ORIGINAL

Florida
Power
CORPORATION

JAMES A. MCGEE
SENIOR COUNSEL

February 29, 2000

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

Re: Docket No. 991779-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket are an original and fifteen copies of the Direct Testimony of Karl H. Wieland on behalf of Florida Power Corporation.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. Also enclosed is a 3.5 inch diskette containing the above-referenced document in WordPerfect format. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

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JAM/kbd
Enclosure

cc: Parties of record

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A Florida Progress Company

FLORIDA POWER CORPORATION

DOCKET NO. 991779-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the Direct Testimony of Karl H. Wieland on behalf of Florida Power Corporation has been furnished to the following individuals by regular U.S. Mail this 29th day of February, 2000:

Wm. Cochran Keating, Esquire
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Stephen C. Burgess, Esquire
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Debra Swim, Esquire
Gail Kamaras, Esquire
Legal Environmental Assistance Foundation
1115 N. Gadsden Street
Tallahassee, FL 32303

Attorney

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DIRECT TESTIMONY OF KARL H. WIELAND

Q. Please state your name and business address.

A. My name is Karl H. Wieland. My business address is Post Office Box 14042, St. Petersburg, Florida 33733.

Q. By whom are you employed and in what capacity?

A. I am employed by Florida Power Corporation as Manager of Financial Analysis.

Q. Please state your educational background and professional experience.

A. I received a Bachelor of Science degree in Electrical Engineering from the University of South Florida in 1968 and a Master's Degree in Engineering Administration, also from the University of South Florida, in 1975. I have also attended the Management Development Program at Georgia State University and the Public Utility Financial Seminar sponsored by the Irving Trust Company in New York. I am a registered Professional Engineer in the state of Florida and I have been employed by Florida Power Corporation on a full time basis since 1972. During the first seven years of my career, I worked as a Transmission Planning Engineer in the System

Planning Department and as an Economic Research Analyst in the Economic Research Department. I became Manager of Generation Planning in 1979, Manager of Economic Research in 1983, and Director of Business Planning in 1990. I assumed my present position in 1998.

My current responsibilities include financial planning and forecasting, financial analysis of projects and proposals, cost benefit analyses, fuel adjustment filings and other fuel-related regulatory activities. I have testified before this Commission on numerous occasions regarding a variety of regulatory policy issues, including the role of utility incentives as a ratemaking tool -- most recently at the fuel adjustment hearings in November 1999 which led to the establishment of this "spin-off" docket.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to urge that the Commission update its long standing practice of providing utilities with an incentive for short-term economy sales made on the Florida energy broker by applying the incentive to short-term (non-separated) off-broker sales as well, in recognition of current market conditions that have led to a drastic reduction in the use of the broker as the vehicle for conducting the beneficial sales.

Q. Do the reasons for the Commission's initial establishment of a shareholder incentive in 1984 remain valid today?

A. Yes. In Order No. 12923 issued January 24, 1984, the Commission acknowledged that, in moving the treatment of economy sales out of base rates where utilities retained 100% of the gain, establishment of an incentive through the fuel adjustment clause was desirable to preserve the then-current level of economy sales and that such an incentive would provide a net benefit to ratepayers. Faced with the current level of competition in the wholesale power market, the case for positive incentives is stronger today than in 1984, when the Commission instituted the 80/20 sharing of gains on economy sales.

Q. Why do you believe there is a greater need for incentives today than there was in 1984 despite the fact that the industry has become more competitive?

A. The need for incentives is greater today than it was 10 to 20 years ago *because of* the fact that the industry has become more competitive. During the early 1980s, wholesale markets for economy sales were simple. The Florida broker system *was* the market, and the participants were the Florida utilities. Each utility entered its hourly incremental and decremental production costs into a computer that matched offers, notified buyers and seller, and established transaction prices.

Today's markets are much more complex and take significantly more effort and resources in order to participate successfully. Transmission paths and payments must be arranged by the seller in accordance with complex FERC rules. Sales are no longer limited to hourly split-the-savings transactions, rather, the transactions can span days, weeks, or even months. Pricing is at the market and all deals are negotiated rather than determined by set formula. The seller must manage additional risks associated with transactions that take place at future times when costs are not known with certainty. Finally, participants are more numerous and sophisticated. They compete for a significant share of the market value that historically has stayed within Florida, to the benefit of the retail customer.

