

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

DOCKET NO. 080001-EI  
ORDER NO. PSC-08-0667-PAA-EI  
ISSUED: October 8, 2008

The following Commissioners participated in the disposition of this matter:

MATTHEW M. CARTER II, Chairman  
LISA POLAK EDGAR  
KATRINA J. McMURRIAN  
NANCY ARGENZIANO  
NATHAN A. SKOP

NOTICE OF PROPOSED AGENCY ACTION  
ORDER CLARIFYING HEDGING ORDER AND PROVIDING GUIDELINES

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

Background

Our current policy regarding risk management and the hedging of fuel prices is embodied in Order No. PSC-02-1484-FOF-EI (the Hedging Order), issued October 30, 2002, in Docket No. 011605-EI, In re: Review of investor-owned electric utilities' risk management policies and procedures. The Hedging Order approved a settlement, referred to as the Proposed Resolution of Issues, which established a framework and direction to follow with respect to risk management of fuel procurement by the four largest investor-owned electric utilities (IOUs). The settlement was entered into by Florida Power & Light Company (FPL or Company), Florida Power Corporation (now Progress Energy Florida, Inc., or PEF), Tampa Electric Company (TECO), the Florida Industrial Power Users Group (FIPUG), and the Office of Public Counsel (OPC). Gulf Power Company (Gulf) agreed to the settlement at the hearing based upon a modification made during the August 12, 2002, hearing. The Hedging Order states:

It [the Proposed Resolution of Issues] provides for the filing of information in the form of risk management plans and as part of each IOU's final true-up filing in the fuel and purchased power cost recovery docket, which will allow the Commission and the parties to monitor each IOU's practices and transactions in this area. In addition, it maintains flexibility for each IOU to create the type of risk management program for fuel procurement that it finds most appropriate

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while allowing the Commission to retain the discretion to evaluate, and the parties the opportunity to address, the prudence of such programs at the appropriate time. Further, the Proposed Resolution of Issues appears to remove the disincentives that may currently exist for IOUs to engage in hedging transactions that may create customer benefits by providing a cost recovery mechanism for prudently incurred hedging transaction costs, gains and losses, and incremental operating and maintenance expenses associated with new and expanded hedging programs.

Hedging Order, p. 2.

Following the issuance of the Hedging Order, each of the four largest IOUs developed financial hedging programs. Each IOU now hedges significant portions of their natural gas and/or residual oil purchases. No proposals to modify the terms of the Hedging Order were filed until FPL filed its petition requesting approval of its improved volatility mitigation mechanism (VMM) or its VMM alternative at the beginning of 2008.

We initiated two separate audits of the IOUs' hedging programs following the conclusion of the 2007 fuel adjustment hearing, but prior to FPL's filing of its petition on the VMM. The Commission's Division of Competitive Markets and Enforcement (CMP) conducted a hedging review (Staff Management Audit, or management audit) which involved an assessment of the IOUs' fuel hedging program costs and benefits realized since the issuance of the Hedging Order. The financial Division of Regulatory Compliance and Consumer Assistance (RCA) conducted an audit of the accounting treatment and results of each IOU's 2007 hedging activities for consistency with each IOU's 2007 hedging plan filed in 2006. The RCA audit was completed on May 5, 2008, and the CMP review was completed in June 2008.

On January 31, 2008, FPL filed a petition requesting that we approve its proposed VMM as an alternative to FPL's financial and physical fuel price hedging programs. The VMM proposal involved FPL collecting under-recoveries of unhedged fuel costs over two years, instead of one year as is the current practice. FPL intended that if the combined final true-up and actual/estimated true-up amounts in any year's fuel proceeding reflects an under-recovery, half of that under-recovery would be collected in the projected year and the remaining half would be collected in the year following the projected year. The Company proposed VMM as a method of achieving our objective of mitigating fuel price volatility while avoiding certain hedging disadvantages. FPL argued that such disadvantages include uncertainty introduced by the uneven reaction shown by certain stakeholders during periods when FPL incurs losses in its hedging program compared to when FPL achieves gains in its program. FPL was also concerned about the regulatory risk it alleged may be associated with the deferral of prudence determinations of hedging losses, as occurred at the November 2007 fuel adjustment hearing (Order No. PSC-08-0030-FOF-EI, issued January 8, 2008, in Docket No. 070001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.). Had we approved FPL's VMM petition, FPL would have sought express assurances of recovery and recognition that the Company is prudent in its decision to not acquire physical or financial hedges to mitigate fuel price volatility.

In the alternative, if we determined not to approve the VMM as proposed, FPL requested two changes to the current hedging approach. First, FPL requested that we reduce the

uncertainty associated with the current hedging program by approving a set of general and specific hedging guidelines set forth by FPL (see Exhibit 3 of the VMM petition). Secondly, the Company proposed that FPL's regulatory risk be reduced by requiring our staff to conduct reviews of hedging results monthly. FPL made this second request so that we would be in a position to rule on the prudence of FPL's hedging results at the fuel hearing in November of each year for the twelve months ending September 30th of that year.

