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**DIRECT TESTIMONY
OF
ROBERT J. CAMFIELD
ON BEHALF OF
FLORIDA PUBLIC UTILITIES COMPANY
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. _____
APPROVAL OF THE ELECTRIC FUEL SUPPLY CONTRACT AND
RELATED TERMS AND CONDITIONS BETWEEN GULF POWER
COMPANY AND FLORIDA PUBLIC UTILITIES FOR THEIR
NORTHWEST DIVISION (MARIANNA) BEGINNING 2008**

**Direct Testimony of
*Robert J. Camfield***

**On Behalf of
FLORIDA PUBLIC UTILITIES COMPANY**

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Robert J. Camfield, and my business address is 4610 University Avenue, Madison, Wisconsin 53705.

Q. WITH WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am employed with Christensen Associates Energy Consulting, LLC, where I serve in the position of Vice President.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. For the consideration of the Florida Public Service Commission, the testimony reviews Florida Public Utilities Company’s (“FPUC” or “Company”) long-term

1 arrangements for wholesale power supply for its Northwest Division. The
2 Company has executed a new agreement for power supply (“Agreement”) that
3 succeeds the Company’s current contract for power supply, and begins in 2008
4 and extends through 2017. The testimony discusses several related elements
5 associated with the new Agreement including FPUC’s wholesale market context
6 and situation with a focus on transmission and transmission accessibility, the
7 Company’s procurement process, and the results of that process including the
8 implications for retail electricity consumers of the Northwest Division.

9
10 As I stated in previous testimony before this Commission (Docket 060001-EI),
11 the process of power procurement of Florida Public Utilities Company for the
12 Northeast and Northwest Divisions during 2005 and 2006 proved to be
13 unusually arduous primarily because of ramifications of the transmission issues
14 associated with service to the Northeast Division. Transmission service for the
15 Company’s Northwest Division however is fairly straightforward, and the
16 Company could thus proceed to negotiate a power supply agreement for
17 generation services with the selected service provider, following the conclusion
18 of the Company’s power procurement process.

19
20 **Q. WOULD YOU BRIEFLY DESCRIBE YOUR BACKGROUND AND**
21 **PROFESSIONAL EXPERIENCE?**

22 A. Yes. I joined the Michigan Public Service Commission in 1976 as a staff
23 economist. During my tenure with the Michigan Commission, I was involved

1 in several retail electricity and natural gas pricing issues, and I testified in rate
2 case proceedings regarding cost of capital and retail gas tariff design. I joined
3 the New Hampshire Public Service Commission in 1979 as the senior
4 economist, and held the position of chief economist beginning in 1981. As
5 Chief Economist, I was responsible for the administration of the economics
6 department of the Commission staff. I oversaw the analysis of regulatory
7 issues, the coordination and guidance of staff participation in regulatory
8 proceedings, the preparation and development of testimony, and I provided
9 policy advice to the Commission on a variety of issues such as construction
10 work in progress, financial planning, and the determination of PURPA Section
11 133 rates. I joined Southern Company in 1983, and held positions in several
12 departments including Pricing and Economic Analysis at Georgia Power
13 Company, Costing Analysis of Southern Company Services, and Southern
14 Company's Strategic Planning Group. In 1994, I joined Laurits R. Christensen
15 Associates, Inc. ("Christensen Associates") as a senior economist, and currently
16 hold the position of Vice President with Christensen Associates Energy
17 Consulting LLC., a subsidiary consulting group of Christensen Associates.

18

19 My experience covers a gamut of issues facing regulated industries. I have been
20 involved in the negotiation of power supply contracts and the terms of franchise
21 licenses. My overseas assignments are several, and I have managed a large
22 market restructuring project in Central Europe. I have served on national and
23 regional advisory panels, and I have advised integrated electric utilities,

1 independent power producers, transmission and distribution companies, utility
2 associations, offices of consumer advocate, and regulatory agencies on
3 numerous policy and technical issues. Innovations include two-part tariffs for
4 transmission services, web-based self-designing retail electric products,
5 marginal cost-based cost-of-service methods, and principles for efficient pricing
6 of distribution services. I have published chapters in technical books, reports,
7 and articles in noted journals such as *The Electricity Journal*, *IEEE*
8 *Transactions on Power Systems*, and *CIGRE*. Currently, I serve as Program
9 Director of the Edison Electric Institute's Market Design and Transmission
10 Pricing School.

11

12 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY**
13 **PROCEEDINGS?**

14 A. I have represented regulatory Commission staff, consumer advocates,
15 generation companies, distribution companies, transmission companies,
16 integrated utilities, and utility associations in proceedings before a number of
17 regulatory agencies regarding a host of issues including cost of capital,
18 performance assessment and benchmarking, electricity forecasting, retail rates,
19 cost-of-service allocation, generation expansion planning, and transmission
20 issues.

21

22 **Q. COULD YOU DESCRIBE THE ELECTRIC SERVICE TERRITORY OF**
23 **FLORIDA PUBLIC UTILITIES COMPANY?**

1 A. Florida Public Utilities Company is a small diversified distribution utility
2 providing electricity, natural gas, and propane services in the State of Florida.
3 The Company's electric operations consist of two divisions in northern Florida,
4 referred to as the Northeast and Northwest Divisions. These two divisions
5 provide bundled retail services to residential, commercial, and industrial
6 consumers in two non-contiguous service territories. During 2006, the
7 Northeast Division, also known as Fernandina Beach, served 15,372 customers
8 with gross electricity sales of 516,962 MWh, while the Northwest Division, also
9 known as Marianna, served 15,264 customers with gross electricity sales of
10 361,910 MWh. The Northeast Division is interconnected with the JEA
11 (previously referred to as Jacksonville Electric Authority) transmission network
12 at one delivery point with 150 MVA of transformer capability and 138 kV
13 primary feeders. The Northwest Division interconnects with Southern
14 Company's (Gulf Power Company) transmission network at six delivery points
15 with a total of 130 MVA of capability and 12.5 kV primary feeders.

