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ORIGINAL



June 8, 2001

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0870

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RECORDS AND REPORTING

010827-E1

Dear Ms. Bayo:

RE: Gulf Power Company's Petition for approval of purchased power arrangement regarding Smith Unit 3 for cost recovery through recovery clauses dealing with purchased capacity and purchased energy

Enclosed are an original and fifteen copies of the following to be filed with the Commission:

1. Petition.
2. Motion for Expedited Treatment and Request for Procedural Schedule.

Also enclosed is a 3.5 inch double sided, high density diskette containing the Petition in Word format as prepared on a Windows NT based computer and the Motion in Wordperfect format.

Sincerely,

Susan D. Ritenour (lwr)

Susan D. Ritenour
Assistant Secretary and Assistant Treasurer

Confidential
DOCUMENT NUMBER-DATE
07169 JUN-8
FPSC-RECORDS/REPORTING

lw
Petition
Enclosures

RECEIVED & FILED
Motion

DOCUMENT NUMBER-DATE
07166 JUN-8

DOCUMENT NUMBER-DATE
07167 JUN-8

DOCUMENT NUMBER-DATE
NO 1
07168 JUN-8

FPSC-RECORDS/REPORTING

Ms. Blanca S. Bayo
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cc: Beggs and Lane
Jeffrey A. Stone
Florida Public Service Commission
Chairman E. Leon Jacobs, Jr.
Commissioner Braulio Baez
Commissioner J. Terry Deason
Commissioner Lila A. Jaber
Commissioner Michael A. Palecki
Mary Andrews Bane
Harold McLean
William D. Talbott

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Gulf Power Company's petition for)	
approval of purchased power arrangement)	Docket No.: 010827 -EI
regarding Smith Unit 3 for cost recovery)	Date Filed: June 8, 2001
through recovery clauses dealing with)	
purchased capacity and purchased energy.)	
_____)	

PETITION

Gulf Power Company ("Gulf Power", "Gulf", or the "Company"), by and through its undersigned attorneys, hereby petitions the Florida Public Service Commission ("Commission") to approve a proposed purchased power arrangement regarding Smith Unit 3 for cost recovery through the cost recovery clauses designated for addressing the recovery of costs associated with purchased capacity and purchased energy. The regulatory treatment requested herein is in lieu of the alternative of rate base treatment of Smith Unit 3 as a Gulf owned generating resource with the associated customer commitment to recovery of all costs associated with the unit over the life of the plant. As grounds for the relief requested by this petition, Gulf Power respectfully shows:

1. Notices and communications with respect to this petition and docket should be addressed to:

Jeffrey A. Stone, Esquire
 Russell A. Badders, Esquire
 Beggs & Lane
 P. O. Box 12950
 Pensacola, FL 32576-2950

Susan D. Ritenour
 Assistant Secretary and Assistant Treasurer
 Gulf Power Company
 One Energy Place
 Pensacola, FL 32520-0780

BACKGROUND

2. Gulf is a corporation with its headquarters physically located at 500 Bayfront Parkway, Pensacola, Florida 32501. The Company's mailing address for its corporate headquarters is One Energy Place, Pensacola, Florida 32520. The Company is an investor-owned electric utility operating under the jurisdiction of this Commission.

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 FPSC-RECORDER/REPORTING

3. Gulf is currently operating under a revenue sharing plan resulting from a stipulation approved by Order No. PSC-99-2131-S-EI. The stipulation setting up the revenue sharing plan contains several key provisions including a restriction on the Company seeking an increase in its base rates that would become effective before the in-service date for Smith Unit 3, a 575 megawatt (“MW”) gas fired combined cycle generating plant currently under construction at Gulf’s Smith Plant outside Panama City, Florida. Revisions in the Company’s adjustment clauses have not been subject to such a restriction and the resulting cost recovery factors have varied during the term of the revenue sharing plan stipulation. The inclusion of capacity costs associated with the proposed purchased power arrangement in the factors for the calendar year 2002 recovery period does not violate any provision of the revenue sharing plan stipulation.

