State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: June 23, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Lester, Draper, Matlock, McNulty, Slemkewicz)
Office of the General Counsel (Bennett, Young)

RE: Docket No. 080001-EI – Fuel and purchased power cost recovery clause with generating performance incentive factor.

AGENDA: 07/01/08 – Regular Agenda – For Issue 1, no oral argument is requested, participation is at the Commission's discretion. For the remaining issues, participation is at the Commission's discretion.

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: McMurrian

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\080001.PEF.RCM.DOC

RECEIVED-FPSC
08 JUN 23 PM 2:51
COMMISSION CLERK

Case Background

On May 30, 2008, Progress Energy Florida, Inc. (PEF or Company) filed a Request for Expedited Approval of Modifications to its Tariff Sheets to Eliminate the Storm Recovery Cost Surcharge and for a Mid-course Correction to its Fuel Cost Recovery Factor. The Commission had previously approved the fuel cost recovery factor for PEF by Order No. PSC-080030-FOF-EI, issued January 8, 2008, in Docket No. 070001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

DOCUMENT NUMBER-DATE
05374 JUN 23 08
FPSC-COMMISSION CLERK

Order No. PSC-06-0772-PAA-EI[1] approved a settlement that authorized PEF to extend its previously authorized storm cost recovery surcharge through the last billing cycle in July 2008. The purpose of the surcharge extension is to generate additional funds to replenish the storm reserve. The monthly storm cost recovery surcharge is $3.61 for a residential customer using 1,000 kWh.

PEF requests the mid-course correction following the procedure established by Order No. 13694, issued September 20, 1984, in Docket No. 840001-EI and Docket No. 840003-GU, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor; In re: Purchased gas cost recovery clause, and Order No. PSC-98-0691-FOF-PU, issued May 19, 1998, in Docket No. 980269-PU, In re: Consideration of change in frequency and timing of hearing for the fuel and purchased power cost recovery clause, capacity cost recovery clause, generating performance incentive factor, energy conservation cost recovery clause, purchased gas adjustment (PGA) true-up, and environmental cost recovery clause, and Order No. PSC-07-00333-PAA-EI, issued April 16, 2007, in Docket No. 070001-EI.

On June 9, 2008, Florida Industrial Power Users Group (FIPUG) filed a Motion to Dismiss PEF's mid-course correction petition, or in the alternative a Motion to Abate the mid-course correction until the Commission can hold a hearing on the petition. On June 16, 2008, PEF filed a Response in opposition to FIPUG's Motion to Dismiss Mid-Course Correction.

Mid-Course Corrections

Mid-course corrections are used by the Commission between Commission fuel hearings whenever costs deviate from revenue by a significant margin. In Order No. 13694, the Commission established "a procedure by which the utilities would notify the Commission that their collections of projected fuel costs were going to be either over-recovered or under-recovered by 10%." By Order No. 13694, the Commission made it a requirement that for any six-month recovery period, a utility must give the Commission a written notice when the utility becomes aware that its projected fuel revenues were either over or under recovered in excess of 10% of its projected fuel costs for the period.[2] Failing to do so may result in the Commission disallowing the utility to collect interest on any portion of the under-recovery in excess of 10%.

In Order No. 98-0691-FOF-PU, the Commission moved the fuel clause hearings from biannual to annual proceedings. In determining to move to an annual docket, the Commission also addressed mid-course corrections. The Commission re-iterated its established policy to require a utility to notify the Commission the utility's projected fuel revenue will result in an over-recovery or under-recovery in excess of ten percent of its projected fuel costs for the period.

The Commission, in deliberating the appropriateness of mid-course corrections, has enunciated several reasons for approving mid-course corrections. In Order No. 23906, issued December 20, 1990, in Docket No. 900001-EI, the Commission found that Florida Power &

[1] Order No. PSC-06-0772-PAA-EI, issued September 18. 2006, in Docket No. 041272-EI, In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.

[2] At the time of Order No. 13694, fuel hearings were held every six months.

Light Company's mid-course correction, even though the under-recovery did not reach the 10% threshold, was in the best interest of FPL's ratepayers. FPL would be entitled to collect interest if the adjustment was deferred. Also, the magnitude of the under-recovery made it preferable to approve the mid-course. In analyzing its decision, in Order No. 23906, the Commission stated, "one of the purposes of levelizing fuel cost recovery is to prevent consumer 'rate shock,' which may be caused by volatile fuel prices. We find that approval of the mid-course correction requested by FPL would similarly help avoid excessive rate shock in that it will lessen the accumulation of a fuel cost under-recovery." Id at p.4.

Another regulatory reason for granting mid-course corrections was stated in Order No. 02-0501-AS-EI, issued April 11, 2002, in Docket No. 001148-EI and Docket No. 020001-EI, In re: Review of the retail rates of Florida Power & Light Company; and In re: Fuel and purchased power cost recovery clause with generating performance incentive factor. In that docket, FPL proposed to refund part of its anticipated over-recovery balance to ratepayers by mid-course correction. The Commission approved the request stating that "[i]n the interest of matching fuel revenues with fuel costs, FPL's proposal to refund part of its anticipated over-recovery balance to its ratepayers sooner rather than later is appropriate." Order No. PSC-02-0501-AS-EI at p. 8.

In 2003, the Commission rendered a series of decisions on mid-course corrections in Docket No. 030001-EI. In Order No. 03-0381-PCO-EI, issued March 19, 2003, and Order No. PSC-03-0849-PCO-EI, issued July 22, 2003, the Commission granted FPL mid-course corrections. In Order No. PSC-03-0400-PCO-EI, issued March 24, 2003, the Commission approved Tampa Electric Company's mid-course correction petition. In Order No. 03-0382-PCO-EI, issued March 19, 2003, the Commission granted PEF's petition for mid-course correction. These four orders discuss the factors considered by the Commission in its evaluation of past mid-course correction requests. In the 2003 orders, the Commission found that granting a mid-course correction beginning in April 2003, would provide a better price signal to customers rather than waiting to recover those costs from customers in January 2004. In other words, a more current recovery of increased costs would provide a better match between the time costs are incurred and the time they are recovered. Furthermore, the Commission was concerned that deferring 2003 costs until 2004 could result in a more severe impact upon customer rates in 2004, especially if the actual 2003 costs or 2004 costs are greater than the newly projected costs. Finally, by granting the mid-course correction, the customers would not pay as much interest on the under-recovery.

