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May 13, 2005

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

RE: Docket No. 041414-EI, In Re: Progress Energy Florida, Inc.'s petition for approval of long-term fuel supply and transportation contracts for Hines Unit 4 and additional system supply and transportation.

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of Office of Public Counsel's Post Hearing Brief for filing in the above-referenced docket.

Also enclosed is a 3.5 inch diskette containing Office of Public Counsel's Post Hearing Brief in Microsoft Word format. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to our office.

Thank you for your assistance in this matter.

Sincerely,

Patricia A. Christensen
Associate Public Counsel

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Progress Energy Florida, Inc.'s petition for approval of long-term fuel supply and transportation contracts for Hines Unit 4 and additional system supply and transportation.	Docket No. 041414-EI Filed: May 13, 2005

OFFICE OF PUBLIC COUNSEL'S POST HEARING BRIEF

Pursuant to Rule 28-106.215, Florida Administrative Code, the Citizens of the State of Florida, by and through undersigned counsel, Office of Public Counsel, hereby files their Post-Hearing Brief and Statement of Issues and Positions.

INTRODUCTION

Progress Energy Florida, Inc. (Progress) filed its Petition on December 20, 2004. In its Petition, Progress asks the Commission to approve three long-term fuel and transportation contracts associated with bringing gas supply to its Hines Unit 4. Progress claims that entering into these 20 year contracts not only provides a dependable fuel supply to Hines 4, but adds geographic fuel diversity, additional system supply, and transportation for its system.

SUMMARY OF ARGUMENT

OPC had concerns that Progress was seeking pre-approval of the fuel costs associated with these contracts which have been traditionally addressed as part of the annual fuel clause proceedings. OPC does not believe that the Company should be able to obtain such pre-approval for fuel costs via this proceeding. However, based on the testimony, it appears that Progress is not seeking pre-approval for those costs traditionally addressed in the fuel clause such as hedging and daily optimization of the contracts.

OPC believes that the contracts to supply Progress' Hines 4 unit provide some benefits to the customers of Florida. While OPC does not endorse the contracts, OPC does not find any concerns which have not been addressed by the Company that should preclude approval of the contracts at this time.

ISSUES AND POSITIONS

ISSUE 1: Did Progress Energy Florida (PEF) adequately solicit potential natural gas providers to provide fuel to the Hines 4 generating unit?

OPC: * Nothing in the record indicates that Progress' RFP process in this case was insufficient.*

ARGUMENT

Based on the testimony, it appears that Progress conducted a series of RFP's. The RFP's were conducted in August 2003, April 2004, and June 2004. (TR 32) Through that series of RFP's, Progress identified two potential LNG suppliers and compared those bids to the Gulf of Mexico suppliers. (TR 32) When asked how Progress could be sure that it found the most economical and reliable source of natural gas for Hines 4, Witness Murphy responded that they had done an extensive RFP process. Witness Murphy further stated that Progress gave 45 suppliers an opportunity to bid the best price they could to Progress. (TR 64)

In explaining why Progress choose the BG/Cypress/FGT combination which brings in gas from Elba Island in Georgia, Progress stated that it was the most cost-effective alternative considering price and non-price strategic factors to meet Progress' future gas needs. (TR 32) Witness Murphy further explained that based on Progress' extensive evaluation of the bid responses, Progress felt that it had presented to the Commission the best overall alternative for Hines 4. Although she admits that only four responded to the Progress' request for a 20 year contract. (TR 65)

It appears from the record that Progress solicited for bids and received offers which were arms length transactions. As noted above, Progress solicited 45 bids and received four viable responses. Nothing in the record indicates that Progress' RFP process in this case was insufficient.

ISSUE 2: Is the proposal contemplated in PEF's petition the most cost-effective option considering price and non-price factors?

