ORIGINAL

Florida Power
CORPORATION

JAMES A. MCGEE
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May 30, 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 Posthearing Statement 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

JAM/kbd
Enclosure

cc: Parties of record

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A Florida Progress Company

Docket No. 991779-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing Posthearing Statement of Florida Power Corporation has been furnished by U. S. Mail on this 31st day of May 2000 to the following:

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ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of the appropriate application of incentives to wholesale power sales by investor-owned utilities.	Docket No. 991779-EI Submitted for filing: May 31, 2000

POSTHEARING STATEMENT OF FLORIDA POWER CORPORATION

Florida Power Corporation (FPC or Florida Power), pursuant to Rule 25-22.056, Florida Administrative Code, hereby submits its Posthearing Statement and states as follows:

Statement of General Position

When the Commission adopted the current 80/20 incentive for broker sales in 1984 it recognized 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 encourage additional sales. Now that the vast majority of economy sales have shifted off-broker and the incentive rpovided by the retention of transmission revenues associated with these sales has recently been eliminated, a replacement incentive is needed -- as it was in 1984 -- to encourage off-broker economy sales for the benefit of ratepayers. This is particularly true in today's more competitive economy sales market, which allows new non-utility participants to retain 100% of the profits from these sales while utilities, absent a regulatory incentive, must flow back 100% of their profits.

Issues and Positions

ISSUE 1: Should the Commission eliminate the 20 percent shareholder incentive set forth in Order No. 12923, issued January 24,1984 in Docket N. 830001-EU-B?

** FPC: No, the Commission should continue its policy of providing shareholder incentives to encourage economy sales. Now that these sales have shifted to more competitive off-broker markets, with new non-utility participants who retain 100% of the profits, the Commission's incentive policy should be updated to reflect current market conditions.

Discussion:

There is no disagreement among the parties that today's economy sales market is much more competitive than in the past. A host of new participants, such as power marketers, brokers and various types of non-utility generators, aggressively compete in an economy sales market that previously consisted only of utilities. The central question in this proceeding is whether this new market provides Florida's investor-owned utilities a sufficient incentive to aggressively compete for economy sales, such that a regulatory incentive from this Commission is now unnecessary.

Indeed, this was the thrust of several questions posed by Commissioner Jaber during the hearing:

"COMMISSIONER JABER: But asked a different way, why isn't the marketplace your incentive? If you were attempting to compete at the wholesale market, then isn't the marketplace your incentive to make those sales?" [Tr. 113]

* * *

"COMMISSIONER JABER: Doesn't that defeat the purpose of deregulating that market? If you are asking this regulatory body to provide you an artificial incentive, doesn't that defeat the purpose of deregulation?" [Tr. 113]

* * *

"COMMISSIONER JABER: Where do artificial incentives fit into a competitive environment in your opinion?" [Tr. 291]

The reason that regulation needs to provide an "artificial" incentive to utilities is because regulation has imposed an equally artificial (*i.e.*, non-market) restraint on the economic incentive that the market provides to all other participants. While non-utility participants are highly motivated by the ability to retain 100% of the profits from economy sales, regulated utilities must flow back their profits through the fuel adjustment clause. [Tr. 189] Utilities, of course, have a duty to charge their customers reasonable rates and should be expected to prudently engage the economy sales market toward that end. [Tr. 305] Nonetheless, absent action by this Commission, the utilities will not have the *economic* incentive enjoyed by non-utility participants to raise the level of their performance in the economy sales market from prudent to exceptional. [Tr. 185-186, 189, 303-304, 308-309]

Contrary to the assertion of Public Counsel witness Dismukes, today's more competitive economy sales market has actually increased the need for utility incentives, not reduced it. During the 1980s, the market for economy sales was 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. [Tr. 123] Today's markets are much more complex and require 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. [Tr. 123-124]

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 are encouraged to compete effectively against highly incentivized non-utility participants and extract the maximum value from the market for the benefit of their customers. [Tr. 124]

Moreover, in Florida Power's case, the Commission's recent decision requiring the flow-back of transmission revenues from off-broker economy sales provides a further need to establish an incentive for these sales. Prior to the effective date of this decision (January 1, 2000), these transmission revenues were credited to Other Operating Revenues and thus provided a strong shareholder incentive to maximize off-broker economy sales. With the elimination of this incentive, much 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. [Tr. 124-125]

ISSUE 2: If the Commission decides to maintain the 20 percent shareholder incentive in Issue 1 or approves a new incentive, what types of non-separated, non-firm, wholesale sales should be eligible to receive the shareholder incentive?

** FPC: In FPC's case, all sales under interchange schedules reported on Fuel Adjustment Schedule A-6 should qualify, with the exception of Schedule A (emergency), and Schedule B (short-term firm).

Discussion:

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. [Tr. 125-126]

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. [Tr. 127]

ISSUE 3: If the Commission decides to maintain the 20 percent shareholder incentive in Issue 1 or approves a new incentive, how should the incentive be structured?

** FPC: The Commission should apply the existing 80/20 sharing mechanism to all non-separated economy sales transactions. The sharing mechanism should be applied symmetrically to both profits and losses from economy sales.

Discussion:

When the Commission adopted the 80/20 sharing mechanism in 1984 to encourage economy sales by utilities, virtually all of these sales took place on the Florida broker. Now that economy sales have shifted almost entirely off-broker, the Commission should simply expand the existing 80/20 mechanism to encompass these off-broker economy sales, in recognition of current market conditions. [Tr. 129, 167] In doing so, the Commission should specify that the expanded sharing mechanism be applied symmetrically to both profitable and unprofitable economy sales. Applied in this manner, shareholders receive 20% of the gain when sales are profitable and 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. [Tr. 126]

Respectfully submitted,

OFFICE OF THE GENERAL COUNSEL
FLORIDA POWER CORPORATION

By ________________________

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