Diamond Williams 100001-EI

From: Bruette Davis [bdavis@kagmlaw.com]
Sent: Friday, November 19, 2010 11:37 AM
To: Filings@psc.state.fl.us
Cc: Lisa Bennett; Erik Sayler; bkeating@gunster.com; jbeasley@ausley.com; jwahlen@ausley.com; jas@beggslane.com; rab@beggslane.com; jbrew@bbrslaw.com; allen.jungels@tyndall.af.mil; karen.white@tyndall.af.mil; john_butler@fpl.com; cecilia.bradley@myfloridalegal.com; kelly.jr@leg.state.fl.us; Charles Beck; john.burnett@pgnmail.com; swright@yvlaw.net; wigglaw@gmail.com
Subject: Docket No. 100001-EI - *Fuel and purchased power cost recovery clause and generating performance incentive factor*
Attachments: FIPUG Response to Staff's Data Request #1 11.19.10.pdf

In accordance with the electronic filing procedures of the Florida Public Service Commission, the following filing is made:

a. The name, address, telephone number and email for the person responsible for the filing is:

Vicki Gordon Kaufman
Jon C. Moyle, Jr.
Keefe Anchors Gordon & Moyle
118 North Gadsden Street
Tallahassee, FL 32301
(850) 681-3828
vkaufman@kagmlaw.com
jmoyle@kagmlaw.com

b. This filing is made in Docket No. 100001-EI.

c. The document is filed on behalf of Florida Industrial Power Users Group.

d. The total pages in the document are 4 pages.

e. The attached document is Florida Industrial Power Users Group's Responses to Staff's Data Request No. 1.

Bruette Davis
bdavis@kagmlaw.com

KA GM Keefe, Anchors Gordon & Moyle

Keefe, Anchors, Gordon and Moyle, P.A.
The Perkins House
118 N. Gadsden St.
Tallahassee, FL 32301
850-681-3828 (Voice)
850-681-8788 (Fax)
www.kagmlaw.com

Keefe, Anchors
Gordon & Moyle

November 19, 2010

VIA E-MAIL

Ms. Ann Cole, Director
Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket No. 100001-EI – Fuel and purchased power cost
<u>recovery clause with generating performance incentive factor</u>

Dear Ms. Cole:

In response to Staff's request of November 12th, please see FIPUG's responses to Staff's Data Request No. 1, which are attached.

Please contact me with any questions.

<u>s/Vicki Gordon Kaufman</u>

Vicki Gordon Kaufman
Jon C. Moyle, Jr.

Attorneys for the Florida Industrial
Power Users Group

Enclosure

cc: Parties of Record (w/encls.)

850.681.3828
850.681.8788 fax

118 N. Gadsden Street
Tallahassee, Florida 32301

Fort Walton Beach | Destin | DeFuniak Springs | Tallahassee | Crestview

FIPUG REPONSES TO STAFF DATA REQUEST NO. 1
Docket No. 100001-EI

1. Do you believe there are problems with current hedging practices? If so, explain.

FIPUG Response:

Yes. There are a number of problems with the existing hedging practices.

- The current process results in a formulaic approach which focuses on hedging a specific percentage of requirements by a date certain. A more effective hedging strategy is one that is interactive with the market and sensitive to market direction. Otherwise, the benefits from the hedging plan will be limited to those periods in which there is an upward move in the market and the plan will fail to allow the utility to take advantage of a market decline.

- The present approach fails to establish specific objectives for the hedging plan. Currently, the hedging policy and hedging plans are designed to hedge against price "volatility." Volatility is simply the up and down price movement of the price of a commodity over a given period of time. Rather than targeting "volatility," hedging practices should target a specific risk or risks subject to mitigation. In determining the objective, consideration needs be given to whether it is upward or downward price movement that is most harmful to customers.

    - The current approach results in utilities placing hedges for a portion of their required supply up to a certain percentage level three years before the year being hedged; an additional percentage of supply will be hedged during the second year before the purchase; and a third tier of hedges will be concluded in the year preceding the year of purchase. In a market in which prices continue to rise over an extended period – 3 years or more – this may prove to be an effective strategy. However, in other market conditions, such as occurred over the last several years, where the market has moved steadily downward, this strategy is ineffective and costly to ratepayers. This highlights the need for flexibility with the ability to adjust the plan as conditions change.

