

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

IN RE: Fuel and purchase power cost recovery  
clause with generating performance incentive  
factor

Docket No: 150001-EI  
Date: January 12, 2015

**FLORIDA POWER & LIGHT COMPANY'S POST-HEARING  
BRIEF ON GAS RESERVES GUIDELINES (ISSUES 4, 5 and 7)**

Florida Power & Light Company ("FPL" or the "Company"), pursuant to Order No. PSC-14-0667-PHO-EI (the "Prehearing Order") and direction given at the December 1-2, 2014 technical hearing and the December 18, 2014 agenda conference concerning this matter, hereby files with the Florida Public Service Commission ("Commission") its post-hearing brief and statement of issues and positions concerning FPL's proposed guidelines for future gas reserves projects, which are addressed in Issues 4, 5 and 7.

**I. Introduction and Background**

On June 25, 2014, FPL petitioned this Commission for a determination that it is prudent for FPL to acquire an interest in a natural gas reserves project, known as "the Woodford Project," that will provide price stability and projected fuel savings for customers, and that the revenue requirements associated with investing in and operating the gas reserves project are eligible for recovery through the Fuel Clause. FPL's petition also requested "that the Commission establish guidelines under which FPL could participate in future gas reserves projects and recover their costs through the Fuel Clause without prior Commission approval, subject to the Commission's established process for reviewing fuel-related transactions in Fuel Clause proceedings."

On December 18, 2014, following months of discovery, a technical hearing that included the testimony of several witnesses for multiple parties, as well as the submission of briefs, the Commission affirmatively found that FPL's investment in the Woodford Project is prudent and applauded FPL's approach as innovative. The Commission determined that, based on the

evidence presented, the Woodford Project is designed to generate customer savings and serve as a physical hedge against gas market volatility.

The Commission's support for the Woodford Project was premised in large part on Florida's need to diversify its fuel sources and stabilize fuel pricing. The Commission recognized that Florida, unlike other states around the country, has limited alternative fuel sources: wind and hydroelectric power are not viable geographically, and environmental regulations render coal an unrealistic future option. Thus, FPL specifically, and the state of Florida more generally, are and will continue to be heavily dependent on natural gas to fuel generation and deliver electric service to customers. As the largest investor owned utility purchaser of natural gas in the country, FPL purchases nearly \$3 billion annually from third parties in a market that in 2014 exhibited over 90 percent price fluctuation.

The Woodford Project represents only a very small portion of FPL's total gas portfolio – approximately 2.7 percent at its peak production point and then tapers off rapidly to lower levels thereafter. To maintain a meaningful level of customer benefits over the long-term, FPL must be able to add new gas reserves projects, which in turn, requires the authority to enter into additional contracts with third party gas producers. As explained more fully below, however, producers are subject to drilling schedules and other constraints that render it impractical, if not impossible, to obtain an advanced prudence determination each time FPL wishes to enter a gas reserves transaction; thus, there is a need for a workable set of guidelines as proposed by FPL in this proceeding.

A workable set of guidelines must: (a) provide FPL the ability to make prompt decisions and the flexibility necessary to negotiate favorably and take advantage of marketplace opportunities; (b) provide an adequate framework that ensures customer interests are met for

transactions within that framework; and (c) preserve an appropriate level of review by the Commission with regard to the individual transactions, consistent with the level of review that the Commission currently has over existing short-term hedging transactions. FPL respectfully submits that its proposed guidelines accomplish these objectives, as will be explained more fully below.

Issues 4, 5 and 7 were identified to address FPL's request for approval of guidelines, and the parties were directed to brief those issues by January 12, 2015. This Post-Hearing Brief is in response to that direction.

## **II. Future Gas Reserves Opportunities Depend on FPL's Ability To Act Promptly**

The projected customer benefits associated with the Woodford Project were made possible by a special arrangement with USG Properties Woodford I, LLC ("USG"), an FPL affiliate that effectively "warehoused" the Project at no cost to FPL pending regulatory approval. Tr. 86-88, 286-87 (Forrest). The need for such an arrangement became apparent during FPL's initial search for a gas reserves project. The market for these types of investment opportunities is very active and robustly competitive, which is a positive attribute insofar as opportunities for transactions on terms that will be beneficial to FPL's customers; however, this also means that successful companies must be able to move quickly and make drilling decisions without delay. Tr. 86-88, 286-87 (Forrest). Potential counterparties, such as PetroQuest, must meet drilling schedules and capital expenditure deadlines. With the wide range of financing options available to gas exploration and production companies, they simply are not willing to wait for standard regulatory approval timing in order to execute an agreement. Tr. 121-22, 286-87 (Forrest). This would be true for any potential investor in gas reserves, and particularly so for FPL since its

business will comprise only a miniscule part of the shale production market.<sup>1</sup> Tr. 85 (Forrest); Exhibit 23.

