

State of Florida



Public Service Commission

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

DATE: December 17, 2014
TO: Carlotta S. Stauffer, Commission Clerk, Office of Commission Clerk
FROM: Andrew L. Maurey, Director, Division of Accounting & Finance *ALM*
RE: Docket No. 140001-EI, FPL Gas Reserves petition

Please include the attached document in the FPL Gas Reserves case file in Docket No. 140001-EI.

cc: Lisa Harvey

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COMMISSION
CLERK

Post Hearing Information Sheet – Docket No. 140001-EI

For the Gas Reserves Decision

(Issues 1, 2, 3, 6, and 8)

ISSUE 1: Should the Commission approve Florida Power & Light Company's request to recover the amounts it would pay to its subsidiary for gas obtained from the PetroQuest joint venture through the fuel cost recovery clause on the basis and in the manner proposed by FPL in the June 25 Petition?

Paraphrased Arguments

FPL: Yes. FPL's investment in the PetroQuest joint venture is projected to provide fuel savings over the life of the project. In addition, the PetroQuest joint venture will provide for fuel price stability, effectively acting as a long-term hedge. Because it is designed to reduce the delivered price of fossil fuel (natural gas) and the costs for the PetroQuest joint venture were not recognized or anticipated in the cost levels used to determine FPL's current base rates, the costs associated with the PetroQuest joint venture are appropriate for recovery through the Fuel Clause.

OPC, FRF, and FIPUG: No. The Commission should not approve the recovery of costs associated with the Woodford Project. The Woodford Project does not satisfy the criteria for Fuel Clause recovery because its costs are not capital costs normally recovered through base rates, and go beyond the policy adopted by the Commission for dealing with fossil fuel-related costs normally recovered through base rates that will result in fuel savings to customers.

In addition, the Commission prohibits utilities from profiting (or earning a return) on fuel purchases recovered through the Fuel Clause. Under FPL's proposal, FPL would "purchase" (or acquire) fuel from the Woodford Project at production costs, and would then allow FPL shareholders to profit (earn a return) on the gas that the Company acquires at production costs.

Options before the Commission

1. Approve the Woodford Project as filed.
2. Approve the Woodford Project but require greater customer protections (i.e., sharing mechanism for costs and benefits, capping recovery at the market price of gas, etc.).
3. Deny the Woodford Project.

Considerations for approving the Woodford Project

- A. FPL’s customers are expected to receive fuel savings and reduced volatility of gas prices.
- B. The type of projects eligible for recovery through the Fuel Clause has evolved since the issuance of Order No. 14546.
- C. Approval of this project could encourage other innovative strategies for reducing the effective cost of natural gas, which is important given that FPL purchases more natural gas than any other electric utility in the country and given Florida’s significant and growing dependence on natural gas for generation.
- D. FPL’s natural gas price forecasts prepared in October 2013 and July 2014 presented in this case are consistent with the forecast assumptions and forecast methodology used in other proceedings before the Commission.
- E. FPL’s natural gas price forecasts of October 2013 and July 2014 indicate that the project will likely produce positive customer fuel savings over the life of the project based on the combination of two factors: well productivity and natural gas market price. Under the July 2014 natural gas price forecast, 6 of 9 sensitivities produce positive customer savings (see Table 1), and the base case indicates savings of \$51.9M. Also, the sensitivities show that the magnitude of potential positive savings (\$170.2M assuming high fuel price and high productivity) exceeds the magnitude of potential losses (-\$50.7M assuming low fuel price and low productivity).

Table 1 Pricing and Production Sensitivities			
(Savings (losses) in Millions \$)			
	Low Fuel Pricing	Base Fuel Pricing	High Fuel Pricing
Low Production	(\$50.7)	\$23.1	\$97.0
Base Production	(\$30.0)	\$51.9	\$134.0
High Production	(\$10.2)	\$79.9	\$170.2
Based on 1. July 2014 Fuel Curve; 2. Pricing: +/- 20.9% per MMBtu around NYMEX Henry Hub based on 8 year historical volatility from 2005-2012; and 3. Production: +/-10% monthly production. Source: Exhibit 64, Attachment 2			

- F. Historically, production costs have been less volatile than market prices. By decoupling production costs from market prices, the Woodford Project may act as a long-term physical hedge.

- G. The Woodford Project will have a small effect on FPL's overall cost of natural gas and on price hedging. This project may act as a long-term physical hedge (30 – 50 years in duration) compared to financial hedges, which typically lock in prices for 12 – 24 months.
- H. The Woodford Project revenue requirement recovered through the Fuel Clause will be limited to FPL's mid-point ROE. FPL has the opportunity to earn up to 100 basis points above the mid-point ROE on rate base items recovered through base rates. FPL currently earns above the mid-point ROE on its rate base.
- I. Recovery of investments in gas reserve projects have been approved by three other state regulatory commissions.
- J. Customers currently bear certain drilling, production, and shale gas risks (earthquakes, environmental issues, etc.) as these factors are embedded in the market price of gas.

