

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of investor-owned  
electric utilities' risk  
management policies and  
procedures.

DOCKET NO. 011605-EI  
ORDER NO. PSC-02-1101-PHO-EI  
ISSUED: August 9, 2002

Pursuant to Notice and in accordance with Rule 28-106.209, Florida Administrative Code, a Prehearing Conference was held on August 5, 2002, in Tallahassee, Florida, before Commissioner Michael A. Palecki, as Prehearing Officer.

APPEARANCES:

JAMES A. MCGEE, ESQUIRE, Florida Power Corporation, P. O. Box 14042, St. Petersburg, Florida 33733-4042  
On behalf of Florida Power Corporation (FPC).

JOHN T. BUTLER, ESQUIRE, Steel Hector & Davis, LLP, 200 South Biscayne Blvd., Suite 4000, Miami, Florida 33131-2398  
On behalf of Florida Power & Light Company (FPL).

JEFFREY A. STONE, ESQUIRE, and RUSSELL A. BADDERS, ESQUIRE, Beggs & Lane, 501 Commendencia Street, P. O. Box 12950, Pensacola, Florida 32591  
On behalf of Gulf Power Company (GULF).

LEE L. WILLIS, ESQUIRE, and JAMES D. BEASLEY, ESQUIRE, Ausley & McMullen, P. O. Box 391, Tallahassee, Florida 32302  
On behalf of Tampa Electric Company (TECO).

JOHN W. McWHIRTER, JR., ESQUIRE, McWhirter Reeves McGlothlin Davidson Decker Kaufman & Arnold, P. A., 400 North Tampa Street, Suite 2450, Tampa, Florida 33601-3350 and VICKI GORDON KAUFMAN, ESQUIRE, and TIMOTHY J. PERRY, ESQUIRE, McWhirter Reeves McGlothlin Davidson Decker Kaufman & Arnold, P. A., 117 South Gadsden Street, Tallahassee, Florida 32301  
On behalf of Florida Industrial Power Users Group (FIPUG).

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ROBERT D. VANDIVER, ESQUIRE, Office of Public Counsel,  
c/o The Florida Legislature, 111 West Madison Street,  
Room 812, Tallahassee, Florida 32399-1400  
On behalf of the Citizens of the State of Florida (OPC).

WM. COCHRAN KEATING, IV, ESQUIRE, Florida Public Service  
Commission, 2540 Shumard Oak Boulevard, Tallahassee,  
Florida 32399-0850  
On behalf of the Florida Public Service Commission  
(Staff).

### **PREHEARING ORDER**

#### **I. CONDUCT OF PROCEEDINGS**

Pursuant to Rule 28-106.211, Florida Administrative Code, this Order is issued to prevent delay and to promote the just, speedy, and inexpensive determination of all aspects of this case.

#### **II. CASE BACKGROUND**

By Order No. PSC-01-1829-PCO-EI, issued September 11, 2001, issues were established for resolution at the November 20-21, 2001, hearing in Docket No. 010001-EI. On November 2, 2001, the Office of Public Counsel (OPC) filed a motion to defer consideration of six of the issues listed in the Order (Issues 11-14, 18A, and 19D) to allow the parties additional time to explore those issues. These issues generally concerned risk management by investor-owned electric utilities with respect to fuel procurement. By Order No. PSC-01-2273-PHO-EI, issued November 19, 2001, OPC's motion was granted. This docket was opened November 26, 2001, for the purpose of addressing the deferred issues, and an evidentiary, administrative hearing was scheduled in this docket for August 12-13, 2002.

By Order No. PSC-02-0192-PCO-EI, issued February 12, 2002, (Order Establishing Procedure) procedural guidelines, a tentative list of issues, and controlling dates were established for this docket. The tentative list of issues was comprised of the six issues deferred from Docket No. 010001-EI, renumbered as Issues 1 through 6. By Order No. PSC-02-0428-PCO-EI, issued March 28, 2002,

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a new issue was added as Issue 7. By Order No. PSC-02-0821-PCO-EI, issued June 14, 2002, Issue 1 was replaced with the issues identified in this Prehearing Order as Issues 1A and 1B, and a new issue was added as Issue 1C. (Issue 1C was added for informational purposes only and does not require a Commission vote.) By Order No. PSC-02-0854-PCO-EI, issued June 21, 2002, Issue 7 was renumbered as Issue 7A, and a new issue was added as Issue 7B.

