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Public Service Commission

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

DATE: March 1, 2007

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

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

RE: Docket No. 060793-EI – Petition for approval of long-term fuel transportation contracts with Duke Energy Southeast Supply Header, LLC and CenterPoint Energy Southeastern Pipelines Holding, L.L.C. ("SESH Pipeline Contracts"), by Progress Energy Florida, Inc.

AGENDA: 03/13/07 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Carter

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060793.RCM.DOC

Case Background

On December 12, 2006, Progress Energy Florida, Inc. (PEF) petitioned the Commission requesting Commission approval of the terms and conditions of its contracts with the Southeast Supply Header Pipeline (SESH). PEF also requests that the Commission determine that the costs associated with the pipeline contracts are recoverable through the fuel cost recovery clause subject to annual review by the Commission to ensure that the costs are being managed in a reasonable and prudent manner.

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The SESH pipeline will begin at the Perryville hub in Northeast Louisiana and end with an interconnection with the Gulfstream Natural Gas System pipeline (Gulfstream) in Mobile County, Alabama. The SESH pipeline will interconnect with the Gulfstream and Florida Gas Transmission (FGT) pipelines, which are the two pipelines currently serving PEF and peninsular Florida. The SESH pipeline will connect the Florida market area with new gas production basins: Barnett Shale in East Texas and Bossier Sands in North Louisiana.

Below are pertinent facts regarding SESH:

FACTS ON THE SOUTHEAST SUPPLY HEADER PIPELINE	
Total Capacity	1 Million Dekatherms per day[1]
PEF's Share of Capacity	100,000 Dekatherms per day, thru May 2009 150,000 Dekatherms per day, thru May 2010 200,000 Dekatherms per day, thru May 2022 50.000 Dekatherms per day, thru May 2023
Estimated In-service Date	Mid-2008
Length	Approximately 270 miles
Diameter of Pipe	36-inch
Ownership	Joint Project between CenterPoint Energy Gas Transmission and Duke Energy Gas Transmission
[1] 1 Dekatherm = 1 MMBtu = 1,000,000 Btu The Precedent Agreement states pipeline capacity in dekatherms per day. Natural gas prices are typically stated as dollars per MMBtu.	

PEF requests that the Commission approve the costs associated with the SESH pipeline and the terms and conditions of the contracts on or before March 15, 2007.

There is no legal requirement that PEF request approval of the contracts or the costs in advance of the costs being incurred. Neverless, in the last fuel clause proceeding, Docket No. 060001-EI, the Commission approved costs associated with Florida Power & Light Company's participation in the SESH pipeline as appropriate for recovery through the fuel cost recovery clause beginning in 2008. (See Order No. PSC-06-1057-FOF-EI, issued December 22, 2006).

The Commission has jurisdiction pursuant to Sections 366.041 and 366.06, Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission approve the terms and conditions of Progress Energy's long term fuel transportation contracts with Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc)?

Recommendation: No. As a matter of policy, the Commission should not approve the terms and conditions of the long term fuel contracts between PEF and Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc). PEF already has sufficient certainty concerning the regulatory treatment of these contracts.

Staff Analysis: PEF petitioned the Commission seeking approval of the terms and conditions of its long term fuel contracts with Duke Energy Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc), hereinafter referred to as the SESH Pipeline Contracts or SESH Pipeline. The five contracts for which PEF seeks Commission approval are: (1) a Precedent Agreement between PEF and Southeast Supply Header, LLC; (2) an agreement for Negotiated Rates for Transportation Services Under SESH Rate Schedule FTS Contract No. 840006 between Southeast Supply Header, LLC and PEF; (3) an agreement for Negotiated Rates for Transportation Service Under SESH Rate Schedule FTS Contract No. 840007 between Southeast Supply Header, LLC and PEF; (4) a Service Agreement, Contract No. (1A) 840006, between Southeast Supply Header, LLC and PEF; and (5) a Service Agreement, Contract No. (1A) 840007, between Southeast Supply Header, LLC and PEF. PEF requested that the Commission rule on the prudence of entering into such contracts and to approve all terms and conditions of the contracts. PEF sought Commission approval on or before March 15, 2007, consistent with the terms and conditions of the contract.

The SESH contracts do not require prior Commission approval of the contracts' terms and conditions. Rather, the Precedent Agreement allows PEF to terminate its rights and obligations under the SESH contracts if the Commission does not approve recovery of costs associated with PEF's obligations under the SESH contracts through the fuel cost recovery clause. PEF has until March 15, 2007 to either obtain Commission approval of fuel clause cost recovery or waive that particular condition precedent. The parties may extend the period for Commission approval of fuel clause cost recovery up to ninety days.

The Commission has previously given its guidance to investor owned electric utilities with basic guidelines for procurement of long term fuel and transportation contracts in Order No. 12645, issued November 3, 1983, in Docket No. 830001-EI. The Commission set forth a broad policy on new long term fuel contracts which it set out in Appendix A to the Order No. 12645. A copy of the order and guidelines is attached to this recommendation. The Commission ruled that compliance with the guidelines was not a prerequisite to fuel clause recovery but rather that if the utility did not comply with the guidelines; it would have a special burden to show that non-compliance was justified. The guidelines did not require Commission approval of contracts but rather is a substitute for its approval. Having previously given its guidance, the Commission

should not be called upon to review and approve the terms and conditions of any long term fuel or transportation contract a utility enters into. To do so is to invite the Commission to become involved in the management of the utility. Contract approval implies the Commission knew and was involved with all portions of contract negotiations. In essence, the Commission becomes a party to the contract rather than a regulator of the utility.

In support of its position that the Commission has previously reviewed and approved long term contracts, PEF cites Order No. PSC-05-0721-FOF-EI, issued July 5, 2005, in Docket No. 041414-EI, In re: Petition for approval of long-term fuel supply and transportation contracts for the Hines Unit 4 and additional system supply and transportation by Progress Energy Florida, Inc. In that docket PEF had filed a petition for approval of its long term fuel supply and transportation contracts for fuel requirements for its Hines Unit 4. The contracts were with BG LNG Services, LLC for re-gasified liquefied natural gas supply, not only for Hines Unit 4, but also for several other units on PEF's system. In addition, there was a contract for firm pipeline transportation from Southern Natural Gas Company (SONAT) through an expansion of SONAT's existing system to be built from Elba Island to an interconnection point with the Florida Gas Transmission (FGT) pipeline. There was also a third contract for firm pipeline transportation from an interconnection point with FGT to PEF's Hines Energy Complex.

