

State of Florida



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# Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

COMMISSION  
CLERK

**-M-E-M-O-R-A-N-D-U-M-**

**DATE:** July 30, 2008

**TO:** Rosanne Gervasi, Senior Attorney, Office of the General Counsel

**FROM:** William F. Coston, Operations Review Specialist, Division of Regulatory Compliance *WFC*

**RE:** 080439-EI - Request for confidential classification of portions of staff's *Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities* by Gulf Power Company.  
Document: 05228-08

Attached is a June 17, 2008 request (document 05228-08) from Gulf Power Company counsel, Susan Ritnour. This document includes the company's request for Specified Confidential Classification on portions of staff's *Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities*. The company cites §366.0963(3)(b), §366.0963(3)(d), and §366.0963(3)(e), F.S.—which address auditing, contractual data, and competitive interests, respectively—as the basis for the request.

Staff has reviewed this request and believes that the specified information is covered by §366.0963(3)(b), (3)(d), and (3)(e), F.S. Staff recommends the approval of Gulf Power Company's Request for Confidential Classification on portions of staff's *Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities*.

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Susan D. Ritenour  
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080439



REDACTED

June 17, 2008

Ms. Ann Cole, Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee FL 32399-0850

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08 JUN 19 AM 9:39  
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Dear Ms. Cole:

RE: Undocketed

Enclosed are an original and fifteen copies of Gulf Power Company's Request for Confidential Classification regarding certain confidential information contained in the Public Service Commission staff's final report on its Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities.

Sincerely,

*Susan D. Ritenour*

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Enclosures

cc: Beggs & Lane  
Jeffrey A. Stone, Esq.

1 cent records

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**REDACTED**

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Public Service Commission  
Management Review of Hedging Practices of  
Investor-Owned Electric Utilities

Docket No.: Undocketed  
Date: June 17, 2008

**REQUEST FOR CONFIDENTIAL CLASSIFICATION**

GULF POWER COMPANY ["Gulf Power", "Gulf", or the "Company"], by and through its undersigned attorneys and pursuant to Rule 25-22.006, Florida Administrative Code, hereby files a request that the Florida Public Service Commission enter an order protecting from public disclosure certain confidential information contained in the Public Service Commission staff's final report on its Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities. As grounds for this request, the Company states:

1. In connection with a management review of Gulf Power's fuel procurement hedging practices (PA-07-11-007), the Public Service Commission staff prepared a report entitled *Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities*. On June 4, 2008, the Commission staff forwarded a draft copy of the report to Gulf Power and informed the Company of its right to request confidential classification of any portions of the report which Gulf Power deems confidential pursuant to Rule 25-22.006(3), Florida Administrative Code. Portions of the report contain "proprietary confidential business information" as defined pursuant to section 366.093(3), Florida Statutes.
2. The last sentence on page 50 of the report and Exhibit 19 thereto contain detailed information on how Gulf Power has distributed its hedging purchases over time between 2003 and 2007. Gulf Power considers this information to be confidential pursuant to section ~~366.09(3)(e)~~ 366.093(3)(e), Florida Statutes, which protects from public disclosure "[i]nformation relating to

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competitive interests, the disclosure of which would impair the competitive business of the provider of the information.” The information reveals the Company’s internal strategy for timing its hedging purchases and public disclosure of this information could potentially affect the pricing and availability of hedging opportunities for Gulf in the market.

3. Exhibit 25 contains a list of current counterparties with whom Gulf Power has contracted to conduct over-the-counter financial hedging transactions. The Exhibit also lists the counterparties’ corresponding Standard & Poor’s credit ratings and contractual credit limits. The specified credit limits are the product of Gulf Power’s internal analysis of the counterparties’ credit-worthiness and constitute “[c]ontractual data, the disclosure of which would impair the efforts of [Gulf Power] to contract for goods or services on favorable terms.” See, § ~~366.09(3)(d)~~ Fla. Stat. These specific credit limits are regarded as confidential by Gulf and the parties with whom it has contracted. Other members of the market in which Gulf Power competes consider this type of information to be competitively sensitive. Disclosure of this information would negatively impact Gulf’s ability to negotiate pricing favorable to its customers in future contracts because possible counterparties may refuse to contract with Gulf if doing so results in such terms being made public.