Issue 5, as identified in the Order Establishing Procedure, was resolved by Order No. PSC-02-0793-PAA-EI, issued June 11, 2002, which was made final and effective by Order No. PSC-02-0920-CO-EI, issued July 10, 2002. Issue 6, as identified in the Order Establishing Procedure, was resolved by Order No. PSC-02-0919-PAA-EI, issued July 8, 2002, which was made final and effective by Order No. PSC-02-1062-CO-EI, issued August 6, 2002. Thus the following issues remain for resolution in this docket: Issues 1A, 1B, 2, 3, 4, 7A, and 7B.

The parties have been involved in settlement discussions on all the issues remaining for hearing. As noted in FPL's statement of basic position and positions on the issues, FPL has adopted as its position a proposed resolution of issues, with one modification, that was the subject of these settlement discussions. To make clear FPL's position, this proposed resolution of issues is attached hereto as Attachment A.

Opening statements, if any, shall not exceed ten minutes per party.

### III. PROCEDURE FOR HANDLING CONFIDENTIAL INFORMATION

A. Any information provided pursuant to a discovery request for which proprietary confidential business information status is requested shall be treated by the Commission and the parties as confidential. The information shall be exempt from Section 119.07(1), Florida Statutes, pending a formal ruling on such request by the Commission, or upon the return of the information to the person providing the information. If no determination of confidentiality has been made and the information has not been used in the proceeding, it shall be returned expeditiously to the person providing the information. If a determination of confidentiality has been made and the information was not entered into the record

of the proceeding, it shall be returned to the person providing the information within the time periods set forth in Section 366.093, Florida Statutes.

B. It is the policy of the Florida Public Service Commission that all Commission hearings be open to the public at all times. The Commission also recognizes its obligation pursuant to Section 366.093, Florida Statutes, to protect proprietary confidential business information from disclosure outside the proceeding.

1. Any party intending to utilize confidential documents at hearing for which no ruling has been made, must be prepared to present their justifications at hearing, so that a ruling can be made at hearing.

2. In the event it becomes necessary to use confidential information during the hearing, the following procedures will be observed:

- a) Any party wishing to use any proprietary confidential business information, as that term is defined in Section 366.093, Florida Statutes, shall notify the Prehearing Officer and all parties of record by the time of the Prehearing Conference, or if not known at that time, no later than seven (7) days prior to the beginning of the hearing. The notice shall include a procedure to assure that the confidential nature of the information is preserved as required by statute.
- b) Failure of any party to comply with 1) above shall be grounds to deny the party the opportunity to present evidence which is proprietary confidential business information.
- c) When confidential information is used in the hearing, parties must have copies for the Commissioners, necessary staff, and the Court Reporter, in envelopes clearly marked with the nature of the contents. Any party wishing to examine the confidential material that is not subject to an order granting confidentiality shall

be provided a copy in the same fashion as provided to the Commissioners, subject to execution of any appropriate protective agreement with the owner of the material.

- d) Counsel and witnesses are cautioned to avoid verbalizing confidential information in such a way that would compromise the confidential information. Therefore, confidential information should be presented by written exhibit when reasonably possible to do so.
- e) At the conclusion of that portion of the hearing that involves confidential information, all copies of confidential exhibits shall be returned to the proffering party. If a confidential exhibit has been admitted into evidence, the copy provided to the Court Reporter shall be retained in the Division of Commission Clerk and Administrative Service's confidential files.

#### IV. POST-HEARING PROCEDURES

Each party shall file a post-hearing statement of issues and positions. A summary of each position of no more than 50 words, set off with asterisks, shall be included in that statement. If a party's position has not changed since the issuance of the prehearing order, the post-hearing statement may simply restate the prehearing position; however, if the prehearing position is longer than 50 words, it must be reduced to no more than 50 words. If a party fails to file a post-hearing statement, that party shall have waived all issues and may be dismissed from the proceeding.

Pursuant to Rule 28-106.215, Florida Administrative Code, a party's proposed findings of fact and conclusions of law, if any, statement of issues and positions, and brief, shall together total no more than 40 pages and shall be filed at the same time.

#### V. PREFILED TESTIMONY AND EXHIBITS; WITNESSES

Testimony of all witnesses to be sponsored by the parties and Staff has been prefiled. All testimony which has been prefiled in

this case will be inserted into the record as though read after the witness has taken the stand and affirmed the correctness of the testimony and associated exhibits. All testimony remains subject to appropriate objections. Each witness will have the opportunity to orally summarize his or her testimony at the time he or she takes the stand. Summaries of testimony shall be limited to five minutes. Upon insertion of a witness' testimony, exhibits appended thereto may be marked for identification. After all parties and Staff have had the opportunity to object and cross-examine, the exhibit may be moved into the record. All other exhibits may be similarly identified and entered into the record at the appropriate time during the hearing.

