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May 31, 2000

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

RE: Docket No. 991779-EI

Dear Ms. Bayó:

Enclosed is an original and fifteen copies of the Brief of the Citizens of the State of Florida for filing in the above referenced file.

Also enclosed is a 3.5 inch diskette containing the Brief of the Citizens of the State of Florida in WordPerfect for Windows 6.1. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

Stephen C. Burgess
Deputy Public Counsel

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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
FILED: May 31, 2000

**BRIEF OF THE CITIZENS
OF THE STATE OF FLORIDA**

The Citizens of the State of Florida, through the Office of Public Counsel, submit this Brief.

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

POSITION: *Yes. Other factors are serving as far stronger incentives for Florida IOU's to maximize their wholesale sales. The one-sided 20 percent incentive simply requires consumers to pay a second time for services for which they are already paying full costs.*

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.

POSITION: *None. There are no wholesale sales to which the 20 percent incentive should apply.*

DISCUSSION

The Citizens recommend that the Commission discontinue any usage of the 20 percent shareholder incentive set forth in Order No. 12923. The Citizens oppose the current application of the 20 percent shareholder incentive (Issue 1), and further oppose its application to any other type of wholesale sales (Issue 2). The reasoning behind the Citizens opposition is the same for both Issue

1 and Issue 2. As a result, the Citizens will not attempt to separate the arguments underlying Issues 1 and 2, but rather will address both issues simultaneously.

Since its inception, the 20 percent incentive has never been applied uniformly by the Florida investor owned utilities (IOUs). No two utilities apply the incentive identically. In this docket, each utility recommends a slightly different future application, as well. Some want expansion and/or modification of the incentive; others recommend a continuation of their current method of applying the incentive. The Citizens oppose all four of the current methods of implementing the incentive, and oppose those utilities' recommendations which urge that the incentives be expanded to cover additional sales.

The basic reasons that the Commission should discontinue any application of the 20 percent incentive are as follows:

- (1) Current data demonstrates that the 20 percent incentive has not been effective for inducing sales.
- (2) Other factors are manifestly more powerful for inducing Florida IOUs to make wholesale sales, so any additional incentive would be merely a windfall for behavior in which the utilities will engage without the incentive.
- (3) Retail ratepayers have already paid their respective utility to undertake a reasonable effort to maximize non-separated wholesale sales, so an additional incentive requires them to pay twice for the same effort.

Data Demonstrates that the Incentive is Ineffective:

An examination of current wholesale trends leads to the inescapable conclusion that the 20 percent is not inducing the utilities to make the type of sales on which the incentive is applied. In fact,

it is clear that outside forces have generated a far stronger incentive for marketing behavior than does the 20 percent incentive.

The actual impact of the 20 percent incentive is a bit difficult to determine because of the lack of consistency with which it has been applied by the various companies. Since its inception in 1984, there has never been consistency in the way the incentive has been applied. No two utilities have applied the incentive in the same fashion.

It is telling that under questioning by PSC Staff, no utility offered any empirical data or any type of study that even purported to confirm their conclusion. [T-81, 159] Each merely offered the unsupported belief that the incentive would result in a benefit to retail ratepayers. This completely unsupported "belief" certainly should not serve as adequate evidence for the PSC to give away retail money on an incentive that has not proven effective to produce the desired behavior.

Where the incentive can be isolated and compared to other market incentives, those other market forces far exceed the influence of the 20 percent incentive. Florida Power and Light (FPL) has been applying the twenty percent incentive to the sales that it makes on the Florida Energy Broker Network (EBN) and to off-broker Schedule C sales. FPL does not apply any such incentive to any other wholesale sales.

A comparison of the trends for these two types (EBN and non-EBN) of wholesale sales is nothing short of stunning. Exhibit 2 (Q. 9 and Q. 17) shows that EBN sales have declined from \$34,449,231 in 1994 down to \$274,565 in 1999, while total non-separated wholesale sales have increased from \$43,923,775 in 1994 up to \$118,766,394 in 1999. Removing the EBN sales from total sales leaves the non-EBN trend going from \$9,424,544 in 1994 to \$118,491,829 in 1999.

So the 1999 sales on the EBN are now 1/123 of what they were in 1994, while the 1999 sales off the EBN are 12 times greater than they were in 1994. In the face of this evidence, it is clear that the 20 percent has had no impact on increasing the sales to which it has been applied.