Over the years the Commission has also clarified the manner in which the mid-course proceedings are conducted. In the early 1990's, the mid-course corrections were decided using the Proposed Agency Action process. In 2001, in a review of the move from semi-annual to annual fuel clause hearings, the Commission also clarified its position on the procedural handling of mid-course corrections. "[W]e have granted or denied such [mid-course correction] petitions through informal proceedings after testing the reasonableness of actual and revised projected data supporting a utility's petition for a mid-course correction." Order No. PSC-01-1665-PAA-EI, issued August 15, 2001, in Docket No. 010001-EI, p. 5. In that order, the Commission acknowledged that the hearing and any refunds due customers because of the mid-course correction would occur in the November fuel hearings. In 2007, the Commission clarified the manner in which the over or under-recovery was to be calculated. In Order No. PSC-07-0330-

FOF-EI, issued April 16, 2007, in Docket No. 070001-EI, the Commission confirmed that prior year under-recoveries not included in the current factor should be included in reporting over and under recovery calculations.

Mid-course corrections are part of the fuel proceeding. They are considered preliminary procedural decisions and the Commission takes testimony regarding those costs in its November hearing. Any over or under recoveries caused by or resulting from the new factor adopted by the mid-course correction, may be included in the following year's fuel factor. The Commission's jurisdiction to consider fuel clause proceedings derives from the Commission's authority to set fair and reasonable rates, Section 366.05, Florida Statutes. The fuel clause proceedings are exempted from rulemaking, Section 120.80(13)(a), Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission grant the Motions to Dismiss or Alternatively to Abate filed by the Florida Industrial Power Users Group?

Recommendation: No. The Commission should deny the Motions to Dismiss or Abate filed by the Florida Industrial Power Users Group. Staff recommends that the Commission deny FIPUG's Motion to Dismiss or Alternately to Abate the proceedings. PEF has complied with Order No. 07-0333-PAA-EI in calculating its under-recovery. Procedural due process is built into the fuel clause proceedings so that ratepayer's interests remain protected. FIPUG's request to extend the under-recovery payment over the projected year is addressed in Issue 2 below. (Bennett)

Staff Analysis:

FIPUG's Motions

On June 9, 2008, FIPUG filed a Motion to Dismiss or Alternatively to Abate the Mid-course Correction proceeding and schedule a hearing. FIPUG, in its motion to dismiss, asserts that PEF's Petition for Mid-course Correction did not meet the criteria for granting the mid-course correction. Alternatively, FIPUG asks that the Commission abate its decision on mid-course corrections until PEF files sworn testimony. FIPUG asks that the matter be set for public hearing and that customers be permitted to cross examine utility witnesses under oath. FIPUG asserts that this would afford the public with minimum due process and allow them to receive a fair understanding of the rate increase.

FIPUG states that while PEF petitioned for a mid-course correction of $213 million, the *fuel cost report filed by PEF for April 2008 shows that PEF has collected 2008 fuel charges in* excess of 2008 fuel costs by $34.5 million. FIPUG contends that the Commission's Order No. PSC-07-0333-PAA-EI, issued April 16, 2007, which requires utilities to include prior year under or over recoveries in mid-course correction calculations; when combined with a national policy allowing the value of the dollar to fall, and with the highly volatile commodity futures trading market, has brought potential hardship to Florida consumers. FIPUG, in its motion provides an illustration which it alleges demonstrates the differing results. FIPUG argues Order No. PSC-07-0333-PAA-EI caused unintended harm to ratepayers because it brings prior year true-ups into play and requires a utility to reproject revenues and expenses for the remainder of the year rather than looking only to the actual losses a utility experiences year to date.

FIPUG poses several questions in its motion, asking: why hedging did not protect customers from rate increases; did PEF delay reporting fuel cost increases until after proposed legislatively mandated rate increases were in place; are customers entitled to a hearing to present testimony about the impact of the unanticipated increase on their operations; is the rate increase designed to conceal the full impact of the nuclear plant increases scheduled to begin in January 2009; if hedging and annual fuel factors are supposed to provide rate stability, will the fuel cost increase move the policy in the opposite direction; and are PEF's estimates of future lost sales credible? In asking why hedging did not protect customers, FIPUG asserts that PEF buys electricity from Shady Hills at an average fuel rate of $122.25/mwh, when PEF has asserted that its sales are falling off. FIPUG asserts that by cutting back on PEF's purchases from Shady Hills, it could save $83 million. FIPUG, in asking why fuel cost increases were not reported earlier than May 30, wonders if it could be because of PEF's legislative activity. FIPUG asserts that this delay in reporting under-recovery requires a dismissal of the petition. FIPUG asserts that consumers should be given a chance to present evidence to show any adverse impact of imposing a rate increase after the Company's budget for the year is in place. FIPUG claims that in the past, utilities have supported an extended payback for under-recoveries rather than a five month payback. FIPUG states that it would like to have the opportunity to recommend to the Commission a reasonable payback period if the fuel cost shortfall actually occurs. Furthermore, FIPUG asserts, the shorter payback period has only been required by the Commission when future year increases are also anticipated. FIPUG states that PEF provided no evidence to indicate an extended payback is not warranted. FIPUG provides the May Natural Gas Price Outlook published by EIA to show that prices in 2009 will moderate. FIPUG also asks if the fuel increase will be on top of the increases for nuclear cost recovery or whether the fuel increases will fall away when the nuclear increases go into effect. FIPUG contends that the Commission objective of rate stability is violated if large increases are not spread over several years. According to FIPUG, this is exacerbated by including carryovers from prior years. Finally, FIPUG questions whether some of the anticipated lost revenue forecast is based on weather related events and asks that PEF be required to present testimony.

PEF's Response

PEF's petition for mid-course correction is addressed in Issues 2-3 below. On June 16, 2008, PEF filed a response to FIPUG's Motions. PEF requests that the Commission deny FIPUG's motion. PEF asserts that its petition complies with the mid-course correction orders, Order No. 13694 and Order No. PSC-07-0333-PAA-EI. PEF states that Order No. PSC-07-0333 requires electric utilities to notify the Commission if a projected fuel cost over or under recovery exceeds 10%. According to PEF, its mid-course correction petition includes a $16,807,030 under-recovery of 2007 fuel costs and a $195,927,841 under-recovery of 2008 fuel costs that PEF projects based on current information. PEF concludes that its calculation of the total under-recovery of $212,822,859 it will experience by the end of 2008 is calculated in accordance with the Commission's Order No. PSC-07-0333-PAA-EI. PEF notes that FIPUG's motion alleges no deviation from the computational requirements of the Commission order.

