Ruth Nettles

From:	Holsinger, Brame N. [BNHOLSIN@SOUTHERNCO.COM]
Sent:	Friday, March 21, 2008 3:12 PM
To:	Filings@psc.state.fl.us
Subject:	Gulf Power Company's complete set of responses to Staff's Data Request dated March 4, 2008
Attachments:	03-21-08 GP Responses to Staff 1st Data Request in 080001-EI.pdf

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B. 080001-EI

C. Gulf Power Company

D. Document consists of twenty-three (24) pages.

The attached document is a letter to Ms. Ann Cole regarding Gulf Power Company's complete set of responses to Staff's Data Request dated March 4, 2008.

Brame Holsinger

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GULF POWER
A SOUTHERN COMPANY

March 21, 2008

Ms. Ann Cole, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0850

Dear Ms. Cole:

RE: Docket No. 080001-EI

Enclosed is a copy of Gulf Power Company's complete set of responses to Staff's Data Request dated March 4, 2008.

Sincerely,

Susan D. Ritenour
bh

bh

Enclosures

cc w/encl.: Lisa Bennett, Esq. (electronically)
Beggs & Lane
Jeffrey A. Stone, Esq.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: **Fuel and Purchased Power Cost Recovery Clause with Generating Performance Incentive Factor**)

Docket No.: **080001-EI**

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing was furnished by U. S. mail this 21st day of March, 2008, on the following:

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Currently, companies typically file hedging plans for the projected year in September of the current year. Companies also typically file the results of their hedging programs for the true-up year in April of the current year.

1A. What comments does GULF have regarding the timing of reports on hedging activities?

GULF'S RESPONSE:

The Company has no comments on this item.

1B. Should the Commission determine the prudence of utility hedging plans for the projected year?

GULF'S RESPONSE:

The Commission should review and approve the Risk Management Plan for Fuel Procurement filed annually and determine the prudence of actual implementation of the plan.

With this next set of questions, staff is seeking to understand the relationship of fuel procurement and hedging activities.

2A. Does an electric utility's participation in financial hedging activities for residual oil and natural gas make it a more effective purchaser of residual oil and natural gas? Please explain.

GULF'S RESPONSE:

Currently, Gulf's procurement of physical natural gas and price risk mitigation using financial hedges are completely separate activities. The fact that Gulf engages in financial hedging does not impact how physical natural gas is procured or the terms of that procurement activity. Gulf purchases natural gas utilizing firm supply agreements priced at market.

If financial hedging was eliminated as a price risk mitigation tool available to Gulf, Gulf would propose to continue procurement of natural gas in the same manner as it does today.

Gulf believes that physical price hedging through the utilization of fixed price gas procurement agreements would make it a less effective purchaser of natural gas. Physical price hedging introduces unacceptable levels of supply risk into gas supply agreements.

2B. Does an electric utility's participation in financial hedging provide it with information that allows it more accurate and timely price discovery and enhanced ability to evaluate specific deals and proposals from suppliers?

GULF'S RESPONSE:

No, that information would be available regardless of participation in a financial hedging program.

NOTE: Please refer to the attached tables and graphs for the remaining questions. Table 1 shows NYMEX Last-Trading-Day Settlement Prices for the month-ahead and the following 17 months, for June 1996 through January 2008. Staff views the month-ahead price as the "current market price." Table 2 shows the differences between the month-ahead settlement price and comparable month's futures prices for from one to 17 months. Graphs 1.1 through 1.4 show the month-ahead prices and the same month's futures prices for contracts purchased six, nine, twelve, and fifteen months earlier. Graphs 2.1 through 2.4 show the differences between the prices graphed in Graphs 1.1 through 1.4, or the difference from Table 2, for the six-month, nine-month, twelve month, and fifteen-month columns.

3. Do the prices in Table 1 agree with the historical market prices used by GULF? If your response is no, please explain what the historical market prices are that are used by GULF.