Witnesses are reminded that, on cross-examination, responses to questions calling for a simple yes or no answer shall be so answered first, after which the witness may explain his or her answer.

The Commission frequently administers the testimonial oath to more than one witness at a time. Therefore, when a witness takes the stand to testify, the attorney calling the witness is directed to ask the witness to affirm whether he or she has been sworn.

VI. ORDER OF WITNESSES

<u>Witness</u>	<u>Proffered By</u>	<u>Issues #</u>
<u>Direct</u>		
Javier Portuondo	FPC	1A, 1B, 1C, 2, 3, 4, 7A, 7B
Pamela R. Murphy	FPC	1B, 1C, 7A
Korel M. Dubin	FPL	7A
Joseph P. Stepenovitch	FPL	1A, 1B, 1C, 2, 3, 4, 7A, 7B
W. N. McKenzie	GULF	1A, 1B, 1C, 2, 3, 4, 7A, 7B
Joann T. Wehle	TECO	1A, 1B, 1C, 2, 3, 4, 7A, 7B

<u>Witness</u>	<u>Proffered By</u>	<u>Issues #</u>
W. Lynn Brown	TECO	1B, 2, 3, 4, 7A, 7B
Lee W. Gooch (adopting the testimony of Bryan Stone)	FIPUG	1A, 2, 3, 4, 7A, 7B
Todd F. Bohrmann	FPSC	1A, 1B, 2, 3, 4, 7A, 7B

Rebuttal

Javier Portuondo	FPC	7A
Pamela R. Murphy	FPC	7A
Korel M. Dubin	FPL	7A
Joseph P. Stepenovitch	FPL	1B, 7A, 7B
W. N. McKenzie	GULF	1A, 7A

VII. BASIC POSITIONS

**FPC:** FPC's proposed Hedging Program is a thorough and reasonable response to the directive in Order No. PSC-02-0428-PCO-EI that utilities file a proposed risk management incentive plan, and should be approved by the Commission as a pilot program for a minimum two-year period.

**FPL:** FPL is prepared to accept Staff's proposed resolution of issues from July 31, 2002, with the addition of the phrase "and/or physical" inserted between "financial" and "hedging" in the first sentence of paragraphs three and four.

**GULF:** It is the basic position of Gulf Power Company that Florida's electric public utilities should be clearly authorized to use financial instruments to hedge price risk associated with the use of natural gas and fuel oil as boiler fuel for retail electric generation. The Commission should allow the utilities to recover all costs associated with hedging programs through the fuel and purchased power cost recovery clause. As part of

this docket, Gulf is specifically seeking authorization to implement the Company's proposed gas/oil hedging program as a means of managing fuel price risk on behalf of its customers. Approval of the proposed program would authorize Gulf to use financial instruments to manage fuel costs. Gulf's customers will gain more rate stability from the proposed program through protection from short-term natural gas price run-ups and a limit on above-market exposure. In return, Gulf will have the opportunity to earn an incentive when its hedging activities achieve savings for the customer.

**TECO:** Tampa Electric is taking reasonable steps to manage price risks associated with fuel and purchased power transactions. The Commission's appropriate role is to oversee and review each utility's risk management plan and its hedging transactions. The extent to which hedging is appropriate must be assessed on a utility-by-utility basis. No incentive plan is required at this time to encourage Tampa Electric to optimally manage the risks to ratepayers associated with fuel and purchased power price volatility. As a consequence, no change to the Commission's current method for calculating shareholder gains on wholesale sales is necessary. Finally, any gains or losses from hedging fuel and purchased power transactions should be credited or recovered through the fuel and purchased power cost recovery clause (the "fuel clause") and all premiums received or paid for hedging fuel and purchased power transactions through option contracts should be credited or recovered, respectively, through the fuel clause.

**FIPUG:** The unregulated financial derivatives market for energy products is presently in great turmoil. State regulatory action giving utilities unbridled discretion to move forward with undisclosed derivative transactions at the customers expense would be premature at best. Therefore, the Commission should reject the proposed risk management plans proffered by the investor owned utilities (IOUs). The IOU plans, if adopted, would substitute estimated costs for actual fuel costs; would relieve the utilities from any obligation to publicly disclose the information



now required on fuel cost schedules A3 through A5; would be very costly to implement - requiring expensive start-up costs, risk premiums and O&M costs; and would offer the customer almost no appreciable benefits.