4. Gulf currently has two capacity purchases subject to recovery through the Company’s capacity cost recovery clause that are scheduled to expire prior to the Summer 2002 in recognition that the new Smith Unit 3 goes into commercial operation in June 2002. As a result, the level of capacity purchases subject to recovery through the capacity cost recovery clause from current sources will be reduced as the new capacity purchase from the proposed purchased power contract becomes effective. The purchase of Smith Unit 3 capacity through the proposed purchased power arrangement will also result in reductions to Gulf’s Southern Company Intercompany Interchange Contract (“IIC”) capacity equalization payments on a going forward basis.¹ Due to the significant net effects of these changes in the composition of Gulf’s

¹ While the amount of the capacity payments under the new contract is subject to a request for confidential status (see paragraph 14 of this petition) and is consequently not disclosed here it will certainly increase the Company’s total capacity costs. At the same time, Gulf’s other above mentioned capacity payments will decline by more than 50% during the calendar year 2002.

capacity purchases, the dollar amount of Gulf's capacity purchases will vary significantly from year to year and the capacity cost recovery clause is the appropriate vehicle to provide for the tracking and true-up of such costs.

5. Pursuant to Section 403.519, Florida Statutes, and Rule 25-22.081, Florida Administrative Code, on March 15, 1999, Gulf petitioned the Commission for a determination of need for an electrical power plant, Smith Unit 3, to be located at Gulf's Lansing Smith facility in Bay County, Florida. The proposed power plant is a combined cycle gas unit with a net capacity of 519 megawatts. In an augmented power mode, the proposed power plant can produce 575 MW. Gulf proposed the unit to fulfill a 427 MW need beginning in the summer of 2002. Pursuant to Rule 25-22.082, Florida Administrative Code, Gulf issued a Request for Proposals ("RFP") for capacity alternatives to the proposed Smith Unit 3. Although there were several competing proposals submitted through the RFP process by third party providers, upon evaluation of the alternatives it was determined that Smith Unit 3 was more cost-effective when compared to the closest alternative unaffiliated third party proposal. On June 7, 1999 in Docket No. 990325-EI, this Commission held a hearing regarding the need for the 575 MW of capacity from the Smith Unit 3 pursuant to the Florida Electrical Power Plant Siting Act. After consideration of the evidence, the arguments of the parties, and Commission Staff's recommendation, the Commission voted unanimously to grant Gulf's petition for a determination of need. The Commission concluded that Gulf's proposed Smith Unit 3 was the most cost-effective alternative available to Gulf Power's customers.

6. In 1992, the Commission established the purchased power capacity cost recovery clause ("PPCC"). As noted in Order No. 25773 issued February 24, 1992, pursuant to legislative directive the Commission has actively encouraged Florida's electric utilities to

purchased power from reliable sources in order to minimize the construction of new generating capacity. The establishment of the PPCC was consistent with this legislative directive because it serves as an incentive for utilities to purchase power rather than construct new capacity.

Recovery of Gulf's proposed purchased power arrangement through the PPCC is also consistent with this legislative directive and past policies of the Commission because the shorter life of the proposed purchased power arrangement will avoid a commitment to the newly constructed Smith Unit 3 for the life of the unit that would come from traditional rate base treatment of the new unit.

7. During the last 5 years there has been a significant expansion of competition in the electric wholesale market. The Federal Energy Regulatory Commission ("FERC") has prompted some of this activity through a number of orders, most notably the issuance of Order No. 888. As part of this expansion of competition in the electric wholesale market, Independent Power Producers ("IPPs") have built and plan to build significant amounts of new generating capacity. The State of Florida has also addressed numerous issues concerning wholesale competition, and the FPSC has received several applications for need certifications for so called "merchant plants" as well as more traditional need applications that have contractual provisions to serve a Load Serving Entity ("LSE"). There has been much debate and controversy over the legality of the "merchant plants" in Florida. This debate and the need to address other important issues such as reliability, environmental protection, and fuel diversity in the generating mix resulted in Governor Bush's establishment of a "blue ribbon panel" to study a series of issues. Although the 2020 Study Commission will issue its final report in December of this year, it has already issued an interim report on wholesale market restructuring in January of this year and made a recommendation that may be relevant in evaluating this petition. In the section of the

