



BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 011605-EI

IN RE: REVIEW OF INVESTOR-OWNED ELECTRIC
UTILITIES' RISK MANAGEMENT
POLICIES AND PROCEDURES

JUNE 24, 2002

TESTIMONY

OF

JOANN T. WEHLE

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FPSC-COMMISSION CLERK

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **PREPARED DIRECT TESTIMONY**

3 **OF**

4 **JOANN T. WEHLE**

5
6 **Q.** Please state your name, address, occupation and employer.

7
8 **A.** My name is Joann T. Wehle. My mailing address is P.O.
9 Box 111, Tampa, Florida 33601, and my business address is
10 702 Franklin Street North, Tampa, Florida 33602. I am
11 employed by Tampa Electric Company ("Tampa Electric" or
12 "company") as Director, Fuels in the Fuels Department.

13
14 **Q.** Please provide a brief outline of your educational
15 background and business experience.

16
17 **A.** I received a Bachelor's of Business Administration Degree
18 in Accounting in 1985 from St. Mary's College, South
19 Bend, Indiana. I am a CPA in the State of Florida and
20 worked in several accounting positions prior to joining
21 Tampa Electric. I began my career with Tampa Electric in
22 1990 as an auditor in the Audit Services Department. I
23 became Sr. Contracts Administrator, Fuels in 1995. In
24 1999, I was promoted to Director, Audit Services and
25 subsequently rejoined the Fuels Department as Director in

1 April 2001. I am responsible for managing Tampa
2 Electric's fuel-related activities including planning,
3 procurement, inventory, usage and combustion by-product
4 management.

5
6 **Q.** Please state the purpose of your testimony.

7
8 **A.** The purpose of my testimony is to describe the reasons
9 why a company would engage in fuel price hedging and to
10 describe Tampa Electric's fuel procurement and price
11 volatility management policies and procedures. In
12 addition, I will present the steps Tampa Electric takes
13 to manage fuel price risk through the use of physical and
14 operational hedging practices. My testimony will
15 describe the appropriate regulatory treatment of hedging
16 costs. I will also describe the role the Florida Public
17 Service Commission ("FPSC" or "Commission") should take
18 concerning the manner in which the company manages risk
19 associated with its fuel procurement. Finally, I will
20 present the company's perspective regarding the
21 appropriateness of the Commission encouraging utilities,
22 through an incentive plan, to enter into exchange-traded
23 derivative instruments to manage risk associated with
24 fuel transactions.

25

1 Q. Are you sponsoring an exhibit in this proceeding?

2

3 A. Yes, I am sponsoring Exhibit No. ____ (JTW-1), which
4 outlines Tampa Electric's proposed fuel and wholesale
5 energy price volatility management plan.

6

7 Q. What is the purpose of hedging?

8

9 A. The purpose of hedging is to protect the value of an
10 investment from the risk of loss due to price
11 fluctuations, or to offset the risk of a position
12 established in the marketplace.

13

14 Q. Why would an electric utility hedge?

15

16 A. An electric utility may use physical and operational
17 hedges to mitigate fuel and wholesale energy supply and
18 price volatility and to enhance reliability. An electric
19 utility may also find it beneficial to use financial
20 hedges to manage fuel price volatility.

21

22 Q. Is Tampa Electric taking reasonable steps to manage price
23 risk associated with its fuel transactions through the
24 use of physical, operational, and/or financial hedging
25 practices?

1 **A.** Yes, Tampa Electric is taking reasonable steps to manage
2 price risk associated with fuel transactions. Because
3 the great majority of fuel used by Tampa Electric has
4 been and currently is coal, the company has entered into
5 coal supply contracts that vary in duration and allow for
6 variable delivery quantities to manage price and physical
7 supply volatility.

8
9 **Q.** Has the company used physical hedges to mitigate coal
10 price volatility?

11
12 **A.** Yes, Tampa Electric has used physical hedges to mitigate
13 coal price volatility. The variable delivery quantities
14 that Tampa Electric includes in its coal supply contracts
15 are physical options that allow the company to vary
16 quantity delivered when additional coal at the contract's
17 pricing benefits Tampa Electric.

18
19 **Q.** Has the company used financial hedges to mitigate coal
20 price volatility?

21
22 **A.** Tampa Electric has not used financial hedges for coal
23 because such financial positions are not readily
24 available for coal. The New York Mercantile Exchange
25 ("NYMEX") has one coal contract offering, and it does not

1 reflect the type of coal that the company uses. Due to a
2 lack of liquidity and limited availability in the coal
3 commodity market, Tampa Electric purchases its coal
4 directly from producers, avoiding brokerage or other
5 "middle-man" costs.

6
7 Tampa Electric targets to maintain a mix of approximately
8 60 percent long- and medium-term and 40 percent short-
9 term or spot market coal contracts to reduce overall
10 exposure to price and supply volatility in the spot
11 market while leaving some tonnage available for spot
12 market pricing. By continually evaluating the market and
13 striving for an optimal blend of fuel supply contracts,
14 the company has been able to mitigate price volatility,
15 while maintaining an adequate fuel supply to ensure
16 system reliability.

