BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080001-EI

In the Matter of:

FUEL AND PURCHASED POWER COST RECOVERY CLAUSE WITH GENERATING PERFORMANCE INCENTIVE FACTOR.
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PROCEEDINGS: AGENDA CONFERENCE
ITEM NO. 11

BEFORE: CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Tuesday, September 16, 2008

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

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PARTICIPATING:

JOHN T. BUTLER, ESQUIRE, and SAM FOREST, representing Florida Power & Light Company.

JOE McGLOTHLIN, ESQUIRE, Office of Public Counsel representing the Citizens of the State of Florida.

MICHAEL COOKE, GENERAL COUNSEL, LISA BENNETT, ESQUIRE, PETE LESTER, and BILL McNULTY, representing the Florida Public Service Commission Staff.

P R O C E E D I N G S

CHAIRMAN CARTER: And with that, Commissioners, we are now on Item 11.

MR. LESTER: Good morning, Commissioners.

CHAIRMAN CARTER: Hang on a second. I know you're ready to go. Just one second.

Staff, you're recognized.

MR. LESTER: Good morning, Commissioners. I'm Pete Lester with staff.

Item 11 concerns FPL's petition for voluntary withdrawal of its improved volatility mitigation mechanism petition, which was known as the VMM petition. And FPL's petition also proposes hedging order clarification guidelines.

At the April 22nd agenda conference, the Commission considered the VMM petition and determined the period of review for hedging transactions to be through July 31st of the current year. The Commission also deferred consideration of the VMM petition in its alternative to allow for completion of staff audits and to allow workshops. The audits are now complete and staff has met several times with FPL and parties.

For Issue 1, staff recommends that the Commission acknowledge FPL's voluntary withdrawal of the VMM petition. Regarding Issue 2, FPL's proposed hedging order clarification guidelines provide that the Commission will approve each electric utility's risk management plan at the annual fuel hearing and this will guide the Commission's determination of prudence of hedging activities the following year. Progress Energy Florida, Tampa Electric Company, and Gulf Power Company support the guidelines. The Office of Public Counsel opposes the guidelines and has provided comments.

Staff recommends that the Commission approve FPL's proposed hedging order clarification guidelines. In doing so, the Commission will demonstrate its support for hedging and will retain its discretion to determine the prudence of hedging results.

Staff has the following corrections or revisions to the recommendation, and the first is on Page 4, and it would be the first full paragraph and the fifth sentence in that paragraph. Insert the word "Gulf" after "TECO and". In the same paragraph, in the seventh sentence, insert the word "Gulf" after "TECO and". And the last one is on Page 8, it is in the section entitled Sections 2 and 3. In the last sentence, the phrase "the previous calendar year" should be replaced with "August 1 to December 31 of the prior year (in 2009, the report will cover all of calendar year 2008)".

CHAIRMAN CARTER: Commissioners, were you able to get that? You may proceed.

MR. LESTER: I believe representatives of FPL and OPC are present and staff is available for questions.

CHAIRMAN CARTER: Are those the only -- are those all of the scrivener corrections and revisions?

MR. LESTER: We had several more, they were minor. We just focused on the --

CHAIRMAN CARTER: Okay. Let's hear from the parties.

MR. BUTLER: Thank you, Mr. Chairman. Good morning. My name is John Butler, Counsel for FPL. With me this morning is Sam Forest (phonetic), FPL's Vice President of Energy Marketing and Trading, which is the business unit responsible for developing and implementing FPL's hedging plans.

First, I would like to say we are very pleased with staff's recommendation on FPL's proposed hedging guidelines, and we respectfully request that the Commission approve the recommendation in its entirety. The Commission approved a stipulation in 2002 that established the current framework for FPL, or, I'm sorry, for IOU hedging programs. The stipulation had broad support from all stakeholders, including OPC at the time. IOUs have hedged pursuant to the 2002 stipulation for several year now.

It has become apparent, however, that stakeholder support has been much stronger for hedging when it results in gains than when it results in losses, even though both outcomes are expected and inevitable as volatility is controlled over time. IOU shareholders receive no special benefit or reward for hedging gains, but this observed asymmetry and the reaction to hedging when it is gains versus losses raises concerns that they might be penalized for hedging losses. This asymmetry can increase perceived financial risk and ultimately the IOUs' cost of capital.

FPL's proposed hedging guidelines are intended to clarify and refine the 2002 stipulation in order to reduce that risk. The proposed guidelines do so not by insulating IOUs from scrutiny, but rather by establishing a better framework for prospectively and collaboratively establishing detailed hedging plans that will guide both the IOUs in implementing their hedging activities and the Commission in reviewing the results.

The proposed hedging guidelines we are looking at here are the product of a full and active collaboration with staff and the parties to this docket. FPL originally filed a form of hedging guidelines as an alternative in its VMM petition in the end of January of this year, over seven months ago. The current guidelines that we are seeking approval for today are a direct outgrowth of the guidelines that we proposed in January, but they have been refined to address comments and concerns of staff as well as the parties.

As noted in the staff recommendation, the guidelines were vetted at workshops and conference calls that staff held on four separate occasions extending from early June through late August. FPL refined the guidelines to respond to specific comments on them from all of the participants in those workshops, including OPC.

Page 11 of the staff recommendation suggests some minor wording changes to clarify certain points in the guidelines. FPL circulated revisions to the guidelines on Monday of last week that addressed staff's suggestions and has confirmed that all of the IOUs support those revisions.

The IOUs' use of hedging has been carefully evaluated by staff through a pair of audits that were conducted to assess the costs and benefits of the hedging programs, and it confirmed that the IOUs 2007 hedging activities were consistent with their hedging plans. At the April 22 agenda conference, you deferred consideration of our VMM petition until those audits were completed. They have now been completed. The management audit was completed in June and found that, quote, the use of financial hedges for fuel purchases provides a benefit to customers. Each IOU's hedging program is appropriately controlled, efficiently organized, and operates under a nonspeculative format, end quote.

The financial audits were completed in May 2008, and identified no problems with the IOUs' implementation of their 2007 hedging activities. The auditors found that those activities were conducted consistent with applicable Commission orders and rules and with applicable FASB standards.

The time is right to approve the hedging guidelines now so that they may be applied to the review of hedging programs starting with this year's fuel adjustment proceedings. Let me explain kind of why it is important to have that approval today so we can move forward with review of the hedging plans at the November 2008 fuel hearings. In the first half of the calendar year, IOUs typically begin placing hedges for the following year and beyond. This means that if IOUs are going to be able to rely on the hedging guidelines for hedges to be placed in 2009, the guidelines need to be approved now.

FPL sees no meaningful benefit from further delay in approving the guidelines. As I mentioned earlier, the guidelines have been fully vetted by staff and all parties over a period of more than seven months. Both the general appropriateness of hedging and its specific application by individual IOUs have been carefully scrutinized by the staff audits. There is nothing further to review about the guidelines or about hedging generally that requires further review or debate.

Last, I would like to respond briefly to objections that OPC has filed, because I don't believe any of those objections withstands scrutiny or would warrant either denying or postponing further approval of the guidelines. OPC's first objection is that there are no demonstrable benefits to hedging. This is directly at odds with staff's audit findings which said, quote, the use of financial hedges provides a benefit to customers, end quote. And, quote, generally each company has successfully mitigated the price volatility for its customers, end quote. That being exactly the benefit hedging is intended to provide. It is also directly at odds with the conclusions in staff's recommendation that says, quote, hedging has contributed to the stability of fuel factors, end quote.

Staff also correctly points out that hedges have reduced the need for midcourse corrections. We have had far fewer of them the last few years, and most recently significantly reduced the magnitude of the underrecoveries that were the source of the midcourse corrections this summer. Speaking for FPL, I can say that the midcourse correction we sought was several hundreds of million of dollars less than it would have had to be if we had not had hedges in place for the 2008 fuel costs.

OPC claims that while hedging mitigates the volatility in fuel prices, it is not having much of an impact on the fuel factors that are charged to customers. However, this is simply not correct. FPL has performed a quantitative analysis using a principle familiar in statistics called the standard deviation, and the standard deviation without hedging is -- excuse me, stated the other way around, the standard deviation with hedging is only about two-thirds as large as it would be without hedging. Another measure that hedging is, in fact, accomplishing what it is intended to accomplish, which is to control the volatility in what customers pay.

OPC next claims that the cost of hedging has not been quantified, but could be substantial. This is, again, at odds with the audit findings in the staff recommendation. The management audit found that direct hedging transaction costs are minimal or nonexistent. OPC is focused on the comment in FPL's initial VMM petition that indirect transaction costs could be substantial. However, as staff correctly notes, FPL subsequently explained the indirect transaction costs are theoretical or potential. Depending on the relative potential or position of buyers and sellers in the fuel markets, the indirect costs could add at most a small amount to total fuel costs on the order of a couple of hundredths of one percent, and they might even be negative so that they would reduce total fuel costs. It all depends period to period on the relative position of buyers and sellers.

Finally, staff correctly points out that incremental hedging O&M costs are not significant relative to IOUs' total fuel costs. For example, FPL has projected 2009 incremental hedging O&M costs of about $695,000 compared to total projected fuel and purchased power costs about $6.9 billion. That is only about 1/100th of one percent.

OPC's third claim is that IOUs somehow benefit from their hedging programs. This is, again, unfounded. Under the Commission's fuel adjustment mechanism, IOUs recover their exact fuel costs, nothing more and nothing less. The same is true for all types of hedging costs. There is no opportunity under the Commission's fuel adjustment mechanism for IOUs to retain any portion of whatever gain may result from hedges when they are placed.

OPC suggests that IOUs benefit from a more stable cash flow and predictable earnings as a result of hedging. However, at the same time, OPC ignores the substantial asymmetric risk that IOUs face as a result of their hedging programs that I spoke to earlier. To the extent that there are any impacts on an IOU's ROE requirements from either the existence of this asymmetric risk or from the proposed hedging guidelines mitigating that risk, we agree with staff that those impacts would be properly addressed in a base rate proceeding.

Finally, OPC asserts that the hedging guidelines somehow curtail or interfere with the Commission's ability to review the prudence of IOU hedging activities. Really, nothing could be further from the truth. The hedging guidelines would actually substantially improve the Commission's review of hedging activities in two important ways.

First, the guidelines contemplate the filing of detailed risk management plans for hedges to be placed in the upcoming year early enough for those plans to be reviewed and approved before they have had to be implemented. Subject to appropriate confidentiality protections, the plans will be accessible to OPC and other parties as well as the Commission. The guidelines will, therefore, facilitate a much more complete, open, and collaborative debate about how hedging programs should function in the upcoming year.

And, second, the guidelines provide explicitly for an IOU's hedging results to be measured against its approved plan. This will provide a context and framework for prudence reviews. FPL does not believe that anyone benefits from an unstructured review process. It creates unnecessary uncertainty for the IOUs, and for the Commission and the parties it makes it difficult to articulate and apply an appropriate and consistent standard for the review.

So we have guidelines that have been thoroughly vetted, input from all parties refined to reflect that input. It would be very useful for them to be approved now so that we can actually start using them to have -- excuse me, review of hedging plans for next year reviewed as part of this year's fuel cycle. There is nothing significant to be gained from either deferring a decision or from hearings on something that has been that thoroughly vetted. And for these reasons we, again, urge you to approve staff's recommendation in its entirety.

And Mr. Forest and I are available for any questions that you may have.

CHAIRMAN CARTER: Thank you. Mr. Wright, are you part of this?

MR. WRIGHT: Mr. McGlothlin is going to present.

