State of Florida

Public Service Commission

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

DATE: July 17, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Economic Regulation (Lester, Draper, Matlock, McNulty, Windham)
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: 07/29/08 – Regular Agenda – 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.GLF.RCM.DOC

Case Background

On June 20, 2008, Gulf Power Company (Gulf or Company) filed a petition for a mid-course correction to its Fuel Adjustment Factors. The Commission had previously approved the fuel cost recovery factors for Gulf by Order No. PSC-08-0030-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.

Gulf 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.

Gulf's last base rate proceeding was finalized by Commission vote on May 8, 2002, after an evidentiary hearing held on February 25-26, 2002. See Order No. PSC-02-0787-FOF-EI, issued June 10, 2002, in Docket No. 010949-EI, In re: Request for rate increase by Gulf Power Company.

Mid-Course Corrections

Mid-course corrections are used by the Commission between 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 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.[1] Failure to do so would result in a disallowance of any interest that would be collected by the utility on any portion of the under-recovery in excess of 10%.

In Order No. PSC-98-0691-FOF-PU, the Commission moved the fuel clause hearings from biennial to annual proceedings. When it moved to an annual proceeding, the Commission also addressed mid-course corrections. The Commission reiterated its established policy to require a utility to notify the Commission when 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.

In deliberating the appropriateness of mid-course corrections, the Commission has enunciated several reasons for approving mid-course corrections. One 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 FPL's mid-course correction, 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. PSC-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-

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

PCO-EI, issued March 19, 2003, the Commission granted Progress Energy Florida's (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 corrections are processed. 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 to 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-07-0333-PAA-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. 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 pursuant to Section 120.80(13)(a), F.S.

Discussion of Issues

Issue 1: Should the Commission approve Gulf's petition for a mid-course correction to its 2008 fuel and purchased power cost recovery factors?

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

Staff Analysis: Staff reviewed Gulf'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

Based on Gulf's actual (January through May) and reprojected (June through December) revenue and expense data for 2008, Gulf expects that its fuel and purchased power costs will be under-recovered by $76,390,153 by the end of 2008. This under-recovery amount is Gulf's estimated December 2008 End-of-Period Total Net True-up. Gulf has based its petition on that estimate's percent of its 2008 estimated Jurisdictional Fuel Revenue Applicable to Period, $415,462,922. The under-recovery percent is 18.39%. The estimated under-recovery is comprised of the difference between the estimated and actual December 2007 End-of-Period Total Net True-up ($13,300,934); the difference between 2008's estimated revenues and estimated expenses ($61,502,126); the estimated 2008 interest on 2007's difference and 2008's monthly true-up balances ($1,705,949); and a prior period revenue adjustment $118,856. Table 1 below presents the calculation of the under-recovery percentage.

TABLE 1 – CALCULATION OF UNDER-RECOVERY PERCENT

Component	Dollars
2007 True-up	-$13,300,934
2008 Projected Under-recovery	-$61,502,126
2008 Interest	-$1,705,949
Prior Period Revenue Adjustment	$118,856
Estimated 12/08 End of Period Total Net True Up	-$76,390,153
Jurisdictional Fuel Revenue Applicable to 2008	$415,462,922
2008 Mid-Course Percent	18.39%
Source: Schedule E1-B, Mid-Course Petition	

Gulf's actual May 2008 End-of-Period Total Net True-up was an under-recovery of $62,435,470. Without its requested mid-course correction, Gulf expects the level of under-recovery to increase during the remaining months of 2008. The August 2008 estimate is an under-recovery of $73,198,851, and the December 2008 estimate is an under-recovery of $76,390,153. (August's estimated under-recovery, excluding the proposed deferral, is the amount to be collected between the beginning of September and the end of December). Based on current estimates, the under-recovery percent will increase from 15.03% to 17.62% from May to August, and increase from 17.62% to 18.39% from August to December.

