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June 5, 2002

HAND DELIVERED

Ms. Blanca S. Bayo, Director
Division of Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Review of Investor-Owned Electric Utilities' Risk Management Policies and
Procedures; FPSC Docket No. 011605-EI

Dear Ms. Bayo:

Enclosed for filing in the above docket are the original and fifteen (15) copies of Tampa
Electric Comments in Response to Proposed Issue 7.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this
letter and returning same to this writer.

Thank you for your assistance in connection with this matter.

Sincerely,

James D. Beasley

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Enclosure

cc: All Parties of Record (w/enc.)
William McNulty (w/enc.)
Todd Bohrmann (w/enc.)

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FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Investor-Owned)
Electric Utilities' Risk Management)
Policies and Procedures.)
_____)

DOCKET NO. 011605-EI
FILED: June 5, 2002

**TAMPA ELECTRIC COMPANY'S
WRITTEN COMMENTS IN RESPONSE TO PROPOSED ISSUE 7**

Tampa Electric Company ("Tampa Electric or "the company") pursuant to Order No. PSC-02-0428-PCO-EI ("Order No. 02-0428"), issued on March 28, 2002 in this proceeding, files the following comments regarding Issue 7, which reads as follows:

What incentive(s), if any, should the Commission establish to encourage investor-owned electric utilities to optimally manage the risks to ratepayers associated with fuel and purchased power price volatility?

Pursuant to Order No. 02-0428, these comments are intended to serve as Tampa Electric Company's statement explaining why an incentive plan as described in proposed Issue 7 is not appropriate for Tampa Electric at this time.

Summary of Tampa Electric's Position

Tampa Electric has carefully reviewed the issues associated with the fuel and purchased power cost recovery clause ("fuel clause"), including the tentative proposals put forth by Staff and other parties to this proceeding. Tampa Electric believes that changing any long established method of ratemaking carries significant risks of its own. The existing fuel and purchased power cost recovery methodology has worked well and has protected the interests of investor-owned electric utilities ("IOUs") and customers

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they serve for 22 years. It provides the flexibility to react to significant market changes and has ensured that utilities recover their prudently incurred fuel and purchased power costs, while also ensuring that utility customers have paid not one penny more.

Tampa Electric currently is primarily a coal-fired generating electric utility. Coal-fired generation has not been problematic from a price volatility standpoint, in part because the company uses long- and medium-term contracts that provide price stability for approximately 60 percent of its coal supply. Given that the company's percentage of natural gas-fired generation will increase significantly in the next two years, Tampa Electric is only in the initial stages of developing optimal, multiple fuel-mix procurement strategies and financial and commodity hedging expertise as well as operating natural gas-fired units.

The cost of reducing fuel price volatility can be significant and should be incurred only if it is beneficial. The volatility associated with an IOU's fuel cost is dependent on operating assumptions governing elements of uncertainty that are inherently difficult to hedge. However, the history of natural gas commodity pricing indicates that the natural gas price spike that occurred in 2000 and 2001 were atypical.

Based on these considerations, Tampa Electric has concluded that an incentive to manage the risks associated with fuel and purchased power price volatility is not warranted at this time. In the near term, Tampa Electric is willing to periodically submit a fuel and purchased power plan that describes the company's emphasis on fuel and purchased power price volatility management. However until the company gains experience operating natural-gas fired generating units and develops hedging expertise, anything beyond this would be premature for Tampa Electric.

Historical Considerations of Cost Recovery Clause Methodology

The current fuel clause with a true-up provision was adopted in 1980 after an extensive evaluation by the Commission. One of the Commission's goals in adopting the current clause was to avoid significant month-to-month price variations in fuel adjustment charges in an effort to lessen customer confusion and misunderstanding.

Under the current fuel clause methodology, IOUs recover their costs for fuel and purchased power, but they do not have the ability to profit from the methodology. That is, the IOUs cannot "game the system" to derive profits from fuel and purchased power cost recovery. Over the long term, the existing methodology protects IOUs and customers from fuel cost volatility. The IOUs recover their prudently incurred fuel and purchased power costs, and customers do not risk paying more than the actual costs of prudently incurred fuel and purchased power costs.