The approval process for the Woodford Project is illustrative of these timing concerns. FPL filed its Petition in June 2014, received an oral decision in December as a result of the Commission's willingness to expedite its decision making, and the Commission issued its written order in January 2015. PetroQuest could not wait the nearly six months it took to obtain a final regulatory order to know whether it would be proceeding with this project. Tr. 286-87 (Forrest). In this instance, USG offered to "stand in" for FPL pending project approval, and agreed to assign the PetroQuest transaction to FPL at net book value if and when the Commission voted to approve the project. Tr. 86-87, 304 (Forrest). FPL cannot, however, rely on that arrangement for future projects. In effect, USG provided FPL's customers a free option to acquire a project that USG otherwise would have been a part of USG's portfolio. It is not commercially realistic to expect USG or any other entity to offer free options on a continuing basis. Tr. 87-88 (Forrest).

For these reasons, FPL has requested Commission approval of a set of guidelines under which FPL could transact for future gas reserves projects and presumptively be eligible to recover revenue requirements through the Fuel Cost Recovery Clause, subject to the Commission's well-established review and oversight processes for fuel-related transactions. Tr. 84-85, 86-88 (Forrest). Allowing FPL to move forward in this manner would address FPL's

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<sup>1</sup> Even if FPL procured 25 percent of its annual fuel from gas reserves, that would represent *less than one percent* of the 2014-2015 shale production market, and an even smaller percentage in future years. See Tr. 85 (Forrest) (explaining that FPL currently purchases up to 600 billion cubic feet of natural gas annually) and Exhibit 23 (projecting approximately 24 trillion cubic feet of shale gas production in the United States in 2014 and 2015 and increasing to more than 32 trillion cubic feet by 2040).

need to take prompt action on future gas reserves opportunities that, like the Woodford Project, will provide customers price stability and projected fuel savings. Tr. 118-19, 121 (Forrest).

### **III. Gas Reserves Guidelines Will Allow FPL To Deliver Customer Benefits**

The Commission should approve FPL's proposed gas reserves guidelines because they will safeguard customer interests while supporting FPL's ability to timely proceed with negotiated contracts in a market that will not wait for regulatory pre-approval. Tr. 87-88 (Forrest); Exhibit 10. The guidelines will provide sufficiently clear direction so that FPL can confidently make decisions on future transactions without being later subject to disallowances based on hindsight judgments. A proper set of guidelines must be structured to serve three objectives:

- First, the guidelines must provide FPL the ability to make prompt decisions and the flexibility necessary to negotiate favorable contracts and take advantage of marketplace opportunities;
- Second, the guidelines must provide a framework that ensures customer interests are met for transactions within that framework; and
- Third, but no less important, the guidelines must preserve an appropriate level of review by the Commission with regard to the individual transactions and the implementation of such contracts, consistent with the level of review that the Commission currently has over existing short-term hedging transactions.

In essence, FPL seeks confirmation from the Commission that the Company's decisions to invest in projects that satisfy the approved set of guidelines will give rise to a presumption that it acted prudently. Tr. 87-88 (Forrest). Under the guidelines, FPL will have the responsibility to demonstrate its adherence to the established parameters, as well as a continuing obligation to

manage the projects prudently for the benefit of customers. Tr. 973 (Deason). The Commission, in its oversight role, will retain the ability to assess customer savings and evaluate the prudence of FPL's actions. *Id.* This framework strikes a harmonious balance among customer benefits, the utility's need for assurance that "the rules of the game" will not change mid-play, and the Commission's responsibility to review the prudence of the utility's conduct. Tr. 973-74 (Deason).

#### **IV. FPL's Proposed Guidelines Provide a Reasonable Framework within Which Customer Interests Are Protected**

FPL has proposed a reasonable set of gas reserves guidelines within which FPL could confidently invest in future projects that are unlikely to be available if FPL had to wait several months for regulatory pre-approval. Tr. 287 (Forrest).<sup>2</sup> The proposed guidelines establish four parameters under which FPL will be able to transact on future gas reserves opportunities:

- First, the guidelines limit the scope of FPL's project participation as a percentage of average daily burn, as well as on an annual capital expenditure basis. Tr. 123 (Forrest); Exhibit 10, Section I.
- Second, the guidelines describe how the deals will be evaluated against FPL's then current forecast of natural gas prices to project customer savings.<sup>3</sup> Tr. 123 (Forrest); Exhibit 10, Section II.

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<sup>2</sup> As with Woodford, FPL does not propose to become an operating partner in any of the projects that would be undertaken under the guidelines. Tr. 429-30 (Ousdahl).

<sup>3</sup> The Commission routinely relies upon FPL's fuel forecast in evaluating the economics of long-term projects. *See e.g., In re: Fuel and purchased power cost recovery clause with generating performance incentive factor*, Docket 150001-EI, Order No. PSC-15-0038-FOF-EI dated January 12, 2015 (approving Woodford Project); *In re: Petition for prudence determination regarding new pipeline system by Florida Power & Light Company*, Docket No. 130198-EI, Order No. PSC-13-0505-PAA-EI dated October 28, 2013 at page 11; *In re: petition to determine need for modernization of Port Everglades Plant, by Florida Power & Light Company*, Docket No. 110309-EI, Order No. PSC-12-0187-FOF-EI dated April 9, 2012 at pages 9-10; *In re: Petition to*

- Third, the guidelines describe the requisite supply diversity for qualifying projects. Tr. 123 (Forrest); Exhibit 10, Section III.
- Finally, the guidelines define the characteristics of eligible gas reserves and the physical characteristics of the gas that would be extracted from them (i.e., the percentage of methane versus natural gas liquids). Tr. 123 (Forrest); Exhibit 10, Section IV.