2020 Commission’s interim report entitled “Transfer of Existing Generation Assets out of Rate Base,” the specific recommendations envision a transition period to a competitive market over a 6 year period and that plants under construction by a utility would be transferred to an affiliated exempt wholesale generator (“EWG”). The report finds “. . . that investor owned load serving utilities should no longer be in the business of owning and operating generation.” Although there is ongoing debate about whether to implement the recommendations of the 2020 Study Commission’s interim report, particularly with regard to the treatment of existing generating capacity already in utility rate base, numerous comments by interested parties during the 2020 Study Commission meetings indicated strong support for a policy that new generating units should not be added to utility rate base. While Gulf’s petition is not intended to meet every specific recommendation of the 2020 Study Commission’s interim report, this request for cost recovery clause treatment of the purchased power arrangement for Smith Unit 3 proposed through this petition is entirely consistent with the policy direction of the interim report towards the establishment of a more competitive wholesale market for electric power, and is a first step toward positioning generating assets to compete in the open market. In a recent Florida Power Corporation docket related to the determination of need for Hines Unit 2 (Docket No. 001064-EI), the FPSC Staff raised a concern that the advent of electric generation restructuring would lead to economic uncertainty, raising potential risks for Florida ratepayers. The Staff left open the potential that the Commission might further explore the policy issue of obligating customers to the 25-30 year life of a power plant. Gulf’s proposed purchased power arrangement is consistent with recent trends toward changes in the competitive wholesale market and also provides a viable alternative to traditional rate base regulatory treatment of the Smith Unit 3 generating plant.

8. Southern Power Company (“Southern Power”) is a corporation organized and existing under the laws of the state of Delaware as an operating company subsidiary of Southern Company. Southern Company Services, Inc. (“SCS”) petitioned the FERC to include Southern Power as a full and equal participant in the IIC to share in the benefits and burdens of that arrangement. Approval by the FERC for that amendment to the IIC was based on the new company being viewed as a natural outgrowth of the competitive wholesale market that has been promoted by FERC, and as a consolidation of the wholesale activities that were being conducted on a “piecemeal” basis by the other five Southern operating companies.² This means that while Southern Power is subject to the Southern electric system power pool’s operating, dispatch, and reserve requirements, its generating resources can be used to meet the needs of wholesale customers in the Southeast through bilateral purchased power agreements. It is also intended that Southern Power will be used in the future to simplify resource planning and expedite decision making on the Southern electric system. The authority to engage in transactions under the Southern electric system’s Market Rate Tariff was also extended to Southern Power thus facilitating its ability to develop new wholesale generation projects in the Southeast. Southern Company Services, Inc., 91 FERC ¶ 61,259 (2000).

9. In an effort to fulfill the obligations to Gulf’s customers that led the Commission to certify the need for Smith Unit 3 while at the same time position the Company’s customers to take advantage of the likely changes in the wholesale market for electricity that will occur during the life of Smith Unit 3, Gulf has engaged in a process of evaluating and developing a proposed purchased power arrangement with Southern Power. Discussions between Gulf and Southern Power after the conclusion of the 2001 legislative session have culminated in an agreement

² Gulf Power Company, Alabama Power Company, Georgia Power Company, Mississippi Power Company and Savannah Electric and Power Company.

regarding such an arrangement that is subject to the regulatory approval of both the FPSC and FERC. Gulf now wishes to present this proposed purchased power arrangement regarding Smith Unit 3 to the Commission for its review and approval as a necessary prerequisite to a filing before the FERC.

10. If the proposed purchased power arrangement regarding Smith Unit 3 is approved by the Commission, Gulf and Southern Power will then file the agreement with the FERC and seek its approval pursuant to the requirements of Boston Edison Company Re: Edgar Electric Energy Company, 55 FERC ¶ 61, 382 (1991) (“Edgar”); Aquila Energy Marketing Corp., 87 FERC ¶ 61,217 (1999) (“Aquila”). In Edgar, the Commission described three non-exclusive ways to demonstrate a lack of affiliate abuse in the context of a market-based transaction between affiliates. In Aquila, the Commission reiterated its holding in Edgar and, in so doing, summarized the requisite finding as follows:

[I]n analyzing market rate transactions between an affiliated buyer and seller, the Commission must ensure that the buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and non-price terms (i.e., that the buyer has not preferred its affiliate without justification).

87 FERC at 61,857. After considering the bidding process used to select a supply alternative, the Commission concluded that the affiliated seller in Aquila had “sufficiently demonstrated that the rates under the [contract] are no higher than the price [the affiliated buyer] would have paid to purchase power from a non-affiliate”, thus satisfying the requirements set forth in Edgar. 87 FERC at 61,858.

PURCHASED POWER ARRANGEMENT

11. As explained more fully below, if approved by the Commission for cost recovery in accordance with the request made through this petition, the proposed purchased power

arrangement between Gulf and Southern Power executed by the parties on June 8, 2001 will be a market-based arrangement that provides for the sale to Gulf Power of the full output (approximately 575 MW) from the new combined cycle generating unit known as Smith Unit 3. Approval of the proposed purchased power arrangement first by the FPSC and then by the FERC will ultimately result in the ownership transfer of Smith Unit 3 to Southern Power prior to commercial operation of the new unit. This ownership transfer will mean that the new unit will never be part of the utility rate base of Gulf Power.

