ORIGINAL

REDACTED

REVISED EXHIBIT "B"

060001-EI

REDACTED

CMP ______
COM ______
CTR ______
ECR ______
GCL 1
OPC ______
RCA 1
SCR ______
SGA ______
SEC 1
OTH 1 conf records

DOCUMENT NUMBER-DATE
01889 MAR-3 8
COMMISSION CLERK

Florida Power & Light Company
April 23, 2004

Audit Disclosure No. 1

Subject: Base Costs in Incremental Hedging

Statement of Fact: The company included incremental hedging costs in Schedule A-2 of the Fuel Recovery Cost filing. In the 2002 fuel clause, the company removed $250,000 from the total contractor expenses as base costs that were included in the rate case filing and therefore would be duplicated if included in the incremental costs

According to the company, "the $250,000 included in the 2002 EMT budget covers consultant fees for special projects that are anticipated to occur during each year. At the time the budget was done, there were no specific contracts or invoices associated with the $250,000 as this budget item is for consultant fees anticipated to occur each year."

"The $250,000 offset to the incremental hedging costs for the period of August 2001 through December 2002 was addressed in Kory Dubin's testimony filed August 20, 2002, pages 8 and 9 and identified as Special Project Consultant Costs included in FPL's MFR filing in Docket No. 001148-EI.

"For 2003, FPL did not have any costs related to incremental hedging in the category of Contractor and Professional Services, therefore, FPL did not net any portion of the $250,000."

In the 2003 Fuel Filing, the company removed $300,000 for base costs for technology related expenses and provided support showing that $300,000 was included in the budgeted numbers in the MFR filing for the GenTrader license fees which the company included in January expenses. Actual license fees allocated to the regulated utility were $327,600. The company recorded the net of $27,600 in January expenses. See audit disclosure two.

Opinion: The MFR filing used to set rates contained the $250,000 of consulting fees for special projects and the $300,000 for GenTrader licenses.

The company position implies that since the $250,000 was for consulting fees for special projects and not specifically for a hedging contract that it should not be removed on a recurring basis. However, its response to Audit Request #4 in audit control 02-340-1 of base costs for security and hedging, shows base amounts for 2002 at $250,000 being removed. A decision needs to be reached on whether these costs should be removed on a recurring basis, or whether the company was correct in saying that they should only be removed once because the budget was not specific.

In addition, the recent support provided for the EMT budget for technology costs shows that "FPL's MFR filing contained $300,000 for projected computer license fees." This information was never provided in our last audit. If these fees do relate to hedging, they should be removed from all future incremental filings as part of the base costs. The company did not remove them from the 2002 filing because the GenTrader license fees were not in the 2002 expenses. See disclosure number two for further information on the GenTrader license fees.

Florida Power & Light Company
April 23, 2004

FPL's Response to Audit Disclosure No. 1

FPL's treatment in 2002 and 2003 of the MFR base amounts for consulting fees and GenTrader license fees is appropriate and consistent with the Commission's decisions on recovery of Incremental Hedging O&M Expenses.

BACKGROUND

Incremental Hedging O & M expenses were addressed in last year's fuel proceeding, Docket No. 030001-EI. On December 22, 2003, Order No. PSC-03-1461-FOF-EI was issued as the final order in Docket No. 030001-EI. The Order states:

> "Incremental Hedging Program O&M Expenses
>
> The parties did not contest that FPL's actual and projected operation and maintenance expenses for 2002 through 2004 for its non-speculative financial and physical hedging programs are reasonable for cost recovery purposes. The evidence in the record indicates that since the inception of FPL's expanded hedging program in 2002, FPL has prudently managed the program to increase the sophistication of its market analysis, forecasting, trade monitoring, and risk management capabilities. The evidence further indicates that this increased sophistication facilitates the expansion of FPL's hedging activities on a well-informed and well- controlled basis. Based on the evidence in the record, we find that FPL's actual and projected operation and maintenance expenses for 2002 through 2004 for its non-speculative financial and physical hedging programs are reasonable for cost recovery purposes with the understanding that the expenses for 2003 and 2004 are subject to audit and true-up through the normal course of our fuel and purchased power cost recovery clause proceedings."