GULF'S RESPONSE:

No. Gulf does not use Gas Markets Weekly for source price data. Gulf uses the Gas Daily prices at Henry Hub, published by Platts, along with daily and monthly NYMEX settlement prices as historical pricing for hedging purposes.

Additionally, because of its physical location, Gulf uses the FGT Zone 3 – Gas Daily price provided by Platts for historical pricing related to the physical purchase of gas. Gas Daily prices are weighted to the volume burned on those days to determine average prices.

4. Does GULF agree that the differences in Table 2 and Graphs 2.1 through 2.4 resemble the hedging gains and losses that would have been realized over the 140-month period, had the Last-Trading-Day Settlement Prices been realized (ignoring transactions costs)? If your response is no, please explain.

GULF'S RESPONSE:

Not necessarily. The resulting settlement is dependent on both the settlement price (assuming last day settlement) and the weighted average price of the initial hedge transactions. Because the weighted average cost is driven by both volume and transaction price(s) for transactions that are completed over a period of time, it is not possible to make such a conclusion.

Gains and/or losses are dependent on the size (volume) and timing of each transaction. Because Gulf sometimes completes hedging transactions years in advance of settlement and each transaction is not completed for the same volume, the weighted average price of all hedging transactions for a particular settlement month would have to be considered. Depending on the volume transacted and the market conditions at the time of each transaction, the weighted average cost could be below or above the last day settlement prices. Therefore, one cannot make a definitive statement regarding gains and/or losses by only reviewing historical market prices.

5. Does GULF agree that, on the average, the differences in Table 2 and Graphs 2.1 through 2.4 resemble the hedging gains and losses that would have been realized over the 140-month period, had the Last-Trading-Day Settlement Prices NOT been (exactly) realized? Explain your response.

GULF'S RESPONSE:

Not necessarily. The resulting settlement is dependent on both the settlement price (assuming last day settlement) and the weighted average price of the initial hedge transactions. Because the weighted average cost is driven by both volume and transaction price(s) for transactions that are completed over a period of time, it is not possible to make such a conclusion.

Gains and/or losses are dependent on the size (volume) and timing of each transaction. Because Gulf sometimes completes hedging transactions years in advance of settlement and each transaction is not completed for the same volume, the weighted average price of all hedging transactions for a particular settlement month would have to be considered. Depending on the volume transacted and the market conditions at the time of each transaction, the weighted average cost could be below or above the last day settlement prices. Therefore, one cannot make a definitive statement regarding gains and/or losses by only reviewing historical market prices.

6. Does GULF agree that during the natural gas "price spikes" in 2000-2001 (all graphs), 2002-2003 (6- and 9-month graphs), and 2005-2006 (all graphs), large gains would have been realized by anyone purchasing futures contracts several months in advance and selling those contracts during the high-price periods? Explain your response.

GULF'S RESPONSE:

Gulf believes that if futures contracts were purchased for months in which prices spiked after the purchase, gains could have been realized by selling those futures contracts at a time when the market prices were above the weighted average price of the purchased futures contracts.

7. Does GULF agree that following the high-price periods, beginning in 2001 and again in 2003, losses would have been realized by anyone purchasing futures contracts several months in advance and selling those contracts during the lower-than-high-price periods (the periods immediately following the high-price periods)? Explain your response.

GULF'S RESPONSE:

Gulf believes that if the weighted average cost of purchased futures contracts was greater than the market price at settlement, losses would have been realized. This would be true regardless of when the futures contracts were purchased.

8. Does GULF agree that immediately following the 2000-2001 and 2002-2003 price spikes, losses would have been realized for only about twelve months? Explain your response.

GULF'S RESPONSE:

Not necessarily. Gulf believes that gains and / or losses are dependent upon the weighted average price of hedging positions as well as the settlement price. Therefore, all hedge transactions for a given hedge month must be taken into consideration, not just transactions entered into during the previous twelve months. The timing and volume of all hedge transactions must be considered, not just market price history.