16

17 **Q. DOES FPUC GENERATE ANY OF THE POWER WHICH IT SELLS TO**
18 **RETAIL CUSTOMERS IN THESE TWO SERVICE DIVISIONS?**

19 A. No. The Company is a distribution utility, and purchases all generation and
20 transmission services from regional wholesale power and transmission service
21 providers.

22

1 **Q. WHAT ARE THE COMPANY'S CURRENT ARRANGEMENTS FOR**
2 **POWER SUPPLY FOR THE NORTHWEST DIVISION AND PLANS**
3 **FOR THE FUTURE?**

4 A. The Company purchases bundled generation and transmission services under a
5 long-term supply contract with Gulf Power Company that dates from 1997, and
6 is scheduled to expire on December 31 of 2007. The Company's current
7 contract with Gulf Power Company provides full requirements service including
8 energy and reserve services, and also covers transmission services.

9
10 **Q. WHAT ARE THE POWER PROCUREMENT OBJECTIVES OF**
11 **FLORIDA PUBLIC UTILITIES COMPANY?**

12 A. The Company's power supply objectives align with the Company's
13 longstanding goal of providing, over the long term, high quality service at
14 favorable prices to its retail customers. The Company's underlying power
15 procurement objectives are to obtain long-term power supply at favorable terms
16 and prices, while assuming an acceptable level of risk. To this end and as I
17 have documented elsewhere before this Commission (Docket 030438-EI),
18 Florida Public Utilities Company is a low-priced service provider within the
19 region, with very favorable retail electricity prices. The Company's costs of
20 generation and transmission services, as provided under the Company's current
21 wholesale supply contracts, are very low with reference to wholesale power
22 prices within the region. In addition, the Company provides comparatively low-

1 cost distribution services and has realized substantial gains in productivity in
2 distribution services over recent years.

3 .

4 **Q. WHAT POWER PROCUREMENT STRATEGIES DID THE COMPANY**
5 **CONSIDER FOR POWER SUPPLY BEYOND 2007?**

6 A. In view of the pending expiration of the Company's current supply contracts,
7 Florida Public Utilities Company engaged in a deliberate process that began by
8 exploring alternative procurement approaches. The Company initiated an open
9 solicitation for power supply, referred to as a Request for Proposal ("RFP"),
10 during 2005. Specifically, the Company released a formal *Request for*
11 *Proposals to Provide Wholesale Power Supply* on April 21, 2005 ("2005 RFP").

12

13 An open solicitation for supply is one of several procurement formats that are
14 potentially available to the Company. Alternative formats were initially
15 explored by the Company including sequential short-term purchases that could
16 involve contract laddering, as well as self-supply where FPUC owns and
17 operates generation resources. Because power generation resources are sizable
18 facilities involving large investment in specialized capital, self-supply would
19 likely involve a jointly owned facility. In addition, the Company could engage
20 in several forms of bilateral contracts including, for example, a tolling
21 agreement with a power generation entity where the Company would purchase
22 primary fuels that would then be transformed into electricity and transmitted to
23 the Company's designated delivery points (points of withdrawal of power from

1 transmission networks). The contractual arrangements for power supply under a
2 tolling agreement would involve three separate contracts covering primary fuel
3 inputs, power transformation, and transmission services.

4

5 The solicitation of power supply by others can be approached in a variety of
6 ways, and several formats are possible. As mentioned, FPUC currently takes
7 power under two bundled power supply contracts covering full requirements
8 generation services (energy and reserves) and transmission services.

9 Alternative solicitation formats include the two general categories of sealed bid
10 and auction procedures. In the case of a so-called sealed bid solicitation, the
11 solicitation—which can be as simple as a one- to two-page letter requesting
12 power services or a formal RFP process that is highly specific as regards to
13 information requirements including but not limited to pre-qualifying,
14 engagement rules, and timetable—can involve a limited number of pre-
15 identified potential suppliers, or can be an open invitation seeking offers from
16 interested parties.

17

18 Auctions for electric power supply first appeared, at least in recent years, within
19 the unbundled wholesale markets of California (CAISO), PJM, and New York
20 (NYISO). Auctions are, literally, markets that operate under highly specific
21 rules. For electricity, auctions can be organized as short-term sequential or
22 simultaneous market procedures involving related services such as energy and
23 reserves which are provided over same-day and day-ahead timeframes. These

1 short-term auctions can include pay-as-bid and uniform-price auction formats.
2 Because these auctions are repeated with high levels of frequency, they are
3 organized electronically as a matter of necessity. Auctions for standard offer
4 service (“SOS”) have recently been organized in the Eastern and the Midwest
5 regions of the U.S. (e.g., New Jersey, Maryland, Ohio, and Illinois). In these
6 auctions, pre-qualified candidate bidders provide offers to serve load shape
7 shares. A type of auction recently implemented in wholesale electricity markets
8 is referred to as a declining clock auction, where the market price follows a
9 schedule of pre-defined decrement steps at periodic intervals (rounds) over the
10 course of the auction. Electricity auctions usually cover very large loads, enjoy
11 wide participation by many candidate suppliers, and can involve numerous
12 auction rounds (i.e., 50 iterations or more).