The IOUs candidly admit that their plans are not designed to lower the customers' rates **at all**. In fact, the utilities have presented no evidence to show that the consumers will save money in the short-term or the long-term if the IOU plans are approved. The only conceivable benefit of the proposed plans - price stability - would actually result in harm to the ratepayers if the price of fuel declines. Moreover, Florida's ratepayers already receive the benefits of price stability through levelized fuel factors. At this time, the only parties that are clearly in a position to benefit from the plans are the IOUs themselves.

In addition, utilities currently engage in long-term fuel purchase contracts, physical forwards contracts, and financial option contracts to manage fuel costs. The costs of these transactions can and have been approved by the Commission after the fact. Currently, there is no compelling reason to authorize an unlimited expansion of the risk management programs without careful study of the utilities' plans, and the result of the pilot programs.

If the Commission approves the IOUs' proposed plans, it should limit approval to certain specific mechanisms its staff recommends after reviewing the utilities' proposals. Specifically, the Commission should approve the following: First, a Commission employed expert should independently evaluate the plans. Second, the utilities actual cost of fuel should be disclosed as it is now, so that it can be compared to the price charged to customers. Third, the Commission should impose limitations on the types of instruments and transactions that the utilities use to hedge. Fourth, at a minimum, the results of the derivative transactions should be filed with the Commission, and the derivative transactions should be independently stated on financial statements in accordance with FAS 133. Fifth, customers

should be given the option to pay spot market or independently hedged fuel costs, rather than accept the utility estimated fuel cost. Sixth, the Commission should prohibit the IOUs from engaging in transactions with affiliates. Finally, the Commission should also require that any items for which the utilities seek recovery from ratepayers be separately delineated so that a meaningful prudence review can be conducted.

**OPC:** The specific plans put forward should not be approved at this time. Additional incentives are unnecessary to encourage responsible risk management by utilities. Citizens assert that the risk premium and other compensation sought are not in proportion to the benefits received by the consumers.

**STAFF:** Staff's positions are preliminary and based on materials filed by the parties and on discovery. The preliminary positions are offered to assist the parties in preparing for the hearing. Staff's final positions will be based upon all the evidence in the record and may differ from the preliminary positions.

#### VIII. ISSUES AND POSITIONS

**ISSUE 1A:** What role should the Commission take concerning the manner in which each investor-owned electric utility manages risks associated with fuel procurement?

##### **POSITIONS:**

**FPC:** With respect to FPC, the Commission should approve the Company's proposed Hedging Program on a trial basis and then monitor and evaluate the Program's results in order to gain the benefit of practical, first hand knowledge for use by the Commission in determining its long-term role concerning the manner in which utilities manage the risks associated with fuel procurement. (Portuondo)

**FPL:** FPL is prepared to accept Staff's proposed resolution of issues from July 31, 2002, with the addition of the

phrase "and/or physical" inserted between "financial" and "hedging" in the first sentence of paragraphs three and four.

- GULF:** Gulf requests the Commission's authorization to implement a hedging program with regard to the Company's purchases of natural gas and fuel oil. Gulf's proposed program is set forth in Exhibit WNM-1. If approved by the Commission, Gulf would be authorized to use financial instruments in order to protect Gulf's customers from price volatility for these two categories of fuel purchases. The Commission's concurrence that the parameters and limits of Gulf's proposed program are prudent is vital. On an ongoing basis, the Commission's role should be one of oversight and monitoring to ensure the program continues to be prudent. (McKenzie)
- TECO:** The Commission should oversee and review each utility's risk management plan. The Commission should also review the utilities' hedging transactions as they are incurred and/or proposed for cost recovery through the fuel clause (Witness: Wehle)
- FIPUG:** The Commission should reject the IOU's proposed plans and maintain the status quo.
- OPC:** The Commission should establish an environment in which investor-owned utilities are able to manage risk associated with fuel procurement that affords consumers with prudent risk avoidance at the lowest possible cost.
- STAFF:** No position at this time.
- ISSUE 1B:** Is each investor-owned electric utility taking reasonable steps to manage the price risk associated with its natural gas and residual oil transactions, as well as purchased power transactions based on natural gas prices, through the use of physical, operational, or financial hedging practices, or a combination of those practices?