4. Finally, the last sentence of the second full paragraph on page 59 of the report contains information derived from “reports of internal auditors” and is therefore confidential pursuant to section ~~366.093(3)(b)~~ Florida Statutes.


5. The information filed pursuant to this Request is intended to be, and is treated as, confidential by the Gulf Power and, to this attorney’s knowledge, has not been otherwise publicly disclosed.

6. Submitted as Exhibit "A" is one copy of the final report, on which is highlighted

the information for which confidential classification is requested. Exhibit "A" should be treated as confidential pending a ruling on this request. Attached as Exhibit "B" are two (2) edited copies of the final report, which may be made available for public review and inspection. Attached as Exhibit "C" to this request is a line-by-line/field-by-field justification for the request for confidential classification.

**WHEREFORE**, Gulf Power Company respectfully requests that the Commission enter an order protecting the information highlighted on Exhibit "A" from public disclosure as proprietary confidential business information.

Respectfully submitted this 17th day of June, 2008.

  
\_\_\_\_\_  
**JEFFREY A. STONE**  
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**RUSSELL A. BADDERS**  
Florida Bar No. 007455  
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(850) 432-2451  
**Attorneys for Gulf Power Company**

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**IN RE: Public Service Commission  
Management Review of Hedging Practices of  
Investor-Owned Electric Utilities**

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**Docket No.: Undocketed  
Date: June 17, 2008**

**REQUEST FOR CONFIDENTIAL CLASSIFICATION**

**EXHIBIT "A"**

**Provided to the Commission Clerk under separate cover as confidential  
information.**

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**EXHIBIT "B"**

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perform a "roll" and "unwind" for each swap transaction to more closely match the financial hedge to the actual burn.

To perform a "roll" and "unwind" on its swap transaction, SCS contacts its counterparty asking that the existing hedge transactions be "rolled" forward one month. The company states that the negotiated price to complete this transaction may be a .01¢ +/- adjustment per MMBtu to the original settlement price. This transaction essentially moves the swap forward one month. The company still considers this the same transaction within its accounting system.

Annual Financial Transactions by Instrument Type Gulf Power Company 2003 - 2007					
Swaps	100%	100%	100%	100%	100%
Total Financial Transactions	278	235	170	95	26

Exhibit 18

Source: Data Request 3.2

The company conducts this swap "roll" in order to "unwind" the transaction throughout the month. The company will settle a portion of this swap each day against the actual burn volumes. SCS states the benefit to performing these transactions is that they reduce the intra-month price risk versus settling the entire position on just one date.

### What are the company's targets and threshold limits for its financial hedging program?

Currently, Gulf Power divides its hedging targets into summer and winter periods, with an overall hedging goal of 40 to 60 percent of its natural gas forecast. SCS and Gulf Power establish the annual natural gas hedging targets, and re-evaluate these targets every 30 to 60 days. The current procedures allow SCS to purchase financial hedges 36 months out from the consumption date. Gulf Power management believes that distributing its hedging purchases over an extended period of time allows the company to benefit from downturns in the market and volume cost averaging.

SCS trading associates will assess current market conditions and purchase financial hedges to ensure that during any settlement month the hedging transactions will be comprised of transactions purchased throughout the prior 36 months. EXHIBIT 19 shows how far in advance the company purchased its financial hedging transactions during the review period.