Uncertainty concerning regulatory treatment for these long term contracts for Liquefied Natural Gas (LNG) was real, especially since PEF had a lower priced potential provider respond to its RFP. The Commission found that "it was reasonable for PEF to eliminate this [lower priced] option due to the significant uncertainty associated with the in-service date of the project," Order No.PSC-05-0721-FOF-EI, p. 5. The Commission found sufficient certainty with the LNG option, and also acknowledged that "the contracts offer important geographic advantages for PEF and its rate payers due to the increase in operational flexibility and supply diversity." Id. In addition, the Commission had concerns with the contract because it was based on a new fuel type and delivery mechanism, because the "new fuel type and delivery mechanism may expose PEF and its ratepayers to new risks that may not be fully mitigated in PEF's contract." Id., p. 6. The Commission required the utility to "respond, as market conditions and events warrant, proactively and prudently to minimize risk and the costs associated with these contracts which are borne by the ratepayers." Id., p. 7.

The Commission approved the contracts, but its review was limited to four specific areas at PEF's request: "(1) the market-based pricing index and the basis used for gas pricing in the re-gasified LNG supply contract; (2) the negotiated transportation rates from SONAT and FGT; (3) the volume of gas that PEF would accept under the re-gasified LNG supply contract; and (4) the duration of the contracts." Id. The Commission permitted recovery of the contract costs through the fuel and purchased power cost recovery clause "subject to a finding that PEF has managed the contracts in a reasonable and prudent manner." Id.

When Florida Power & Light Company submitted similar long term fuel transportation contracts for approval with the Commission, the Commission approved fuel clause recovery of the costs associated with the gas transportation project but did not address the terms and conditions of the contract itself.

There is no regulatory uncertainty associated with these SESH contracts. The Commission should decline to review or approve the terms and conditions of the SESH Pipeline Contracts as a matter of policy. The Commission has previously given its guidance to utilities on procurement of long term contracts. The utility should be able to follow those guidelines to meet its need without specific Commission approval of each term and condition of its contracts.

Issue 2: Are the costs associated with PEF's proposed participation in the Southeast Supply Header pipeline appropriate for recovery through the fuel cost-recovery clause beginning in 2008?

Recommendation: Yes, costs associated with PEF's proposed participation in the Southeast Supply Header Pipeline project are appropriate for recovery through the fuel cost recovery clause. The Commission should allow PEF to charge the gas transportation costs associated with the pipeline to the clause when the pipeline begins providing service to PEF. The costs associated with this pipeline, like all gas transportation costs, will be subject to the annual cost review in the fuel clause proceeding and further review, subject to a finding that PEF has managed its contracts in a reasonable and prudent manner. (Lester, Colson)

Staff Analysis: In its petition, its testimony, and its responses to staff's discovery, PEF represents that enhancing the diversity and reliability of its natural gas supply is the primary purpose for its participation in the SESH pipeline. In addition, the pipeline will allow PEF to access new gas supply to meet growing natural gas supply requirements. A secondary reason is that the new pipeline creates the potential for lower gas costs, i.e., fuel savings for customers.

Currently, PEF depends heavily on the Mobile Bay area to meet its gas supply needs. PEF projects that by 2009, without the addition of the SESH pipeline, approximately 78% of its gas transportation capacity on the Gulfstream and FGT pipelines will be sourced from the off-shore Mobile Bay area. This area is susceptible to production curtailments during and after Gulf of Mexico hurricanes and tropical storms. With the SESH pipeline, PEF's reliance on the Mobile Bay area will be reduced to approximately 39%.

PEF notes that its participation in the SESH pipeline will allow it access to on-shore gas sufficient to fuel approximately 1,500 megawatts (MW) of gas-fired capacity. PEF currently has 4,300 MW of gas-fired capacity.

By participating in the SESH pipeline, PEF projects that, by 2009, the new pipeline would support 200,000 MMBtu per day of PEF's total Mobile Bay firm transportation., which is approximately 400,000 MMBtu per day. Therefore, PEF's participation in the SESH pipeline would give it access to on-shore gas and cut in half its reliance on the Mobile Bay area for supply. PEF would ship the gas to its plants in Florida using its existing transportation capacity on the Gulfstream and FGT pipelines.

PEF states that its participation in the SESH pipeline will increase supplier diversity. The SESH pipeline will connect the Mobile Bay area with new gas production basins: Barnett Shale in East Texas and Bossier Sands in East Texas and North Louisiana. Production from these basins is growing and the production technology is proven. The pipeline will allow PEF access to independent producers in this area.

PEF notes that it has growing requirements for gas, that gas production in the Mobile Bay area will not be sufficient to meet the additional requirements, and that gas production in the Mobile Bay area is declining. PEF's demand for gas will grow by approximately 200,000 MMBtu per day over the next four years. PEF has over 4,300 megawatts of gas-fired generation capacity in Florida and projects adding more than 2000 megawatts by 2014. In general, Florida

will need an additional 1,200,000 MMBTU per day of natural gas by 2010 to meet the requirements of gas-fired generation expansions.

By participating in the SESH pipeline, PEF will incur additional gas transportation costs. This cost will result from transporting gas on the pipeline and will be based on the rates – fixed demand charges and variable commodity charges – negotiated between PEF and the SESH pipeline. The Commission has granted confidential treatment of the negotiated rates. PEF states this transportation cost will be similar to the transportation costs it incurs with Gulfstream and FGT.

PEF notes that the additional gas transportation costs could be offset by lower gas costs. Currently, the Mobile Bay area gas prices carry a premium over NYMEX prices. That is, gas at the Mobile Bay Hub is typically more expensive than gas at Henry Hub. Since the SESH pipeline will increase gas supply in the Mobile Bay area, gas prices should decrease, which would reduce or eliminate the premium. The resulting savings could partially or entirely offset the additional gas transportation costs.