These parameters are additive, not exclusive or independent. That is, a proposed project must satisfy *each* guideline in order to be deemed presumptively prudent. Tr. 162-63, 275 (Forrest). Each of these four parameters, addressed in more detail below, is reasonable and provides significant safeguards.

*A. Scope of FPL’s Gas Reserves Project Participation*

Guideline I.A places a cap on the estimated aggregate annual output of all gas reserves projects as a percentage of FPL’s projected average daily natural gas burn. The table below shows the percentages allowed for 2015 through 2017:

Year	Maximum Volume as a Percentage of Average Daily Burn
2015	15%
2016	20%
2017	25%

Exhibit 10, Section I. Separately, Guideline I.C provides that FPL will not invest more than \$750 million in the aggregate on gas reserves projects over the course of any one calendar year.

*Id.*

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*determine need for West County Energy Center Unit 3 electrical power plant, by Florida Power & Light Company, Docket No. 080203-EI, In re: Petition for determination of need for conversion of Riviera Plant in Palm Beach County, by Florida Power & Light Company, Docket No. 080245-EI, In re: Petition for determination of need for conversion of Cape Canaveral Plant in Brevard County, by Florida Power & Light Company, Docket No. 080246-EI, [Omnibus] Order No. PSC-08-0591-FOF-EI dated September 12, 2008, at pages 7-8.*

The Intervenors' suggestion that these proposed limits on the scope of gas reserves participation are excessive is misplaced and reflects a complete lack of understanding of the relationship between the gas reserves and FPL's fuel needs and supply portfolio. Taking the Woodford Project as an example, even at the peak of production the project represents only 2.7 percent of FPL's peak daily burn as a percentage of its overall needs in 2016. Tr. 288 (Forrest). To provide customers a meaningful level of hedging benefits, FPL must move from a peak of only 2.7 percent to a significant, continuing percentage of daily burn. Tr. 288, 299.

Similarly, the Intervenors' criticism of the proposed annual \$750 million limit on capital investment fails to consider that limit in the appropriate context. First, the \$750 million limitation does not represent the target amount that FPL intends to spend each year. Tr. 219-20 (Forrest). Rather, it places a cap on the annual aggregate capital investment. *Id.* Consistent with the overall goal of these guidelines, the \$750 million figure is designed to provide flexibility within negotiations with gas production and exploration counterparties who have their own demands for capital. *Id.* Customers will not pay for the full capital investment upfront, in the year that they are made. Tr. 465 (Ousdahl). Rather, FPL would collect the annual revenue requirements, which comprise only a fraction of the \$750 million investment. Tr. 85, 122, 321-22 (Forrest). Those revenue requirements need to be considered in comparison to the nearly \$3 Billion that customers are already paying for natural gas each year. Tr. 220, 322 (Forrest). Thus, even if FPL invested the maximum allowable amount, the revenue requirements would be a relatively small portion of the overall gas portfolio. Tr. 299-300 (Forrest). Additionally, the "tapering off" that occurs in a project's later years creates the need to introduce layers of future transactions at greater investment levels in order to develop production levels projected to provide long-term customer benefits. *Id.*



It is also important to keep in mind that FPL already has a large, Commission-approved, fuel hedging program and that the gas reserves will substitute for a portion of that program, not expand it. Tr. 96 (Forrest). Each year, FPL will provide an update to the three year window as part of its Risk Management Plan filed annually in the Fuel Clause docket. Exhibit 10, Section I (Guideline I.B). The estimated aggregate volumes of natural gas from all gas reserves transactions in each calendar year will be netted against the amounts that FPL forecasts to hedge pursuant to FPL's annual Risk Management Plan. Exhibit 10, Section I (Guideline I.C). FPL will continue its financial hedging on the net amount as prescribed in the Risk Management Plan. *Id.* Thus, mathematically, the gas reserves projects will be a one-for-one substitute for the current short-term hedges such that the total volume hedged will not change. Tr. 96 (Forrest).