CHAIRMAN CARTER: No, no, that's not my question. I am going to Mr. McGlothlin next, but I was going to come to you last if you are a part of this.

MR. WRIGHT: No, I don't intend to speak other than to support Public Counsel. Thank you.

CHAIRMAN CARTER: Okay. Mr. McGlothlin, you're recognized.

MR. McGLOTHLIN: Joe McGlothlin with the Office of Public Counsel. I apologize for my lack of voice this morning. I hope you will bear with me as I speak through my cold. And perhaps --

CHAIRMAN CARTER: Did you say something?

(Laughter.)

MR. McGLOTHLIN: It's a form of reassurance that I'm not going to talk a long time this morning. In January of this year, Florida Power and Light Company filed what it called its improved volatility mitigation mechanism. And it proposed to improve the volatility mitigation mechanism by unwinding its hedging transactions and asked the Commission to support that endeavor.

In the course of that petition, its primary contention was that hedging does not mitigate volatility perceived by the customer materially beyond that which is already accomplished by the levelized fuel cost-recovery factor. As you're aware, when the Commission sets the fuel factor for the upcoming year, it divides the total annual fuel expenses by 12 and sets a constant fuel cost-recovery factor that appears on the customer's bill for each month during that period, absent some extraordinary circumstances like a midcourse correction. And FPL provided exercises which demonstrated that when you compare the impact of this levelized mechanism on a customer's bill with the impact of the levelized fuel factor plus the hedging transactions, the hedging adds very little to the protection against volatility that the customers already see in the form of the levelized factor.

Their second point is that along with this dubious value of hedging in terms of mitigating the volatility seen by the customer on their bills, the hedging transactions cause the companies, and through the companies the customers to incur inevitable -- that's their word, inevitable direct and indirect costs. And with respect to the indirect costs, they said that those costs are difficult to quantify, but could be quite substantial.

In September of this year, Florida Power and Light Company filed the petition that they're supporting today. And in that petition they asked the Commission to reaffirm its support for hedging as a valuable and effective means of mitigating volatility seen by customers. On the surface that seems to be quite a contradiction, but there's something that is a constant in both efforts. FPL is quite up front about it. FPL's primary objective in the January petition and the September petition is to reduce its regulatory risk.

Now, let's take a moment and consider what is the regulatory risk that FPL wants to reduce. Regulatory risk is the possibility or the potential that the Commission could disallow some portion of a request from being borne by customers. To the company and investors that's a risk. To the customers that is the primary tool in place to protect customers from what would otherwise be a monopoly situation.

And bear in mind that this mechanism of guarding ratepayers from imprudent actions and/or unreasonable costs is something of a continuum. You cannot accede to request to reduce regulatory risk without diminishing your ability to protect customers against potentially imprudent actions and/or unreasonably higher costs. And so when they ask you to consider a reduction of risk, you have to take that as a very serious matter and one that bears on your ultimate responsibility.

Now, they say that you should do this because uncertainty and regulatory risk increase the cost of capital. Bear in mind that when investors review a utility's risk profile, they look at the entire profile.

And when they look at Florida Power and Light Company, they will see, among other things, I can't list all of them, they will see a monopoly, no competition for the retail business. They will see ratemaking mechanisms that include the ability to ask for and receive within 60 days interim rates if they are warranted. They will see a fuel cost-recovery clause that enables them to collect their fuel costs on a current basis with a true-up. They will see a conservation cost-recovery clause and an environmental cost-recovery clause. They will see cases in which the Commission has been responsive to requests to enable them to recover storm-related expenses in a timely station. And so they will see a host of things which when you add them up would lead a company in a competitive business to say where can I sign up for risks like that.

So when they say -- when they point to a single component and say, oh, that is a source of risk, you have to bear in mind the overall risk picture and risk profile which under Florida regulation is in many ways favorable to the utilities.

Now, today FPL says it's withdrawing its petition for an improved volatility mitigation mechanism. It can withdraw its petition, but it can't withdraw the facts, which as John Adams famously said are stubborn things. And the facts which they supplied in support of that January petition we found to be quite persuasive in terms of the limited benefits that hedging provides in terms of protection against volatility seen by customers. And for that reason we think that the Commission should not agree to the proposed guidelines without considering after six years of experience from its 2002 order whether hedging truly performs in the way it anticipated at the time, or whether it has, as was described in the January petition, a set of unquantified costs and very limited benefits.

On the other hand, if after investigating the value of hedging, the Commission determines that it is a worthwhile endeavor, we would continue to oppose the guidelines in their current form because they do have the effect of reducing protection available to customers.

Now, bear in mind when we talk about regulatory risk, we are talking about the Commission's review of actions to determine whether they are imprudent and costs to determine whether they are reasonable. And in performing that function the Commission always applies the same prudence test. And the Commission has been careful never to use hindsight and never to second guess the utilities, and so the possibility of applying that test to some big numbers as to small numbers is not in itself a source of risk if the Commission acts on the evidence and applies the right test. And so we think the risk perceived by FPL is overstated for that reason.

Mr. Butler referred to statements in the audit and in the staff recommendation which support the proposition that there are benefits. But from the word go, from the year 2002 forward, the mantra of the utilities has been over the longhaul gains and losses will offset themselves. That over the longhaul there would be a wash. And to say that you can look at a particular period of time and say, aha, there are some benefits, there are some gains, flies in the face of the overall proposition which is that over the longhaul there is going to be offsetting gains and losses. And if that is true, if that is valid, then it's simply impossible to look at a snapshot in time and say, well, this proves that hedging is worthwhile.

On the other hand, if the application of the hedging transactions can be and should be to lower fuel costs, which seems to be the suggestion in FPL's presentation, that's another reason why the Commission should maintain and reserve its ability to review this transaction for prudence and effectiveness. With respect to the contention that the guidelines would lower FPL's cost of capital, from time to time that contention is made, but it never seems to be translated into a lower required rate of return, or lower rates necessary to achieve that return so that the customers never seem to catch up to realize that benefit.

Those are my comments. Thanks for your attention, and I will answer any questions.

CHAIRMAN CARTER: Thank you, Mr. McGlothlin.

Commissioners? Commissioner McMurrian, you're recognized.

COMMISSIONER McMURRIAN: And I'm probably not organized, so I will try a couple, and maybe I'll have some after.

I guess it is best to start out asking FPL this, or maybe staff, too. With respect to the plans that will be filed, will you be filing a plan every year, or will you be filing a plan one year and asking for approval and you will follow that until you see some need to change the plan?

MR. BUTLER: The expectation would be that the plans be filed every year. I suppose a utility could do no more than confirm that it intended to continue implementing on the same terms as it had the year before if it didn't intend to make any changes, but under the mechanism we envision with the guidelines there would be a filing each year.

COMMISSIONER McMURRIAN: And I guess this is for staff. Mr. McNulty, if we approve the plan and that gives the IOU the green light to pursue the hedging plan that they have laid out and the Commission would have approved, but the prudence determination would still come after that, right? I mean, wouldn't you still be looking at the period that the hedging costs and all were subject to recovery? When that full period was closed, wouldn't you be making a prudence determination at that time? And I guess this goes to the things that Mr. McGlothlin has raised, and I don't mind him jumping in, either. But I want to get straight in whether or not we are doing a prudence review, because my understanding was that we were still doing that.

MR. McNULTY: Yes, Commissioner, you would be doing a prudence review at the time that you received the results of the hedging program. And that prudence review will be tempered, if you will, by the fact that a plan has been set forth that the Commission has approved. You would be evaluating whether or not the company stayed within the parameters of the plan, or if they deviated from the plan, if it was a justifiable case to do so. So the plan set forth sort of a guideline for evaluating the result that would be received later. That's the staff's perspective of the regulatory process that would ensue from the approval of plans in advance as is suggested in the guidelines.

COMMISSIONER McMURRIAN: So the approval of the plan would be more significant than, like, the process we use for the Ten-Year Site Plan, for instance. We find it appropriate for planning purposes, but, of course, the utilities aren't held to everything they have put in that just because the plan was appropriate and things change. You are saying with respect to these plans that it would be -- what they actually do, we would be comparing that to what they laid out in the plan, what the Commission approved, and you would be trying to make sure that they had followed the plan that the Commission approved, would be more of the --

MR. McNULTY: Yes, Commissioner. I do believe it has more weight than Ten-Year Site Plans.

COMMISSIONER McMURRIAN: Okay. I think that is it for now, Mr. Chairman. I think I have some more, but I will come back.

CHAIRMAN CARTER: I will come back to you.

Commissioner Edgar and then Commissioner Argenziano.

COMMISSIONER EDGAR: Thank you. And my questions are actually more general and a little overarching, and then I am going to drill in a little bit further.

But, first of all, I was going to maybe suggest, Mr. Chairman, of course, it's up to your discretion if it might be useful to dispose of Issue 1. It seems like we have kind of moved beyond that, but we can certainly wait until the end, whatever is your pleasure.

But I also wanted to -- I thought I understood what was before us. And then from the comments that I have heard from both FPL and from OPC, I had to go back and look at the issues a little more specifically, because I feel like what I was hearing from both of you was -- well, from FPL was kind of a request, my words, but I look for you to correct me or clarify, but more of an endorsement or a continuation of the hedging order and the hedging program. And from OPC some real questions raised as to the hedging program overall and the benefits or lack of benefits. And you made some specific comments that I will go into a little later. But yet my understanding of what is before us is to specifically approve or not approve guidelines to clarify. And so I just got -- so I guess I would ask each of you if you could to see what is the issue that you see before us today.

MR. BUTLER: Commissioner, from FPL's perspective, I think the way you have characterized it was accurate. We do not view the issue of whether hedging should continue as being part of what we are petitioning to have approved. In our minds that is something that exists now. It's a mechanism that all of the utilities have been using. It was pursuant to the 2002 stipulation, and we are really looking to have the Commission approve these hedging guidelines that fundamentally do two things. I think one of them is process, one of them more substantive.

The substantive part is just setting out a set of principles that the Commission and the parties would look to in evaluating the plans and then determining whether the plans are consistent with -- and their implementation consistent with what everybody expects. And then the procedural part of it is kind of what Commissioner McMurrian was referring to that you have this process of filing plans up front, get some review and consensus that they should be implemented, and then after the fact look and see whether the utilities have implemented what they said they were going to do.

But that's it. I responded to questions or concerns raised by Office of Public Counsel about hedging, but it's not part of our petition kind of whether the issue of continuing hedging is something that needs to be decided today.

COMMISSIONER EDGAR: Mr. McGlothlin.

MR. McGLOTHLIN: The request to discontinue hedging was part of the original January VMM petition that FPL is withdrawing. And the support provided by FPL with respect to that original petition we found persuasive, and we think calls into question the value of hedging as it relates to the stated objective, which is the mitigation of fuel cost volatility that appears on customers' bills. Not to the company, which buys fuel, you know, from month-to-month and experiences that volatility, but to the customer who is already insulated by the levelized fuel factor.

And so we question the wisdom of hedging for this purpose. We question the costs incurred, and we suggest that it is time, six years having lapsed since the 2002 order, to get one's arms around that subject before doing anything else.

With respect to the guidelines that are the subject of the newest petition, we see that as an attempt, another attempt to persuade the Commission to provide up-front approval, and one does that at the expense of the greater ability to protect customers and a more typical after-the-fact prudence review. Of course, utilities would love to have a situation where everything they do is considered in advance, approved up front and irrevocably. But that comes at a cost, and it comes at a cost to the customers who depend on the Commission to maintain and reserve its ability to review the actions and costs of the utility in a timely fashion with the purpose of protecting them from bearing unreasonable costs.