In evaluating whether to participate in the SESH pipeline, PEF considered several options. PEF considered an on-shore gas supply and transportation bundle. This option would enhance reliability of fuel supply but it would not increase the number of potential suppliers. Furthermore, the SESH pipeline was more cost effective. PEF considered additional storage, which would act as a physical hedge and provide a reliable source of gas during hurricanes and tropical storms. While PEF has contracted for firm storage, additional storage will not provide more gas to meet growing requirements.

PEF also considered purchasing additional liquefied natural gas (LNG). PEF has a LNG supply and transportation arrangement with BG LNG Services, LLC and the Cypress pipeline, which will bring LNG from Savannah, Georgia to an interconnection with FGT in Clay County, Florida. This arrangement will make up approximately 14% of PEF's gas supply portfolio. The Cypress pipeline will begin service in May 2007. PEF states that additional LNG would not increase supply diversity and that the Gulf of Mexico LNG terminals are susceptible to hurricanes and tropical storms.

Staff agrees with PEF that its participation in this new pipeline will increase the reliability of gas supply. The SESH pipeline will provide a significant amount of on-shore gas. Severe weather events are much less likely to interrupt the delivery of on-shore gas. Since the pipeline will interconnect with both Gulfstream and FGT, PEF's operational flexibility will be enhanced.

Staff believes diversifying by supply basin is important. Such diversification increases reliability of supply. Also, diversification increases the number of suppliers, which potentially could lead to fuel savings. Furthermore, having access to several supply basins protects against declining production, temporary or permanent, in a particular basin. PEF's participation in the SESH pipeline will provide new gas supply to meet growing demand.

PEF's participation in the new pipeline will result in additional gas transportation costs. This cost or some portion of it could be offset by lower gas costs in the Mobile Bay area. The

premium in the Mobile Bay area likely will be greatest during Gulf of Mexico hurricanes and tropical storms. Staff emphasizes that, depending on the market factors, PEF may or may not realize actual savings.

Based on Order No. 14546, issued July 8, 1985 in Docket No. 850001-EI, the SESH pipeline costs are gas transportation costs and qualify for cost recovery through the fuel cost recovery clause. In the recent fuel clause proceeding, the Commission granted similar cost recovery to FPL for the same pipeline (See Order No. PSC-06-1057-FOF-EI issued December 22, 2006 in Docket No. 060001-EI). If PEF's participation in the SESH pipeline is approved, the Commission would have the opportunity to review these charges during the annual fuel clause proceeding.

Staff believes PEF has acted prudently in considering a number of gas supply options as part if its decision to participate in the SESH pipeline. Staff has reviewed the costs associated with the SESH pipeline and believes the costs are reasonable.

For the reasons cited above, staff recommends the Commission find that PEF's proposed participation in the Southeast Supply Header pipeline is appropriate for recovery through the fuel cost recovery clause. The Commission should allow PEF to charge the appropriate costs to the clause when the pipeline begins providing service to PEF.

Issue 3: Should this docket be closed?

Recommendation: Yes. The Commission should close this docket upon issuance of a consummating order unless a person whose interests are affected by the Commission's decision files a protest within 21 days of the issuance of the proposed agency action. (Bennett)

Staff Analysis: If no timely protest to the proposed agency action is filed within 21 days, the Commission should close this docket upon issuance of the consummating order.

*1983 Fla. PUC LEXIS 163, **

In re: Investigation of **Fuel** Adjustment Clauses of Electric Utilities

DOCKET NO. 830001-EU; ORDER NO. 12645

Florida Public Service Commission

1983 Fla. PUC LEXIS 163

83 FPSC 12

November 3, 1983; Partial Publication Only

CORE TERMS: fuel, staff, true-up, inventory, prudence, oil, coal, guidelines, procurement, generic, transportation, nonrecoverable, long-term, monthly, supplier, plant, expenditure, recommends, audit, tank, rate case, confidential, retroactive, expensed, reporting, subject to refund, ratepayer, normally, invoice, fuel oil

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PANEL: The following Commissioners participated in the disposition of this matter: Gerald L. Gunter, Chairman; Joseph P. Cresse, Susan W. Leisner, John R. Marks, III, Katie Nichols

OPINION: Pursuant to notice, a public hearing on the above matter was held before the Florida Public Service Commission on June 1, 2, 3 and 24, 1983, in Tallahassee, Florida.

ORDER CONCERNING GENERIC ISSUES

BY THE COMMISSION:

Background

During the June, 1983, true-up hearings certain "generic" issues were raised for consideration. The time alotted for hearing was insufficient and a second hearing on these issues was

Issues Presented

The following issues were raised in this proceeding: n1

1. Whether the Commission should require that all company inventory policies be supported and justified to the Commission's satisfaction by a comprehensive and systematic inventory study?

2. Whether or not a generic inventory policy should be adopted by the Commission on a standby basis and be applied by the Commission for ratemaking purposes in cases where a utility fails the justify an alternative inventory policy? **[*3]**

3. Whether **fuel** oil that cannot be burned for generation should be maintained in inventory and, if not, how should it be taken off the books.

4. Whether base coals that are nonrecoverable for operating purposes should remain a component of coal inventory?

5. When should a transfer of nonrecoverable base coal to Account 312 be effectuated and what ratemaking treatment should be used to recognize the transfer?

6. Should the Commission adopt specific standards for new **long-term fuel contracts?**

7. What, if any, should be the Commission standards for new **long-term fuel contracts?**

8. Should compliance with Commission standards be a prerequisite to recovery of new **long-term fuel contract** costs?

9. Whether affiliates and subsidiaries of utilities or utility holding companies engaged in procurement of **fuel** or services for a utility should be required to conduct such activities under the same standard as a utility would be required to meet had it purchased the same **fuel** or service.

10. Whether the Commission should require that all ulilities file a monthly report detailing all purchases of **fuel,** transportation and/or **fuel** handling services as proposed by staff.