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4  
5



A B C D E

Initiation of Transactions in Relation to Settlement Date Gulf Power Company 2003-2007	
1	2007
2	2006
3	2005
4	2004
5	2003

Exhibit 19

Source: Data Request 2.8

**Has the company's fuel procurement hedging program operated in a manner that is non-speculative?**

The current strategy allows SCS to interject greater subjectivity in the purchasing of financial hedges, and according to company management, its goal is to purchase during downward turns in the market. While this may, at times, provide a benefit to the ratepayer, it can be counterintuitive to the overall hedging goal of stabilizing prices. If SCS delays purchasing financial transactions because of upswings in the market, the company may be under-hedged or reliant upon purchasing more costly hedges in the short term. Gulf Power may consider establishing a purchasing timeline within its strategy to ensure a more consistent, volume-averaging approach to its hedging purchases.

Audit staff believes that Gulf Power and Southern Company Services take a non-speculative approach to hedging strategy. Gulf Power has consistently hedged less fuel than it consumes and has a long-term purchasing strategy that achieves a volume cost average for each settlement month. Although the current strategy allows the company to purchase hedges up to 36 months out from settlement, the plan does not establish a requirement that a certain volume must be purchased over time.

**What volume of each fuel type has been hedged for the period 2003-2007?**

As mentioned, Gulf Power only initiates financial hedges on its natural gas purchases, which comprise approximately 15 percent of the company's overall fuel purchases. Gulf Power has taken a reserved approach to its hedging program during the period, hedging between 40 and 60 percent of its annual total fuel forecasts. When comparing to actual burns, the annual percent of gas hedged ranges from 30 to 59 percent during the period. EXHIBIT 20 details the annual percentage of gas hedged against the company's actual burns.

**How does the company evaluate and select the counterparties with which it conducts financial hedging transactions?**

Southern Company Services has a group of approved financial counterparties that it uses to transact its over-the-counter financial hedging transactions. The company selects these financial counterparties based on their knowledge of the industry, experience, knowledge of the southeast region, customer service, ability to offer appropriate products, credit stability, and levels of any fees or costs. Multiple counterparties are used by SCS to assure competitive pricing and to diversify credit exposure.

When SCS is seeking additional counterparties, the company interviews several candidates and conducts a full evaluation, including credit, for each. The SCS Fuel Services division makes the final selection of any new counterparty, with input from the Southern Company Treasury Services. Once a counterparty is selected, an International Swaps and Derivatives Association agreement is negotiated and executed, allowing the SCS traders to commence transacting business. The company provided, during this review, copies of each current counterparty ISDA agreement.

The middle office will monitor the counterparty's overall credit strength and grant the limit using the counterparty's overall credit rating and common equity balance. Each company is reviewed on a monthly basis, with input from Southern Company Treasury Services. Currently, all of SCS's financial counterparties have an external credit rating of A or higher. A list of current SCS counterparties and each corresponding credit rating is detailed in **EXHIBIT 25**.

**A**

Company Financial Counterparty Relationships Gulf Power Company			
1	ABN Amro	AA-	
2	Bank of America	AA	
3	Barclays	AA	
4	CIBC	A+	
5	Credit Suisse	AA-	
6	Deutsche Bank	AA-	
7	JPMorgan Chase	AA-	
8	Mitsui & Company	A	
9	Morgan Stanley	A	

**Exhibit 25**

*Source: Data Request 2.2*

Southern Company Services does maintain dual relationship with counterparties in which the company can initiate financial hedging transactions and also contract for physical supply of natural gas. However, as a general practice, the company does not enter into a financial contract with a counterparty from which it has purchased the physical commodity in a given year. Company management points out that with continuing trend of consolidations of financial institutions and changes in the physical fuel markets, keeping these transactions segregated is

becoming a greater challenge. In 2007, the company completed a financial transaction with JPMorgan, an institution from which Southern Company Services also purchases physical natural gas. This gas was used by other Southern Company affiliates, not Gulf Power.

