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GULF POWER
A SOUTHERN COMPANY

July 25, 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 Prehearing Statement of Gulf Power Company to be filed in the above docket.

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

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 Date Filed: July 26, 2002

PREHEARING STATEMENT OF GULF POWER COMPANY

Gulf Power Company, ("Gulf Power", "Gulf", or "the Company"), by and through its undersigned attorneys, and pursuant to Rule 25-22.038(3), Florida Administrative Code, files this prehearing statement, saying:

A. APPEARANCES:

JEFFREY A. STONE, Esquire, and RUSSELL A. BADDERS, Esquire, of Beggs & Lane, 501 Commendencia Street, P.O. Box 12950, Pensacola, FL 32591
On behalf of Gulf Power Company.

B. WITNESSES: All witnesses known at this time, who may be called by Gulf Power Company, along with the subject matter and issue numbers which will be covered by the witness' testimony, are as follows:

Witness	Subject Matter	Issues
(Direct)		
W. N. McKenzie (Gulf)	Gulf's proposed gas/oil hedging program; regulatory treatment for gains, losses, premiums and transaction costs; administrative costs; incentives	1A, 1B, 1C, 2, 3, 4, 7A, 7B
(Rebuttal)		
W. N. McKenzie (Gulf)	minimum fuel procurement; Gulf's proposed gas/ oil hedging program; administrative costs; incentives	1A, 7A

C. EXHIBITS:

Exhibit Number	Witness	Description
(WNM-1)	McKenzie	Gulf's proposed gas/oil hedging program; examples of hedging

D. STATEMENT OF BASIC POSITION:

Gulf Power Company's Statement of Basic Position:

It is the basic position of Gulf Power Company that Florida's electric public utilities should be clearly authorized to use financial instruments to hedge price risk associated with the use of natural gas and fuel oil as boiler fuel for retail electric generation. The Commission should allow the utilities to recover all costs associated with hedging programs through the fuel and purchased power cost recovery clause. As part of this docket, Gulf is specifically seeking authorization to implement the Company's proposed gas/oil hedging program as a means of managing fuel price risk on behalf of its customers. Approval of the proposed program would authorize Gulf to use financial instruments to manage fuel costs. Gulf's customers will gain more rate stability from the proposed program through protection from short-term natural gas price run-ups and a limit on above-market exposure. In return, Gulf will have the opportunity to earn an incentive when its hedging activities achieve savings for the customer.

E. STATEMENT OF ISSUES AND POSITIONS:

ISSUE 1A: What role should the Commission take concerning the manner in which each investor-owned electric utility manages risks associated with fuel procurement?

GULF: Gulf requests the Commission's authorization to implement a hedging program with regard to the Company's purchases of natural gas and fuel oil. Gulf's proposed program is set forth in Exhibit WNM-1. If approved by the Commission, Gulf would be authorized to use financial instruments in order to protect Gulf's customers from price volatility for these two categories of fuel purchases. The Commission's concurrence that the parameters and limits of Gulf's proposed program are prudent is vital. On an ongoing basis, the Commission's role should be one of oversight and monitoring to ensure the program continues to be prudent. (McKenzie)

<u>ISSUE 1B</u>: Is each investor-owned electric utility taking reasonable steps to manage the price risk associated with its natural gas and residual oil transactions, as well as purchased power transactions based on natural gas prices, through the use of physical, operational, or financial hedging practices, or a combination of those practices?

<u>GULF</u>: Yes, with regard to Gulf Power Company. (McKenzie)

<u>ISSUE 1C</u>: For what purposes does each investor-owned electric utility engage in physical, operational, or financial fuel price hedging practices, or a combination of those practices, and to what extent do such purposes involve reductions in fuel price volatility versus reductions in fuel costs?