Gulf's Projected Fuel Cost Under-recovery for 2008

According to Gulf, the reason for the projected 2008 under-recovery is that fuel prices have increased to a higher level than the estimated prices upon which it based its current fuel factors. Gulf originally estimated its 2008 fuel costs as of July 7, 2007, and it bases its mid-course request on fuel price estimates made on May 8, 2008.

Gulf states that fuel prices have increased due to the following factors:

- Coal prices increased due to force majeure declarations by an Illinois Basin coal supplier, American Coal Company (American). These events impaired deliveries and caused Gulf to buy approximately 1 million tons of replacement coal on the spot market. On August 9, 2007, American notified Gulf of a force majeure declaration for the Galatia North Mine and on May 15, 2008, American notified Gulf of a force majeure declaration for the New Future Mine. These declarations are due to safety and geological conditions. Gulf states that it has verified that the force majeure events are valid. At the time of its 2008 projection filing, spot market coal prices were substantially above Gulf's contract prices. Prices for spot coal have increased significantly since Gulf's September 2007 projection filing due to increased U.S. coal exports. Also, while Gulf purchases a large percentage of its coal based on long-term contracts, its 2008 projection filing included approximately 10 percent of its 2008 coal purchases as uncommitted spot purchases. Based on the revised projections in its petition, Gulf projects it will burn 5.8 million tons of coal in 2008.

- Gulf states natural gas prices have increased significantly, but Gulf's natural gas cost, net of projected hedging gains in 2008, is less than originally projected. Staff notes that, while Gulf is less dependent on natural gas compared to other Florida IOUs, its purchased power costs are primarily based on natural gas. Natural gas prices have increased due to: a projected tightening of supply for filling storage requirements by the end of October 2008; declining Canadian production; and domestic gas prices being lower than prices in Europe and Asia, which diverts LNG cargoes from the U.S and reduce domestic supply. Power generation demands in Europe and Asia have driven a surge in demand for LNG. Domestic production has not grown fast enough to match demand.

Gulf's Actions to Mitigate Fuel Costs and Price Volatility

Gulf has endeavored to reduce 2008 fuel costs and fuel price volatility. For 2008, the Company hedged portions of its natural gas purchases, which has generated, on an actual and mark to market basis, significant amounts of gains. These gains reduce but do not eliminate the impact of higher fuel prices.

For 2008, Gulf's actual and estimated (mark to market) hedging gains for gas are $13,987,282 as of May 31, 2008. Staff notes the following: (1) these results are as of a single point in time, (2) given volatile markets, the results can vary from day to day, and (3) the goal of its hedging program is volatility control, such that hedging can result in gains or losses within any given calendar period. Staff will review in a more comprehensive way the actions taken by Gulf 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, fuel mix, and Gulf's assertions regarding the force majeure event. The data used for comparison purposes are the original projections contained in the September 4, 2007, testimony of Gulf witness Rhonda Martin in Docket No. 070001-EI and the mid-course projections filed by Gulf with its petition on June 20, 2008. Gulf used these data to support its reprojected fuel costs and revenue estimates. The comparative data appear in Tables 2-5.

Table 2 - Change in Gulf's 2008 Delivered Fuel Price Forecast ($/MMBtu)

	As filed (9/4/07)	As filed (6/20/08)	% Change
Coal	2.74	3.10	13.1
Natural Gas[2]	10.27	12.06	17.4
Distillate Oil	13.24	15.15	14.4
Source: Schedule E3			

Table 3 - Change in Gulf's 2008 System Efficiency (Btu/kwh)

	As filed (9/4/07)	As filed (6/20/08)
Coal	10,184	10,456
Natural Gas	7,302	7,064
Distillate Oil	21,897	19,699
Weighted Average	9,704	9,927
Source: Schedule E3		

Table 4 - Change in Gulf's 2008 System Net Generation (MWH) by Fuel Type

	As filed (9/4/07)	As filed (6/20/08)	Percent Change
Coal excluding Scherer	13,296,860	12,700,113	-4.5
Coal at Scherer	1,418,860	1,267,519	-10.7
Natural Gas	2,944,840	2,581,845	-12.3

[2] The delivered gas prices do not reflect the projected hedging gains for 2008.

