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GULF POWER
A SOUTHERN COMPANY

November 13, 2015

Ms. Carlotta Stauffer, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 150001-EI

Dear Ms. Stauffer:

Attached for official filing is Gulf Power Company's Post-Hearing Brief and Statement of Issues and Positions to be filed in the above-referenced docket. Pursuant to the Order Establishing Procedure, a copy of this Post-Hearing Brief prepared using Microsoft Word is being provided to Commission staff and parties.

Sincerely,

Robert L. McGee, Jr.
Regulatory and Pricing Manager

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Attachments

cc: Beggs & Lane
Jeffrey A. Stone, Esq.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Fuel and Purchased Power Cost	)		
Recovery Clauses and Generating	)	Docket No.	150001-EI
Performance Incentive Factor	)	Date Filed:	November 13, 2015

POST-HEARING BRIEF AND STATEMENT OF ISSUES AND POSITIONS OF GULF POWER COMPANY

Gulf Power Company, ("Gulf Power," "Gulf," or "the Company"), by and through its undersigned attorneys, files the following as its post-hearing brief and post-hearing Statement of Issues and Positions in this proceeding pursuant to Order No. PSC-15-0512-PHO-EI and Rule 28-106.215, Florida Administrative Code ("F.A.C.").

GENERAL DISCUSSION

The Florida Public Service Commission ("Commission") in Order No. PSC-02-1484-FOF-EI approved a settlement which established a framework and direction to follow with respect to risk management of fuel procurement by the four largest investor-owned electric utilities ("IOUs"). The settlement was ultimately agreed to and supported by Florida Power & Light Company ("FPL"), Florida Power Corporation (now Duke Energy or "Duke"), Tampa Electric Company ("TECO"), Gulf Power Company ("Gulf"), the Florida Industrial Power Users Group ("FIPUG"), and the Office of Public Counsel ("OPC"). In 2008, the Commission again looked at the implementation of natural gas hedging and clarified its policy through the adoption of a set of guidelines to govern natural gas hedging by the IOUs. [See Order No. PSC-08-0667-PAA-EI] Through these guidelines, the Commission supported the continuation of hedging and recognized that the appropriate review of hedging programs requires a balanced, disciplined, and long-term view of hedging transactions. [2008 Order at 9] The proposed guidelines clarified the regulatory process regarding utility hedging programs, including the timing and content of risk management plans for the IOUs. [2008 Order at 12] Specifically, the Commission stated that "utility hedging programs provide benefits to customers" and that a hedging program's primary purpose is to reduce the impact of volatility in the fuel adjustment charges paid by an IOU's customers. [Id.] The Commission recognized that hedging could result in significant lost opportunities for savings in the fuel costs to be paid by customers, if fuel prices actually settle at lower levels than at the time that hedges were placed. [2008 Order at 9 and 16] The Commission found this possibility to be a reasonable trade-off for reducing customers' exposure to fuel cost increases that would result if fuel prices actually settle at higher levels than when the hedges were placed. [Id.]

The Florida Retail Federation ("FRF"), the OPC and the FIPUG (collectively, "Intervenors") are asking the Commission to reverse its hedging policy established in Order Nos. PSC-02-1484-FOF-E and PSC-08-0667-PAA-EI ("2008 Order"). As a general proposition, Gulf is not opposed to revisiting and modifying Commission policy if doing so is justified under the circumstances. Intervenors have provided no justification in this proceeding for the Commission to reverse its hedging policy. Rather, Intervenors' positions are based on a near-singular focus on lost opportunity costs, or "losses," that have occurred in the IOUs' hedging programs as justification for their position that natural gas hedging should end. [Tr. 823, 1028] While the Intervenors focus on losses, the reduction of natural gas price volatility is the primary goal of the Commission's hedging policy and thus should be the measure of the effectiveness of the IOUs' hedging plans. [2008 Order at 16 and Tr. 690, 1028] As further support for the Intervenors' request to end hedging, OPC's witness Lawton offers a view of future natural gas price volatility that is remarkably free of any disruptive events and not impacted by the interplay of the economic forces of supply and demand. [Tr. 1029-30] OPC's view of future natural gas price volatility is simply there is little potential for natural gas price volatility. [Tr. 860] As explained by Gulf Witness Ball, the Commission's natural gas hedging policy should be continued because future market price risk and price volatility still exists for natural gas purchases. [Tr. 1032] Changes in the natural gas market have occurred and will continue to occur in the future as gas producers and consumers adapt to both regulatory and market price pressures and uncertainty. [Id.] The Commission's hedging policy is an appropriate fuel risk management tool for the IOUs' use in limiting future natural gas price volatility and should be continued going forward. [Id.]