**POSITIONS:**

**FPC:** With respect to FPC, yes. FPC has successfully engaged in traditional physical and operational hedging practices to manage the risk of price volatility in the procurement of natural gas and residual (as well as distillate) oil. FPC has been reluctant to engage in non-traditional financial hedging practices due to regulatory uncertainty, which could be overcome by the Commission's approval of FPC's proposed Hedging Program. (Portuondo/Murphy)

**FPL:** Yes, FPL continually manages natural gas, residual oil and wholesale energy price risk through multiple hedging practices, including diversification of its generation mix, use of short-, mid and long-term physical fuel and purchased power transactions, fuel switching, optimization of fuel storage and transportation, and wholesale power trading. (Stepenovitch)

**GULF:** Yes, with regard to Gulf Power Company. (McKenzie)

**TECO:** Tampa Electric is taking reasonable steps to manage price risks associated with fuel and purchased power transactions. The company has used physical hedges to mitigate the price volatility of coal, its primary fuel source. (Witnesses: Brown; Wehle)

**FIPUG:** FIPUG can take no position. The information is not available for customer review.

**OPC:** No position at this time.

**STAFF:** No position at this time.

**ISSUE 1C:** For what purposes does each investor-owned electric utility engage in physical, operational, or financial fuel price hedging practices, or a combination of those practices, and to what extent do such purposes involve reductions in fuel price volatility versus reductions in fuel costs?

**POSITIONS:**

**FPC:** The purpose of FPC's proposed Hedging Program is consistent with the Commission's directive to file an incentive plan for managing the risk associated with fuel price volatility. The Hedging Program expressly states that reducing this risk will not necessarily result in reduced fuel costs. (Portuondo/Murphy)

**FPL:** (None provided)

**GULF:** Historically, Gulf's electric generation has consisted primarily of coal fired resources. Gulf has managed fuel price risk and availability of supply risk through a combination of both long-term contracts and purchases of coal through the short-term spot market. With the addition of Smith Unit 3 to Gulf's generation mix, Gulf now has a significant amount of generation that is fired by natural gas. Gulf has proposed a hedging program (see Exhibit WNM-1) that, if approved by the Commission, will allow Gulf to manage fuel price risk of natural gas through the use of financial instruments. Gulf's proposed program, if approved by the Commission, would be primarily focused on reducing fuel price volatility by aggressively hedging price risk in upward markets and cautiously hedging price risk in downward markets. Gulf's proposed program would provide Gulf an opportunity to share in any savings achieved for its customers. This incentive to manage the program in a manner that achieves savings for customers is in exchange for the Company's willingness to provide certain caps on the customers' exposure under the proposed hedging program (see Issue 7 below). (McKenzie)

**TECO:** Tampa Electric utilizes physical hedges with respect to the acquisition of coal, its primary fuel source, in an effort to control fuel price volatility and to secure a reliable source of coal at the lowest available cost. Fortunately, the price of coal has not been as volatile as the prices for oil and natural gas. Mitigating fuel price volatility does not necessarily produce an overall reduction in fuel cost. (Witness: Wehle)

**FIPUG:** As much of this activity is conducted secretly, FIPUG cannot respond to this issue. The Commission should require the utilities to fully disclose what types of activities the utilities engage in and for what purpose. The utilities should be required to explicitly document any fuel cost reductions.

**OPC:** No position at this time.

**STAFF:** This issue was established for informational purposes only. Accordingly, staff takes no position on this issue.

**STIPULATED**

**ISSUE 2:** What is the appropriate regulatory treatment for gains and losses on futures contracts and net settlements associated with swaps an investor-owned electric utility incurs through fuel and purchased power hedging transactions?

**POSITION:** Gains and losses on derivatives used prudently to hedge risks associated with fuel procurement, gains and losses on derivatives used prudently to cross-hedge natural gas-indexed purchased power, and settlement proceeds on fuel swaps used prudently to hedge risks associated with fuel procurement should be recovered through the Fuel and Purchased Power Cost Recovery Clause.

**STIPULATED**

**ISSUE 3:** What is the appropriate regulatory treatment for the premiums an investor-owned electric utility receives and pays for hedging fuel and purchased power transactions through options contracts?

**POSITION:** Premiums paid or received on the purchase or sale of options used prudently to hedge the risks associated with fuel and purchased power transactions should be recovered through the Fuel and Purchased Power Cost Recovery Clause.

**STIPULATED**

**ISSUE 4:** What is the appropriate regulatory treatment for the transaction costs an investor-owned electric utility incurs from hedging its fuel and purchased power transactions through futures and options contracts?

**POSITION:** Transaction costs on the purchase or sale of derivatives used prudently to hedge the risks associated with fuel or purchased power transactions should be recovered through the Fuel and Purchased Power Cost Recovery Clause.

**ISSUE 5:** For the period March 1999 to March 2001, did FPL take reasonable steps to manage the risk associated with changes in natural gas prices?