MR. BUTLER: Commissioner, may I briefly respond? I'm sorry. Mr. Chairman.

COMMISSIONER EDGAR: A comment, Mr. Chairman, and a question to you, I guess, and maybe to our legal staff. It just seems to me that we are blurring petitions and requests. And the issue of regulatory certainty, and the role of prudence review, and all of that is -- quite frankly, those issues I love to discuss, and I'm fascinated by, and if that is the discussion for today I look forward to all of us engaging in it.

But from the issues that are before us, it seems like some of the comments we are hearing are about the petition filed in January which we have an item before us to withdraw, and then some of the comments are about a later petition requesting discussion and potential approval of the guidelines. And it just seems to me that from my thinking, anyway, it would be helpful to separate those. So is it the petition in January that there is an item to withdraw, is that petition before us, or are we going to withdraw it, in which case it is not before us for discussion? I mean, could you or maybe Legal help me think this through procedurally.

CHAIRMAN CARTER: Let's do this. Let's see. In reference to Issue 1, Commissioners, do you have any further questions on that or do we need to hear from legal or staff further on Issue 1? And Issue 1 deals with whether or not to allow the company to take a voluntary withdrawal of this petition, and obviously staff has briefed this issue from a legal standpoint as well as from a procedural standpoint on that, and I would just kind of -- let's do that, because it does seem like we are mixing apples and grapefruits again.

Commissioner Skop, you're recognized, sir.

COMMISSIONER SKOP: Thank you, Mr. Chairman.

I tend to agree with Commissioner Edgar with respect to disposing of Issue 1 just based on the brief that was provided by staff. The company has a voluntary right to withdraw a petition, and I think that while the discussion may be valid, I don't think that that's relevant to the issue before us on Issue 1.

CHAIRMAN CARTER: Commissioners, anything further on Issue 1?

COMMISSIONER EDGAR: If it's appropriate, Mr. Chairman, I would make a motion that we go ahead and adopt the staff recommendation on Issue 1 with the additional comment that I think that may clarify our discussion for the remaining issues.

CHAIRMAN CARTER: You're recognized for that motion.

COMMISSIONER EDGAR: I make a motion that we adopt the staff recommendation on Issue 1 with further discussion on the remaining issues to follow.

COMMISSIONER SKOP: Second.

CHAIRMAN CARTER: It has been moved and properly seconded.

Commissioners, anything further on our discussion on Issue 1, which is whether or not the company is entitled to a voluntary withdrawal of its original petition?

Hearing none, all of those in favor of the motion let it be known by the sign of aye.

(Simultaneous affirmative vote.)

CHAIRMAN CARTER: All those opposed, like sign.

Now, let's take a moment here. Staff, could you kind of get us back in the posture so we can -- I think we got a lot of rhetoric and it kind of threw us off. Let's kind of put us in the posture of discussing the remainder of the case here. It did seem that we were far afield from what I thought we were talking about, but, you know --

MR. COOKE: Commissioners, maybe I will take a shot at it.

CHAIRMAN CARTER: Good shot. Mr. Cooke.

MR. COOKE: I think that by dealing with Issue 1 it does tend to address some of the Issue raised by Mr. McGlothlin. I think the question he was raising is with regard to the entire hedging order and the hedging program, and I would say on a prospective basis this Commission can deal with that, but I think having voted to approve the withdrawal of that petition, perhaps that issue was put to bed at this point for this proceeding, for today's agenda.

I also think probably something of that magnitude is not well teed up for today's discussion. And I really think there would be potential notice issues, et cetera. So I would recommend focusing on Issue 2, which is simply should you or should you not approve the guidelines to the hedging order that has been proposed by FPL at this point.

CHAIRMAN CARTER: I said I would go to Commissioner Argenziano, and then I will come back to Commissioner McMurrian.

Commissioner Argenziano, you're recognized.

COMMISSIONER ARGENZIANO: Thank you, Mr. Chairman.

I think when Commissioner McMurrian had asked a question to staff the answer was that there would be a prudence determination afterwards. Anyway, I think they are trying to get to the point that is there a prudence determination to be had later on. But when I read through, it seems to me that that prudency determination would be more topical than it is currently.

And I think maybe going back to Mr. McGlothlin's or OPC's written comments, maybe the question should be, once again, if I could hear OPC explain to me, I see that basically what you are saying is that considering this request would diminish the Commission's ability to gauge the prudence of the utility's activities. And if you could better explain to me, am I correct in thinking that if the guidelines were adopted, the prudency determination is not as in-depth as it would ordinarily be? Do I have that wrong?

MR. McGLOTHLIN: I think the ultimate effect of that would be that the prudence review would be less in-depth. You would have less tools at your disposal, because you would be called upon to approve guidelines up front which are designed to provide protection to the company. And then the prudence review in the form that remains would be one of many subjects to be considered at the November hearings, which are already piled high with complicated and time-consuming matters.

So I think from the standpoint of moving some of the approval up front to the consideration of the plans themselves, to the task of dealing with this very complex subject matter at the same time one is considering already having a full plate, you squeeze too much into too small a time frame to ensure that the customers are getting the depth of review that is warranted.

COMMISSIONER ARGENZIANO: Mr. Chairman, if I may. So then the guidelines, if approved, basically when you get to that point that Commissioner McMurrian had asked about, it would not be a determination of looking in-depth of individual items, or however you want to phrase those, it would be more of did you meet the guidelines and that's it, is that correct?

MR. McGLOTHLIN: That's the way I see it, Commissioner.

COMMISSIONER ARGENZIANO: And if I could ask FPL, what risks -- and forgive me for just asking it simply. What risks do you see that you are trying to avoid that do not just fall upon the consumer? I'm trying to figure out what risk you are trying to avoid.

MR. BUTLER: Let me put it this way. Here is what I think we are trying to do. It is a good question and it is probably a good place for me to try to explain what we are wanting to accomplish with the process that we envision here. In our mind, what's wrong with the current state of affairs is not that there is too much prudence review, it's that it is inadequately structured. That nobody really knows going into it what the measure of prudence will be, what the hedging implementation that would have occurred in the period being reviewed will be measured against, how you are going to determine whether it was a good decision or a bad one. In my mind, that works against both the company and customers. I don't think anybody benefits from an unstructured sort of ad hoc prudence review mechanism.

What we are trying to substitute is not something that involves less review. I mean, arguably there will end up being more review. There will be a process of reviewing the plans up front. This is something that is going to be open to staff, to OPC, to other parties to participate in if they think we are not going to be doing our hedging properly or that we are tying our hands inappropriately or whatever their concern might be. They are free to raise that. And if it is something of concern to the Commission, that will get factored in and there will be a revision to the plans that would be approved.

Now, we are not expecting that our plans automatically would be approved. You may well decide, staff may decide and you may approve that something different needs to be done about it. But then once that has happened, you now have a framework by which to review the actions that are taken. And I think it is really unfair to try to trivialize that as just determining whether they comply with the guidelines. I'm sorry, with the plans that were approved. That can be a very significant exercise. You have got the matter of whether the utility followed the specifics of the plan that was approved, whether the individual quantitative or qualitative sort of goals for the program have been met in the implementation of the plan, and you have got the issue of whether the utility acted properly within the range of discretion that inevitability is going to exist in any plan.

You are not going to be 100 percent nailed down as to how the hedging will be accomplished within the parameters of the plan, but you have got this opportunity to structure that review. So there are two opportunities. You have got it up front and then you have afterwards. When you are looking at it afterwards, you are doing it in accordance with sort of an agreed set of expectations of what that plan is going to be.

So in our mind really it is a win/win. This is something that gives a better prudence review that we like because we are more comfortable, you know, with what it is going to be. I think customers, the Commission, others should like it because they have got a better opportunity to say, look, you said exactly you were going to do X and you did Y, and that is a problem. Right now that is something that is more ambiguous how it would be applied working against everybody's interests.

COMMISSIONER ARGENZIANO: Mr. Chairman. But with all due respect, and it is not trivializing to try to find out if the consumers will be affected negatively or if more risk is going to be put upon the consumers. So with all due respect, I can still see -- and I understand the companies wanting certainty in saying, you know, if we follow this. But I can see there are instances where you follow guidelines, but yet within those subcategories of those guidelines maybe you didn't. And how then would that be questioned if it is nonprudent? And I think it could be diminishing, and that is what I'm trying to get to today. Because I understand the need for certainty, but I also want to make sure.

And with all due respect, again, it seems to me that the companies don't have a lot of risk anymore. The past bill that passed, I mean, everything is pretty much risk on the consumer. So I don't want to take any last, I guess, protections away from the consumer without hurting the company, also. I want the best for both, but I want to make certain. And I don't feel comfortable yet thinking that, okay, here is the guidelines, because I have seen this done before. Here is the guidelines, but yet when you look into those guidelines there could be many circumstances that then we cannot question because you followed those guidelines. And I think that's what I'm feeling from OPC. And if you can respond and then I can have OPC maybe get it through this skull here, because I'm feeling some hesitation about thinking that the consumer would not be more at risk.

MR. BUTLER: Well, again, I think, first of all, one of the benefits is the fact that there has been this opportunity up front to decide on whether the plan, the parameters in the plan are what the Commission and other parties think is appropriate for hedging in the upcoming period. And that can be at two levels, Commissioner. One level of it could be that what is specified the Commission doesn't agree with. You ought to do X rather than Y. The other might be that the Commission might end up saying that you either have left yourself too much discretion or you haven't left yourself enough discretion. We need you to decide how to implement within these parameters and that is direction that you could end up providing.

So I think that by anything other than kind of a hindsight after-the-fact, gosh, we wish you had done it differently, this is something that really protects both sides better because everybody knows what is supposed to be done, what the range of expected discretionary behavior is, and then the focus of the review will, again, be on whether it stayed within the parameters that were identified, and then specifically focusing down, being able to narrow in on how the discretion was exercised within the range that all parties agreed was the proper sort of area of expertise for the utility to exercise in applying the parameters.

So that is the approach that we envision. And, really, from my experience with quite a few years of utility regulation, I mean, it seems to me that the prudence reviews consistently have worked best when they are measured against something that people knew sort of upfront what it was going to be measured against so that utilities feel some comfort and so that the Commission has something solid it can point to and say that this was imprudent because you didn't do something that we all agreed you were going to do.

CHAIRMAN CARTER: You're recognized.

COMMISSIONER ARGENZIANO: My concern is I don't know that you can all encompass everything that could be imprudent in a guideline. Now, if I may ask staff, since the hedging has -- was it six years? Have the companies taken on much risk? Have they lost because of an imprudent decision or --

MR. McNULTY: Well, it's variable depending upon the utility and the time frame in which you --

COMMISSIONER ARGENZIANO: Well, I mean, let me ask it this way as plainly as I can, whether imprudent decisions and were they determined to be imprudent and, of course, cost the company, were there a lot of those?

MR. McNULTY: There haven't been as far as I understand any specific decisions determining imprudence of the utilities' hedging results.

COMMISSIONER ARGENZIANO: So, then, what brings this about?

MR. McNULTY: I think that as specified in FPL's petition, they have stated a concern of basically nascent asymmetry of reaction between stakeholders related to times when there are losses compared to times when there are gains in the hedging programs. And they have noted a defection, if you will, of support in times when there are significant losses, and that has been a concern to the utilities, and I think is the reason why we sit here today.

COMMISSIONER ARGENZIANO: But they -- excuse me, Mr. Chairman. But they haven't felt the pain from that yet.