Distillate Oil	740	276	-62.7
Total	17,661,300	16,549,753	-6.3
Source: Schedule E3			

As can be seen from Table 2, Gulf projects that its delivered fuel prices will increase above its original projections. Per the mid-course correction filing, 2008 coal prices are projected to be \$3.10/MMBtu, an increase of \$.36/MMBtu over the September projection. Gulf projects that its natural gas prices for 2008 will be \$12.06/MMBtu, an increase of \$1.79/MMBtu over the projection filing. The mid-course filing's price estimate for natural gas includes transportation costs and basis.

As indicated in Table 3, Gulf shows a decrease in system efficiency compared to original projections as measured by btu/kwh. Weighted average heat rates increased from 9,704 btu/kwh to 9,927 btu/kwh. Staff will review heat rates and system efficiency as part of the generating performance incentive factor issues for the November fuel clause hearing.

As indicated in Table 4, Gulf projects that its system generation will decrease by 6.3%. The mid-course projection for system generation shows decreases in coal and natural gas generation.

Staff sought to identify the sources of the 2008 under-recovery by fuel type, power sales, purchased power, and all other factors, based on kilowatt hour sales. This breakdown is presented in Table 5.

Table 5 - Estimated Under-recovery and Over-recovery by Source of Kilowatt Hour Sales in 2008		
1	Coal	\$(44,893,999)
2	Natural Gas	(3,040,453)
3	Non-fuel Generation[3]	14,059,279
4	Power Sold	(9,606,809)
5	Qualifying Facilities	(1,464,667)
6	Economy Energy	(17,931,629)
7	Territorial kWh Sales (Sum of 1-6)	(62,878,277)
8	Wholesale kWh Sales	(1,917,110)
9	Jurisdictional kWh Sales (Line 7- Line 8)	(60,961,168)
10	Revenue Variance (Wholesale\Jurisdictional\Rate Class)	(243,852)
11	Uncollected True-up and GPIF for 2008	(297,107)
12	Total June 2008 Projected Under-recovery (Sum of 9 – 11)	(61,502,126)
Source – Schedules E1, E1-B, E3, E6, E7, E8, E9 from 9/4/07, 6/20/08 Mid Course filings, and June 25 Data Request Responses.		

[3] This amount includes \$13,987,282 in natural gas hedging gains, actual and estimated as of May 31, 2008.

Table 5 shows the impact of higher coal prices and other factors in 2008, wherein reprojected 2008 costs exceed reprojected 2008 revenue by $61,502,126.

As shown on Table 5, Gulf projects a significant under-recovery for economy energy purchases. Gulf also projects an under-recovery for power purchased from qualifying facilities. Gulf's purchased power is based primarily on natural gas and is therefore affected by higher gas prices. The higher coal prices due to the force majeure event also move Gulf down in the Southern system's dispatch order and contribute to the under-recovery in power sold.

Compared with other Florida IOUs, Gulf depends more on coal-fired generation. Electric utilities primarily purchase coal through long-term contracts. When a supplier cannot or does not meet its contractual obligation, utilities have to find replacement coal in the spot market and pay current market prices. In this case, spot prices for coal have increased significantly during 2008 due to increased U.S. exports of coal. Increasing world-wide demand for coal and the declining value of the dollar have contributed to the increase in U.S. exports. The increase in exports tightens supply and increases coal prices.

Overall, staff believes the primary cause for Gulf's projected under-recovery is that its current coal prices are higher than originally projected. The higher coal prices affect coal generation and power sold. The secondary cause is higher natural gas prices causing an under-recovery in purchased power. Gulf's gas hedging gains more than offset the under-recovery in natural gas generation.