Finally, the Intervenors curiously focus their criticism of the guidelines on the potential level of FPL's earnings, which do not directly affect customers, rather than on reducing gas prices, which directly lowers customer bills. Intervenors have not – and cannot – identify any scenario in which FPL “overearns.” Rather, consistent with Commission precedent, FPL would earn a return at the midpoint of the authorized return on equity. Tr. 1029 (Forrest). By definition, earning a return at that midpoint is appropriate. And, as the second guideline (below) indicates, FPL will pursue projects only where fuel savings are expected to more than offset the projects' revenue requirements. *Id.* Simple math dictates that any such projects therefore would be expected to reduce customer bills, and the more projects FPL is able to find that meet the criteria, then the greater the reduction will be. *Id.*

#### B. *Customer Savings*

The purpose of FPL's investment in gas reserves projects is to offer significant price stability for the volumes produced, while also providing customer savings in a market of rising

gas prices. Tr. 85-86; 96 (Forrest); Exhibit 10, Section II. A well-managed gas reserves investment program can secure a stable, low-cost source of natural gas for customers for years into the future and deliver an expected pricing discount relative to the forward curve. *Id.* In fact, when production costs are lower than existing market gas prices, customers will save immediately. Tr. 289-90 (Forrest). Short-term hedges, by contrast, are not entered into by FPL with any expectation of producing *savings* relative to forecasted fuel prices; rather, the sole purpose of the Commission-approved short-term hedging program is to reduce *volatility* of natural gas costs. Savings provided by the gas reserves, therefore, are an improvement over conventional hedging.

To that end, Guideline II.A requires that FPL's decision to enter into a new gas reserves project must be based on a showing that the project is estimated to generate savings for customers on a net present value basis, relying solely on information available to FPL at the time it entered the transaction. Exhibit 10, Section II. Under this guideline, FPL's evaluation of the estimated savings must be based on an independent third party reserves engineering report and FPL's standard fuel price forecasting methodology. *Id.*

Intervenors criticize this guideline because it does not have a defined minimum or threshold level of estimated savings. They argue that, in the absence of such a threshold, FPL could transact for projects estimated to generate customer savings as low as one dollar. FPL witness Forrest confirmed, however, that this is idle speculation: such transactions are not the type of gas reserves investments that FPL intends to pursue. Tr. 1030 (Forrest). There is no fixed level of customer savings that renders a transaction a good deal. Rather, a reasonable level of customer savings depends on the gas market at the time. Tr. 257-58 (Forrest). Rising gas prices would result in substantial savings, as with the Woodford Project for example. Tr. 258

(Forrest). If, by contrast, gas prices fell to historical lows, it could be reasonable and in customers' interest for FPL to invest in reserves that yield lower projected savings in that relative market. *Id.*

Intervenors also fail to recognize the value of having a long-term supply of gas that is not subject to market volatility, even in a circumstance where estimated customer savings are small. Tr. 1030 (Forrest). The benefit of stable pricing, while difficult to quantify, is also very advantageous to customers and one of the defining characteristics of an effective physical hedge. *Id.*

### C. *Supply Diversity*

In addition to generating fuel savings and physical hedges, gas reserves projects will provide the added benefit of geographic diversity of fuel supply. Exhibit 10, Section III. Investments in multiple gas reserves across various regions will reduce the impact of a single event, such as a hurricane, which can disrupt FPL's ability to procure and deliver fuel. *Id.* To that end, FPL intends to transact with a wide range of suppliers in order to minimize concentration of supply with any one producer. *Id.* Such diversity will allow FPL to transact in multiple regions and will also provide for reduced credit exposure to any one entity. *Id.*

Under Guideline III.A, FPL will only enter into transactions for onshore gas reserves projects, which must be located in areas with reserves that have a well-established history of gas production. Exhibit 10, Section III. Moreover, Guideline III.B provides that FPL will only enter into a transaction if there is a transportation path available to deliver the gas produced from that project to FPL's service territory. *Id.* Texas, Louisiana, Oklahoma, Arkansas, Mississippi, Alabama, West Virginia, Ohio and Pennsylvania currently meet this criterion. Exhibit 10, Section III. FPL buys from these areas today. Tr. 228-29 (Forrest). And, with the exception of

West Virginia, Ohio and Pennsylvania (collectively known as the “Marcellus”), each area has a strong transportation path back to Florida, which will facilitate FPL’s acquisition of gas transport. Tr. 228-29 (Forrest).

FPL will make use of its transportation portfolio, along with considering new physical paths, which might take time to develop in the Marcellus area. Tr. 228-29 (Forrest); Exhibit 10, Section III. The costs of any new transportation needed to deliver gas from a gas reserves project will be taken into consideration when analyzing the customer savings for that project. *Id.*

#### D. *Characteristics of Gas Reserves*

There is a range of designations for reserves denoting the degree of certainty that the predicted quantity of gas is commercially recoverable from the well under current conditions: Proved, Probable, and Possible. Exhibit 10, Section IV. FPL intends to focus in areas with good proven reserves or where there is known production upon which FPL can rely. Tr. 1057 (Forrest). Nevertheless, FPL’s gas reserves portfolio could appropriately be comprised of a wide range of projects, including reserves that fall within each of those categories. *Id.*; Exhibit 10.