MR. McNULTY: Well, they haven't felt the pain from that. They feel that -- I don't mean to put words in their mouths, they may be able to address this specifically, but I think they sense a future penalty could happen as a result of not improving the process in the way that they feel or the way they have set forth in their guidelines.

COMMISSIONER ARGENZIANO: I would like to ask staff another question that I am concerned with that OPC raises that FPL in its original petition indicated that the indirect cost associated with hedging could be quite substantial. Can you maybe elaborate a little bit more on that, and then OPC also, on how that effects the consumer.

MR. McNULTY: OPC is correct in that it was raised in the VMM petition, Volatility Mitigation Mechanism petition filed by FPL in January that there could be indirect transaction costs associated with hedging and that they could be substantial in nature.

As you heard FPL mention today, they could be either positive or negative, and the type of indirect transaction costs that were specified in the VMM petition and then also reviewed in our management audit had to do with the bid ask spread of swaps, which is the financial instrument that FPL uses in the main for its financial hedging program. And so if you look at that bid ask spread, that is a price differential, if you will, that would exist on the major indices such as the NYMEX and ICE. And that bid ask spread establishes a range of prices for a specific index, say natural gas, and its trading in a particular day, a particular time period. And so you have a differential that exists there.

If you were to measure the midpoint of that differential of what is happening in the market to what is actually entered into as a transaction for a hedge by the utility at that point in time, that differential could be considered an indirect transaction cost. As I say, it could be either higher or lower.

I should note that FPL recognizes that as an indirect cost and has done so in the VMM petition, whereas the other three utilities that are engaged in hedging programs in Florida do not recognize that as a cost. So there is some debate as to whether or not that is a true cost or not. It is somewhat, you know, theoretical.

COMMISSIONER ARGENZIANO: And just maybe one more, and forgive me on this one because it may be that I need more information. But if there are savings realized because there are ups and downs in hedging, and hopefully you get it right as many times as possible. If there are savings realized, do the customers realize those savings also, and how does this affect ROE?

MR. McNULTY: I will address the first question and then I will defer the second question to Pete Lester of staff. The first question is how does it effect customers, directly through the fuel clause. I believe that was the intent of the question. And to that extent, if, I guess, I could give an example, in that we had a series of midcourse corrections this past summer, and in staff's recommendation we noted that but for hedging actions of the utilities, the midcourse adjustment which was, of course, an increase to the fuel factors, would have been significantly higher had the companies not hedged. And that was because we found ourselves in an increasing price market for natural gas and oil. And so you could see very clearly then that the utilities' customers because the factor was adjusted based upon costs that are incurred plus the hedging transactions and the effect of those hedging transactions, would have lower fuel factors as a result in that case.

Well, it works the other way, too. A utility's customers can be paying more in the event that there is a declining cost market. And then as expected, customers that are served by utilities that are significantly hedged in oil and gas would be paying more and it would be reflected in the factor and through our normal true-up process.

COMMISSIONER ARGENZIANO: And then I think people that may be listening, and, again, it could be two people out there listening in, but I want them to have a good understanding of the pros and cons. And if you could answer the other question for me.

MR. LESTER: On ROE, I think OPC has alleged that hedging provides more stable cash flows and that that would lower the risk per the investors for the stockholders. And that's rather debatable. But to the extent it is true, it would be an appropriate consideration, it could affect their overall risk profile it would be an appropriate consideration in an ROE determination in a rate case, a base rate proceeding. So it's not something that directly relates to the fuel clause.

COMMISSIONER ARGENZIANO: Well, in reading OPC's comments about that, I think they're saying -- and let me see if I can find it. Okay. And 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 the rate of return on equity that it is commensurately lower. And that's the point I guess I was trying to get at. And if OPC and FPL would like to give me more of their point of view on that, I would appreciate it.

Mr. McGlothlin.

MR. McGLOTHLIN: The point we made in the written comments, and that I mentioned earlier today is that when a utility points to a particular activity or regulatory action as having the benefit to the customers of lowering its cost of capital, that always seems to be something that never -- the wheels don't quite turn far enough for the customers to actually receive the benefit of that. And the same would be true in this instance.

I did not intend say that as a part of the consideration of the guidelines it is incumbent or necessary for the Commission to lower the rate of return by X basis points. But I think it is worth noting that with respect to those benefits that arguably enure to the customer, we never quite seem to get to that point where it actually becomes translated into lower rates that the customer is paying in return for that.

If I could follow up on a couple more things while I've got the floor momentarily. There have been references to the fact that the 2002 order was a result of a stipulation, a resolution of dispute, and that is true and we were a party to it. I would like to make a point, if it isn't clear enough already, that we do not have a stipulation today. That we have references to a collaboration to the full vetting of the guidelines. Well, along the way we have made known our objections to and our disagreement with the direction that the utilities were going, and so our appearance here today is not a surprise to FPL or anybody else.

MR. BUTLER: Commissioner Argenziano, I think that in answer to your question, FPL sees that the existence of hedging in an environment of uncertainty, which is kind of what we have been characterizing our current situation and what we hope the guidelines will address, that certainly will have upward pressure on ROE. It is, you know, one of those measures of financial risk that increases investors' expectations of return.

You know, FPL has not had its ROE set in the period during which hedging has been in place. I think it would be fair to say that whatever increment of uncertainty exists in that is a result of the hedging and the uncertainty about how hedging results will be reviewed is something that is upward are pressure on the ROE.

You know, we would agree that the adoption of the guidelines will help to mitigate that upward pressure. It will bring greater certainty, it will have a downward influence on what the ROE is or requirements are. Ultimately, we go back to what Mr. Lester said. You know, we definitely agree this is a subject that isn't something that would properly be addressed in isolation, that one needs to look at all of the factors that affect ROE. That traditionally happens, it will happen in base rate proceedings, and that is the appropriate place to have the full analysis.

But, frankly, I think if you were to look today, say compare 2001 to now, my guess is that even with the adoption of the guidelines, there would probably be some perception of a residual increase in FPL's overall risk because of what hedging has brought into the equation compared to where we were when we weren't hedging, but the guidelines would go a long ways toward reducing that risk.

Just on the subject you had mentioned earlier of kind of what are the utilities concerned about, it's true that we have not had any amounts disallowed. We think that is because we have been doing a good job with our hedging programs and certainly intend to continue. But understand that, you know, the fuel markets are extremely volatile. There are run-ups and run-downs that are in the hundreds of millions, even pushing up toward a billion dollars in a year of variability. And when we take that out of the equation by hedging so that it doesn't show up in fuel costs, where it shows up instead is in the gains and losses that the hedging programs show.

And we can up having hundreds and hundreds of millions of dollars of benefits of gains in periods of increasing prices. You can have that same measure or that same magnitude of hedging losses reported in periods where the prices are running down. And both of those are expected, intended functions of the hedging program. We just have had a lot of concern that if we were caught out in one of those periods where the prices have gone down, there are hundreds of millions of dollars of reported losses. We want to be sure it is really clear how the results of that program is being evaluated for prudence, because uncertainty over that evaluation when you have got dollars at that magnitude outstanding is just the sort of thing that makes investors very wary.

CHAIRMAN CARTER: You made proceed.

COMMISSIONER ARGENZIANO: And I understand that. I guess the hard time I'm having is understanding where your risk really comes in. Because what you are saying is if -- let's say you went out and hedged and the costs dropped and you bought at a higher rate, and that's where you would kind of have risk if something imprudent was done. So the risk really comes in if there is something deemed imprudent, otherwise there is no other risk. And I don't mean to repeat it again, but I don't see where the risk is on the utility any more when legislatively most of the risk has been put upon the consumer.

I understand -- and that's what I'm trying to extract from you. I understand what you are saying about the volatility and at that point that you having risk is only if you have done something imprudent. And understanding what the criteria is, I guess, for what is imprudent and what is not is what you are trying to get at. But, like I said before, I'm afraid that within a guideline it's not going to encompass the many, many other things that could be in there that we couldn't look at to safeguard the consumer. That's my real concern.

But, again, let me see if I can get this out right. The risk to me is only if it's imprudent. And you are trying to find more specifics. But I don't see where the company or the shareholder shares in that risk. I see only the consumer shares in that risk. So to take away something that may be more definitive whether there is prudency or imprudence is concerning to me, because I see all the risk really going to the consumer and not to the company.

MR. BUTLER: Let me try this. I don't know if this will help, I hope it does. You know, let's take two years. The first year prices ran up compared to what we hedged and we ended up with $500 million of gain. And our perspective is we don't get a lot of criticism in those years. Now, you've got this substantial gain from the hedges, everybody is pretty pleased that fuel prices didn't increase as much as they should, or as they would have otherwise.

The next year, just the mirror image of that, that we place hedges, fuel prices decline, there is $500 million reported of loss. Now, in that year customers will probably actually pay less than they were expected to pay because the market has gone down, but they won't pay as much less as they would have without the hedges. And so you have this reported $500 million loss. Both of those are fully expected outcomes of a hedging program, because it is about volatility control, trying to keep the fuel prices closer to level rather than having them swing rapidly up and down.

But in that second year, what we are concerned about is that is, of course, a very large sum of money. And the Commission could review that. It could say, you know what, FPL, if you had not placed these hedges, or if you had placed them at different points of time, or if you had used different instruments, or et cetera, et cetera, that loss didn't have to be $500 million. Maybe there is some other mechanism you could have used and it would have only been $300 million. So we are not going to allow you to recover $200 million of that hedging loss that existed, because looking at it now there were other ways you could have hedged and you could have had less of a loss in that year.

That would be a very, very large disallowance. I mean, enormous compared to the sort of scope of what normally is at stake in prudence reviews. And we would not know in advance even exactly how we would be defending our actions, because there wouldn't be any standards or guidelines of what we should have been doing. And we would, of course, be saying you can't look at it with hindsight, et cetera, et cetera. But there is always this sense that, my gosh, there was something else out there, maybe you should have done that instead.

What we want to do is get everybody understanding up front the direction that we will be taking and then looking at the results within the framework of what everybody agreed ought to have been done. It won't completely eliminate, it certainly won't eliminate the prudence review, it won't completely eliminate the uncertainty of the risk, but it gives us a better sense that it's within a structure we can live with. We know how to work within it. We know how to be sure that we are doing what we need to do so that when that review comes we can demonstrate to you that we acted prudently.

CHAIRMAN CARTER: I guess what the crux of it is, and I'm glad that that is really where we are now, the crux of it is whether or not the hedging, when prices go up, we have a lower cost of fuel like we did this year. And consequently it is passed through to the ratepayers where they are paying less. But what happens in the inverse? And I think that the fact of the matter remains that this year was a good year in terms of using hedging to protect against the spiraling cost of fuel.

And fuel is a pass-through. And we all know it is a pass-through, it's not like it goes to the company's bottom line, per se. But I think that the context of it is, is that if prices go up we look at the company like you guys are a bunch of geniuses, you did a great thing. But in the flip side, when they hedge and it goes against them, then I think that the crux of issue, and I think we have been on the collateral of the issue, but I think that the crux of issue is that on a going-forward basis how do we put some parameters in there to say when we do the prudence review what is or what isn't.

COMMISSIONER ARGENZIANO: And, Mr. Chair, I understand the crux very well. I understand what it is. What I'm trying to say is the only risk that the company is concerned with at this point, and I understand that risk, is at the point that if they have spent -- it doesn't matter whether they have -- because hedging is a gamble, so it is all a gamble, and I understand that very well. Maybe I have been born somewhat of a gambler, and I understand that. But in looking and trying to articulate what I'm saying one more time is that the risk here, the only risk here for the company is if it is deemed imprudent.

