BEFORE THE
GEORGIA PUBLIC SERVICE COMMISSION

IN THE MATTER OF: GEORGIA POWER COMPANY'S FUEL COST RECOVERY (FCR) APPLICATION (FCR-23)

DOCKET NO. 35277

DIRECT TESTIMONY

AND EXHIBITS

OF

RANDALL J. FALKENBERG
PHILIP M. HAYET

On Behalf of the

Georgia Public Service Commission
Public Interest Advocacy Staff

Public Disclosure Version

May 11, 2012

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Exhibits:

I. BACKGROUND AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAMES AND BUSINESS ADDRESSES.

A. Randall J. Falkenberg, PMB 362, 8343 Roswell Road, Sandy Springs, Georgia 30350. Philip M. Hayet, 215 Huntcliff Terrace, Atlanta, GA 30350.

Q. MR. FALKENBERG, WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?

A. I am a utility rate and planning consultant holding the position of President and Principal with the firm of RFI Consulting, Inc. ("RFI"). I am appearing in this proceeding as a witness for the Georgia Public Service Commission ("Commission") Public Interest Advocacy Staff ("Staff").

Q. PLEASE BRIEFLY DESCRIBE THE NATURE OF THE CONSULTING SERVICES PROVIDED BY RFI.

A. RFI provides consulting services in the electric utility industry. The firm provides expertise in electric restructuring, system planning, load forecasting, financial analysis, cost of service, revenue requirements, rate design, and fuel cost recovery issues.

Q. MR. HAYET, WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?

A. I am an electric utility industry consultant and I am President of Hayet Power Systems Consulting ("HPSC"). I am appearing in this proceeding as a witness for the Staff.

Q. WHAT CONSULTING SERVICES DOES HPSC PROVIDE?

A. HPSC provides consulting services related to electric utility system planning, resource analysis, production cost modeling, and utility industry policy analysis.

Q. MR. FALKENBERG, PLEASE BRIEFLY DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.

A. Exhibit No.___(STF-Panel-1) describes my education and experience within the utility industry. I received my Bachelor of Science degree in Physics and a minor in mathematics from Indiana University. I received a Master of Science degree in Physics from the University of Minnesota. At Minnesota I also did graduate work in engineering economics and econometrics. I have also completed advanced study in power system reliability analysis.

I have thirty years of work experience in the electric utility industry. I have worked for utilities, both as an employee and as a consultant, and as a consultant to major corporations, state and federal governmental agencies, and public service commissions. I have been directly involved in a large number of rate cases and regulatory proceedings concerning the economics, rate treatment, and prudence of nuclear and non-nuclear generating plants.

Q. MR. FALKENBERG, HAVE YOU APPEARED PREVIOUSLY BEFORE THE GEORGIA PUBLIC SERVICE COMMISSION ("GPSC")?

A. Yes. Over the past twenty-five years, I have appeared as an expert witness on many occasions, presenting testimony on behalf of the GPSC Staff, the Georgia Textile Manufacturers Association ("GTMA"), and Calpine Corporation.

In 1984, in Docket No. 3498, I testified before this Commission concerning the economics of Georgia Power Company's ("GPC") generation construction program, including the Vogtle, Scherer and Rocky Mountain projects. In 1987, in Docket No. 3673, I testified concerning the planning prudence of the Vogtle nuclear plant. In 1989, in Docket No. 3840, I testified before the Commission concerning the need for and economics of the Scherer Unit. In the same year, I testified concerning Staff's coal procurement audit of Plant Scherer. In 1993, in Docket No. 4132, I testified concerning Demand Side Options for Georgia Power Company. In 1997, in Docket No. 6739, I testified concerning the prudence of GPC's planning related to the Rocky Mountain pumped storage plant. In 2004, I testified in Docket Nos. 15392 and 15393 concerning Georgia Power and Savannah Electric and Power Company's ("Savannah" or "Savannah Electric") purchase of the McIntosh combined cycle plant. With regard to fuel cost proceedings, I testified in Docket Nos. 22403, 23540, and 26794 concerning the Staff's recommendations in GPC's requests for a change in its fuel cost tariffs FCR-18, FCR-19, and FCR-20. In 2011, I testified in Docket No. 34218 concerning Georgia Power's decertification request of Plant Branch 1 & 2, and Mitchell Unit 4C, certification request of a set of power purchase agreements, and the Company's 2011 Integrated Resource Plan Update.

Q. MR. HAYET, PLEASE SUMMARIZE YOUR EDUCATION, QUALIFICATIONS AND APPEARANCES.

A. My qualifications and appearances are provided in Exhibit No.___(STF-Panel-2). I graduated from Purdue University in 1979 with a Bachelor of Science degree in Electrical Engineering. In 1980, I received a Master of Science degree in Electrical Engineering from the Georgia Institute of Technology, with a specialization in Power Systems.

I have more than thirty years of experience in the electric utility industry in the areas of generation resource planning, economic analysis, and rate analysis. After my graduate program, I went to work for Energy Management Associates ("EMA"), an Atlanta based utility consulting firm, in the PROMOD IV™ ("PROMOD") department. PROMOD is a production cost model, similar to the PROSYM model that the Company relied on in this proceeding.

I began my own consulting firm in 1996, Hayet Power Systems Consulting. My clients have included global power plant developers, multi-national oil and gas exploration and power development companies, State Energy Offices, Staffs of Public Utility Commissions, Offices of Consumer Advocates, law firms, and international consulting firms.

Q. HAVE YOU APPEARED PREVIOUSLY BEFORE THIS COMMISSION?

A. Yes I have. In June 2004, I testified on behalf of Staff regarding Georgia Power Company ("Georgia Power" or "Company") and Savannah Electric's 2004 Integrated Resource Planning Studies ("IRP") in Docket Nos. 17687 and 17688. I testified on behalf of Staff regarding Georgia Power's 2007 IRP in Docket No. 24505. I testified on behalf of Staff concerning Georgia Power's Application for Certification of Vogtle Units 3 and 4

(Docket No. 27800) and Georgia Power's Semi-Annual Vogtle Construction Monitoring Reports (Docket No. 29849). With regard to prior fuel cost proceedings, I have testified on behalf of Staff in Docket Nos. 22403 (FCR-18), 23540 (FCR-19), 26794 (FCR-20), 28945 (FCR-21), and 33302 (FCR-22). In 2011, I testified in Docket No. 34218 concerning Georgia Power's decertification request of Plant Branch 1 & 2, and Mitchell Unit 4C, certification request of a set of power purchase agreements, and the Company's 2011 Integrated Resource Plan Update.

Q. IS ANYONE ELSE SUBMITTING TESTIMONY ON BEHALF OF STAFF?

A. Yes. Dr. William R. Jacobs, Jr. will file testimony regarding nuclear plant issues.

II. CONCLUSIONS AND RECOMMENDATIONS

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. In this testimony, we present Staff's position regarding Georgia Power's overall Fuel Cost Recovery ("FCR") rate request. We also present findings and recommendations regarding additional requests Georgia Power has made in this proceeding. In this testimony any discussion of the fuel balance refers to the amount of fuel costs that has either been under-recovered or over-recovered from ratepayers. An under-recovered fuel balance means that the Company has spent more in past actual fuel costs than customers paid for through fuel rates. An over-recovered fuel balance means that the Company charged customers more through fuel rates than was actually spent for fuel costs.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

A. Our conclusions and recommendations are as follows:

1. Staff recommends adoption of the seasonal FCR-23 rates proposed by the Company with some minor modifications. Staff agrees with the proposal to eliminate the Part B rate, and to substantially reduce the Part A rate that was previously approved in FCR-22. Staff supports the new rates going into effect June 1, 2012, and proposes using a June 1, 2012 to April 30, 2014 test year. Any disallowances related to the historical period, approved by the Commission, should be applied to the fuel balance.

2. Staff has developed new rates based on the assumptions that rates would start June 1, 2012, and the rates would be amortized over the June 1, 2012 to April 30, 2014 test year. Staff also examined whether seasonal definitions should be switched in the months of May and September based on the large under/over recoveries that occur in those months. Staff has been unable to conclude that a change is warranted at this time, and recommends a more thorough examination be conducted of this matter prior to the next FCR case. One option would be to examine this in the next base rate case or to establish a separate collaborative process to evaluate this jointly with the Company.

3. The Company supports the continuation of the Interim Fuel Rider ("IFR"), but with modifications, given that the under-recovered balance is expected to be fully paid off by the time FCR-23 rates go into effect. The Company states that the objective of the IFR is to ensure that over/under-recoveries do not substantially deviate from the budget. Staff's recommended IFR language is included in Exhibit No.___(STF-Panel-3).

4. Staff has analyzed outages at Georgia Power's fossil units covering the FCR-23 historical period, and recommends no imprudence disallowances. However, at the time Staff finalized its testimony, it was still waiting on additional discovery responses concerning a couple of outages. If time permits, Staff will attempt to address any concerns it has prior to the hearing. Otherwise, Staff requests that the outstanding items be finalized in FCR-24.

5. Dr. Jacobs has reviewed Georgia Power's nuclear plant availabilities in his testimony, and he recommends a disallowance of $3.206 million related to clearly imprudent nuclear plant outages.

6. In FCR-22, the Company was permitted to widen its target inventory requirement from 45 - 50 days to 40 - 50 days; however, the Commission ordered the Company to review the results to determine the quantifiable benefits, and to determine whether

any coal supply reliability problems occurred. While the Company was unable to quantify any specific benefits, it stated that it provides the Company additional flexibility in managing its inventory levels. The Company also indicated the change has not caused any reliability problems. Staff is generally satisfied with the change, and will continue to monitor the reasonableness of the target inventory levels in future FCR proceedings based on the information the Company files in the Minimum Filing Requirements ("MFRs").