Our staff filed a recommendation on April 14, 2008, and recommended that we deny FPL's petition and alternative position, in part because it would be premature to make a decision before our review of the results of ongoing hedging audits by RCA and CMP. FPL concurred with our staff that a decision by us of FPL's petition would be premature, and FPL suggested in a post-recommendation letter that a workshop be held to consider improvements to our hedging process.

At the April 22, 2008, Agenda Conference, we considered FPL's VMM Petition. By Order No. PSC-08-0316-PAA-EI, issued May 14, 2008, in Docket No. 080001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor, we clarified the Hedging Order. Specifically, we decided that the period of review for utility hedging transactions will be through July 31 of the current year. We will determine the prudence of hedging transactions at the annual fuel clause hearing, typically held every year in November. To facilitate this review, the four largest IOUs are required to file current year hedging results by August 15. The IOUs are required to provide the same hedging information required in Section 5 of the "Proposed Resolution of Issues" in the Hedging Order. We also decided to defer Issues 2 and 3 of our staff's recommendation regarding the VMM issue and the alternative to the VMM issue to a later time so that the hedging audits underway at the time could be completed and reviewed, and so that we could have the benefit of the information gathered at an informal workshop.

Subsequently, our staff and the parties held two workshops regarding FPL's petition. At the June 9, 2008, workshop, FPL proposed revised hedging guidelines and indicated it now favored pursuing guidelines rather than the VMM. OPC took a position during the workshops that the VMM needed to be more fully analyzed by all four large IOUs as a possible alternative to hedging. At the June 24, 2008, workshop, OPC indicated its objection to portions of the proposed guidelines. The meeting concluded with an understanding that ongoing discussion among the parties would attempt to resolve whether hedging activity contributes to fuel factor volatility reduction and whether the guidelines as proposed by FPL were acceptable to all parties.

On August 5, 2008, FPL filed its petition for leave to withdraw its January 31, 2008, VMM petition and alternative. With its petition to withdraw, FPL filed a new petition for approval of its proposed hedging guidelines. FPL indicates in its new petition that it proposes the guidelines in response to the asymmetric reactions of certain stakeholders to gains and losses. FPL states that its guidelines are designed to mitigate against this asymmetry by reaffirming and clarifying our support for hedging as an appropriate means of managing the impacts of fuel price volatility. FPL indicated PEF, TECO, and GULF supported the proposed guidelines. Our staff issued a set of data requests regarding FPL's August petition, and all responses were timely filed. In addition, our staff conducted a telephonic meeting with parties on August 27, 2008, to

consider FPL's petition. At the meeting, PEF, TECO, and GULF expressed support for the guidelines, but also indicated that they were not proposing the guidelines. OPC indicated it was not ready to stipulate to FPL's proposed hedging guidelines. Based on our staff comments at the meeting, FPL made several revisions and provided its changes to the guidelines to all parties on August 29, 2008, after confirming PEF, GULF, and TECO's support for the changes.

We have jurisdiction pursuant to Sections 366.04, 366.041, and 366.05, Florida Statutes.

#### Voluntary Withdrawal of VMM Petition and Alternative

FPL has requested that it be permitted to withdraw its Improved Volatility Mitigation Mechanism Petition and Alternative that was filed by FPL on January 28, 2008. The law is clear that a plaintiff's right to take a voluntary dismissal is absolute. Fears v. Lunsford, 314 So. 2d 578, 579 (Fla. 1975). It is also established civil law that once a timely voluntary dismissal is taken, the trial court loses its jurisdiction to act and cannot revive the original action for any reason. Randle-Eastern Ambulance Service, Inc. v. Vasta, 360 So. 2d 68, 69 (Fla. 1978). Both of these legal principles have been recognized in administrative proceedings.<sup>1</sup> In Saddlebrook Resorts, Inc. v. Wiregrass Ranch, Inc., 630 So. 2d 1123, 1128 (Fla. 2d DCA 1993), the court concluded that "the jurisdiction of any agency is activated when the permit application is filed . . . [and] is only lost by the agency when the permit is issued or denied or when the permit applicant withdraws its application prior to completion of the fact-finding process."

In this case, we deferred our decision regarding the petition pending receipt of additional audit information. We had not reached our final decision on FPL's VMM petition. Thus, FPL can dismiss its petition as a matter of right. This is consistent with our past decisions.<sup>2</sup> Accordingly, we approve FPL's voluntary withdrawal of its VMM petition.