17
18 **Q.** Has Tampa Electric purchased instruments to hedge the
19 price of other fuels?

20
21 **A.** With the repowering of the company's Gannon Station,
22 Tampa Electric is currently making a transition from
23 generation fueled almost exclusively by coal to having
24 significant amounts of natural gas in its fuel mix. The
25 company is thus in the early stages of building

1 experience operating base loaded natural gas powered
2 units and in developing optimal, multiple fuel mix
3 procurement strategies and financial and commodity
4 hedging expertise.

5
6 Until May 2002, Tampa Electric had not purchased
7 financial instruments to hedge the price of any fuel.
8 However, in light of the company's commitment to
9 continually evaluate opportunities that benefit Tampa
10 Electric's ratepayers, the company recently purchased an
11 over-the-counter swap to limit the volatility of natural
12 gas prices for a portion of its expected use during the
13 summer of 2002. As Tampa Electric gains experience in
14 base loaded natural gas generating unit operation and
15 natural gas procurement and hedging, the company will
16 continue to evaluate the costs and benefits of
17 implementing additional risk management practices related
18 to fuel transactions.

19
20 **Q.** Does mitigating fuel price volatility result in lower
21 fuel costs for ratepayers?

22
23 **A.** Mitigating fuel price volatility does not necessarily
24 lower the fuel costs that would be passed on to a
25 company's ratepayers. Hedging is a form of insurance; as

1 such the associated costs of hedging could result in a
2 higher, but more stable price for the fuel costs passed
3 on to ratepayers.
4

5 **Q.** What is the appropriate regulatory treatment for gains
6 and losses that a company incurs from hedging fuel
7 transactions through futures contracts?
8

9 **A.** Any gains or losses from hedging fuel transactions
10 through futures contracts should be credited or
11 recovered, respectively, through the fuel and purchased
12 power cost recovery clause ("fuel clause") methodology
13 currently applicable for Florida's investor-owned
14 electric utilities ("IOUs"). Ratepayers receive any
15 benefits of hedging using futures contracts and should
16 pay any prudently incurred costs of mitigating fuel price
17 volatility using those instruments.
18

19 **Q.** What is the appropriate regulatory treatment for the
20 premiums that a company receives and pays for hedging
21 fuel transactions through options contracts?
22

23 **A.** All premiums received or paid for hedging fuel
24 transactions through options contracts should be credited
25 or recovered, respectively, through the fuel clause as

1 occurs under the current fuel clause methodology.
2 Ratepayers receive any benefits of hedging using options
3 contracts and, accordingly, should pay any prudently
4 incurred costs of conducting those hedging activities.
5

6 **Q.** What is the appropriate regulatory treatment for the
7 transaction costs that a company incurs from hedging its
8 fuel transactions through futures and options contracts?
9

10 **A.** The transaction costs that a company incurs as the result
11 of hedging its fuel transactions through futures and
12 options contracts should be recovered through the fuel
13 clause. Ratepayers receive any benefits of hedging with
14 futures and options contracts and should pay any
15 prudently incurred costs of such hedging.
16

17 **Q.** What should be the Commission's role in administering the
18 utilities' risk management plans?
19

20 **A.** The Commission should oversee and review each utility's
21 risk management plan. The Commission should also review
22 the utilities' hedging transactions as they are incurred
23 and/or proposed for cost recovery through the fuel
24 clause.
25

1 Q. What incentive(s), if any, should the Commission
2 establish to encourage IOUs to optimally manage the risks
3 to ratepayers associated with fuel price volatility?
4

5 A. Given Tampa Electric's upcoming transition to a greater
6 amount of natural gas in its fuel mix, the company has
7 concluded that it would not be appropriate for Tampa
8 Electric to propose or adopt an incentive to manage risks
9 associated with fuel price volatility at this time.
10 However, Tampa Electric is amenable to considering a
11 hedging incentive once it has developed experience with
12 natural gas commodity hedging and base loaded natural gas
13 powered generation. In addition, Tampa Electric proposes
14 that the company periodically file a fuel and wholesale
15 energy transaction management plan. An outline of the
16 company's proposed plan is provided in Exhibit No. ____
17 (JTW-1).
18

19 Q. As the Commission continues to examine hedging practices,
20 what general considerations should it take into account?
21

22 A. The issue of how best to mitigate price volatility does
23 not require altering the existing fuel clause
24 methodology. Any action that separates fuel and
25 purchased power costs passed on to ratepayers from the

1 actual cost incurred may be an unnecessary departure from
2 a methodology that has worked for 22 years in a fair
3 manner for all concerned. Although it is certainly
4 appropriate for the Commission to explore the nature,
5 effectiveness, cost-effectiveness, and desirability of
6 various hedging practices, any such study should be
7 conducted on a utility-specific basis. The state's IOUs
8 have very different operating characteristics, fuel mix
9 portfolios, and fuel-switching and storage capabilities;
10 thus, one plan or one incentive is not likely to address
11 the needs of all of the utilities. Finally, the
12 Commission should consider the costs and benefits of
13 hedging for each utility individually. While hedging may
14 be beneficial for one company's ratepayers, it could
15 increase costs for another company's ratepayers.