7. The Company proposes to expand the current Time-of-Use ("TOU") FCR tariffs to allow more customers to become eligible for participation. The Company has not analyzed the revenue impact of this expansion, but has set the rate with the intention that it will achieve revenue neutrality. The TOU Pilot Study annual report produced by the Company shows that the revenue produced by TOU rate customers differs little from what would have been produced had those customers used the standard rate. Consequently, Staff does not oppose the expansion of the program, but recommends the Company continue to track the revenue difference. The results can then be used to adjust the TOU rate in future FCR proceedings unless the deviations continue to be immaterial, or can be justified. Given the Company's proposed expansion of the number of rate categories that will become eligible for TOU rates, Staff prefers that TOU FCR rates should remain voluntary at this time. Staff recommends that the Commission should wait until the next FCR proceeding to consider the question of whether customers that are on TOU Base Rates should also be required to be on TOU FCR rates.

8. The Commission should open a rulemaking to review existing MFRs and determine if any additions, deletions, or modifications should be made to the existing requirements. This process should be completed and an updated list of MFRs should be filed with the Commission at least 30 days prior to the next FCR filing. Otherwise, the Company should be required to proceed with the existing set of MFRs in the next FCR proceeding.

9. In FCR-22, the Commission resolved the Plant Branch outage matter that had been held in abeyance since FCR-20 due to litigation that had been pending between Georgia Power and one of its maintenance contractors. The Commission found that there was no imprudent conduct on the part of the Company; however, the Commission required that any costs recovered through litigation should be used to reduce the under-recovered fuel balance. Staff has verified that the $5.5 million settlement with the maintenance contractor has been properly applied to reduce the under-recovered fuel balance.

10. In order to ensure there is no gap in reviews from one FCR case to the next, Staff recommends that the first month of the FCR-24 review period should be March 2012.

11. Staff has completed its Coal Procurement Investigation and filed its report on March 19, 2012. The report included a section containing Staff's recommendations, and another containing comments the Company wrote regarding the report. Most of Staff's recommendations were either agreed to already and noted in the Company's comments that it included in Staff's report, or have been resolved based on discussions with the Company during this proceeding. Exhibit No.____(STF-Panel-5) contains a list of the recommendations and the resolution of each. One item remains to be resolved, and this testimony contains Staff's recommendation to resolve this matter.

12. The Company is permitted to retain a portion of the profits associated with certain types of sales that Southern Company makes on its behalf. The Company is permitted to keep 20% of the profits from Schedule E capacity and energy sales, and 25% from economy/opportunity energy sales. Staff recommends that this sharing mechanism should be re-examined in the next base rate case. Staff's reason for raising this now is to notify the Company that if this recommendation is adopted, then any profits identified during the historic period of FCR-24, will be shared with the Company in accordance with whatever decision the Commission makes in the next base rate case.

III. PROJECT SCOPE

Q. PLEASE DESCRIBE STAFF'S APPROACH TO THIS FCR CASE.

A. Staff followed the same procedures for this FCR case as in prior cases. Staff provided the overall direction of this project, and this testimony represents Staff's positions.

Q. PLEASE DESCRIBE THE OVERALL SCOPE OF DISCOVERY IN THIS CASE.

A. In total, three formal sets of data requests were submitted, including a total of 80 questions, with some having multiple parts. Several informal data requests were also submitted to the Company. Staff had several telephone conference calls with Company personnel, and has reviewed numerous documents obtained from the Company and other public sources.

Q. HOW DID THE MFRs CONTRIBUTE TO THE STAFF'S EFFICIENCY IN CONDUCTING ITS INVESTIGATION?

A. The MFRs continue to play an important role in providing information that is relied on during any fuel cost proceeding. Georgia law allows just ninety (90) days from the time the Company files its request until an order must be issued. This affords very little time to conduct discovery and perform investigations, and therefore, the fact that the MFRs are filed at the same time that the Company makes its FCR filing allows Staff to conduct its investigation in a more efficient manner. In FCR-22, Staff recommended collaborating with the Company to improve the MFRs. Since the Company advanced its FCR-23 filing by about 8 months, the Company did not have time to work with Staff to improve the MFRs, and the Company filing was in compliance with existing requirements.[1] The Company's testimony in this proceeding contains some recommendations concerning changes to the MFRs, and notes that a rulemaking should be opened to formally address these MFR changes. Staff agrees that these should formally be addressed in a rulemaking that should be opened and completed prior to the beginning of the next FCR proceeding, which the Company proposes to file on March 28, 2014.

Q. WHAT STANDARDS AND REGULATORY PRINCIPLES ARE APPLICABLE TO THE DETERMINATION OF THE FCR RATE IN THIS PROCEEDING?

[1] While the Company followed the existing MFR requirements, it voluntarily provided additional information as requested in Staff's Coal Procurement Investigation, which will be discussed further in this testimony.

A. There are three primary standards or tests that are applicable in this proceeding:

1. Were all of the requested costs legally and prudently incurred? Illegal or imprudent costs may not be charged to ratepayers through the FCR.
2. Will the recovery of the requested costs result in just and reasonable rates? Are the requested costs reasonable and is the proposed recovery of these costs just and reasonable in light of circumstances at the time, and the historical cost recovery afforded the Company by this Commission?
3. Are all of the requested costs eligible for the requested method of recovery?

Q. HAVE YOU RELIED ON THESE STANDARDS IN PAST FCR PROCEEDINGS?

A. Yes we have. These are the standards that have been followed in recent FCR proceedings, and additional support for these standards was contained in Staff's testimony that we filed in FCR-19 (Docket No. 23540). No party has objected to the use of these standards, which are based on the "Rocky Mountain" prudence standard, which the Commission first adopted in Docket No. 6739. Concerning the prudence of a past decision, the standard does not necessarily require that the most optimal decision had to have been made, particularly when judged with the benefit of hindsight, only that the decision that was made could now be judged as having been reasonable in light of the information that was known and knowable at the time.

Q. DESCRIBE THE METHODOLOGY PRESCRIBED BY LAW FOR COMPUTATION OF THE DEFERRAL BALANCES.

A. The method used in this case is the same as in prior FCR cases, as prescribed by the following statutes.

O.C.G.A. § 46-2-26 (f) Each utility shall compute, record, and report to the

> commission monthly the most current data available showing the monthly and accumulated over-recovery or under-recovery of actual fuel costs resulting from application of its base rates.
>
> O.C.G.A. § 46-2-26 (g) Each base rate amendment shall include an adjustment based on actual expense to date in order that the accumulated retail fuel costs of the utility shall equal, as nearly as possible, the revenues recovered pursuant to the fuel recovery allowance contained in its base rates. The resulting adjustment in the charge, if any, shall be made to the nearest 0.0001 cent(s) per kilowatt hour.[2]

IV. FCR-23 RATES

Q. WHAT IS THE STATUS OF THE PRIOR PERIOD UNDER-RECOVERED BALANCE?

A. At the start of the period when FCR-22 rates went into effect on June 1, 2011, the under-recovered balance was $331 million. Based on projections of FCR-22 rates and expenses from Georgia Power's FCR-22 filing, the Company anticipated that the under-recovered balance would decline to $152 million by the end of February 2012. Instead, expenses have been much lower than expected, and the under-recovered balance has been completely paid off, and in fact, as of the end of March 2012, there is about a $22 million over-recovered balance. As a result of the under-recovered balance declining even faster than had been expected in FCR-22, and turning positive, the Company decided to file a new FCR case eight months earlier than it had previously planned. According to the

[2] While the statute states base rates, it is referring to the recovery of fuel costs.

Company's proposal, which assumes new rates would go into effect July 1, 2012, the over-recovered fuel balance is anticipated to grow to $132 million.

Q. PLEASE DESCRIBE THE COMPONENTS OF THE EXISTING FCR-22 RATES THAT ARE CURRENTLY IN EFFECT.

A. FCR-22 rates that are currently in effect include two tariff components. This two component rate structure was first introduced as far back as FCR-13. The two tariff components are:

- Part A Rate – This component was designed to collect all projected fuel expenses that the Company assumed it would incur in the future beginning at the time that FCR-22 rates went into effect on June 1, 2011.
- Part B Rate – This component was designed to collect all under-recovered fuel costs that had built up in a cumulative balance prior to the start when FCR-22 rates first went into effect.

Q. WHAT HAS THE COMPANY PROPOSED REGARDING RATES IN THIS FCR PROCEEDING?

A. The Company proposes to eliminate the Part B rate. Based on the Company's proposal, the Part A rate is projected to recover fuel costs over the 24 month period of July 1, 2012 through June 30, 2014. This rate has also been designed to address over/under-recovered costs that occurred prior to the start of FCR-23.

Q. WHAT RATES HAS THE COMPANY PROPOSED FOR FCR-23?

A. The Company's Direct Testimony included the following table on page 5, which presented its proposed seasonal and stratified rates in cents per kWh.

Table 1

	Average Rate	Transmission	Primary	Secondary
Winter (Oct-May)	3.2385	3.1778	3.2244	3.2584
Summer (June-Sept)	3.9082	3.8349	3.8912	3.9323

Q. HOW DO THE PROPOSED FCR-23 RATES COMPARE TO THE CURRENT FCR-22 RATES?

A. The Company's projection for FCR-23 indicates that the proposed FCR-23 rate will be lower than the FCR-22 rate by about 18%, based on a calculation of an average monthly fuel bill for a typical 1,000 kWh residential customer. This amounts to a decrease of about $8.00 per month on that customer's bill.

Staff's FCR-23 Rate Proposal

Q. THE COMPANY HAS PROPOSED THAT FCR-23 RATES SHOULD BEGIN JULY 1, 2012, AND IT PROJECTED THERE WOULD BE AN OVER-RECOVERED BALANCE OF $132 MILLION AT THAT DATE. SINCE THE BALANCE IS PROJECTED TO BE OVER-RECOVERED BY THIS AMOUNT, WOULD STAFF SUPPORT STARTING NEW RATES ONE MONTH EARLY ON JUNE 1, 2012?

A. Yes, Staff would support such a proposal. Given the impact the state of the economy has had on customers over the last few years, Staff believes it is in the best interest of customers to provide rate relief as quickly as possible, thus Staff supports new rates going into effect on June 1, 2012. Staff is mindful, however, that, the balance has been under-recovered for so long that having a relatively small over-recovered balance could provide a cushion in the event that there would be some dramatic future event that might cause fuel costs to substantially increase (e.g. hurricanes causing supply disruptions, increase in world demand for coal, gas price spikes, etc.). Staff proposes modifications to the IFR to address this concern.