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<sup>1</sup> Orange County v. Debra, Inc., 451 So. 2d 868 (Fla. 1st DCA 1983); City of Bradenton v. Amerifirst Development Corporation, 582 So. 2d 166 (Fla. 2d DCA 1991); Saddlebrook Resorts, Inc. v. Wiregrass Ranch, Inc., 630 So. 2d 1123 (Fla. 2d DCA 1993) aff'd, 645 So. 2d 374 (Fla. 1994).

<sup>2</sup> See Order No. PSC-07-0725-FOF-EU, issued September 5, 2007, in Docket No. 060635-EU, In re: Petition for determination of need for electrical power plant in Taylor County by Florida Municipal Power Agency, JEA, Reedy Creek Improvement District, and City of Tallahassee; Order No. PSC-07-0877-FOF-EI, issued October 31, 2007, in Docket No. 070467-EI, In re: Petition to determine need for Polk Unit 6 electrical power plant, by Tampa Electric Co.; Order No. PSC-07-0485-FOF-EI, issued June 8, 2007, in Docket Nos. 050890-EI, In re: Complaint of Sears, Roebuck and Company against Florida Power & Light Company and motion to compel FPL to continue electric service and to cease and desist demands for deposit pending final decision regarding complaint and 050891-EI, In re: Complaint of Kmart Corporation against Florida Power & Light Company and motion to compel FPL to continue electric service and to cease and desist demands for deposit pending final decision regarding complaint; Order No. PSC-94-0310-FOF-EQ, issued March 17, 1994, in Docket No. 920977-EQ, In re: Petition for approval of contract for the purchase of firm capacity and energy from General Peat Resources, L.P. and Florida Power and Light Company; Order No. PSC-97-0319-FOF-EQ, issued March 24, 1997, in Docket No. 920978-EQ, In re: Complaint of Skyway Power Corporation to require Florida Power Corporation to furnish avoided cost data pursuant to Commission Rule 25-17.0832(7), F.A.C.; Order No. PSC-04-0376-FOF-EU, issued April 7, 2004, in Docket No. 011333-EU, In re: Petition of City of Bartow to modify territorial agreement or, in the alternative, to resolve territorial dispute with Tampa Electric Company in Polk County. But see Order No. PSC-07-0297-FOF-SU, issued April 9, 2007, in Docket No. 020640-SU, In re: Application for certificate to provide wastewater service in Lee County by Gistro, Inc. and Order No. PSC-96-0992-FOF-WS, issued August 5, 1996, in Docket No. 950758-WS, In

Although the effect of the withdrawal of a petition is to divest the agency of jurisdiction over the petition, it does not divest the agency of subject matter jurisdiction. We retain the discretion to review our hedging policy and make changes after affording all stakeholders the appropriate due process.

#### FPL's Proposed Guidelines

FPL's proposed guidelines are the result of meetings with our staff and parties to the fuel docket after the April 22, 2008, Agenda Conference. FPL's purpose in proposing these guidelines is to reaffirm and clarify our support for hedging as an appropriate means of managing the impacts of fuel price volatility. FPL seeks this reaffirmation of the Commission's support based on its observation that the reaction of certain stakeholders to hedging results has been asymmetric. FPL states in its petition that "[s]upport for hedging has generally been strong during periods of rising fuel prices, when hedging programs are showing gains, but has waned when prices are falling and hedging programs are showing losses." FPL Petition, p. 3.

FPL believes this "observed asymmetry" can increase the perceived financial (regulatory) risk for IOUs and could increase their cost of capital. FPL believes the proposed guidelines will reduce regulatory risk.

#### Section I

The proposed guidelines clarify the timing of our annual review of utility hedging programs. The Hedging Order requires the four IOUs to file hedging/risk management plans but does not require such plans to be approved by this Commission. The proposed guidelines would have us approve each utility's risk management plan in advance. For example, in 2008, we would approve utility risk management plans that would describe hedging activities during 2009, affecting activities during 2009 and subsequent years. The risk management plans will be filed in early August with the Estimated/Actual Testimony filing.

The approved risk management plans will be the basis for our review of the performance of utility hedging programs. Under the guidelines, a utility's plan may deviate from one or more of the guiding principles set forth in Section IV, therefore allowing a utility to tailor its plan for its particular circumstances. The guidelines reiterate the timing of our review of hedging results that was approved by Order No. PSC-08-0316-FOF-EI, issued May 14, 2008, in Docket No. 080001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor. Under the guidelines, the hedging program will apply to both financial and physical hedging transactions for natural gas and fuel oil.

### Sections II & III

Section II of the guidelines defines hedging activities, which will primarily involve financial transactions for fuel oil and natural gas, including natural gas provided to generators under purchased power agreements. Section III of the guidelines notes that we will determine the prudence of each IOU's hedging activities for the year ending July 31, as clarified by Order No. PSC-08-0316-FOF-EI. To facilitate the prudence review, the IOUs will file monthly hedging data in two reports: a Hedging Activity True-Up Report filed in April that covers August 1 to December 31 of the prior year (in 2009, the report will cover all of calendar year 2008), and a Hedging Activity Supplemental Report filed by August 15, covering the months of the current year through July 31.

