 and the coal is made into synfuel and sold to the end user as synfuel at a \$1 to
21 \$2 discount. As a result of such an arrangement, the end user, in the case of
22 Crystal River, the ratepayers, benefit as they have paid less than they would
23 have paid had PFC not done the twist deal.

1 As I have explained, for the New River synfuel that was delivered to
2 Crystal River, PFC received a 10% portion of the tax credit associated with
3 synfuel. However, in all cases the ratepayer was obtaining fuel (synfuel) at a
4 cost below the cost the ratepayer would have paid had the original coal
5 contract price been paid, which coal contract price itself, it should be
6 remembered, reflected the lowest cost coal at the time the coal supply
7 contract was entered into. Such an arrangement was therefore a “win-win”
8 situation in which the ratepayer benefited.

9
10 **IX. REGULAR DIALOGUE WITH FPSC STAFF AND OPC.**

11
12 **Q: Did PFC provide the FPSC Staff with information concerning its coal**
13 **procurement activities during the period 1996-2002?**

14 **A:** Yes, of course. We maintained a regular dialogue with the FPSC Staff on
15 coal procurement practices and results during the entire period 1996 (and
16 before) through the present. These meeting typically occurred quarterly and
17 were generally referred to as “Staff Update Meetings.” They were used to
18 bring the Staff up to date on PFC fuel procurement activities since the last
19 such meeting, to share information with Staff about how we saw coal
20 procurement going forward, including our expected coal sources, costs and
21 challenges. OPC representatives were in attendance. The meetings were
22 always open to OPC.

23 In the meetings we answered Staff and OPC questions and provided
24 post-meeting information and further answers where the information

1 necessary to answer questions was not on hand at the meeting or required
2 research. PEF maintained agendas for each of these meetings. They are
3 Composite Exhibit No. ___ (DMD-16) to this testimony.

4 PEF also created outlines for the meetings, which outlines were not
5 handed out at the meeting, but used as notes for the PEF representatives to
6 guide their presentation. Those outlines reflect with reasonable accuracy the
7 information provided at the meetings. Those outlines are Composite Exhibit
8 No. ___ (DMD-17) to this testimony.

9
10 **Q: Are there any other examples of PFC sharing information or making**
11 **information available to the Staff in connection with coal procurement?**

12 **A:** Yes. Pursuant to an order of the FPSC PFC and PEF were required to
13 conduct an internal audit annually to compare PFC's revenue requirements
14 under full regulatory treatment relative to the revenue requirements using an
15 equity amount of 55% of net long term assets (the latter being called the
16 "short-cut method"). These audits specifically focused on revenues
17 associated with the purchase of coal since coal purchases were treated as part
18 of the "regulated" portion of PFC's business.

19 This audit was conducted annually and its results provided to the
20 FPSC. In connection with this FPSC mandated audit, PFC maintained and
21 made available to FPSC all records relating to coal procurement. This
22 underscores and illustrates how all of PFC's records regarding coal purchase
23 transactions were open to the FPSC.

1 A: I would make a number of points in response to Mr. Sansom's testimony on
2 this point.

3 I would note initially that information from which Mr. Sansom draws
4 his conclusion is the data reported by each utility in FERC Form 423, which I
5 discussed earlier in my testimony. I have reviewed that same data, as I
6 regularly did in my duties at PFC. This information for TECO is attached as
7 Exhibit No. ___ (DMD-10) to this testimony. Similar information for PFC
8 and PEF is attached as Exhibit No. ___ (DMD-19) to this testimony.

9 My first point is that the data reveals that Mr. Sansom is comparing
10 TECO *spot* purchases of sub-bituminous coal to PFC's annual total of *all*
11 (contract and spot) coal deliveries for CR4 and CR5 each year. This is an
12 "apples to oranges" comparison because it includes deliveries of coal under
13 various PFC contracts whose prices were established in years prior to the
14 year in which the delivery occurred – i.e., the year of contracting.

15 Second, I think it is very noteworthy that the sub-bituminous coal
16 delivered cost shown for TECO is *higher* than the delivered cost shown for
17 TECO spot purchases of bituminous coals during the same period. As I have
18 previously indicated, this suggests strongly that TECO may have been
19 purchasing sub-bituminous coal for reasons other than price.

20 Third, he fails to account for the actual delivered cost of coal to CR4
21 and CR5. The delivered cost to TECO's transfer facility at Davant,
22 Louisiana, which is what is reflected in the FERC Form 423, does not include
23 a transfer charge while PEF's does include a transfer charge. I know this
24 from having worked in fuel accounting matters at both TECO and PFC and

1 having prepared the Form 423s for both companies. This can also be derived
2 from Exhibit No. ____ (DMD-20) to my testimony, which is the Staff
3 comparison of the waterborne costs for PEF, TECO, and Gulf from 1995 to
4 2000.

5 Fourth, TECO's transportation charges to final delivery in Tampa,
6 which comprise the bulk of the delivered cost for sub-bituminous coal, are
7 not the same as those of PEF. I also know this from having worked at both
8 TECO and PEF. PEF's water transport charges were the "waterborne proxy"
9 set by FPSC Orders. TECO's water transport charges were not calculated
10 using that proxy and were in fact capped, rather than set by proxy, by FPSC
11 Order. Moreover, because of different channel depths at Port Tampa where
12 TECO's barges offloaded, and Crystal River, TECO was able to use much
13 larger barges capable of hauling greater quantities of coal than the barges that
14 PEF could use to deliver to Crystal River.

15 Fifth, I would also note that the spot TECO purchase of sub-
16 bituminous coal that Mr. Sansom uses for 1998 was from Kennecott, a
17 producer that declined to bid for PFC business in 1998.

18 Finally, as I have previously testified, I would note that PEF
19 compared favorably to TECO in comparative coal costs measured on both a
20 generated cost per MM Btu and generated cost per Kwh basis. See Exhibits
21 Nos. (DMD-11) and (DMD-12) to this testimony.

22 As a result, Mr. Sansom's comparisons are misleading, "apples to
23 oranges" comparisons and therefore do not support the assertion or

1 implication that sub-bituminous coal was the lowest delivered cost coal for
2 CR4 and CR5 during the 1996-2002 time period.

3

4 **Q: Does this conclude your testimony?**

5 **A: Yes.**

6

7

8