BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 050001-EI
CONTINUING SURVEILLANCE AND REVIEW OF
FUEL COST RECOVERY CLAUSES OF ELECTRIC UTILITIES

Direct Testimony of
George M. Bachman, Mark Cutshaw,
Cheryl M. Martin
On Behalf of
Florida Public Utilities Company

Q. Please state your names, employer and business addresses.

A. George M. Bachman, Florida Public Utilities, Company, 401 South Dixie Highway, West Palm Beach, FL 33401.

A. Mark Cutshaw, Florida Public Utilities Company, 2825 Pennsylvania Avenue, Marianna, Fl 32448.

A. Cheryl M. Martin, Florida Public Utilities Company, 401 South Dixie Highway, West Palm Beach, FL 33401.

Q. Have you previously testified in this Docket?

A. Bachman, Cutshaw, and Martin: Yes.

Q. What is the purpose of your testimony at this time?

A. Martin: I will briefly describe the basis for the computations that were made in the preparation of the various Schedules that we have submitted in support of the January 2006 - December 2006 fuel cost recovery adjustments for our Consolidated Electric division and for informational purposes, the two separate electric divisions. In addition, I will advise the Commission of the projected differences between the revenues collected under the levelized fuel adjustment and the purchased power costs allowed in developing the levelized fuel adjustment for the period January 2005 – December 2005 and to establish a "true-up" amount to be collected or refunded during January 2006 - December 2006.

Q. You are also proposing that the Commission allow FPUC to consolidate their Fuel Cost Recovery Clause and fuel rates for their two operating divisions (Northeast Florida-Fernandina Beach, and Northwest Florida- Marianna) aren't you?

A. Martin: Yes we are. FPUC should be allowed to consolidate their Fuel Cost Recovery Clause and fuel rates for the two operating divisions. This would be consistent with the Commission's practice within the State of Florida of other investor owned utilities. Moreover, fuel consolidation is consistent with the Commission's recent action to consolidate base and conservation rates for FPUC's customers in 2004. We also feel this would also be beneficial to all FPUC customers in the long term.

Q. Why does FPUC feel it is appropriate to allow consolidation of the Fuel Cost Recovery Clause for their electric operations?

A. Bachman: FPUC feels it is appropriate to consolidate their Fuel Cost Recovery Clause and fuel rates for several reasons.

First, as Cheryl previously mentioned, the consolidation of fuel rates for all customers in a Company's operating divisions within the State of Florida is consistent practice within the State of Florida for all other investor owned electric utilities. All electric utilities in the State of Florida have one set of fuel rates for all retail customers regardless of the actual costs associated with obtaining fuel for those individual customers. Even if there is only one fuel contract to serve all customers in their operating areas, those contracts have more than likely been developed by averaging the actual cost to serve their customers living in different areas into one set of weighted average rates.

Second, the Commission has allowed consolidation of FPUC's base and conservation rates for many of the same reasons that apply to the fuel rates. In our recent base rate proceeding, the Company offered support for consolidation of all rates. See Docket No. 030438-EI and Docket No. 030002-EI for additional details on the consolidation of these two rates.

Third, the consolidated fuel factor for FPUC will provide additional savings to the FPUC ratepayers by reducing the cost associated with preparing and filing the fuel adjustment factors. The savings will include corporate accounting costs to prepare one filing rather than two, division costs to prepare to file one tariff revision rather than two and the legal costs to make one filing rather than two. The quantifiable cost savings associated with these activities are as follows:

Corporate Accounting Savings -	$1,000
Division Savings -	$1,250
Legal Savings -	$ 500

Furthermore, one can reasonably expect that the FPSC and its staff would experience savings in the areas similar to our savings mentioned above relating to the review, audit, and administrative work associated with the fuel filings. While we do not have a basis to assess or measure these savings, the FPSC staff may be able to guide the Commission in the assessment of the direct savings in the on-going costs of this reduction that may materialize on the regulatory agency side.