PEF asserts that Order No. PSC-07-0333-PAA-EI requires a utility to notify the Commission when the total projected under-recovery exceeds 10% of the utility's current projection of the Jurisdictional Fuel Revenue Applicable-to-Period (Schedule A-2, Line C-3). PEF states that its total projected under-recovery for 2008 is more than 10% of the current projection of 2008 Jurisdictional Fuel Revenue Applicable-to-Period. PEF concludes that because its calculations indicate it will exceed the 10% threshold, it must notify the Commission and the petition for mid-course correction satisfies PEF's reporting responsibility. PEF argues that, because PEF has correctly calculated its projections according to Order No. 07-0333-PAA-EI, and filed the petition, the motion by FIPUG alleges no deficiency of the petition for mid-course correction that warrants dismissal. PEF asserts that because FIPUG's motion does not allege any violation of Commission orders on mid-course corrections, its motion to dismiss should be denied.

PEF next addresses FIPUG's motion to abate until a hearing is conducted on the proposed mid-course correction. According to PEF, the Commission has not traditionally held hearings prior to ruling on mid-course corrections. PEF asserts that to do so in this instance would be unnecessary and inappropriate. PEF states that a hearing is unnecessary because, as is the case in all fuel proceedings, the revenues collected pursuant to the mid-course correction are subject to review and true-up at the subsequent fuel clause hearing. PEF further asserts that FIPUG's concern that it be permitted to present its views on the mid-course correction can be addressed at the Agenda Conference on July 1, 2008, if the Commission permits parties to participate. PEF's final argument on this point is that a hearing would be inappropriate because it would work against one of the fundamental purposes of a mid-course correction, which is to adjust fuel cost recovery factors promptly to reflect major changes in projected fuel costs. PEF concludes that holding a hearing would delay implementation of the mid-course correction which likely would result in a substantial reduction in the number of months remaining in 2008 over which collection would be spread.

PEF also responds to FIPUG's assertion that the under-recovery be spread over 17 months rather than 5 months by asking the Commission to deny that request. PEF alleges that this action would likely contribute to another step-increase in customers' total bills at the beginning of 2009. PEF contends that spreading the payment over 17 months would also result in a significant increase in the total interest charges inured by customers on the outstanding under-recovery balance.

PEF also responds stating FIPUG indirectly questions the Commission's policies on fuel hedging and on the fuel cost recovery in general. FIPUG's questions, according to PEF, do not support FIPUG's motion.

<u>Analysis</u>

Staff believes that the purpose of Order No. 13694, which requires notification of mid-course corrections is to protect the ratepayers. In previous orders, the Commission granted mid-course corrections: (1) because the ratepayers would pay a substantial amount of interest if the under-recovery was deferred to the following year (Order No. 23906), (2) to prevent consumer 'rate shock,' which may be caused by volatile fuel prices (Order No. 21325), (3) to match fuel revenues with fuel costs (Order No. PSC-02-0501-AS-EI), and (4) to provide a better price signal to customers (Order Nos. PSC-03-0849-PCO-EI, PSC-03-0400-PCO-EI, PSC-03-0382-PCO-EI), and PSC-03-0381-PCO-EI).

With the purpose of mid-course corrections being ratepayer protection, it is staff's opinion that FIPUG's concerns as set forth in its motion can be adequately addressed in the normal course of the fuel docket. First, technical staff provides the Commission and parties a preliminary review of the petition testing the reasonableness and accuracy of actual and revised data supporting a utility's position (Order No. PSC-01-1665-PAA-EI). The information obtained by staff in data requests and set forth in Issue 2 and 3 below addresses many of the factual questions raised by FIPUG. Second, the parties, including FIPUG, have a complete opportunity in the November fuel hearing to conduct discovery, present witnesses, and cross-examine utility witnesses about the reasonableness of the company's fuel costs, including the mid-course corrections. Third, if a mid-course correction is granted by the Commission now, but later the utility becomes over-recovered, the utility must refund customers by reducing the fuel factor for 2009. Fourth, the Commission may allow FIPUG and other parties to address their concerns at the July 1, 2008, Agenda Conference.

As addressed more specifically in Issue 2 below, staff believes that PEF has calculated its under-recovery as directed by Order No. PSC-07-0333-PAA-EI. PEF included the actual under-recovery it had experienced in 2007 that was not included in this year's fuel factor. PEF also reprojected its revenues and expenses, as directed by that same order. Staff's review of those responses and its analysis of the need for a mid-course correction are discussed in Issue 3.

FIPUG also challenges PEF's interpretation of Order No. PSC-07-0333-PAA-EI. The 2007 order clarifying the appropriate mechanism to calculate over and under-recoveries is not new to the Commission, as FIPUG appears to suggest. In TECO, FPL, and PEF's 2003 mid-course correction orders referenced above, the Commission had before it very similar factual circumstances. In Order No. 03-0400-PCO-EI, TECO re-projected its fuel costs using updated assumptions to develop future cost and revenue estimates. The Commission allowed the mid-course correction and stated that "[d]uring the scheduled November 12-14, 2003, hearing in this docket, we will compare these estimates to actual data, then apply the difference to next year's fuel factors through the true-up process. Any over-recovery that Tampa Electric may collect through its approved fuel factors will be refunded to Tampa Electric's ratepayers with interest." And in Order No. PSC-03-0382-PCO-EI, the Commission was presented with PEF's reprojected revenues and expenses, as well as a prior year's under-recovery. The Commission acknowledged that historical year under-recoveries could be included as part of the mid-course correction, and found good reason to do so in the 2003 mid-course correction request. In approving PEF's request to include part of the historical year under-recovery, the Commission stated:

> First unlike PEF's projected 2003 under-recovery amount, PEF's 2002 under-recovery represents the difference between actual costs incurred and revenues received. Although unaudited, these actual fuel revenues and costs from 2002 have a higher degree of certainty than the projected fuel revenues and costs for 2003. We note that our staff has commenced an audit of PEF's 2002 fuel revenues and costs in the normal course of this docket, and that any audit findings which compel an adjustment to these amounts may be addressed at our November 12-14, 2003, hearing scheduled for this docket. Second, recovery of $28.5 million of the total under-recovery commencing in April 2003, instead of January 2004, would be consistent with the basic principle of ratemaking which seeks to match the timing of the incurrence of costs with the timing of their recovery.

Order No. PSC-03-0382-PCO-EI, at p. 4. Likewise, the Commission approved FPL's mid-course correction which included historical year (2002) under-recovery amounts and reprojected current year (2003) revenues and expenses. Order No. PSC-03-0381-PCO-EI.

