BEFORE THE PUBLIC SERVICE COMMISSION

In re: 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.	DOCKET NO. 060793-EI ORDER NO. PSC-07-0294-PAA-EI ISSUED: April 5, 2007

The following Commissioners participated in the disposition of this matter:

LISA POLAK EDGAR, Chairman
MATTHEW M. CARTER II
KATRINA J. McMURRIAN

NOTICE OF PROPOSED AGENCY ACTION
ORDER GRANTING PROGRESS ENERGY FLORIDA'S REQUEST FOR RECOVERY OF SOUTHEAST SUPPLY HEADER PIPELINE COSTS THROUGH THE FUEL COST RECOVERY CLAUSE AND DENYING REQUEST FOR APPROVAL OF TERMS AND CONDITIONS OF CONTRACTS.

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

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

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.

Request for Approval of Contract Terms and Conditions

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 our 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 us to rule on the prudence of entering into such contracts and approve all terms and conditions of the contracts. PEF sought approval on or before March 15, 2007, consistent with the terms and conditions of the contract.

We find, however, that 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 we do 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.

We have previously given guidance to investor owned electric utilities by providing basic guidelines for procurement of long term fuel and transportation contracts in Order No. 12645, issued November 3, 1983, in Docket No. 830001-EI, <u>In re: Investigation of Fuel Adjustment Clauses of Electric Utilities</u>. We set forth a broad policy on new long term fuel contracts which is set out in Appendix A to Order No. 12645. We 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 guideline, 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 our approval. Having previously given our guidance, we 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.

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, <u>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.</u> 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. We 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. We found sufficient certainty under 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, we 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. Thus we 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.

We approved the contracts, but our 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. We 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 our approval we 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.

Upon consideration of the foregoing, approval of the terms and conditions of the SESH Pipeline Contracts is denied. There is no regulatory uncertainty associated with these SESH contracts. We have previously given our 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.

Fuel Clause Recovery of Costs Associated with SESH Pipeline

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.

We agree 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.

We believe 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. Depending on the market factors, PEF may or may not realize actual savings.

By Order No. 14546, issued July 8, 1985, in Docket No. 850001-EI, In re: Cost Recovery Methods for Fuel Related Expenses, we provide for recovery of transportation costs through the fuel clause. The SESH pipeline costs are gas transportation costs and qualify for cost recovery through the fuel cost recovery clause. In the last fuel clause proceeding, we 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). As we do for FPL, we will also have the opportunity to review PEF's charges during the annual fuel clause proceeding.

Upon consideration, we find that PEF has acted prudently in considering a number of gas supply options as part if its decision to participate in the SESH pipeline. The costs associated with the SESH pipeline are reasonable. For the reasons cited above, we find that the costs associated with PEF's proposed participation in the Southeast Supply Header pipeline is appropriate for recovery through the fuel cost recovery clause. We will allow PEF to charge the appropriate costs to the clause when the pipeline begins providing service to PEF, subject to the annual fuel clause proceeding and further subject to a prudence review of the administration of the contracts.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Progress Energy Florida's request for approval of the terms and conditions for the Southeast Supply Header Contract is denied. It is further

ORDERED that the costs associated with Progress Energy Florida's proposed participation in the Southeast Supply Header Pipeline project are appropriate for recovery through the fuel cost recovery clause subject to the annual cost review in the fuel clause proceeding and further, subject to a finding that PEF has managed its contracts in a reasonable and prudent manner

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 5th day of April, 2007.

Ann Cole

ANN COLE
Commission Clerk

(S E A L)

LCB

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on April 26, 2007.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.