Considerations for not approving the Woodford Project

- K. Approving the Woodford Project as proposed by FPL represents a change from past regulatory policy by including non-regulated investments in rate base. This investment will involve FPL and its customers directly in a competitive industry. Participation in such non-regulated projects could increase FPL's risk and cost of capital.
- L. Fuel savings for customers will depend on the level of market prices and the actual results of the drilling and production operations. If the Woodford Project investment is found prudent at the outset as requested by FPL, the Company's recovery of its costs and return on investment is assured through the Fuel Clause independent of the level of market prices or the results of the drilling and production operation.
- M. Customers bear the risk that fuel savings expected from the Woodford Project might not materialize. In addition, there is the loss of opportunity for greater fuel savings had the investment never been made.
- N. FPL's Pricing and Production Sensitivities matrix (Table 1 above) shows that 3 of the 9 sensitivities produce losses, and the losses could be as much as \$50.7M. FPL bases its estimate of customer savings on its October 2013 natural gas price forecast which was prepared over a year ago. FPL's July 2014 natural gas price forecast reflects significantly lower projected prices for all years compared to the Company's October 2013 natural gas price forecast. The likelihood of fuel savings resulting from the Woodford Project is less certain than at the time FPL filed its petition. In addition, the expected savings of \$107M based on FPL's October 2013 base case natural gas price forecast has dropped to \$52M based on FPL's July 2014 base case natural gas price forecast. The more current forecast should be recognized as the most relevant forecast to be used to analyze the cost effectiveness of the project.

- O. All previous gas reserve investment programs approved for recovery by other state regulatory commissions involve gas utilities. FPL's proposal is the only example involving an electric utility. In addition, the program in Montana was approved pursuant to statutory authority and the program in Oregon was approved through a stipulation.
- P. The Woodford Project is a much larger capital project than the capital projects previously approved for recovery through the Fuel Clause. The potential fuel savings associated with the Woodford Project are less certain than in other examples of capital substitution previously approved for recovery through the Fuel Clause.
- Q. The Woodford Project is not a true fixed price hedge. Production costs are not fixed and some degree of price volatility will remain. In addition, there have been times when production costs in the Woodford Shale area have exceeded concurrent market prices.
- R. Drilling, production, and project-specific risks will be borne by FPL customers. The record indicates there are additional risks as an investor in gas reserves that are not currently being borne by FPL as a purchaser of gas. FPL's proposal calls for the liability, if any, associated with these additional risks to be recovered from customers through the Fuel Clause.

Other Considerations

- S. For auditing purposes, the Commission will only have access to invoices from PetroQuest. FPL will be responsible for auditing PetroQuest's actual costs.
- T. Commission auditors will need the subaccount detail that correlates the "industry standard chart of accounts" used by FPL for the Gas Reserve Company to the FERC natural gas chart of accounts to more efficiently audit the amounts and transactions related to the Woodford Project investment.
- U. Approval of the Woodford Project for recovery through the Fuel Clause may become a precedent for growing rate base through the various cost recovery clauses. Requests for approval of clause recovery of similar investments by other investor-owned utilities (IOUs) in the state may follow.
- V. Although for different reasons, neither FPL nor OPC support a sharing mechanism for recovery of the Woodford Project.
- W. The Florida Legislature sets policy. An argument can be made that a proposal such as this, with such significant policy implications for not just FPL but for all IOUs in the state, is best addressed by the Legislature.

ISSUE 6: Is FPL contractually precluded by paragraph 6 of the Stipulation and Settlement Agreement dated December 12, 2012 and approved by the Commission in Order No. PSC-13-0023-S-EI from seeking to increase rates as it proposes?

Paraphrased Arguments

FPL: No. The first sentence of paragraph 6 in the Stipulation and Settlement Agreement provides expressly that “[n]othing shall preclude the Company from requesting the Commission to approve the recovery of costs (a) that are of a type which traditionally and historically would be, have been, or are presently recovered through cost recovery clauses or surcharges” FPL’s request to recover costs associated with the PetroQuest joint venture through the Fuel Clause is projected to provide net savings for customers and would serve as a valuable longer term physical hedge.

OPC, FRF: Yes. By the terms of the agreement, FPL is barred from recovering base rate costs through the fuel clause. The provision in the agreement that “It is the intent of the Parties in this Paragraph 6 that FPL not be allowed to recover through cost recovery clauses increases in the magnitude of costs of types or categoriesthat have been and traditionally, historically and ordinarily would be recovered through base rates,” is controlling and restricts what, if any, costs can be recovered. The Woodford Project costs are not a hedge and not costs that are traditionally and historically recovered through the fuel clause.