OPC: *It appears that Progress has appropriately taken into account the pricing and non-pricing factors to determine the most cost-effective option in this case.*

ARGUMENT

It is appropriate to consider non-pricing factors as well as pricing factors. In this instance, it appears that Progress has appropriately taken into account the pricing and non-pricing factors. Witness Murphy testified that four criteria were used to evaluate the bids. (TR 31)

The four criteria were: 1) certainty of a Proposal's success; 2) economics; 3) operational flexibility; 4) and supply diversity. (TR 31-32). The factor regarding certainty of a Proposal's success considered a proposal's ability to deliver gas supply to Hines 4 at or near the unit's in-service date of December 2007. The economics factor considered the all-in price for commodity and transportation components associated with the proposal. The operational flexibility criteria considered the degree of flexibility provided by a proposal's contract terms and conditions to serve other existing and potential plants in Progress system. The supply diversity factor considered the degree to which a proposal could reduce Progress' reliance on the Mobile Bay-Destine supply area. Witness Murphy further testified that this last factor of geographic diversity provides operational flexibility to manage supply disruption caused by hurricane and thereby enhances system reliability. (TR 32)

Witness Murphy stated that based on a purely economic basis, the Bahamas based contract was the cheapest. However, the Bahamian project was dismissed because of the uncertainty with the project. (TR 75)

Witness Murphy further testified that from the perspective of the business analysis package, the economics of the Gulf of Mexico and Elba Island alternatives were nearly equal based on comparable volumes. (TR 76) She stated that while the Gulf of Mexico supply via the Gulfstream pipeline clearly has the most certainty (since it is already built), there is also a high degree of certainty that the Cypress pipeline will be built. Witness Murphy testified that the BG/Cypress/FGT combination of contracts based on economic and non-economic factors provides the best overall value. (TR 76) There is nothing in the record that disputes that the BG/Cypress/FGT combination of contracts is the best option. Thus, it appears that Progress has appropriately taken into account the pricing and non-pricing factors to determine the most cost-effective option in this case.

ISSUE 3: Is the 20-year term of the contracts contemplated in PEF's petition appropriate?

OPC Progress has clarified that it is not seeking pre-approval of the fuel costs associated with these contracts which have been traditionally addressed as part of the annual fuel clause proceedings. In particular, Progress is not seeking approval for hedging and daily optimization activities. OPC has no concerns regarding the long-term contract in this instance.

ARGUMENT

Progress stated that is was seeking a 20 year contract for gas supply for the Hines 4 unit. (TR 66). Witness Murphy testified that it is reasonable and prudent to have a diverse portfolio mix of short, long-term, and intermediate contracts. And this 20 year contract provides a long-term market-based contract firm supply over the term of the contract. (TR 66) She further testified that the Cypress agreements were tied to a market industry index and the basis adder is small and fixed for the term of the contract which provides price stability. In fact, in her opinion the trend for basis adders appears to be increasing which could result in a savings to customers over time. (TR 83) Because this contract requires that the Cypress pipeline be built to accommodate the gas demand, it appears reasonable that a long-term contract would be preferable in this circumstance. (TR 76)

Given the 20 year nature of the contracts, Progress provided clarification regarding what costs it was seeking pre-approval for and what costs would remain subject to review in the annual fuel clauses. Witness Murphy testified that the Company was seeking pre-approval for the pricing mechanism under the BG contract, the market indices, and the basis adder identified in the contract. (TR 46-47) The market price of the LNG contract is tied to an industry-wide U.S. market index, the Henry Hub. (TR 54) She further stated that the pricing for the gas industry starts at Henry Hub, and then the locational differences are the basis adders. Witness Murphy testified that

> So, for instance, if you buy gas in FGT Zone 1, it's a Henry Hub plus a basis, or could very well be Henry Hub minus a basis, but normally it is

> Henry Hub plus a basis, because you have to get it from Henry Hub to that particular location.