FIPUG's motion to abate requests that the decision on a mid-course correction be deferred until a hearing on PEF's petition is held by the Commission. In making the decision to abate or not, the Commission should weigh the timing of a hearing with the need to protect ratepayers. It is staff's opinion that ratepayers would be better served by the Commission evaluating the mid-course correction now and considering the substantive merits of witnesses testimony at the November fuel hearing. A hearing on the mid-course correction prior to the mid-course correction going into affect would delay and perhaps prohibit the mid-course correction from occurring. It is better for the Commission to evaluate the information it has before it and determine what is in the best interest of ratepayers at the July 1, 2008, Agenda Conference, than to defer a decision until later in the year. This is uniquely true in the fuel clause docket because of the layers of procedural due process afforded to ratepayers. First, parties may be permitted to address the Commission regarding their concerns at the July 1, 2008, Agenda Conference. Second, there is a full procedural hearing to consider the actual costs and revenues of PEF, during which the parties are afforded opportunity for discovery, to present witnesses, and to cross-examine utility witnesses. Finally, if a utility over recovers for the year, the customer's will receive a refund with interest for that over-recovery.

Conclusion

Staff recommends that the Commission deny FIPUG's Motion to Dismiss or Alternately to Abate the proceedings. PEF has complied with Order No. PSC-07-0333-PAA-EI in calculating its under-recovery. Procedural due process is built into the fuel clause proceedings so that ratepayers' interests remain protected. FIPUG's request to extend the under-recovery payment over the projected year is addressed in Issue 2 below.

Issue 2: Should the Commission approve PEF's request to eliminate the storm cost recovery surcharge?

Recommendation: Yes. The storm cost recovery surcharge should be eliminated effective with the last billing cycle in July 2008. (Slemkewicz, Draper)

Staff Analysis: In its petition, PEF proposes that the storm cost recovery surcharge (SCRC) be eliminated effective with the last billing cycle in July 2008. This request is in compliance with the provisions of the stipulation that was approved in Order No. PSC-06-0772-PAA-EI.[3] Paragraph 2 provides for an extension of the SCRC through the last billing cycle in July 2008. After the last billing cycle in July 2008 is completed, the stipulated extension of the SCRC expires. Therefore, PEF's tariffs need to be revised to eliminate the SCRC from future billing cycles beginning in August 2008. The monthly reduction for a residential customer using 1,000 kWh is $3.61.

[3] Order No. PSC-06-0772-PAA-EI, issued September 18, 2006, in Docket No. 041272-EI, In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.

Issue 3: Should the Commission approve PEF's petition for mid-course correction to its 2008 fuel and purchased power cost recovery factors?

Recommendation: The Commission should approve PEF's petition for a mid-course correction to its 2008 fuel and purchased power cost recovery factors. The factors are shown on Attachment C. If the Commission approves an alternative to PEF's petition, PEF should file revised fuel and purchased power cost recovery factors for administrative approval by staff. (Lester, Matlock, McNulty, Draper)

Staff Analysis: Staff analyzed PEF's petition and the components of the projected under-recovery. Staff then developed options for the mid-course correction to the fuel factors.

Calculation of Under-recovery

PEF's estimated December 2008 End-of-Period Total Net True-up is an under-recovery of $212,822,858. PEF based its petition on that estimate's percent of its 2008 Estimated Jurisdictional Fuel Revenue Applicable to Period, $1,963,062,394. The under-recovery percentage is the ratio of these two numbers, or 10.84%. The under-recovery is comprised of the difference between the estimated and actual December 2007 End-of-Period Total Net True-ups ($16,807,030), the estimated 2008 interest on 2007's difference and 2008's monthly balances ($87,987), and the difference between 2008's estimated revenues and estimated expenses ($195,927,840). Table 1 below presents the calculation of the under-recovery percent.

TABLE 1 – CALCULATION OF UNDER-RECOVERY PERCENT

Component	Dollars
2007 True-up	-$16,807,030
2008 Projected Under-recovery	-$195,927,840
2008 Interest	-$87,987
Estimated 12/08 End of Period Total Net True Up	-$212,822,857
Jurisdictional Fuel Revenue Applicable to 2008	$1,963,062,394
2008 Mid Course Percent	10.84%
Source: Schedule E1-B, Mid-Course Petition	

PEF's estimated under-recovery for 2008 will occur in the last 7 months of 2008. In its September 2007 projection filing, PEF projected that it would have an over-recovery balance of $169,376,547 at the beginning of 2008 and was expected to net to zero by the end of the year. PEF's End of Period True-up estimate for April 2008 was an over-recovery of $166,803,881. However, PEF's actual April 2008 End-of-Period Total Net True-up was an over-recovery of $116,803,365. Based on PEF's mid-course petition, PEF's July 2008 End of Period Total Net True-up estimate is expected to be an under-recovery of $77,528,938, and the December 2008 estimate is expected to be an under-recovery of $212,822,858. (July's estimate is the amount to be collected via the mid-course correction between the beginning of August and the end of December.) Stated in percentage terms, the April over-recovery of 5.95% will give way to a July under-recovery of 3.95%, and the under-recovery will increase to 10.84% by year-end 2008 if the fuel factors remain at their current levels and PEF's mid-course cost and sales assumptions are correct.

PEF's Projected Fuel Cost Under-recovery for 2008

According to PEF, the reason for the projected 2008 under-recovery is that fuel prices have increased to a higher level than the estimated prices upon which its current fuel factors are based. PEF originally estimated its 2008 fuel costs in mid-2007 and it bases its mid-course request on fuel price forecasts as of April 21, 2008. The graphs on Attachment A depict the change in forecasted prices. These graphs are as of particular days. Staff notes oil and gas markets are volatile and futures prices change from day to day.

PEF states that fuel prices have increased due to increased demand for energy around the world, notably in China and India. The following factors have affected fuel prices:

- Crude oil prices have increased due to falling U.S. inventories, increased demand based on world economic growth, low OPEC spare production capacity, and geopolitical risks. Higher crude oil prices directly affect the price of heavy fuel oil and diesel fuel.

- Delivered coal prices have increased because higher diesel fuel prices have increased transportation costs and because of unexpected supply disruptions. With the declining value of the dollar and increased demand for coal from Europe and Asia, U.S. coal exports have increased, which tightens supplies and increases prices.

- Natural gas prices have increased due to growing demand for gas for electric generation and higher prices in Europe and Asia, which divert LNG cargoes from the U.S and reduce domestic supply. Additional reasons for higher natural gas prices are that higher oil prices increase demand for gas due to fuel switching, storage levels are somewhat lower than the year-ago level, and the extended outage of Independence Hub, an important source of gas in the Gulf of Mexico.