16
17 **Q.** Does this conclude your testimony?

18
19 **A.** Yes it does.
20
21
22
23
24
25

**Risk Management Plan Outline for
Fuel Procurement and Wholesale Power Purchases**

I. Risk Management Responsibilities

- A. Indicate which committees, if any, provide oversight to the utility's risk management of its fuel procurement and purchased power transactions.
- B. Indicate what company or division will procure fuel and purchase wholesale power for the utility and what individual should be contacted regarding the risk management plan.

II. Fuel procurement and purchased power – historical information

- A. Coal
 - 1. Coal Procurement Requirements
 - a. How much coal did the utility or utility affiliate, on the utility's behalf, procure in total during the last calendar year? Please provide response in tons and million British thermal units.
 - b. How much coal did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year on the spot market? Please provide response in tons and million British thermal units.
 - 2. Coal Inventory
 - a. How much coal did the utility have in inventory as of the last day of the last calendar year? Please provide response in tons, million British thermal units, and days supply.
- B. Residual Oil
 - 1. Residual Oil Procurement Requirements
 - a. How much residual oil did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year? Please provide response in barrels and million British thermal units.
 - b. How much residual oil did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year on the spot market? Please provide response in barrels and million British thermal units.

2. Residual Oil Inventory
 - a. How much residual oil did the utility have in inventory as of the last day of the last calendar year? Please provide response in barrels (or million British thermal units) and days supply.
- C. Distillate Oil
1. Distillate Oil Procurement Requirements
 - a. How much distillate oil did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year? Please provide response in barrels and million British thermal units.
 - b. How much distillate oil did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year on the spot market? Please provide response in barrels and million British thermal units.
 2. Distillate Oil Inventory
 - a. How much distillate oil did the utility have in inventory as of the last day of the last calendar year? Please provide response in barrels (or million British thermal units) and days supply.
 - b. What was the minimum amount of the utility's distillate oil inventory during the last calendar year? Please provide response in barrels (or million British thermal units) and days supply.
- D. Natural Gas
1. Natural Gas Procurement Requirements
 - a. How much natural gas did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year? Please provide response in million British thermal units.
 - b. How much natural gas did the utility or utility affiliate, on the utility's behalf, procure during the last calendar year on the spot market? Please provide response in million British thermal units.
 2. Natural Gas Inventory
 - a. How much natural gas did the utility have in inventory as of the last day of the last calendar year? Please provide response in million British thermal units and days supply.
 - b. What was the minimum amount of the utility's natural gas inventory during the last calendar year? Please provide response in million British thermal units and days supply.

- E. Purchased Power
 - 1. How much wholesale power did the utility or utility affiliate, on the utilities behalf, purchase during the last calendar year? Please provide the response in MWH.

III. Fossil and purchased power - future needs

- A. Coal
 - 1. How much coal does the utility plan to purchase for the current year and for the following two years? List by units and MMBTU for each year.
- B. Residual Oil
 - 1. How much residual oil does the utility plan to purchase for the current year and for the following two years? List by units and MMBTU for each year.
- C. Distillate Oil
 - 1. How much distillate oil does the utility plan to purchase for the current year and for the following two years? List by units and MMBTU for each year.
- D. Natural Gas
 - 1. How much natural gas does the utility plan to purchase for the current year and for the following two years? List by units and MMBTU for each year.
- E. Purchased Power
 - 1. How much wholesale power does the utility plan to purchase for the current year and for the following two years? List by MWH for each year.

IV. Risk Management Strategy

- A. Risk Identification
 - 1. Identify each substantive change in risk that the utility may encounter other than those previously identified when procuring :
 - a. Coal
 - b. Residual Oil
 - c. Distillate Oil
 - d. Natural Gas
 - e. Purchased Power

2. Separately identify the utility's goal(s) in managing the recognized risks associated with each fuel or power purchases.
 3. Describe how the utility decides what an acceptable level of risk is when associated with fuel procurement and purchased power transactions.
- B. Describe your fossil fuel procurement and wholesale purchased power plans separately for 2002. Please include:
- General
1. Types of fuel used and power purchased
 2. Quantities and mix and by percent
 3. How purchased (contract vs. spot) and by percent
 4. Describe all purchasing strategies in items 1-3.
- Specific
1. What financial instruments will be used and how
 2. What will be hedged and how
- C. Audits
1. Internal Auditor – describe the level of audit oversight that the utility's internal auditor provides to the utility's risk management efforts.
 2. Outside Auditors
 - a. Indicate which outside auditors, if any, provide oversight to the utility's risk management efforts.
 - b. Describe the level of audit oversight that these outside auditors provide to the utility's risk management efforts.