FIPUG: Yes. The parties to the December 12, 2013 Stipulation and Settlement Agreement negotiated a resolution to a litigated rate case that provided rate stability and predictability for the duration of the Settlement. Language was included in the Agreement to prevent “end runs” around the Agreement, and the associated rate stability and predictability. Oil and gas exploration and production costs are more analogous to base rate type expenditures that would be “ordinarily” recovered in base rates. Large capital expenditures expended on things like drilling wells and related equipment would be the type of expenditures that would ordinarily be recovered in base rates. the settlement agreement contractual language precludes the recovery of such costs through the fuel clause, at least until the term of the current settlement agreement expires.

Background

The relevant portions of Paragraph 6 of the Stipulation and Settlement Agreement (2012 Settlement), approved in Order No. PSC-13-0023-S-EI, issued January 14, 2013, in Docket No. 120015-EI, In re: Petition for increase in rates by Florida Power & Light states:

Nothing shall preclude the Company from requesting the Commission to approve the recovery of costs (a) that are of a type which traditionally and historically would be, have been, or are presently recovered through cost recovery clauses or surcharges,

* * * * *

It is the intent of the Parties in this Paragraph 6 that FPL not be allowed to recover through cost recovery clauses increases in the magnitude of costs of types or categories (including but not limited to, for example: investment in and maintenance of transmission assets) that have been and traditionally, historically, and ordinarily would be recovered through base rates.

Relevant Orders

Order No. **12645**, issued November 3, 1983, in Docket No. 830001-EU, In re: Investigation of Fuel Adjustment Clauses of Electric Utilities.

- Established guidelines for fuel procurement
- The utility should have the flexibility to employ any means to achieve this result.
- All utility transaction with affiliated companies which provide fuel or fuel related services should be based on costs which are consistent with or lower than the costs a utility would incur if the utility received the fuel or services from an independent supplier in the competitive market obtained through competitive bidding.

Order No. **14546**, issued July 8, 1985, in Docket No. 850001-EI-B, In re: Cost recovery Methods for Fuel-Related Expenses.

- Fuel related costs which are subject to volatile changes are recoverable through the fuel clause
- Fuel related costs recovered through base rates but which were not recognized or anticipated and which if expended result in fuel savings to customers were to be considered for recovery through the fuel clause on a case by case basis.

Order No. PSC-02-**1484**-FOF-EI, issued October 30, 2002, in Docket No. 011605-EI, In re: Review of investor-owned electric utilities' risk management policies and procedures.

- Hedging maintains flexibility for each IOU to create the type of risk management program for fuel procurement that it finds most appropriate while allowing the Commission to retain the discretion to evaluate, and the parties the opportunity to address, the prudence of such programs at the appropriate time
- Hedging removes the disincentives that may currently exist for IOUs to engage in hedging transactions that may create customer benefits by providing a cost recovery mechanism for prudently incurred hedging transaction costs, gains and losses, and incremental operating and maintenance expenses associated with new and expanded hedging programs.

Order No. PSC-06-**1057**-FOF-EI, issued December 22, 2006, in Docket No. 060001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

- the objective of the hedging programs is to minimize price volatility, and that prices are uncertain and volatile, particularly for natural gas, so there will be periods when the companies have hedging gains and other periods where the companies will have hedging losses.
- minimizing price volatility produces customer benefits.

Order No. PSC-08-0667-PAA-EI, issued October 8, 2008, in Docket No. 080001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

- Sets hedging guidelines
- Reduce the volatility of fuel adjustment charges
- "Hedging Activities" that are appropriately reported by IOUs in their hedging information reports are defined to be natural gas and fuel oil fixed price financial or physical transactions
- primary purpose is not to reduce an IOU's fuel costs paid over time, but rather to reduce the variability or volatility in fuel costs paid by customers over time.
- an IOU is not expected to predict or speculate on whether markets will ultimately rise or fall and actually settle higher or lower than the price levels that existed at the time hedges were put into place.