9. Does GULF agree that between the each of the 2000-2001 and 2002-2003 price spikes and the twelve-month periods immediately following each of those periods, gains and losses would have roughly cancelled each other, and price stability would have resulted for anyone purchasing futures contracts several months in advance and selling those contracts during the lower-than-high-price periods, and using the gains and losses to offset "market price volatility"? Explain your response.

GULF'S RESPONSE:

Not necessarily. Gulf believes that gains and / or losses are dependent upon the weighted average price of hedge positions as well as the settlement price. Therefore, all hedge transactions for a given hedge month must be taken into consideration, not just transactions entered into during the previous twelve months. The timing and volume of all hedge transactions must be considered, not just market price history.

However, Gulf does believe that a consistent, disciplined approach to hedging will result in hedging outcomes that are close to "break-even" over the long-term, as there will be periods of both hedging losses and hedging gains.

10. Does GULF agree that losses are still occurring roughly 24 months after the 2005-2006 price spike? Explain your response.

GULF'S RESPONSE:

Although Gulf does agree that hedging losses occurred in 2006 and 2007, the losses were not a direct result of the "price spike" incurred during 2005-2006. It should be noted that during the past two years, natural gas prices have declined due to both weather and market forces, i.e. back to back mild winters, no hurricane impacts, high storage volumes, along with the collapse of a large energy hedge fund in 2006. The price "dip" during 2006 and 2007 provided our customers lower overall fuel prices during this period. Hedging losses mean that overall fuel costs are lower, and because of the hedging strategy employed by Gulf, our customers were able to take advantage of these market conditions from both a fuel cost perspective and a hedging perspective in that we were able to hedge lower fuel prices for future periods.

11. Can GULF tell us why, roughly 24 months after the 2005-2006 price spike, futures prices are still one to two dollars above their comparable current market prices?

GULF'S RESPONSE:

The market incorporates risk and uncertainty around gas supply and demand into future prices. At this time the perception of the market is that this risk and uncertainty is higher in the future.

12. Should another price spike occur in the near future, with regard to natural gas market prices and futures prices, does GULF think that the period following the spike would resemble the period following the 2000-2001 and 2002-2003 spikes, or the period following 2005-2006 price spike? Why?

GULF'S RESPONSE:

We simply do not know what gas prices may do in the future in response to changes in market conditions. There are many variables that influence the market price of natural gas and there have been fundamental changes in the market since these prior year events occurred.

13. In carrying out hedging activities to achieve reduced price volatility, does GULF regard "volatility" as 1) unknown prices in future periods, or 2) period-to-period price variability?

GULF'S RESPONSE:

Gulf does not regard volatility as unknown prices in future periods. Since the price Gulf pays for the gas it purchases is indexed to a daily FGT Zone 3 price, price volatility would be measured most effectively by determining the standard deviation of this daily gas price over as long a period as reasonable.

14. Generally, the longer the refund/recovery period for refunding over recoveries or recovering under recoveries, the smoother will be the period-to-period recovery factors. Agree? Explain your response.

GULF'S RESPONSE:

All else remaining constant, Gulf agrees that spreading an over or under-recovery amount over a longer period of time will result in a smoothing effect. However, Gulf does not agree with the statement in its entirety due to other factors affecting period-to-period recovery factors, such as changes in the Company's over or under-recovery position and changes in projected fuel costs in future periods.

15. Is this truer for under recoveries than it is for over recoveries?

GULF'S RESPONSE:

No. See response to item no. 14.

16. If an under recovery is extraordinarily small (negative sign, large number of dollars) or an over recovery is extraordinarily large (positive sign, large number of dollars), what benefit is there to ratepayers deferring part of the amount beyond the next immediate recovery period?