Other Market Factors Far Outweigh the 20 Percent Incentive

The data cited in the preceding paragraphs demonstrates that the utilities' wholesale behavior is being driven by influences far more powerful than the 20 percent incentive. The Citizens have offered testimony as to some of the market influences that are driving the Florida IOUs behavior. While the IOUs may debate the factors cited by the Citizens, the fact remains that whatever these influences are, they far outweigh the 20 percent incentive.

During the hearing, Dr. Dismukes pointed out several reasons that utilities are aggressively pursuing wholesale sales in areas where the Commission has not authorized an incentive. Perhaps most important is that utilities are positioning themselves for a more competitive market. As Dr. Dismukes points out:

I believe that wholesale markets have become increasingly competitive since the promulgation of Order 888, and as a consequence of this policy, there are a number of new participants in the market and a number of transmission access barriers to wholesale trade that have been substantially reduced. It is this increased competition and opportunity that create a number of incentives for utilities to participate in these wholesale markets.

In order to compete in these wholesale markets, utilities will have to become increasing more cost-effective. In addition,

experience will be a prerequisite for effectively participating in these markets. Thus, it seems unlikely to me that these utilities would want to forego the opportunities for becoming more cost-effective and gaining this experience by sitting out of the market without the 20 percent incentive gain.

[T-268, 269]

As Dr. Dismukes points out, FERC Order 888 has already generated a competitive wholesale market. Given what has happened in other states, the current retail regulatory paradigm could also significantly shift to a more competitive model. No one knows whether, when or how the market might shift. Everyone knows, however, that there could be a shift. Depending on the exact nature of the shift, wholesale gains which are currently passed through to retail ratepayers could receive drastically different treatment. The utilities could well be faced with a market in which their corporate health or even survival depends on their ability to compete in all areas of wholesale sales.

Given this uncertainty, the utilities cannot passively wait to see what the future holds and then react. If a change occurs, the IOUs must already be prepared to compete effectively. They must already have fully in place an experienced, efficient, well-connected wholesale marketing process. This expectation is the most probable reason that over the past few years each Florida IOU has taken such unprecedented strides to sell off-system, even on those sales on which the entire benefit currently flows back to retail ratepayers. If the regulatory paradigm shifts, those same benefits may flow instead to the stockholders or create a competitive advantage. The Citizens believe that this anticipation has been driving -- and will continue to drive -- the utilities' maximum effort in making all off-system sales that are available.

During the hearing, the utilities claimed that their aggression in the wholesale markets was a result of their corporate concern for retail customers and a greatly expanded market for placing such sales. The utilities did not acknowledge the motive of preparing for future expanded competition but nor did they directly dispute it. Regardless of the motivation, however, the undisputable fact is that sales without the 20 percent incentive have skyrocketed, while sales with the 20 percent incentive have plummeted (except for Gulf, which takes the 20 percent in a unique fashion). Whatever is motivating utility behavior is so much more powerful than the 20 percent as to make the 20 percent inconsequential. It would be an absolute travesty for the Commission to require retail ratepayers to pay this 20 percent to incent behavior that utilities will engage in anyway.

The utilities' main argument is that if the PSC grants the 20 percent, the utilities will achieve enough of an increase in sales to benefit the retail customers. The utilities acknowledged that unless they increased sales by at least 20 percent above what they would be without the incentive, retail customers actually would be economically harmed by the incentive.

Gulf power should be noted as a unique circumstance. Gulf has no wholesale marketing department of its own but rather participates in wholesale sales through Southern Company. Southern Company's wholesale marketing department makes the wholesale decisions and administers those decisions. Southern then divides the proportionate share of the wholesale transactions down to each separate operating utility. Gulf's share of Southern's wholesale transactions is only 6 percent. Accordingly, whatever incentive the Florida PSC applies will affect only 6 percent of Southern's wholesale sales. It is beyond any reasonable expectation that Southern's wholesale aggressiveness or decisionmaking could be significantly altered by the treatment received by 6 percent of its transactions.

The 20 Percent Incentive Requires Retail Ratepayers to Pay a Second Time for a Service they have already Purchased

The wholesale sales in question are non-separated. All of the O&M expenses (fixed and incremental) are recovered by each utility either in base rates or through the fuel cost recovery. [T-103-104; 247] All costs associated with the utilities' wholesale marketing departments are recovered through base rates. [T-131-132] The Florida IOU's incur no costs that are not fully covered in retail rates. Retail customers are being fully charged for all costs that their respective utility incurs to place non-separated wholesale sales.