The final reason to consolidate fuel is the mitigation of price risk inherent to wholesale markets. As discussed by our consultant in our testimony in support of the Phase in of expected prices of new contracts for fuel, price risk is costly to retail consumers, and it is appropriate to mitigate price risk where possible. The level and volatility of wholesale electricity prices are, to a substantial extent, determined by the level and volatility in the prices of primary fuels, particularly natural gas. In turn, price volatility of fuels is determined by the level of scarcity of supply in comparison to the level of demand. Although natural gas volatility is also sensitive to seasonal weather patterns – e.g., a cold snap in the Northeast – and unexpected supply shocks – e.g., Hurricane Katrina – natural gas has also been relatively scarce beginning in the third quarter of 2005 as a result of continued pressure on supply. In summary, natural gas prices can be unusually volatile during periods of relative scarcity, in this is manifested directly in wholesale spot price volatility.

An historical perspective is always useful, and shown below observed prices and volatility at commercial hubs within the Eastern Interconnection.

	PJM West		Florida-Ga Border		In-State Florida		SERC	
Year	*Average Daily Prices*	*Variation In Daily Prices*	*Average Daily Prices*	*Variation In Daily Prices*	*Average Daily Prices*	*Variation In Daily Prices*	*Average Daily Prices*	*Variation In Daily Prices*
1996	$0.00	$0.00			$25.36	$3.15	$24.85	$3.52
1997	$0.00	$0.00			$28.59	$6.45	$26.23	$8.33
1998	$28.39	$9.96	$61.14	$93.66	$44.79	$47.15	$47.10	$49.78
1999	$38.79	$20.78	$49.52	$43.96	$54.57	$54.40	$50.60	$50.71
2000	$40.40	$11.97	$48.01	$10.75	$50.59	$11.29	$42.99	$11.79
2001	$40.39	$12.49	$41.75	$7.41	$46.23	$7.53	$38.08	$8.48
2002	$35.89	$9.33	$34.95	$5.41	$40.41	$6.64	$30.55	$4.77
2003	$48.63	$10.13	$45.12	$8.50	$52.58	$9.12	$42.00	$7.96
2004	$53.50	$6.41	$51.31	$3.76	$55.69	$4.49	$48.71	$3.73
Average	$40.85	$11.58	$47.40	$24.78	$49.27	$20.09	$42.86	$19.60

Currently prices are sharply higher than the prices shown above, and there appears to be little immediate relief in sight.

This means that short-term volatility in primary fuel prices and thus wholesale power prices are likely to remain for some time. Accordingly, wholesale power suppliers are increasingly reluctant to engage in long-term contracts without the appropriate mechanisms to hedge risks. These mechanisms imply that it is likely that FPUC will, within its new contracts, be shouldering some of costs of price hedging, as incorporated within the commercial terms of the new contracts. As envisioned, the provisions of the new contracts will vary from one contract to another, and thus the integration of the contracts under a common fuel clause umbrella means that retail consumers can better hedge the price risk inherent in fuel contracts, to the benefit of all.

Q. Please describe the regulatory treatment that FPUC would implement for the true-up amounts that exist for each division at the end of the last month prior to consolidating the two division's factors.

A. Martin: It is the intention of FPUC to incorporate the true up amounts that exists for each division at the end of the last month prior to consolidating the two division's factors into the consolidated rate calculations. An alternative course of action would be to exclude the respective true-up amounts from the consolidated rate calculations then adjust the resulting consolidated factor by each true up amount for the respective divisions. The company would then collect from/refund to the customers for a one year period or until the end of 2006.