Considerations

- A. The first question the Commission should determine is whether the cost of the PetroQuest joint venture should be recovered.
- B. If the answer is yes, the Commission should determine where these costs are recovered: base rates or Fuel Clause.
- C. The 2012 Settlement precludes FPL from requesting an increase in base rates to take effect before January 1, 2017.
- D. If the Commission determines that the costs should be recovered through base rates, FPL would be precluded from seeking to recover those costs until 2017. Thus, the petition should be denied.
- E. Paragraph 6 of the 2012 Settlement states that FPL may recover costs that "are of a type which traditionally and historically would be, have been, or are presently recovered through cost recovery clauses or surcharges."
- F. For the Commission to determine that the costs are appropriate for recovery through the Fuel Clause, the Commission must first decide whether the costs of the PetroQuest joint venture are the type of costs traditionally and historically recovered through the Fuel Clause.
- G. If the Commission decides that the nature of the costs are traditionally recovered through the Fuel Clause, the 2012 Settlement would not preclude the granting of the petition.
- H. If the Commission determines that the PetroQuest joint venture is in fact a long-term physical hedge, the costs may be recoverable through the Fuel Clause and the 2012 Settlement would not preclude FPL from recovering the costs.

ISSUE 2: If the Commission answers Issue 1 in the negative, what standard should the Commission apply to a request by FPL to recover the price that FPL pays to its subsidiary/affiliate for gas obtained through the joint venture with PetroQuest? *(This is a fall-out Issue.)*

Paraphrased Arguments

FPL: FPL believes this issue is effectively moot. If the Commission rejects FPL's Petition, FPL will not pursue the PetroQuest joint venture. Instead, FPL's unregulated affiliate, USG, will retain all rights and responsibilities associated with the joint venture with PetroQuest. Thus, the question is hypothetical and need not be addressed.

OPC, FRF, and FIPUG: Cost recovery of any gas purchased under the arrangement described in this issue should be no more than the market price of gas.

Considerations

- A. If the Commission does not approve the joint venture proposal in Issue 1, FPL's non-regulated affiliate, USG, will be involved in the joint venture with PetroQuest. If FPL were to purchase gas from USG, the price of gas FPL pays to USG would undergo the same level of scrutiny as all other gas purchases FPL makes from any other producer. Staff would analyze FPL's gas costs against the market price of gas.
- B. If the Commission approves the joint venture proposal in Issue 1, the joint venture agreement between FPL and PetroQuest addresses cost recovery.

ISSUE 3: What amount, if any, associated with the transactions proposed in FPL's June 25 Petition should be included for recovery through FPL's 2015 fuel cost recovery factor? *(This is a fall-out issue.)*

Paraphrased Arguments

FPL: For 2015, the amount to be recovered is projected to be \$45,473,295, which is based on FPL's share of the costs to be incurred in 2015 for the PetroQuest joint venture. The recovery amount will be recovered through the normal Fuel Clause actual/estimated and final true-up mechanisms as actual 2015 costs are known.

OPC, FRF, and FIPUG: Zero. Nevertheless, if FPL's subsidiary goes forward with the transaction, then any natural gas obtained by FPL from such subsidiary should be recovered through FPL's 2015 fuel cost recovery factor based on the market price of gas, consistent with how fossil fuel costs obtained from affiliated entities are recovered. However, if the Commission finds that the transaction falls within its regulatory jurisdiction, despite OPC's strong contention that it does not have such authority, then the amount recovered through the 2015 fuel cost recovery factor should be based on the lower of cost or market for the gas obtained from the subsidiary.

Considerations

- A. FPL's 2015 fuel cost recovery factors were set at the October 22, 2014 Fuel Hearing without including any amount of estimated costs associated with the Woodford Project.
- B. If the vote on Issue 1 approves FPL's proposal, FPL will not change its 2015 factors. Instead, FPL will file for cost recovery of actual expenses in its actual/estimated and final true-up filings for 2015 (to be implemented in the first billing cycle of 2016).
- C. If the vote on Issue 1 denies FPL's proposal, this issue is moot.
- D. In either scenario, FPL will not change its 2015 fuel factors during 2015 as a result of the Woodford Project.

ISSUE 8: What effect, if any, does Commission's decision on Issue 3 have on the fuel cost recovery factor and GPIF targets/ranges for the period January 2015 through December 2015? *(This is a fall-out issue.)*

Paraphrased Arguments

FPL: By stipulation, the Commission approved the 2015 Targets without recognition of the Woodford Project. If the Woodford Project is approved, the 2015 GPIF targets/ranges would change slightly. As noted in Issue 3, FPL does not propose to revise the 2015 fuel factors. Rather, FPL would reflect both the costs and the fuel savings associated with the Woodford Project in the actual/estimated and final true-up filings for 2015.

OPC, FRF, and FIPUG: No position. (OPC and FRF) As the Commission should not permit natural gas drilling and production costs to be recovered through the Fuel Clause, no change to the GPIF targets/ranges is necessary. (FIPUG)

Considerations

- A. The record in the 2014 Fuel Clause proceeding includes the GPIF targets/ranges both with and without the impact of the Woodford Project. The GPIF results for 2015 will be calculated by comparing actual performance measures against the appropriate targets/ranges.