13
14 **Q. PLEASE DESCRIBE THE COMPANY’S APPROACH AND POWER**
15 **PROCUREMENT FORMAT.**

16 Of the various alternative procurement formats that are potentially available, the
17 Company settled on the open solicitation format, where bidders are free to
18 propose a variety of service arrangements and terms. The open solicitation
19 approach, when properly conducted and with ample participation by potential
20 suppliers, can induce a sufficient level of competition to obtain desirable
21 outcomes for retail electricity consumers and the Company. The open
22 solicitation format, manifested as the Company’s 2005 RFP, sought power
23 supply for both the Northeast and Northwest Divisions. The 2005 RFP process

1 was designed in a manner to facilitate (and encourage) participation in order to
2 increase the level of contestability and supply options available to the Company.

3 **Q. DID THE POWER PROCUREMENT STRATEGY OF THE COMPANY**
4 **CONSIDER DIVERSIFICATION OF POWER SUPPLY?**

5 A. Yes. The Company's 2005 RFP provided bidders with options to submit offer
6 packages with multiple offers covering full requirements, partial requirements,
7 and energy only services. Energy offers could be submitted for a variety of
8 timeframes such as, for example, specific hours of weekdays of defined seasons
9 for individual years. The Company sought offers for a five-year term, although
10 offers of shorter duration would also be considered. In addition, the Company's
11 2005 RFP requested ten-year offers as options. Finally, the 2005 RFP provided
12 bidders with considerable flexibility regarding the proposed commercial terms;
13 bidders could submit, for example, offers with fixed charges, demand charges,
14 energy charges, or energy charges indexed to primary fuel prices and wholesale
15 electricity prices.

16
17 The open solicitation format provides two main advantages with reference to
18 other approaches the Company could have pursued. First, multiple offers
19 covering a variety of forms provide a basis for the Company to potentially build
20 a portfolio of supply including laddered contracts to hedge risks. Second, by
21 allowing for a broad range of potential services and structure of terms, the 2005
22 RFP design, to the extent possible, held to a minimum the level of constraints
23 and impediments to participation by serious, potential bidders. As a result,

1 participation by bidders is enhanced thus increasing the potential level of
2 competition and contestability, all in the interest of obtaining the lowest
3 possible prices.

4

5 **Q. WOULD YOU DESCRIBE THE IMPLEMENTATION OF THE**
6 **PROCUREMENT PROCESS?**

7 A. Yes. The Company's 2005 procurement process began with the identification
8 of power suppliers and power marketing entities operating within the Southeast
9 and Midwest regions. Potential suppliers situated to the Western area of the
10 Eastern Interconnection including locations in Kansas, Missouri, and Oklahoma
11 were also identified. Potential suppliers were then surveyed in order to gauge
12 their interest in taking receipt of the Company's formal RFP. The 2005 RFP
13 was released on April 21 to suppliers that expressed interest in participation.
14 The RFP explicitly defines several procedural steps, and the necessary
15 information and data to be included in the offer packages submitted by bidders.

16

17 **Q. CAN YOU BRIEFLY DISCUSS THE POWER SUPPLY SERVICES**
18 **ASSOCIATED WITH THE RFP?**

19 A. Yes. The Company's 2005 RFP process involved generation services including
20 energy and certain ancillary services. Bidders were free to offer various
21 bundles of services within offer packages, and could potentially include
22 transmission services. The implication is that, for example, a selected bidder
23 could provide a service bundle including energy and load following service,

1 such that the Company would be required to self-supply or contract for
2 transmission and other ancillary services not covered under the bundle provided
3 by the generation service provider (winning bidder).

4
5 Transmission services could be provided under a contract between the selected
6 generation service provider(s) on behalf of the Company and the relevant
7 control areas, or under a contract between the Company and the control areas
8 directly.

9
10 **Q. BRIEFLY REVIEW THE DATA AND INFORMATION INCLUDED IN**
11 **THE OFFER PACKAGES OF BIDDERS RESPONDING TO FPUC'S**
12 **RFP FOR POWER SUPPLY.**

13 A. In addition to the commercial terms and the definition of services, several
14 information items were requested to be included in the offer packages submitted
15 by bidders. First, bidders were requested to provide a business overview that
16 summarizes the bidder's activities in wholesale markets and the generation
17 technologies available to them. A business overview provides a means to gauge
18 the full range and extent of the business activities of bidders, as bidders are
19 often subsidiary organizations within the diversified business activities of very
20 large firms—for example, a commodity group of an investment banking firm, a
21 merchant supply business unit of an independent power producer, or an energy
22 company involved in oil and gas exploration. Where relevant, bidders were
23 requested to list their wholesale market certification.

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The RFP requested bidders to provide statements of financial condition and credit worthiness and identified financial surety in the form of letters of credit. The 2005 RFP also imposed non-disclosure obligations and commitments on bidders including confidentiality agreements and signed submission agreements.

Q. PLEASE DESCRIBE THE RFP PROCESS.

A. The RFP identified specific procedural steps with an accompanying schedule, as follows (original schedule cited). First, *Response Window for Inquiries and Questions* (April 22 – May 16) provided candidate bidders with the opportunity to obtain additional information to assist them in deciding whether to prepare an offer package and in the preparation of such packages. Responses to questions were circulated to all candidate bidders. Bidders were requested to indicate their *Intent to Submit Offer Packages* on May 17, and *Offer Packages Were Due* on June 2. The Company would conduct an *Initial Screen of Offers* and provided *Notice of Status* to bidders on June 22. Specifically, offer packages of bidders were reviewed for completeness and conformance with the delineated information requested within the offer packages submitted in response to the 2005 RFP. Bidders were advised of non-conforming conditions of offer packages, and were provided one week to correct, clarify, or provide additional information as identified. Under the original schedule of the 2005 RFP process, the Company would conduct an initial assessment of offer packages, identify qualifying bids, and noticed qualifying bidders by July 29 of their status. While

1 the schedule was delayed early on within the RFP process, the Company was
2 nonetheless in a position to interview qualifying bidders during early September
3 2005.

