

State of Florida



## Public Service Commission

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**-M-E-M-O-R-A-N-D-U-M-**

**DATE:** December 1, 2006

**TO:** Chairman Lisa Polak Edgar  
Commissioner Isilio R. Arriaga  
Commissioner Matthew M. Carter II  
Commissioner J. Terry Deason  
Commissioner Katrina J. Tew

**FROM:** Division of Economic Regulation (Slemkewicz, Lester)  
Office of the General Counsel (Bennett)

*JS PL CRB*  
*WAM*  
*RT*

**RE:** Docket No. 060362-EI – Petition to recover natural gas storage project costs through fuel cost recovery clause, by Florida Power & Light Company.

Continuation of Hearing for the purpose of determining the recovery of natural gas storage project costs, including base gas charges and carrying costs on natural gas stored in inventory

Pursuant to notice issued November 27, 2006, the Commission announced the continuation of the fuel clause hearing from November 6 – 8, 2006, to December 8, 2006, at 9:30 a.m. One of the purposes of this hearing is for the Commission to make a determination of recovery of natural gas storage project costs, including base gas charges and carrying costs on natural gas stored in inventory.

During the hearing on November 8, 2006, the Commission determined that the parties should be afforded the opportunity to file briefs on the unresolved issues in this docket. It was further determined that staff would provide a written recommendation on the unresolved issues by December 1, 2006. Staff's recommendation is attached.

cc: Mary Bane  
Chuck Hill  
Division of the Commission Clerk & Administrative Services

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

**FLORIDA POWER & LIGHT COMPANY  
DOCKET NO. 060362-EI  
STAFF RECOMMENDATION**

**Case Background**

On April 28, 2006, Florida Power & Light Company (“FPL” or “Company”) petitioned the Commission to recover natural gas storage project costs through the fuel cost recovery clause. The gas storage project is the MoBay Gas Storage Hub (MoBay) that is to be built and operated by Falcon Gas Storage, Inc.

FPL entered into a Firm Storage Precedent Agreement (the “Precedent Agreement”) with MoBay on April 1, 2006. The gas storage facility is scheduled to go into service between December 31, 2006, and July 1, 2008. FPL included in its petition the Precedent Agreement, an affidavit from Gerard Yupp, who is FPL’s Director of Wholesale Operations in its Energy Marketing and Trading Division, and copies of a slide presentation by MoBay. FPL requested confidential treatment for some of the gas storage project costs and for parts of the Precedent Agreement.

FPL believes that the MoBay Gas Storage Hub will significantly increase system reliability and reduce natural gas price volatility. FPL currently depends on natural gas for approximately 50% of the electric energy it generates, and approximately 48% of FPL’s firm gas transportation capacity on the Florida Gas Transmission and Gulfstream pipelines is tied to off-shore production in the Destin/Mobile Bay area. This area is vulnerable to production curtailments caused by tropical storms and hurricanes in the Gulf of Mexico.

FPL will be an “anchor tenant” of the MoBay storage facility. It will be entitled to store up to 6 million dekatherms at the facility, which will be 50% of the phase I capacity. FPL states this amount of gas is equivalent to five days of its typical natural gas consumption. This gas storage project should act as a physical supply hedge and allow FPL to get gas to its gas-fired generators in the event of production curtailments. Significantly, MoBay will be the only gas storage facility to-date capable of delivering natural gas into the Gulfstream pipeline. The MoBay project will also act as a physical hedge against price spikes during production curtailments and periods of high demand.

In its initial analysis, staff reviewed the Company’s filing, met with the Company, reviewed written responses to staff data requests, and reviewed all confidential information filed in this docket. Staff also reviewed prior Commission orders regarding recovery through the fuel clause of transportation charges and of hedging plans designed to manage the risks associated with fuel price volatility. On August 3, 2006, staff filed its recommendation that the Commission grant the Petition with certain modifications. At the August 15, 2006 agenda conference, the Commission heard arguments concerning the Petition. Several parties objected to fuel clause recovery of some of the costs. The Commission determined that it needed more factual information and legal briefings on the issues raised during the discussion. Accordingly, the Commission moved to continue the item to a later agenda conference with directions that if

the parties could not reach agreement on cost recovery, the docket be set for a future hearing. The Commission also requested that interested persons file briefs supporting their positions.