12. The proposed purchased power arrangement between Gulf and Southern Power has two distinct parts with different lengths of contract terms. The first part is the purchase of capacity under a 10-year contract with Southern Power. The capacity purchase portion is generally similar to other purchased capacity arrangements Gulf has entered into with various suppliers which are recovered through the capacity cost recovery clause. It is structured around a capacity charge which provides Gulf Power with first call rights to the energy produced by the unit. Gulf will have the right to economically dispatch the operation of the unit and take energy when it is cost effective to do so. The resulting purchases of energy would essentially be the same as energy purchases made under similar purchased power arrangements Gulf has entered into with various suppliers. Such energy purchases are normally recovered through the fuel and purchased power energy clause.

13. The second part of the proposed purchased power arrangement entitles Gulf Power to call upon Smith Unit 3 for needed voltage support in the Panama City area. Gulf's call on the unit to operate for voltage support would occur when the unit is not otherwise operating, either for Gulf during the 10 year term of the capacity purchase portion of the proposed purchased power arrangement, or for another purchaser during the 10-years following the

expiration of the capacity portion of the proposed purchased power arrangement. When Gulf issued its RFP in the Smith Need Determination process, it made clear that capacity for voltage support was needed in the Panama City area. Absent this geographically critical voltage support, significant amounts of electrical transmission would have to be built. Although gas transportation capacity is more expensive for the Panama City area compared to less expensive areas outside Florida, locating the generating capacity needed to meet Gulf's system load forecast at Plant Smith, will enable the new generating unit to also be used for needed voltage support in the Panama City area. Thus the new generating unit not only satisfies a capacity need but also eliminates the need for more expensive electrical transmission facilities that would be associated with generating capacity located outside the area. The increased costs for gas transportation relative to other locations outside Northwest Florida are more than offset by the savings due to avoided electrical transmission facilities. In order to ensure that Smith Unit 3 has an adequate supply of gas transportation, Gulf/Southern entered into a 20-year firm gas transportation agreement specifically designated for Smith Unit 3. The voltage support portion of the proposed purchased power arrangement has a term that corresponds to the last 10 years of the 20-year term of the firm gas transportation agreement. The pricing of the voltage support agreement contains a charge for capacity equal to the location premium of the firm gas transportation related to Smith Unit 3's location in the Panama City area and is otherwise similar in form and structure to a capacity reservation charge under purchased capacity contracts.

14. The specific terms and conditions of the proposed purchased power arrangement are considered confidential proprietary business information of Southern Power and Gulf. A complete copy of the proposed contract is being filed with the Commission pursuant to a separate notice of intent to request confidential treatment. Although Gulf is committed to

providing the Commission the information necessary for it to rule on this request, the nature of the competitive wholesale market in which Southern Power operates requires that the confidentiality of the specific terms and conditions of this proposed purchased power arrangement be assured in order to safeguard it from the competitive disadvantages that could result from disclosure. Otherwise Southern Power would not enter into such an agreement with Gulf, and Gulf's customers would not have this opportunity to benefit from the advantages offered by this arrangement and similar opportunities for purchased power from either Southern Power or unaffiliated wholesale providers at the end of the 10-year term for the capacity portion of the proposed purchased power arrangement. As discussed below, these opportunities would be foreclosed to Gulf's customers because Gulf would be forced to pursue rate base treatment of the new generating capacity with the associated commitment for the life of the plant. As a result, under Gulf's notice of intent to request confidential treatment and any subsequent request for such treatment, Gulf will specifically advise the Commission that Southern Power would not be willing to move forward with the agreement, and thus Gulf could not move forward with the request in this petition, if the Commission intends to deny confidential treatment to the specific terms and conditions of the proposed purchased power arrangement. Gulf will specifically be asking the Commission to agree that the documents can be returned to Gulf upon withdrawal of this petition, which Gulf would intend to do if the Commission decides it cannot grant Gulf's request for confidential treatment.