PEF's Actions to Mitigate Fuel Costs and Price Volatility

PEF has endeavored to reduce 2008 fuel costs and fuel price volatility. For 2008, the Company hedged 72% of the volume of its gas purchases and 71% of the volume of its oil purchases. This hedging has generated, on an actual and marked to market basis, significant amounts of gains. These gains, which are netted against fuel costs, reduce but do not eliminate the impact of higher fuel prices. For 2008, PEF's actual and estimated (marked to market) hedging gains for gas and oil are $267,501,928 and $129,613,015, respectively. Given volatile markets, the results vary from day to day. Staff notes the goal of PEF's hedging program is volatility control, such that gains or losses can result in a given period. Staff will review in a more comprehensive way the actions taken by PEF to mitigate fuel costs and price volatility as part of the November fuel clause proceeding.

Staff's Review

Staff reviewed the key assumptions regarding changes in fuel prices, system efficiency, system generation, and fuel mix. The data used for comparison purposes is the original projection data contained in the September 4, 2007, testimony of PEF witness Lori Cross in Docket No. 070001-EI and the mid-course projection data filed by PEF with its petition on May 30, 2008. The comparative data appear in Tables 2-5. PEF used these data to support its reprojected fuel costs and revenue estimates.

TABLE 2 - CHANGE IN PEF'S 2008 DELIVERED FUEL PRICE FORECAST ($/MMBTU)			
	As filed (9/4/07)	As filed (5/30/08)	Change
Natural Gas	$10.10	$10.04	-$0.06
Residual Oil	$8.97	$9.78	$0.81
Distillate Oil	$17.48	$21.42	$3.94
Coal	$3.07	$3.55	$0.48
Nuclear	$0.37	$0.36	-$0.01
Source: Schedule E3			

TABLE 3 - CHANGE IN PEF'S 2008 SYSTEM EFFICIENCY (BTU/KWH)		
	As filed (9/4/07)	As filed (5/30/08)
Natural Gas	7,641	7,835
Residual Oil	10,502	10,772
Distillate Oil	18,076	16,938
Coal	9,741	9,816
Nuclear	10,724	10,296
Weighted Average	9,423	9,325
Source: Schedule E3		

TABLE 4 - CHANGE IN PEF'S 2008 SYSTEM NET GENERATION (MWH) BY FUEL TYPE			
	As filed (9/4/07)	As filed (5/30/08)	Change
Natural Gas	11,852,959	13,342,872	12.57%
Residual Oil	4,444,519	3,183,673	-28.37%
Distillate Oil	314,678	191,291	-39.21%
Coal	15,520,789	15,545,371	0.16%
Nuclear	6,663,840	6,398,503	-3.98%
Total	38,766,785	38,661,710	-0.35%
Source: Schedule E3			

As can be seen from Table 2, coal, residual oil, and distillate delivered prices are all projected to increase compared to the original projections. These changes have contributed significantly to the under-recovery. The natural gas price for the year is projected to decline slightly. Staff notes that PEF projects it will experience a significant under-recovery in natural gas (See Table 5 below.). This is due to PEF burning a higher percentage of natural gas in its generation mix than it originally projected. PEF is replacing oil-fired generation with gas-fired generation.

While it is true that natural gas prices (commodity price) in the graphs in Attachment A for the period show a marked increase, the mid-course price estimate of natural gas includes the impact of hedging gains identified above. Hedging gains, both realized and projected, included in the delivered natural gas price shown in the mid-course filing were not contained in the original projection. Such gains erase the price increase that would otherwise have been reflected in the delivered price of natural gas in the mid-course petition.

As indicated in Table 3, PEF shows a slight increase in system efficiency compared to original projections as measured by btu/kwh. Weighted average system efficiency improved from 9,423 btu/kwh to 9,325 btu/kwh. The percent increase is 1.03%. Most of this increase in efficiency is due to the shift from less efficient sources of generation (oil) to more efficient sources of generation (natural gas) compared to original projections.

The mid-course projection for system generation shows a decrease in both residual oil and distillate oil generation, as measured in megawatt hours, by significant margins (28% and 39%, respectively). Meanwhile, PEF projects it will generate more electricity in 2008 from burning natural gas (13% increase) than originally projected as natural gas becomes the more cost-effective option compared to oil. PEF also shows a decrease in nuclear generation (4%). PEF states that the reason for this decrease in nuclear generation is an unplanned outage of Crystal River Unit 3 in March 2008 lasting 20 days.

Staff sought to identify the sources of the 2008 under-recovery by fuel type, power sales, purchased power, and other factors based on kilowatt hour sales. This breakdown is presented below in Table 5. The table shows the impact of higher coal, oil, and natural gas prices and increased gas sales in 2008, resulting in additional costs of $184,417,782 compared to the original estimate. Significantly lower residual oil volumes in 2008 are projected to result in an over-recovery related to that fuel of $61,797,346, despite the marked increased price of residual oil compared to original projections. As discussed above, PEF has replaced much of its oil-fired generation with lower cost and more efficient gas-fired generation.

The projected under-recovery in coal is due in part to the increased cost of diesel fuel for coal transportation. In addition, PEF has experienced a default on a coal supply contract and expects to replace this coal with higher-priced spot coal. PEF has been somewhat insulated from rising coal prices because 95% of its 2008 coal supply is under contract. However, higher coal prices can lead to defaults on coal supply contracts.

As shown on Table 5, PEF projects an under-recovery in purchased power, which includes purchased power by contract, power purchased from qualifying facilities, and economy purchases. PEF's purchased power is based on gas and coal and is, therefore, affected by higher natural gas and coal prices. This under-recovery is offset by an over-recovery in power sales. Overall, staff believes the primary cause for PEF's projected under-recovery is that coal, residual oil, and distillate oil prices are higher than originally projected.

TABLE 5 ESTIMATED UNDER-RECOVERY AND OVER-RECOVERY BY SOURCE OF KILOWATT HOUR SALES IN 2008		
1	Coal	($102,635,656)
2	Residual oil	61,797,346
3	Light Oil	24,940,008
4	Natural Gas	(182,379,311)
5	Nuclear	(259,996)
6	Non-fuel Generation	(374,016)
7	Power Sold	81,181,666
8	Purchased Power	(42,542,108)
9	Qualifying Facilities	(18,107,708)
10	Economy Energy	(25,161,847)
11	System kWh Sales (Sum of 1-10)	(164,623,045)
12	Wholesale kWh Sales	(19,794,737)
13	Jurisdictional kWh Sales (Sum of 11-12)	(184,417,782)
14	Revenue Adjustment Due to Rate Class Usage Variations	(20,243,155)
15	Unrefunded True-up and GPIF for 20080	8,733,109
14	Line-Loss Correction	(670,897)
15	Total June 2008 Projected Under-recovery (Sum of 13 – 14)	($195,927,840)
Source – Schedules E1, E1-B, E3, E6,E7, E8, E9 from 9/4/07 and 5/30/08 filings		

Consistent with our review of previous mid-course corrections, our analysis of PEF's petition includes an examination of whether the assumptions (i.e. fuel prices, retail energy sales, generation mix, and system efficiency) that PEF used to support its re-projected fuel costs appear reasonable. PEF used these updated assumptions to develop future cost and revenue estimates. During the scheduled November 4-6, 2008, hearing in this docket, we will compare these estimates to actual data, and then apply the difference to next year's fuel factors through the true-up process. Any over-recovery that PEF may collect through its approved fuel factors will be refunded to FPL's ratepayers with interest. We will address whether PEF's actions to procure fuels reliably and cost-effectively, including its action to hedge fuel prices, were appropriate at our November 6-8, 2008, evidentiary hearing.

