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July 23, 2002

Ms. Blanca S. Bayo, Director  
Division of the Commission Clerk and Administrative Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee FL 32399-0870

Dear Ms. Bayo:

RE: Docket No. 011605-EI

Enclosed are an original and fifteen copies of the Rebuttal Testimony of William N. McKenzie on behalf of Gulf Power Company to be filed in the above docket.

Sincerely,

A handwritten signature in cursive script that reads "Susan D. Ritenour".

Susan D. Ritenour  
Assistant Secretary and Assistant Treasurer

lw

cc: Beggs and Lane  
Jeffrey A. Stone, Esquire

DOCUMENT NUMBER DATE

07689 JUL 24 02

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

Certificate of Service

I HEREBY CERTIFY that a true copy of the foregoing was furnished by hand delivery or the U. S. Mail this 13<sup>th</sup> day of July 2002 on the following:

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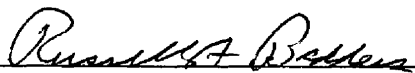
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# **GULF POWER COMPANY**

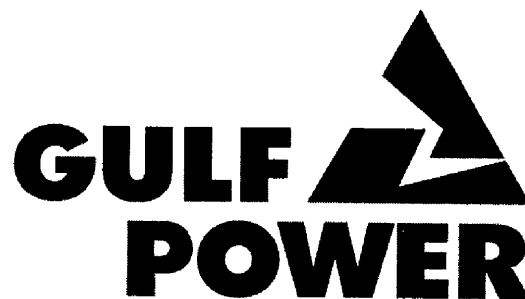
**Before the Florida Public Service  
Commission**

**Rebuttal Testimony of**

**William N. McKenzie**

**Docket No. 011605-EI**

**Date of Filing: July 24, 2002**



**A SOUTHERN COMPANY**

DOCUMENT NUMBER DATE

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FPSC-COMMISSION CLERK

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission

3 Rebuttal Testimony of

4 William N. McKenzie

5 Docket No. 011605-EI

6 Date of Filing: July 24, 2002

1 Q. Please state your name, address, and occupation.

2 A. My name is William N. McKenzie and my business address is Southern  
3 Company Services, 600 North 18<sup>th</sup> Street, Birmingham, Alabama 35291-  
4 8162. I am General Manager Gas Procurement for Southern Company  
5 Services (SCS), Gulf Power Company's fuel procurement agent.

6  
7 Q. Are you the same William N. McKenzie who provided testimony on Gulf  
8 Power's behalf in this docket?

9 A. Yes.

10  
11 Q. What is the purpose of your rebuttal testimony?

12 A. The purpose of my rebuttal testimony is to respond to a few of the points  
13 raised by Staff's witness, Mr. Bohrmann, in his direct testimony. I will  
14 address his positions related to four aspects of hedging activities: the  
15 procurement of a minimum amount of fuel through fixed price  
16 mechanism(s); the appropriateness of an incentive to encourage a utility  
17 to hedge its fuel risks; the logic of recovering incremental administrative  
18 costs and the level of detail that should be included in a utility's risk  
19 management plan.

20

21

1 Q. Is it appropriate for the Commission to require that Gulf Power procure a  
2 minimum amount of its gas needs through a fixed price mechanism?

3 A. No. Under the fuel risk management plan proposed by Gulf, there is a  
4 maximum volume that may be hedged in order to prohibit speculation, but  
5 no minimum volume that must be hedged. It is in the best interest of our  
6 customers that Gulf maintains the flexibility to consider all relevant  
7 information, including market conditions and operational issues, before  
8 entering into a hedging transaction. To require that a certain level of fuel  
9 volume must be hedged could put Gulf in the position of hedging when  
10 market conditions are not favorable for a hedging transaction. For  
11 example, if a utility locks into a fixed price position in a falling market, the  
12 ratepayers lose the opportunity for lower fuel costs.

13  
14 Q. In his testimony, Mr. Bohrmann discusses whether the Commission  
15 should approve an incentive for each utility to manage its fuel risks.  
16 Please comment on Gulf's proposed incentive.

17 A. As I stated in my direct testimony filed in this docket, the incentive  
18 included in Gulf's proposed fuel risk management plan is structured to  
19 encourage cautious hedging in a downward market and aggressive  
20 hedging in an upward market, thus encouraging actions that can create  
21 additional customer value. Under Gulf's plan, shareholders receive a  
22 portion (25%) of any savings achieved through hedging activities. In  
23 return, Gulf's plan shifts some of the risk away from customers to  
24 shareholders by limiting the annual above market cap to 10% of the  
25 current year projection for delivered natural gas and oil and by limiting the

1 forward mark-to-market negative amount to 5% of the forward 42-month  
2 projection. The incentive to shareholders and the above market caps for  
3 customers go hand-in-hand. If there is no incentive mechanism approved  
4 as part of the hedging program, then the company should not be required  
5 to guarantee a limit on the customers' exposure to hedging losses. As I  
6 stated in my direct testimony, Gulf only receives an incentive if savings  
7 are achieved through Gulf's proposed program that hedges natural gas  
8 and oil.

9  
10 Q. Do you agree with Mr. Bohrmann's proposed disallowance through the  
11 fuel clause of incremental capital and O&M costs associated with the  
12 proposed hedging program?

13 A. No. Although such administrative costs are typically recovered through  
14 the base rates, it was not possible for Gulf to project these expenses in its  
15 recent rate case proceeding. Docket 011605-EI was an open docket at  
16 the time, and the outcome of this proceeding could not be predicted.  
17 Until Gulf's next rate case proceeding the company proposes that such  
18 incremental costs be recovered through the fuel clause.

19  
20 Q. Please comment on Mr. Bohrmann's proposed components of a utility's  
21 fuel procurement risk management plan as provided in his Exhibit TFB-4.

22 A. Gulf's proposed fuel risk management plan provides sufficient detail to  
23 describe the key components and parameters of its proposed hedging  
24 activities, while maintaining the flexibility to implement the plan in the most  
25 efficient and cost-effective manner possible. The detailed plans and

1 activities requested in Exhibit TFB-4 are a function of some of the  
2 management activities performed by personnel at a variety of levels within  
3 the company. Staffing levels, for example, are subject to a number of  
4 internal and external influences. Additionally, it is not possible to predict  
5 with any level of accuracy the company's response to each specific risk  
6 since each situation will be unique due to existing market conditions,  
7 changes in weather, equipment availability, maintenance schedules, etc.  
8 Our managers make these decisions on a case-by-case basis based on  
9 their training and experience and the existing conditions associated with  
10 the risk. This philosophy is no different from the current management  
11 philosophy and practice. The level of detail set forth in Exhibit TFB-4  
12 would eliminate the flexibility necessary to implement the plan in the best  
13 manner possible for our customers.

14  
15 Q. Does this conclude your testimony?

16 A. Yes.

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