The Intervenors' focus on hedging gains or losses as the measure of the value of the Commission's hedging policy and the success of IOU's hedging activities undertaken pursuant that policy is improper. [Tr. 1028] The Commission has been very clear in stating that the primary purpose of the hedging policy and the programs implementing that policy is to reduce the impact of volatility in the fuel adjustment charges paid by an IOU's customers. [2008 Order at 16 and Tr. 690, 1028] Even OPC Witness Noriega recognizes that the "basic intent [of the Commission is] that utility hedging programs are designed to reduce fuel price volatility." [Tr. 800, 1028] Despite the clear intent of hedging being to reduce fuel price volatility, the Intervenors point to hedging losses as a basis for the Commission to end hedging by the IOUs. [Tr. 822-23] The fact that losses occurred in the hedging program is clearly recognized as a potential outcome of a utilities hedging program as stated in Order No. PSC-08-0667-PAA-EI. The fourth guiding principle is:

> d. The Commission acknowledges that hedging can result in significant lost opportunities for savings in the fuel costs to be paid by customers, if fuel prices actually settle at lower levels than at the time that hedges were placed. The Commission recognizes this as a reasonable trade-off for reducing customers' exposure to fuel cost

by Gulf Witness Ball, the Commission's natural gas hedging policy should be continued because future market price risk and price volatility still exists for natural gas purchases. [Tr. 1032] Changes in the natural gas market have occurred and will continue to occur in the future as gas producers and consumers adapt to both regulatory and market price pressures and uncertainty. [Id.] The Commission's hedging policy is an appropriate fuel risk management tool for the IOUs' use in limiting future natural gas price volatility and should be continued going forward. [Id.]

The Intervenors' focus on hedging gains or losses as the measure of the value of the Commission's hedging policy and the success of IOU's hedging activities undertaken pursuant to that policy is improper. [Tr. 1028] The Commission has been very clear in stating that the primary purpose of the hedging policy and the programs implementing that policy is to reduce the impact of volatility in the fuel adjustment charges paid by an IOU's customers. [2008 Order at 16 and Tr. 690, 1028] Even OPC Witness Noriega recognizes that the "basic intent [of the Commission is] that utility hedging programs are designed to reduce fuel price volatility." [Tr. 800, 1028] Despite the clear intent of hedging being to reduce fuel price volatility, the Intervenors point to hedging losses as a basis for the Commission to end hedging by the IOUs. [Tr. 822-23] The fact that losses occurred in the hedging program is clearly recognized as a potential outcome of a utilities hedging program as stated in Order No. PSC-08-0667-PAA-EI. The fourth guiding principle is:

> d. The Commission acknowledges that hedging can result in significant lost opportunities for savings in the fuel costs to be paid by customers, if fuel prices actually settle at lower levels than at the time that hedges were placed. The Commission recognizes this as a reasonable trade-off for reducing customers' exposure to fuel cost

increases that would result if fuel prices actually settle at higher levels than when the hedges were placed. The Commission does not expect an IOU 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.

The proper measure of the success of natural gas hedging programs is whether a utility's hedging plan reduced natural gas price volatility. [Tr. 653-54] Gulf's activities undertaken pursuant to Gulf's Commission-approved risk management plan have met and continue to meet the Commission's hedging policy goal of reducing natural gas price volatility. [Tr. 653-54, Hearing Exhibit 35, page 4] Gulf's view of the potential for natural gas price volatility in future periods is markedly different from the view taken by the Intervenors. It is undisputed that no one can know with certainty the future of natural gas price volatility. [Tr. 699, 766, 1006, 1008] In fact, the natural gas market conditions change every day. [Tr. 762] Significant uncertainty exists in the U.S. regarding fuel policy and regarding the projected financial impact of regulations recently enacted or proposed on both fuel production and use, as well as how all of these factors will be reflected in future natural gas prices. [Tr.1031, Hearing Exhibit 96 at bates 00327 through 00330] Looking at the options market to develop probabilities that prices will fall within a certain bandwidth shows that further out into the future, that bandwidth will get larger, which indicates more uncertainty further out into the future. [Tr. 699] More uncertainty means more potential volatility. Gulf cannot determine exactly how much volatility will occur, but there is a possibility that price volatility will exist in the future. [Tr.699] In contrast, OPC witness Lawton calls for the end of the Commission's natural gas hedging policy because he believes that price volatility mitigation is no longer a reason available to support natural gas hedging activities. [Tr. 860] Simply put, the OPC is saying that the potential for volatility in natural gas markets is so low that it can be ignored. One of the primary drivers for the OPC's position is the production of shale gas as an indicator of why natural gas supply will outpace demand and eliminate price volatility. [Tr. 858, 860] However, any number of future events could disrupt the production of shale gas and, thus, the future supply of natural gas in the market. [Hearing Exhibit 96 at bates 00329] It is likely that more, not fewer, regulatory requirements will be enacted around shale gas production and hydraulic fracturing. [Id.] Likewise, other potential future events could impact the supply and demand of natural gas and, therefore, significantly impact natural gas price volatility. Examples of these include changes in the market price of oil, drilling activity, exports of liquefied natural gas, continued shift from coal to natural gas for the generation of electricity, the use of natural gas for manufacturing, and gas pipeline constraints or disruptions. [Tr. 689, 1057, Hearing Exhibit 96 at bates 00327 through 00330] Weather can also impact the demand for natural gas. [Tr. 883, 945] It is also logical to assume that, as demand for natural gas increases, the increase in gas production that is evident in the market today will become less of a protection against price volatility in the future. [Tr. 1030]