(TR 54) Witness Murphy stated that the basis adder represents three-quarters of one percent of the overall price of the Cypress contracts and therefore Progress is going to be paying the same price as everybody else. (TR 54) She stated in deposition that the long-term contract is very much a mirror of the short and intermediate term contracting process. (H.E. 3 – Deposition at p. 121) Progress is also seeking pre-approval of the transportation contracts associated with Cypress and FGT, and the volumes associated with all of these contracts. (TR 47)

However, witness Murphy made it clear that Progress was not seeking pre-approval for its hedging and daily optimization under the contracts. (TR 48-49, H.E. 3 – Deposition at p. 120) There are pricing options built into the contract. With the agreement of BG, Progress has the ability to switch indices based on the pricing indices. Further, there are no limitations as the number of times Progress can change indices in a given month or in a given year. Progress stated that it could go to the financial markets if BG does not agree to change the indices. (TR 47)

Witness Murphy described how this type of hedging activity in the financial markets would be conducted under the contracts. She testified that

> [i]f for some reason, let's say, we saw an opportunity in some forward contract months to lock in a fixed price and BG was not willing to do that, we would go to the NYMEX futures and we would buy contracts there which are based on a Henry Hub price, and we would lock in the price through financial instruments.

(TR 48) She agreed that this type of hedging activity is part of the costs that would be looked at in the annual fuel clause. (TR 48)

Progress can also purchase additional gas under the contracts from BG for Progress system. Witness Murphy agreed that any additional purchases made under the contracts beyond the required amounts set out in the contracts, would be subject to the scrutiny of the annual fuel adjustment clause proceeding. (TR 48)

Since the companies are making significant capital investments to bring LNG gas from Elba Island, Georgia to Florida, a 20 year contract seems reasonable. Additionally, Progress has clarified that it is not seeking pre-approval of the fuel costs associated with these contracts which have been traditionally addressed as part of the annual fuel clause proceedings. In particular, Progress is not seeking approval for hedging and daily optimization activities. Thus, OPC has no concerns regarding the long-term contract in this instance.

ISSUE 4: Based on the resolution of the foregoing issues, should the Commission grant PEF's petition?

OPC: * While OPC does not endorse the contracts, OPC does not find any concerns which have not been addressed by the Company that should preclude approval of the contracts at this time. *

ARGUMENT

OPC believes that the contracts to supply Progress' Hines 4 unit provide some benefits for Progress' customers in Florida. First, these contracts provide additional geographic diversity to gas supply in Florida. Currently, a majority of the gas supply comes in from the Mobile Bay/Destin area. (TR 53) Geographic diversity in gas fuel supply is important in ensuring the adequacy and availability of gas to Florida. With approval of these contracts, an additional gas pipeline will be built to bring fuel in from the Georgia coastline. (TR 35) Diversification of gas supply will reduce the risk of supply interruption due to hurricanes and other weather disturbances in the Gulf of Mexico, or any other supply disruption. Additionally, once a fourth pipeline is constructed to bring LNG to Florida from Georgia, the geographic diversity of the east coast fuel supply will be further maximized. (TR 35) OPC believes that these are benefits for customers.

Second, Progress indicated that it is has a favorable force majeure clause under its contract. Witness Murphy explained that while the standard force majeure clause is in the contract, Progress has been able to exclude certain events. In other words, if certain events occur upstream of a certain location, the other company could not claim a force majeure event. (TR 43) Thereby providing Progress and customers the protection that if an event in a foreign nation were to cause a disruption in the supply of LNG and Progress had to obtain gas on the open market, BG would bear the risk of any costs differentials. (TR 44)

Third, since the price under the contract is fixed to the Henry Hub price, customers are not exposed to any greater risk of price fluxuation than under a shorter term contract also tied to the Henry Hub price. There may even be a benefit since the basis adder is fixed under the contract if the cost of the basis adder continues to increases in relation to the domestic Gulf market. Plus, the addition of international gas supply may create some downward pressure on the cost of domestic gas supply.

As noted above, it appears that there may be some benefits to customers by having an additional source of gas supply and an additional gas pipeline available in Florida. While OPC does not endorse the contracts, OPC does not find any concerns which have not been addressed by the Company that should preclude approval of the contracts at this time.

ISSUE 5: Should this docket be closed?

OPC: Yes.

ARGUMENT

Regardless of whether the Commission approves or denies the proposed contracts, this docket should be closed.

Respectfully submitted,

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<u>**CERTIFICATE OF SERVICE**</u>

I HEREBY CERTIFY that a true copy of the foregoing Prehearing Statement has been furnished to the following individuals as indicated in the service list on this 13th day of May, 2005.

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