Additionally, the Order states:

> "B Base Level for Hedging – Related O&M Expenses The parties did not contest that the appropriate base level for purposes of determining the incremental operation and maintenance expenses for each investor-owned electric utility's non-speculative financial and/or physical hedging program to mitigate fuel and purchased power price volatility are as follows:
>
> FPL: There is no one general base level that would be appropriate for the expanded hedging program. Each category of cost requested for recovery must be evaluated on a case by case, item by item basis to determine what portion, if any, of that category of cost was included in FPL's 2002 MFRs."

Thus, the Order confirmed that the proper focus for evaluating whether an incremental hedging cost proposed for recovery is indeed incremental must be on the level of *that* *particular type of cost* in the MFRs, in order to be sure that FPL would not be double recovering the cost (*i.e.*, recovering it in both base rates and through the fuel cost recovery clause). In defining what constitutes "incremental" for the purpose of allowing recovery of incremental operating and maintenance expenses associated with a hedging program, the Commission has approved in the Hedging Docket (No. 011605-EI) the following procedure:

> "All base year and recovery year FERC sub-account operating and maintenance expense amounts associated with financial and physical hedging activities shall be included in the Fuel Clause Final True-up filing each April during the years 2003 through 2007, including the difference between the base year and recovery year expense amounts, then summed, yielding a total incremental hedging amount which may be compared for cost recovery review purposes to the requested cost recovery amount produced in the Projected Filing for the recovery year."

This procedure confirms that the proper focus is on the specific account where a cost for which recovery is sought has been recorded, not on the costs for the entire range of a utility's operations or a business unit's entire budget. FPL has applied this procedure when seeking recovery of incremental hedging O & M expenses through the Fuel Cost Recovery Clause. The specific evaluations for Consulting Fees and GenTrader License Fees are described below.

CONSULTING FEES

In 2002, FPL recovered $2.7 million for consultant fees associated with its expanded hedging program through the Fuel Cost Recovery Clause. That amount represented the total consultant fees (i.e., Dean & Company, Iconnix, and E-Systems) incurred in connection with the expanded hedging program, reduced by $250,000 that had been included in FPL's 2002 MFRs for Contractor & Professional Services for Special Projects. This $250,000 budget amount was not tied specifically to hedging (e.g., this budget amount could have been used for a non-hedging purpose such as hiring a gas pipeline consultant). Although the expanded hedging program was not contemplated at the time the MFRs were developed and, therefore, the baseline for such expenses could very well have been treated as zero FPL took the conservative approach of netting the entire $250,000 MFR amount for Contractor & Professional Services for Special Projects against the recovery of expanded hedging program consultant fees in 2002.

For 2003, FPL did not seek recovery through the Fuel Cost Recovery Clause of incremental hedging costs related to the category of Contractor & Professional Services for Special Projects. Therefore, there were no recoverable costs against which to net any portion of the $250,000 that had been budgeted in the MFRs.

This approach is consistent with the Commission's directions outlined above concerning how to determine recoverable incremental hedging costs. Each category of cost for which FPL requested for recovery was evaluated to determine the portion, if any, that was included in FPL's MFR filing. This amount was then subtracted from the amount sought for recovery through the fuel clause to ensure no double recovery.

<u>GENTRADER LICENSE FEES</u>

FPL budgeted $300,000 in its 2002 MFR filing for licensing GenTrader. At that time, the GenTrader license allowed for a fixed number of "seats" (i.e., computers utilizing GenTrader), and the $300,000 budgeted amount was for seats that would be used by FPL. Prior to its expanded hedging program, FPL used GenTrader as a tool to determine projected daily and next month fuel burns, day-to-day dispatch decisions and fuel allocation, purchased power and power sales cost projections and general fuel procurement activities. GenTrader was not used for the expanded hedging program in 2002, and the number of seats allowed under the existing license was adequate to meet FPL's needs. However, when FPL hired a full-time volume forecaster in 2003 for its expanded hedging program, FPL needed additional access to GenTrader. FPL had two options to facilitate this additional access. The first option was for FPL to buy an additional seat under the existing form of the GenTrader license, which would add approximately [redacted] to FPL's GenTrader license fee (for a total of [redacted]). The second option was for FPL and FPL Energy (which also uses GenTrader) to enter into a site license jointly, in order to have access to unlimited GenTrader seats. The joint site license option would cost [redacted] FPL and FPL Energy chose the second option since it was more cost effective.