The Intervenors also rely on historical data and future price forecasts from EIA to support their position that little or no natural gas price volatility exists in the natural gas market and, therefore, the Commission should end its hedging policy. However, historical data is not a reliable predictor of future events and, in this case, is not reliable evidence of the absence of future gas price volatility. [Tr. 1030] Witness Lawton actually agrees that historical data is not necessarily indicative of future results, though he spends significant time addressing historical information seemingly to make a point about future volatility. [Tr. 856] Further, the source of the fuel price forecasts relied on by Lawton, EIA, states that future uncertainty in natural gas markets may result in actual future prices being higher than EIA's short term forecast indicates.

[Tr. 1030] This same uncertainty can be seen in EIA's long term natural gas price forecast. [Tr. 1031-32] Thus, even the source relied on by OPC's witness recognizes future uncertainty in the natural gas markets. To agree with witness Lawton and the Intervenors is to believe that natural gas will remain at the low prices that we see today and to discount completely the uncertainty that exists in the natural gas markets and its impact on natural gas price volatility.

Lastly, the OPC's allegation that there is a discrepancy in the hedging costs reported by Gulf for the period 2002 through 2014 is without merit. Gulf properly reported financial hedging settlement costs, including allowable support costs for this period. [Tr. 1028] Witness Noriega erroneously omitted Gulf's allowable support costs in Table 1, found on page 15 of his direct testimony. [Id.] The amount of hedging support costs that Gulf was allowed to recover during the period 2003 through 2006, per Commission Order No. PSC-02-1484-FOF-EI as shown in Exhibit HRB-6, page 1 was $185,315. This is the same amount witness Noriega claims is a discrepancy in the hedging costs reported by Gulf. [Id.] Despite Gulf having provided the amounts of the hedging support costs to the Office of Public Counsel during discovery in response to OPC's first set of interrogatories, Item No. 4b as shown in Hearing Exhibit 114, at page 2, Mr. Noriega did not correct the error in his pre-filed direct testimony when he took the stand at the hearing. There is no credible argument that Gulf failed to accurately report its financial hedging settlement costs for the period 2002 through 2014. Gulf has accurately reported its financial hedging settlement costs, including allowable hedging support costs, to the Commission for the purpose of cost recovery.

DISCUSSION OF SPECIFIC ISSUES[1]

ISSUE 1D: Is it in the consumers' best interest for the utilities to continue natural gas financial hedging activities?

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SUMMARY: Yes. Future market price risk and price volatility still exists for natural gas purchases. Changes in the natural gas market have occurred and will continue to occur in the future as gas producers and consumers adapt to both regulatory and market price pressures and uncertainty. Order No. PSC-08-0667-PAA-EI provides the utilities an appropriate fuel risk management tool for use in limiting future natural gas price volatility and should be continued going forward. Gulf has demonstrated that implementation of its risk management plan has accomplished the objective of the hedging order to limit price volatility.

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DISCUSSION:

The Commission's natural gas hedging policy should be continued because the potential for future market price risk and price volatility still exists for natural gas purchases. [Tr. 1032] Changes in the natural gas market have occurred and will continue to occur in the future as gas producers and consumers adapt to both regulatory and market price pressures and uncertainty. [Id.] It is undisputed that no one can know with certainty the future of natural gas price volatility. [Tr. 699, 766, 1006, 1008] In fact, the natural gas market conditions change every day. [Tr. 762] Significant uncertainty exists in the U.S. regarding fuel policy and regarding the projected financial impact of regulations recently enacted or proposed on both fuel production and use, as well as how all of these factors will be reflected in future natural gas prices. [Tr.1031] Moreover, any number of future events could disrupt the production of shale gas and, thus, the future supply of natural gas in the market. [Hearing Exhibit 96 at bates 00329] It is likely that more, not less, regulatory requirements will be enacted around shale gas production

[1] The listing of issues and position summaries that follow in this section is also intended to serve as Gulf Power's post-hearing Statement of Issues and Positions required by Order No. PSC-15-512-PHO-EI.