And I understand they need to know what imprudent is, because they are afraid that if they put billions or millions of dollars at stake it could then be considered imprudent and that could cripple the company. But what I'm saying is when you possibly diminish what could be encompassed by just saying -- how do you cover some of the things that then we cannot question because if they met those guidelines, you can't cover that. And what I need to hear is a little bit more certainty that there is some kind of an out to say that for me, as a Commissioner, or OPC, or the company to defend, how do you encompass a little bit more of what might not be. You might have met a guideline, but it still might not have been prudent, and that is where my concern was.

CHAIRMAN CARTER: Let me go to Commissioner Edgar and I will come back to you. I said I would come back to Commissioner McMurrian. I will come back to you.

Commissioner Edgar.

COMMISSIONER EDGAR: Thank you, Mr. Chairman. And I was born very risk averse, so here we are.

So on that point to follow up, because my question to staff is if the guidelines were to be approved today, would the review by staff be lessened in any way than if the guidelines were to not be approved?

MR. McNULTY: Commissioner, maybe I can --

COMMISSIONER EDGAR: I need it.

MR. McNULTY: Maybe I can address that with spinning off the example that was started by Mr. Butler of FPL. He gave out an example of a year in which you would potentially have -- in a declining price market you would have $500 million in hedging losses. And we know that FPL, as stated earlier, engages mostly in swaps for their hedging transactions. If in the results that we receive from the company we see that these $500 million in losses, and we go back and we look at the time period in which they engaged in those hedges, and the utility in struggling to meet maybe the parameters of its plan, say 40 to 60 percent is the range of the volume in which they want to have hedged, and in an attempt to meet that 40 to 60 percent at a specific time period, they engaged in a hedge without checking counter-party risk and engaged with a financial institution that had significant counter-party risk. My perception of that is even though they are within the bounds of the plan that was set forth, if they engaged -- and let's go back one step and say in their plan they put in specific parameters that says we have a very diligent program for assessing counter-party risk, and we do that regularly, okay. And then we see that they went and they engaged with a counter-party that had significant financial risk that would be considered too high, then this Commission would be able to evaluate that situation, would be able to determine whether or not that was a prudent action for the company to make.

I think that would be an example where the company is staying within its plan, yet hasn't really fully complied with other aspects of the plan, so you could have two things intentioned. So I don't look at these plans as being rock solid, if you have done one thing you are then in compliance and prudent. You have to be in compliance with everything that is expected. It does raise the level of the importance of our review process of the plans.

CHAIRMAN CARTER: I think I wanted to kind of burrow in a little deeper on that, because I think that is the crux of the issue that Commissioner Argenziano, Commissioner Edgar, and I were talking about is that within the confines of the plan, and even if they do engage in the swaps, just because they engage in a swap as we look at that we can say, well, conceptually you are right, you engaged in a swap, that is what you said you were going to do in the plan, but based upon our financial analysis of that swap versus another swap versus at another vendor they could have saved more.

That does not restrain us as a body to say, well, yes, you engaged in swaps like you said you were going to do, however at the time when you engaged in the swap there was Company A, Company B, and Company C. You chose Company C and you chose poorly. We would still have the authority to do that, is that correct?

MR. McNULTY: I would say that if you had three different companies that they could have transacted business with at that time, that you would want to say -- you would not want to get into the process of micromanaging that decision. You would want to say, did they violate some other aspect of the plan that would be a basic parameter that they should have followed? Did they fall below a thorough review process, is the example I gave, of counter-party risk.

To get into the question of should they have picked Company A or B, which both may have been viable, but one had, you know, in the end result resulted in better, you know, gains or less losses, higher gains or less losses, I don't think that that is the kind of review that is contemplated by staff going forward.

CHAIRMAN CARTER: I'm going to Commissioner McMurrian, and then I will come back.

Commissioner McMurrian.

COMMISSIONER McMURRIAN: Thank you, Chairman.

And let me start off by saying I think this discussion is great, and I was even thinking to myself that you might even argue that the regulatory risk that FPL is talking about would not be so great if we had had this kind of discussion among ourselves sooner. And I'm not sure we have had that many opportunities to do that. But the point about the asymmetric risk, I would agree that I have seen that. I realize that there hasn't been a determination of imprudence in the past, but I think that the asymmetry that was mentioned -- I think we have had more concern when we have had those periods of declining rates and then we have had the hedging costs on top of that, and I think that I'm concerned by that, too.

And I find myself thinking that although I think hedging is a good strategy to try to minimize the volatility, that I myself when I started seeing that we have lost, and lost some of those savings that we would have had just by virtue of what fuel they would have bought, that I myself sort of questioned that, too.

And I think that has been raised by a number of the parties in some of the proceedings, and I think particularly with the last fuel case there was some additional risk that came in with how we sort of decided what period of time would be reviewed. There were those things that came up, and I think that that sort of started this deeper look into how it might be better to structure this thing.

So I think the company is trying to address that. And sort of getting back to the point about the prudence review and are we reviewing less or not, I noted, and I was trying to find it and I did finally find it in here. On Page 16 in the clarification guidelines -- and this is leading up to a question, Chairman. Under I.C., under Roman Numeral I and then the C under that, because I have sort of struggled with this, you know, is it better to have the process like we had it before, is it better to have the plan up front. And I noted in the last, I guess that is a full sentence at the last part of that, C, where it talks about that in the staff recommendation on April 14th that staff believed the more appropriate approach was for the Commission to approve in advance company risk management plans that identify ranges and percentage of volumes to be hedged and the types of hedging instruments. And then acting within those guidelines the company can rebalance its hedge positions in response to the changes in market conditions.

And I guess when I saw that, then I felt like that because of the concerns that have been brought up and, of course, at that time we had a different proposal before us, that perhaps staff was saying this might be a better way to go. And then the company went and looked at that approach and that is part of what they have proposed here.

You know, whether or not it's perfect, I don't know, but I think that we probably have a lot of discretion to review the actual hedging transactions when they come to us. I do think that we will have the plans and that we will look at whether or not they have been consistent with the plan, but I think, as Mr. McNulty suggested, we probably have a little bit more flexibility to look at anything. If something was imprudent, I think we still have the ability to say so.

But, again, I do think that there is probably more risk. But I wanted to allow Mr. McNulty or Mr. Lester a chance to sort of explain what their thinking was when they wrote that sentence in that recommendation on April 14th to help us better understand why you put that proposal out there to begin with.

MR. McNULTY: We felt like it just provides more order and clarity to the whole process. They provide a plan, it is going to lay out the types of fuel, the instruments used, ranges of volumes hedged, and that's going to just spell out what they are going to be doing. And then following up on that, we can audit and compare their actual hedging transactions to market prices and verify the prudence of those transactions.

I think it gives order and clarity, but it doesn't diminish your ability to review hedging transactions. It just gives them the assurance that they are heading in the right direction and lets you know what is going on, as well.

CHAIRMAN CARTER: (Inaudible. Microphone off.)

COMMISSIONER McMURRIAN: I had one other thought that I had wanted to say earlier, and it was in relation to some of the discussion we had about that in the times of rising costs it seems like that it has been beneficial, and I think you said this, Chairman, in the times of the lower costs it doesn't seem so. And I guess -- I know that the question is really before us, as Commissioner Edgar mentioned, the question isn't really before us about hedging or no hedging, although I think we are having somewhat of that kind of discussion, as well.

And I guess maybe it goes back a little bit to how you think the prices will be reflected in the coming years. And I think I have said before, I think that we are probably going to see a period of increasing prices for natural gas in particular. I'm not as familiar with oil, although I think that they have fairly consistently gone -- well, they have been volatile. And I think that was the reason that the Commission decided years ago to put this in place. And I think that it has been beneficial.

Again, we have had those periods where it maybe didn't look as beneficial. But I guess because I see that we are probably -- at least in my opinion, I think that we will probably have more periods of increasing prices, that I think that hedging will provide us some benefits in the same way we have seen in this last cycle. So I guess I just wanted to share that, as well, that I think that all in all that it is going to benefit the consumer and sort of mitigate some of that volatility we have seen. Thank you.

CHAIRMAN CARTER: Thank you. I'm going to go to Commissioner Argenziano, and then I will come back to Commissioner Skop.

Commissioner Argenziano.

COMMISSIONER ARGENZIANO: Thank you.

For staff, again. You mentioned that -- the order on clarity, and I understand that, and I will keep saying that. And it is not about hedging, this is about the guidelines. And you said, I think, they spell out what they are doing to verify the prudence of those transactions, I think were your words. Well, probably the answer that I would like from you is how are you then not focusing -- and I will use this for some kind of comparison -- when you have these guidelines, how are you not focusing on the forest rather than the trees?

I mean, you are just focusing on the bigger and not what it encompasses, all the little things that could encompass prudency. And how do you -- or, I guess I'm going to ask you this way. You think that the guidelines would include the trees. My concern is that once you say, well, you have met the guidelines, you can't go back then. You are not going to be able to go back. And I understand the certainty part of that, but my focus again is there is a lot of little things that have to take place. And once you have the guidelines set like this, you are looking at the forest and not those little trees, which should be and have been included in the prudency determination. So to me for you to say that you are not diminishing that, I think you are by not including the trees.

MR. LESTER: Well, we'll be doing audits. We are doing one now, and that is going to be --

COMMISSIONER ARGENZIANO: Well, that is true. But your audits will only go to the guidelines, because that is what we are saying here. If you have met the guidelines, then that is it, that is pretty much it. Instead of what you have now, you have met the guidelines and included some of those trees in there, then your audit would make a big difference.

So, again, going back to the guideline, to me it does diminish a prudency that we have currently. And understanding the need for the company's certainty, and we need to get there, but I don't think that this is the right way by lessening prudency, which is the only thing we have and the only risk the company does have on the grand scale.

I mean, I'm not willing to give up that, I guess, greater prudency determination right now without finding a better way of giving the company some certainty with the things they need, because this is the only place that they have risk. And I understand that risk, and I understand what it could do, but I just don't feel that we have gotten to that point with these guidelines that will take those trees into account somehow. And there needs to be something in there that says if I find a tree, you know, so what if you met the guidelines. But the tree here is going to make a big difference to the consumer, and I'm not willing to do that, because I do think it diminishes.

And that's probably what I'm asking staff, because you have quite readily said that you didn't feel it diminishes it. But now given the fact -- I'm just saying given the fact that maybe those little trees, I don't know how else to say it, could pop up, even though you have an audit, isn't it true then that pretty much if you met the guidelines that is where it is going to be.

MR. LESTER: Let me give you an example of a tree from the way I see it.

COMMISSIONER ARGENZIANO: Okay.

MR. LESTER: Okay. Today there is a futures price for natural gas for December 2009, and let's just say the market price is $10. I don't know exactly, but let's say that. Okay. We are going to audit the transactions. If we find out FPL today locked in a $12 price through a swap, then we are going to look at that because there is a discrepancy there. That's a tree we are going to look at, as well as looking at the big picture of all the transactions, of their hedging volume, of their counter-party credit risk in their analysis process, and things like that which are going to be spelled out in the plan.

So I see that as being more like a preview of what you are going to do in a prudence review, and then following up and doing it. But I think it gives you --

you have the discretion, you retain the discretion to make the prudent cost determination.

I guess just to simplify, I see the trees in your example as being the individual hedging transactions. We are not going to ignore those. We would continue to do an audit regarding that, and then do discovery on the full policy and direction of their hedging program.

COMMISSIONER ARGENZIANO: Mr. Chairman, then I don't understand the purpose of guidelines if you could still get to the trees. I think I would like to have OPC weigh in on that. What is your feeling, OPC's feeling, I guess on -- when you say diminish our ability for prudency, for full prudency, could you specify? And, I mean, now is your chance. And I need to hear from the company, too, again, on the certainty. Because there has got to be a way to get them some certainty that they do need.