11. Whether **[*4]** the proposed monthly reporting forms should be accorded specified confidential treatment.

12. Whether the Commission should change the operation of the clause to place a jurisdictional limitation on the review of prudence rather than treat prudence at the end of each six month period and explicitly make revenues subject to refund.

13. What is the Commission's current power to review expenditures during prior true-up periods?

14. What is the proper legal procedure for the Commission to adopt a conservation reward/penalty methodology and to grant a reward or impose a penalty?

15. Would the Commission deny due process if it were to grant conservation rewards or impose conservation penalties during the June true-up hearings.

16. Whether costs to be recovered by FPL should be calculated using the original or the current version of the rule. (This issue is being preserved pending appeal by Public Counsel)

17. Are net savings to be calculated on a monthly or six month basis? (This issue is being preserved pending a petition for reconsideration by Public Counsel)?

n1 These issues were commingled with other issues in the Prehearing Order (Order No. 11999) and are not numbered the same as in that order. **[*5]**

Of these seventeen issues, the first twelve involve questions of fact and policy, while the last five involve questions of law.

Findings of Fact

Fuel Inventory Policies (Issues 1 and 2)

In recent rate cases we have reviewed the inventory policies of each of the four large generating utilities as part of our analysis of working capital requirements. Each utility's inventory policy effects the level of **fuel** held in inventory, which effects in turn the utility's working capital requirements under the balance sheet approach. In each case we encountered difficulties in analyzing each company's policy and in Order No. 11498 and we found that Gulf Power Company's inventory policy was not justified.

The staff has proposed that we require each utility to support and justify its inventory policy by a comprehensive and systematic study. The staff envisions a proceeding separate from a rate case wherein we would review the results of each utility's study and rule on the reasonableness of its inventory policy. FPL and FPC agree that further study of inventory policies is appropriate. TECO and Gulf, however, maintain that any review of inventory policy should fall within a **[*6]** rate case.

We agree that further study of **fuel** inventory policies is needed. However, we will not order special studies to be performed for approval separate from rate cases. Instead, we expect each utility to fully document its inventory policy in its next rate case.

The staff has proposed a "generic" **fuel** inventory policy to be applied in a rate case if a utility fails to fully justify its own policy. The staff's proposed policy is as follows:

1. Heavy Oil - 45 days projected burn plus normally unavailable oil.

2. Light Oil - 30 days burn at the lighest average monthly rate during the most current and five year period plus normally unavailable oil.

3. Coal - 90 days projected burn plus base coal volumes.

All other parties objected to the adoption of a generic policy. Each utility proposed that we rely on the record of each case to identify the proper inventory level if the utility's policy is not justified. Public Counsel also preferred a case-by-case analysis.

If a utility fails to justify its own inventory policy in a rate proceeding the Commission should have a generic policy available in order to evaluate the reasonableness of the dollar amount of inventory requested **[*7]** in working capital. The generic policy will not be used automatically in the event that the utility's policy is not justified, rather, we will strive to determine an optimum policy from the evidence presented in the rate case. If we cannot determine an optimum policy from the record, we would have the option of using the generic policy, or the generic policy modified by evidence of record. In such a case, the utility would be free to demonstrate that the generic policy would not provide acceptable inventory levels for its operation or the utility could build an alternative inventory based on the generic policy with modification to meet its operational requirements.

The generic policy recommended by staff is not represented to be the most optimal policy. Staff witness Foxx stated that it is not possible to create one generic inventory policy which is equally fair to all utilities. This is due to the differences in the system generating characteristics of the utilities.However, staff's proposed generic policy was shown to be reasonable by Mr. Foxx's testimony, which showed utility inventory levels throughout the nation in relation to burn levels.Although the levels specified **[*8]** by staff's generic policy are not equal to the national averages, we find the proposed generic policy to be reasonable. We therefore adopt the staff's proposed generic inventory policy for the purposes set forth above.

Nonrecoverable Oil (Issue 3)

Each utility that maintains an oil inventory holds a certain amount of "nonrecoverable oil" in inventory. The point of discharge in an oil storage tank is above the bottom, allowing water and sediment to fall below the level from which oil is pumped. Nonrecoverable oil represents the volume of oil below the discharge pipes at the bottom of oil storage tanks. This nonrecoverable oil typically contains a certain amount of noncombustible oil which must be processed before use as **fuel** oil. It also contains a certain amount of combustible oil, but this oil cannot be removed for use without special equipment.

The staff had originally proposed that each company estimate the amount of combustible oil when filling its tanks and expense that oil at the then current price of oil.The staff has modified that approach and now proposes that the value of all nonrecoverable oil below the discharge value be expensed at average unit cost at the **[*9]** next **fuel** adjustment true-up and thereafter expensed after each tank cleaning and refill at the then prevailing cost. FPL and TECO propose to retain all nonrecoverable oil in inventory and expense it out at tank cleaning. Public Counsel proposes that all nonrecoverable oil be removed from inventory and be amortized over the expected period between tank cleanings.

We find that the value of all heavy and light oil which normally resides in the storage tanks below the normal operating intake pipe and is normally unavailable should be expensed at the end of the next **fuel** adjustment true-up hearing. This oil should be expensed at the average unit cost of oil residing in the tanks on the day expensed. If a tank is emptied and refilled, the nonrecoverable oil should be expensed when the tank is refilled.

In recent rate cases nonavailable oil has been included in working capital for utilities and those utilities' rates currently allow a recovery on the investment in that nonrecoverable oil. If that oil is expensed off the utility should no longer receive a return on it. Therefore, when each utility calculates the expense of its nonrecoverable oil it should likewise calculate the revenue **[*10]** effect of removing that oil from rate base. The adjustment to the **fuel** adjustment clause to expense the oil would reflect the offset of the rate base reduction. After the nonrecoverable oil has been expensed through the **fuel** adjustment clause the clause would thereafter reflect an adjustment to recognize the rate base reduction until the utility's next rate case.