Q. Were the schedules filed by your Company completed under your direction?

A. Martin: Yes.

Q. Which of the Staff's set of schedules has your company completed and filed?

A. Martin: We have filed Schedules E1, E1A, E2, E7, E8 and E10 for our Consolidated Electric division. They are included in Composite Prehearing Identification Number CMM-6. For informational and analysis purposes only, we have filed Schedules E1, E1A, E2, E7, and E10 for Northwest Florida (Marianna) and E1, E1A, E2, E7, E8, and E10 for Northeast Florida (Fernandina Beach). They are included in Composite Prehearing Identification Number CMM-3. We have also prepared and filed Schedules E1 for our Consolidated Electric division, Northwest division (Marianna) and Northeast division (Fernandina Beach) with the special fuel surcharge requested in Docket 050317-EI as Composite Prehearing Identification Number CMM-5. Additional support for the surcharge amount has been filed as Composite Prehearing Identification Number CMM-4 (CONFIDENTIAL) as well as within this testimony and the testimony filed in Docket No.050317-EI.

Schedule E1-B and E1-B1 for both Northwest Florida (Marianna) and Northeast Florida (Fernandina Beach) were filed last month in Composite Prehearing Identification Number CMM-2. These schedules support the calculation of the levelized fuel adjustment factor for January 2006 - December 2006. Schedule E1-B shows the Calculation of Purchased Power Costs and Calculation of True-Up and Interest Provision for the period January 2005 - December 2005 based on 6 Months Actual and 6 Months Estimated data.

Q. In derivation of the projected cost factor for the January 2006 - December 2006, period, did you follow the same procedures that were used in the prior period filings?

A. Martin: Yes, with the exception that we are now requesting one consolidated electric Fuel Cost Recovery Clause and set of fuel rates for both of our electric operating divisions. We are also requesting permission, through Docket No. 050317-EI filed in May 2005, to include a fuel surcharge as an additional add-on to the fuel factor to help minimize the significant future effects of fuel contracts that are expiring at the end of 2007.

Q Why has the GSLD1 rate class for Northeast Florida (Fernandina Beach) been excluded from these computations?

A. Martin: Demand and other purchased power costs are assigned to the GSLD1 rate class directly based on their actual CP KW and their actual KWH consumption. That procedure for the GSLD1 class has been in use for several years and has not been changed herein. Costs to be recovered from all other classes are determined after deducting from total purchased power costs those costs directly assigned to GSLD1.

Q. How will the demand cost recovery factors for the other rate classes be used?

A. Martin: The demand cost recovery factors for each of the RS, GS, GSD, GSLD, GSLD1 and OL-SL rate classes will become one element of the total cost recovery factor for those classes. All other costs of purchased power will be recovered by the use of the levelized factor that is the same for all those rate classes. Thus the total factor for each class will be the sum of the respective demand cost factor and the levelized factor for all other costs.

Q. Please address the calculation of the total true-up amount to be collected or refunded during the January 2006 - December 2006.

A. Martin: We have determined that at the end of December 2005 based on six months actual and six months estimated, we will have under recovered $285,297 in purchased power costs in our Consolidated Electric division. We will have under-recovered $702,270 in purchased power costs in our Northwest Florida division (Marianna). In our Northeast Florida division (Fernandina Beach) we will have over-recovered $416,973 in purchased power costs.

Based on estimated sales for the period January 2006 - December 2006, it will be necessary to add .04204¢ per KWH to collect this under-recovery in our Consolidated Electric division during the January 2006 - December 2006 period (excludes GSLD1 customers). For informational purposes, Northwest division's (Marianna) separate factor would have been to add .21568¢ per KWH to collect the under recovery, and Northeast division's (Fernandina Beach) separate factor would have been to subtract .11814¢ per KWH (excluding GSLD1 customers) to refund the over recovery. Page 3 and 10 of Composite Prehearing Identification Number CMM-3 and page 3 of Composite Prehearing Identification Number CMM-6 provides a detail of the calculation of the true-up amounts.

Q. What are the final remaining true-up amounts for the period January 2004 - December 2004 for both divisions?

A. Martin: For our Consolidated Electric division, the final remaining true up amount was an under-recovery of $1,433,132. In our Northwest division (Marianna) the final remaining true-up amount was an under-recovery of $966,951. The final remaining true-up amount for our Northeast division (Fernandina Beach) was under-recovery of $466,181.