DISCUSSION

15. Gulf's proposed purchased power arrangement provides the opportunity for certain benefits to accrue to ratepayers that would not be available if the costs associated with Smith Unit 3 were included in rate base and operating expenses, and recovered through base

rates. The initial term of the proposed purchased power arrangement is for ten years as compared to the estimated depreciable life of Smith Unit 3 of thirty years. As stated earlier in this petition, the trend in the electric industry is towards a more competitive wholesale market for generation. At the end of the 10-year term of the proposed purchased power arrangement, Gulf would meet its incremental capacity needs with capacity available from such a competitive wholesale market. Any reduction in costs, such as those resulting from technological development or other productivity improvements, would directly benefit Gulf's customers. Also, Gulf's customers would not bear any risk associated with stranded costs related to Smith Unit 3, since it would not be owned by Gulf or included in the Company's rate base. When Smith Unit 3 is placed in service, the capacity purchases that Gulf is currently making from the IIC and from other utilities will decrease significantly and partially offset the cost of the new capacity. These costs are currently being recovered through the purchased power capacity clause. Recovery of the proposed Smith Unit 3 purchased power arrangement through the PPCC would match up the timing of the costs of this new capacity with the timing of the reduction in costs associated with other capacity purchases that would no longer be made.

16. The proposed purchased power arrangement for Smith Unit 3 is being presented to the Commission as an alternative to traditional rate base treatment of utility owned generation. Although no one can know exactly what the wholesale electric power market will look like in the future, approval of this proposed purchased power arrangement is an attempt to reduce the risk to Gulf's customers that the benefits of wholesale electric competition will not be available for that portion of Gulf's capacity needs represented by Smith Unit 3 until the end of the useful life of the unit.

REQUEST FOR EXPEDITED TREATMENT

17. The Company urges the Commission to recognize the time sensitive nature of the request made in this petition due to the deadline for filing Gulf's cost recovery clause projections for the 2002 time period. Such projections are due to be filed by September 20, 2001. As part of this petition and through the Company's separate motion for expedited treatment and request for procedural schedule filed in conjunction with this petition, Gulf requests a final ruling on this petition with regard to conversion of Smith Unit 3 to a purchased power arrangement and the recovery of the associated purchased power costs through both the capacity cost recovery clause and the fuel and purchased power energy clause prior to the end of August. This will allow the Company to consider the results in the upcoming projection filings due in September and also to provide an opportunity to obtain the requisite approval of the agreement by the FERC prior to the cost recovery hearings set for November in Docket No. 010001-EI. The Company specifically requests that the Commission set this matter for an early hearing during the week of July 23 and issue a final decision on this proposal no later than the August 14, 2001 Commission Conference. This time frame will allow for the inclusion of such costs in the calculations of cost recovery factors effective during calendar year 2002 consistent with the June 1, 2002 projected in-service date of Smith Unit 3. This schedule is also necessary so that an appropriate request for approval can be filed with the FERC after this Commission has indicated that it approves the arrangement. In order to implement the proposed purchased power arrangement, it is necessary to ensure that all required regulatory approvals are finalized in time to facilitate the transfer of ownership of Smith Unit 3 on or before the commercial in-service date. As is the case with all costs

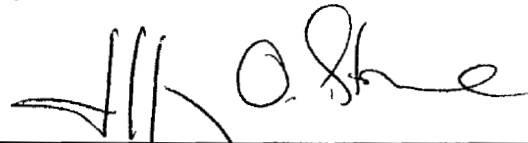
recovered through the cost recovery clauses, costs incurred by Gulf pursuant to the proposed purchased power arrangement regarding Smith Unit 3 would be subject to true-up if the actual in-service date varies from the projected in-service date.

18. As part of the Company's request for expedited treatment, Gulf represents to the Commission that the Company intends to provide responses to all reasonable data requests on an expedited basis and is willing to meet with the Commission Staff and others upon request to address questions regarding the proposal.

WHEREFORE, Gulf Power Company requests that the Commission approve the purchased power arrangement regarding Smith Unit 3 described herein for cost recovery through the cost recovery clauses designated for addressing the recovery of costs associated with purchased capacity and purchased energy, or grant such other similar relief as is just and reasonable consistent with this petition. Gulf further requests that the Commission make findings that the rates under the proposed purchased power arrangement between Southern Power and its affiliate, Gulf Power, are no higher than the price Gulf Power would have paid to purchase power from a non-affiliate under the RFP process reviewed and approved by the

Commission in Docket No. 990325-EI, and that such process resulted in the selection of Smith Unit 3 as a more cost effective alternative to purchases from non-affiliated third parties. Finally, Gulf Power Company further requests that this petition be considered on an expedited basis in order that the Company may make any necessary adjustments in its purchased energy and purchased capacity projection filings for 2002 due in September.

Respectfully submitted this 8th day of June, 2001.



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