Moreover, the composition of the natural gas produced can vary in different regions and even within an individual region. Exhibit 10, Section IV. Natural gas production can consist of a combination of hydrocarbons, which can include methane, natural gas liquids (“NGLs”), and oil. FPL’s natural gas plants burn primarily methane. *Id.* For that reason, it is important that gas reserves projects are weighted toward methane production. By the same token, however, FPL does not want to foreclose the pursuit of projects that could bring significant benefits to customers simply because the production is not expected to be comprised entirely of methane. Therefore, Guideline IV.A provides that FPL will only enter into a transaction for a gas reserves

project if the estimated output of the wells in the project contains at least 50% from methane by volume. Exhibit 10.

There also are active third party markets for purchase and sale of NGLs and oil. Thus, under Guideline IV.B, all NGLs and oil produced from an FPL gas reserves project will be sold at market prices and the resulting revenues will be credited to the Fuel Clause to offset the production costs for which customers are responsible, thus lowering the effective cost of natural gas. Exhibit 10, Section IV. The projected revenues from NGLs and oil produced from a gas reserves project will be taken into consideration when analyzing the economics of that project. *Id.*

OPC argues that FPL should not pursue gas reserves transactions that contain NGLs and oil, but that criticism is unrealistic, especially given the industry's focus on NGLs and oil. While FPL was able to find a dry gas opportunity with the Woodford Project, there may not be many other such projects available. Indeed, customers will benefit from NGLs and oil production even when the market price for those products is low, as the guidelines require that the project be economic and generate customer savings whatever the environment. Further, logic dictates that when market is low, over the long run prices are more likely to rise than fall further. Therefore, rather than forego the opportunity to continue benefiting customers with future gas reserves projects in the absence of attractive dry gas projects, it would be in the best interest of customers to allow FPL to pursue projects that have a limited amount of NGLs and oil so long as dry gas is at least 50% of the projected volume of production. Tr. 1032 (Forrest).

Each of the four parameters described above is reasonable, and collectively, the guidelines are designed to balance the three gas reserves objectives addressed in Section III above. Nonetheless, FPL would not object in principle if the Commission in its discretion

prefers to “test the waters” by initially adopting guidelines that scale down the size of presumptively allowed transactions or narrow the scope of eligible reserves. Should the Commission choose to revise the proposed guidelines, however, FPL considers it extremely important that (i) the revised guidelines still reflect a reasonable balance of the three gas reserves objectives, and (ii) the Commission maintains flexibility to make further refinements in the future as circumstances dictate and as the Commission gains experience and comfort. Tr. 973-74 (Deason). If, for example, FPL achieves a track record of prudent investments, the Commission may increase the scope of investments allowed under the guidelines in a step-wise fashion. Tr. 974-75 (Deason). By the same token, the Commission may reduce the scope of allowable investments if circumstances dictate, so long as such changes are applied strictly on a prospective basis. Tr. 973-74 (Deason). On the other hand, the purpose of the guidelines would be fatally frustrated if the Commission were to disallow costs based on modifications instituted after FPL made a decision in reliance on then-existing guidelines. Finally, the Commission should not foreclose FPL’s ability to seek an advanced prudence determination for particularly favorable opportunities that fall outside of the approved guidelines. Tr. 975 (Deason).

#### **V. The Guidelines Are Structured To Properly Protect Customers**

While investment in gas reserves as a tool to address high fuel prices and market volatility is innovative, the proposed guidelines that would frame future projects are subject to the same, traditional regulatory principles that govern all utility investments. Whether the investment concerns a generation plant, transmission and distribution assets, or fuel contracts, utilities must make investments that benefit their customers and provide reliable service. Tr. 980-81 (Deason). For projects of any nature, the utility must demonstrate that undertaking the project is prudent and it has an ongoing obligation to manage it in a manner that continues, to the extent possible, to produce the benefits that are anticipated. Tr. 981 (Deason).

Gas reserves investments under FPL's proposed guidelines would be no different. *Id.* As a threshold for entering into any future transaction, FPL must identify a potentially suitable project and thoroughly analyze the economics of it to determine whether it benefits customers. Tr. 982 (Deason). FPL must present its findings to the Commission at the time it seeks cost recovery. *Id.* It is the Commission that ultimately determines whether to allow FPL to recover the costs associated with a particular project. Even if a project is approved, moreover, FPL maintains the obligation to manage each project prudently. Tr. 982 (Deason).

A. *The Commission Retains Its Ability To Review FPL's Conduct*

The guidelines in no way interfere with the Commission's necessary and appropriate oversight role. Rather, the guidelines provide the context within which the Commission would evaluate the prudence of FPL's investments and decisions. First, FPL must show that the project for which it seeks recovery falls within the parameters established by the guidelines. Tr. 274 (Forrest). As stated above, the guidelines set forth requirements for fuel mix percentage, customer savings, supply diversity and gas characteristics. FPL must satisfy each requirement; it is not sufficient for FPL to simply show, for example, that the investment falls within the annual capital expenditure limit if it does not also meet the other three requirements. Tr. 274-75 (Forrest).