4

5 **Q. HOW WERE BIDS SOLICITED AND HOW MANY RESPONSES**
6 **WERE OBTAINED?**

7 A. The Company contacted numerous potential suppliers, and thirty-five entities
8 expressed interest in taking receipt of the 2005 RFP. Nine entities provided
9 Letters of Intent to submit offer packages following the release of the RFP.
10 Seven offer packages were submitted.

11

12 **Q. WITH RESPECT TO THE SUBMISSIONS RECEIVED, WERE THE**
13 **OFFERS BY BIDDERS TO SERVE ONE OR BOTH DIVISIONS?**

14 A. Three bidders provided offers to serve either or both electric divisions of the
15 Company. Other offer packages focused on one of the two divisions.

16

17 **Q. OF THE OFFER PACKAGES RECEIVED, WERE ANY PACKAGES**
18 **SUBMITTED BY ENTITIES AFFILIATED WITH FPUC?**

19 A. No entities providing offer packages, or for that matter participating in the RFP
20 process, are affiliated with FPUC in any way.

1 **Q. ONCE THE RESPONSES WERE RECEIVED AND QUALIFIED**
2 **BIDDERS IDENTIFIED, WHAT WERE THE NEXT STEPS?**

3 A. At the time that the RFP was released, the schedule would have placed the
4 Company in the position to select winning bidders during August and to
5 negotiate contracts during the September – October timeframe. However, the
6 overall level of participation was greater than anticipated, and several viable
7 bidders for both the Northeast and the Northwest Divisions were identified.
8 Also, it became evident that, at least potentially, the Company could induce
9 lower prices through an auction-style market procedure. Thus, the Company's
10 2005 RFP concluded with a quasi-auction involving three rounds, where bidders
11 were invited to provide revisions to the price terms of offers. The relative
12 standings of the offers of bidders were noticed to bidders following the first and
13 second rounds.

14
15 **Q. WHAT FACTORS WERE INCLUDED IN THE EVALUATION OF**
16 **OFFERS?**

17 A. The criteria for evaluation of the offers of bidders, as stated within the
18 Company's RFP, included overall price level, counterparty risk, environmental
19 quality of the underlying resources used to provide services, and delivery risks.
20 Where appropriate, the potential monetary impact of policy actions at the
21 federal level aimed to internalize the social costs of CO2 emissions were
22 incorporated into the analyses.

23

1 To the extent possible, the analyses involve quantitative assessment and utilize
2 multi-criteria analysis methods. Particular attention was given to the implied
3 level of price risks, as some of the terms of the offer packages of bidders
4 contained variable price terms. Indeed, one specific offer package with
5 favorable terms stated on an expected value basis, would involve a contract for
6 differences with a major financial institution in order to hedge much of the
7 inherent price risk associated with the commercial terms of the offer, should the
8 offer be selected.

9

10 **Q. HOW WAS THE EVALUATION CONDUCTED?**

11 A. The evaluation was conducted independent of the Company by Christensen
12 Associates Energy Consulting, and the results of the evaluation were presented
13 to the Company as an outside assessment. The evaluation included unit-specific
14 and total bills criteria, where the commercial (price) terms are converted to an
15 equivalent price basis, stated as net present value over the term of the potential
16 contract.

17

1 The evaluation of the final terms of the Offers, as obtained during the third
2 round, was conducted during late 2005. The evaluation of terms, when
3 combined with the assessment of non-price factors, provided the basis for the
4 recommendations provided to the Company. The Company selected the
5 winning bidders, and all bidders were advised of the outcome during late
6 January 2006.

7

8 **Q. PLEASE IDENTIFY THE SERVICE PROVIDERS SELECTED**
9 **THROUGH THE 2005 RFP PROCESS.**

10 A. Through the 2005 RFP process, the Company selected Southern Company as its
11 prospective service provider, including Southern Power Company (“Southern
12 Power”) to serve the Northeast Division over the 2008 – 2017 period, and Gulf
13 Power Company (“Gulf Power”) to serve the Northwest Division from 2008
14 through 2012.

15

16 The prospective contracts with Southern Power and Gulf Power would cover
17 several key generation services including energy as well as ancillary services
18 that in total conform to the well known categories of regulation, imbalance
19 energy, spinning reserves, and supplemental reserves. The new contracts would
20 not cover voltage support and reactive power.

21

1 **Q. PLEASE DISCUSS SUBSEQUENT DEVELOPMENTS FOLLOWING**
2 **THE CONCLUSION OF THE COMPANY’S RFP PROCESS?**

3 A. Two events subsequent to the RFP process are of interest. First, as I alluded to
4 above, Florida Public Utilities Company was forestalled from completing its
5 contract with Southern Power Company for generation services for the
6 Northeast Division because of difficulties associated with obtaining rights to
7 firm transmission service over the transmission interface that electrically
8 connects Georgia and the Florida FRCC. As a consequence, the Company thus
9 negotiated and executed a power supply agreement with the JEA (Jacksonville
10 Electric Authority) for the Northeast Division for the period 2007 – 2017.

11
12 Second, the Company explored through discussion with Gulf Power Company,
13 a ten-year power supply agreement beginning in 2008 in lieu of a five-year
14 contract as originally contemplated. The new Agreement is for the term 2008 –
15 2017.