Q. HAS STAFF COMPUTED FCR RATES BASE ON A JUNE 1, 2012 EFFECTIVE DATE?

A. Yes, this was done as part of a detailed evaluation that Staff performed to examine the historic fuel balance, the rate structure, and the IFR mechanism. The reason for conducting this evaluation was to determine if there might be a better way to structure the FCR rates and to implement an IFR that would lead to the under or over recovered fuel balance staying as small as possible. To do this, we developed our own spreadsheet to perform a rate analysis that reproduced the Company's Analysis. This was used to conduct sensitivity analyses in a straightforward manner. In all we developed 18 different cases to examine different ways to structure the rates including starting the rates in June, quicker amortization of the fuel balance, changes in seasonal definitions, etc.

Q. IN REVIEWING THE RESULTS, WHAT FACTORS DID STAFF EXAMINE?

A. As mentioned already, Staff's overarching goal was to develop a rate structure and corresponding IFR that would lead to minimizing the fuel balance. It became obvious that any change in the structure or pattern of the rates (no matter how desirable they might seem) produced unintended adverse effects, elsewhere in the rate structure or in the fuel balance. One important finding that we made is that it appears that May and September are key months in terms of over and under-recoveries. It appears that there is a pattern each year in which May generally under-recovers costs by a substantial amount, while September does just the opposite. One reason this may be is that these are months on the border when rates switch from winter rates to summer rates, and vice-a-versa. This suggests that the seasonal definitions for May and September should be reversed. Currently, May is considered a winter month and September is considered a summer month.

Q. IS STAFF SUPPORTING A CHANGE IN THE SEASONAL DEFINITION OF THESE TWO MONTHS AT THIS TIME?

A. No. Staff continues to support the use of seasonal rates, as the use of these rates attempts to ensure there will be a proper matching of revenues with expenses, to send better price signals to customers, and to reduce the likelihood of under-recoveries occurring. In order to achieve this matching of revenues with expenses, it is important to include the appropriate set of months in the seasonal definitions. Thus we believe that the question of whether May and September should be reversed is important. However, we are unable to conclude that it would be appropriate to switch the seasonal definition of these months at this time for two reasons. First, the Company uses these same definitions for other purposes and it would be best to consider further whether it would be appropriate just to change the definitions for purposes of the FCR or whether it should be done across the board. Second, it is possible that what we noticed is a temporary factor that has occurred based on a certain set of circumstances that have arisen in this FCR case. Certainly, one thing that is temporary is the fact that the under-recovered balance was completely eliminated in March 2012. Based on these reasons, and the possibility there may be another explanation of why these fuel balance impacts occur in these months, we believe it would be best to examine it in another process prior to the next FCR case. One option would be to evaluate this further in the upcoming 2013 base rate case, and another would be to establish a separate collaborative process in which interested parties could evaluate this jointly with the Company. Regardless of the process, the evaluation should determine whether it is appropriate to change the seasonal definition, and if so whether the change should be applied consistently to seasonal base rates and seasonal fuel rates.

Q. BASED ON STAFF'S OVERALL ANALYSIS, WHAT IS STAFF'S RECOMMENDATION FOR FCR-23 RATES?

A. First, Staff recommends that the rate be recomputed under the assumption that new FCR-23 rates will go into effect in June 2012. Second, we recommend that the projected test period cover 23 months ending April 2014. This will allow the possibility that when new rates go into effect in FCR-24, the first month (May 2014) could begin as the start of the summer period and that a full summer cycle would be included in that period. This would also allow a redefinition of May as a summer month, if that is determined to be appropriate at that time.

Q. HAS STAFF RECOMPUTED THE RATES UNDER THESE ASSUMPTIONS?

A. Yes, Table 2 compares the rates Staff developed to the Company's.

Table 2

Company's Proposed Rates

	Average Rate	Transmission	Primary	Secondary
Winter (Oct-May)	3.2385	3.1778	3.2244	3.2584
Summer (June-Sept)	3.9082	3.8349	3.8912	3.9323

Staff's Recommended Rates

	Average Rate	Transmission	Primary	Secondary
Winter (Oct-May)	3.1715	3.1120	3.1577	3.1910
Summer (June-Sept)	3.9743	3.8998	3.9570	3.9988

This reflects a very small change to the rates that the Company proposed and still results in about an 18% reduction from FCR-22 rates, and about an $8 per month decrease in an average monthly residential customer bill based on 1,000 kWh per month usage, and averaged over a 12 month period.

Q. HAVE YOU COMPARED THE FUEL BALANCE UNDER THE TWO DIFFERENT RATE ALTERNATIVES?

A. Yes. Figure 1 compares a projection of the fuel balance under the Company's proposed rates versus Staff's. Since the test year periods are different, the chart shows the projected balance amounts for the months that are part of the relevant test year periods.

Begin Trade Secret

Figure 1

REDACTED

End Trade Secret

Staff prefers its proposal for the fact that the rates begin in June 2012, and because it results in a lower over-recovered fuel balance for every month of the period.

Q. WHAT IS THE IMPACT OF THE NEW RATES ON CUSTOMERS?

A. Assuming energy consumption in the prior year was similar, if a customer were to compare their bill from June 2011 to their bill from June 2012, the customer would see a sizable reduction in their fuel bill (over 16%). However, with rates going into effect one month early on June 1, 2012, it is possible that customers will not notice the significant rate decrease when they compare their May 2012 bill to their June 2012 bill. The reason is that their May 2012 bill will have been based on a winter FCR-22 rate, while their June 2012 bill will be based on a summer FCR-23 rate.

Plant McDonough Pipeline Related Costs

Q. DID STAFF INCLUDE THE RECOVERY OF THE PLANT MCDONOUGH PIPELINE DEFFERAL COST IN THE RATES STAFF DERIVED?

A. Yes. Staff allowed these costs to be recovered beginning June 1, 2012. The Commission's order in Docket No. 24506, dated September 10, 2010, permitted a regulatory asset to be setup to capture certain pipeline related costs associated with the firm transportation of natural gas to the new Plant McDonough combined cycle units that were incurred during the period that the units were delayed. The order stated that the costs were to be deferred to when a fuel rate change occurred after December 2012, and that the costs should be fully collected by 2015.

Q. IS THERE A REASON STAFF STARTED RECOVERY OF THESE COSTS PRIOR TO DECEMBER 2012, WHICH IS WHEN THE COMMISSION ORDERED RECOVERY TO BEGIN?

A. Only that the Company also developed its rates by assuming the pipeline related costs would be recovered beginning the first month that the new rates go into effect. The Company provided the following justification for this: 1) the Commission has demonstrated a desire to keep the fuel balance from being under-recovered, and this would be in keeping with that objective, 2) since there already is going to be a large reduction in the fuel rate, this would be a good time to include a cost that would only reduce the rate reduction a small amount, and 3) at the time the Commission issued its McDonough order, the Company had planned to file FCR-23 towards the end of 2012, which was around the same time that the Commission stated that the recovery of these pipeline expenses should begin. Now that FCR-23 has been filed early, the Company believes it would be consistent to begin recovering the McDonough pipeline costs when FCR-23 rates go into effect.

Q. WHAT IS STAFF'S RECOMMENDATION REGARDING THIS MATTER?

A. Staff has no preference, and recommends that the Commission should consider whether the Company's justification is sufficient such that it would be willing to allow the Company to deviate from the Commission's Order in Docket No. 24506. The rates that Staff computed in Table 2 above, assume that the McDonough pipeline related costs, approximately $42 million, are recoverable beginning the first month that FCR-23 rates go into effect. Should the Commission decide that the McDonough pipeline costs should be recovered beginning after December 2012, the Company would have to re-compute these rates in a compliance filing.

Time-of-Use Rates

Q. PLEASE PROVIDE BACKGROUND CONCERNING GEORGIA POWER'S PILOT TOU FUEL RATE.

A. Georgia Power proposed a TOU Fuel Rate in FCR-21 to provide more options for customers to control time varying costs related to fuel, that differ significantly between peak and off-peak periods. The purpose of the rate was to provide customers with better price signals and encourage more efficient use of electricity. The Pilot TOU Fuel rate was proposed to be made available to customers that subscribe to the time of use residential base rate tariff and if approved by the Commission, Georgia Power would make the rate available to TOU-REO customers. The Commission's Order in FCR-21 approved the Company's proposed TOU pilot program and ordered that it also be made available to FPA and TOU-MB customers. On September 30, 2011, the Company filed its evaluation of the TOU-FCR pilot program and has reached the conclusion that the TOU fuel rate should continue as a permanent rate. The Company also recommended that the Commission consider making the TOU fuel rate mandatory for all customers being billed under a TOU base rate.

Q. THE COMPANY PROPOSES TO EXPAND THE TIME-OF-USE FCR TARIFFS TO ALLOW MORE CUSTOMER CLASSES TO BECOME ELIGIBLE TO PARTICIPATE IN THE PROGRAM. HAS STAFF EXAMINED THIS ISSUE?

A. Yes. A TOU rate serves three objectives: 1) To more accurately assign costs to customers; 2) To provide better price signals so that customers may adopt more beneficial usage patterns; and, 3) To provide for a more equitable rate structure by providing higher bills for customers who use energy at high cost times and lower bills for customers who use energy at low cost times. One potential unintended consequence may be that the stated goal of revenue neutrality for TOU rates may be compromised. This is currently being monitored by the Company and Staff.

To evaluate this issue, the Company has tracked the revenues of the pilot TOU customers and compared their total revenue to that which would have occurred with the standard FCR rates. The results filed in the September 2011 report indicate inconsequential differences in revenue for participating customers as compared to the standard rate. For the participating residential customers the standard rate would have produced $558,990 for the 12 months ended June, 2011, while the TOU-FCR rate produced $557,817. This amounts to a difference of -$1,173 or -0.2%.