\*This issue was resolved by Order No. PSC-02-0793-PAA-EI, issued June 11, 2002, which was made final and effective by Order No. PSC-02-0920-CO-EI, issued July 10, 2002.

**ISSUE 6:** For the period March 1999 to March 2001, did Florida Power take reasonable steps to manage the risk associated with changes in natural gas prices?

\*This issue was resolved by Order No. PSC-02-0919-PAA-EI, issued July 8, 2002, which was made final and effective by Order No. PSC-02-1062-CO-EI, issued August 6, 2002.

**ISSUE 7A:** What incentive(s), if any, should the Commission establish to encourage investor-owned electric utilities to optimally manage the risks to ratepayers associated with fuel and purchased power price volatility?

**POSITIONS:**

**FPC:** With respect to FPC, the Commission should approve FPC's proposed Hedging Program, under which FPC would bare full responsibility for the gains and losses of its hedging practices on a portion of its annual natural gas and residual oil quantities for which the customers' risk of

price volatility has been completely eliminated.  
(Portuondo/Murphy)

**FPL:** FPL is prepared to accept Staff's proposed resolution of issues from July 31, 2002, with the addition of the phrase "and/or physical" inserted between "financial" and "hedging" in the first sentence of paragraphs three and four.

**GULF:** Gulf's proposed hedging program is structured to encourage cautious hedging in a downward market and aggressive hedging in an upward market. In return for a 25% incentive on hedging savings, Gulf will guarantee the annual above market cap for natural gas and oil and limit the forward mark-to-market negative amount (see Exhibit WNM-1). (McKenzie)

**TECO:** Tampa Electric does not believe it is appropriate or necessary for the Commission to establish any incentives at this time to encourage Tampa Electric to optimally manage the risks to ratepayers associated with fuel and purchased power price volatility. Tampa Electric believes that it is optimally managing risks to ratepayers associated with fuel and purchased power price volatility. The company does not believe it appropriate to use financial hedging instruments for wholesale energy transactions until a liquid, published wholesale market exists in the state. As Tampa Electric's reliance on natural gas fired generation increases, it will continue to evaluate the costs and benefits of implementing additional risk management practices relating to fuel transactions. (Witnesses: Brown, Wehle)

**FIPUG:** FIPUG agrees with Staff that consideration of incentives should be postponed until pilot programs have proven their worth.

**OPC:** Adequate incentives such as the ability to recover prudent costs incurred in the provisions of utility service already exist for investor-owned utilities. See Section 366.041, Florida Statutes (2001).



**STAFF:** The allowance of recovery of gains, losses, settlement proceeds, premiums, and transaction costs as addressed in Issues 2, 3, and 4, if approved, would reduce or remove utilities' disincentives for hedging risks associated with fuel procurement; however, any further incentive to hedge such risks, including the incentives contained in the hedging plans proposed by the utilities, should not be approved.

**ISSUE 7B:** If the Commission were to approve any utility's incentive plan for optimally managing fuel price risk which includes a change in the method for calculating shareholder gains on wholesale sales as specified in Order Nos. PSC-00-1744-PAY-EI and PSC-01-2371-FOF-EI, what changes, if any, should be made to the requirements of these orders?

**POSITIONS:**

**FPC:** If the Commission were to approve FPC's proposed Hedging Program, thereby approving the expansion of the current method for sharing the gains on wholesale transactions that is included as a part of FPC's proposal, the order granting such approval would effectively modify or supersede the requirements of the two prior orders with respect to FPC, without the need to make any changes to the generic requirements set forth in these prior orders. (Portuondo)

**FPL:** FPL is prepared to accept Staff's proposed resolution of issues from July 31, 2002, with the addition of the phrase "and/or physical" inserted between "financial" and "hedging" in the first sentence of paragraphs three and four.

**GULF:** Gulf's proposed gas/oil hedging program does not include a change in the method for calculating shareholder gains on wholesale sales. (McKenzie)

**TECO:** Tampa Electric does not believe it is appropriate or necessary at this time for the Commission to approve an

incentive plan for Tampa Electric. Accordingly, Tampa Electric does not believe the Commission should change the current methodology for calculating shareholder gains on wholesale sales and, thus, no changes to the orders in question are necessary. If the Commission were to approve a utility's incentive plan, the characteristics of the plan would indicate what changes, if any, need be made to the orders in question. (Witnesses: Brown, Wehle)

**FIPUG:** The only change which should be made to the incentive plan in the current orders should be to eliminate such incentives; they certainly should not be increased or applied to purchases as well as sales. Until there is open access, an independent system operator for the Florida transmission grid, and a viable wholesale market in Florida, such incentive plans would merely allow one utility to increase its revenues at the expense of another. The Commission should mandate the return of the Florida broker system in which power is transferred at cost, and utilities share the savings of using the most efficient generation.

