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Electronic Filing

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b. Docket No. 080001-EI

In re: Fuel and Purchased Power Cost Recovery Clause with Generating Performance Incentive Factor.

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 6 pages.

e. The document attached for electronic filing is OPC's Comments on Proposed Hedging Guidelines.

Thank you for your attention and cooperation to this request.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Fuel and Purchased Power) Cost Recovery Clause with) Generating Performance Incentive) Factor)	Docket No. 080001-EI FILED: September 3, 2008

OPC'S COMMENTS ON PROPOSED HEDGING GUIDELINES

The Office of Public Counsel submits its observations and comments on the proposed hedging guidelines submitted by Florida Power & Light Company in Docket No. 080001-EI on August 5, 2008. For the following reasons, OPC opposes the request of FPL and the other major investor-owned electric utilities for approval of the proposed guidelines. With 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. However, by FPL's own admission, the hedging costs could be substantial. While the hedging programs do not add materially to the insulation against fuel price volatility already in place in the form of the levelized fuel cost recovery charge, it appears to OPC that the hedging transactions provide financial benefits to the utilities themselves. That being the case, if the utilities continue to hedge their fuel prices, the Commission should not relinquish its full ability to gauge the prudence of the utilities' transactions. The proposal contained in FPL's petition and the attached guidelines goes far beyond "clarifying" the Commission's 2002 order. It would sacrifice the Commission's ability to conduct full, after-the-fact prudence reviews in order to accede to the utilities' desire to reduce their regulatory risk through an "up front" sign-off. Even if the Commission were to entertain the request, such an explicit lowering of regulatory risk should be accompanied by a commensurate lowering of the authorized return on equity, but that is not part of the proposal.

The data indicate that the utilities' hedging programs do not add materially to the customers' insulation against fuel cost volatility already in place in the form of the levelized fuel cost recovery factor.

During all meetings held to discuss the value of the utilities' fuel hedging programs, utilities have emphasized that the limited purpose of their fuel hedging programs—the sole benefit that they identify as the justification for their hedging programs, and the costs thereof--- is to reduce the impact of the volatility of fuel prices on the retail customer. OPC believes a first step in the Commission's appraisal of the "clarifying" new hedging guidelines is to take stock of information available six years after the Commission issued its original hedging order. It should consider, based on historical information, whether the hedging activities are needed to accomplish that purpose. Said differently, the appropriate starting point is to consider whether data gained from experience indicate that there is a problem (volatility in fuel costs felt by the customer) for hedging to solve. This is the same question that FPL raised initially in its "VMM" petition of January 31, 2008. In that pleading, FPL asserted that the levelized fuel adjustment charge has the effect of insulating the retail customer from changes in the price of fuel. In a meeting held to discuss the "VMM" proposal, FPL compared its customers' bills *with* hedging to the customers' bills as they would have been if there had been *no* hedging. The comparison showed that the existing levelized fuel cost recovery mechanism already protects customers from volatility of fuel prices as measured by the customers' monthly bills, and little additional "tempering" of volatility seen and felt by customers through their bills is accomplished by the hedging activities. Additional information that Gulf Power provided to OPC, in response to an informal request for information, reinforces the conclusion to which FPL's data leads.

At one point during a more recent meeting to discuss hedging, someone suggested that there are only two relevant "data points" –December, when one approved factor expires, and January, when the replacement factor takes its place--to consider when evaluating the contribution of hedging to the objective of moderating the fuel price volatility felt by customers. That is not true. Customers receive bills monthly. Therefore, customers are exposed to volatility of fuel costs monthly. Each monthly bill is, therefore, a "data point" that must be observed in ascertaining the extent to which the volatility of the fuel markets reaches and affects customers. In Florida, the volatility that would otherwise register on customers' bills each month is reduced by the application of a levelized annual charge on each of the monthly bills, regardless of differences in prices paid by the utility from month to month. While it is certainly true that bills rise or fall in conjunction with the establishment of a new levelized factor in January, it is incorrect to state that December and January are the only relevant data points. Accurately viewed, the situation is that, because of the levelizing that is done independent of hedging, 12 of 13 relevant data points reflect minimal volatility in fuel costs. Further, as FPL demonstrated in the VMM petition, there are means other than hedging—such as spreading a large underrecovery over a period longer than the following 12 months—with which the Commission and utilities may manage any issue of rate shock at the outset of the calendar year. In short, retail customers are called upon to bear the costs of hedging programs, but derive little value from hedging in the form of an additional layer of protection against volatility.