Q. What are the estimated true-up amounts for the period of January 2005 - December 2005?

A. Martin: For our Consolidated Electric division, the estimated true up amount was an under-recovery of $735,918. In our Northwest Florida division (Marianna) the estimated true-up amount was an under-recovery of $246,528. The estimated true-up amount for our Northeast Florida division (Fernandina Beach) was under-recovery of $489,390.

Q. What are the total true-up amounts to be collected or refunded during the period January 2006 through December 2006?

A. Martin: In our Consolidated Electric division, there is an estimated under recovery of $285,297. In our Northwest Florida division (Marianna), there is an estimated under-recovery of $702,270. The Northeast Florida division (Fernandina Beach) has an estimated over-recovery of $416,973.

Q. What will the total fuel adjustment factor, excluding demand cost recovery, be for the Consolidated Electric division and for informational purposes, both separate divisions for the period?

A. Martin: For our Consolidated Electric division, the total fuel adjustment factor as shown on Line 43, Exhibit CMM-6, Schedule E1, is 2.278¢ per KWH. In the Northwest Florida division (Marianna) the total fuel adjustment factor as shown on Line 33, Exhibit CMM-3, Schedule E1, is 2.819¢ per KWH. In the Northeast Florida division (Fernandina Beach) the total fuel adjustment factor for "other classes", as shown on Line 43, Exhibit CMM-3, Schedule E1, amounts to 1.857¢ per KWH.

Q. What will the total fuel adjustment factor, excluding demand cost recovery be for the Consolidated Electric division and for information purposes; both separate divisions for the period if the fuel surcharge is approved (Docket No. 050317-EI) and allowed to be added to the fuel adjustment factor in 2006.

A. Martin: If the fuel surcharge is approved and allowed, the total fuel adjustment factor for the Consolidated Electric division as shown on Line 43, Exhibit CMM 5, Schedule E1, is 2.532¢ January 2006 through June 2006 and is 2.804¢ July 2006 through December 2006. The fuel adjustment factor for the Northwest Florida division (Marianna) as shown on Line 33, Exhibit CMM5, Schedule E1 is 3.074¢ January 2006 through June 2006 and is 3.346¢ July 2006 through

December 2006. The fuel adjustment factor for the Northeast Florida division (Fernandina Beach) as shown on Line 43, Exhibit CMM5, Schedule E1 is 2.111¢ January 2006 through June 2006 and is 2.383¢ July 2006 through December 2006.

Q. Please advise what a residential customer using 1,000 KWH will pay for the period January 2006 - December 2006 including base rates, conservation cost recovery factors, and fuel adjustment factor and after application of a line loss multiplier.

A. Martin: For our Consolidated Electric division, a residential customer using 1,000 KWH will pay $64.79, a decrease of $4.76 in our Northwest Florida division (Marianna) from the previous period, and an increase of $2.58 in our Northeast Florida division (Fernandina Beach). For information purposes, if the separate fuel factors were used then in our Northwest Florida division (Marianna) a residential customer using 1,000 KWH would have paid $71.48, an increase of $1.93 from the previous period. In our Northeast Florida division (Fernandina Beach) a customer would have paid $58.97, a decrease of $3.24 from the previous period.

Q. Please advise what a residential customer using 1,000 KWH will pay for the period January 2006 - December 2006 including base rates, conservation cost recovery factors, and fuel adjustment factor and after application of a line loss multiplier if the fuel surcharge is approved.

A. Martin: If the surcharge is allowed and added to the cost of fuel for our Consolidated Electric division, a residential customer using 1,000 KWH will pay $67.39 from January 2006 through June 2006 and they will pay $70.18 from July 2006 trough December 2006. For informational purposes if separate fuel factors were used with the surcharge added, a residential customer using 1,000 KWH would pay

$74.09 from January 2006 through June 2006 and would pay $76.88 from July 2006 through December 2006 in our Northwest Florida division (Marianna). In our Northeast Division (Fernandina Beach), a residential customer using 1,000 KWH would pay $61.58 from January 2006 through June 2006 and would pay $64.37 from July 2006 through December 2006.