- Given the vagaries of the market, the present approach, which relies upon the submission of a plan for preapproval, with that plan being followed formulaically, does not benefit consumers.

2. Pursuant to Order No. PSC-02-1484-FOF-EI, in Docket No. 011605-EI, the Commission developed a checklist of guidelines for the utilities to follow in hedging (Exhibit TFB-4 of the order). Are there any items on that checklist that:

A: need to be revised, or refreshed.
B: need to be deleted, or are no longer applicable;
C: need to be added to the list?

FIPUG Response:

There are several aspects of Exhibit TFB-4 that should be considered for revision.

- Item 1: FIPUG has observed no quantitative benchmarks in the Risk Management Plans. That is, the plans lack any quantitative measures by which the Commission can judge whether the plans have been successful. To establish such measures, as explained in Response to Request No. 1, the risk to be mitigated needs to be more clearly identified. The effectiveness of a hedge is not based on the percent of a product hedged, but rather the results of the hedges – that is, gains and losses on the hedges. Examples of quantitative benchmarks could include: i) limit plan losses to less than a certain dollar amount if the market trend reverses; and/or, ii) reduce the price paid for the commodity by a certain percent in times of rising prices. That is, the results can and should be measured against the market; *i.e.*, how well have the hedges mitigated market price risk?

- Item 2: Unless established on an exceptionally broad basis, the use of a minimum level of purchases to be hedged by a date certain, such as 1 year in advance of the purchases, constitutes a constraint on the ability of the utility to adjust to longer term market changes.

- Item 3: One of the risks that is not quantified or identified is the potential for losses that will occur when the market direction changes. What is lacking is designated loss limits. Loss limits act as a restraint on the trading floor's ability to enter into transactions that will result in losses charged to ratepayers. As currently structured, the utilities have total freedom to play with an unlimited amount of house money, *i.e.*, ratepayer money. A level of market-to-market losses that are likely to be incurred and passed on to ratepayers needs to be established.

It is important to establish loss limits, as can be seen by looking at the losses incurred in 2009 and 2010 to date, as well as potential losses in 2011. In 2009, losses incurred as a result of PEF's hedging activities were approximately $583 million. This results in a $16.32 per MWH increase in the cost of PEF generation. (Hearing transcript at 83). The estimated losses from hedging in 2010 are $219 million, which increases the costs of generation by $6.02 per MWH. And as of September 30, 2010, the hedging losses from 2011 were approximately $200 million or $5.68 per MWH. (*Id.* at 88-89). Loss limits would require the utility to stop hedging and work out some portion of the hedges to mitigate losses, force the utility to revise its hedging approach, or require the filing of a revision to its plan or a demonstration as to why the continuation of the plan would ultimately serve consumers' interest. An overall loss limit level should be discussed in detail at a workshop.

3. Do you believe certain aspects of current hedging practices should be modified to derive greater benefit for customers? If so, explain what should be modified and why.

FIPUG Response:

See Response to Request No. 1.

4. Does the purpose of hedging include taking advantage of low market prices at any given time, or is hedging better accomplished by planning amounts to be hedged at designated intervals and then strictly adhering to that plan?

FIPUG Response:

As explained in Response to Staff Request No. 1, hedging should target a particular risk against which protection is sought. The over-arching objective of utility fuel procurement programs should be to provide reliable service at least cost. As such, in FIPUG's view, a hedging strategy should target the mitigation of price spikes or price increases caused by sustained price increases. A hedging plan to accomplish that goal needs to be flexible and attuned to overall market direction. This does not mean that the plan should focus on day-to-day price fluctuations but rather price movement over a more sustained period.

5. Do you believe it would be appropriate for a utility to deviate from an approved hedging plan in order to take advantage of low market prices at any given time? Explain.

FIPUG Response:

See Responses to Nos. 1 and 4 above.

6. Does Order No. PSC-08-0667-PAA-EI address a utility's ability to deviate from approved plans in order to take advantage of low market prices at any given time? Explain.

FIPUG Response:

It does not appear to permit this.

7. If utilities were required to obtain Commission approval to deviate from hedging plans to take advantage of low market prices, how should that be accomplished procedurally?

FIPUG Response:

Such procedures should be discussed at a workshop held for that purpose.