### Section IV

Finally, the guidelines set forth guiding principles that we would employ in reviewing utility hedging programs and results. This section states that the purpose of hedging is to reduce fuel factor volatility, not just fuel price volatility. Section IV notes that hedging does not involve speculation, that fuel prices are volatile, and that hedging can result in lost opportunities for fuel savings. Importantly, Section IV notes that the approved risk management plans will be the controlling document for our review of hedging activities. The plans, with our approval, may deviate from one or more of the guiding principles. The risk management plans would designate a range of volumes to be hedged for natural gas and fuel oil within which the IOU normally will operate.

### Parties' Comments

OPC filed comments regarding FPL's proposed hedging guidelines on September 3, 2008, and addressed us at our September 16, 2008, Agenda Conference. OPC states that it opposes FPL's proposed hedging guidelines. OPC argues that hedging activities are of very limited value to customers. OPC argues that we should evaluate the six years' worth of historical hedging information now available to determine whether hedging activities are needed to achieve the purpose of reducing the volatility of fuel price on the retail customer. OPC indicates that the leveled fuel adjustment charge already has the effect of insulating the customer from the changes in the price of fuel, and that little additional "tempering" of volatility seen and felt by customers through their bills is accomplished by hedging activities. Meanwhile, OPC argues that hedging costs have not been quantified satisfactorily, but notes such costs could be substantial by FPL's own admission.

In addition, OPC argues that the guidelines sacrifice our ability to conduct full, after-the-fact prudence reviews. OPC contends that if we adopt such guidelines, the IOUs would enjoy the benefit of lower regulatory risk and should, as a consequence, be restricted to a lower authorized return on equity. OPC notes that FPL did not include any such quid pro quo proposal in its proposed hedging guidelines petition.

Regarding other parties to the fuel docket, FPL states in its current petition that the Office of Attorney General, AARP, the Florida Retail Federation, and FIPUG have all stated that they

take no position at this time on the Hedging Guidelines.<sup>3</sup> These parties reserve their right to take a position at a later time.

### PSC Audits Regarding Hedging

Our staff's audits of IOU hedging activities are now complete. Regarding utility hedging practices, the management audit concluded:

Overall, audit staff believes that the use of financial hedges for fuel purchases provides a benefit to utility customers. Each program is appropriately controlled, efficiently organized, and operates under a non-speculative format. There are areas of improvement, which are outlined later in each company's chapter. Generally, each company has successfully mitigated the price volatility for its customers. There have been years in which each company's hedging program provided a gain on its fuel cost, and years in which each program has incurred losses. This is to be expected. Hedging commodities involves the risk of higher prices at the expense of attempting to reduce price volatility. For each company, there is an acceptable level of risk tolerance between the two. Each utility must continue to gauge its customers' tolerance of the cost associated with hedging versus the benefits of reduced fuel cost volatility and any resulting rate increases.

Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities, June 2008, Staff Management Audit, pp. 10-11

The financial audits conducted by RCA did not identify any problems with the IOUs' hedging program. The PSC auditors verified that FPL's hedging transactions are in compliance with our Orders and Rules and with applicable Financial Accounting Standards Board statements.

### Analysis

The Hedging Order authorized the IOUs to charge hedging gains and losses to the fuel clause and provided initial support for utility hedging programs. Since 2003, the IOUs have charged or credited large amounts of hedging gains and losses to the clause. However, due to the volatility of fuel prices, this cumulative measurement depends on the period in question and the actual day of fuel price quotes.

The Hedging Order did not and could not address all issues and questions that have arisen concerning hedging. For example, such issues as whether we should approve the risk management plans and the appropriate periods for our review of hedging results are not addressed in the hedging order. FPL proposes answers to these questions and others in its proposed hedging guidelines.

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<sup>3</sup> "FPL attempted to contact White Springs concerning its petition on the Hedging Guidelines but was unable to do so before filing this petition." Petition, p. 5.

The proposed guidelines also intend to address the issue of regulatory risk. We note that, at any particular moment in time, IOUs can carry substantial amounts of hedging gains or losses on their books. This introduces the issue of regulatory risk into consideration of hedging as our policy, since those amounts may not have been determined to be prudent for cost recovery purposes.

Below, we address specific sections of the guidelines. We have also analyzed the guidelines with particular attention to regulatory risk and whether hedging is in the public interest.