16
17 **Q. IS IT YOUR VIEW THAT, AS A RESULT OF THE 2005 RFP PROCESS,**
18 **THE SELECTION OF GULF POWER COMPANY TO SERVE THE**
19 **NORTHWEST DIVISION IS IN THE BEST INTEREST OF RETAIL**
20 **CUSTOMERS?**

21 A. Yes, the Company’s selection of the incumbent supplier, Gulf Power Company,
22 beyond 2007 is the best power supply alternative known by and available to the
23 Company. The Agreement that resulted from this decision ensures that the

1 Company's customers of the Northwest Division continue to receive reliable
2 power supply at favorable prices over the foreseeable future. The long-term
3 contract with Gulf Power Company can be considered the best option open to
4 the Company. The terms of the Agreement are competitive with respect to
5 alternative offer packages and potential suppliers made available to the
6 Company through the 2005 RFP process, to contemporary wholesale electricity
7 prices in the region during late-2005 – early-2006, and to the current long-term
8 outlook for power supply at the wholesale level in the Southeast Region.

9
10 Over many years, Gulf Power has proven to be a good business partner,
11 providing high levels of service reliability to FPUC and the Northwest Division.
12 In consistent fashion, Gulf Power has responded promptly to various technical
13 issues with regards to electric services. In addition, Gulf Power has provided
14 various support services to FPUC in the form of market studies, load data and
15 information, and analysis of data. This information proves valuable to the
16 Company for operations and for use in response to regulatory issues and
17 proceedings.

18
19 Gulf Power and the parent organization, Southern Company, are well
20 recognized, established electricity service providers with attending low levels of
21 counterparty risks. Through conservative resource management and a clear
22 focus on the markets that they serve, Gulf Power and Southern Company

1 provide very high levels of customer satisfaction to electricity consumers
2 through high service quality and innovative products at favorable prices.

3

4 **Q. WILL THERE BE CHANGES IN THE CONTRACTUAL**
5 **ARRANGEMENTS FOR TRANSMISSION SERVICES FOR THE**
6 **NORTHWEST DIVISION, BEGINNING IN 2008?**

7 A. Yes. Going forward, arrangements for transmission services will be handled
8 directly by the Company whereas under its current contract with Gulf Power,
9 transmission services are bundled together with generation services. Under the
10 current arrangement, Gulf Power essentially contracts for transmission services
11 with Southern Company on behalf of Florida Public Utilities Company.

12

13 The Company's Northwest Division is recognized as native load and is thus
14 entitled, as a matter of the market rules regarding transmission access rights, to
15 Network Integration Transmission Service. Under the current contract with
16 Gulf Power Company, FPUC for many years has utilized and paid for the
17 generation services provided by Southern Company's system-wide generation
18 resources situated at various locations across Southern's transmission network
19 including, in particular, the generation resources of Gulf Power Company. This
20 broad base of generation facilities constitutes integration services and, because
21 of its longstanding status as a native load customer, the Company is entitled to
22 continued access to the network transmission resources of its service provider,
23 Southern Company (Gulf Power Company). In support of the new Agreement

1 with Gulf Power for generation services, the Company *rolls over* (continues) the
2 transmission services provided under the current agreement with Gulf Power.

3

4 Thus, in parallel with the new Agreement for generation services, the Company
5 will assume the position of a direct customer of Southern Company for
6 transmission services. Under a contract for transmission service with Southern
7 Company, the Company will pay transmission charges monthly for scheduling
8 services (Schedule 1), voltage control and reactive power (Schedule 2), direct
9 transport services (transmission), plus a federal regulatory fee. These services
10 are (will be) defined in the transmission service agreement between the
11 Company and Southern Company. The charge levels for these services are
12 posted within Southern Company's Open Access Transmission Tariff (OATT),
13 and are approved by the Federal Energy Regulatory Commission.

14

15 In addition, the Company will pay for interconnection services, including costs
16 for dedicated substations (voltage transformation and related equipment
17 including metering equipment) and metering facilities, where such costs are
18 based on embedded costs that, as a matter of level, will be very similar to the
19 charges for interconnection services covered by the current contract with Gulf
20 Power for generation and transmission services.

21

1 **Q. HOW DOES THE STRUCTURE OF TERMS OF THE NEW**
2 **AGREEMENT COMPARE WITH THAT OF THE CURRENT**
3 **CONTRACT?**

4 A. The terms of the Company's current contract with Gulf Power includes charges
5 for demand that cover transmission services, ancillary services, and generation
6 services stated as dollars per kW-month; charges for electric energy stated as
7 dollars per kWh; charges for voltage transformation stated as dollars per
8 kilovolt-amperes; and charges for delivery services (interconnection) stated as
9 dollars per month. The current contract includes provision for escalation in the
10 level of the charges over the life of the contract. The charges for transmission
11 services and ancillary services under the current contract are defined in
12 Southern Company's OATT as mentioned above.

13
14 The structure of the commercial terms of the new Agreement beginning in 2008
15 includes an energy charge (\$/MWh), an environmental compliance charge
16 (\$/MWh), and a demand charge (\$/kW-month), sometimes referred to as a
17 capacity payment. The energy and environmental compliance charges are based
18 on embedded costs, where the cost levels are subject to regulatory review by the
19 Florida Public Service Commission.

20

1 **Q. CAN YOU PLEASE HIGHLIGHT OTHER PROVISIONS OF THE NEW**
2 **CONTRACT?**

3 A. The new Agreement deals more explicitly with contingency events and risks
4 than previously, which is a natural result of the evolution of the wholesale
5 power and transmission markets since the mid- to late-1990s. The history of the
6 electric power industry in general and wholesale energy markets in particular
7 since 1998 reveals much higher levels of uncertainty and risks. These risks
8 assume several dimensions, such as high short-term variation in wholesale
9 electricity prices and primary fuel prices; a higher likelihood of power system
10 reliability failures; potential for large-scale financial losses incurred by
11 investors in entities in energy markets; increased frequency of congestion events
12 across major transmission corridors leading to higher likelihood of transaction
13 curtailments; uncertainty regarding the direction of environmental policy
14 initiatives at the federal, regional, and state level; and force majeure events.
15 These factors pose greater financial risk for participants in wholesale power
16 markets today, as well as heightened potential for temporary loss of power
17 supply at considerable cost and inconvenience for retail consumers.
18 Accordingly, contemporary power contracts to a much greater extent than in the
19 past incorporate provisions to explicitly manage these and other risks.