On August 29, 2006, FPL filed a Brief in Support of Petition to Recover Natural Gas Storage Project Costs and Motion to Approve Procedure for Final Decision on Petition ("Motion"). The Motion requested that the Commission hear FPL's Petition in the fuel proceeding, Docket No. 060001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor. In support of its motion, FPL stated that if the Commission proceeds on its present path toward making a proposed agency action (PAA) decision on the Petition at the September 19, 2006 agenda conference, it would likely be protested and proceed with a hearing process that realistically could not be completed by the end of December, 2006. FPL wished to have a final decision by the Commission prior to December 28, 2006, so that it would be able to determine whether to go forward with the project or terminate the agreement.

Upon consideration, FPL's Motion was granted and Docket Nos. 060001-EI and 060362-EI were consolidated for purposes of an evidentiary hearing only. FPL and OPC presented testimony during the November 6-8, 2006, hearing that addressed the four issues<sup>1</sup> identified in the Prehearing Order No. PSC-06-0921-PHO-EI, issued November 2, 2006, in this docket. Issue 1A was stipulated<sup>2</sup>. The hearing has been continued until December 8, 2006, to provide the parties with the opportunity to submit briefs and for staff to submit a written recommendation. This recommendation addresses the remaining three issues. It should also be noted that the decisions made on these issues will not affect FPL's 2007 fuel adjustment factors.

The Commission has created a framework to review utilities' physical and financial hedging projects which are recoverable through the fuel and purchased power cost recovery clause. In Order No. PSC 02-1484-FOF-EI, issued October 30, 2002, in Docket No. 011605-EI, In Re: Review of investor-owned electric utilities' risk management policies and procedures ("Hedging Order"), the Commission adopted a resolution of issues which requires investor-owned utilities to annually submit risk management plans and to report risk management activities. Each year, the investor-owned utilities (IOU) file their hedging plan as part of the fuel docket. Each IOU is:

authorized to charge/credit to the fuel and purchased power cost recovery clause its non-speculative, prudently-incurred commodity costs and gains and losses associated with financial and/or physical hedging transactions for natural gas, residual oil, and purchased power contracts tied to the price of natural gas.

Order No. PSC-02-1484-FOF-EI, at p. 5. The Commission audits the costs submitted as part of the fuel clause.

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<sup>1</sup> Issues 1A, 1B, 1C and 1D.

<sup>2</sup> Per the stipulation, the MoBay monthly storage reservation charges, fuel retention and commodity charges for injection and withdrawal, and the monthly insurance charges should be recovered annually through the fuel clause.

Docket No. 060362-EI  
Date: December 1, 2006

The Commission has jurisdiction pursuant to the provisions of Chapter 366, including Section 366.06, Florida Statutes.

### Discussion of Issues

**Issue 1B:** Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *base gas charges?*

**Recommendation:** The Commission should not allow FPL to recover the cost of base gas for the MoBay Storage facility project as a one-time charge to the fuel clause. Instead, the base gas should be recorded as a regulatory asset and be amortized to the fuel clause over the 15-year term of the storage agreement. When FPL is compensated, either through exchange or sale, for the base gas at the end of the storage agreement, FPL should credit this amount to the fuel clause. The base gas at the Bay Gas storage facility is not at issue because the base gas is not owned by FPL. (Slemkewicz)

### Position of the Parties

**FPL:** Yes. FPL should be authorized to charge the cost of base gas, a physical form of hedging, to the fuel clause when the base gas is injected into the storage facility, with a credit to the fuel clause at the end of the storage arrangement.

**AARP:** Agrees with OPC.

**FIPUG:** Agrees with OPC. (Per Prehearing Order)

**FRF:** Agrees with OPC. (Per Prehearing Order)

**AG:** Agrees with OPC.

**OPC:** Base gas should be recovered over the 15-year life of the contract and amortized through the fuel clause. The decision to expense or capitalize an item should be directly matched with the period in which the cost incurred provides a benefit. Because the gas has to remain in storage for the full length of the contract and cannot be burned it should be capitalized and amortized over that same time period. Moreover, base gas correlates closer with base coal than non-recoverable oil. Base coal is used to support the coal pile and is not burned. Non-recoverable oil is removed as often as the storage tank is cleaned, and represents a minimal amount of the total capacity of the storage tank.