**Section I.c.** This section would revise the filing date of the risk management plans. According to the guidelines, each IOU would file an annual Risk Management Plan for Fuel Procurement as part of its Actual/Estimated Fuel Filing each August. In its original guidelines petition, FPL indicated that the risk management plans should continue to be part of the IOU's Fuel Projection Filing each September. At the August 27 meeting, our staff commented that this does not allow sufficient time for regulatory review. Our staff argued that a comprehensive annual review of hedging plans, as contemplated in the proposed guidelines, would require more time for discovery and potential opposing testimony than the two months afforded by a September filing. The Hedging Order did not state that our prior approval was required, only that the IOUs must file a plan. In its response to a staff data request issued August 14, FPL stated that its future risk management plans will be highly detailed. The IOUs agreed to shift the date of the plan from the Projection Filing Date to the Actual/Estimated Filing Date in accord with our staff's suggestion.

**Section III.** The petition states that this section codifies the timing of our review of hedging results set forth in Order No. PSC-08-0316-PAA-EI. It clarifies that the period to be reviewed for prudence of each IOU's hedging activities includes August 1 of the prior year through July 31 of the current year. Such clarifying language is helpful and consistent with the order.

The proposed guidelines fail to address the timing mismatch between the period of the hedging plans (calendar year) versus the time period included in hedging reports (August to December and January to July). According to the Hedging Order, the period addressed by hedging plans is January through December of the projection year. Thus, targeted quantitative objectives for hedging plans are designed for the calendar year. According to Commission Order No. PSC-08-0316-PAA-EI, hedging reports address the quantitative results of hedging activities for August to December and January to July. We believe it is important for purposes of our review that the timing of the plan objectives matches the timing of the information in the reports.

The IOUs can address this matter in their hedging plans and reports. IOUs that establish monthly hedging objectives in their filed hedging plans, such as FPL, are encouraged to bifurcate their hedging objectives into two segments within the calendar year to match the periods of the reported results. Other IOUs that do not establish monthly objectives, such as Gulf, are encouraged to address this timing matter in both their risk management plans and in their hedging reports so that comparability of the targeted hedging objectives and hedging results are achieved.



**Section IV.** FPL's guiding principal IV-d would clarify that "the Commission does not expect the IOU to predict or speculate on whether markets will ultimately rise or fall and actually settle higher or lower than the price levels that existed at the time hedges were put into place." FPL's guiding principal IV-e would clarify that we do not expect the IOU to attempt to "outguess the market." While we are in general agreement with these guidelines, it became clear at the staff and parties' August 27, 2008, meeting that at least one IOU (GULF) did not agree with being precluded from utilizing market timing as part of its hedging strategy. We find that the correctness of whether to exclude market timing in our review is highly dependent upon the approved hedge plan for the IOU in question. Subsequent to the August 27, 2008, meeting, FPL amended its proposed guidelines clarifying that the Commission may approve plans notwithstanding deviations from one or more of the guiding principles. If a plan deviates from the guidelines in some way, and the plan is approved by the Commission, the IOUs recognize that the plan controls for purposes of evaluating hedging actions.

Section IV of the guidelines acknowledges that hedging can reduce the volatility of fuel adjustment charges paid by customers and that a well-managed hedging program does not involve speculation. With fuel price hedging, the expectation is that gains and losses will cancel out over the long-run. At various times since 2002, FPL has had either cumulative hedging losses or cumulative hedging gains. While price volatility is reduced, hedging is not expected to create long-run profits or losses. Thus the appropriate review of hedging programs requires a balanced, disciplined, and long-term view of hedging transactions. The most recent fuel order, as quoted by FPL in its petition, states that, "[h]edging program[s] are designed to assist in managing the impacts of fuel price volatility. Within any given calendar period, hedging can result in gains or losses. Over time, gains and losses are expected to offset one another." Order No. PSC-08-0030-FOF-EI, p. 4.

The preceding quote demonstrates our support for the long-term view of hedging programs. Further support for utility hedging practices and the long-term view of such practices is stated in the 2006 fuel order:

After evaluating the exhibits and testimony filed by PEF, staff recommended that the Commission find that Progress, through its hedging activities, has adequately mitigated the price risk for natural gas, residual [oil] and purchased power through September 1, 2006. Staff summarized that each utility presented testimony that the objective of the hedging programs is to minimize price volatility, and that prices are uncertain and volatile, particularly for natural gas, so there will be periods when the companies have hedging gains and other periods where the companies will have hedging losses. Staff also found that the utilities follow risk management plans to avoid speculation. Staff's belief is that minimizing price volatility produces customer benefits.

Order No. PSC-06-1057-FOF-EI, issued December 22, 2006, Docket No. 060001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor, p. 5.

Further, by Order No. PSC-08-0316-PAA-EI, we clarified the Hedging Order by stating that at the annual fuel clause hearings we will rule on the prudence of utility hedging transactions

through July 31 of the current year. This addressed in part FPL's concern regarding regulatory risk.

