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February 29, 2000

Ms. Blanca S. Bayo, Director  
Division of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee FL 32399-0870

Dear Ms. Bayo:

RE: Docket No. 991779-EI

Enclosed are an original and fifteen copies of the testimony of M. W. Howell on behalf of Gulf Power Company to be filed in the above referenced docket.

Sincerely,

*Susan D. Ritenour*

Susan D. Ritenour  
Assistant Secretary and Assistant Treasurer

lw

AFA	<u>1</u>	cc: Beggs and Lane
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CMU	_____	
CTR	_____	
EAG	<u>Howell</u>	
LEG	_____	
MAS	<u>Stacy</u>	
OPC	_____	
RRR	_____	
SEC	<u>1</u>	
WAW	_____	
OTH	_____	

DOCUMENT NUMBER-DATE  
02699 MAR-18  
FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Review of the appropriate application )  
of incentives to wholesale power sales by )  
investor-owned electric utilities )  
\_\_\_\_\_ )

Docket No. 991779-EI

Certificate of Service

I HEREBY CERTIFY that a true copy of the foregoing was furnished by hand delivery or the U. S. Mail this 29th day of February 2000 on the following:

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 991779-EI

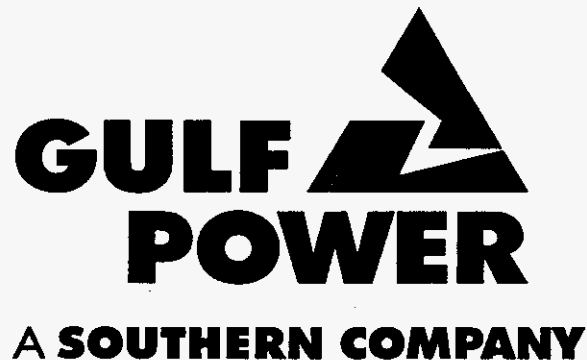
**REVIEW OF INCENTIVES FOR WHOLESALE  
SALES BY INVESTOR-OWNED UTILITIES**

PREPARED DIRECT TESTIMONY

OF

M. W. HOWELL

MARCH 1, 2000



DOCUMENT NUMBER-DATE

02699 MAR-18

FPSC-RECORDS/REPORTING



1       Manager of System Planning, Manager of Fuel and System  
2       Planning, and Transmission and System Control Manager.  
3       My experience with the Company has included all areas of  
4       distribution operation, maintenance, and construction;  
5       transmission operation, maintenance, and construction;  
6       relaying and protection of the generation, transmission,  
7       and distribution systems; planning the generation,  
8       transmission, and distribution systems; bulk power  
9       interchange administration; overall management of fuel  
10      planning and procurement; and operation of the system  
11      dispatch center.

12               I am a member of the Engineering Committees and  
13      the Operating Committees of the Southeastern Electric  
14      Reliability Council and the Florida Reliability  
15      Coordinating Council, and have served as chairman of the  
16      Generation Subcommittee of the Edison Electric Institute  
17      System Planning Committee. I have served as chairman or  
18      member of many technical committees and task forces  
19      within the Southern electric system, the Florida  
20      Electric Power Coordinating Group, and the North  
21      American Electric Reliability Council. These have dealt  
22      with a variety of technical issues including bulk power  
23      security, system operations, bulk power contracts,  
24      generation expansion, transmission expansion,  
25      transmission interconnection requirements, central

1 dispatch, transmission system operation, transient  
2 stability, underfrequency operation, generator  
3 underfrequency protection, and system production  
4 costing.

5  
6 Q. What is the purpose of your testimony in this  
7 proceeding?

8 A. The purpose of my testimony is to address the issues in  
9 this docket concerning the currently allowed 20 percent  
10 shareholder incentive for certain non-separated  
11 wholesale sales. At the November 1999 fuel hearing in  
12 Docket No. 990001-EI, the Commission decided that the  
13 incentive issues should be addressed in a separate  
14 proceeding.

15  
16 Q. Should the Commission continue its present policy and  
17 provide for stockholder incentives to encourage non-  
18 separated, non-firm, wholesale sales?

19 A. Yes. The Commission should, at a very minimum, continue  
20 the existing direct 20% incentive to utilities for  
21 participating in the wholesale, non-firm, economy energy  
22 market. Retail customers of both a net purchasing  
23 utility and a net selling utility benefit from a vibrant  
24 economy energy market where selling utilities have both  
25 direct and indirect incentives to satisfy the market's

1 demand for off-system economy energy. The lower cost of  
2 economy energy available from sellers allows the net  
3 purchasing utility to meet its customers' needs for  
4 energy without having to generate the energy from its  
5 higher priced units, while the 80% credit from economy  
6 sales gains allows the net selling utility to lower its  
7 retail customers' overall fuel cost.