Options for Mid-course Correction to Fuel Factors

The fuel adjustment charge is designed to allow utilities to recover fuel cost on a projected basis. As the recovery period unfolds, actual and reprojected costs typically differ from original projections, so an under-recovery or over-recovery results. Order No. 13694 requires utilities to notify the Commission if the projected under-recovery or over-recovery exceeds 10% of the estimated jurisdictional fuel revenue applicable to the period.

In Order No. PSC-98-0691-FOF-PU, issued May 19, 1998, in Docket No. 980269-PU, the Commission changed from setting fuel factors every six months to setting fuel factors for the calendar year, i.e., annual fuel factors. When the Commission receives petitions for mid-course corrections in the middle of the year rather than the beginning of the year, the period for spreading an under-recovery is shorter and can have a significant rate impact. While the utility is permitted to recover its fuel costs, the Commission retains the discretion to evaluate the rate impact of a mid-course correction upon customers and set rates appropriately.

With mid-course corrections in past years, the Commission has considered the stability of fuel factors within the year and between years (e.g. Order Nos. PSC-03-0382-PCO-EI, Page 9). The Commission has noted that stable annual fuel factors are important for customers because stable factors give customers more certainty in planning their expenditures for electricity. However, several issues are in tension with the concept of rate stability. [4]

If fuel costs vary significantly from original projections, then fuel factors will be less representative of costs and customers will not receive accurate price signals regarding the cost of electricity. In the case of actual and projected fuel costs being higher than original projections, an under-recovery will result and, if not corrected, will affect the calculation of subsequent year fuel factors. In times of rising fuel prices, such an under-recovery can compound the rate impact in that the subsequent year's fuel factors would reflect higher fuel prices and the under-recovery. In addition, interest would accrue on the under-recovery. Another aspect of deferred under-recoveries is the concept of intergenerational inequity. If a cost is deferred, even a year or portion of a year, a slightly different set of customers will be charged for collection of the costs incurred.

Consideration of a mid-course change to fuel factors involves balancing the goals of achieving a stable annual fuel factor with the goal of sending accurate price signals to customers. Consistent with past orders, staff believes it is appropriate for the Commission to consider the rate effects and bill impacts for not only the remaining months of the current year but also for the next calendar year.

Table 6 below shows the recent trend in PEF's fuel factors and residential bills and estimated fuel factor in 2009.

[4] For a discussion of rate stability, see Order No. PSC-98-0691-FOF-PU, page 4. For a discussion of the impacts of deferrals and mid-course corrections, see Order No. PSC-03-0382-PCO-EI, pages 8 and 9.

TABLE 6 – TREND FOR PEF'S FUEL FACTORS AND RESIDENTIAL BILLS						
	2004	2005	2006	2007	2008 Current	2008 Proposed Mid-Course (includes elimination of Storm Cost Recovery Surcharge)
Levelized Fuel Cost Recovery Factor, ¢/kWh	3.453	3.912	5.321	5.132	4.604	5.809
Residential 1,000 KWH Bill, $	89.11	94.43	109.56	110.34	108.11	116.79
Source: Orders approving factors issued in December/January for 2004-2008, Mid Course Petition Schedule E-10						

PEF's fuel factors and PEF's residential class 1,000 KWH bill increased from 2004 through 2006. PEF's fuel factors declined from 2006 to 2008, while its residential class 1,000 KWH bill remained at about the same level.

To allow consideration of all the above points regarding rate impact, staff requested PEF to provide estimated bill impacts and associated rates/factors for four possible mid-course correction recovery options. Staff has included PEF's response as Attachment B to this recommendation. The four options (scenarios) include:

Option A. Approve the requested mid-course correction as filed,

Option B. Deny the requested mid-course correction and allow any under-recovery to be collected in 2009 fuel factors,

Option C. Collect 50% of the identified under-recovery during August through December of 2008 and defer the remaining 50% to 2009; or

Option D. Collect the under-recovery over 17 months (from August 2008 through December 2009).

Staff believes these four options offer a reasonable range of alternatives from which to consider possible rate adjustments and bill impacts. PEF's projected total bill impacts in 2009 are available in redacted format for purposes of this recommendation since PEF is requesting confidentiality of the projected 2009 cost recovery amounts of proposed PEF Levy Nuclear Units 1-2 in Docket No. 080148-EI (Petition for Determination of Need for PEF Units 1-2). Nonetheless, it is apparent from the data in Attachment B that both the 2009 fuel factor increases and 2009 bill impacts under Options B, C, and D are high relative to Option A. Also, Option A appears to offer the greatest degree of stability in the fuel factor from 2008 to 2009.

Upon review of the rate impacts and likely bill impacts under the four different scenarios (exclusive of nuclear cost recovery in 2009), staff recommends that the Commission approve PEF's requested mid-course correction as filed. Of the four options presented, Staff believes PEF's requested mid-course correction as filed offers the greatest degree of rate stability. Staff's considerations include:

1. Accurate Price Signals – Approval of PEF's requested mid-course correction would bring fuel factors in line with current and expected costs and provide an accurate price signal to customers.

2. PEF's 2009 Fuel Factors Are Projected to Be Higher Than Mid-Course Fuel Factors - PEF projects that its 2009 fuel factor will rise $5 per 1,000 KWH over the mid-course 2008 fuel factor. Given that projection, deferral of a large under-recovery in 2008, or some portion thereof, would have the effect of compounding the rate impact in 2009 of higher fuel prices.

3. Prevent Possible Compound Increase in 2009 Fuel Factors - If the 2008 final true-up amount shows a high under-recovery, deferring the mid-course would compound the 2009 fuel factor increase. This could result from a number of events, such as sharp fuel price increases due to decreased gas production and delivery in the event of a Gulf of Mexico hurricane during the latter half of 2008.