20
21 Accordingly, the new Agreement with Gulf Power is fully consistent with the
22 current practice of recognizing the realities of contemporary wholesale power
23 markets, and several elements are worthy of mention. First, the new Agreement

1 incorporates credit worthiness standards, and provisions that identify how the
2 cost impacts of potential changes in the business environments confronting the
3 counterparties to the Agreement, Florida Public Utilities Company and Gulf
4 Power Company, are to be managed. Specifically, the Agreement incorporates
5 a *Change in Law* provision to manage the cost impacts associated with potential
6 policy actions by legislative and regulatory authorities.

7
8 Second, the Agreement includes a provision to accommodate renewable
9 resource requirements that potentially may be imposed on the Company in the
10 form of a renewable portfolio standard mandated by federal or state legislation,
11 or by regulatory policy rule. Third, the new Agreement incorporates a provision
12 that protects Florida Public Utilities Company and its Northwest Customers by
13 explicitly defining the responsibilities of the supplier, Gulf Power Company,
14 should the organization of wholesale power markets in the Southeast region of
15 the Eastern Interconnection undergo a major market design change—e.g., the
16 formation of a Regional Transmission Organization. A more detailed
17 assessment of risks and the provisions of the new Agreement to manage risks
18 will be provided later in the testimony.

19

1 **Q. CAN YOU PLEASE REVIEW THE RELATIVE PRICE LEVELS FOR**
2 **GENERATION SERVICES IMPLIED BY THE COMMERCIAL TERMS**
3 **OF THE COMPANY’S NEW AGREEMENT WITH GULF POWER**
4 **COMPANY?**

5 Yes. The RFP-obtained offer prices submitted by bidders for the Northwest
6 Division, as estimated for the standard suite of generation services identified
7 above, average \$67/MWh for the period 2008 through 2012. The all-in prices
8 of the new Agreement for services for the Northwest Division beginning in
9 2008, as executed by the Florida Public Utilities Company and Gulf Power
10 Company, are estimated to approximate this level. Taken as a whole, the
11 overall price level and attending risks associated with the executed Agreement
12 between the Company and Gulf Power Company are competitive.

13
14 Wholesale electricity prices and primary fuel prices have eased somewhat since
15 the late-2005 – early-2006 timeframe and, as a consequence, it is useful to
16 consider how the estimated prices of the new contract compare to estimates of
17 wholesale prices in the Southeast region. Because of lower levels of market
18 liquidity in the Southeast particularly within the FRCC region, however,
19 wholesale market benchmarks over several years ahead are not readily
20 observable. Thus, price benchmarks must be developed, either directly by
21 projecting wholesale electricity price for the region with computer simulation
22 techniques, or by inferring future wholesale prices from historical experience.
23 In the latter approach, observed short-term prices over past years for

1 commercial hubs within the Eastern Interconnection (including the Southeast
2 region) are used in conjunction with forward power contracts for selected hubs,
3 to develop projections of prices over longer-term forward periods in the
4 Southeast—for example, for three years ahead.

5
6 Once developed, the wholesale price benchmark then serves as a basis to gauge
7 the estimated price level implied under the new Agreement. Here, the approach
8 taken is to use inferred wholesale electricity prices as the benchmark.

9
10 The analysis indicates that the estimated prices under the new Agreement are
11 consistent with expected wholesale electricity market prices in the Southeast
12 over the next several years, and align well with what wholesale power buyers in
13 the market today would expect to pay, at the least, for power over the next few
14 years. Projections of wholesale electricity prices stated on a per-MWh basis for
15 the Southeast region, not including reserve services, are estimated at \$62, \$68,
16 and \$66 for the years 2008 – 2010, respectively. These results closely
17 approximate the results of the RFP process, suggesting that expectations of
18 future wholesale market conditions have not materially changed from
19 late-2005 – early-2006. Furthermore, references from industry media indicate
20 that, in some cases, contract prices for power supply in the South Central region
21 have reached over \$80 per MWh.

22

1 In summary, projected regional prices align with the estimated prices under the
2 new Agreement. Also, is important to note that the projected regional prices
3 cited above do not cover reserve services. Over the ten-year contract term, the
4 prices for generation services implied by the Agreement are likely to escalate at
5 annual rates of change approximately equal to overall inflation, though the
6 change in prices of any one year, either up or down, can deviate substantially
7 from overall inflation for the year.

8
9 It is perhaps useful to mention that the commercial terms of the current contract
10 between the Company and Gulf Power are unusually favorable to retail
11 consumers, with commensurate economic losses for Gulf Power, Southern
12 Company, and Southern Company shareholders. For years, the current contract
13 has provided overall prices covering energy, reserve services, and transmission
14 services for prices of \$39 to \$41, stated on a per-MWh basis. These contract
15 prices contrast sharply with the corresponding average day-ahead prices for
16 2004 – 2006 of \$66, \$60, and \$55, also stated on a per-MWh basis, for regional
17 hubs referred to as Instate Florida, Florida-Georgia Border, and Into Southern
18 Company, respectively. For 2006, the benchmark wholesale prices are \$72,
19 \$67, and \$61 for Instate Florida, Florida-Georgia Border and the Southern-
20 SERC areas, respectively. Again, these market benchmark prices do not cover
21 reserve and ancillary services.