Base Coal (Issues 4 and 5)

Each coal pile maintained by a utility contains a certain amount of "base coal" used to support the pile. This coal is normally low grade coal and is not expected to be burned as part of normal utility operations. Except for TECO, this coal is maintained in inventory in spite of the fact that it is not expected to be burned. All parties (except FPL, which uses no coal) have agreed that base coal should be capitalized in Account 312 and depreciated over the life of the plant. TECO currently accounts for its base coal in this manner. We find that the proper treatment of investment in base coal is to capitalize it in account 312 as proposed. Normally, plant items such as base coal would be depreciated over the life of the plant to which it relates. However, we find that a **[*11]** shorter period of five years is more appropriate for the depreciation of base coal.

The staff proposes that we require the transfer of base coal to account 312 in the next true-up and allow recovery of depreciation through the **fuel** adjustment until each company's next rate case. FPC, Gulf and Public Counsel propose that no change occur until the next rate case. We agree with FPC, Gulf and Public Counsel. There is no need for extraordinary measures in correcting the accounting for base coal. A delay until each company's next rate case is appropriate.

Commission Standards for New **Long Term Fuel Contracts** (Issues 6-9)

The staff had proposed that we adopt specific detailed guidelines for new **long-term contracts.** The original staff proposal envisioned a set of specific guidelines that a utility should meet in obtaining new **contracts.** These guidelines would cover solicitation and negotiation of new **contracts.** FPL, FPC, TECO and GULF all opposed the adoption of detailed standards governing **fuel contracts.** Each expressed a concern that detailed standards would not be flexible enough to encompass all reasonable procurement decisions. In response to the positions of the other **[*12]** parties, the staff modified its proposal to involve a set of broad guidelines to be adopted by the Commission. More detailed guidelines would be approved for use by the staff, but would not be adopted for direct application by the Commission to each utility. We agree that we should adopt broad guidelines, as proposed by staff. Utilities will then be placed on notice as to the basic procurement standards we intend to apply.

We next must determine what broad guidelines should be adopted. The staff, in its final recommendation, broadened the standards that it has originally proposed. We view these revised standards as appropriate and adopt them as our central policy on new **long term fuel contracts.** The approved guidelines are set forth on Appendix A of this Order. These broad guidelines will be augmented by more specific guidelines that we will approve for internal staff use.

The staff proposed that compliance with the broadened guidelines be a prerequisite to cost recovery through the **fuel** adjustment. Again, the four utilities opposed the application of preset criteria as a condition for cost recovery. We find that compliance with our central guidelines should not be a prerequisite **[*13]** to **fuel** cost recovery. However, should a utility fail to comply with the our central guidelines it would have a special burden to show that non-compliance was justified.In addition, staff's detailed guidelines would be considered in any **fuel** adjustment proceeding where staff sought to apply them to utility's purchases. We would then formally determine whether compliance with staff's guidelines is also appropriate.

The staff has also proposed that our guidelines be applied to affiliates and subsidiaries of utilties or utility holding companies engaged in the procurement of **fuel** or services for a utility. Public Counsel agrees with the staff, stating that a utility should show that its affiliated companies are the most cost-effective providers of **fuel** and services.

We agree with the staff and Public Counsel. Given the broad standards that we have adopted,

we consider it reasonable to expect purchases by affiliated companies for a utility to meet the same standards as purchases by the utility itself.

Monthly **Fuel** Reports (issues 10 and 11)

The staff has proposed that we require all utilities to file a monthly report detailing all purchases of **fuel,** transportation **[*14]** and **fuel** handling services and has recommended the form and content of the report.

FPL is willing to provide the information but suggests that quality adjustments need not be included because they are not made on an invoice by invoice basis. FPC has no objection to providing the information if we determine that the information cannot be adequately reviewed by our monthly field audits. TECO states that the requested information is being compiled and submitted at the audit staff's request. Gulf has no objection to filing the information, as long as it is done concurrently with the filing of FERC's Form 423. All of the utilities stressed the need to protect the confidentiality of information filed on the forms. Public Counsel supports the staff's proposed reporting forms.

We agree with the staff and Public Counsel that the information requested by the proposed forms is a valuable and useful tool in analyzing the prudence of utility **fuel** purchases and related transactions.We find that the information requested by staff should be provided on a monthly basis, to be filed with the Commission Clerk within 30 days after the end of the reporting month unless the utility demonstrates **[*15]** a need for an extension. The monthly reporting forms are to be completed on a plant specific and supplies specific basis.

The first form proposed by staff is the Coal Receipt Analysis form. One form would be completed for each plant. This form includes information on the delivered price and quality of coal received in each month from each supplier for each plant. The point of receipt is usually at a river loading facility or rail tipple where the coal is loaded into river barges or rail cars. Separate invoices from a given supplier may be combined into one entry if the coal was purchased under the same **contract** and invoiced at the same price. Any retroactive or quality adjustments known at the time of filing should be included in the appropriate columns. Retroactive and quality adjustments for coal from previous reporting periods would be attached as an addendum to this form which already documents the time period involved, the specific previously reported entries to revise, the revision (in total dollars and in dollars per ton) to each previously reported entry, and the nature or cause of the revision. If quality reports are not available at the time of filing, they would **[*16]** be updated in a similar fashion.

The second form proposed by staff is the **Fuel** Oil Receipt Analysis which reflects the invoice information of oil delivered to generating facilities or terminals. One form would be completed for each plant or terminal. One entry would be made for each supplier for each grade of **fuel.** Residual **fuel** oil of different sulfur grades must be reported separately.Multiple invoices may be reported as one entry so long as the above criteria are met. In the event multiple invoices are reported as one entry, the weighted average price would be reported. Retroactive price changes and quality adjustments would be reported as an attachment which documents the previously reported entry to revise, the nature of the revision, ad the revision in total dollars and dollars per barrel.

The third form proposed by staff is the Coal Rail Transportation Cost Analysis form which documents the rail transportation costs for coal shipped from each supplier to each plant. One form would be completed for each plant. Retroactive adjustments to this form would be reported in a similar manner as above. The entries would be on a date shipped basis.

The fourth form **[*17]** proposed by staff is the Coal Waterborne Transportation Cost Analysis form which documents the costs of the various components in the waterborne coal

transportation network. One form would be completed for each plant. The entries would be on a date shipped basis. Retroactive adjustments would be made in a similar manner as the first two forms.