The current projection/true-up fuel cost recovery mechanism was adopted in March of 1980.¹ Fuel adjustment factors based on projections and subsequent true-ups were set on a semi-annual basis from the period April through September 1980 through the end of December 1998. Thereafter fuel adjustment factors have been set on an annual basis.² The adoption of the current fuel adjustment methodology was accompanied by the creation of the generating performance incentive factor ("GPIF"),

...to provide to the utilities a monetary incentive to operate their generating units as efficiently as possible and, thus, minimize fuel costs borne by their customers. . . (emphasis supplied)

(Order No. 9558 issued September 19, 1980 in Docket No. 800400-CI, at page 1)

¹ Order No. 9273 issued in Docket No. 74680-CI March 7, 1980.

² Order No. PSC-98-0691-FOF-PU issued in Docket No. 980269-PU on May 19, 1998.

The current methodology also prevents the “correct level” of projected fuel and purchased power costs from being an issue. The Commission transferred economy sales projections from base rates into the fuel adjustment clause in 1984 to avoid this very issue. In Order No. 12923 issued January 24, 1984 in Docket No. 830001-EU-B, the Commission observed:

The proposed treatment [taking out of base rates and placing into the fuel adjustment clause] would also remove from rate cases the difficult issue of what level of economy sales profits to include in base rates. Under current rate case treatment a utility is rewarded if actual economy sales profits exceed the projected amount included in the test year and penalized if the actual economy sales are less than projected. Problems with the current treatment stem from the difficulty in projecting economy sales and the potential bias of a utility to under project their economy sales profits. . . . (bracketed material supplied)

The current fuel clause methodology has a mid-course correction mechanism designed to keep fuel cost recoveries in line with actual fuel costs. There have been 41 cost recovery periods (37 on a semi-annual basis and 4 based on a 12 month cost recovery basis for a total of 41 cost recovery periods) since the inception of the current methodology 22 years ago. During that time frame, there have been 13 mid-course correction orders with 6 of those orders approving fuel factor increases and 7 of those orders approving fuel factor decreases. The mid-course correction threshold is a 10 percent or greater variance from projected. Thus, stated differently, the IOUs have been able to project fuel and purchased power costs to within a 90 percent or greater accuracy 68 percent of the time and for the remaining 32 percent, the numbers of under and over projections have been approximately equal. The IOUs’ customers have paid the true cost of fuel and purchased power, rather than overpaying or underpaying, as would be the case

if the fuel clause was decoupled from the utilities' actual fuel and purchased power costs. On the 13 occasions that mid-course corrections were approved, they accomplished positive results from the perspective of customers. As the Commission observed in an earlier mid-course correction order:

We note that not only does the use of the special hearing provision [for mid-course corrections], under appropriate circumstances, allow a utility's customers to receive a 'pricing-signal' more accurately reflecting existing fuel costs to generate the electricity, but it also precludes the collection, or payment, of substantial amounts of interest during the true-up process corresponding to the unexpected under or over recoveries.³ (bracketed material supplied)

The use of mid-course corrections has enabled the Commission to better mitigate cost swings, while providing a valuable "pricing-signal" to enable customers to effectively hedge their fuel and purchased power cost contribution by adjusting their consumption patterns. Although Tampa Electric always attempts to minimize costs for its customers, fuel price volatility that reflects market conditions relays signals to customers that can result in more efficient use and improved conservation of energy resources. Eliminating these signals entirely could negatively impact conservation and efficient resource allocation.

The current fuel and purchased power cost recovery mechanism has worked well for the past 22 years. No other cost recovery methodology could have better assured that utilities customers pay only for prudently incurred fuel and purchased power costs and nothing more.

As discussed below, the unanticipated natural gas related fuel and purchased power price spike that occurred in late 2000 through early 2001 necessitated mid-course

³ Order No. 10123 issued in Docket No. 810001-EU on July 1, 1981 at page 2.

corrections and raised concerns over the need to mitigate price volatility. While that may be an appropriate issue to be addressed, it should be done on a utility-by-utility basis. The issue of how best to mitigate price volatility should not be assumed to require any alteration of the existing fuel clause methodology. Any action that would de-couple fuel and purchased power cost recovery from the actual cost incurred would be an unnecessary departure from a methodology that for many years has worked in a fair manner for all concerned.