8  
9 Q. Were there any particular concerns which motivated the  
10 Commission to institute the 80/20 split that is the  
11 current incentive mechanism?

12 A. Definitely. In testimony filed on November 7, 1983 by  
13 the Commission Staff in Docket No. 830001-EU, their  
14 witness expressed a primary concern regarding the  
15 "potential for over-recovery or under-recovery of  
16 revenues associated with economy energy sales." Also,  
17 the Staff suggested "that a specific incentive provision  
18 be adopted to encourage utilities to maximize economy  
19 sales." In Order No. 12923, issued January 24, 1984, in  
20 Docket No. 830001-EU-B, the Commission adopted Staff's  
21 proposal and established the existing 20% direct  
22 shareholder incentive that recognized the need for and  
23 overall benefit to all of our customers of increased  
24 sales of economy energy.

1           The old system of including sales projections in  
2 base rates presented utilities an incentive to maximize  
3 economy sales by allowing them to keep 100% of the sales  
4 profits above the level included in the rate case test  
5 year. Therefore, the Commission's 1984 change in Order  
6 No. 12923 did not initiate an incentive, but rather  
7 improved the old incentive mechanism with one that also  
8 allowed the Commission to eliminate any concern that  
9 projections of economy sales might be manipulated to  
10 "game the system". This highlights the point that  
11 uncertainty regarding projections of economy sales  
12 existed in the 1980s. This uncertainty is even more  
13 pronounced in today's market. The current economy sales  
14 incentive program has produced a win-win situation for  
15 customers and stockholders of Florida's investor owned  
16 utilities and should be retained.

17  
18 Q. Would utilities engage in economy sales transactions  
19 which benefit their customers but do not offer any  
20 benefits to their stockholders?

21 A. Yes. Utilities did this well before the existence of  
22 the 20% incentive, and they would continue to engage in  
23 these sales if the incentive were removed by this  
24 Commission. But the more important question is, "To  
25 what degree would these sales occur?" With the



1 provision of the current shared direct incentives  
2 associated with economy sales, a net selling utility is  
3 motivated to closely monitor the wholesale power market  
4 and proactively seek out opportunities for increased  
5 economy energy sales in today's competitive wholesale  
6 power market. Therefore, if the Commission maintains  
7 its current policy and continues the direct incentive,  
8 the degree to which utilities enter into these  
9 beneficial market-based economy sales should be  
10 maximized.

11  
12 Q. What happens if the Commission reverses its current  
13 incentive policy?

14 A. If the Commission were to reverse its current policy and  
15 remove the incentive, the current motivation for  
16 utilities to closely monitor the wholesale power market  
17 would be reduced or lost. Any decrease in this ability  
18 to track the market and know what opportunities are  
19 available would lead to a reduction in a selling  
20 utility's amount of economy energy sales, and thereby,  
21 reduce the fuel cost credit for its retail customers.  
22 Today, customers get to keep 80% of the profits of a  
23 relatively large pie. If the direct stockholder  
24 incentive is removed and the level of sales falls, that  
25 results in the customers getting 100% of a smaller pie,

1 and the customers lose.

2

3 Q. Should this proceeding be focused exclusively on economy  
4 sales incentive issues?

5 A. Absolutely not. The same incentive that motivates  
6 utilities to know the market and be in a position to  
7 increase sales also results in the utilities' discovery  
8 of opportunities to purchase cheaper economy energy.  
9 All of the savings produced by these purchases go to the  
10 customer. Decreasing the incentive will also shrink the  
11 pool of available sellers, which hits the customer smack  
12 in the forehead with a double-whammy.

13

14 Q. If a stockholder incentive is maintained by the  
15 Commission, what types of non-separated, non-firm,  
16 wholesale sales should be eligible to receive the  
17 stockholder incentive?

18 A. In Gulf's case, all of its non-separated, non-firm,  
19 wholesale economy energy sales made under current FERC  
20 wholesale tariffs that utilize cost-based and market-  
21 based pricing should receive the stockholder incentive.  
22 It is irrelevant whether or not such sales are made on  
23 the Florida Energy Broker Network, because the benefits  
24 to the customer of economy sales are independent of  
25 whether or not they occur on the Broker. All non-firm

1 energy that is sold at a price that results in gains  
2 above incremental production costs, regardless of  
3 whether they are labeled as "economy", should receive  
4 the incentive. In a discussion between the  
5 Commissioners and the recommendation Staff at the  
6 November 1999 fuel hearing, it was acknowledged that  
7 today's wholesale market provides utilities an  
8 opportunity to make market-based economy sales that  
9 produce higher profit margins than are produced by  
10 traditional "split-the-savings" transactions. Thus,  
11 with market-based pricing for economy sales, the retail  
12 customer receives a greater overall benefit than with  
13 the traditional "split-the-savings" type of economy  
14 sales because the customer receives 80% of these higher  
15 margins as a fuel cost reduction.