The staff proposed that retroactive revisions or adjustments to transactions previously reported would be included in the form of an addendum which would be specific enough in nature to enable the staff to revise the original filing of the form. The forms would be required to be filed in a timely manner. We find that the content of the forms proposed by the staff is reasonable and except for reformatting to isolate confidential material (see below), we approve the format of the forms as well.

Next, we must determine whether any portion of the monthly reports should be accorded confidential treatment. We agree that certain portions of the monthly reports will contain proprietary confidential business information. However, many portions of the monthly reports will not. The proprietary information for all types of **fuel** is transportation. **[*18]** Any breakout of transportation costs must be treated confidentially. In addition, F.O.B. mine prices for coal is proprietary in nature as is the price of **fuel** oil. Disclosure of separate transportation or F.O.B. mine prices would have a direct impact on a utility's future **fuel** and transportation **contracts** by informing potential bidders of current prices paid for services. Disclosure of **fuel** oil prices would have an indirect effect upon bidding suppliers. Suppliers would be reluctant to provide significant price concessions to an individual utility if prices were disclosed because other purchasers would seek similar concessions.

As proposed, staff's reporting forms commingle confidential and non confidential information.By segregating transportation and base **fuel** price information to separate parts of the form, confidential material can be separate from non confidential material. Revised forms to accomplish this purpose are shown on Appendix B of this order. Each utility participating in the **fuel** adjustment clause should file these forms monthly. Forms 423-1 and 423-2 would be public record. Forms 423-1(a), 423-2(a) and 423-2(b) would be confidential and exempt from public **[*19]** access.

Change in the Operation of the **Fuel** Adjustment Clause (Issue 12)

The staff has proposed that we change the operation of the **fuel** adjustment clause so as to clarify the nature of our jurisdiction over amounts passed through the clause. As proposed by the staff, this change is to be prospective in nature. We will discuss our jurisdiction over amounts previously passed through the clause as currently structured at a later point in this order.

As currently structured, the clause provides that utilities are to justify their expenditures at a true-up hearing immediately following each six month period. The staff proposed that we change the clause so that, instead of requiring proof of prudence at the true-up immediately following a six month period, we simply limit our jurisdiction over all transactions passed through the **fuel** clause for a period of three years from the date we approve the amount at the true-up hearing. Under the staff proposal, if before the end of the three year period the Commission indicates a need for further review for any specific transaction, the Commission would explicitly retain jurisdiction over amounts passed through the **fuel** clause **[*20]** relating to that transaction. The Commission may then continue jurisdiction over those amounts until a final order is issued. Once a specific transaction which has been explicitly set aside for review has been ruled upon by the Commission, the Commission would lose jurisdiction over that transaction for the period reviewed by the Commission. The above jurisdictional limitations would not apply for transactions when fraud or other such irregularities can be shown.

Each of the parties responded to the staff proposal in different ways.

FPL proposed that unless a utility has fraudulently or through error provided incorrect or incomplete information, or the amounts paid have changed due to litigation or dispute, Commission jurisdiction should cease after one year from the date of the transaction, unless the Commission identifies a problem and retains jurisdiction over a specific transaction.

FPC agreed that the current six month may not be adequate for proper review, but stated that the Commission may not lawfully extend its jurisdiction beyond a reasonably determined review period in order to provide a catch-all for the possibility that it may have overlooked something.

According **[*21]** to TECO, the Commission should first enter a provisional true-up order within sixty days of the end of the six month period under review. The Commission should then provide for a further true-up followed by a final order after a reasonable length of time. TECO submits that such final order should be entered within one year of the end of the six month period under review.

Gulf's position is that unless the Commission specifically reserves jurisdiction to allow further study of expenditures, jurisdiction lapses on approval of the true-up. The exception to this limitation of jurisdiction are instances of fraud or misrepresentations.

Public Counsel supported staff's approach.

The current structure of the clause creates two problems. First, although under the current clause prudence is to be reviewed at the true-up hearing after each six-month period, varying positions have been stated as to our jurisdiction to look at the prudence of transactions after a true-up order has been issued. Although we have now resolved the issue, a second problem was caused by our prior practice of identifying questionable transactions and placing the associated revenues subject to refund. In recent **[*22]** periods, utilities have preferred to stipulate to continuing jurisdiction rather than have their revenues explicitly made subject to refund. According to the utilities, making revenues subject to refund creates a financial uncertainty about those revenues, adversely affecting a utility's financial position.

The staff's proposal achieves two goals. It resolves all uncertainty as to our jurisdiction over amounts passed through the clause by explicitly retaining the power to review prior transactions. Thus, the complex factual and legal problem engendered by the structure of the current clause is avoided. It also obviates any desire or need to explicitly declare revenues subject to refund, as jurisdiction continues without question. The financial uncertainty that arises when revenues are declared subject to refund is avoided. We therefore agree with the staff's proposal that the operation of the clause should be changed.

Staff's proposal to place a time limit on our jurisdiction, however, is inappropriate. We see no justification in limiting our ability to scrutinize past transactions. We fully intend to review a utility's procurement decisions solely in light of the **[*23]** facts known or knowable at the time a decision was made. The appropriate limitation of our jurisdiction is based on whatever statute of limitations or other jurisdictional limitations applies to our actions as a matter of law.

Under the new structure, rather than explicitly considering prudence at the end of each six month period, we will consider only the question of comparing projected to actual results.Questions of prudence require careful and often prolonged study. When a question arises as to the prudence of a utility's expenditures, proper time should be taken to fully analyze the question and resolve the matter on all of the facts available. Often, a full staff analysis should be made before the matter is formally included within the **fuel** adjustment proceeding.

From now on, each utility will be required at true-up only to demonstrate how the amounts

actually expended for **fuel** and purchased power compare with the amounts projected for the prior six month period. The true-up approved at that time will reflect the reconciliation of projected to actual results (with the appropriate calculation of interest, other true-up amounts, etc.). Although the burden of proving the **[*24]** prudence of its actions will remain with the utility, the question of prudence will arise only as facts regarding **fuel** procurement justify scrutiny. Hopefully, we will be presented with complete analyses of procurement decisions in a timely manner.