**Staff Analysis:** Base gas is natural gas that is injected into the storage facility to provide pressurization to allow the working gas to be extracted from the storage facility. (TR 1014) FPL proposes to pay for a quantity of base gas that will be injected into MoBay's natural gas storage reservoir. This base gas will remain in the reservoir until the end of the storage agreement. (TR 1015-16) The base gas at the Bay Gas storage facility is not at issue because the base gas is not owned by FPL.

FPL states that the base gas cost, like other proposed hedging costs associated with the Mobay and Bay Gas facilities, falls within the scope of hedging costs approved for fuel clause recovery pursuant to the Proposed Resolution of Issues (the "Hedging Resolution") that the

Commission approved in Order No. PSC-02-1484-FOF-EI, issued October 30, 2002 (the "Hedging Order"), and should therefore be recovered through the fuel clause.

As explained by FPL witness Dubin, FPL proposes to expense the base gas through the fuel clause in the same manner that "tank bottoms" (the non-recoverable oil that sits at the bottom of oil storage tanks) are expensed through the fuel clause. (TR 1034) This non-recoverable oil is needed to keep the oil level in a tank high enough for the working volume to be removed by the suction piping in the tank. Non-recoverable oil remains in the tank until it is periodically cleaned, at which time the oil is removed and burned as fuel. Pursuant to Order No. 12645, in Docket No. 830001-EI, issued November 3, 1983, FPL and other utilities have been authorized to charge the cost of non-recoverable oil to the fuel clause when the oil is loaded into the tanks, with a credit to the fuel clause when it is ultimately removed and burned. This is the treatment that FPL seeks with respect to the base gas cost.

OPC states that a fundamental question is whether the base gas provides a benefit over more than one accounting period and whether it should therefore be treated as a capital asset. OPC states that the cost of base gas should be spread over the term of the agreement, which is 15 years. Witness Merchant also testified that:

...base gas correlates better with base coal than non-recoverable oil. Base coal is used to support the coal pile and is not burned. Non-recoverable oil is removed as often as the storage tank is cleaned, and represents a minimal amount of the total capacity of the storage tank. Because base gas represents 50% of the storage capacity, it contrasts with the minimal percentage of the oil under the intake pipe of a ground storage tank.

TR 949-950

None of the parties object to the recovery of the base gas through the fuel clause. It is the timing of that recovery that is at issue. FPL proposed charging the cost of base gas to the fuel clause in the month when it is injected into the storage facility. The following statement from staff's prior recommendation<sup>3</sup> was included in OPC witness Merchant's testimony and is still applicable to the question of whether there should be a one-time charge to the fuel clause:

Staff does not believe that this is an appropriate treatment for the cost of base gas. This treatment ignores the fact that the purpose, use, benefit and cost of base gas is applicable to the entire 15 year term of the storage agreement, not just the day that it is injected into storage. There is also the issue of possible intergenerational inequity. Today's ratepayers would be required to pay for the total cost of base gas that will benefit current and future ratepayers over the next 15 years. It is also possible that many of today's ratepayers will not be the ratepayers that benefit from the reduction

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<sup>3</sup> This Proposed Agency Action recommendation was filed on August 3, 2006, for the August 15, 2006 Agenda Conference.

in expense when FPL is compensated for the base gas at the end of the storage agreement.

TR 948

Although the intergenerational inequity cannot be totally eliminated, it can be mitigated. Rather than charging the entire cost of base gas to the fuel clause on the day that it is injected into storage, the cost could be deferred as a regulatory asset and be amortized to the fuel adjustment clause over the term of the storage agreement. This treatment of base gas is analogous to the approved treatment of base coal rather than non-recoverable oil. Base coal is capitalized and then amortized over a set period. Non-recoverable oil is expensed when the storage tank is cleaned and refilled.

Staff recommends that FPL should not be allowed to recover the cost of base gas for the MoBay Storage facility project as a one-time charge to the fuel clause. Instead, the base gas should be recorded as a regulatory asset and be amortized to the fuel clause over the 15-year term of the storage agreement. When FPL is compensated, either through exchange or sale, for the base gas at the end of the storage agreement, FPL should credit this amount to the fuel clause. The base gas at the Bay Gas storage facility is not at issue because that base gas is not owned by FPL.