For 2003, FPL determined the portion of the GenTrader site license fee that is recoverable as an expanded hedging program cost by subtracting the amount of the original GenTrader license fee included in the MFR filing ($300,000) from its [redacted] share of the site license fee ($327,600), resulting in an incremental expense of $27,600. For 2002, FPL did not seek to recover any portion of the GenTrader license fee as an incremental hedging cost, because (i) it was not yet using GenTrader in support of the expanded hedging program, and (ii) it was still operating under the earlier license and was not incurring incremental costs beyond the $300,000 budgeted in the MFRs. Therefore, there was nothing in 2002 against which FPL would net any of the $300,000

This approach is consistent with the Commission's directions outlined above concerning how to determine recoverable incremental hedging costs. Each category of cost that FPL requested for recovery was evaluated to determine the portion, if any, that was included in FPL's MFR filing. This amount was then subtracted from the amount sought for recovery through the fuel clause to ensure no double recovery.

CONFIDENTIAL

Audit Disclosure No. 2

Subject: GenTrader License Fees in Incremental Hedging

Statement of Fact: The company has included $27,000 in [redacted] expenses related to the incremental costs of hedging in the Fuel Filing Schedule A-2 GenTrader software license fees. The total license fees were [redacted] The company then removed $300,000 for the GenTrader license fees that were included in the MFR base rate calculation. The company did not include the GenTrader costs in the 2002 filing and therefore, did not remove the base costs from the filing.

Opinion: Staff received answers to requests on these fees late in the audit. Therefore, we will continue to determine whether the license fees are specifically related to hedging programs only and whether the [redacted] allocation is reasonable.

<u>FPL's Response to Audit Disclosure No. 2</u>

As described in response to Audit Disclosure No. 1, FPL believes that its determination of the portion of GenTrader license fees that are recoverable through the Fuel Cost Recovery Clause is reasonable and consistent with the Commission's directions on recovery of incremental hedging costs. Nonetheless, FPL remains as always happy to respond to additional questions that the Auditors may have about recovery of the GenTrader license fees.

The Opinion in Audit Disclosure No. 2 could be read as suggesting that FPL did not respond timely to the Auditors' requests for information about the GenTrader license fees. That is not the case. FPL provided information on the $300,000 base level for these fees on February 27, 2004. The auditors then requested additional information on March 24, 2004 (Audit Request Nos. 33 and 34), and FPL responded to those requests two days later, on March 26, 2004.

Note: The Statement of Fact in Audit Disclosure No. 2 incorrectly identifies the amount that FPL included for recovery of GenTrader license fees as $27,000. The correct amount is $27,<u>600</u>.

Audit Disclosure No. 3

Subject: Relocated Fees in Incremental Hedging

Statement of Fact: The company included relocation fees of $7,500 in February and $24,150 in August of 2003. Two employees were hired for the hedging program, one in January and one in February. The company procedure manual allows for $7,500 to be paid for relocation expenses. The February payment met these requirements. The company has informed us that there are additional provisions in other parts of its policy that were not provided.

Opinion: Staff cannot determine why the August payment of $24,150 exceeded the $7,500 and came at a time when no employees were hired. The company has been asked to provide further documentation and the additional company policy and it will be followed up in the second half of this audit.

FPL's Response to Audit Disclosure No. 3

Florida Power & Light Company's Tier-1, Domestic Relocation Handbook dated 10/1/99 is attached. The $7,500 and the $24,150 are for two separate types of relocation expenses – both of which are reimbursed to employees consistent with the Company procedure.

The Company procedure allows for an amount up to one month's salary (with a maximum of $7,500) to be paid as a "Miscellaneous Relocation Allowance" (see page 6 of the attached). The $7,500 in relocation expenses that were paid in February 2003 fell into this category.

The Company procedure also allows for the reimbursement of "Home Sale Assistance" costs, including closing costs on an "Independent Sale" (see page 7 of attached). There are formulas stated in the Company procedure that determine how much may be reimbursed for various types of costs, but there is no overall dollar-amount cap on this category of reimbursement as there is on the "Miscellaneous Relocation Allowance" category. The $24,150 in relocation expenses that were paid in August 2003 were for closing costs that are reimbursable under the "Home Sale Assistance" category.

The Opinion in Audit Disclosure No. 2 notes that the $24,150 payment did not coincide with a point in time when employees were hired. This is because of the nature of the expenses involved. The hire date for a new employee and the date when that employee closes on a the sale of his or her home do not necessarily occur simultaneously. Therefore, the Company procedure allows for the reimbursement of closing costs for sales that occur within 12 months of the effective date of transfer