In addition, none of the retail rate base is separated to reflect these sales. In other words, all non-separated sales are derived from assets that are in the retail rate base. As such, retail ratepayers are paying a return to the utility for usage of these assets. Included in that overall return is a return on the utility's common equity. The equity return covers the utility for all risk and provides the regulatory quid pro quo for the utility's reasonable efforts to reduce costs.

The Commission has long considered it a utility's obligation to use surplus capacity to place off-system sales when possible. Even utility witnesses have agreed with this concept. As Deirdre Brown states:

Q. (By OPC) So you would agree with me that there is a normal effort that is part of the quid pro quo of being a monopolistic enterprise, is that correct?

A. Yes, I would agree with that.

[T-248]

Utilities should make reasonable efforts to sell off-system. This expectation has already been purchased by the retail ratepayers as a quid pro quo for supplying a return on the nonseparated rate base. The 20 percent incentive simply requires the retail ratepayers to pay a second time for this same expectation that they have already purchased. For over fifteen years, retail ratepayers have been paying twice for the same service. The Commission should discontinue this offensive practice.

Conclusion

No concrete evidence has even been offered to show the effectiveness of the 20 percent incentive. All empirical evidence indicates that other forces bear a far stronger influence on the utilities' wholesale efforts, to the point that the 20 percent is irrelevant as an inducement to utility behavior in the wholesale markets. Adding 20 percent to induce behavior which is already undertaken is nothing more than a giveaway of retail money.

Retail customers are already paying for the right to expect their respective utility to aggressively pursue wholesale sales. The additional 20 percent incentive requires the retail customers to pay a second time for efforts they have already fully purchased. Florida retail customers have been making this double payment for over fifteen years. This Commission should end this practice.

The 20 percent incentive is nothing more than a double payment for a behavior in which the utilities engage anyway. It is unfair; unnecessary, and should be discontinued.

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?

POSITION: *Any incentive structure that provides a reward for superior effort should also impose a penalty for substandard performance. Just as the utilities would be offended by a penalty-only

incentive plan, the customers should no longer be saddled with the current process that provides a positive reward for even substandard performance.*

DISCUSSION

The Citizens reiterate that they do not believe any incentive is necessary or appropriate for non-separated wholesale sales. This has not prevented the Commission from imposing a one-sided, reward-only incentive for the last fifteen years. Utilities have contended that a reward-only mechanism is the only way that an effective incentive can be implemented. The only reason the Citizens have offered their alternative is to provide an example of a two-sided mechanism that would be as effective an incentive as the current one. This alternative mechanism was recommended by Dr. Dismukes for application only to Florida EBN sales, and only in the event that the Commission insists on continuing an incentive for those sales. Both Dr. Dismukes and the OPC, however, recommend that the 20 percent incentive be discontinued altogether. The balance of this discussion is intended to demonstrate the fundamental unfairness of the one-sided 20 percent incentive which has been in effect for fifteen years.

To begin with, the Commission needs to recognize that retail rates already provide each utility a compensatory rate of return. Then, beginning with the very first KWH of eligible non-separated economy energy sold, the utility is adding to the shareholder earnings which were already deemed to be adequate compensation. The problem with this process is that, as more fully described in the previous issue, the utility is obligated to attain a reasonable level of these sales in exchange for the original compensatory rate of return provided in the retail base rates.

By allowing the utilities to keep an additional 20 percent of the split on each and every eligible sale, the Commission institutionalizes a reward for sub-par effort. The utilities generally acknowledge

that they are obligated to make a reasonable effort to place wholesale sales. The current system, however, does not require utilities to achieve even their minimum obligation (for which they've already been paid) before they begin adding stockholder earnings above that set in base rates. Thus, a utility could be consistently achieving below their reasonable obligation, and yet still earn above the established rate. This absurdity is totally inconsistent with any reasonable regulatory philosophy.

In no other situation would sub-par achievement result in above par earnings. Sub-par achievement should generate sub-par earnings. In other words, sub-par achievement should result in a subtraction from the established return, rather than an addition to it. Inexplicably, however, the current incentive rewards, rather than penalizes, sub-par performance.