**Issue 2C:** Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *carrying costs on natural gas stored in inventory?*

**Recommendation:** The Commission should not allow FPL to recover the carrying costs of the gas inventory through the fuel clause. (Slemkewicz)

**Position of the Parties**

**FPL:** Yes. FPL should be permitted to recover carrying costs incurred on the quantity of gas that it stores in the Bay Gas and MoBay gas storage facilities. Because the purpose of storing gas is to effect a physical hedge, the stored gas carrying costs are appropriately considered hedging costs and recoverable through the fuel clause.

**AARP:** Agrees with OPC.

**FIPUG:** Agrees with OPC. (Per Prehearing Order)

**FRF:** Agrees with OPC. (Per Prehearing Order)

**AG:** Agrees with OPC.

**OPC:** No. The estimated \$7 million in annual carrying charges are not appropriate to be recovered through the fuel clause for several reasons. Carrying costs on fuel inventory are typically and historically base rate items and inappropriate to include in the fuel clause. These costs also do not result in any fuel savings, nor are they volatile or related to inventory adjustments, as required by Order No. 14546. Further, the physical hedging costs allowed by the Hedging Order were hedging transaction costs or incremental operating and maintenance expenses and the Hedging Order did not provide for rate of return components on fuel inventory to be recovered through the fuel docket. Finally, requesting recovery of costs which would typically and historically be recovered in base rates violates the 2005 Rate Case Settlement approved by the Commission. Accordingly, the carrying costs on gas inventory should be recovered through base rates not the fuel clause.

**Staff Analysis:** FPL considers the storage of gas at the MoBay and Bay Gas facilities to be physical hedges for natural gas. (TR 1018) Therefore, FPL asserts that all costs related to the stored natural gas inventory are hedging costs that are recoverable through the fuel clause. FPL witness Yupp stated that this treatment would be fully consistent with the Hedging Order. (TR 1014) FPL witness Dubin testified as follows:

Stored natural gas is not fuel inventory in the conventional sense. Storing the gas serves the purpose of hedging rather than meeting ordinary operational needs of FPL's gas-fired plants. Because the purpose of storing gas is to effect a physical hedge, the gas storage carrying costs are appropriately considered hedging costs that are recoverable through the fuel clause pursuant to the hedging



resolution approved by the Commission in Order Number PSC-02-1484 dated October 30th, 2002. Said another way, FPL's proposal to recover the gas storage carrying costs associated with the MoBay and Bay Gas storage projects through the fuel clause is fully appropriate and consistent with the hedging resolution.

Recovery of the stored gas carrying costs through the fuel clause is also fully consistent with the 2005 rate case stipulation and subsequent stipulation in the 2005 fuel docket that states, I quote, FPL's continued recovery of incremental hedging costs through the fuel and purchased power cost recovery clause during the term of the rate stipulation is reasonable and consistent with the intention of the parties to the rate stipulation, end quote.

TR 922

In addition, OPC witness Merchant defined O&M expenses as the types of costs that are incurred on an annual basis to operate the company, citing salaries and chemicals as examples. OPC witness Merchant also defined carrying costs as being related to the rate of return component that the Commission allows the utility to earn on its investment. The carrying cost includes debt, the recovery of interest cost, the rate of return on equity, the inclusion of customer deposits, and deferred income taxes. Together, these items develop the overall rate of return that a utility is allowed to earn. (TR 981)

OPC witness Merchant testified that carrying costs on fuel inventory are typically and historically base rate items and inappropriate to include in the fuel clause. (TR 951) These costs also do not result in any fuel savings, nor are they volatile or related to inventory adjustments, as required by Order No. 14546<sup>4</sup>. (TR 952-953) Further, the physical hedging costs allowed by the Hedging Order were hedging transaction costs or incremental operating and maintenance expenses and the Hedging Order did not provide for rate of return components on fuel inventory to be recovered through the fuel docket as hedging costs. (TR 955) Finally, OPC witness Merchant testified that it was her opinion that requesting recovery of costs which would typically and historically be recovered in base rates would violate the 2005 Rate Case Settlement approved by the Commission. (TR 957) Accordingly, OPC witness Merchant recommended that the carrying costs on gas inventory should be recovered through base rates not the fuel clause.