At the true-up hearing that follows a six month period a utility will still be free to present whatever evidence of prudence it chooses to provide. We note that certain utilities have periodically presented broad statements as to the prudence of their **fuel** procurement activities.Such prsentations are not inappropriate, but they hardly elucidate the subject matter. **Fuel** procurement is an exceedingly complex matter and a determination of the prudence of procurement decisions requires a complex analysis.

While a utility may feel satisfied that it has properly met its burden by such a presentation, we expect the quality and quantity of evidence to be presented in support of the prudence of **fuel** procurement decisions to match the complexity of the subject matter. We will therefore accept any relevant proof a utility chooses to present a true-up, but we will not adjudicate the question of prudence, nor consider ourselves bound to do so **[*25]** until all relevant facts are analyzed an placed before us. We will be free to revisit any transaction until we explicitly determine the matter to be fully and finally adjudicated.

Although this order is being issued after the true-up order for the October, 1982 - March 1983 period, the restructuring of the clause is effective as of that true-up hearing. Except for the delay engendered by an extended hearing on the generic issues, we would have decided this issue in conjunction with the final true-up decision for that period. Therefore, all **fuel** transactions, beginning October 1, 1982, are subject to the newly structured clause and Order No. 12172, the true-up order for the October, 1982 - March, 1983 period is the first true-up order under the new structure.

Future Rulemaking

Having resolved the above policy issues within an adjudicatory framework, we consider it appropriate to move toward rulemaking and codify our policy. The staff is directed to begin drafting rules to encompass the policy decisions made in this order.

Conclusions of Law

Review of Prior True-up Periods (Issue 13)

Periodically, we find it necessary to review the prudence of certain **[*26]** utility **fuel** procurement actions. Often the transactions in question extend into prior six-month periods. From time to time questions have arisen as to our authority to review transactions in prior true-up periods. We find it appropriate to fully resolve the issue at this time.

According to the staff, absent an allegation of prudence, evidence of record thereon and an order making a finding of prudence, the Commission may review expenditures made during prior true-up periods. According to staff, however, where a particular transaction has been called into question by the Commission, evidence in support of its reasonableness has been presented by the utility, and the expense has not been disallowed, the Commission should consider the prudence of that transaction to have been ruled on, even if the order did not make an explicit finding of prudence. In addition, the staff asserts that the nature of the six-month clause and the manner in which costs flow through the clause shows that a true-up order is not truly final as to prudence.

FPL, FPC, Gulf and TECO all assert that Commission jurisdiction over **fuel** transactions lapses at true-up unless the Commission explicitly reserves **[*27]** jurisdiction to allow further study.

Public Counsel's position is that the Commission may review any expenditure that has previously passed through the clause and disallow those costs that were imprudently incurred. According to Public Counsel, the utilities are relieved of regulatory lag by the operation of the clause and, in exchange, the Commission and ratepayers must have assurances that the costs collected are proper.

We conclude that the staff's view is proper. The question of whether we may review the prudence of expenditures made during prior true-up periods is governed by whether the prudence regarding of expenditures has been adjudicated. The issuance of a true-up order does not adjudicate the question of prudence per se. As pointed out by staff, the true-up hearings have never been relied upon by the Commission or any other party as the point at which prudence is actually reviewed. With rare exception, prudence has not been alleged, proven nor ruled upon during those proceedings. An actual adjudication of prudence depends on whether an allegation of prudence was made, evidence was presented thereon and a ruling made. Where an expenditure has been disputed and **[*28]** its prudence examined on the record, a ruling in favor of prudence should be inferred even if none is explicitly made.

This approach to jurisdiction over prior true-up periods naturally involves a review of the record of prior proceedings. Since several hearings are held each year, this process is necessarily complex. We will defer such a review until such time as we must face the question for a particular utility.

Staff is also correct in stating that the nature of the clause and the way costs are passed through it belies any finality to a true-up order. As stated in Order No. 11572, the effect of expenditures during any six month period extend beyond that period and utilities frequently pass retroactive price adjustments through the clause.

The nature of the **fuel** adjustment is continuous and the segregation of charges to **fuel** cost into 6-month periods is for ease of administration only.Indeed, **fuel** purchases in any one period will affect future periods, as **fuel** cost is charged on an "as burned" basis at weighted average inventory cost. Thus, instead of **fuel** costs collected in any one period reflecting only **fuel** purchased during that period, those costs reflect the **[*29]** weighted average cost of purchases during and prior to that period. In addition, it is quite common for utilities to receive retroactive adjustments to **fuel** price and transportation costs well after the close of the original transaction to which they relates.

Conservation Penalty/Reward (Issues 27 and 28)

Since we have declined to adopt any penalties or rewards at this time these issues are moot.

Proper Version of Oil Backout Rule (Issue 29)

Public Counsel has raised this issue in order to preserve its pending appeal. No ruling is necessary.

Calculation of Net Savings on Six-Month or Monthly Basis (Issue 30)

Public Counsel has raised this issue in order to preserve it pending a motion for reconsideration. No ruling is necessary.

Other Conclusions of Law

The findings of fact and policy decisions made in this order are supported by the weight of the evidence of record and are within the range of the discretion granted to the Commission by the legislature under Chapter 366, Florida Statutes.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the issues of fact and law set forth on pages 2 and 3 of this order be and **[*30]** the same are resolved as set forth in the body of this order. It is further

ORDERED that each electric utility seeking to recover the cost of **fuel** through the **fuel** adjustment clause shall file monthly reports in the form of Appendix B to this order, each report to be submitted within 30 days after the end of the reporting month.

By Order of the Florida Public Service Commission this 3rd day of November, 1983.

APPENDIX A

FLORIDA PUBLIC SERVICE COMMISSION **FUEL** PROCUREMENT POLICY

I. General

A. The Public Service Commission requires that all expense associated with the procurement of **fuel, fuel** related handling services and **fuel** transportation which are recovered through the **Fuel** Adjustment Clause be prudently incurred, result from competitive procurement procedures, be reasonably competitive in cost or value relative to what other buyers are paying under similar terms and conditions for **fuel** or services of comparable quality or specifications and result from sound administration of **fuel** supply agreements.