Consistent with our review of previous mid-course corrections, our analysis of Gulf's petition includes an examination of whether the assumptions (i.e. fuel prices, retail energy sales, generation mix, and system efficiency) that Gulf used to support its re-projected fuel costs appear reasonable. For purposes of calculating the mid-course correction, staff believes Gulf's assumptions are reasonable. Gulf used these updated assumptions to develop future cost and revenue estimates. During the scheduled November, 2008, hearing in this docket, staff will compare these estimates to actual data, and then apply the difference to next year's fuel factors through the true-up process. In particular, staff will review Gulf's due diligence efforts regarding the force majeure events with its coal supplier. This will be the subject of staff discovery. Any over-recovery that Gulf may collect through its approved fuel factors will be refunded to Gulf's ratepayers with interest. Staff will address whether Gulf's actions to purchase fuels cost-effectively were appropriate, including its actions to hedge fuel prices, at our November, 2008, evidentiary hearing.

Options for Mid-course Correction to Fuel Factors

The fuel adjustment charge is designed to allow utilities to recover fuel costs on a projected basis. As the recovery period unfolds, actual and reprojected costs as a rule 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 the past, the Commission has considered the stability of fuel factors within the year and between years (e.g. Order No. 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 because the subsequent year's fuel factors would reflect both the higher fuel prices and the prior year's under-recovery. In addition, interest would accrue on the under-recovery.

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.

Compared with the recent mid-course correction petitions filed by PEF and FPL, Gulf's under-recovery percentage is significantly larger - 18.39% - compared with 10.84% for PEF and 12.90% for FPL. Gulf's mid-course petition is based on increasing coal prices due to a force majeure event, whereas PEF's and FPL's petitions were based on increasing oil and gas prices. Finally, in contrast with PEF and FPL, Gulf proposes to spread the under-recovery over 2008 and 2009, rather than recover the full amount in the remaining months of 2008.

Table 6 shows the recent trend in Gulf's fuel factors and 1,000 kWh residential bills.

TABLE 6 – TREND FOR GULF'S FUEL FACTORS AND RESIDENTIAL BILLS						
	2004	2005	2006	2007	2008 Current	2008 Proposed
Levelized Fuel Cost Recovery Factor, ¢/kWh	2.459	2.822	3.076	3.938	3.954	5.073
Residential 1,000 kWh Bill, $	80.08	85.13	92.48	101.87	102.22	113.76
Source: Orders approving factors issued in December/January 2004-2008, Mid-course Petition Schedule						

[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.

As Table 6 indicates, Gulf's fuel factors and Gulf's residential class 1,000 KWH bill increased steadily during 2004 through 2008.

In its petition, Gulf proposes to reduce the rate impact upon customers by recovering the projected under-recovery over the remaining four months in 2008 and the twelve months of 2009. Based on its current projections for fuel, environmental, and capacity costs, Gulf proposes to increase its fuel factors for 2008 to enable it to recover $41,341,302 (52%) of the projected $76,390,153 under-recovery during September through December 2008. The remaining portion of the 2008 under-recovery, $35,048,851, would be deferred to 2009 and recovered through 2009 fuel factors. Recovering 52% of the under-recovery in 2008 and 48% in 2009 would keep the levelized fuel factor approximately the same for the remainder of 2008 and for 2009. Under Gulf's proposal, for 2008, the monthly 1,000 kWh residential bill will increase from $102.22 to $113.76, an increase of $11.54. Gulf expects the January through June 2009 bill to be $116.59, reflecting all clause adjustments. Gulf expects the July through December 2009 bill to be $113.95, reflecting the elimination of the storm cost recovery surcharge.

To allow consideration of all the above points regarding rate impact, staff requested Gulf to provide estimated bill impacts and associated rates/factors for four possible mid-course correction recovery options (scenarios). Staff notes the storm surcharge amount of these bills, $2.57, will end with June 2009 bills pursuant to Gulf's stipulation[5] with parties. Gulf's response is attached as Attachment A.