MR. McGLOTHLIN: Commissioner, I think the question you have posed to the company and the staff is this: If we give the companies what they are asking, can we retain our full ability to protect the ratepayers? And I submit to you the answer is no. I submit to you that the certainty to which the utility is entitled is the certainty that you will apply to the prudence test the facts of the law in a responsible manner and that you will do so with full knowledge that the balancing test you are called upon to implement which balances the interests of the company with the interests of the customer.

Now, in rising markets and falling markets, the prudence test and with big numbers and small, the prudence test remains the same. The prudence test is under the circumstances which were known or should have been known to the company, did they act prudently and responsibly, and were the costs reasonable? And that doesn't change. To what the companies call reduction in regulatory risk, I would call a shifting of risk. Because once you go away from that format and place greater emphasis on up front approval of a set of guidelines, you can be sure that down the road the company's primary defense is going to be but we met the guidelines. And so I think there is this continuum. And within that continuum if you move toward a regulatory policy that is utility favoring, at the same time you move to a policy that gives up the ability to protect the ratepayers.

CHAIRMAN CARTER: Mr. Reilly (sic), I didn't follow you. Because I didn't see where you specifically delineated what protections for the ratepayers are there now that will be taken away. That's what I was listening for. So could you help us out on that? Because it seems that you are saying to approve this then we are taking away all kind of protections for the ratepayers, but I didn't hear that in what you had to say. So could you --

MR. McGLOTHLIN: Well, the thrust of FPL's request is to develop the guidelines that would be presented at the outset, and then to limit the ability to review those to one of many things that go under the November hearings. And so from the standpoint of pushing things to the front of the process rather than to the rear, and to the standpoint of limiting the time and opportunity for review, those are both very limiting mechanisms for protecting ratepayers.

CHAIRMAN CARTER: When you say limitations, though, what I'm saying is that you have heard what staff has said in terms of our ability to do the audit as well as the transactions themselves. I'm trying to find what protections for the ratepayers that has been lost in this process, particularly in light of hedging as it has existed before.

MR. McGLOTHLIN: Part of it is the up-front nature of it, where in approving guidelines you by implication limit ones review. And part of it is the timing of review, and the timing that is -- the review that is performed in conjunction with other things that are on your plate at the time.

MR. BUTLER: Mr. Chairman, may I respond?

CHAIRMAN CARTER: You're recognized, Mr. Butler.

MR. BUTLER: Thank you.

Two or three things to try to make it quick. First of all, just so everybody knows, we have been filing hedging plans since the inception of the hedging process with the 2002 hedging resolution. What's different, what we are proposing here, one, is I think our plans will be more specific, more detailed, give more guidance. And, two, the review mechanism, review and approval mechanism that we have been talking about here, I continue to fail to understand how anybody could suggest this process will be less rigorous or involve less review than what we have been having. Because there will be, first of all, the review and approval of the plans, and the Commission is free to make changes to the plans that we submit.

If you don't think that they are prescriptive enough, if you think they are too prescriptive, if you don't think they cover the right subjects, those are things that, you know, could be brought back to us typically in the form of staff review, but obviously it could be at the hearing itself where there is a decision that the plan needs to be different than as was stated. So there is a very explicit opportunity for input up front where I think everybody would agree it does the most good.

And then there is the subsequent review that will occur. We will be filing hedging results every month, and then we will be doing a report that wraps up the period from January through July of all of the results comparing that to what we said we were going to be doing. There will be full opportunity to review that. You don't come to hearing on that until the following year's fuel hearing, and everybody will have had an opportunity to, one, see whether we did what we said we were going to do; two, within the range of implementation discretion we had whether we made good choices or bad choices. And if there is anything that people feel needs to be brought to the Commission as a matter of imprudence, they will have had most of a year to review that information and do so.

So it seems to me that that compared to what we are doing now, which is there is a filing of these risk management plans, but not really a thorough vetting of them up front, and then just this one shot, get an annual hedging report, and look at that and come back to a subsequent fuel hearing to pass on the prudence of it, it seems to me like we are proposing something that involves actually quite a bit more process of review and approval.

And why we are willing to propose that, you know, sort of somewhat more involved regulatory mechanism is because it does structure it in a way that just helps us to kind of see it move forward and understand where we ought to be in terms of implementing within it. I can't see how that is anything but a win for everyone.

CHAIRMAN CARTER: Thank you. You have been most patient.

Commissioner Skop, you're recognized.

COMMISSIONER SKOP: Thank you, Mr. Chair.

I just have listened to the discussion and kind of wanted to chime in and just make a few quick points. I guess with respect to the issue before us, I guess looking at the historical context, it seems to me that the VMM and the ensuing discussion all seems to be somewhat of an industry response to the deferral of the prudency determination of hedging cost that occurred last November. And although I was never in favor of the VMM and they have withdrawn it to the extent that FPL is heavily dependent on natural gas-fired generation for its generation mix, and at least for me, the VMM did nothing to protect consumers from fuel price volatility risk. And to me that is a big concern given the fluctuation in natural gas prices that we have seen in the course of the year. Gas had gone from about $7 per MMBtu all the way up to near 13 and now it is back. I think the last time I checked it's 7, so that is wild volatility swings.

To briefly kind of summarize, I guess, how I look at it is at least for utilities who are heavily dependent upon natural gas, I feel that hedging is necessary to mitigate that fuel price volatility risk and to protect consumers from that. I know there is different methodologies, but looking at it in terms of the VMM, that's analogous in some regards to what we did with midcourse correction. We are just passing the total costs through and we are taking costs as we find them in the market. We are doing nothing to constrain those costs and mitigate that volatility.

To briefly touch upon a point that Commissioner McMurrian raised about asymmetric risk, I tend to agree. Everyone loves hedging gains. When we see the big gains of years past, everyone is happy. It's just when big losses come before us, it tends to raise eyebrows. So I think that was worthy of touching on.

To touch upon a point that Commissioner Argenziano touched upon in terms of what we are being asked to approve in the risk mitigation efforts that the utilities may be trying to get out there, I know there are different arguments. At least to me we are being asked to approve guidelines which I tend to view as overarching principles. Then beyond that, each IOU would be required to submit an individual plan, which I guess based on last November was confidential, and it articulates the company-specific strategies for how they choose, you know, what percentage of hedges, and options, and collars, and swaps and whatever they intend to do and how they intend to implement that.

So I think that there would be significant discretion for staff to review those type of plans and make some appropriate determinations of the reasonableness on a forward-going basis. And then the execution of that plan, I think that basically the companies, the IOUs would be allowed to exercise management discretion within the range of the guidelines in the plan itself.

So I do see some of the points that Commissioner Argenziano raised about topical in terms of prudency. I do tend to think that there is a prudency review through the entire course, and I think that some of the guidelines may provide, you know, at least some direction from the Commission to the IOUs of what we expect so that things like November don't reoccur on a forward-going basis.

Just two more quick comments on I.C. of the proposed hedging order guidelines. I guess Commissioner McMurrian raised the point that the staff comment, and I think what that spawned from is that, if my memory serves me correctly, that as an alternate approach to the VMM, I think back in January FPL proposed a simplified type of prescriptive hedging program or approach, and I think staff thought that that was unduly prescriptive. Again, I tend to kind of thought that I would be willing to give something like that a try to see if it worked, but I think staff's concern on I.A. is that it is not really appropriate for the Commission to be prescriptive and approve prescriptive plans. They should leave that discretion to the company so that we have that prudency determination on a forward-going basis.

So, again, in terms of passive hedging versus hedging guidelines, I think this is staff's attempt to say that the company is responsible for hedging by submitting their individual plans as they deem fit to do so subject to our review and on-going prudency determinations.

And then, finally, just two quick questions and I will be done. With respect to a point that was raised by Mr. McNulty on counter-party risk, and on Page 42 of the report, and most of it is confidential, it lists the counter-party relationships. And just two quick questions to FPL. In terms of mitigating exposure to counter-party risk in light of the current financial situation industry, what steps is FPL actively taking to mitigate counter-party risk?

MR. FOREST: Commissioner, again, my name is Sam Forest. I'm Vice-President of Energy Marketing and Trading for Florida Power and Light. My group, among other things, is primarily responsible for the hedging program for FPL.

To your question, we have a very active credit management program. It is a daily monitoring process. Sometimes inter-day, as we have been recently. We have a very consistent approach to how we manage those risks. We have several counter-parties, probably upwards of 20, I would say, that we transact financially with on these over-the-counter derivatives. We actively manage. As we see somebody reaching financial difficulty, we would take definitive steps to slow down the trading process. If we saw further decay, we would stop trading with that counter-party altogether.

COMMISSIONER SKOP: And, secondly, on Page 32 it identifies FPL's goal. And, again, the number is confidential, so I'm not going to mention it. But it mentions the goal for the percent of hedging that FPL was going to do in 2008. Does it expect in 2009 to have a similar percentage?

MR. FOREST: Unless something changes, I would suggest we probably would be in the same range.

COMMISSIONER SKOP: Okay. And hopefully I did not repeat myself, but I think I left off one point. In terms of fuel price volatility, I think that the current state of the airline industry is also a striking example of what happens when fuel price volatility is not properly mitigated. And to that point, briefly, Southwest employs hedging, and it is currently able to keep its fares very low, resulting in a competitive advantage where other carriers are not, and they are forced to pass increased costs along to consumers. And I think that may be an alternate way of looking at it.

But if you are heavily dependent on fuel, you are very susceptible to those volatility increases, and ultimately as fuel is a pass-through cost, as Chairman Carter has duly noted, you know, we have to pay for it. So if you could mitigate to some extent that volatility risk, that hopefully in the aggregate over the long-term, not necessarily in a myopic year-to-year basis, but in the long-term hopefully they will even out and result in mitigating that volatility. Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioner Edgar.

COMMISSIONER EDGAR: Thank you, Mr. Chairman.

I think we may be at the point where, once again, after lots of discussion we are kind of all saying the same thing. With one of Mr. McGlothlin's -- I hope I attribute this correctly -- statements that I believe he made earlier, which was something along the lines of the certainty is that the prudency review will be applied, and that's the way I see it, that there is certainty, but the certainty is that the audits will be done and the prudence review will be done, and that this Commission will look at the information in the time frame that is appropriate under our procedures.

So, again, I think we are kind of all saying the same thing. When I looked at the guidelines, I did not see it, I did not read it, I not think of it as a diminishment of our prudency review at all, or as putting something, you know, out of bounds for our staff to review through the audit and other processes that we have. And so I guess I come back, once again -- let me go back to one other point. I have had concerns in the past on some other issues that sometimes we may be being a little overly prescriptive on the front end and that that could limit our ability to look at some things later in the process. That has concerned me on some other items in some other dockets that we have, and it would still concern me as those sorts of discussions come before us.

I didn't see these guidelines in that way. And some of the answers and discussion that we have had just for me have not been clarifying on that point, but have raised more questions than answers. So I guess I want to bring it back to that same just sort of the essence of what I see in my mind, which is would we be, if we adopt guidelines, which I think of as guidelines, then would we be limiting our review from what we would do if we did not have the guidelines. And then with just the additional thought of when I looked at it I saw it as perhaps a clarification of the process on the front end, but I did not see that as a diminishment. But from the answers that I am getting, it is just not clarifying that for me. So let me put that to staff. Even though I know we have had the same question asked before, let me put that to staff, and then, if I could to, Mr. McGlothlin and to the utility.