B. To accomplish the objectives expressed in (A), the Commission establishes the following guidelines that it recommends to electric utilities seeking **fuel** **[*31]** expense recovery through the **Fuel** Adjustment Clause. The Commission fully recognizes that differing **fuel** mixes and plant locations will necessarily result in vastly different **fuel** procurement strategies. However, the Commission also believes that there are certain fundamental, common procedures which, when employed, will result in the lowest, long run overall **fuel** expense to the companies and their ratepayers.

C. While the Commission believes that compliance with the guidelines expressed in this policy will achieve the lowest system **fuel** cost, the utility's management has sole responsibility to procure **fuel** in the most cost efficient manner possible and therefore it should have the flexibility to employ any means to achieve this result. In consideration of the above, departures from Commission policy are authorized when such departures can be justified and shown to be in the best interest of the utility and its ratepayers.

D. Departures from Commission policy which through Commission audit, investigation and hearing can be shown to have resulted in unjustified additional **fuel** expense are inappropriate for recovery through the **Fuel** Adjustment Clause and such expense will be **[*32]** disallowed.

E. If the Commission determines, based upon Staff audit and/or investigation, that a utility's unjustified departure from recommended Commission policy has resulted in unnecessary **fuel** expense, then the utility shall be required to apply credits against the clause or to make refunds to its customers.

F. The Commission's guidelines are intentionally broad to allow utility management the flexibility to tailor procurement procedures to fit a broad range of contingencies and adapt to

changes in **fuel** markets.

G. The burden of proof rests solely with the utility to document the reasonableness of its procurement practices and the resultant expenses from such practices.

H. General overall compliance with Commission policy in no way removes the responsibility of a utility to justify andy particular transaction the Commission may require the specifically justified.

II. **Long-Term** Agreements for **Fuel, Fuel** Handling Services, **Fuel** Transportation, Spot Purchases and Affiliate Transaction.

A. The Commission recommends that the majority of a utility's requirements for **fuel, fuel** handling services and/or transportation be procured under the terms of a **long-term contract.** **[*33]** Primary reliance upon **long-term contracts** will ensure that **fuel** or services will be available when required at reasonable, stable costs to the utility and its ratepayers.

B. The Commission recommends that, to the extent practicable, such **long-term contracts** be negotiated in a competitive environment. It is recommended that the primary method employed should be an open competitive bidding process or some comparable alternative which produces the same result.

C. All aspects of the procurement process employed in acquiring a **long-term fuel** or services supply **contract** should be documented and available to the Commission upon request.

D. Vendors should be selected on the basis of a formal evaluation system which is neutral in its application and capable of producing quantifiable ratings of individual suppliers. Considerations other than delivered price, **fuel** quality and vendor performance should be thoroughly documented.

E. The Commission recommends that all **fuel** agreements incorporate clear specification for the **fuel** or service to be provided and bonus/penalty provisions to ensure that the **fuel** or services contracted for are provided in accordance with **contract** terms.

F. **[*34]** The Commission recommends that the utility arrange for adequate **fuel** sampling techniques and equipment to be deployed at the point of receipt from the **fuel** supplier and the point of delivery, if different. Such a procedure will ensure that the quality of the **fuel** received at the unloading facility is consistent with that of the **fuel** as loaded, the invoiced priced and the **contract** specifications.To the extent possible, all such arrangements should be clearly written in the **contract.**

G. Utilities subject to the Commission's jurisdiction should not pay for or agree to pay for **fuel** or services at prices in excess of that dictated by the negotiated price terms of executed **contracts** existing between such utilities and providers of such **fuel** or services.

H. The Commission recommends that **long term fuel** or service **contracts** be based upon a base price plus well defined escalators, public tariffs or public postings unless a benefit to the ratepayer can be demonstrated by using some other pricing arrangement.

I. The Commission recommends that all utilities seek to incorporate a "right to audit" clause in any **contract** which utilizes escalators. The right to audit clause should give the **[*35]** utility the authority to audit specific records of the supplier.

J. The Commission recommends that all utilities enforce the right to audit through the annual use of its own audit staff or an independent accounting firm. Any refunds or adjustments due,

as identified by audit, should be promptly resolved and credited to **fuel** expense.

K. The Commission recommends that any escalation methodology to be employed in a **long-term contract** be tied as closely as possible to actual changes in a suppliers verifiable costs.

L. The Commission recommends that all utilities seek to incorporate adequate well defined remedies in all **long-term contracts** for substandard quality performance unreliable volume or quality performance and unacceptable high price over protracted periods of time.

N. It is recommended that all **contracts** and the individual terms of each **contract** be reviewed and approved by the legal office of the utility.

O. All utility personnel having any interest in a particular firm seeking a **long term fuel** or services **contract** with a utility should be removed from any selection process, **contract** negotiation or administration of a **contract** with the firm. All personnel **[*36]** having any potential conflict of interest should be prevented from having any impact upon the contracting process.

P. All utility transaction with affiliated companies which provide **fuel or fuel** related services should be based on costs which are consistent with or lower than the costs a utility would incur if the utility received the **fuel** or services from an independent supplier in the competitive market obtained through competitive bidding.

Q. All spot transactions should be priced at, or below, the market price at the time of purchase and should not exceed the normal **contract** price for similar **fuel or fuel** related services unless required for reliability purposes.

R.The Commission expects, to the extent possible, that each utility utilize the terms of their **long-term contracts** relating to minimum and maximum volumes of **fuel** required to be delivered in order to take advantage of lower prices in the spot market when they exist.

S. The Commission expects that any utility which has a **contract** with an affiliated organization shall administer that **contract** in a manner identical to the administration of a **contract** with an independent organization.

T. Any **fuel or fuel** related **[*37]** transaction which does not meet the above criteria shall be denied recovery through the **fuel** clause by the Commission, unless the utility, which has the full burden of proof, can demonstrate that the transaction is in the best interest of the ratepayer.

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Date/Time: Wednesday, February 28, 2007 - 12:15 PM EST

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