Interestingly, the utilities do not incent their own employees in the fashion they seek from the Commission. Many utility employees are under incentive plans. Those plans pre-establish reasonable goals for the employees to achieve. The employees achieve a positive reward only when they exceed their preset goals. As Mr. Lynn Brown testified:

Q. (By OPC) And as I understand it, if there is a substantial achievement in the realm of these wholesale sales and you are responsible for this achievement, there is a possibility you could receive a bonus, is that correct?

A. There is.

Q. (By OPC) But it would require an achievement that exceeds a certain expected standard, is that correct?

A. Yes.

[T-217, 218]

TECO uses wholesale sales as an incentive goal for Mr. Brown's performance. TECO, however, gives Mr. Brown an added bonus only if he exceeds expectations. The current 20 percent incentive, on the other hand, gives utilities a bonus even when they fall below expectations.

The fairer and more logical incentive approach is for subpar performance to result in a penalty. Once again, this is the approach that utilities use for their own employees. As Mr. Brown testified:

Q. (By OPC) And if someone constantly achieves well below their merit goals, they are counseled and perhaps if necessary they may be terminated, is that correct?

A. That's correct.

[T-219]

In dealing with its own employees, a utility understands the absurdity of granting positive awards for subpar achievement. Retail ratepayers have borne this very absurdity for fifteen years.

The most obvious way to assure that subpar performance is not rewarded is to establish a reasonable goal for achievement. The utilities, have argued against such goalsetting, complaining of the difficulty in establishing a realistic target. Once again, however, it is instructive to look at the utilities' treatment of incentives for their own employees. Mr. Brown testified:

Q. And you have some managers who report immediately to you, is that correct?

A. That's correct.

Q. And they have certain merit goals, some of which are quantitative in nature, is that correct?

A. That's correct.

- Q. And one such example that you have given as a quantitative goal is the development of market forecasts, is that correct?
- A. Yes.
- Q. And then what you do in evaluating is on a historical basis you look back at the price that the power actually was and a quantitative goal is determined -- achieved based on how close they came to the forecast, is that correct?
- A. That's correct.
- Q. And to evaluate whether they have done a good job, you have to have a standard set as to how close they ought to be, is that correct?
- A. Yes.
- Q. As to how close they ought to be to the forecast that they have made?
- A. Yes.
- Q. And that standard is something that is difficult to establish, is that correct?
- A. It is.
- Q. But you do it anyway?
- A. Yes.
- Q. Because it seems to be the best way to determine whether they -- what their actual performance is, is that correct?

A. For the qualitative goals, it is slightly different though than the quantitative. I think you are referring to the quantitative here.

Q. That's correct, I am.

A. Yes, I would agree.

[T-218, 219]

The fact that goalsetting is difficult does not deter TECO (or any other company) from setting goals for evaluating employee performance. In spite of its difficulty, goalsetting is necessary to assure that positive rewards are not given for subpar achievement. No company would do that for its employees; the PSC should not do it for the utilities.

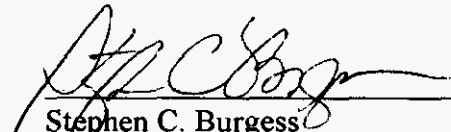
One final argument put forth by the utilities is that the current incentive actually does provide both a reward and a penalty. The utilities argue that when they produce less, their positive reward is less, which in effect is a penalty. This fallacious argument is no more logical than imposing a penalty-only incentive and contending that a lower penalty is in essence the same as a positive reward.¹ The utilities' argument that a lower reward is the same as a penalty is a disingenuous game of semantics. A "reward" is additional shareholder gain that is added to a utility's return that is established in base rates. A "penalty" is shareholder loss that is deducted from the return established in base rates. A lower reward is not a penalty, just as a lower penalty is not a reward.

¹In fact, such a one-sided incentive would be particularly justified at this point. The customers have funded a reward-only incentive for 15 years. Let the utilities absorb a penalty-only incentive for the next fifteen years and we can start off even after that. In reality, the Citizens do not expect the Commission to impose a penalty-only incentive, but they do hope the Commission will value their rights as much as the utilities' rights.

The current 20 percent incentive is one-sided and blatantly unfair. The Commission should discontinue its use altogether.

Respectfully submitted,

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**CERTIFICATE OF SERVICE
DOCKET NO. 991779-EI**

I HEREBY CERTIFY that a true and exact copy of the above and foregoing BRIEF OF THE CITIZENS OF THE STATE OF FLORIDA has been furnished by hand-delivery* or U.S. Mail to the following parties of record this 31st day of May, 2000.

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