Section IV of the Guidelines clarifies our support for prudently managed hedging programs and acknowledges the principles in the orders cited above. The guidelines do not compromise our ability to review hedging programs and results, and to make appropriate adjustments where necessary. As we discussed, and as our staff confirmed at the September 16, 2008, Agenda Conference, the guidelines provide guidance to the parties and the Commission, but are not meant to cover all circumstances. The Guidelines will provide additional clarity regarding the timing and scope of the review of hedging results. However, we must retain our ability to review the prudence of a utility's conduct. In approving the Guidelines, any regulatory risk that could be associated with hedging is minimized.

In its comments, OPC alleges that hedging reduces risk for the company and thereby benefits its shareholders. Any such risk reduction that might occur will be reflected in the company's overall risk profile, which we can consider in the cost of equity issue during a base rate proceeding.

FPL buys more gas than any other electric utility in the nation. In general, Florida IOUs burn large quantities of natural gas, and their use of natural gas will increase over the next five years. Natural gas prices are volatile and are influenced by weather (winter and summer temperatures), industrial demand, power generation demand, the price of alternative fuels, and tropical storms and hurricanes. Global influences may begin to affect natural gas prices as future gas supply could become more dependent upon the import of liquefied natural gas (LNG). Similarly, FPL buys large quantities of residual fuel oil. The price of this fuel oil depends on the price of crude oil, which, in turn, depends on global supply and demand, the price of alternative fuels, and geopolitical risks. Given these circumstances, having hedging available as part of FPL's fuel procurement strategy is appropriate.

In its comments, OPC states "[w]ith respect to reducing fuel price volatility felt by retail customers, which is the single purpose of hedging identified by the utilities, the hedging activities are of very limited value to customers, while the costs of those activities have never been quantified satisfactorily." In response to a staff data request, FPL stated that hedging reduces the volatility of fuel costs over time and that this reduction generally should reduce the volatility of annual fuel adjustment factors. In support of this contention, FPL provided the following chart.

RESIDENTIAL FUEL ADJUSTMENT CHARGES WITH AND WITHOUT HEDGING		
	Hedging 1 year in advance (\$/1000 kWh)	W/O Hedging (\$/1000 kWh)
2003	37.11	40.63
2004	37.50	33.07
2005	40.09	42.76
2006	58.41	51.43
2007	52.95	48.87
2008 <sup>4</sup>	52.27	57.14

We note that in the recent 2008 mid-course corrections for PEF, FPL, and GULF hedging gains significantly reduced the projected under-recoveries. In these particular cases, hedging significantly reduced the amount of the mid-course factor increases. Of course, the opposite case can apply as well. Hedging losses, typically in times of declining fuel prices, can reduce the amount of factor reductions. In either case, hedging gains and losses affect fuel factors. FPL notes that hedges have reduced the need for mid-course corrections. In its petition, FPL states, “[d]uring periods of rising prices, the IOUs’ fuel costs have risen more slowly than market prices, and hedges have shown gains; during periods of declining prices, the IOUs’ fuel costs have declined more slowly than market prices, and hedges have shown losses.” Petition, page 2.

We have previously found that customers benefit from receiving accurate price signals through cost-based rates, and that customers benefit from stable rates that allow the customer to budget for electric bills. Hedging has contributed to the stability of fuel factors.

Our staff’s Management Audit indicates that direct transaction costs for each of the four IOUs are minimal or nonexistent. Regarding indirect transaction costs, OPC is correct that FPL indicated in its VMM petition that indirect transaction costs have not been quantified but could be substantial. However, in our staff’s April 14, 2008, recommendation regarding FPL’s VMM petition, our staff stated that FPL referred to these costs as “potential” costs, and such costs are largely theoretical. The indirect transaction costs noted by FPL include the price differential between the bid-ask range for swap transactions. The bid-ask range is the difference in price from the lowest and highest price for an equivalent daily transaction on the New York Mercantile Exchange (NYMEX) or the Intercontinental Exchange (ICE). According to our staff Management Audit, PEF, GULF, and TECO agree that the bid-ask range does not constitute a transaction cost. Another type of cost associated with hedging is incremental operations and maintenance costs associated with establishing and maintaining a hedging program. We approved such costs for recovery through the fuel clause in the Hedging Order. We note that such costs are not significant relative to the total fuel costs of the utilities. In addition, three of the IOUs (PEF, TECO, and GULF) no longer recover these costs via the fuel clause. In sum, the four IOUs’ transaction costs (direct or indirect) or incremental costs of maintaining their hedging programs as currently established are not substantial relative to the total fuel costs of the utilities.

<sup>4</sup> 2008 pre-mid course correction fuel factors..

Ruling

By approving FPL's proposed guidelines, we demonstrate our support for hedging. We retain our discretion to determine the prudence of hedging results and acknowledge that the guidelines do not bind us in our review of a utility's hedging practices.