**OPC:** No changes are necessary at this time for the reasons set forth in the Staff testimony.

**STAFF:** No changes should be made to the method for calculating shareholder gains on wholesale sales as specified in Order Nos. PSC-1744-PAA-EI and PSC-01-2371-FOF-EI at this time.

IX. EXHIBIT LIST

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
	<u>Direct</u>		
Javier Portuondo	FPC	<u>                    </u> (JP-1)	Examples of FPC's Hedging Program Proposal

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Javier Portuondo	FPC	<u>(JP-2)</u>	FPC's June 5, 2002 Hedging Program Proposal overview
Korel M. Dubin	FPL	<u>(KMD-1)</u>	FPL's Proposed Risk Sharing Program
Joseph P. Stepenovitch	FPL	<u>(JPS-1)</u>	FPL's Proposed Risk Sharing Program
Joseph P. Stepenovitch	FPL	<u>(JPS-2)</u>	Sample Calculations of Fuel Charges Under Status Quo (Current Actual Cost Recovery Mechanism) and FPL's Proposed Risk Sharing Plan
W. N. McKenzie	GULF	<u>(WNM-1)</u>	Gulf's proposed gas/oil hedging program; examples of hedging
Joann T. Wehle	TECO	<u>(JTW-1)</u>	Risk Management Plan Outline for Fuel Procurement and Wholesale Power Purchases
Lee W. Gooch	FIPUG	<u>(LWG-1)</u>	New York Times Article titled "Contracts So Complex They Imperil the System"
Lee W. Gooch	FIPUG	<u>(LWG-2)</u>	Derivative Trading Chart Labeled "The Money Merry-Go-Round"

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-1)	Investor-Owned Electric Utilities' Natural Gas-Fired Generation: 1991, 2001 and 2011
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-2)	History of Risk Management
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-3)	Establishment of and Modifications to Fuel and Purchased Power Cost Recovery Clause
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-4)	Components of a Utility's Risk Management Plan
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-5)	Total Fuel Cost Statistical Measures for Florida Power & Light Company, Florida Power Corp., Gulf Power Company, and Tampa Electric Company: July 1996 through June 2001

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Todd F. Bohrmann	FPSC	<u>(TFB-6)</u>	Comparison of High Bill Complaints Filed with the Commission by Florida Power & Light Company's, Florida Power Corporation's, and Tampa Electric Company's Ratepayers
Todd F. Bohrmann	FPSC	<u>(TFB-7)</u>	Example of A Utility Engaging in Futures Contracts to Hedge Its Natural Gas Costs
Todd F. Bohrmann	FPSC	<u>(TFB-8)</u>	Example of A Utility Engaging in Options Contracts to Hedge Its Natural Gas Costs
Todd F. Bohrmann	FPSC	<u>(TFB-9)</u>	Excerpts from Order No. 14546, Docket No. 850001-EI-B, Issued July 8, 1985, Pages 4-5
Todd F. Bohrmann	FPSC	<u>(TFB-10)</u>	Definition and Hypothetical Example of Each Type of Risk That A Utility May Experience with its Fuel Procurement Transactions
Todd F. Bohrmann	FPSC	<u>(TFB-11)</u>	Types of Hedging Techniques

<u>Witness</u>	<u>Proffered By</u>	<u>I.D. No.</u>	<u>Description</u>
Todd F. Bohrmann	FPSC	<u>                    </u> (TFB-12)	Glossary of Terms
<u>Rebuttal</u>			
Joseph P. Stepenovitch	FPL	<u>                    </u> (JPS-3)	Forward Price As a Percentage Above or Below Spot At Time of Maturity
Joseph P. Stepenovitch	FPL	<u>                    </u> (JPS-4)	FPL Proposed Risk Sharing Program Cost / Benefit Analysis

Parties and Staff reserve the right to identify additional exhibits for the purpose of cross-examination.

X. PROPOSED STIPULATIONS

There are no proposed stipulations at this time.

XI. PENDING MOTIONS

There are no pending motions at this time.

XII. PENDING CONFIDENTIALITY MATTERS

Florida Power Corporation's June 26, 2002, request for confidential classification of Document No. 05903-02 is pending.

Florida Power Corporation's June 12, 2002, request for confidential classification of Document No. 06096-02 is pending.

Florida Power & Light Company's June 28, 2002, request for confidential classification of Document No. 06733-02 is pending.