With respect to the estimates of customer savings, it is FPL's obligation to demonstrate that it used the best available information to perform those estimates. Tr. 162 (Forrest). The Commission will have an opportunity to examine that customer savings analysis, just as it would for any proposed utility project, investment or clause-related expense. Tr. 162-63 (Forrest). FPL bears the burden of proving that its economic analysis that formed the basis for concluding that the project falls within the guidelines was properly conducted. *Id.* If the Commission

determines the analysis was not proper, it may conclude that the project does not fall within the established parameters and disallow recovery of the associated costs. *Id.*

Nor would FPL's obligations – or the Commission's oversight role – end when the Commission initially determines that the project falls within the guidelines. Tr. 276-77 (Forrest). FPL has a continuing obligation to make prudent decisions regarding the actions it takes within each approved project, and, each time FPL incurs additional costs for which it seeks recovery, the Commission will have the opportunity to evaluate FPL's project management as part of the annual fuel clause proceeding. *Id.* As FPL witness Forrest explained, decisions to drill a particular well when prior wells were under-producing or when production costs are particularly high or electing to drill when market gas prices have fallen below projected drilling costs are a few examples of decisions within a given project that would be subject to continuing Commission review. Tr. 285-86 (Forrest). Like any other fuel-related expense, if the Commission determines FPL made imprudent decisions, recovery of the attendant costs would be disallowed. Tr. 122 (Forrest).

#### B. *Additional Customer Protections*

During the proceedings regarding the Woodford Project, the Commission expressed a desire to condition its approval on the inclusion of certain additional customer protections. FPL fully supports those protections and will apply them to all future projects that are pursued under approved guidelines.

- *First*, FPL will make available through the Commission's audit or discovery processes (formal or informal) any documents related to the gas reserves projects within FPL's possession, custody or control, including third party documents. Tr. 196 (Forrest).



- *Second*, as explained by FPL witness Ousdahl, FPL will actively control its participation in the drilling program as managed by PetroQuest, will receive detailed transactional monthly invoices for all costs and will retain audit rights over the resulting costs of production. Tr. 366 (Ousdahl). For additional transparency and objectivity for Woodford, the Commission required FPL to engage an outside auditor. FPL would do the same for any projects secured pursuant to the guidelines; and
- *Third*, with regard to accounting, the Commission required that FPL use subcategories of the FERC system of accounts to closely align with the oil and gas system of accounts. Use of the subcategories will address concerns regarding how the oil and gas system of accounts will correlate with the FERC system of accounts. FPL would use the same subaccounts for any future gas reserves project.

C. *FPL's Due Diligence*

FPL's evaluation of potential gas reserves projects pursued under the guidelines will be subject to the same level of due diligence the Company exercised for the Woodford Project. Tr. 305-07 (Forrest). FPL will use the expertise it has gained over many years regarding gas transportation to evaluate its options and negotiate transportation contracts. Additionally, FPL will rely upon its affiliate U.S. Gas,<sup>4</sup> which has developed a specialized skill set for gas production transactions. *Id.* at 305, 307 (Forrest). U.S. Gas, for example, has landmen responsible for pulling title information from local county courthouses and researching the rights associated with the land in question. *Id.* at 307 (Forrest). To the extent the mineral rights

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<sup>4</sup> U.S. Gas, the name used by Mr. Forrest during the technical hearing, refers to NextEra Energy's Gas Infrastructure and Development business unit. *See* Tr. 86 (Forrest).

associated with the land are encumbered, U.S. Gas engages the necessary resources to cure whatever issues may exist. *Id.* FPL will also utilize the U.S. Gas team to monitor well activity as it is being drilled and evaluate the log data. Tr. 308 (Forrest). Finally, FPL also will continue to utilize Dr. Taylor to assess individual wells to determine whether they are economic, while FPL will remain responsible for determining whether to consent. *Id.*

## **VI. FPL's Proposed Guidelines are Appropriate for the Fuel Clause**

### *A. Adopting Gas Reserves Guidelines is Consistent with the Commission's Existing Hedging Program*

Investments FPL will make pursuant to gas reserves guidelines are designed to provide a physical hedge against natural gas price volatility. The Commission historically has allowed hedging costs to be recovered through the Fuel Clause, and has adopted a set of guidelines that describes the regulatory process that govern short-term hedges. Using gas reserves as a physical hedge will share similar characteristics and should therefore be treated similarly. Tr. 122 (Forrest).

In 2002, as part of its investigation into risk management for fuel procurement (Docket No. 011605-EI), the Commission approved a framework for fuel hedging initiatives that was precipitated largely by the increasing reliance on natural gas as a fuel source to generate electricity and the high level of volatility in those prices. Tr. 891 (Deason). In accepting a proposed resolution of the issues, the Commission acknowledged the importance of managing fuel risk when the reliance on one type of fuel grows. *Id.* By Order No. PSC-02-1484-FOF-EI, the Commission endorsed the use of both financial *and physical* hedges, as a risk management tool to mitigate price volatility for the benefit of customers. Tr. 891, 901 (Deason). Significantly, the Commission also recognized that the fuel clause is an appropriate mechanism for cost recovery for those hedges. Tr. 902 (Deason); *see also* Order No. PSC-02-1484-FOF-EI