<u>GULF</u>: Historically, Gulf's electric generation has consisted primarily of coal fired resources. Gulf has managed fuel price risk and availability of supply risk through a combination of both long-term contracts and purchases of coal through the short-term spot market. With the addition of Smith Unit 3 to Gulf's generation mix, Gulf now has a significant amount of generation that is fired by natural gas. Gulf has proposed a hedging program (see Exhibit WNM-1) that, if approved by the Commission, will allow Gulf to manage fuel price risk of natural gas through the use of financial instruments. Gulf's proposed program, if approved by the Commission, would be primarily focused on reducing fuel price volatility by aggressively hedging price risk in upward markets and cautiously hedging price risk in downward markets. Gulf's proposed program would provide Gulf an opportunity to share in any savings achieved for its customers. This incentive to manage the program in a manner that achieves savings for customers is in exchange for the Company's willingness to provide certain caps on the customers' exposure under the proposed hedging program (see Issue 7 below). (McKenzie)

<u>ISSUE 2</u>: What is the appropriate regulatory treatment for gains and losses an investor-owned electric utility incurs from hedging fuel and purchased power transactions through futures contracts?

<u>GULF</u>: All gains, losses and other costs and receipts related to hedging fuel transactions through futures should be included in the determination of the recoverable fuel costs by the utility in the Commission's fuel and purchased power cost recovery clause. Gulf's proposed program is limited to natural gas and fuel oil. Gulf is not proposing a program to hedge purchased power transactions through futures contracts. (McKenzie)

ISSUE 3: What is the appropriate regulatory treatment for the premiums an investor-owned electric utility receives and pays for hedging fuel and purchased power transactions through options contracts?

GULF: Any premiums received and paid for hedging fuel transactions through the use of options contracts should be included in the determination of the recoverable fuel costs by the utility in the Commission's fuel and purchased power cost recovery clause. (McKenzie)

ISSUE 4: What is the appropriate regulatory treatment for the transaction costs an investor-owned electric utility incurs from hedging fuel and purchased power transactions through futures and options contracts?

GULF: All transaction costs associated with hedging fuel transactions should be included in the determination of the recoverable fuel costs by the utility in the Commission's fuel and purchased power cost recovery clause. This should include the incremental costs of establishing and maintaining the personnel and infrastructure needed to manage a hedging program such as that proposed by Gulf in this proceeding. (McKenzie)

ISSUE 5: For the period March 1999, to March 2001, did FPL take reasonable steps to manage the risk associated with changes in natural gas prices?

GULF: No position.

ISSUE 6: For the period March 1999, to March 2001, did Florida Power take reasonable steps to manage the risk associated with changes in natural gas prices?

GULF: No position.

ISSUE 7A: 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?

GULF: Gulf's proposed hedging program is structured to encourage cautious hedging in a downward market and aggressive hedging in an upward market. In return for a 25% incentive on hedging savings, Gulf will guarantee the annual above market cap for natural gas and oil and limit the forward mark-to-market negative amount (see Exhibit WNM-1). (McKenzie)

ISSUE 7B: If the Commission were to approve any utility's incentive plan for optimally managing fuel price risk which includes a change in the method for calculating shareholder gains on wholesale sales as specified in Order Nos. PSC-00-1744-PAA-EI and PSC-01-2371-FOF-EI, what changes, if any, should be made to the requirements of these orders?

GULF: Gulf's proposed gas/oil hedging program does not include a change in the method for calculating shareholder gains on wholesale sales. (McKenzie)

F. STIPULATED ISSUES

GULF: Yet to be determined. Gulf is willing to stipulate that the testimony of all witnesses whom no one wishes to cross examine be inserted into the record as though read, cross examination be waived, and the witness's attendance at the hearing be excused.

G. PENDING MOTIONS:

GULF: Request for Confidential Classification, Document Number 07443-02 filed July 17, 2002.

H. OTHER MATTERS:

GULF: To the best knowledge of counsel, Gulf has complied, or is able to comply, with all requirements set forth in the orders on procedure and/or the Commission rules governing this prehearing statement. If other issues are raised for determination at the hearings set for August 12-13, 2002, Gulf respectfully requests an opportunity to submit additional statements of position and, if necessary, file additional testimony.

Dated this 25 day of July, 2002.

Respectfully submitted,

Russell A. Badders

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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 25th day of July 2002 on the following:

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