We approve FPL's proposed Hedging Order Clarification Guidelines attached hereto as Attachment A. The proposed guidelines clarify the regulatory process regarding utility hedging programs, including the timing and content of filings. In addition, the guidelines allow the utilities flexibility for creating and implementing risk management plans. We find that utility hedging programs provide benefits to customers. By approving these guidelines we provide regulatory support and guidance regarding hedging programs.

Evaluation of hedging results can be problematic since they are not reported on a calendar basis similar to the original plans. Therefore, we encourage the IOUs to address the comparability of reported results to their original plans by structuring their plans to match reporting periods, or otherwise show the comparability of objectives and results.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Florida Power & Light Company's voluntary dismissal of its Volatility Mitigation Mechanism Petition and Alternative, filed with the Commission on January 31, 2008, is approved. It is further

ORDERED that the Hedging Order Guidelines, proposed by Florida Power & Light Company, and included in Attachment A are approved as set forth herein. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall remain open.

By ORDER of the Florida Public Service Commission this 8th day of October, 2008.

ANN COLE  
Commission Clerk

By:   
\_\_\_\_\_  
Hong Wang  
Office of Commission Clerk

( S E A L )

LCB

CONCURRENCE BY: COMMISSIONER ARGENZIANO

*COMMISSIONER NANCY ARGENZIANO, concurring with opinion as follows:*

I am writing separately to fully explain my vote to approve the guidelines requested by FPL. I understood that we were not taking a vote on fuel hedging in general, only whether to approve the additional clarifying guidelines regarding hedging programs the electric utilities currently engage in pursuant to prior order of the Commission.

As I made clear at the Agenda Conference, I have two main concerns with the guidelines: first, that we don't "loose the forest for the trees," and second that this Commission retain its full powers to review the prudence of a utility's fuel hedging activities.

Based on the questions I asked and the answers I received, I am confident that the Commission staff understands the need to not only review the details of a utility's hedging plans and the compliance with that plan, but the need to take a bigger look at a utility's hedging activities, especially whether those activities continue to benefit ratepayers. I would further expect that parties to the docket would raise any issues or concerns they become aware of.

Most importantly, however, the discussion at the agenda conference satisfies me that electric utilities are now fully on notice that this Commission will not allow them to engage in imprudent activities, then attempt to hide behind pre-approval of a fuel hedging plan or compliance with the terms of that plan. While a plan might be prudent when approved in advance, situations and circumstances can and do change rapidly, and I expect electric utility companies to competently and diligently manage their hedging activities for the sole benefit of their ratepayers – not their stockholders.

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on October 29, 2008.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

## **EXHIBIT 1**

### **Hedging Order Clarification Guidelines**

- I. Investor-owned utilities (IOUs) shall file an annual Risk Management Plan for Fuel Procurement (the "Plan") as part of the IOU's Annual Estimated/Actual Fuel Filing. The Plan would be submitted for Commission approval at the annual Levelized Fuel Cost Recovery and Capacity Cost Recovery Hearing held in November (the "Annual Fuel Hearing").
  - a. Each IOU will file a comprehensive Plan as part of its annual Levelized Fuel Cost Recovery and Capacity Cost Recovery Estimated/Actual True-up filing ("Estimated/Actual Filing", which typically occurs in early August) that includes the level of detail the IOU feels is appropriate for the risk management/hedging program to be executed. As has been the case with risk management plans filed to date, the Plan will address Items 1, 2, 3 (to the extent possible), 4-9 and 13-15 of Exhibit TFB-4 (ref. Paragraph 2 of the Proposed Resolution of Issues approved in Order No. PSC-02-1484-FOF-EI, Docket No. 011605-EI, dated October 30, 2002). A copy of Exhibit TFB-4 is Attachment 1 to these Guidelines and is incorporated herein by reference. The Plan will cover the activities to be undertaken during the following calendar year for hedges applicable to subsequent years (e.g., file Plan in August 2008 describing the hedging program to be executed during calendar year 2009 for hedges applicable for ongoing activities for 2009 and subsequent years included in the hedging program).
  - b. The Plan may be filed with a request for confidentiality to ensure that an IOU's anticipated hedging activities are not broadcast to the market prior to execution.
  - c. The Commission will review for approval each IOU's Plan during the Annual Fuel Hearing, which approval is required to proceed with the hedging activities proposed in that Plan. This is consistent with page 18 of the Staff recommendation, dated April 14, 2008, on FPL's VMM proposal: "Staff believes the more appropriate approach is for the Commission to approve in advance company risk management plans that identify ranges for the percentages of volumes to be hedged and the types of hedging instruments. Acting within those guidelines, the Company can rebalance its hedge positions in response to changes in market conditions."
- II. "Hedging Activities" that are appropriately reported by IOUs in their hedging information reports are defined to be natural gas and fuel oil fixed price financial or physical transactions; instruments include fixed price swaps, options, etc. If an IOU is responsible under a power purchase agreement for providing the natural gas or fuel oil required to generate the power purchased thereunder, the IOU will report on any hedging activities that it undertakes with respect to such fuel.
- III. At the Annual Fuel Hearing, the Commission will review and determine the prudence of each IOU's hedging activities for the year ending the immediately preceding July 31 (e.g., at the November 2009 Annual Fuel Hearing, the Commission will review and determine the prudence of hedging activities for the period August 1, 2008 though July 31, 2009). To facilitate this review, each IOU will file the following reports each year:

- a. A Hedging Activity Final True-Up Report in April, covering August 1 to December 31 of the prior year (in 2009, the Hedging Activity Final True-Up Report will cover all of calendar year 200); and
- b. A Hedging Activity Supplemental Report by August 15, covering the period January 1 to July 31 of that year.

Hedging Activity Final True-Up Reports and Hedging Activity Supplemental Reports will present the data on hedging activities by month, for each month covered by the reports.

- IV. The Commission will establish the following guiding principles that the Commission recognizes as appropriate and will follow in reviewing Plans and an IOU's hedging actions; provided, however, that the Commission may approve a Plan notwithstanding deviations from one or more of the guiding principles, and the terms of an approved Plan will control for the purpose of reviewing hedging actions:
- a. The Commission finds that the purpose of hedging is to reduce the impact of volatility in the fuel adjustment charges paid by an IOU's customers, in the face of price volatility for the fuels (and fuel price-indexed purchased power energy costs) that the IOU must pay in order to provide electric service.
  - b. The Commission finds that a well-managed hedging program does not involve speculation or attempting to anticipate the most favorable point in time to place hedges. Its primary purpose is not to reduce an IOU's fuel costs paid over time, but rather to reduce the variability or volatility in fuel costs paid by customers over time.
  - c. The Commission endorses the goal of controlling volatility of fuel adjustment charges and finds that hedging is a useful tool for this purpose.
  - d. The Commission acknowledges that hedging can result in significant lost opportunities for savings in the fuel costs to be paid by customers, if fuel prices actually settle at lower levels than at the time that hedges were placed. The Commission recognizes this as a reasonable trade-off for reducing customers' exposure to fuel cost increases that would result if fuel prices actually settle at higher levels than when the hedges were placed. The Commission does not expect an IOU to predict or speculate on whether markets will ultimately rise or fall and actually settle higher or lower than the price levels that existed at the time hedges were put into place.
  - e. The Commission recognizes that market prices and forecasts of market prices have experienced significant volatility and are expected to continue to be highly volatile and, therefore, does not intend that an IOU will try to "outguess the market" in choosing the specific timing for effecting hedges or the percentage or volume of fuel hedged.
  - f. In order to balance the goal of reducing customers' exposure to rising fuel prices against the goal of allowing customers to benefit from falling fuel prices, the Commission finds that it is appropriate to hedge a portion of the total expected volume of fuel purchases; the volume and timing of such hedges will be implemented within the parameters of an approved Plan, subject to any modifications or exceptions to the approved Plan that have been filed with and approved by the Commission.



- g. The Commission understands that each respective company's forecast of fuel burns is an ongoing process and forecasts do change over time. As a result, the volume to be hedged within the hedging program is based on a point-in-time forecast and the actual hedge percentages will vary from forecasts.

Exhibit TFB-4 (Page 1 of 1)

COMPONENTS OF A UTILITY'S FUEL PROCUREMENT RISK MANAGEMENT PLAN

When a utility files its fuel procurement risk management plan with the Commission, this plan should include information regarding the following components:

1. Identify overall quantitative and qualitative risk management objectives;
2. Identify minimum quantity of fuel to be hedged;
3. Identify and quantify each risk, general and specific, that the utility may encounter with its fuel procurement;
4. Describe the utility's oversight of its fuel procurement activities;
5. Verify that the utility provides its fuel procurement activities with independent and unavoidable oversight;
6. Describe the utility's corporate risk policy regarding fuel procurement activities;
7. Verify that the utility's corporate risk policy clearly delineates individual and group transaction limits and authorizations for all fuel procurement activities;
8. Describe the utility's strategy to fulfill its risk management objectives;
9. Verify that the utility has sufficient policies and procedures to implement its strategy;
10. Indicate the number and type of personnel who are responsible for fulfilling the utility's risk management objectives;
11. Verify that the utility has a sufficient number and type of personnel who can fulfill its risk management objectives.
12. Describe the utility's cost effective response to each general and specific risk associated with its fuel procurement;
13. Describe the utility's reporting system for fuel procurement activities;
14. Verify that the utility's reporting system consistently and comprehensively identifies, measures, and monitors all forms of risk associated with fuel procurement activities; and
15. If the utility has current limitations in implementing certain hedging techniques that would provide a net benefit to ratepayers, provide the details of a plan for developing the resources, policies, and procedures for acquiring the ability to use effectively the hedging technique.