Q. You have included a fuel surcharge in the fuel adjustment factor. Could you explain that?

A. Bachman: Yes. Since the Company does not have any generating capability we purchase all of the power which we provide customers. Currently we have contracts to purchase power from JEA and the Southern Co. ("Gulf Power"). Both of these have very favorable rates which have benefited our customers for the past 8 years; in fact, the contract rates are significantly below current market rates. Both of these contracts expire on December 31, 2007, and we know that there will be a sharp increase in power costs so we have proposed a surcharge to be added to the adjustment factor to mitigate those expected sharp increases.

Q. How would this surcharge be implemented?

A. Martin: The surcharge would be added to the cost of fuel for two years and when the new contracts are effective the accumulated amounts would be credited back to customers over a three-year period.

Q. Would there be a separate account for the surcharge?

A. Bachman: All of the revenue collected from the surcharge would be held in an interest bearing account and all of the accumulated amounts plus interest would be flowed back to the customers. The Company will not receive any of these revenues and the accumulated surcharge would not be part of the working capital.

Q. How will this benefit customers?

A. Bachman: We know that there will be a sharp increase in the fuel adjustment factor beginning January 1, 2008 and this proposal would mitigate that increase. By collecting the surcharge now and incurring the additional interest and then crediting these amounts back to customers the increase can be phased in and we can mitigate the rate shock to our customers.

Q. What is the amount of the surcharge for 2006 that has been added to the fuel rates?

A. Bachman: Effective January 1, 2006, the Company will add a surcharge of $.00254 per KwH to the cost of fuel. Effective July 1, 2006, the Company will add a surcharge of $.00526 per KwH to the cost of fuel. This surcharge has been incorporated into our requested fuel rates and schedules.

Q. Have you entered into new contracts that result in these amounts?

A. Bachman: No, we do not have the final contracts in place at this time.

Q. What is the status of those contracts?

A. Bachman: We are reviewing and analyzing proposals at the present.

Q. Explain the process you established.

A. Bachman: We began looking at our options several months ago. We recognize the importance of these contracts and we involved Christensen Associates to assist in looking at our options and helping with the RFP and negotiations. With their help, we invited interested parties to provide proposals and we received a number of responses and those are being evaluated. We expect to have discussions with several of the responding parties and our objective is to negotiate the most favorable contract that we can for our customers.

Q. When will that be completed?

A. Bachman: Probably sometime in 2006.

Q. What is the basis for the surcharge you have proposed?

A. Bachman: We have detailed projections supporting expected future price increases that more than justify the use of these conservative fuel surcharge factors. Since we are still in the process of negotiations for fuel contacts, our future fuel expectations are confidential in nature. We have provided this projection on a confidential basis, as Exhibit _____ (CMM-4). We feel there is sufficient evidence to support the use of this surcharge in 2006. Even without finalization of our fuel contracts and completion of the bidding process, we are able to estimate what market fuel costs are expected to be in the future, and fuel costs are expected to be well above the amount of our requested 2006 surcharges. Since the surcharge is a gradual increase and a phase in of the future expected price increases, the surcharge for 2006 is appropriate and is expected to provide for a gradual increase in the fuel costs to our customers.

Q. Have you requested approval of this proposal in a separate petition?

A. Martin: Yes, we have. We have filed a petition and testimony for approval of the surcharge in Docket No. 050317-EI but we think it appropriate to consider it in this docket since it is a component of the fuel adjustment factor.

Q. You mentioned that you used Christensen Associates to assist in this process. Have those costs been included in the calculation of the proposed fuel adjustment factor?

A. Martin: Yes, they have.

Q. Should the Commission allow FPUC to recover fees paid to

Christensen Associates to perform FPUC's request for proposals for wholesale capacity and energy commencing 2008 and develop a rate smoothing surcharge for 2006 and 2007?