4. PEF's 2009 Non-Fuel Rates Projected to be Higher Than 2008 Non-Fuel Rates - Known and projected increases to non-fuel components of customer bills, including environmental, nuclear, and energy conservation costs are likely to contribute to additional bill impacts in 2009. PEF projects that environmental recovery projects will increase the 1000 kWh residential bill by $3 to $4 per 1000 kWh. Further, the costs of the Levy nuclear units and the Crystal River Unit 3 uprate will begin to be charged to the capacity clause in 2009. These increases in non-fuel rates are an additional reason to avoid substantial 2008 fuel cost deferral and to maintain rate stability.

5. Reduced Interest - If the Commission approves the requested mid-course correction, interest costs to customers associated with any deferral of the under-recovery would be avoided.

6. Reduced Intergenerational Inequity – Matching the timing of the collection of costs with the time the costs will be recovered would serve to reduce any intergenerational inequity associated with fuel cost recovery.

Conclusion

Staff believes that PEF's basis for requesting the proposed mid-course correction is sound. Actual and projected coal, residual oil, and distillate oil price increases indicate that PEF's current estimated under-recovery is reasonable. Staff will continue to conduct discovery on the actual and estimated expenditures of PEF and conduct a thorough review of costs in preparation for the November 2008 fuel hearing.

In order to promote rate stability and to reduce the risk of compounded increases in rates in 2009, Staff recommends the Commission approve PEF's requested mid-course correction to its fuel factors to collect its projected under-recovery of $212,822,859 in 2008. PEF's proposed fuel and purchased power cost recovery factors for the period August through December 2008 are shown in Attachment C.

Issue 4: If the Commission approves PEF's petition for a mid-course correction, when should the new fuel and purchased power cost recovery factors become effective?

Recommendation: If the Commission approves staff's recommendation in Issue 3, the new factors should become effective with the Company's first billing cycle in August 2008. (Draper)

Staff Analysis: PEF has requested that the new factors become effective with the first billing cycle in August 2008. An effective date of the first billing cycle in August will ensure that all customers are billed under the new factors the same amount of time.

Starting June 26, 2008, PEF will notify its customers of its proposed mid-course correction through a bill insert. In order to provide customers with a 30-day notice, PEF must start mailing the bill inserts to notify customers of its proposed midcourse correction prior to the July 1 Agenda Conference. The June 26 mailing date ensures that customers receive a 30-day notice that fuel factors may change. The bill insert states PEF's proposed total under-recovery amount, the effective date of the proposed cost recovery factors, and the impact on a 1,000 kWh residential bill. The bill insert also states that the Commission will vote on PEF's requested proposal at its July 1, 2008, Agenda Conference. Staff has reviewed the bill insert. PEF proposes to include details of the Commission's decision in customers' August bills.

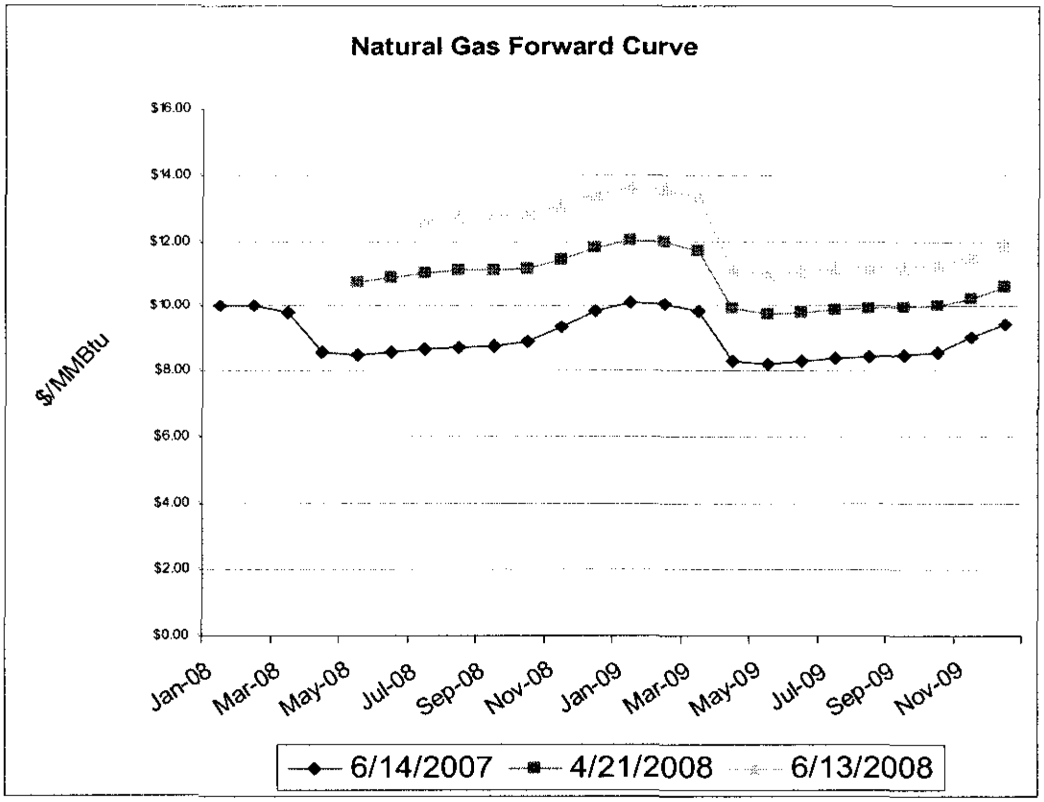
Providing customers with a 30-day notice prior to implementing new fuel factors as a result of a midcourse correction is consistent with the Commission's past decisions and allows customers the opportunity to adjust their usage in light of the new factors.[5] Staff believes that PEF's proposed effective date and plan to notify its customers are appropriate and should therefore be approved.