Current regulatory treatment incents utilities to manage fuel costs

The fuel clause is an on-going docket and is subject to continuing review and audit. Although the customers pay the costs associated with procuring fuel or power, the utility is responsible for prudently managing its fuel supply and costs while maintaining reliable service. In the event that the Commission determines that the utility has not fulfilled its duty to prudently incur costs, the company's shareholders bear the risk. The current system allows the customer to benefit from any fuel savings that the utility may negotiate and encourages utilities to manage fuel costs in a manner that is consistent with customers' interests. Such characteristics should not be jeopardized lightly.

Additional incentives unnecessary in light of current fuel mix

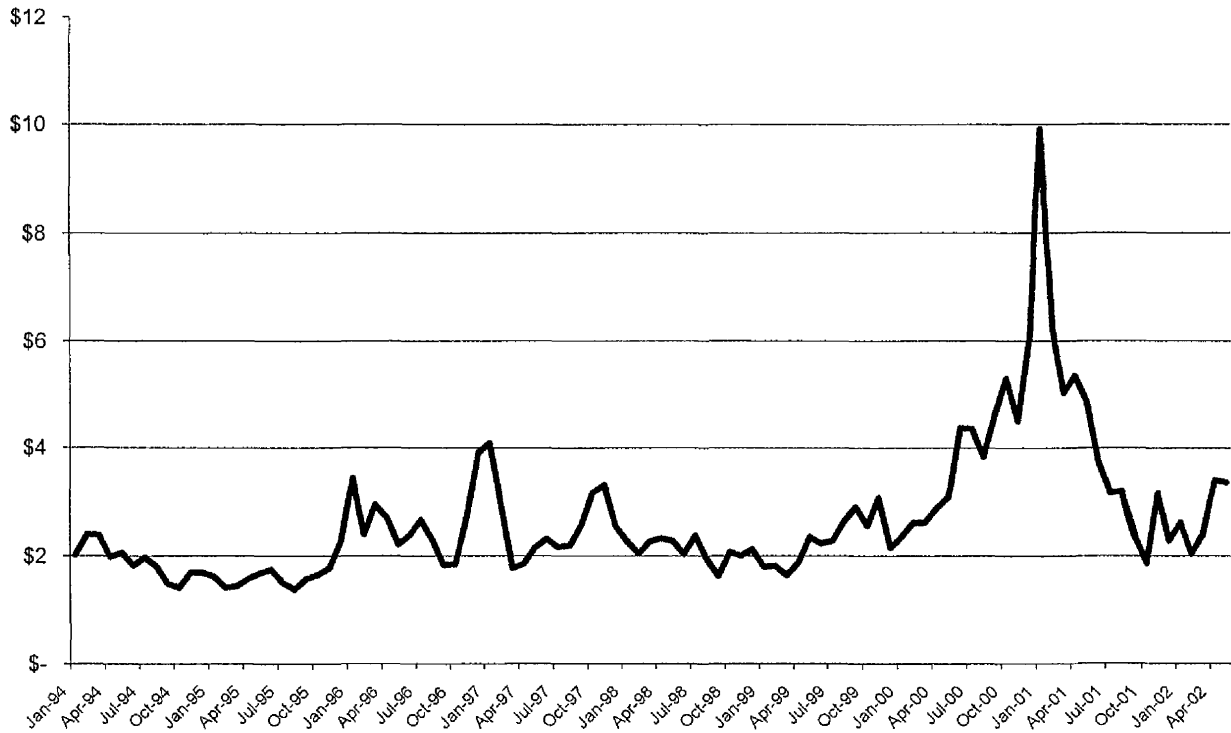
Though Tampa Electric will be relying on natural gas as its fuel source for Bayside Power Station in approximately two years, the company currently relies predominantly on coal-fired generation. Coal prices have not been as volatile as those of oil and natural gas in late 2000 and early 2001. Additionally, recognizing the lack of coal price volatility, Staff did not include coal feedstock in its strawman incentive proposal.