22

1 **Q. PLEASE REVIEW SPECIFIC RISKS INHERENT TO THE**
2 **COMPANY’S EXECUTED AGREEMENT WITH GULF POWER.**

3 A. The expiration of the Company’s current contracts and its 2005 power
4 procurement process coincide with an unusually difficult and challenging time
5 for power markets, and energy markets more generally. Currently, primary fuel
6 supplies at the national level are relatively tight based on historical standards, a
7 direct consequence of high worldwide demand for fuels and fairly high levels of
8 uncertainty in several dimensions including weather-induced supply disruptions
9 such as that associated with Hurricane Katrina in the case of natural gas and oil
10 supplies, and rail line failures in the case of Powder River Basin coal supplies.
11 Accordingly, wholesale electric prices have reached historically high levels and
12 remain sensitive to unplanned events. These events and other risks mentioned
13 earlier have affected the commercial terms of power supply contracts generally.
14 It is useful to review the implied risks as they are significant, and how the new
15 Agreement manages these risks.

16
17 Because the commercial terms of the Agreement including fuel and
18 environmental charges are based upon embedded costs, the contract prices are
19 likely to have greater stability than short-term wholesale electricity prices.
20 Second, the price levels (and annual charges) for generation services under the
21 Agreement are likely to vary in similar fashion to that of the retail prices
22 charged by Gulf Power. The contract prices are likely to remain below that of
23 the charges for generation services implicit in retail tariffs charged by other

1 incumbent service providers within the State of Florida, though not necessarily
2 with respect to retail service prices within the Southeast region as a whole.

3
4 Moreover, annual changes in the contract prices will to a substantial extent
5 follow primary fuel prices particularly coal prices. As with electric utilities
6 generally, Gulf Power's embedded fuel costs are sensitive to changes in market
7 prices for fuels experienced nationally. Because fuel charges are directly
8 reflected in both the retail charges to Gulf Power's retail customers and
9 wholesale charges under the Agreement, the charges for services paid by FPUC
10 for the Northwest Division will, to a substantial extent, follow Gulf Power's
11 charges to its retail consumers.

12
13 Primary fuel prices including natural gas and coal have risen substantially in
14 recent years particularly during late 2005 and continuing through the second
15 quarter of 2006, though they have declined somewhat recently. Over the
16 foreseeable future, fuel prices are not likely to fall back to the levels seen in the
17 period 2000 to 2004. Moreover, the prices for these two major fuel types
18 appear to be more highly correlated currently than in past years, a natural result
19 of the increased substitution of fuels for electric power generation, in the short
20 run. Since early 2005, the sharp increases in electric prices nationally are
21 attributable in part to much higher costs for fuels. While short-run primary fuel
22 prices can vary greatly, the contract terms for fuel costs are likely to reveal

1 substantially less variability, thus implying lower risks for the Company and
2 retail customers with respect to spot markets for fuels.

3
4 As mentioned, another risk factor arises through potential costs of
5 environmental compliance, as the Company is subject to future environmental
6 charges through the Change in Law provision of the Agreement. Of particular
7 concern under this provision is future restrictions imposed by federal legislation
8 on CO2 emissions associated with fossil fuels, and the resulting impacts on
9 electricity service providers and retail electricity prices. While CO2 compliance
10 costs will be borne by all electricity generators, compliance costs are likely to
11 be uneven across utilities. Indeed, restrictions on CO2 emissions will favor
12 natural gas-fired generators and, to the degree that natural gas is increasingly
13 “on the margin,” regional wholesale prices are likely to increase relatively less,
14 with respect to the embedded cost impacts on electric utilities like Gulf Power
15 Company that predominantly employ coal-fired generation. In short, the
16 implication is that, in the face of restrictions on CO2 emissions—which could
17 be implemented in the form of a so-called *cap and trade* market scheme such as
18 that currently in place to manage SO2 emissions or a direct tax on emissions—
19 Gulf Power and many incumbent utilities in the Southeast region are
20 comparatively disadvantaged. Because the Northwest Division’s costs and
21 retail prices for services under the Agreement are wedded to Gulf Power’s
22 potential compliance costs for CO2 compliance, the Company’s costs may also
23 be comparatively disadvantaged with respect to regional wholesale prices. It is

1 likely, however, that should CO2 policy initiatives be implemented, that such
2 policy would be phased in over a number of years. Second, the burden on
3 customer bills as a result of potential CO policy would be borne approximately
4 equally by the customers of the Company and of Gulf Power. Third, and most
5 importantly, the implementation of CO2 policy would tend to reduce the
6 absolute and relative price for coal, as coal users substitute away from coal in
7 order to mitigate the cost impacts associated with CO2.

8
9 Other dimensions of risk covered by the Company's new Agreement with Gulf
10 Power are noteworthy. Specific events under the Agreement with potential
11 price impacts include: 1) declines in the future level of electricity consumption,
12 2) the impact of storms in the Gulf region resulting in long-term power outages,
13 and 3) change in the structure of wholesale electricity markets. Each is
14 reviewed below.

15
16 Possible Declines in the Future Level of Electricity Consumption: Growth in
17 electricity sales of the Company's Northwest Division has been within the range
18 of 1.5 – 2.0% in recent years, although year-by-year change in retail sales are
19 quite sensitive to weather and the resulting demand for space conditioning. One
20 can realistically anticipate that sales will advance at annual rates of change that
21 approximate historical patterns, though perhaps somewhat more slowly.
22 Nonetheless, there is the possibility that sales could decline. The price risks
23 attending the decline in retail sales levels are a direct result of the structure of

1 the commercial terms of the Agreement regarding capacity purchase, which are
2 manifested as demand charges. Specifically, the demand charges contain a
3 ratchet provision, where the minimum level of demand charges are based upon
4 the level of peak demand (MWs) observed when the contract is initiated.
5 Demand charges are not harmful to retail consumers in terms of impact on the
6 overall prices for services, unless the level of demand declines fairly
7 significantly over the term of the Agreement. For example, declining future
8 retail sales levels of the Northwest Division could potentially result from the
9 combined impact of a slowdown in the growth of long-term economic activity
10 for the territory covered by the Northwest Division, coupled with aggressive
11 electricity conservation policy. The likelihood of rising overall contract prices
12 as a result of declining sales levels is small and, should it occur, the impact on
13 the overall price level appears to be comparatively modest (less than 5 mills).