Florida Power & Light Company's July 18, 2002, request for confidential classification of Document No. 07466-02 is pending.

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Gulf Power Company's June 11, 2002, request for confidential classification of Document No. 06066-02 is pending.

Gulf Power Company's July 17, 2002, request for confidential classification of Document No. 07443-02 is pending.

Tampa Electric Company's June 11 and June 24, 2002, requests for confidential classification of Document Nos. 06489-02 and 06490-02 are pending.

It is therefore,

ORDERED by Commissioner Michael A. Palecki, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth above unless modified by the Commission.

By ORDER of Commissioner Michael A. Palecki, as Prehearing Officer, this 9th day of August, 2002.



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MICHAEL A. PALECKI  
Commissioner and Prehearing Officer

( S E A L )

WCK

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 or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be

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construed to mean all requests for an administrative hearing or judicial review 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.

Any party adversely affected by this order, which is preliminary, procedural, or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code, if issued by a Prehearing Officer; (2) reconsideration within 15 days pursuant to Rule 25-22.060, Florida Administrative Code, if issued by the Commission; or (3) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of the Commission Clerk and Administrative Services, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.



**PROPOSED RESOLUTION OF ISSUES  
DOCKET NO. 011605-EI**

Components of Proposed Resolution:

1. Each investor-owned electric utility recognizes the importance of managing price volatility in the fuel and purchased power it purchases to provide electric service to its customers. Further, each investor-owned electric utility recognizes that the greater the proportion of a particular fuel or purchased power it relies upon to provide electric service to its customers, the greater the importance of managing price volatility associated with that energy source.
2. Each investor-owned electric utility shall submit to the Commission, at the time of its projection filing in the fuel and purchased power cost recovery docket each year, its risk management plan for fuel procurement. For purposes of this proposed resolution, each risk management plan shall address the following items set forth in Exhibit TFB-4 to the prefiled testimony of Todd F. Bohrmann in this docket: item numbers 1, 3, 4, 5, 6, 7, 8, 9, 13, 14, and 15. The information provided as part of each risk management plan should emphasize the utility's numerical assessment of an acceptable level of price risk for each type of fuel and for purchased power, the method used to determine the acceptable level of risk, identification of the mechanisms to mitigate risk above the acceptable level, and a valuation of that risk in dollars, where possible. The information provided as part of each risk management plan shall include the quantities of fuel and purchased power that each utility expects to hedge through physical and financial hedging, to the extent such forecasts are made. These risk management plans shall be submitted for informational purposes and shall not be subject to approval/disapproval by the Commission. In addition, each investor-owned electric utility shall submit, as part of its final true-up filing in the fuel and purchased power cost recovery docket each year, a report indicating the success of its risk management activities with respect to the objectives set forth in its risk management plan.

ATTACHMENT A

3. Each investor-owned electric utility shall be authorized to recover, through the fuel and purchased power cost recovery clause, its prudently-incurred costs associated with financial and/or physical hedging transactions for natural gas, residual oil, and purchased power contracts tied to the price of natural gas. Examples of such costs include transaction costs associated with derivatives (e.g., fees and commissions), gains and losses on futures contracts, premiums on options contracts, and net settlements from swaps transactions. Each utility choosing to engage in such transactions shall maintain records of each transaction for Commission audit purposes.
4. Each investor-owned electric utility may recover through the fuel and purchased power cost recovery clause prudently-incurred incremental administrative costs associated with initiating and maintaining a financial hedging program. New capital items which traditionally and historically would be recoverable through base rates shall not be recoverable through the fuel clause. All incremental administrative costs for which fuel clause recovery is sought shall be separately identified and addressed in the utility's projected and final true-up filings in the fuel and purchased power cost recovery clause. All such costs which are authorized for fuel clause recovery shall be transferred to base rates at the time of the utility's next rate proceeding.
5. Each investor-owned utility shall provide, as part of its final true-up filing in the fuel and purchased power cost recovery docket, the following information: (1) the volumes of each fuel the utility actually hedged using a fixed price contract or instrument; (2) the types of hedging instruments the utility used, and the volume and type of fuel associated with each type of instrument; (3) the average period of each hedge; and (4) the actual total cost (e.g., fees, commissions, options premiums, futures gains and losses, swaps settlements) associated with using each type of hedging instrument.

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\* The Commission will review the prudence of each IOU's hedging transactions, including financial hedging transactions, as part of its annual fuel and purchased power cost recovery proceedings. Prudence shall be determined under established legal standards.

\* No implication concerning the relative merits of using financial versus physical hedging techniques should be drawn from this proposed resolution.