By Order No. PSC-08-0667-PAA-EI dated October 8, 2008, the Commission reaffirmed its support for hedging and adopted a set of hedging guidelines. The approved short-term hedging guidelines “clarif[ied] the regulatory process regarding utility hedging programs, including the timing and content of filings.” Order No. PSC-08-0667-PAA-EI at p. 12. In addition, the guidelines “allow the utilities flexibility for creating and implementing risk management plans.” *Id.* The Commission emphasized that, even with guidelines in place, it “retain[s] discretion to determine the prudence of hedging results and acknowledge that the guidelines do not bind [the Commission’s] review of a utility’s hedging practices.” *Id.* The collaborative effort between the Commission and the electric utilities to develop, implement and later refine the hedging review process and the substantive guidance for what should and should not be part of the short term hedging programs has given the Commission a clear line of sight into the nature and extent of the utilities’ planned short-term hedges. Tr. 122 (Forrest). That collaboration also has given the utilities comfort that they can execute on what are often very substantial financial positions without having their decisions second-guessed as market conditions unfold. *Id.*

The gas reserves guidelines would operate similarly. Tr. 122-23 (Forrest). The guidelines are designed to provide FPL clarity regarding the types of transactions that the Commission will deem prudent, and the flexibility to capture favorable opportunities and the ability to negotiate the best deals for customers within a substantially competitive marketplace. Tr. 219, 287 (Forrest). Also similar to the hedging guidelines, FPL would bear the burden of demonstrating prudence based on the information known and available at the time a particular decision is made, recognizing that gas reserves, like short-term hedges, involve risk. Tr. 123, 277-78 (Forrest). Finally, like the Commission’s evaluation of short-term hedges, entering a gas

reserves transaction that fits within the guidelines based on properly performed analyses cannot be deemed imprudent based on results. Tr. 123 (Forrest).<sup>5</sup>

B. *The Guidelines Satisfy the Commission's Criteria for Fuel Clause Recovery Because the Projects Are Expected To Result in Fuel Savings*

FPL's proposed Guidelines for future capital investments in natural gas exploration and drilling joint ventures satisfy the Commission's criteria for consideration in the Fuel Clause proceeding because the guidelines require that the investments be projected to generate fuel savings for customers. Exhibit 10, Section II. By Order No. 14546 dated July 8, 1985, the Commission confirmed its desire to have utilities pursue opportunities to achieve fuel savings and articulated a list of items eligible for cost recovery through the Fuel Clause. Tr. 880 (Deason). The tenth item on that list reads:

Fossil fuel-related costs normally recovered through base rates but which were not recognized or anticipated in the cost levels used to determine current base rates and which, if expended, will result in fuel savings to customers. Recovery of such costs should be made on a case by cases basis after Commission approval.

Order No. 14546.

Item 10 encouraged utilities to pursue innovative ways to lower fuel costs, by giving them an opportunity to seek prompt, Fuel Clause recovery of costs incurred to achieve fuel savings. Tr. 881 (Deason). Investing in gas reserves is an "outside-the-box" approach to

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<sup>5</sup> This Commission's set of short-term hedging guidelines is not the only comparable set of guidelines for gas reserves. In May 2013, the Montana Public Service Commission commented favorably on NorthWestern Energy's inclusion of acquisition criteria for gas reserve properties in its 2012 Natural Gas Biennial Procurement Plan. Tr. 123-24 (Forrest). While each utility is different in terms of the mix of their fuel portfolio and every jurisdiction is unique in some way, the favorable comments from the Montana Public Service Commission as well as this Commission's adoption of short-term hedging guidelines reflect regulators' recognition that establishing a framework for future deals will help the utility to transact on a more expedited basis in ways that will benefit customers. *Id.* Thus, although obtaining advanced prudence determinations is the traditional approach, it is not practical. Simply put, gas producers move quickly and will not delay drilling to wait the several months it typically takes to obtain regulatory approval. No intervenor presented a workable alternative solution to bridge the gap between industry needs and the ability to deliver customer benefits.

reducing fuel expenses by setting prices at the cost of the investment, operating and maintenance expenses and a return on the investment. Tr. 882-83 (Deason). The fuel savings generated by investments made pursuant to the guidelines are projected to more than offset the revenue requirements, thus netting savings for customers. Tr. 222 (Forrest). The savings potentially will grow over time, since wells can produce gas for several decades.

Furthermore, approval of guidelines does not foreclose the Commission's "case-by-case" review. Rather, the guidelines establish a set of parameters pursuant to which the Commission will conduct its case-by-case review. The guidelines are in no respect a "blank check" for cost recovery simply because a project is forecasted to produce fuel savings; rather, the project still must meet the scope, supply-diversity and quality-of-production criteria addressed in Section IV above. Tr. 275 (Forrest). By adopting a set of guidelines, the Commission simply defines a specified set of conditions that must be met – in addition to the projected fuel savings – in order for a particular gas reserves investment to be deemed eligible for cost recovery. Tr. 84-85 (Forrest). The Commission still will ensure in each instance that the guidelines are satisfied, and, with every cost recovery request, will examine FPL's transaction and operational conduct to determine whether the Company had conducted itself in a prudent manner for the benefit of customers. Tr. 274-76 (Forrest).