14
15 *Storm Activity and Supply Interruptions:* The Force Majeure provisions of the
16 new Agreement excuse the payment by the Company of demand charges in the
17 case of transmission interruptions, but not in the case of power interruptions at
18 the distribution level. This means that the Company will continue to be
19 responsible for monthly demand charges for up to 90 days. The reasoning
20 underlying this provision is that the capital charges incurred by Gulf Power
21 Company on generation resources committed to serving the Company and its
22 retail customers continue unabated regardless of the occurrence of storm-related
23 events. Nonetheless, the provision puts the retail customers and the Company at

1 risk in the case of a natural disaster that results in an extended loss of power at
2 the distribution level. As a practical matter, the impact of this contract
3 provision, stated in money terms is in my view remote, for two reasons. First,
4 the Northwest Division is substantially inland from the Gulf Coast, and thus
5 large-scale loss of power from storm activity is small. Second, it is highly
6 likely that the damage to the Company's distribution system in the Northwest
7 Division, in the event of serious storm activity, can be repaired with expedience.
8 In brief, the likelihood and magnitude of burdensome demand charges resulting
9 from an extended power outage at the distribution level due to storms is small.

10

11 *Change In the Structure of Wholesale Markets:* As mentioned earlier, the new
12 Agreement covers generation services and the Company must purchase and
13 arrange for transmission services in order to transport generation services from
14 points of delivery in the transmission network to the Company's Northwest
15 substations where power is delivered. The prices and charges for transmission
16 services for the Northwest are based on the embedded costs of transmission
17 facilities, as reflected in Southern Company's OATT. These OATT prices are
18 based on contract path principles, which do not recognize the true underlying
19 economic costs of transmission services, which are highly locational. The risks
20 here arise from the possibility that the Southeast region, as a result of federal
21 mandate or for other reasons, implements locational pricing principles, and that
22 the relevant delivery points designated by Gulf Power under the Agreement
23 change in a manner that is unfavorable to the Company. As a consequence,

1 transmission charges under a locational pricing regime potentially increase
2 dramatically.

3

4 The risks of this event are very small. First, it is highly likely that the transition
5 to a locational pricing framework would involve the grandfathering of existing
6 transmission rights, where Financial Transmission Rights (FTRs) are granted in
7 lieu of the contract path-based physical transmission rights that the Company
8 purchases under Southern Company's OATT. This means that the Company
9 should be fully protected from locational congestion charges. Second, it is
10 likely that, should Gulf Power Company designate new delivery points, such
11 points would not, relatively, disadvantage the Northwest Division as the
12 Division resides within Gulf Power's service territory.

13

14 Nonetheless, risks exist that a change in delivery points could cause increases in
15 transmission charges for the Company in two ways: First, following the
16 implementation of locational pricing, a change in delivery points involves the
17 substitution of one set of FTRs for another. Second, locational pricing could
18 involve the incorporation of a price component that accounts for marginal losses
19 not covered by FTRs; the level of marginal line losses is larger, tending to be
20 roughly twice that of average losses. Given the current direction in the structure
21 of wholesale markets and the inherent protections obtained through the
22 grandfathering of rights as discussed above, the risks are small.

1 **Q. WILL CUSTOMERS IN THE NORTHEAST DIVISION EXPERIENCE**
2 **ANY CHANGES IN 2008, AS A RESULT OF THE NEW AGREEMENT**
3 **WITH GULF POWER FOR SERVICE TO THE NORTHWEST?**

4 A. No. Retail customers of the Company's Northeast Division will experience no
5 change in the level of customer bills during 2008 as a result of the recently
6 executed Agreement with Gulf Power Company.

7
8 **Q. IN YOUR PROFESSIONAL OPINION, IS THE COMPANY'S**
9 **AGREEMENT WITH GULF POWER COMPANY FOR POWER**
10 **SUPPLY FOR THE NORTHWEST DIVISION THE MOST PRUDENT**
11 **ARRANGMENT FOR RETAIL CUSTOMERS OVER THE SHORT-**
12 **AND LONG-TERM?**

13 A. Yes, the new Agreement with Gulf Power Company for generation services for
14 the Northwest Division is the best long-term power supply option and choice
15 available to the Company and its retail customers at this time.

16
17 The commercial terms of the Agreement with Gulf Power are based largely on
18 embedded costs and, while the prices will follow charges for primary fuels and
19 environmental costs, such prices are likely to demonstrate reasonably high
20 levels of stability. The outlook for the overall level of the contract prices appear
21 to be competitive though it is possible that future wholesale electricity prices
22 within the region may vary from the prices projected under the terms of the new
23 Agreement. Gulf Power and Southern Company are well established,

1 financially sound partners and have historically provided high levels of reliable
2 power supply and service quality to the Company and its customers over many
3 years. Gulf Power and Southern Company have high levels of credit
4 worthiness. Gulf Power, has a well balanced generation mix, particularly with
5 participation within Southern Company's pool, which draws upon a substantial
6 amount of coal-fired resources and nuclear power complemented by gas-fired
7 generation for peaking capability.

8

9 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 A. Yes, it does.