The order in which the mid-course correction recovery options are presented is consistent with the order of options appearing in staff's recommendations for PEF's and FPL's mid-course corrections. Gulf is proposing and staff is recommending Option C. The four options are:

Option A 2008 Recovery: Gulf collects the projected under-recovery amount ($76,390,153) during the last four months of 2008.

Option B 2009 Recovery: Gulf collects the projected under-recovery amount in 2009 fuel factors.

Option C Approve Gulf's Petition: Gulf collects $41,341,302 (52%) of the projected under-recovery during September through December of 2008 and collects the remaining $35,048,851 (48%) in 2009.

Option D Recover Over 16 Months: Gulf collects the projected under-recovery over 16 months, from September 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. It is apparent that both the 2009 fuel factor increases and 2009 bill impacts under Options B and D are high relative to Option C. Option A would have lower fuel factors and bills in 2009 compared to Option C but the tradeoff is that Option A would have dramatically higher bills and rates for the last four months of 2008. Option

[5] Order No. PSC-06-0601-S-EI, issued July 10, 2006, in Docket No. 060154-EI, In re: Petition for issuance of storm recovery financing order pursuant to Section 366.8260, F.S. (2005), by Gulf Power Company.

C (52% in 2008, 48% in 2009) suggests step increases in bills in September 2008 and January 2009. Option C's appeal is that it would reduce the full rate impact of higher fuel costs in the short-term while also allowing customers the opportunity to adjust their budgets for the eventual increases in 2009. The drawback for Option C, as with Options B and D, is that additional interest costs will result from the deferral. Option C offers the greatest degree of stability in fuel factor and bills from 2008 to 2009. No matter which option is selected, Gulf's 2009 rates and bills are projected to be higher than any time in the past.

Upon review of the projected rate changes and bill impacts under the four different options, staff believes that Gulf's requested mid-course correction should be approved as filed. Staff believes Gulf's proposal (Option C) offers the greatest degree of rate stability of the four options presented based on the best available information at this time. Staff's considerations include:

1. Levelized Bills – If the mid-course correction is approved as filed (Option C), Gulf's customers' bills are expected to stay at about the same level from September 2008 through December 2009. Under Option C, the highest level of Gulf's bill during the 2008-2009 period ($116.59) will be significantly lower than the highest level of Gulf's bill under any of the other options (Option A – $124.56, Option B - $120.13, Option D - $118.48).

2. Prevent Possible Compound Increase in 2009 Fuel Factors - If the 2008 final true-up amount is a high under-recovery, deferring the mid-course correction amount under Options B, C, and D would compound the 2009 fuel factor increase. This could result from a number of events, such as higher natural gas prices if there is a Gulf of Mexico hurricane during the latter half of 2008. While Option A would prevent this possible compounding effect, staff notes that Gulf, being primarily coal based, is less susceptible to natural gas price increases compared to other Florida IOUs.

3. Gulf'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 and capacity costs recovery increases, are projected to contribute to additional bill impacts. In particular, environmental costs are projected to increase by $2.39 per monthly residential 1,000 kWh bill. While increases in 2009 non-fuel rates might provide a reason to avoid a 2008 fuel cost deferral to 2009, staff notes that Gulf, unlike earlier mid-course petitions from PEF and FPL, does not have nuclear charges applying to the capacity clause nor does it project changes to its base rates in 2009. Further, pursuant to its stipulation, Gulf's storm surcharge will end in June 2009. The storm surcharge amount for the monthly residential 1,000 kWh bill is $2.57.

4. Reduced Interest - If the Commission approves the requested mid-course correction as filed, Gulf's customers will pay interest on the deferred

portion of the under-recovery. Staff estimates the interest amount to be $829,787. This interest amount is small compared to Gulf's total fuel revenue. Interest costs could be avoided if Gulf collected the projected under-recovery over the last four months of 2008; however, the rate impact would be significant and the bills would not be stable during September 2008 through December 2009.

