Gulf Power

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March 6, 2017

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

Re: Docket No. 170057-EI

Dear Ms. Stauffer:

Attached for official filing in the above-referenced docket is Gulf Power Company's Post-Workshop Comments on Hedging.

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: Analysis of IOUs' hedging practices.	)	Docket No. 170057-EI
	)	
	)	Filed: March 6, 2017
	)	

GULF POWER COMPANY'S
<u>POST-WORKSHOP COMMENTS ON HEDGING</u>

Gulf Power Company ("Gulf Power" or "the Company") hereby submits its Post-Workshop Comments pertaining to the Hedging Workshop that took place on February 21, 2017.

Since the inception of hedging in 2002, the Commission has recognized the benefits of hedging. In 2008, the benefits of hedging were highlighted in a management audit conducted by the Commission's Division of Auditing. The audit concluded, "Overall, audit staff believes that the use of financial hedges for fuel purchases provides benefits to utility customers. Each program is appropriately controlled, efficiently organized, and operates under a non-speculative format." Gulf Power continues to believe that its existing hedging program, which primarily utilizes fixed price SWAPs, is a reasonable hedging method which provides benefits to its customers by reducing fuel price volatility and mitigating spikes in natural gas prices. The use of SWAPs, while effective at fixing future prices and mitigating volatility, does not allow customers to fully participate in lower fuel costs for the hedged portion of the portfolio when market prices settle below the hedged price levels. In periods of declining prices, SWAPs result in hedging costs and likewise in periods of rising prices, SWAPs produce hedging savings to customers.

The Office of Public Counsel ("OPC") and the Florida Industrial Power Users Group ("FIPUG") argue that the utilities should do away with hedging in its entirety. Gulf Power hears the position of the intervenors who advocate discontinuing hedging and the expectation from the Commissioners to consider alternatives to the status quo and look for ways to minimize hedging costs. At the Hedging Workshop, OPC raised the point of the potential for deferring fuel costs over longer periods of time. Gulf Power does not believe deferring fuel costs and recovering those costs over extended periods of time with the risk of potentially carrying large under recovery balances is in the best interest of customers. Deferring recovery could compound the impact to customers if deferred costs and continued under-recoveries stack up in consecutive subsequent years. In addition, the use of ratemaking tools like the Volatility Mitigation Mechanism proposed by FPL years ago and the Commission's Midcourse Rule do nothing to manage the risk of upward movements in natural gas prices or the volatility of the underlying commodity— the cost of which is ultimately borne by customers.

Gulf believes the proposal put forward by the utilities (the "IOU Proposal") at the February 21, 2017 Workshop is a reasonable alternative and strategy to address natural gas price volatility while minimizing potential unknown hedging costs. Below, Gulf provides its comments on both the Gettings' Proposal and the IOU Proposal.

Gettings' Proposal

Gulf Power reviewed the testimonies of Staff witnesses Ciccetti and Gettings and attended three days of informal meetings in January 2017 to explore in detail the proposal (the "Gettings' Proposal") brought forward by Staff's witnesses. There are certain elements of the Gettings' Proposal that have merit and certain elements that Gulf finds problematic. In general, there are over-arching concerns about the Gettings' Proposal that bring pause to Gulf. Our concerns are as follows:

1. Complexity. The Gettings' Proposal is hard to understand, hard to quantify, hard to interpret, vulnerable for mistakes, and not transparent. The number of parameters that must be defined to manage a program as proposed by Witness Gettings and avoid prudence second-guessing is evidenced by days of meetings and hours of internal discussions with many questions that must be answered in order to implement the Gettings' Proposal.
2. Trading vs. Hedging. Gettings' Proposal advocates getting out of hedge positions if losses get too high (a level that must be predefined and agreed to by the Commission), leaving the retail customers vulnerable to potential price spikes for the unhedged volume of natural gas. Imposing a "maximum loss limit" on the hedge portfolio is also troublesome. Implementing the portion of Mr. Gettings' contingent strategy that would unwind or close out hedge positions is not a tactic Gulf would support. This strategy undermines the purpose of hedging, to manage price risk, and locks in losses while leaving customers exposed to upside risks if the market were to change and begin to rise again.
3. Hedging Losses. The Gettings' Proposal does not avoid hedging settlement losses from occurring, it merely calls for the regulator to define and impose a limit on hedging losses and provides for spending put options premiums to limit further losses or exiting hedge positions altogether when potential mark-to-market portfolio hedge losses mount.
4. Details of the Gettings' Proposal. After three full days of asking questions surrounding his model, Gulf Power remains unclear about certain aspects of his model, especially details around the contingent and defensive strategies. The Commission would necessarily need to approve many parameters in each utilities' Risk Management Plans,

including how the utilities would respond in unknown and potentially rapid changing market conditions, to allow for the IOUs to effectively manage their respective hedging programs without the risk of second-guessing.

5. Time to Implement. The utilities all indicated that it could take two years to implement the Gettings' program as proposed. Mr. Gettings himself even indicated that it could take up to two years to implement his proposal.
6. Cost and Resources to Implement. In addition to time, the Gulf would incur incremental costs to procure additional resources to implement the Gettings' program. The resulting incremental costs would disproportionately affect the smaller IOUs and its customers. Gulf anticipates it will need one additional full-time equivalent employee to monitor, report, and provide quantitative and trading support to successfully manage the program on a going-forward basis. Gulf Power estimates these costs to be no more than $100,000 annually. There will also be additional costs on the front-end either in the form of direct charges from Southern Company Services or a hired consultant to work with the Company to implement the program. Gulf estimates a one-time incremental cost of approximately $250,000 to make enhancements to its current hedging and risk management systems.

IOU Proposal

The proposal brought forward by the IOUs at the February 21, 2017 Workshop is a Call-Option based program. A Call-Option based program is intended to limit upside price risk, thereby dampening volatility, while at the same time allowing for full downside price participation for the customer. This would allow the customer to enjoy as much downside participation as feasible in the market. There are many benefits to the IOU proposal:

- Simple and transparent – easy to understand and explain to customers and Commissioners
- Easy to audit and define prudence parameters.
- Can be implemented immediately upon approval by the Commission
- Can be easily adjusted prospectively in each utility's Risk Management Plan
- Effectively manages upside natural gas fuel price risk
- Allows for participation in falling natural gas price market conditions
- Avoids "surprises" – hedging costs known upfront (options premiums), all costs are embedded in the premium and recognized at the time of settlement
- No incremental program costs (consultants/experts, IT/computing, FTEs etc.)
- More conservative than Gettings' proposal and past hedging plans
- Current hedging reporting requirements would remain the same; no additional reporting

For all these reasons, Gulf Power supports implementing a Call-Option hedging strategy as proposed by the IOUs.

Conclusion

After thorough review and evaluation of the Gettings' Proposal, Gulf Power has many concerns. Because of these concerns, we believe the IOU Proposal is a better option. The IOU Proposal is transparent, easy to understand, and continues to provide hedging protection to its customers in a way that reduces fuel price risk.

WHEREFORE, Gulf Power submits the foregoing Post-Workshop Comments in this matter and recommends the adoption of the IOU's Proposal as the replacement of the current hedging model utilized by the investor-owned utilities.

DATED this 6th day of March 2017.

Respectfully submitted,

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Analysis of IOUs' hedging practices)
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) Docket No.: 170057-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing was furnished by electronic mail this 6th day of March, 2017 to the following:

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