Given Tampa Electric's upcoming transition to natural gas-fired generation, it would not be appropriate for Tampa Electric to adopt a fuel price volatility mitigation incentive program at this time. As stated earlier, Tampa Electric is only in the initial stages of developing optimal, multiple fuel-mix procurement strategies and financial and commodity hedging expertise and of operating natural gas-fired units. However, once Tampa Electric has gained the needed experience, the company is amenable to considering or developing proposals designed to incent utilities to reduce fuel price volatility.

Recent historical fuel price volatility is not representative

As can be seen from the chart below, recent fuel factor volatility is not representative of the historical movement of fuel costs. Nor is it consistent with long-term expectations. The price of natural gas spiked in late 2000 and early 2001, and that spike is not representative of the normal price movement of this commodity. Thus, it is not necessary to react to the apparently abnormal price movement by changing the existing fuel clause methodology when the current process works.

Henry Hub Index Price (\$/mmBtu)



Source: Platts

Elements of uncertainty are inherently difficult to hedge

Management of the volatility associated with a utility's fuel costs is a far more complicated matter than simply managing risks associated with fuel prices. In addition to the risks associated with volatility in the unit price of fuel commodities, utilities face, at a minimum, two additional risks.

First, the utility is obligated to serve, in its entirety, an uncertain demand for electricity. The forecast of the utility's fuel and purchased power costs is highly dependent on assumptions regarding weather, electric consumption and the associated

dispatch of generating units. Therefore, as weather impacts electric consumption, unit dispatching and fuel costs differ from forecasted values.

Second, the utility is exposed to risks associated with the availability of its generating units. Again, forecasts are highly dependent on assumptions regarding the rate at which power units operate. If units are available at a rate that is higher or lower than forecast, dispatch and fuel costs differ from forecasted values. This point was acknowledged by the Commission in its order removing economy sales from base rates into the fuel clause.

. . .The difficulty in projecting economy sales profits is due to uncertainty associated with fuel prices, weather, and forced outages of generating units and transmission lines. These variables affect not only how much a utility can sell and at what price, but also how much other utilities will buy at different prices.

Order No. 12923, issued January 24, 1984 in Docket No. 830001-EU-B.

High cost for creating systems and processes to manage price volatility

Significant mitigation of commodity price risk requires a complex infrastructure. In most cases, real-time management of commodity price risk increases transaction complexity and volume many-fold. Tampa Electric's current systems and processes were not designed to handle the volume or types of transactions necessary to effectively manage price exposure in the manner required to significantly mitigate the effects of fuel price variations because the company has not had a need to make such transactions given its current reliance on coal-fired generation. Once Tampa Electric has sufficient experience with its natural gas-fired Bayside Power Station, the company will evaluate the costs and benefits of such types of activity. Mitigating fuel price volatility is similar

to insuring against other types of risks in that risk mitigation efforts have a cost. The more risk one insures against, the higher the cost or premium. Thus, the IOUs must strike a balance between the value of price volatility mitigation and the cost of protection from price volatility for customers.

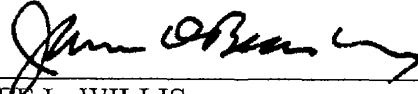
Conclusion

Tampa Electric believes that an incentive to encourage IOUs to optimally manage the risks associated with fuel and purchased power price volatility may be appropriate for many utilities and commends the Commission for its willingness to explore the issue. However, implementing an incentive such as has been proposed to date within this proceeding would be premature for Tampa Electric. As the company gains experience with natural-gas fired unit operation and develops optimal, multiple fuel-mix procurement strategies and financial and commodity hedging expertise, Tampa Electric will continue to take positions advantageous to customers. The company will seek to enhance the benefits of its management of fuel and energy transactions, including cost minimization and price stability, as it completes the transition to a generating system that is no longer primarily coal-fired.

WHEREFORE, Tampa Electric submits the foregoing as its written comments and statement pursuant to Order No. 02-0428.

DATED this 5th day of June 2002.

Respectfully submitted,



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ATTORNEYS FOR TAMPA ELECTRIC COMPANY

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Written Comments, filed on behalf of Tampa Electric Company, has been furnished by hand delivery (*) or U. S. Mail on this 5th of June 2002 to the following:

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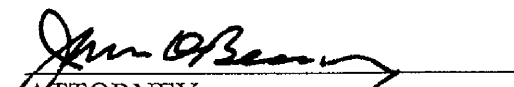
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