5. Accurate Price Signals – While Gulf's proposal would send better price signals than deferring the entire amount, approval of Gulf's requested mid-course correction will not bring fuel factors fully in line with current fuel costs. However, Gulf's proposal would allow customers a transition to what may be an extended period of higher fuel costs.

Conclusion

Staff believes that Gulf's basis for requesting the proposed mid-course correction is appropriate. Actual and projected coal and natural gas cost increases indicate that Gulf's current estimated under-recovery is reasonable. Staff considered four options for implementing the rate adjustments, and believes Option C (Approve the Mid-Course Correction as filed) is the best overall option, especially considering rate stability. Staff will continue to conduct discovery on the actual and estimated expenditures of Gulf and conduct a thorough review of costs in preparation for the November 2008 fuel hearing.

To promote rate stability, staff recommends the Commission approve Gulf's requested mid-course correction to its 2008 fuel factors. Gulf's proposed fuel and purchased power cost recovery factors by rate class for the period September through December 2008 are shown in Attachment B.

Issue 2: What is the appropriate effective date for Gulf's revised cost-recovery factors?

Recommendation: If the Commission approves Issue 1, the new factors should become effective with Gulf's first billing cycle in September 2008. (Draper)

Staff Analysis: Gulf has requested that the new factors become effective with the first billing cycle in September 2008. An effective date of the billing cycle in September ensures that all customers are billed under the new factors for the same amount of time.

Starting with the first billing cycle in August 2008, Gulf will notify its customers of the mid-course correction through a bill insert. The August mailing date ensures that customers receive a 30-day notice that fuel factors will change starting in September. Specifically, the notice will state Gulf's total under-recovery amount, the effective date of the revised cost recovery factors, and the impact on a 1,000 kWh residential bill. Staff has reviewed the notice.

Providing customers with a 30-day notice period prior to implementing new fuel factors as a result of a midcourse correction is consistent with the Commission's past decisions.[6] Providing 30-days' notice allows customers the opportunity to adjust their usage in light of the new factors.

Staff believes that Gulf's proposed effective date and plan to notify its customers are appropriate and should therefore be approved.

[6] 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 3: Should this docket be closed?

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

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

GULF POWER COMPANY

RESIDENTIAL BILL COMPARISON

FOR MONTHLY USAGE OF 1000 KWH

PROPOSED FOR THE PERIOD OF: SEPTEMBER 2008 - DECEMBER 2008

AND ESTIMATED FOR: JANUARY 2009

2008 MIDCOURSE ANALYSIS

	2008	**OPTION A**						**OPTION B**					
	Current Approved	2008 Recovery Collect $76 in Sep. - Dec. '08						2009 Recovery Collect $0 in 2008 & $76M in 2009					
		Sep. - Dec. 2008	% change	Jan. - Jun. 2009	% change	Jul. - Dec. 2009	% change	Sep. - Dec. 2008	% change	Jan. - Jun. 2009	% change	Jul. - Dec. 2009	% change
Base Rate	$49.30	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%
Fuel Cost Recovery	39.75	61.53	54.8%	48.09	-21.8%	48.09	0.0%	39.75	0.0%	54.53	37.2%	54.53	0.0%
Capacity Cost Recovery	2.71	2.71	0.0%	3.00	10.7%	3.00	0.0%	2.71	0.0%	3.00	10.7%	3.00	0.0%
Energy Conservation Cost Recovery	0.97	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%
Environmental Cost Recovery	4.36	4.36	0.0%	6.75	54.8%	6.75	0.0%	4.36	0.0%	6.75	54.8%	6.75	0.0%
Storm Surcharge	2.57	2.57	0.0%	2.57	0.0%	0.00	-100.0%	2.57	0.0%	2.57	0.0%	0.00	-100.0%
Subtotal	$99.66	$121.44	21.9%	$110.68	-8.9%	$108.11	-2.3%	$99.66	0.0%	$117.12	17.5%	$114.55	-2.2%
Gross Receipts Tax	2.56	3.12	21.9%	2.84	-9.0%	2.77	-2.5%	2.56	0.0%	3.01	17.6%	2.94	-2.3%
Total	$102.22	$124.56	21.9%	$113.52	-8.9%	$110.88	-2.3%	$102.22	0.0%	$120.13	17.5%	$117.49	-2.2%
		2008 Interest $245,870						2008 Interest $564,734					
		2009 Interest $3,034						2009 Interest $942,320					
		Total Interest $248,904						Total Interest $1,507,054					