16 If Gulf becomes a party to any new FERC schedules  
17 that offer economy-type, non-firm energy for sale, the  
18 resulting energy sales should also receive the 20%  
19 stockholder incentive.

- 20
- 21 Q. If a stockholder incentive is maintained by the  
22 Commission, how should the incentive be structured?
- 23 A. The existing system has well served the customers of  
24 Florida's investor owned utilities for over 15 years.  
25 The Commission's establishment of this incentive

1 mechanism has resulted in a much higher level of  
2 wholesale transactions that have produced substantial  
3 savings for Florida's electric customers. Therefore,  
4 Gulf proposes that retail customers should continue to  
5 receive 80% of the economy sales gains produced by all  
6 non-separated, non-firm, wholesale economy sales as a  
7 reduction to their overall fuel cost, while utility  
8 stockholders should continue to keep 20% of the gains as  
9 an incentive to develop and maintain the capability to  
10 aggressively participate in the economy sales market.

11  
12 Q. Should there be some minimum level of sales that do not  
13 qualify for the incentive?

14 A. No. At the last fuel hearing, the utility witnesses,  
15 and the Commission Staff during their recommendation,  
16 made clear that the level of available sales is  
17 dependent on buyers' needs, which vary widely depending  
18 upon a number of factors, none of which can be  
19 controlled or even determined in advance by the utility.  
20 The Commission agreed with that conclusion. Setting the  
21 "bar" either too low or too high would be unfair. Even  
22 having such a "bar" ignores the unchangeable fact that  
23 the incentive mechanism does just what the Staff said  
24 seventeen years ago - it provides the motivation for  
25 utilities to maximize such sales. The laws of human

1 behavior cannot be repealed by setting artificial  
2 standards. An incentive provides a motivation.  
3 Motivation influences behavior. If any party to this  
4 docket wants to see sales and customer benefits  
5 maximized, retaining the incentive mechanism is their  
6 correct answer.

7  
8 Q. Do the changes in the wholesale market over the last few  
9 years have an effect on the investor-owned utilities'  
10 ability to make economy sales?

11 A. Yes. The realities of the new wholesale market and of  
12 competition have had a profound effect on the investor-  
13 owned utilities in Florida. No one can really say what  
14 level of transactions would have taken place without the  
15 incentive, because it has been in place in recent years.  
16 But everyone agrees that it would have been less. Also,  
17 a new market exists today, with more players, many of  
18 them selling out of merchant facilities, but almost all  
19 of them selling under market-based tariffs. When there  
20 were no market-based tariffs, only split-the-savings  
21 opportunities, these new players were a small part of  
22 the business. But the level of wholesale transactions  
23 has literally exploded in the last few years, because  
24 now they can maximize profit. These new players get to  
25 keep 100% of their profits, so they have quite a

1 powerful incentive to maximize sales. Giving utilities  
2 a 20% incentive at minimum allows them the motivation to  
3 compete with the new players and at the same time share  
4 these savings with customers.

5  
6 Q. Why is this true?

7 A. If all incentive to make sales were removed, the  
8 competition that is now provided by investor-owned  
9 utilities will be diminished. The likely result would  
10 be that prices for economy purchases will increase.  
11 Thus, the customer risks not only being deprived of his  
12 80% share of the profits on economy sales not made, but  
13 also risks having to pay even higher prices during times  
14 of economy purchases. This dual detriment to the  
15 customer can be avoided by keeping the current  
16 incentive.

17 I emphasize again that there now exists a win -  
18 win situation in Florida. Any reduction in the  
19 incentive will only hurt the customer. The Commission  
20 should appropriately resist any move to send the wrong  
21 market signals by such a major policy shift as  
22 eliminating the incentive.

23  
24 Q. Does this conclude your testimony?

25 A. Yes.

AFFIDAVIT

STATE OF FLORIDA     )  
                                  )  
COUNTY OF ESCAMBIA    )

Docket No. 991779-EI

Before me the undersigned authority, personally appeared M. W. Howell, who being first duly sworn, deposes, and says that he is the Transmission and System Control Manager of Gulf Power Company, a Maine corporation, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

*M. W. Howell*

M. W. Howell  
Transmission and System Control  
Manager

Sworn to and subscribed before me this 28th day of  
February, 2000.

*Jackie L. Whipple*

Notary Public, State of Florida at Large

Commission No.

My Commission Expires



Jackie L. Whipple  
My Commission CC662984  
Expires August 23, 2001