For larger customers the standard rate would have produced $35,871,067 while the TOU-MB & FPA rates produced $35,727,642, resulting in a revenue difference of -$143,425 or -0.4%. These revenue differences are not sufficient enough to justify any particular remedy at this time.

Q. HAS THE COMPANY DECIDED TO EXPAND THE OFFERING OF THE TOU-FCR TO ADDITIONAL RATE CLASSES?

A. Yes. Under the Commission approved TOU-FCR Pilot program, only those customers served under TOU-REO, TOU-MB (Multiple Business), FPA (Fixed Price Alternative), and the newly created TOU-RN (Revenue Neutral) rates were eligible and participated in the pilot. In this FCR proceeding, the Company has now proposed to expand its offering of the TOU-FCR to customers served under TOU-PEV (Plug-In Electric Vehicle), TOU-EO (Energy Only), TOU-GSD (General Service Demand), TOU-SSD (Special Service Demand), TOU-HLF (High Load Factor), MLM (Multiple Load Management), TOU-SC (Supplier Choice) and FS (Farm Service) rate classes.

Q. HAS THE COMPANY PERFORMED ANY ANALYSIS TO DETERMINE THE IMPACT OF EXPANDING ELIGIBILITY OF THE PROGRAM AND WHETHER IT WILL REMAIN REVENUE NEUTRAL?

A. No. In response to STF-HPSC-2-10, the Company stated that the success of the program so far justified its expansion and no analysis of revenue effects had been performed. Staff did, however, review the rate design and does agree that (based on the assumed usage patterns) the rate is intended to be revenue neutral.

Q. DOES THIS RAISE ANY CONCERNS?

A. Yes. Staff remains concerned that the goals of the program be met, including revenue neutrality. However, some of the new categories of eligible loads (for example Plug-In Electric Vehicles) are obviously rather difficult to forecast at this time. Further, given the current results, Staff does not object to the expansion of the program. However, the Company should continue to track the revenue differences and consider using the deviations to adjust the TOU rates in the next FCR, unless they can be shown to be immaterial or otherwise justifiable.

Q. DOES STAFF ALSO SUPPORT THE COMPANY PROPOSAL TO MAKE THE TOU RATE MANDATORY FOR ALL CUSTOMERS THAT ARE ON A TOU BASE RATE?

A. No. Given the Company's proposed expansion of the number of rate categories that will become eligible for TOU rates, Staff prefers that TOU FCR rates remain voluntary at this time. Staff recommends that the Commission wait until the next FCR proceeding to consider the question of whether to make it mandatory for customers that are on TOU Base Rates, to also be on TOU FCR rates.

V. HISTORIC PERIOD REVIEW

Q. DESCRIBE THE HISTORIC PERIOD REVIEW UNDERTAKEN IN THIS PROCEEDING.

A. This process consisted of a review of discovery responses and information supplied in MFRs, and conferences with Staff and the Company, including a review of the Coal Buy Books at the Company's premises on April 5, 2012. Furthermore, conference calls were held with the Company on May 1 and May 7, 2012 in order to expedite the process of answering some of Staff's questions including those regarding the historic period.

Q. WHAT IS THE HISTORICAL REVIEW PERIOD FOR THIS PROCEEDING?

A. The Company's MFRs covered the 13-month historical period of February 1, 2011 through February 29, 2012.

Q. WHY WAS THIS REVIEW PERIOD CHOSEN?

A. The review period is consistent with a prior order, the Commission's Order in FCR-20, which stated:

> **ORDERED FURTHER**, that in the next FCR-21 case, the Company will provide historical Minimum Filing Requirements beginning with the last month reviewed by Staff in this docket so that there is no gap in the reviews, and, unless otherwise ordered by the Commission, the Company will continue that practice in subsequent FCR cases.

Q. SHOULD THIS PRACTICE CONTINUE?

A. Yes it should. As the order states this practice ensures that there will be no gap in the reviews from one FCR case to the next. Therefore, the first month of the FCR-24 historic review period should be March 2012.

<u>Historic Variance Analysis</u>

Q. HAVE YOU CONDUCTED A VARIANCE ANALYSIS TO BETTER UNDERSTAND WHAT DRIVERS IMPACTED FUEL COST RESULTS DURING THE HISTORIC PERIOD?

A. Yes. In addition to reviewing the variance analysis that the Company provided in MFRH-2, we also performed our own analysis. Table 3 presents a comparison of the FCR-22 budget sales and requirements to the actual sales and requirements over the historic period of February 2011 through February 2012.

Begin Trade Secret

Table 3

Supply and Requirements - Budget vs Actual (MWH)
February 2011 - February 2012

REDACTED

End Trade Secret

Table 3 shows that Actual Total Requirements and hence Total Supply was 6.1% less than budget. Territorial Load nearly matched budget, while decreases in External Sales and Losses accounted for most of the difference in Actual Total Requirements being below budget. Due to low gas costs, actual steam generation was below budget by 8.4% and gas-fired generation was nearly 14% above budget. Although steam generation was below budget, steam-fired energy is still critically important to the Georgia Power System as it supplies almost 44% of the Company's energy, which is more energy than provided by all of the Company's nuclear, gas, and hydro resources combined.

Q. PLEASE DISCUSS THE REVENUES AND COSTS THAT OCCURRED DURING THE HISTORIC PERIOD AND HOW THAT AFFECTED THE UNDER-RECOVERED BALANCE.

A. Table 4 below indicates that the Company actually over-recovered more during the historical period than forecast by $156 million. This helped the total under-recovered balance decline more quickly than expected. This was attributed to the following factors.

- Both total revenues and total costs declined compared to budget, however, costs in nearly all cost categories were below budget, and this decline in costs led to a large reduction in the under-recovered balance. Total period revenues fell by $242 million, and total costs fell by $398 million compared to budget.
- Gas generation costs were only $[redacted] million higher than budget, despite the fact that gas generation increased by $[redacted] million compared to budget. Average gas-fired generation cost on a $/MWH basis was budgeted to be $[redacted]/MWH, but actually turned out to be $[redacted]/MWH.
- Coal generation costs were $[redacted] million below budget, amounting to about a [redacted]% reduction in coal generation costs, nearly matching the [redacted]% decrease in the amount of coal energy produced. The actual cost of coal on a $/MWH basis was $[redacted]/MWH, slightly exceeding the budgeted amount of $[redacted]/MWH.
- Pool purchases fell significantly compared to budget, likely due to the lower cost gas generation resources that the Company was able to depend on.
- Hedging losses are embedded in the gas costs in Table 4. The budget anticipated hedging losses would be $[redacted] million, but the actual hedging losses were $[redacted] million, which represents a $[redacted] million increase in these losses. While these hedging losses have a negative impact on customer costs, they have resulted from the fact that gas prices have dropped precipitously and customers have benefited more from the drop in gas prices than the increase in hedging losses.

Table 4

Revenue and Cost - Budget vs Actual (k$)
February 2011 – February 2012

Begin Trade Secret

REDACTED

End Trade Secret

Q. WHAT HAVE YOU CONCLUDED FROM THESE VARIANCE ANALYSES?

A. Georgia Power has been able to over-recover its costs and pay down its under-recovered balance more quickly than had been expected. Furthermore, gas fired generation is increasingly becoming a more important source of generation for the Company and is helping the Company to be able to diversify its fuel supply and be able to depend less on coal-fired energy. This increased utilization of natural gas has come about because of the low cost natural gas that is readily available today and is expected to continue to be into the foreseeable future. This does, however, suggest that the risk of future increases in fuel costs is potentially greater because of the increased reliance on natural gas as a power plant fuel.

<u>Coal Inventory Analysis</u>

Q. ARE THERE SPECIFIC INVENTORY TARGETS THAT THE COMPANY IS OBLIGATED TO MEET?

A. Yes. Prior to FCR-22, the Company was required to keep target coal inventory levels between 45 to 50 days at its coal-fired power plants. In FCR-22, the Company proposed to be able to widen the target range to maintain between 40 and 50 days of inventory at its plants. Staff ultimately supported the proposal as the Company explained it would allow the Company greater flexibility to manage unexpected and temporary swings in inventory levels.

Q. DID STAFF RECOMMEND ANY CONDITIONS BE PUT IN PLACE ALONG WITH THE CHANGE TO THE TARGET INVENTORY LEVEL?

A. Yes. Staff believed it would be best to monitor the impact of the change in the fuel inventory level to determine if in fact it provided the flexibility the Company expected, and if it led to any unintended consequences such as supply shortages resulting in an uneconomic dispatch of the Company's units. While Staff supported the Company's proposal, Staff recommended that the Company be required to report on the impacts caused by the change in the inventory level when it made its FCR-23 filing. The Company provided comments concerning the impacts in its Direct Testimony filed in this case.

Q. IS STAFF SATISFIED WITH THE CHANGE TO WIDEN THE TARGET INVENTORY LEVEL?

A. Yes. The Company did not report any problems managing its coal stockpiles, and it explained that no coal shortages occurred during the historical period. The Company reconfirmed its belief that the larger inventory window continues to provide it with additional flexibility in managing its inventory levels. Staff will continue to monitor the Company's coal inventory levels in future FCR proceedings to determine if this target inventory level continues to be reasonable.

<u>Coal Purchasing</u>

Q. PLEASE DISCUSS YOUR INVESTIGATION OF COAL ACQUISITIONS.

A. Staff's investigation followed the same approach as in prior FCR proceedings, which included reviewing the Company's Buy Books at the Company's headquarters, reviewing MFRs, requesting additional discovery, and participating in conference calls with the Company to discuss specific coal issues. A comprehensive coal procurement audit cannot be conducted during the 90-day FCR proceeding schedule. Because of this, our practice during FCR proceedings has been to review the Company's Buy Books, and follow-up with the Company on any issues of concern to us.

<u>Buy Books Review</u>

Q. HOW DID STAFF ANALYZE COAL PURCHASING ASSOCIATED WITH SPECIFIC CONTRACTS?

A. In addition to reviewing the Coal Buy Books, Staff also reviewed coal purchase information supplied to us in MFRHs 3, 6, 7, 8 and 9, and submitted discovery questions. Our review of the coal Buy Books took place on April 5, 2012 at the Company's headquarters. Along with Phil Hayet, Staff including, Veronica Thomas, Julia Truss, Rob Trokey, Leslie Tench, and Dennis Sewell participated in the review of the Company's Buy Books.