For all these reasons, today's marketing operations have grown from a part-time activity for dispatchers to departments staffed with experienced traders, risk managers, and sophisticated computer equipment. Current marketing operations take significantly more effort and resources in order to participate successfully. Incentives provide the Commission with the most effective and efficient tool for ensuring that utilities extract the maximum value from the market for the benefit of the customer.

Q. Florida Power has significantly reduced the level of sales made through the Florida broker, for which a shareholder incentive is provided, and instead makes most of its non-separated sales through tariffs that do not provide an incentive. Doesn't that indicate that incentives are no longer needed to encourage these sales?

A. No. One reason that Florida Power participates in the non-broker market is to help reduce rates to its customers. That clearly is the obligation of any utility. It is also true, however, that while 100% of the generation-related gains on sales have been returned to customers through the fuel or Capacity Cost Recovery (CCR) clauses, Florida Power has been retaining 100% of transmission revenues from such sales. Except for sales made through the broker, a separate transmission charge based on the Company's open access tariff is added to the sales transaction. For the current year, Florida Power projects $2.7 million in additional transmission revenues for non-separated sales. By comparison, 20% of projected generation-related gains would yield an additional $2.1 million. Prior to January 2000, transmission revenues were credited to other operating revenues in surveillance reports, thus benefiting customers in the long term, but providing a strong shareholder incentive to increase sales in the short term. At the November 1999 fuel adjustment hearings, however, the Commission ordered 100% of these revenues to be flowed back to customers via the CCR clause, thereby eliminating this incentive. Therefore, like the situation in 1984 when the Commission eliminated the base rate incentive for economy sales, a replacement incentive is needed to encourage these sales for the benefit of ratepayers.

Q. If the Commission approves an incentive, how should it be structured?

A. I recommend that the Commission apply the existing 80/20 sharing to all non-separated economy transactions. Doing so would continue to apply the incentive provision in the manner intended by Order 12923 which stated "...economy energy sales profits are to be divided between ratepayers and the shareholders on a 80% - 20% basis, respectively."

Q. How you would define economy sales for purposes of applying an incentive?

A. In order to qualify for an incentive, a sale should meet three simple tests:

1. The sale is not separated, *i.e*, less than one year in duration.
2. The sale is profitable (revenues exceed incremental fuel costs), *i.e.*, provides a net benefit to ratepayers.
3. The seller must be able to influence whether or not the sale takes place and the transaction price.

Q. How would your proposed incentive mechanism treat "unprofitable" sales?

A. An unprofitable sale, *i.e.*, when incremental fuel costs exceed revenues, can arise in many ways. A sale during the peak or off-peak hours of a day could show a loss for an hour or two, or a sale for a week could contain one or more unprofitable days. The risk of a sale turning out to be unprofitable is inherent in any transaction whose profitability is based on estimates of future costs.

Florida Power proposes a symmetrical treatment for both profitable and unprofitable sales. In the same way that shareholders receive 20% of the gain when sales are profitable, they would absorb 20% of the loss when sales are unprofitable. For example, if incremental fuel costs exceed revenues by $10 per MWH during 2 hours of an 8-hour sale for 50 MWs, the loss over this two-hour period would be $1,000 and result in recoverable fuel costs being reduced by $200. In this manner, utilities would be encouraged to aggressively seek out sales that produce the greatest benefit to ratepayers by providing shareholders with a reward commensurate with a sale's profit and a penalty commensurate with a sale's loss.

Q. Which of Florida Power's interchange schedules would qualify under your definition of economy sales?

A. With the exception of Schedule A (emergency), and Schedule B (short-term firm), all sales reported on Fuel Adjustment Schedule A-6 should qualify. Schedules A and B meet criteria 1 and 2 above, but are made upon request by a buyer, not marketed by the seller.

Q. Could your definition include firm sales?

A. Yes, it could. The vast majority of non-separated sales Florida Power makes are as-available or recallable. By including all sales, the Commission eliminates having to define exactly what a firm sale is or risk inconsistent interpretation and application. As long as a utility expects to have adequate reserves over the period of the sale and the criteria advocated above are met, there is no reason to exclude a sale from an incentive provision simply because it is firm. Since firm sales generally have more value and thus a higher price than non-firm sales, excluding such sales would encourage a utility to engage in transactions that brings less value to customers only because they qualify for an incentive.

Q. How should the shareholder incentive be treated for regulatory accounting purposes?

A. The incentive should continue to be recorded below-the-line for ratemaking and surveillance purposes, as it is today.

Q. Does this conclude your direct testimony?

A. Yes.