Thank you, Mr. Chairman.

MR. McNULTY: Yes, Commissioner. I don't think that it is a significant diminishment of our ability to review the prudence of the utilities' hedging actions. As part of this, these guidelines, you'll note that we are going to have an additional month in which to be able to review the hedging plans. We have shifted the time frame in which the hedging plans will be filed with the Commission from the projection filing in September to one month prior to the actual/estimated filings in August.

COMMISSIONER EDGAR: And I apologize for interrupting, but I may forget my question. And I saw that, too, again, some clarification of time frame. And as you said, maybe adding a month. But what you said, I think, to my question of is there a diminishment if indeed the guidelines were to be approved, you said not a significant diminishment. Well, to me not a significant diminishment is a diminishment, so could you speak to that more narrow point?

MR. McNULTY: Well, you know, I mean, one of the items that is listed in Section IV of the guidelines is that the utilities are not expected to apply market timing and they are not expected to outguess the market and so forth. That gives a clear weight to, in my mind, to saying that the companies are encouraged by this Commission to develop a hedging program that does not do that. And so in the sense that if this Commission were ever to say, well, you know, in a circumstance where they could have taken advantage of, you know, greater gains and so forth, they didn't do so because they had as a formula a sort of structured approach to hedging, a dollar cost to averaging approach, if you will, to hedging, it puts, I think, a little bit of restraint on this Commission to challenge that notion.

So that is why I say I don't think it is substantial, but I think it does by giving this indication, this clear indication within the guidelines, unless they deviate from that guideline and specify it within their plans, it does, I think, limit somewhat what this Commission could reasonably challenge as being imprudent behavior.

COMMISSIONER EDGAR: And I guess on that point -- and I appreciate your thoughtful answer in helping us work our way through this for the past two or so hours. But on that point I think I may very respectfully disagree. I don't see from what I read and the discussion that we have had, I don't see it as a limitation. If, indeed, it is, that would be important, and I guess maybe I would look to Legal a little more on that. I don't see it as a diminishment or a restraint. And, again, I say that with all respect. Just a disagreement perhaps on interpretation on that point.

Mr. Cooke, could you --

MR. COOKE: I may need to ask Ms. Bennett to help me out on this, but my understanding is there are plans filed currently under our approach to hedging every year. I don't believe we approve them, per se. That to me is probably the difference that is happening here.

I think if a detailed plan were to be filed with us, we reviewed it, approved it, I think there would be some diminishment of what we can do down the road. Some diminishment in the sense that we are saying that this structure, the volume of hedging that occurs, et cetera, is appropriate, and it would tend to shift some burden to us later on to decide that if they followed that approach that they were being imprudent. I think a lot depends upon how detailed the plans are.

I agree with everything that Mr. McNulty said earlier, that you would look within those outlines as to how they were applied, the various types of audit issues, and you would be able to have a lot of discretion to decide whether they were prudently implemented. But I think that is the main difference to me. I don't believe we current approve the plans in advance.

COMMISSIONER EDGAR: And I guess that comes back to the point that Commissioner McMurrian raised with the ten-year site plan as an example. You know, a plan is a plan; a guideline is a guideline. And maybe it's how you define those, but when you said a shift of burden, I mean, I see our burden as -- which is not much of a burden, but of prudency review not being a shifting.

MR. COOKE: That is a bad term to use, because the company always has the burden of proving prudence. But when we take an action that sends a message by looking at these plans and approving these plans, I think it hems us in a little bit. I'm not saying it is a significant diminishment, but I think there is some diminishment beyond what currently occurs.

CHAIRMAN CARTER: Is it, or did I hear this wrong, is that it's better for us not to have a plan and then to determine prudence than to present the plan, we approve the plan, then go for a prudence determination? Because that's what it sounds like you are saying is that we don't approve the plans now and everything is hunky-dory. But if we approve the plans, then we have less -- a diminishment of our authority for prudency.

MR. COOKE: It may be just a question of timing, also. In this case we are being asked to approve these plans ahead of time. Ultimately we have to look at those plans and were they prudent to begin with. So it may just really be a question of timing. We still have to look at them and we have full discretion to look at them, and I think that's a point that Mr. Butler and FPL have been making. We will full discretion to look at those plans and decide what to do with them.

CHAIRMAN CARTER: Commissioner Argenziano.

COMMISSIONER ARGENZIANO: Well, then are we doing things backwards? Shouldn't we have plans in front of us first to determine whether they can encompass the things that would concern me or others? And if I'm hearing staff right, saying that there is restraint to challenge and that was some of my points before, because once you have met the guidelines it is going to be pretty hard to challenge afterwards. And then hearing counsel say there is a diminishment, couldn't it be done the other way around? Is there any restraint or any prohibition from us look at guidelines first to determine whether they can seriously encompass some of the company's real concerns about certainty and also take care of the problems that I may have of any diminishment to the consumer, which the risk is all on now anyway? Is there any problem with looking at plans ahead of time?

MR. HINTON: Commissioner, I think that's the intent. Right now we are looking at the guidelines that would require them to file these plans.

COMMISSIONER ARGENZIANO: Right now we are saying we would approve guidelines to come later. I think we are doing it backwards. Some of my real questions are can the guidelines encompass some of the concerns I have, as well as OPC, and maybe some consumers out there. And also incorporate some of the concerns that are real concerns of the company who need some certainty. So I think we are doing it backwards. Because at this point I have too many concerns, and hearing the words restraint to challenge and hearing the words diminishment are not going to be a good vote for me today as far as the company would be concerned, because I'm not willing to do that.

MR. HINTON: Commissioner, could I try to clarify my understanding of some of the words that he used.

COMMISSIONER ARGENZIANO: I appreciate that, and I don't mind if you do, but I'm just going to tell you that it doesn't negate the fact that those words have already been said. And in lieu of what I have been -- not in lieu, in view of what I have been saying about my concerns for both parts, for the company and the consumer, but, please, go on.

MR. HINTON: Well, Commissioner, I think it is, as Mr. Cooke has stated, a matter of timing. We are removing some of the review from the back to the front. And to draw upon your example of the forest for the trees, there are a number of different forests out there, different ways of approaching hedging, and what we are doing up front is saying, okay, we are going to be in this forest. And then at the tail end we are going to go in and still make sure that they were operating correctly within the forest. But up front we are all getting on the same page, that's the forest we are going to be working in. Whereas there is a number of different forests that we could be.

So as far as restraint to challenge, up front we are saying we are all agreeing this is our forest, so we are not going to challenge on the back end that we're in the right forest. We will look at the trees, but that is kind of the restraint to challenge right there that we agreed up front which forest.

COMMISSIONER ARGENZIANO: That's my point. I'm very uncomfortable with agreeing up front when there could be a tree that pops up later and then it is too hard and the restraint of challenge then comes in. So I look at that as a diminishment of my ability to look into it further. And that's why I'm asking, can this be turned around? The company and the staff, can we do it the other way around? Can we start workshopping and looking at real guidelines that maybe will make me feel more comfortable. I mean, you know, it's up the Chairman. I don't know what our rules are, and --

CHAIRMAN CARTER: Let's do this. I'm always at a disadvantage when I try to guess on timing, but the court reporter has been going for over two hours now, and I think it's time for us to give her a break. Don't forget your train of thought, and we will come back. Let's give the court reporter a break. I am looking at the clock to my right today, and we will come back at twenty of. We're on recess.

(Recess.)

CHAIRMAN CARTER: We are back on the record. And when we left we were in discussion. I think -- Commissioner Argenziano, had you finished your thought?

COMMISSIONER ARGENZIANO: The only other thing I wanted to ask OPC was given the fact that the Commission would have the ability to change the plans on these up-front plans, does that alleviate some of the concerns that OPC would have?

MR. McGLOTHLIN: No, Commissioner. I continue to think that while this package was described as a request for clarification, it's clear to us and should be clear to you that the intent of the company is to obtain in the form of these plans an up-front approval, and that if they didn't see some comfort and protection against subsequent challenge, they would not view this as risk reduction. That's our whole point.

CHAIRMAN CARTER: Commissioner Edgar.

COMMISSIONER EDGAR: Could I ask staff to maybe briefly go over the steps of the process again. My reading of it was that over the set time frame that the utilities would file a plan, a plan would come before the Commission, that there would be review, discussion. That then obviously the plan would be implemented. However, that it would have room for variation and adjustment as any, in my mind, plan does. And that towards the end of the process then there would be a prudency review, and that any variation from the plan would be part of that prudency review.

I guess I was getting confused, again, about the steps, and maybe some of it's definitional with plan and guideline and process and review. But if you could just walk me through those steps, please. Somebody, anybody.

MR. McNULTY: Yes, Commissioner, I would like to address that. I would say, first of all, you have to look at the guidelines themselves. The guidelines are basically saying -- in its barest bones it's basically saying that you will, as a Commission, review the hedging plans that are filed by the company. And, by the way, you are going to have more time in which to review them. You are going to have an extra month.

I think that implies that the staff is going to do a heightened level of review. And I can commit to you that we will do that. We will review those plans with great scrutiny because of the import that these plans have. And this is an improvement in the process. You have a process in place today, and you have a process in place tomorrow with these plans that will involve a greater level of in-depth understanding of what the companies' intent is in the coming period. The companies have already indicated that they intend to provide a more in-depth plan, and in the process we will have an opportunity to bring that to you. So there will be greater clarity and understanding up front.

We will receive those in early August, and it will be a matter for determination at the November fuel hearing. After the fuel hearing has concluded, those plans go into effect the following January and guide the company's actions for the next twelve months.

Subsequent to that taking place, we will receive hedging reports. We will receive -- in the month of April we will receive a final hedging report for the last five months of the preceding calendar year. Then in August of that same year, we will receive actual results for January through July of that current year. So we will have, in essence, almost like a fiscal year period in which to review how the company has performed.

We will apply those results against what has already been approved by this Commission as the plan that's specific to that utility. Again, if in the process of reviewing that plan we think it is too prescriptive, or we don't like certain parameters and elements of the plan, it's at this Commission's discretion to challenge those and to make changes where they see changes need to be made.

COMMISSIONER EDGAR: That was helpful to me. Thank you very much. And I guess that kind of brings us back full circle to where I was in my thinking a little earlier, which was along the lines of the guidelines before us being -- setting out some clarity of process and timing, which in my mind I see as different than what I think of certainty. So I will just throw that out for further discussion.

Thank you, Mr. Chairman.

CHAIRMAN CARTER: Commissioner Argenziano.

COMMISSIONER ARGENZIANO: And can I ask OPC, in hearing staff's understanding of how the process is going, can you tell me your opinion on that and how that doesn't satisfy the concerns that you have. If we can go in and scrutinize and things are more up front from the company as to how they are going to proceed, how that is negative, or what you see negative about that, or if you can give me your opinion. And the positives to that, too. Because there are, if you are getting more scrutiny up front, as far as -- or more understanding of what they are going to do. So if you can maybe speak to staff's last comments.

MR. McGLOTHLIN: The answer is in two parts. As I indicated at the outset of my remarks, even though FPL has withdrawn its VMM petition, and we have never disputed its right to do that, and I wasn't trying to confuse the dialogue by referring to it. What lingers after the withdrawal is, in our mind, some pretty convincing indications that hedging, first, is costly to customers; and, secondly, is of dubious value with respect to the stated objective, and so that colors everything we have to say about it.

With respect to these proposed guidelines, putting aside that discomfort to begin with, the process that is described in the petition and that Mr. McNulty has described today has a well-delineated procedure, but it doesn't get away from the fact that the intent of the companies, of FP&L company is to obtain from you some assurance up front that if they adhere to what has been put in front of you at the outset of the process they will be protected from subsequent challenge.