Q. WHAT INFORMATION IS CONTAINED IN THE BUY BOOKS?

A. The coal Buy Books contain documentation concerning the coal solicitations. The solicitations are typically based on the plants served by specific railroads, such as Norfolk Southern ("NS") or CSX. Typically, each Buy Book includes the following documents:

- A copy of Georgia Power's Coal Procurement Strategy;
- A letter explaining why coal purchase contracts were entered into;
- Bid solicitation documentation
- Bids received and analysis of the bids
- Copies of communication with suppliers
- Email confirmation and letter confirmation of purchase agreements
- Contract documentation
- Analysis of restructured contracts (if applicable)
- Purchase orders

Q. DID STAFF CONDUCT THE SAME EVALUATION AS IT HAD PERFORMED IN FCR-22 AND PRIOR PROCEEDINGS?

A. Yes, the process that Staff followed was the same as was performed in FCR-22 and prior proceedings, and has been explained in Staff's testimony in those proceedings.

Q. IN STAFF'S REVIEW OF THE BUY BOOKS, MINIMUM FILING REQUIREMENTS, AND DATA RESPONSES, DID STAFF IDENTIFY ANY CONCERNS?

A. Yes, there were a few items that required further examination. Additional discovery was submitted to the Company and telephone conference calls were held. Of all of the issues Staff investigated, there were two issues that required additional investigation. These included a concern with the performance of [redacted] ("[redacted]"), and a concern with the fact that [redacted]

Q. PLEASE DESCRIBE THE [redacted]

A. This is the second FCR proceeding in which [redacted]. In Staff's testimony in FCR-22, [redacted]

[redacted]. Ultimately, the Company satisfied Staff's concern by explaining [redacted] The overall result was that Georgia Power was able to reduce the customer's cost of this coal.

Q. [redacted]

A. In addition to discovery that Staff submitted, Staff discussed recent events concerning this contract on a conference call with the Company on May 7, 2012, which was helpful to Staff in developing a better understanding of this issue. [redacted]

[redacted]

Q. [redacted]

A. [redacted]

Q. [redacted]

A. [redacted]

Q. [redacted]

[redacted]

A. [redacted]

Q. PLEASE DISCUSS THE SECOND ISSUE.

A. The second issue that required additional investigation was the fact that the Company continues to [redacted] coal suppliers. Staff reported a similar concern in its testimony in FCR-22. For example, in this case, in Buy Book #2, it noted that the Company [redacted]. Staff issued additional discovery to better understand why this coal [redacted]. In the Company's response to STF-HPSC-2-16, the Company explained that it was [redacted] that had been offered because it [redacted] that were necessary before [redacted].

Q. DOES STAFF HAVE AN UNDERSTANDING AS TO [redacted] WILL BE COMPLETE?

A. Based on the Company's discovery response in STF-HPSC-2-16, Staff understands that results from [redacted]. It would seem that if the results are positive, [redacted]

If Staff's understanding is not correct, in other words, if [redacted] to be used at Georgia Power's units will still exist after [redacted], then Staff requests the Company to provide clarification in its rebuttal testimony. Beyond that, Staff plans to continue monitoring this in future FCR proceedings.

<u>Generation Units</u>

Q. DID YOU ALSO REVIEW THE PRUDENCE OF GEORGIA POWER'S FOSSIL PLANT OUTAGES?

A. Yes. We reviewed individual plant outage information provided with the filing in MFRH 4.2, which included outage dates and durations, lost energy, NERC cause codes and a brief description of each event. This information consisted of Root Cause Analyses ("RCAs") performed and documented by Company personnel, which provide a more thorough description of the outage, and includes information gathered via interviews with plant personnel directly involved in the outage. The RCA includes a determination of the cause(s) of the outage, and a description of the actions that were taken to bring the plant back online. The Company also included a table of unplanned fossil plant outages that were at least 50,000 MWH in duration. Additional information in this table included an estimate of the net cost of replacement power associated with the outages. Dr. Jacobs reviewed nuclear plant outages and addresses the prudence of those in his testimony.

Q. DID YOU PERFORM AN ANALYSIS SIMILAR TO THE ONE YOU

PERFORMED IN FCR-22 THAT EVALUATED FORCED OUTAGES AND PARTIAL DERATIONS DUE TO ERRORS ON THE COMPANY'S PART?

A. Yes. Through discovery we obtained information on such outages due to operator errors, O&M personnel errors, and contractor errors, which are designated by the NERC cause codes 9900, 9910, 9920, 9930, and 9940. While we determined that several of the outages related to errors in operation or maintenance were due to a lack of training and other similar problems, none appeared to be consequential. Thus, we determined that there was no material adverse impact to customers because of the errors that occurred as a result of plant operations or maintenance in the FCR-23 historical period.

Q. PLEASE SUMMARIZE HOW YOU CONDUCTED YOUR REVIEW OF THE OUTAGES IN EXCESS OF 50,000 MWH THAT WERE CONTAINED IN THE TABLE IN MFRH-4.2.

A. Staff requested detailed information on each of these outages from Georgia Power, which the Company provided in response to STF-HPSC-2-1. In addition, we discovered that the Company did not include in the aforementioned table an outage for [redacted] that exceeded 50,000 MWH, and so we requested additional information on that outages and an explanation as to why the Company did not include them in the table contained in MFRH-4.2. In its response to Staff's data request, the Company explained that it did not include the [redacted] outage in the table because it was coded as a "maintenance outage", not a forced outage or a deration event.

Q. WHAT ARE YOUR CONCLUSIONS AND RECOMMENDATIONS WITH

RESPECT TO THE [redacted] OUTAGE?

A. Based on our review of the information supplied by the Company, we found nothing unreasonable about the [redacted] outage. However, we recommend that in future FCR filings the Company should include maintenance outages, similar in nature to the [redacted] outage, in the table in MFRH-4.2 showing outages exceeding 50,000 MWH.

Q. WERE THERE ANY OTHER OUTAGES GREATER THAN 50,000 MWH, SHOWN IN THE TABLE IN MFRH-4.2 THAT APPEARED TO BE A PROBLEM?

A. Yes. Georgia Power experienced a significant outage at [redacted] plant that lasted from [redacted] Lost MWH were [redacted] and the Company incurred retail power replacement costs of $[redacted]. The cause of the outage was an [redacted] In its finding regarding this outage, Georgia Power stated:

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

There appears to be a significant question as to the prudence of this outage. The Company's findings indicate that an [redacted], which led to a [redacted] Other information was not [redacted] Our initial review of the information on this outage suggests that it possibly could have been avoided with prudent maintenance procedures. Staff has issued additional discovery on this outage, but the responses may not be available until after Staff has finalized its testimony.

Q. SHOULD THE COMMISSION IMPOSE A PENALTY AND/OR DISALLOWNCE OF COSTS DUE TO IMPRUDENCE ASSOCIATED WITH THIS OUTAGE?

A. We will attempt to address this issue prior to filing our testimony or at hearing, assuming that there is sufficient time for us to complete our analysis. If not, we recommend that Staff be permitted to finalize its recommendations regarding this matter in FCR-24. This is similar to the issue with the Branch unit, which was finalized in a later FCR proceeding from the one in which it was first identified.

Q. DID YOU ALSO REVIEW GEORGIA POWER'S FCR-23 HISTORIC PERIOD FOSSIL UNIT PLANNED OUTAGES?

A. Yes. We reviewed planned outages using data provided in MFRH 4.2 from FCR-23 and compared that information to similar data from FCR-22, FCR-21 and FCR-20.

Q. HOW DID YOU COMPARE THE PLANNED OUTAGE DATA FROM THE PRESENT PROCEEDING TO PAST FCR CASES?

A. First, we began by taking the total lost generation from planned outages for FCR-20 through FCR-23 and divided that by the total number of months to obtain average monthly lost generation for each FCR period. The result of this analysis showed that the average monthly lost generation for the FCR-23 historical period greatly exceeded the average monthly lost generation for the other three FCR periods. For example, the average monthly lost generation for FCR-23 was [redacted] MWH, compared to the average monthly lost generation for FCR-22 of [redacted] MWH. This represented an increase of [redacted] MWH per month.

However, we recognize that there is an issue with this analysis, which Georgia Power pointed out in its testimony in FCR-22. In that testimony, Georgia Power noted that the average monthly lost generation can be unduly affected by the number of summer months in any given FCR historical period. Since the Company tries not to schedule planned maintenance during the summer, if a particular FCR historical period has fewer summer months than another FCR period, the average monthly lost generation will be higher for the FCR period that has fewer summer months. This will result in a comparative measure that is not truly reflective of the amount of generation lost due to planned outages. As a result, we performed a second analysis that reviewed both the number of planned outages and the average amount of lost generation for major planned outages that experienced lost generation of 500,000 MWH or more. Thus, reviewing only major planned outages in excess of 500,000 MWH causes this to be less of an issue, and provides a direct year-to-year comparison of the number and duration of such outages. We reviewed the number of these outages and the average lost generation for the historical periods from FCR-20 through FCR-23. Table 5 below shows the results of this analysis.

Begin Trade Secret

Table 5

REDACTED

End Trade Secret

Q. PLEASE DESCRIBE THE RESULTS SHOWN IN TABLE 5.

A. The first column contains the total number of planned outages that resulted in lost generation greater than 500,000 MWH. For example, in the FCR-21 historical period there were [redacted] such planned outages. It should be noted that the total number of these outages is not necessarily relevant because there is a different number of months covered by the various FCR proceedings. For example, FCR-21 covered a 21-month historical period so it is not surprising that there are a [redacted] of outages in FCR-21 than in FCR-22, which covered an historical period of 15 months. However, it is a little concerning that the number of outages in FCR-23 was [redacted], based only on a 13-month historical period. Still this is not necessarily an indication of a problem, because maintenance requirements change over time due to such factors as environmental requirements, the aging of the units, etc.

