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GULF POWER
A SOUTHERN COMPANY

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,

Susan D. Ritenour

Susan D. Ritenour
Assistant Secretary and Assistant Treasurer

lw

cc: Beggs and Lane
Jeffrey A. Stone, Esquire

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 23rd day of July 2002 on the following:

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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

GULF POWER

A SOUTHERN COMPANY

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

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

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

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

A. Yes.

Q. What is the purpose of your rebuttal testimony?

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

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

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

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

A. As I stated in my direct testimony filed in this docket, the incentive included in Gulf's proposed fuel risk management plan is structured to encourage cautious hedging in a downward market and aggressive hedging in an upward market, thus encouraging actions that can create additional customer value. Under Gulf's plan, shareholders receive a portion (25%) of any savings achieved through hedging activities. In return, Gulf's plan shifts some of the risk away from customers to shareholders by limiting the annual above market cap to 10% of the current year projection for delivered natural gas and oil and by limiting the forward mark-to-market negative amount to 5% of the forward 42-month projection. The incentive to shareholders and the above market caps for customers go hand-in-hand. If there is no incentive mechanism approved as part of the hedging program, then the company should not be required to guarantee a limit on the customers' exposure to hedging losses. As I stated in my direct testimony, Gulf only receives an incentive if savings are achieved through Gulf's proposed program that hedges natural gas and oil.

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

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

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

A. Gulf's proposed fuel risk management plan provides sufficient detail to describe the key components and parameters of its proposed hedging activities, while maintaining the flexibility to implement the plan in the most efficient and cost-effective manner possible. The detailed plans and activities requested in Exhibit TFB-4 are a function of some of the management activities performed by personnel at a variety of levels within the company. Staffing levels, for example, are subject to a number of internal and external influences. Additionally, it is not possible to predict with any level of accuracy the company's response to each specific risk since each situation will be unique due to existing market conditions, changes in weather, equipment availability, maintenance schedules, etc. Our managers make these decisions on a case-by-case basis based on their training and experience and the existing conditions associated with the risk. This philosophy is no different from the current management philosophy and practice. The level of detail set forth in Exhibit TFB-4 would eliminate the flexibility necessary to implement the plan in the best manner possible for our customers.

Q. Does this conclude your testimony?

A. Yes.