## **VII. Conclusion**

This Commission has affirmatively determined that FPL's investment in gas reserves through the Woodford Project is a prudent and innovative tool to address the state's need to secure stable, low-cost natural gas prices. Woodford was just one example. FPL will be in a position to evaluate similar investment opportunities to achieve greater levels of fuel cost savings reduced volatility. As described in detail, the constantly evolving nature of the competitive gas

production market renders approval of guidelines essential for FPL to continue delivering these benefits to customers. FPL has proposed a set of guidelines that strikes the appropriate balance between protecting customer interests, supporting FPL's ability to make a timely decision in the gas production market without being subject to hindsight judgments, and the Commission's important oversight role. The guidelines are, in essence, representative of the regulatory compact that governs all utility investments and are appropriate for fuel clause recovery. Accordingly, FPL requests that the Commission approve guidelines under which FPL could participate in future gas reserves projects and recover their costs through the Fuel Clause.

#### **ISSUES AND POSITIONS**

**ISSUE 4:**     **Do FPL's proposed Guidelines for future capital investments in natural gas exploration and drilling joint ventures satisfy the Commission's criteria for consideration in the fuel cost recovery clause proceeding?**

**FPL:**             \*Yes. The investments also would provide a physical hedge against natural gas price volatility. The Commission historically has allowed hedging costs to be recovered through the fuel clause. Additionally, FPL's proposed Guidelines require that gas reserves investments be projected to produce fuel savings for FPL's customers. The Commission has a long history of allowing cost recovery through the fuel clause for investments that result in fuel savings.\*

**ISSUE 5: If the Commission answers Issue 4 in the affirmative, should the Commission approve FPL’s proposed criteria?**

**FPL:** \*Yes. FPL’s proposed Guidelines strike an appropriate balance the FPL’s desire to secure low-cost, stable fuel sources for customers, the need to make prompt decisions in a competitive market, and the need to maintain regulatory oversight for the ongoing protection of customers. As proposed, the guidelines allow FPL to consummate a transaction when an agreement has been reached that meets the Guidelines, without having to wait on the normal several month-long Commission approval process that likely would foreclose FPL from participating in many potentially valuable gas reserves projects. The Guidelines are appropriately structured to limit the total dollar amount of FPL’s gas reserves investments and to ensure both that the investments are projected to produce fuel savings for customers and that they are for the types of reserves that are most useful for FPL’s customers. Specifically, the Guidelines cover the scope of FPL’s project participation as a percentage of average daily burn, as well as on an annual capital expenditure basis. They also describe how the deals will be evaluated against FPL’s then-current forecast of natural gas prices. Finally, the Guidelines discuss the composition of gas reserves that FPL can pursue. While the parameters proposed by FPL are reasonable, the Company would not object to modifications by the Commission so long as the approved guidelines satisfy three gas reserves objectives.\*

**Issue 7: If the Commission concludes that FPL’s petition has merit, should the Commission engage in rulemaking pursuant to section 120.54, Florida Statutes, and adopt rules addressing gas reserves guidelines and operations rather than adopting the Gas Reserves Guidelines as proposed by FPL?**

**FPL:** \*No. Order No. PSC-14-0065-PCO-EI addressed the same issue. That Order recognizes that section 120.80(13), F.S. exempts cost recovery clause matters from rule making.\*

Substantively, Issue No. 7 is the same as the issue raised by the Florida Industrial Power Users Group (“FIPUG”) in its Motion To Strike FPL’s Request To Establish Guidelines Related to Oil and Gas, which was denied in Order No. PSC-14-0665-PCO-EI on November 17, 2014. That Order held that “electric cost recovery clauses are specifically exempt from rule making under Section 120.80(13)(a), F.S.,” which states:

Agency statements that relate to cost-recovery clauses, factors, or mechanisms implemented pursuant to chapter 366, relating to public utilities are exempt from the provisions of s. 120.54(1)(a).

Based on this exemption, the Order thus concluded that rule-making “is not required to address FPL’s request for guidelines on the Gas Reserve Issues.” FIPUG did not timely seek reconsideration of Order No. PSC-14-0665-PCO-EI, and nothing has changed since that order was entered to warrant reopening it here.<sup>6</sup>

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<sup>6</sup> FPL also notes that it would be improper to establish rules applicable to only one utility. No other electric utility in Florida has requested approval of an investment in gas reserves. The Commission has the ability to thoroughly review the proposed Gas Reserves Guidelines in this proceeding and does not need a separate proceeding to do so.



**CERTIFICATE OF SERVICE**  
**Docket No. 150001-EI**

**I HEREBY CERTIFY** that a true and correct copy of the foregoing has been furnished by electronic service on this 12th day of January 2015 to the following:

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