The second column presents the average lost generation per outage. Again referring to FCR-21, the average length per planned outage with lost generation greater than 500,000 MWH was [redacted] MWH. The trend from FCR-20 through FCR-23 shows a significant [redacted] of these major outages. The average generation lost per outage [redacted] MWH in FCR-20 to [redacted] MWH in the current FCR-23 proceeding. This represents an [redacted] from FCR-20 to FCR-23.

Q. DO YOU HAVE A RECOMMENDATION WITH RESPECT TO GEORGIA POWER'S PLANNED OUTAGES AS PRESENTED BY THE COMPANY IN THIS PROCEEDING?

A. Yes. There appears to be a sizable increase in the average generation lost per outage for outages greater than 500,000 MWH, although as mentioned previously it may not necessarily be a problem as maintenance requirements do change over time due to many factors including environmental requirements, the aging of the units, etc. Our recommendation at this time is for the Company to explain in its Rebuttal Testimony why there appears to be such a large increase in the length of these major outages going from FCR-20 to FCR-23.

<u>Plant Branch Outage</u>

Q. PLEASE DISCUSS THE STATUS OF THE PLANT BRANCH OUTAGE THAT STAFF FIRST PROPOSED IN FCR-20.

A. In FCR-22, the Commission resolved the matter by finding that there was no clearly imprudent conduct on the part of the Company, however, it did find that the money the Company was able to recover from the maintenance contractor that damaged the Plant Branch Unit 4 boiler, [redacted], should be used to reduce the under-recovered fuel balance. Staff has reviewed the fuel balance in MFRH-14, and has confirmed that the fuel balance has been reduced by [redacted]

Carrying Costs

Q. DID THE COMMISSION PREVIOUSLY AUTHORIZE THE COMPANY TO RECOVER CARRYING COSTS ON UNDER-RECOVERED FUEL COST BALANCES?

A. Yes. In Docket No. 17066 the Commission approved the accrual of carrying costs, calculated with Georgia Power's short-term debt rate for unrecovered fuel costs above the first $15.0 million.

Q. DID YOU REVIEW THE COMPANY'S CARRYING COST CALCULATION?

A. Yes. MFRH-15 shows the computation of carrying costs based on the short-term debt rates during the historic period. For the months of February through November 2011, the interest rates seem reasonable given the economic climate experienced during the historical period. For example, the short-term debt rates were less than 0.3% during these months.

However, beginning in December 2011 and extending through February 2012, the short-term debt rate jumped significantly and ranged from 0.63% to 0.73%. Attachment MFRH-15A showed that the Company began utilizing short-term debt using an interest rate associated with the Eurodollar London Interbank Offered Rate ("LIBOR"). This rate was significantly higher than the other short-term debt used by the Company by nearly 1.0%, or 100 basis points. The use of this LIBOR rate was responsible for the significant increase in the cost of short-term debt, compared to prior months.

In STF-HPSC-2-3, Staff requested the Company to explain the use of this short-term debt denominated in Euros and why it should be assigned to the fuel under-recovery balances. The Company's response stated that this rate "is just one of several types of short term debt the Company has access to" and "is properly counted as part of the Company's short term debt." This answer was not satisfactory to Staff, so Staff requested further information justifying use of these interest rates. The Company responded that it [redacted] so it entered into a $300 million loan for six months based on LIBOR, which has a higher interest rate. The full answer is attached to this testimony as Exhibit No.___(STF-Panel-4)

Q. IS THE COMPANY'S USE OF A SHORT TERM BANK LOAN INSTEAD OF COMMERCIAL PAPER APPROPRIATE?

A. Staff requests that the Company further address this issue in its rebuttal testimony. Specifically, Staff wants to understand why sufficient commercial paper capacity was not available at the time the short term bank loan was taken out. Given the fuel balance was dropping significantly, this should have resulted in less demand for short term financing.

Q. WHAT WAS THE IMPACT OF THE LOAN COMPARED TO COMMERCIAL PAPER?

A. Given the disparity in the cost of the LIBOR rate debt and ordinary commercial paper the additional cost of these loans was more than $[redacted] higher for the term of the loan. However, for FCR purposes the impact was minor. During the portion of the historical period where the LIBOR rate debt was in use (December 2011-February 2012) the fuel balance was very low, and total carrying charges were less than $[redacted] thousand. Consequently, any impact of this debt on the fuel balance has been to this point inconsequential. Further, the impact may be perversely beneficial to customers when the fuel balance became a credit in March 2012 because the carrying charges will reverse and become a credit which will equal the short-term debt rate including the LIBOR rate debt.

<u>Historical Under/Over Recovery Balance</u>

Q. HAVE YOU INVESTIGATED THE STATUS OF THE OVER/UNDER-RECOVERED BALANCE?

A. Yes. Figure 2 below shows the historical trend in the fuel balance beginning May 2007 and includes the Company's projection of the fuel balance based on the Company’s proposed request in this proceeding.

Begin Trade Secret

Figure 2

REDACTED

End Trade Secret

The under-recovered balance was nearly $900 million in March 2007. Between the rate increases that have occurred in recent past FCR proceedings, the drop in natural gas prices since about July 2008, and the impact of the economic downturn that began in late

2007, the under-recovered balance has finally been eliminated, and there is now an over-recovered balance.

Q. HAVE YOU EXAMINED THE HISTORICAL FUEL BALANCE GOING BACK OVER A LONGER PERIOD OF TIME?

A. Yes. Figure 3 below shows the Georgia Power Company fuel balance from January 1998 to present. Once again, the scale of the graph is in millions of dollars and positive values indicate an under-collection. As the chart shows, the fuel balance reached a maximum level of just a bit less than $1 billion in August, 2006. During this period, the average fuel balance has been $372 million, and it was positive more than 95% of the time, and negative less than 5% of the time. Figure 3 also shows how substantially the FCR balance can change in a short period of time. During the period shown, the maximum increase in the FCR balance in a 12 month period was $376 million (the twelve months ended July, 2006)[3]; the maximum decrease was $372 million (the 12 months ended February, 2011). The largest increase in a single month was $92 million,[4] while the largest decrease in a single month was $91 million.

Q. DOES THE PRESENCE OF A LARGE UNDER-RECOVERED BALANCE COST RATEPAYERS MONEY?

A. Yes. Even though short term interest rates have been fairly low over the past ten years, the average balance of $372 million was quite costly. At a 5% annual interest rate, the cost would be $18.6 million per year. Even at a 2.5% average interest rate, the cost

[3] In part this was due to the impact of Hurricane Katrina, which occurred in August 2005.
[4] Excluding the month when the Savannah balance was rolled into the Georgia Power balance.

would be $9.3 million. At the current very low interest rates (less than .5%) the cost would be nearly $2 million per year.

Begin Trade Secret

Figure 3

REDACTED

End Trade Secret

Q. WHAT ARE THE LESSONS LEARNED FROM THIS HISTORICAL EXPERIENCE?

A. First, the fuel balance can change quickly in very substantial and unexpected ways. Second, despite the best efforts of the Commission, Staff and the Company, the fuel balance has been difficult to reduce. When the fuel balance becomes very large, it is difficult to schedule the amortization of the balance over a single test year. As a result, the Commission has at times used a four year amortization period. It has actually taken nearly six years to eliminate the peak under-recovered balance that occurred in mid-2006. Third, much of the recent reduction in the fuel balance was due to fortunate market conditions – gas prices have fallen below previously projected levels in each of the past few FCR cases. The under-collection of the fuel balance has been mitigated and as a result there is now an over-collection.

The Staff has a strong desire to take the necessary steps to maintain as low a fuel balance (either positive or negative) as possible in the future and to do what is necessary to avoid the creation of very large balances again in the future. This has shaped Staff's position in this case, as will be discussed further below.

VI. PROJECTED TEST PERIOD REVIEW

Process/Forecast Overview

Q. WHAT TEST PERIOD DID THE COMPANY PROPOSE FOR FCR-23?

A. The 24 month period ending June 30, 2014.

Q. DESCRIBE THE PROCESS GEORGIA POWER USED TO PREPARE THE FCR-23 PROJECTION OF FORECASTED RECOVERABLE FUEL COSTS FOR THE TEST PERIOD.

A. The projected portion of the FCR is based on an energy budget that was prepared using the PROSYM and FUELPRO production cost models to forecast recoverable fuel costs. The projected costs are then unitized by projected sales to develop the FCR rates.

Q. DESCRIBE PROSYM AND FUELPRO.

A. PROSYM is a detailed production cost model, and FUELPRO is used to develop the fuel cost purchase plan used in the energy budget.

Q. THE TEST YEAR PROJECTIONS ARE TRUED-UP LATER IN THE DEFERRAL BALANCE. DOES THIS MEAN THEY ARE NOT IMPORTANT?

A. No, it does not. In order for rates to be just and reasonable, the best projections possible should be used.

Q. DESCRIBE THE STAFF ANALYSES RELATED TO THE PROJECTED PERIOD.

A. In the MFRPs, the Company filed substantial workpapers related to the development of its projections. From these workpapers we identified certain issues that we have addressed concerning the validity of the overall projections.

Q. WHAT IS THE PROJECTED TEST YEAR INCREASE IN COST BETWEEN FCR-22 AND FCR-23?

A. The budget test period that was used in FCR-22 covered the 21-month period ending February 2013, while the Company is now using a 24-month test period ending June 2014. A comparison of a 21-month and 24-month test period is not particularly useful, so we compared a 12-month period for each budget. The Company projected a total FCR cost in FCR-22 for the 12 months ending May 2012 of approximately $[redacted] billion dollars. In the first 12 months of the FCR-23 test period, the Company is now projecting a total FCR cost of [redacted] billion, which is a decrease in the test period cost of $[redacted] million.