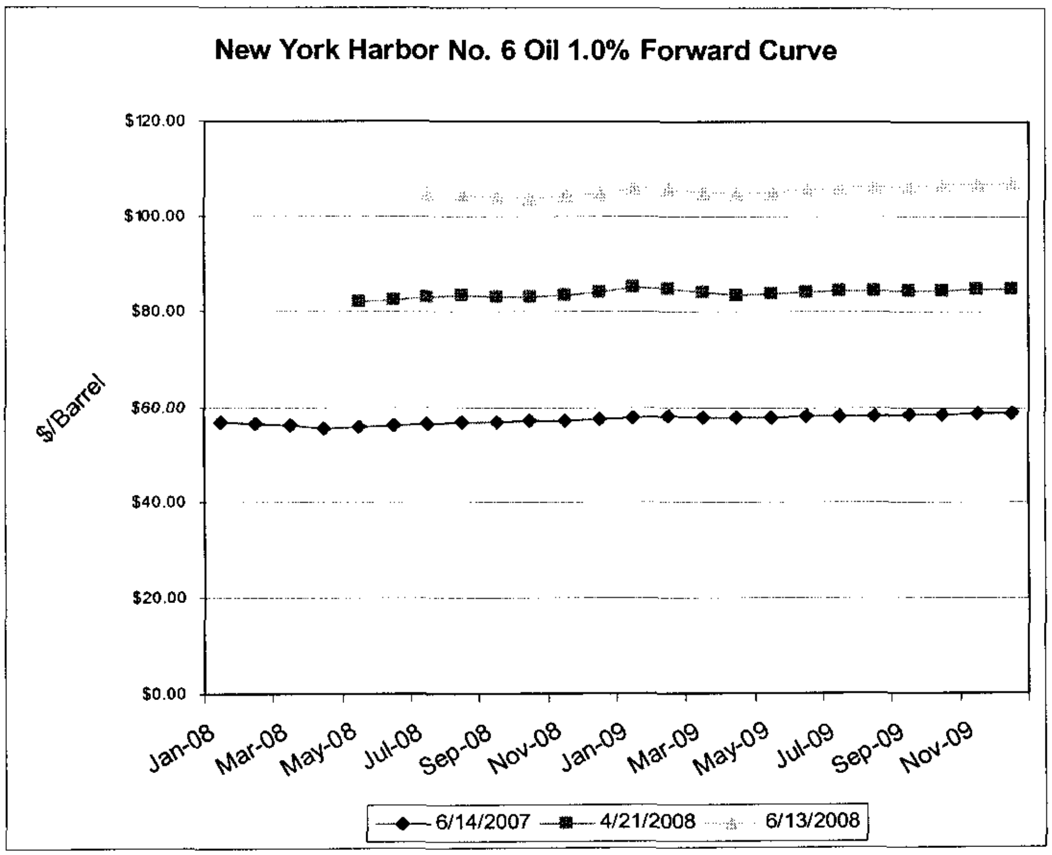
[5] See Order No. PSC-07-0739-PCO-EI, issued September 17, 2007, in Docket No. 070001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

Issue 5: Should this docket be closed?

Recommendation: This docket is an on-going docket and should remain open. (Bennett, Young)

Staff Analysis: This fuel docket is an on-going docket and should remain open.


Natural Gas Forward Curve
$/MMBtu
$16.00
$14.00
$12.00
$10.00
$8.00
$6.00
$4.00
$2.00
$0.00
Jan-08
Mar-08
May-08
Jul-08
Sep-08
Nov-08
Jan-09
Mar-09
May-09
Jul-09
Sep-09
Nov-09
6/14/2007
4/21/2008
6/13/2008


New York Harbor No. 6 Oil 1.0% Forward Curve
$/Barrel
$120.00
$100.00
$80.00
$60.00
$40.00
$20.00
$0.00
Jan-08
Mar-08
May-08
Jul-08
Sep-08
Nov-08
Jan-09
Mar-09
May-09
Jul-09
Sep-09
Nov-09
6/14/2007
4/21/2008
6/13/2008

Progress Energy Florida

E-10 Schedules for 2008 & 2009

Staff 2nd Mid-Course Data Request

Answer to Question #1

Residential Price Impact @ 1000 kWh:

	Current Rates	(A) Approve Petition				(B) Deny Petition				(C) Approve 50% in '08 & 50% in '09				(D) Approve 17 month Recovery			
		Collect $213m Aug 08 - Dec 08				Collect $213m Jan 09 - Dec 09				Collect $106.5m in '08 + $106.5m in '09				Collect $213m Aug 08 - Dec 09			
	Jan-Jul 08	Aug-Dec 08	% change	Jan-Dec 09	% change	Aug-Dec 08	% change	Jan-Dec 09	% change	Aug-Dec 08	% change	Jan-Dec 09	% change	Aug-Dec 08	% change	Jan-Dec 09	% change
Base Rate	$43.91	$43.91	0%	$43.91	0%	$43.91	0%	$43.91	0%	$43.91	0%	$43.91	0%	$43.91	0%	$43.91	0%
Fuel Cost Recovery	42.78	54.85	28%	59.71	9%	42.78	0%	64.99	52%	48.81	14%	62.36	28%	46.43	9%	63.39	37%
Capacity Cost Recovery	11.92	11.92	0%	9.49	-20%	11.92	0%	9.49	-20%	11.92	0%	9.49	-20%	11.92	0%	9.49	-20%
Energy Conservation Cost Recovery	2.01	2.01	0%	3.17	58%	2.01	0%	3.17	58%	2.01	0%	3.17	58%	2.01	0%	3.17	58%
Environmental Cost Recovery	1.18	1.18	0%	4.93	318%	1.18	0%	4.93	318%	1.18	0%	4.93	318%	1.18	0%	4.93	318%
Storm Cost Recovery Surcharge	3.61	0.00	-100%	0.00	0%	0.00	-100%	0.00	0%	0.00	-100%	0.00	0%	0.00	-100%	0.00	0%
Nuclear Cost Recovery - CR3 Uprate	0.00	0.00	0%	0.70	100%	0.00	0%	0.70	100%	0.00	0%	0.70	100%	0.00	0%	0.70	100%
Nuclear Cost Recovery - Levy	0.00	0.00	0%	[redacted]	[redacted]	0.00	0%	[redacted]	[redacted]	0.00	0%	[redacted]	[redacted]	0.00	0%	[redacted]	[redacted]
Subtotal	105.41	113.87	8%	[redacted]	[redacted]	101.80	-3%	[redacted]	[redacted]	107.83	2%	[redacted]	[redacted]	105.45	0%	[redacted]	[redacted]
Gross Receipts Tax	2.70	2.92	8%	[redacted]	[redacted]	2.61	-3%	[redacted]	[redacted]	2.76	2%	[redacted]	[redacted]	2.70	0%	[redacted]	[redacted]
Total	$108.11	$116.79	8%	[redacted]	[redacted]	$104.41	-3%	[redacted]	[redacted]	$110.59	2%	[redacted]	[redacted]	$108.15	0%	[redacted]	[redacted]

PEF's proposed fuel factors for the period August through December 2008

Fuel Cost Factors (cents/kWh)						
					Time of Use	
Group	Delivery Voltage Level*	First Tier Factor	Second Tier Factor	Levelized Factors	On-Peak	Off-Peak
A	Transmission	--	--	5.702	7.800	4.687
B	Distribution Primary	--	--	5.760	7.880	4.735
C	Distribution Secondary	5.485	6.485	5.818	7.959	4.782
D	Lighting	--	--	5.376	--	--

*PEF bills its customers based on delivery voltage level. Residential and small commercial customers typically take service under distribution secondary. Larger commercial or industrial customers may opt to take service under distribution primary or transmission level