GULF'S RESPONSE:

With respect to under-recoveries, deferring large under-recovery amounts into multiple subsequent years will result in lower fuel rates for the immediate projection period. However, the long-term cumulative effects of compounding under-recovery balances could negate any short-term benefit to the ratepayer by carrying large under-recovery balances into years where rates otherwise may have decreased.

With respect to over-recoveries, deferring large over-recovery amounts into multiple subsequent years will result in higher fuel rates for the immediate projection period, and although customers would receive interest on the unrefunded balance, they would not receive the immediate benefit of the refund.

17. As future months draw nearer, if you realize that your natural gas (heavy oil) needs are going to be lower than anticipated when swaps were initiated, do you reverse your short positions to maintain your percentage of hedged MMBtu's (barrels)?

GULF'S RESPONSE:

Not necessarily, we evaluate the economics of the options available and make adjustments to the hedge positions that we believe provide the most benefit to the customer.

Table 3 shows the estimated End-of-Period Total Net True-ups [Column (c)], estimated Total Fuel Revenue [Column(d)], and estimated Fuel Revenue Applicable to Period [Column (f)] for the last five years' reprojected estimates. The table also shows over-recovery percentages based on total revenue [Column (e)] and over-recovery percentages based on applicable revenue [Column (g)]. The percents are also based on reprojected estimates.

18. Do you agree that the amounts in Table 3 are correct for GULF? If not, please provide corrected dollar amounts.

GULF'S RESPONSE:

The Company agrees that the amounts in Table 3 are correct for Gulf.

19. Do you agree that the percents in Column (g) are calculated according to the mid-course percent method adopted in 2007 (Order No. PSC-07-0333-PAA-EI)? If not, please provide corrected percents.

GULF'S RESPONSE:

Gulf agrees, recognizing that the current mid-course methodology adopted in 2007 is applied to periods prior to issuance of the order referenced above.

20. Although none of the four large IOU's have petitioned for mid-course corrections since early 2003, do you agree that during the previous five years, your mid-course percents have been greater than 10 percent, at least at the times that some of the estimated revenues and expenses were "reprojected." If you disagree, please explain.

GULF'S RESPONSE:

Gulf agrees that on two occasions in the identified period, pursuant to the Commission's "mid-course correction" policy, Gulf determined that its estimated end-of-period net true-up amount for fuel and purchased power (energy) costs for the period crossed the applicable 10% threshold and provided the required notice to the Commission regarding this determination. In both instances, Gulf reported to the Commission that it was not seeking a mid-course adjustment to its fuel cost recovery factors.

21. Please indicate the years from 2003 through 2007 in which hedging gains or losses prevented the percents in columns (e) and (g) from being less than -10% or greater than +10% at the time that the estimates were reprojected.

GULF'S RESPONSE:

Gulf recalculated the percentages in columns (e) and (g) by removing the actual hedging settlement amounts that had been included in the reprojected net true up balances in column (c). Gulf's approach does not consider the impact of the monthly over/(under)-recovery amounts and the resulting impact on the monthly interest calculations. Using the described methodology, Gulf determined the under-recovery balance as a percentage of total revenue (column e) was prevented from being higher than 10% at the time of filing reprojections due to the estimated impacts of hedging gains in years 2003 and 2004.

22. Please indicate the years from 2003 through 2007 in which hedging gains or losses caused the percents in columns (e) and (g) to be greater than -10% or greater than +10% at the time that the estimates were reprojected.

GULF'S RESPONSE:

Gulf recalculated the percentages in columns (e) and (g) by removing the actual hedging settlement amounts that had been included in the reprojected net true up balances in column (c). Gulf's approach does not consider the impact of the monthly over/(under)-recovery amounts and the resulting impact on the monthly interest calculations. Using the described methodology, Gulf determined that the hedging loss in the year 2007 caused the under-recovery balance as a percentage of applicable revenue (column g) to be higher than 10% at the time of filing reprojections.