A. Martin: Yes. As I discussed, FPUC retained the consulting group, Christensen Associates, to develop and manage the bidding process for power supply beginning in 2008 for FPUC's electric operations. This process organized by our consultants is a highly structured process that casts a wide net in search of the best overall power supply arrangement for our retail customers. The level of interest in, and market response to, the Company's RFP has been good and, as intended, a substantial level of contestability has developed. Our company is not large enough to have this type of resource on staff and the experience, knowledge, and expertise that they contribute to the process helps us to obtain more favorable results. If we were to expand our staff to include similar resources, the customer impact would be great.

Q. How do the customers benefit from your use of the consultants?

A. Martin: By using a consultant in this process, we are able to supplement our in-house resources with the experience and knowledge the consultants have of the broad process. We believe that having this resource available to us will result in a more favorable power supply arrangement. Any reduction in the cost of fuel over the life of the contract benefits the customers. For example, a $.0001 per kWh reduction in the cost of fuel results in savings of over $400,000 in just five years and this well exceeds the cost for the consultant in this process. We feel that the savings will be much greater than this over the life of contracts through lower fuel prices.

Q. Couldn't you negotiate new contracts with Company resources?

A. Martin: We could, but the market now is very different than it was when the current contracts were negotiated and there may be more options available to us now than there were then. Having the advice and assistance of consultants who work with this process more frequently strengthens our efforts and enhances our ability to obtain contracts favorable to our customers.

Q. Are these consultant's costs included in your base rates?

A. Martin: No. These costs have not been recovered through our base rates as they directly relate to the fuel and fuel costs. Since these costs directly relate to our fuel costs and will likely result in lower fuel costs to the customers, they are appropriate to recover through the fuel cost recovery clause. These costs are not the normal procurement and administrative costs that would be associated with ongoing fuel purchases. It is possible upon award of our new fuel contracts that administrative personnel will be needed to manage and procure our fuel on an ongoing recurring basis; however, we cannot determine whether this will be necessary with our new fuel contracts at this time. The costs for the services of Christensen Associates are nonrecurring special costs associated directly with the cost of fuel and these probably would not have been allowed for recovery through base rates since they would not be in the test year and would not be recurring expenditures. To disallow the recovery of these costs would penalize the Company for acting in a prudent manner on behalf of the customers for savings in their fuel costs.

If the Commission feels it would be more appropriate to recover these costs through base rates, we would like to request permission to defer these until our next rate proceedings and amortize the costs at that time with the associated recovery of the costs.

Q. The audit report of the Fuel and Purchased Power Cost Recovery Clause conducted by Staff contained a disclosure regarding payments to Gulf Power for a transformer agreement that commenced in November 2004. Can you explain that agreement?

A. Cutshaw: Yes. As previously discussed, FPUC currently purchases all wholesale capacity and energy from Gulf Power/Southern Company for the Northwest Division. At each of the delivery points, Gulf Power provides all transmission, substation and transformer facilities and associated equipment. FPUC only provides the distribution facilities at each delivery point. In 2004, additional facilities were needed to service a new "Family Discount Distribution Center" and FPUC and Gulf Power entered into an amendment to the current contract where Gulf Power provides a transformer and associated equipment necessary to establish an additional delivery point at our Marianna substation. The terms of the five year agreement calls for Florida Public Utilities Company to pay Gulf Power $3,678 a month commencing November 2004. The "South Marianna delivery point" was constructed to match the facilities at the other delivery points in order to maintain the integrity of the current contract.

Based upon the fact that the new transformer and associated equipment at the "South Marianna delivery point" are owned and operated by Gulf Power Company who currently provides wholesale capacity and energy, it seems reasonable that these costs to FPUC should be included for recovery through the fuel clause. Since this delivery point was not included in the existing wholesale power contract and was not included in the development of those rates, it was determined that the cost to provide power to this delivery point was not justified by the current contract price. This resulted in the necessity for a facilities charge being added to the current contract energy cost.

Q. Does this conclude your testimony?

A. Martin, Bachman, and Cutshaw: Yes.