And the difficulty in that, even though one could argue that more thought is given up front, is that you can't anticipate every circumstance in approving up front a plan that the company says it's going to be its blueprint for subsequent activities.

And so there simply remains in our mind a shifting of risk from the company to the customer at any time the company says to you, oh, it's important to us that this has to be accelerated and expedited and the approval has to be up front as opposed to later. When, in fact, that departs from the more typical scenario in which, as we discussed earlier, the Commission reviews after the fact the activities and transactions and applies to it the standard of the prudence review which is not prejudicial to the company and which protects the customers.

CHAIRMAN CARTER: You're recognized.

COMMISSIONER ARGENZIANO: I'm not so sure that their only intent or their intent is to do as you described. It could be for certainty that they need also, and I understand that. But I think what I heard you first say was that you really didn't want hedging and didn't think it was a benefit to the consumer. But I don't know, I mean, and that's a discussion probably for another time, but obviously to me there are benefits to hedging also, just as there were recently with the fuel coming in lower than it actually would have been for the consumer. So I see benefits there.

And I guess maybe trying to hone in, again, is that if we have more certainty with specifics up front, and if we are able to change the plans as we go along, my concern has been all along, as I've stated for the past few hours is that -- and I guess honing in, you said we can't anticipate every circumstance, and I guess to some degree that is what the company is trying to say is we can't anticipate every circumstance, either. But, back to your point, and my concern was that if you're looking at the forest you may not be seeing the trees, again, and anticipating certain things.

And I guess this question is for you and then for staff to answer, and as bluntly as you can. If we were to approve these guidelines and work along with the guidelines as we can, change them, or whatever, will -- do you feel, and staff for you also, will we be able then to challenge, if we feel something, one of those trees, I wish I could elaborate more on what those trees are, but if one of those trees pop up and it is not prudent, I mean, the restraint to challenge the action, in other words. Can they then just turn around and say, well, we met the guidelines? Is that what you are saying? And, staff, if you can assure me that I can come back later and say, well, you may have met the guidelines, but this tree here doesn't -- it's not right. Am I then limited, in your opinion, OPC, and then staff if you could do that. And I know we have done this, but this is what I have to do. Sorry.

MR. McGLOTHLIN: I'll go first.

COMMISSIONER ARGENZIANO: Okay. Please.

MR. McGLOTHLIN: The word certainty has been used today. I believe from FPL's standpoint, the certainty they seek is the certainty that there will be no risk of disallowance. And I think that is not something that you can give them without diminishing the ability to protect ratepayers in a full prudence review.

And, secondly, Mr. McNulty gave what I think is a good example of a situation in which you would be giving up the ability to regulate after the fact that provision that says the utilities are not expected to try to time their hedging. And so if they simply place the same quantity of hedges month-to-month without regard to indications that it's smarter to do more now and not later, then the Commission would be without the ability to review that when it conducts a prudence review after the fact. That's just one example. And one problem in trying to assess and be more specific with respect to delineating the areas in which you would be painting yourselves into a corner is that we can't project the future.

I have heard several individuals say, well, with respect to this time frame it was a rising market and the customers came out ahead. But I can point to a year ago when FPL's losses were $800 million. And that's not by way of criticism, it's by way of illustrating that we can't predict what fuel costs are going to do in the future. And for those reasons, we remain opposed to the specific request being made of you.

COMMISSIONER ARGENZIANO: Staff.

MR. McNULTY: Commissioner, I guess I would just say that I believe that like the example that was raised by Mr. McGlothlin just now, that what constraint is there, and that he used as an example the constraint that I raised, which is the constraint of not being able to utilize market timing is the idea that is most centrally expressed within the guidelines.

And I think that that is a basic aspect of hedging that staff believes is correct, is that when you place a hedge, the hedge -- there is no way to know whether the market after that point in time is going to go up or go down. And so it is an appropriate view to look at market timing as something that should not be a constraint on the utility. They should not be tempted to know the future as to whether or not the market is going to go up or down. And we do take that as the one slightly limiting aspect of the guidelines in terms of the review process that would impact the Commission.

Other than that, everything else defaults to the plan. And if the plans are, as the guidelines have established -- the guidelines would establish that the plans would be approved up front, everything else is basically to the Commission's disposal to review within the plans. So I don't think it diminishes your ability to review the actions of the utility in any regard, except it shows a clear preference to not holding the companies accountable to exercising market timing outside of the parameters of the plan that they have specified.

COMMISSIONER ARGENZIANO: Mr. Chairman.

CHAIRMAN CARTER: You're recognized.

COMMISSIONER ARGENZIANO: I'm sorry. Let me put it differently. And I understand what you are saying, but I need a different way of getting it into my brain. If the company follows the guidelines, and then I find as a Commissioner that there was something else that even though they followed the guideline really should have been looked at. And I know you can't decide what the fuel is going to be down the road, but there are indicators sometimes, you know, things that happen around the world that pretty much can give you a clue on whether prices -- look the other day at all those people who ran to gas stations filling up their tanks and leaving no gas for anybody else. Something gave them a clue that something was coming, whether is was right or wrong. Sometimes it's vindicated.

But I guess getting down to it, and that is my last question, if the company, as I said before, followed the guidelines, and I find that there was something else that really should have been looked at, do they have a point then of saying that, well, we followed the guidelines, so, you know, you can't -- and I understand the certainty they need, but I'm talking about something that really should be considered, and it's not in that guideline. What happens then? The company says I met the guideline. Hey, I did what I had to do. Is that what will occur?

MR. McNULTY: Commissioner, I believe that the Commission at the time that it is making a prudence determination on the hedging activities of a utility can consider all factors, including what the actual results of the company were, what the elements of the plan were, and things that may not have been specified within the plan. So it's not --

COMMISSIONER ARGENZIANO: Then what --

MR. McNULTY: Excuse me. I'm sorry.

COMMISSIONER ARGENZIANO: I'm sorry. No, I cut you off.

MR. McNULTY: I don't believe that you have any constraints in terms of making your prudence review. If there is a specific aspect as an example I gave earlier where the company tried to stay within one guideline, but failed miserably with another guideline that was of importance, that's on the table for you to review and make a determination of prudence. It's not off the table.

COMMISSIONER ARGENZIANO: But, again, I'm sorry, Mr. Chairman. You're using the term guideline. I'm talking about outside of the guideline that I consider should have been considered, or is it one of those trees that was not specified in the guideline because you can't encompass everything, and you can't think ahead of time of what everything may be include.

If I find something else that is not within that guideline and I think they should have known better, am I then painted in a corner? Because the company is going to say, hey, we followed the guideline.

MR. McNULTY: Commissioner, I would argue that you're not.

COMMISSIONER ARGENZIANO: Okay. That's on record, then. That's on record that if I find something in a guide that is outside of the guideline that should have been known, you're telling me -- see, I don't understand why you have guidelines, then.

MR. McNULTY: And I would say maybe too much is being made of these guidelines. I mean, in essence the guidelines boil down to you are going to approve a plan, and the companies are expecting to not employ market timing, and there is even an out within the guidelines for that. You can specify deviations for anything in Section IV. So, really, when you get down to what it is we are looking at today, we are just saying that we as a Commission are going to be reviewing and the Commission themselves will be approving a plan, and the company will use that plan.

Now, prudence down the road is going to

encompass what's in the plan, what's in the results, and maybe things that weren't contemplated, you know, in either the plan or the guidelines, but have evolved through the process of events that occurred in the year in question.

COMMISSIONER ARGENZIANO: Okay.

With that, Mr. Chairman, if that is the way it is, if there are guidelines and I'm not painted into a corner for something that is outside of that guideline, then I feel more comfortable. And that's why I want it on the record now. Because if there is something that comes up outside of that guideline, I'm hearing today that I would have the ability as a Commissioner, or any one of us have the ability then to say, hey, this does not meet the prudent decision-making that we require and need to protect the consumer.

CHAIRMAN CARTER: And that's on the record, Commissioner, and we have got it, and that gives us the opportunity to make a complete review of all the facts and all of the circumstances, and even including timing and things that, you know, there are some things we may not anticipate at this time that may happen down the road. So I think that's within the confines of that.

MR. DEVLIN: Mr. Chairman.

CHAIRMAN CARTER: Tim.

MR. DEVLIN: I was just wondering a couple of things. I don't believe Commissioner Edgar ever got an answer to her question awhile back about will the level of scrutiny and auditing be higher or lower with these guidelines.

CHAIRMAN CARTER: Can you break it down. Don't take us to New York to cross the street.

MR. DEVLIN: I will be very fast.

CHAIRMAN CARTER: Okay, you're recognized.

MR. DEVLIN: The answer, in my mind, is the level of auditing and scrutiny will be more, because the auditors will now have some guidelines or guidance, if you will, on what to be looking at and what to be judging. And I think the auditing review process will be more intense and more precise. I just wanted to give that answer.

And the other thing, just as a suggestion, I think what is making the discussion kind of difficult is the guidelines are very broad. What is really important, I think, will be the plan that will come out of these guidelines that we don't have before you today, and I think Commissioner Argenziano has made that point. We don't have the specifics of the plans to evaluate, which will be the first part of our prudency review, if you will.

So I guess I would offer to the Commission that let's go through maybe one year, one cycle, and evaluate the plans, and if we need to come back, or maybe we will just commit that we will come back either way and take another look at these guidelines to see whether they need to be changed or not sometime next year, and we would commit to do that.

COMMISSIONER ARGENZIANO: Mr. Chairman.

CHAIRMAN CARTER: Commissioner Argenziano.

COMMISSIONER ARGENZIANO: Just to make sure that -- because what I heard staff telling me that I would have the ability if something was outside of those guidelines tells me then that right at this moment then I'm not diminishing my ability, okay, to look at prudency that may fall outside of those guidelines, or remove any consumer protections. I mean, with all due respect to OPC, and I worked very hard to try to get this out, but I want to put that on record. Because if I felt today that I didn't have the right to be able to look at something that falls outside of that guidelines and that took away from the consumer protection, I would not vote for this today. So getting that on record and making sure I want that understood, and I appreciate you lending me a minute to do that.

CHAIRMAN CARTER: Thank you, Commissioner. It was, like, kind of pulling teeth to get those direct answers, but I think we have practiced dentistry without a license today, but I think we got there.

Commissioners, anything further? At this point in time I'm open for a suggestion for the disposition of this matter.

Commissioner Skop, you're recognized.

Commissioner Edgar.

COMMISSIONER EDGAR: Either way, I will take a stab at it and see if we get there. With the understanding from the discussion that we have all had today, my understanding and my motion is in this light, that what we have before us in Issues 2 and 3 is intended to be an improvement of the process and to give greater understanding and clarity to some of the steps within that process. That the after-the-fact review will still take place. And with that as a prelude, I would make a motion that we adopt staff's recommendation on Issues 2 and 3.

COMMISSIONER SKOP: Second.

CHAIRMAN CARTER: It has been moved and properly seconded that we adopt staff's recommendation on Issues 2 and 3 as per our discussion from the bench and the questions that we elicited as well as the direction to staff.

Commissioners, any questions about the motion or any concerns with that? Hearing none, all in favor let it be known by the sign of aye.

(Simultaneous affirmative vote.)

CHAIRMAN CARTER: All those opposed, like sign. Show it done.

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STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Hearing Reporter Services Section, FPSC Division of Commission Clerk, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 25th day of September, 2008.

Jane Faurot

JANE FAUROT, RPR
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