The costs of hedging programs have not been quantified, but, according to FPL, "could be quite substantial." At the same time the value of hedging in accomplishing the only purpose ascribed to it by the utilities is demonstrably very small, we know that the utilities incur costs associated with hedging activities. OPC believes a comparison of benefits and costs should be a fundamental component of any consideration of a utility-proposed and utility-serving revamping of the regulation of hedging programs. OPC has seen no precise quantification of the total costs that customers bear as a result of utilities' hedging programs. However, in its original petition FPL said the indirect costs associated with hedging (i.e., costs other than direct transactional costs) "could be quite substantial." (FPL's "VMM" petition, at page 6.) The unquantified, but likely "quite substantial," costs of hedging transactions should be taken into account when considering a request to diminish the Commission's ability to gauge the prudence of the utilities' activities.

The utilities benefit from their hedging programs. While the utilities like to characterize hedging as a means of reducing volatility of fuel costs from the customers' perspective, to OPC's knowledge the utilities have never described or even acknowledged the benefits that *they* receive from hedging. The hedging of fuel costs can lead to more stable cash flow and more predictable earnings, both of which are valued highly by corporate management and investors, separate and apart from any claimed benefit to customers. Rather than leading to a higher perceived risk, as asserted (but not supported) by FPL in its pending petition, the hedging activities provide distinct financial advantages to the utilities. At the same time, the proposed guidelines would shift more financial risk away from the utilities and onto their customers. The advantages and benefits of hedging that inure to utility management and investors should be taken into account when considering a request to diminish the Commission's ability to protect customers' interests.

The proposed guidelines would reduce the utilities' regulatory risk, at the cost of the Commission's ability to conduct the oversight role necessary to protect customers' interests fully, without achieving a concomitant reduction in the utilities' authorized rate of return.

Each time the Commission accommodates the utilities' desire for expedited, up-front approval of the utilities' transactions and conduct, the ability of the Commission to conduct a comprehensive prudence review with the requisite time and attention is diminished, to the detriment of its ability to protect customers' interests fully. If the Commission were to approve the proposed guidelines, the effect would be to lower the utilities' regulatory risk. Inasmuch as the utilities are compensated for the level of risk they bear through an approved rate of return, any approval by the Commission should be reflected in a rate of return on equity that is commensurately lower. But the utilities have not proposed to lower the rate of return (or lower rates that would be needed to generate the lower return) in their proposal. The Commission should not implement one side of the equation without implementing the other.

SUMMARY

In conjunction with its consideration of FPL's pending petition to approve hedging guidelines, the Commission should use the six years of experience gained since it issued its 2002 hedging order to evaluate whether the utilities' hedging programs are providing benefits to customers that are justified by the costs of hedging that customers bear. It should recognize the benefits and advantages of hedging that inure to the utilities and their investors rather than customers. It should maintain its full ability to protect customers' interests with a procedure that provides the full time and attention that the subject matter requires. It should ensure that any steps taken to reduce the utilities' risk profile is accompanied with a corresponding reduction in the authorized return on equity that customers are required to support through the rates they pay. Based on OPC's view of these considerations, OPC opposes the proposed guidelines.

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DOCKET NO. 080001-EI
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing **OPC'S COMMENTS ON PROPOSED HEDGING GUIDELINES** has been furnished by U.S. Mail and electronic mail to the following parties on this 3rd day of September, 2008.

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