Staff agrees with OPC that fuel inventory, whether it is coal, oil or gas, is a normal component of working capital that is included in rate base for ratemaking purposes. Therefore, the associated inventory carrying costs are included in, and recovered through, base rates. Paragraph 4 of FPL's Stipulation contains the following provision:

During the term of this Stipulation and Settlement, except as otherwise provided for in this Stipulation and Settlement, or except for unforeseen extraordinary costs imposed by government agencies relating to safety or matters of national security, FPL will not petition for any new surcharges, on an interim or permanent basis, to

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<sup>4</sup> Issued July 8, 1985, in Docket No. 850001-EI-B, In re: Cost recovery methods for fuel-related expenses.

recover costs that are of a type that traditionally and historically would be, or are presently, recovered through base rates.<sup>5</sup>

The carrying cost of fuel inventory, both traditionally and historically, is a cost that is included in rate base and recovered through base rates. Both Gulf Power Company and Tampa Electric Company have included stored natural gas inventory as a component of working capital in rate base. (TR 357-358, 600) Staff also agrees with OPC that the carrying cost of the working gas inventory is not a hedging cost as contemplated in the Hedging Order. Therefore, staff recommends that FPL not be allowed to recover the carrying costs of the working gas inventory through the fuel clause.

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<sup>5</sup>Page 12, Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050045-EI, In re: Petition for rate increase by Florida Power & Light Company.

**Issue 3D:** Should the Commission approve cost recovery through the fuel clause by Florida Power & Light Company for the following natural gas storage project costs and charges at both the MoBay storage facility and the Bay Gas storage facility: *carrying costs on unamortized amounts of base gas?*

**Recommendation:** The Commission should not allow FPL to recover the carrying costs on the unamortized amounts of the MoBay Storage facility project base gas through the fuel clause. The carrying costs on the base gas at the Bay Gas storage facility is not at issue because the base gas is not owned by FPL. (Slemkewicz)

**Position of the Parties**

**FPL:** The Commission should authorize FPL to charge the cost of the base gas to the fuel clause when base gas is initially injected into the MoBay storage facility, with a credit to the fuel clause at the end of the storage arrangement, when the base gas is either removed and burned or FPL receives compensation for leaving the gas in the facility. Under that approach, there is no need to recover carrying costs on unamortized base gas. However, if base gas costs are instead amortized and recovered through the fuel clause, the carrying charges on the unamortized balance are properly recovered through the fuel clause as a hedging cost.

**AARP:** Agrees with OPC.

**FIPUG:** Agrees with OPC. (Per Prehearing Order)

**FRF:** Agrees with OPC. (Per Prehearing Order)

**AG:** Agrees with OPC.

**OPC:** No. The carrying costs associated with the unamortized balance of base gas should be recovered through base rates, not the fuel clause. Purchasing base gas is a capital asset similar to gas inventory. Consistent with Citizen's position in Issue 1B above, this unamortized asset is normally included in base rates as a component of the working capital calculation and included in rate base to which the company's rate of return is applied. The carrying costs on the unamortized balance of base gas will be approximately \$4 million in first year assuming a 15-year amortization period.

**Staff Analysis:** As described with respect to Issue 1B, FPL proposes that base gas cost be charged through the fuel clause at the time it is purchased. This eliminates the need for any carrying costs on base gas. However, in the event that the Commission determines that the base gas should be recorded as a regulatory asset, to be amortized over the period of the contract with a return, then FPL contends that the carrying costs for the base gas should be recovered through the fuel clause as a hedging cost consistent with the terms of the Hedging Order.

OPC states that the carrying costs associated with the unamortized balance of base gas should be recovered through base rates, not the fuel clause. Purchasing base gas is a capital asset similar to gas inventory. Consistent with OPC's position in Issue 1B, this unamortized asset is normally included in base rates as a component of the working capital calculation and included

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in rate base to which the company's rate of return is applied. The carrying costs on the unamortized balance of base gas will be approximately \$4 million in the first year assuming a 15-year amortization period.

Staff agrees with OPC that the carrying costs associated with any unamortized balance of base gas should be included as a component of working capital and that no associated carrying costs should be recovered through the fuel clause.

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**Issue 4:** Should this docket be closed?

**Recommendation:** The docket should be closed after the time for filing an appeal has run.  
(Bennett)

**Staff Analysis:** The docket should be closed 32 days after issuance of the order, to allow the time for filing an appeal to run.