and hydraulic fracturing. [Id.] Likewise, other potential future events could impact the supply and demand of natural gas and, therefore, significantly impact natural gas price volatility. Examples of these include changes in the market price of oil, drilling activity, exports of liquefied natural gas, the continued shift from coal to natural gas for the generation of electricity, the use of natural gas for manufacturing, and gas pipeline constraints or disruptions. [Tr. 689, 1057, Hearing Exhibit 96 at bates 00327 through 00330] Weather can also impact the demand for natural gas. [Tr. 883, 945] It is also logical to assume that, as demand for natural gas increases, the increase in gas production that is evident in the market today will become less of a protection against price volatility in the future. [Tr. 1030] Industry-accepted forecasts from EIA, the same forecasts relied on by Intervenors, indicate that future uncertainty in natural gas markets may result in actual future prices being higher than EIA's short term forecast indicates. [Tr. 1030] This same uncertainty can be seen in EIA's long term natural gas price forecast. [Tr. 1031-32] In addition, looking at the options market to develop probabilities that prices will fall within a certain bandwidth shows that further out into the future, that bandwidth will get larger, which indicates more uncertainty further out into the future. [Tr. 699] More uncertainty means more potential volatility. Gulf cannot determine exactly how much volatility will occur, but there is a possibility that price volatility will exist in the future. [Tr.699] Given the uncertainty in, and unpredictability of, future natural gas markets and natural gas price volatility, the Commission's hedging policy is an appropriate and necessary fuel risk management tool for the IOUs' use in limiting future natural gas price volatility and should be continued going forward. Gulf's activities undertaken pursuant to Gulf's Commission-approved risk management plan have met and continue to meet the Commission's hedging policy goal of reducing natural gas price volatility. [Tr. 653-34]

<u>ISSUE 1E:</u> What changes, if any, should be made to the manner in which electric utilities conduct their natural gas financial hedging activities?

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SUMMARY: None. As noted in response to Issue 1D, Gulf believes that it is appropriate to continue its financial hedging activities as an appropriate risk management tool. Gulf has demonstrated that implementation of its risk management plan has accomplished the objective of the hedging order to limit price volatility. No changes are necessary or appropriate at this time.

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DISCUSSION:

The Commission's hedging policy is an appropriate and necessary fuel risk management tool for the IOUs' use in limiting future natural gas price volatility and should be continued going forward. The guidelines adopted by the Commission in Order No. PSC-08-0667-PAA-EI have provided and continue to provide clarity around the regulatory process regarding utility hedging programs, including the timing and content of filings. [2008 Order at 12] In addition, the guidelines allow the utilities flexibility for creating and implementing risk management plans. [Id.] Gulf is not requesting any changes be made to the Commission's hedging policy. Gulf's activities undertaken pursuant to Gulf's Commission-approved risk management plan have met and continue to meet the Commission's hedging policy goal of reducing natural gas price volatility. [Tr. 653-34, Hearing Exhibit 35] Gulf's 2016 Risk Management Plan for Fuel Procurement is a reasonable and prudent implementation of the Commission's hedging order and should be approved without modification. [Tr. 679, Hearing Exhibit 39]

<u>ISSUE 5B:</u> Should the Commission approve Gulf's 2016 Risk Management Plan?

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SUMMARY: Yes. Gulf's 2016 Risk Management Plan for Fuel Procurement is a reasonable and prudent implementation of the Commission's hedging order and should be approved. Gulf believes that continued compliance with the "Hedging Order" provides an appropriate fuel risk management tool for utilities to utilize to limit natural gas price volatility.

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DISCUSSION:

Gulf's 2016 Risk Management Plan for Fuel Procurement is a reasonable and prudent implementation of the Commission's hedging order and should be approved without modification. [Tr. 679, Hearing Exhibit 39] Gulf has demonstrated that implementation of its risk management plan has accomplished the Commission's objective of limiting natural gas price volatility. [Tr. 653-34, Ex. 35] Moreover, no party has taken issue with any specific component of Gulf's 2016 Risk Management Plan for Fuel Procurement. Gulf's 2016 Risk Management Plan for Fuel Procurement is nearly identical to its 2014 and 2015 Risk Management Plans approved by the Commission in Dockets 130001 and 140001. [Tr. 685, 691]

CONCLUSION

Gulf Power respectfully requests that the Commission reject the Intervenors' request to reverse the Commission's policy of supporting natural gas hedging by the IOUs. Intervenors have failed to provide a sufficient basis for departing from the sound Commission policy and practice established in Order Nos. PSC-02-1484-FOF-E and PSC-08-0667-PAA-EI.

Respectfully submitted this 13th day of November, 2015.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: **Fuel and Purchased Power Cost)**
Recovery Clause with Generating)
Performance Incentive Factor) Docket No.: **150001-EI**

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing was furnished by electronic mail this 13th day of November, 2015 to the following:

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