Q. HAVE YOU CREATED A VARIANCE ANALYSIS THAT COMPARES TWELVE MONTHS OF COSTS IN THE FCR-22 PERIOD TO THE FCR-23 PERIOD?

A. Yes. The results are summarized in Table 6 below.

Table 6

Begin Trade Secret

REDACTED

End Trade Secret

Q. PLEASE DISCUSS THE RESULTS OF TABLE 6.

A. Compared to the 12-month FCR-22 period, the 12-month FCR-23 period includes [redacted] GWH more Total Load Requirements. Even though load increases, coal generation does not increase in response. In fact, compared to the FCR-22 period, coal generation declines significantly ([redacted] GWH) primarily due to the availability of low cost gas generation and purchases. Company gas generation increases in FCR-23 by [redacted] GWH, while net pool purchases decrease by [redacted] GWH.

Despite the increase in Total Requirements, total production costs continue to decline by $[redacted] million over the comparable twelve month period. The major difference in costs in the two periods relates to gas fired generation, which on average decreases from $[redacted]/MWH during the FCR-22 period, to $[redacted]/MWH during the FCR-23 period. The Company is continuing to forecast sizable hedging losses, though they are expected to decrease a little from [redacted] million in FCR-22 to [redacted] million in FCR-23.

The analysis also shows a modest decline in the average cost of coal-fired energy from $[redacted]. This is partly due to replacement of some of the higher cost coal contracts with lower cost coal contracts that have recently been entered into.

<u>Coal and nuclear availability</u>

Q. HAVE YOU COMPARED THE COMPANY'S PROJECTED COAL AND NUCLEAR PLANTS EAFS TO THE PLANT'S HISTORICAL PERFORMANCE?

A. Yes. To test the reasonableness of the GPC budget assumptions, we compared projected EAFs from MFRP 4.3 to historical plant performance by unit for the past four year, using data from MFRH 4.3 from the two preceding FCR cases. The Company's projected performance levels border on being significantly higher ([redacted]% or +[redacted] standard deviations) than the historical averages for the individual plants. This does give rise to some concern that the projected figures may be a bit optimistic. In the end, the prudence of the projected planned outages will be based on actual results that will be reviewed in FCR-24. Consequently, we do not propose any adjustment to address this issue, though we do believe the Company should review this data prior to the next FCR proceeding so that this does not contribute to causing the FCR balance being out of line with projections.

<u>Fuel Price Forecast Assumptions</u>

Q. HAVE YOU EVALUATED GEORGIA POWER'S FCR-23 NATURAL GAS PRICE FORECAST?

A. Yes. Figure 4 compares Georgia Power's gas price forecast to a NYMEX projection based on data available on April 17, 2012. The Company's forecast is on average $[redacted]/MMBTU higher than the NYMEX figures primarily due to the fact that gas prices have declined since the Georgia Power forecast was produced. It is also apparent that the gap in price forecasts narrows over time. It is our understanding that the Company uses a 20-day NYMEX average, while the April 17, 2012 data is a NYMEX projection based on a single day. Given the volatility in gas prices it is quite likely that any two forecasts prepared more than two months apart will show similar disparities. If the Company updates its gas price forecast, the resulting change in gas prices would be reflected in the final FCR Part A rates.

Begin Trade Secret

Figure 4

REDACTED

End Trade Secret

VII. ADDITIONAL ISSUES

<u>Interim Fuel Rider</u>

Q. IS STAFF PROPOSING MODIFICATIONS TO THE INTERIM FUEL RIDER ("IFR")?

A. Yes. Please see Exhibit STF-Panel-3.

Q. HOW WOULD STAFF'S PROPOSED IFR FUNCTION?

A. The IFR proposed by Staff provides a mechanism for modest adjustments to fuel rates between FCR proceedings. Any adjustment to fuel rates under the Staff's IFR would require the adjustment to be placed as an item on the Commission's agenda for review and consideration. Under no circumstances would fuel rates change without direct approval of the Commission.

Q. WOULD STAFF'S PROPOSED IFR ALLOW THE COMPANY TO RECOVER EXPENSES THAT THEY ARE NOT ENTITLED TO RECOVER?

A. No. The IFR only impacts fuel rates and revenues and not fuel expenses. All expenses that the Company seeks recovery of through FCR-23 rates would continue to be reviewed and approve or disallowed by the Commission in a subsequent FCR proceeding. The IFR does not impact the Commission's ability to review all of the Company's fuel expenses.

Q. WHAT ARE THE UNDERLYING PRINCIPLES IN STAFF'S DEVELOPMENT OF AN IFR?

A. Rates should be aligned with costs as accurately as possible to all ratepayers in a timely manner. Further, the IFR should be available as a tool to prevent the fuel balance from becoming excessive, whether it be an over or under-recovery.

Q. HOW DOES STAFF BELIEVE THE IFR PROMOTES SOUND REGULATORY POLICY?

A. The IFR proposed by Staff provides a mechanism for modest adjustments to fuel rates between FCR proceedings. This would result in costs being assigned more accurately to all ratepayers. Another important benefit of the IFR is that it would enhance the timely recovery of the Company's expenses. Timely recovery of utility expenses is a critical issue considered by bond rating agencies as well as other investors in assessing the credit worthiness of utilities. All things being equal, a stronger credit rating leads to the utility incurring lower costs of debt and customers being charged lower rates.

Q. PLEASE EXPLAIN THE STAFF'S IFR PROPOSAL.

A. During the FCR-23 rate effective period, the Company shall be required to file with the Commission, at a minimum, the following information when the cumulative over collection or under collection ("fuel balance") exceeds $175 million.

1) For each month of the FCR-23 test period the Company will provide historic (incurred) and projected fuel revenues, fuel expenses, the monthly over or under collected amount, and the cumulative over or under collected balance.

2) A plan to reduce the over or under collected fuel balance over the remainder of the FCR-23 test period.

3) Identify whether the current FCR-23 rates must be adjusted and the size of the adjustment if required.

This information will be filed with the Commission within 20 calendar days from the end of any month when the fuel balance exceeds $175 million in either direction. If the Company requests an adjustment to the current FCR-23 rates, then this request must be submitted to the Commission for review. The maximum cumulative amount that FCR-23 rates can be changed during the FCR-23 test period is 15% in either direction from the original FCR-23 rates approved by the Commission in Docket No. 35277. Thus, the maximum level of FCR-23 rates for the test period will not exceed 115% of the original

FCR-23 rates set by the Commission, and corresponding, the minimum level of FCR-23 rates for the test period will not fall below 85% of the original FCR-23 rates set by the Commission.

Q. PLEASE PROVIDE THE STAFF'S REASONS FOR SELECTING $175 MILLION AS THE TRIGGER REQUIRING THE COMPANY TO MAKE AN IFR FILING.

A. The purpose of the $175 million threshold is to provide a defined trigger point for the Company and Staff to affirmatively address fuel balances proactively between FCR proceedings. This threshold would provide an opportunity to the Commission to prevent the fuel balance from growing unreasonably large in either direction in a timely manner.

Q. THE COMPANY'S PROPOSED IFR USES A TWO TIERED TEST, TRIGGERED BASED ON A BUDGET TO ACTUAL COMPARISON, AND A COMPARISON BASED ON THE OVERALL FUEL BALANCE. WHY HAS STAFF CHOSEN TO SUPPORT AN ALTERNATIVE PROPOSAL?

A. The Company's proposal is complex and Staff requested an analysis showing how the Company proposal would have performed over the past several years. The Company stated that it had not performed any such analysis. Staff attempted to create such an analysis itself. Our analysis did not fully model the proposal, but indicated that the Company proposal would not have been particularly effective during the historical period analyzed. Staff believes that while the budget to actual comparison is a useful "leading indicator" it is the overall fuel balance that is the more important variable. Rating agencies are not generally privy to a utility's budget to actual comparison, and therefore focus on published data, such as the overall fuel balance. Consequently, this is the more significant variable for an IFR.

The Company has every opportunity to review its own internal budget to actual comparisons. If the Company determines that its budget projections are becoming far off base, it could, of course, file a new FCR.

Q. DOES A FUEL BALANCE (WHETHER POSITIVE OR NEGATIVE) IN EXCESS OF $175 MILLION AUTOMATICALLY MEAN THAT THERE WILL BE AN IFR RATE ADJUSTMENT?

A. No. It merely provides a mechanism for the Company to request a change in the fuel rate subject to Commission approval without the necessity of filing a full FCR case. Further, the Company and Staff may determine that the fuel balance deviations are temporary and that no rate adjustment is needed. All the IFR requires is that the Company notify the Commission that the level of the fuel balance has exceeded the trigger and a plan for addressing this problem. That plan may, or may not, include a request for a rate change.

Q. WHY DOES STAFF BELIEVE THAT $175 MILLION FOR OVER AND UNDER COLLECTED FUEL BALANCES ARE REASONABLE THRESHOLD VALUES?

A. The current fuel balance is close to zero and rates proposed by Staff would result in close alignment of fuel revenue and expense for each month of the FCR-23 test period. Staff's projection using the Company's data shows the cumulative fuel balance falling within a range of zero to $100 million for the majority (close to 70%) of the months in Staff's proposed FCR-23 test period. The maximum projected balance in the period is $155 million. Therefore, the $175 million threshold provides ample room during most months.

Staff recognizes that there are six months where the projected under or over recovery exceeds $100 million, and that there is a higher likelihood that the threshold may be reached in those months. However, they are also the earliest months of the FCR 23 rate effective period when the projections used are "freshest" and most likely to provide accurate forecasts. Further, the expected drop in the FCR balance at the start of 2013 suggests any excursion above the threshold is likely to be short-lived suggesting that the implementation of an IFR rate change may be unnecessary.

Q. PLEASE PROVIDE STAFF'S REASONS FOR CAPPING TOTAL CUMULATIVE INCREASES OR DECREASES IN FCR-23 RATES TO 15 PERCENT ABOVE OR BELOW THE ORIGINAL FCR-23 RATES.

A. The 15 percent total cumulative increases or decreases provides the Commission enough leeway to proactively address under- or over-recovery balances in a meaningful manner before they grow unreasonably large, while at the same time, avoiding burdening ratepayers with large changes in FCR rates between FCR proceedings. Staff's review of the Company proposal indicated that a 10% IFR adjustment would have been insufficient to have made a meaningful "dent" in problems associated with the fuel balance over the past several years.