Attachment A
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Docket No. 080001-EI
Date: July 17, 2008

GULF POWER COMPANY
RESIDENTIAL BILL COMPARISON
FOR MONTHLY USAGE OF 1000 KWH
PROPOSED FOR THE PERIOD OF: SEPTEMBER 2008 - DECEMBER 2008
AND ESTIMATED FOR: JANUARY 2009
2008 MIDCOURSE ANALYSIS

	2008 Current Approved	OPTION C: Approve Gulf's Petition. Collect $41M in Sep. - Dec. '08 & $35M in 2009						OPTION D: Recover over 16 months. Collect $76M evenly over 16 months					
		Sep. - Dec. 2008	% change	Jan. - Jun. 2009	% change	Jul. - Dec. 2009	% change	Sep. - Dec. 2008	% change	Jan. - Jun. 2009	% change	Jul. - Dec. 2009	% change
Base Rate	$49.30	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%	$49.30	0.0%
Fuel Cost Recovery	39.75	51.00	28.3%	51.08	0.2%	51.08	0.0%	45.74	15.1%	52.93	15.7%	52.93	0.0%
Capacity Cost Recovery	2.71	2.71	0.0%	3.00	10.7%	3.00	0.0%	2.71	0.0%	3.00	10.7%	3.00	0.0%
Energy Conservation Cost Recovery	0.97	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%	0.97	0.0%
Environmental Cost Recovery	4.36	4.36	0.0%	6.75	54.8%	6.75	0.0%	4.36	0.0%	6.75	54.8%	6.75	0.0%
Storm Surcharge	2.57	2.57	0.0%	2.57	0.0%	0.00	-100.0%	2.57	0.0%	2.57	0.0%	0.00	-100.0%
Subtotal	$99.66	$110.91	11.3%	$113.67	2.5%	$111.10	-2.3%	$105.65	6.0%	$115.52	9.3%	$112.95	-2.2%
Gross Receipts Tax	2.56	2.85	11.3%	2.92	2.5%	2.85	-2.4%	2.71	5.9%	2.96	9.2%	2.90	-2.0%
Total	$102.22	$113.76	11.3%	$116.59	2.5%	$113.95	-2.3%	$108.36	6.0%	$118.48	9.3%	$115.85	-2.2%
		2008 Interest $393,089						2008 Interest $476,734					
		2009 Interest $436,698						2009 Interest $683,095					
		Total Interest $829,787						Total Interest $1,159,829					

Fuel Cost Recovery Factors by Rate Schedule

Proposed for the period September – December 2008

Group	Rate Schedules*	Fuel Cost Factors ¢/KWH		
		Standard	Time of Use	
			On-Peak	Off-Peak
A	RS, RSVP,GS, GSD, GSDT, GSTOU, OSIII, SBS(1)	5.100	5.642	4.877
B	LP, LPT, SBS(2)	5.017	5.550	4.797
C	PX, PXT, RTP, SBS(3)	4.975	5.504	4.757
D	OSI/II	5.074	N/A	N/A

*The recovery factor applicable to customers taking service under Rate Schedule SBS is determined as follows: (1) customers with a contract demand in the range of 100 to 499 KW will use the recovery factor applicable to Rate Schedule GSD; (2) customers with a contract demand in the range of 500 to 7,499 KW will use the recovery factor applicable to Rate Schedule LP; and (3) customers with a contract demand over 7,499 KW will use the recovery factor applicable to Rate Schedule PX.