**Does the company conduct audits of its fuel procurement program and hedging instruments?**

Yes, Southern Company has an Internal Audit division that performs both risk based audits and scheduled audits for its corporate and operating companies. The Southern Company audit offices are located in Birmingham, Alabama and Atlanta, Georgia. Gulf Power also maintains an audit staff in Pensacola, Florida. The company's Fuel Procurement activities are not on a scheduled audit cycle. Fuel Procurement is reviewed as-needed based on the company's annual internal risk assessment.

The last financial hedging review completed by the company's Internal Audit Division was in 2003. This review examined the *Natural Gas Hedging Process of Southern Company Services*. In 2004, the Internal Audit unit completed a follow-up to the *2003 Natural Gas Hedging Review*. The follow-up review examined the company's process in implementing its recommended action plan. The 2004 audit determined that the company had implemented all recommended changes from the 2003 audit.

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Audit staff recognizes that a risk-based audit approach allows a company's Internal Audit division the ability to collect and analyze the areas of most critical risk within the company. This approach allocates resources to the areas of greatest concern. Since the fuel procurement hedging process does present a risk to the company, audit staff believes management should consider updating its 2004 process evaluation.

**In summary, what changes should the company make to its hedging program?**

Gulf Power Company uses a relatively small amount of natural gas within its generation fleet. Currently, natural gas comprises approximately 15 percent of the company's fuel purchases. Therefore, Gulf Power's natural gas hedging programs have a reduced overall impact on its fuel expenditures. Gulf Power employs Southern Company Services to develop and implement its hedging strategy. Gulf Power has a conservative approach to its hedging strategy, with a current goal of hedging between 40 and 60 percent of its fuel forecast. On average, the company has hedged 48 percent of its natural gas annually over the period 2003-2007.

Audit staff believes that Gulf Power and Southern Company Services have developed a non-speculative hedging process that meets the intent of the Hedging Order. The company believes that its customers have benefited from the use of this program. Audit staff believes that the company's approach may, at times, be too conservative.

Audit staff notes the following positions from its review of Gulf Power:

EXHIBIT C

**Line-by-Line/Field-by-Field Justification**

**Line(s)/Field(s)**

**Justification**

Page 50; Lines 1-5  
Page 51; Lines 1-5; Columns A-E

This information is entitled to confidential classification pursuant to §366.093(3)(e), Florida Statutes. The basis for this information being designated as confidential is more fully set forth in paragraph 2.

Page 58; Lines 1-9; Column A

This information is entitled to confidential classification pursuant to §366.093(3)(d), Florida Statutes. The basis for this information being designated as confidential is more fully set forth in paragraph 3.

Page 59; Lines 1-3

This information is entitled to confidential classification pursuant to §366.093(3)(b), Florida Statutes. The basis for this information being designated as confidential is more fully set forth in paragraph 4.

STATE OF FLORIDA

COMMISSIONERS:  
MATTHEW M. CARTER II, CHAIRMAN  
LISA POLAK EDGAR  
KATRINA J. MCMURRIAN  
NANCY ARGENZIANO  
NATHAN A. SKOP



OFFICE OF COMMISSION CLERK  
ANN COLE  
COMMISSION CLERK  
(850) 413-6770

**CONFIDENTIAL**

**Public Service Commission**

**ACKNOWLEDGEMENT**

DATE: June 19, 2008

TO: Susan Ritenour, Jeffrey Stone, Gulf Power Company

FROM: Ruth Nettles, Office of Commission Clerk

RE: Acknowledgement of Receipt of Confidential Filing

This will acknowledge receipt of a **CONFIDENTIAL DOCUMENT** filed in Docket Number 080000-OT or, if filed in an undocketed matter, concerning information contained in PSC staff's final report on its Review of Fuel Procurement Hedging Practices of Florida's Inverstor-Owned Electric Utilities, and filed on behalf of Gulf Power Company. The document will be maintained in locked storage.

If you have any questions regarding this document, please contact Marguerite Lockard, Deputy Clerk, at (850) 413-6770.

DOCUMENT NUMBER DATE  
05229 JUN 19 08  
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