Q. **WHY DOES STAFF BELIEVE IT IS IMPORTANT FOR THE COMMISSION TO APPROVE THE IFR TO ALLOW FOR POTENTIAL ADJUSTMENT(S) TO FUEL RATES BETWEEN FCR PROCEEDINGS?**

A. The vast majority of the Company's fuel costs are subject to fluctuation. The prices paid by the Company for fuel are set in competitive markets and can and have varied widely. By allowing fuel rates to be adjusted between FCR proceedings, fuel rates will better reflect changes in fuel prices incurred by the Company. This will allow for greater accuracy in the allocation of fuel cost to individual ratepayers and will help to mitigate the build-up of large over- or under-collected fuel balances. The Commission is painfully aware that in 2006, the fuel balance reached nearly $1 billion and it has taken over six years to bring the balance down to zero.

Q. IS THERE POTENTIAL RATEPAYER HARM IN HAVING A LARGE FUEL BALANCE?

A. Yes. A substantial problem is that having a large fuel balance makes it difficult, if not impossible for the Commission to amortize the balance in a single FCR test period. This means that the costs incurred during the historical period may not be paid by the same customers who incurred those costs. There is a perfect example in recent history. When the fuel balance reached $995 million in the summer of 2006, there were two large automobile factories in Georgia. Both have now gone out of business. However, new businesses and factories have moved into the state. The customers that went out of business likely never paid the entire amount of fuel cost they incurred while the new customers would have had those costs included in their monthly bills.

Q. IS IT UNREASONABLE FOR RATEPAYERS TO BE SUBJECT TO MODEST FLUCTUATIONS IN FUEL RATES BETWEEN FCR PROCEEDINGS?

A. No. While customers naturally value price stability, they are already exposed to fluctuation in prices for goods and services purchased. The Company's base and fuel rates change with the season. Under the current accounting order the Company's base rates will increase four times between base rate cases. Natural gas bills for many ratepayers in the state are subject to fluctuation due to changes in natural gas prices. Of course, gasoline and food prices have experienced severe fluctuations in the past. Clearly, ratepayers have extensive experience in dealing with fluctuating prices for goods and services. In contrast, the fluctuation of FCR-23 rates under Staff's proposed IFR is subject to hard caps and is quite modest. Finally, the Company offers certain payment plans such as budget billing and flat bill which allows ratepayers to minimize fluctuation in their bills.

<u>Staff's Coal Procurement Report</u>

Q. PLEASE DISCUSS THE PURPOSE AND STATUS OF STAFF'S COAL PROCUREMENT INVESTIGATION.

A. In Docket No. 28945 (FCR-21), the Commission ordered Staff to conduct a focused investigation of the Company's coal procurement practices and to file a report containing Staff's findings, conclusions and recommendations. The purpose of Staff's investigation was to consider the prudence of some of Georgia Power's coal procurement decisions, and to address a series of questions that could possibly lead to recommendations for improvements in an attempt to lower coal procurement costs in the future. Staff filed its report titled, Staff's Investigation of Georgia Power's Coal Procurement Practices ("Report") on March 19, 2012. The Company was given an opportunity to review the report and submit comments which were incorporated into the final report.

Q. DID THE REPORT IDENTIFY ANYTHING CONCERNING GEORGIA POWER'S COAL PROCUREMENT THAT STAFF CONSIDERED TO BE IMPRUDENT?

A. No. While Staff's report discusses various concerns that it had regarding certain decisions the Company made, ultimately Staff did not find anything it considered to be imprudent, and Staff found that Georgia Power's procurement practices are consistent with the peer utilities that Staff examined.

Q. WHAT RECOMMENDATIONS DID STAFF MAKE IN THE REPORT?

A. Staff's recommendations for the Company are found in Staff's Conclusions 4, 5, and 6 in Section VI of the report. Conclusion 4 recommends that the Company supplement its Minimum Filing Requirements in FCR proceedings with additional information. Conclusion 5 pertains to recommendations concerning coal contracts, and Conclusion 6 relates to the use of Illinois Basin coal. Most of the recommendations were either agreed to already and noted in the Company's comments that were included in Staff's report, or have been resolved based on discussions the Company has had with Staff during the course of this proceeding. Exhibit STF-Panel-4 contains a list of the recommendations and provides the resolution of each one. The exhibit indicates that all of the items are resolved except for one.

Q. WHAT ITEM REMAINS TO BE RESOLVED?

A. Conclusion 5a is the only item that remains to be resolved, which is as follows:

> If possible, the Company should attempt to identify a new ultra high risk category and a cost threshold for which the Company would use in decisions to avoid entering into certain high risk contracts. Staff has already noted the difficulty in establishing this policy, and believes that it would have to evolve over time. Staff recommends that the Company could address this further in comments to this document, as well as in the Company's Direct Testimony in the next FCR proceeding.

This was recommended because Staff noted that the Central Appalachian (CAPP) region is an important coal supply region for the Company, and that a significant number of suppliers from that region are listed by the Company as being high risk. Staff believed there were so many high risk suppliers that those suppliers should be re-classified into two categories, high risk, and ultra-high risk. With the single high risk category that the Company has now, it is difficult to discern the difference in the condition of one supplier from the next, given how many there are in the high risk category.

Q. WHAT IS THE COMPANY'S CONCERN?

A. The Company quite understandably is concerned that any attempt to avoid entering into contracts with high risk suppliers could result in an increase in the Company's coal purchase costs and would therefore lead to higher costs to customers. Furthermore, the Company notes that most of the suppliers have met their contractual obligations and therefore, customers have benefitted from purchasing at lower cost from those suppliers.

Q. HOW DOES STAFF RECOMMEND THAT THIS BE RESOLVED?

A. Staff believes that both the Company's and Staff's concerns can be resolved satisfactorily.

Staff agrees that it would not be appropriate at this time to establish a hard and fast rule requiring a specific percentage or amount of coal to be bought from suppliers in different risk categories. Such a requirement would necessitate an analysis to identify the costs and benefits of such a requirement and, given that the current state of the coal market at the present time is a buyer's market, such an analysis is currently unnecessary. However, Staff still believes there would be value in attempting to differentiate coal suppliers between high risk and ultra-high risk. It is likely that additional precautions would be taken before entering into contracts with ultra-high risk suppliers, and it would allow for a better assessment of the riskiness of the Company's portfolio of coal suppliers.

Q. HOW MIGHT SUCH AN ULTRA-HIGH RISK CATEGORY BE DIFFERENTIATED?

A. In response to discovery request STF-HPSC-2-22, the Company discussed that while it did not endorse creating such a category, if such a classification were warranted,

> ...credit ratings derived from Moody's Investor Service, Standard & Poor’s, or Fitch Ratings could be used to establish such a classification. Companies rated from Caa1 to Ca by Moody’s Investor Service, CCC+ to CC by Standard & Poor’s, and CCC+ to CC by Fitch Ratings, or estimated to be within those ratings bands by SCS Treasury could be rated Ultra High Risk. SCS Treasury would use the same process as described in the Company’s response to STF-HPSC-2-21 to analyze a company’s expected rating for non-rated entities.

Staff believes that this would be a reasonable approach to begin with in order to create an ultra-high risk category, and to differentiate it from the high risk category. Staff believes this could be monitored and adjusted as necessary in future FCR proceedings.

Q. WHAT IS STAFF'S RECOMMENDATION REGARDING THIS MATTER?

A. Staff recommends that the Commission should require the Company to establish an ultra-high risk category and consider that additional category when it establishes a risk ranking for each coal supplier. A list of the Company's portfolio of suppliers and their associated risk ranking should be included as part of the Company's MFRs in future FCR proceedings.

<u>Economy Sales Profit Issue</u>

Q. PLEASE DISCUSS THIS ISSUE.

A. In accordance with prior Commission Orders, the Company was permitted to retain a portion of the profits associated with certain types of sales that the Southern Company makes on its behalf. In the 2004 Base Rate Case (Docket No. 18300), the Commission authorized the Company to keep 20% of the profits from Schedule E capacity and energy sales and give the remaining 80% to the ratepayers. These sales are addressed in base rate proceedings and the profits associated with those sales are not included in FCR rates.

Profits from another type of sales, economy energy/opportunity sales, are included in FCR rates, and the Company is entitled to keep 25% of the profits from these sales and give the remaining 75% to the ratepayers (per the Commission's 1989 Order in Docket No. 3840).

Q. WHAT CONCERN DOES STAFF HAVE REGARDING THESE SALES?

A. The question of whether the Company should be entitled to continue sharing in the profits of these sales has arisen in other dockets. For example, as stated above, the capacity and energy sales sharing mechanism was originally set to 60/40, and was revised to 80/20 as a result of the 2004 Base Rate Case. The 75/25 sharing of economy sales profits has never been revised since 1989 when it was initially approved, and Staff believes the time has come for this issue to be re-examined.

Q. IS STAFF REQUESTING ANY CHANGE TO THE ECONOMY SALES SHARING MECHANISM AT THIS TIME?

A. No. Staff recognizes that the Company is entitled to the recovery of economy sales profits that occurred during the historic period based on the authority provided in the prior orders. To disallow historic period costs at this time would not be appropriate. Furthermore, Staff has not completed an evaluation of this matter in order to make a recommendation that would be in the best interests of the ratepayers regarding future costs. For example, Staff believes that it would be best to examine the economy sales sharing and the capacity sales and energy sharing mechanisms together in the upcoming base rate case. In any event, Staff recommends that the Commission should make the Company aware that this is an issue that will be examined further in the next base rate case, and that the Company should be on notice that it may or may not be permitted to continue to share in the economy sales profits when the next FCR proceeding takes place. In other words, whether or not the Company can continue to share in the economy sales profits in the next FCR proceeding will be determined in the next base rate case.

<u>Hedging Program</u>

Q. PLEASE DISCUSS THE NATURAL GAS HEDGING PROGRAM.

A. Staff and the Company are currently actively discussing potential short term and long term modifications to the hedging program.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.