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July 3, 2017

-VIA ELECTRONIC FILING -

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

Re: Docket No. 170057-EI - Analysis of IOUs' Hedging Practices

Dear Ms. Stauffer:

Enclosed for filing on behalf of Florida Power & Light Company ("FPL") are the prepared testimony and exhibits of FPL witnesses Gerard J. Yupp and Renae B. Deaton.

If there are any questions regarding this transmittal, please contact me at (561) 304-5795.

Sincerely,

s/ Maria J. Moncada
Maria J. Moncada

Enclosures
cc: Counsel for Parties of Record (w/encl.)

:6049518

CERTIFICATE OF SERVICE

Docket No. 170057-EI

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by electronic service on this 3rd day of July 2017 to the following:

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By: s/ Maria J. Moncada
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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **TESTIMONY OF GERARD J. YUPP**

4 **DOCKET NO. 170057-EI**

5 **JULY 3, 2017**

6

7 **Q. Please state your name and address.**

8 A. My name is Gerard J. Yupp. My business address is 700 Universe Boulevard,
9 Juno Beach, Florida, 33408.

10 **Q. By whom are you employed and what is your position?**

11 A. I am employed by Florida Power & Light Company (“FPL”) as Senior Director of
12 Wholesale Operations in the Energy Marketing and Trading Division.

13 **Q. Please summarize your educational background and professional**
14 **experience.**

15 A. I graduated from Drexel University with a Bachelor of Science Degree in
16 Electrical Engineering in 1989. I joined the Protection and Control Department
17 of FPL in 1989 as a Field Engineer where I was responsible for the installation,
18 maintenance, and troubleshooting of protective relay equipment for generation,
19 transmission and distribution facilities. While employed by FPL, I earned a
20 Masters of Business Administration degree from Florida Atlantic University in
21 1994. In 1996, I joined the Energy Marketing and Trading Division (“EMT”) of
22 FPL as a real-time power trader. I progressed through several power trading
23 positions and assumed the lead role for power trading in 2002. In 2004, I
24 became the Director of Wholesale Operations and natural gas and fuel oil

1 procurement and operations were added to my responsibilities. I have been in
2 my current role since 2008. On the operations side, I am responsible for the
3 procurement and management of all natural gas and fuel oil for FPL, as well as
4 all short-term power trading activity. My regulatory responsibilities include the
5 preparation of testimony for all fossil fuel, interchange, and hedging-related
6 areas for the Fuel and Capacity Cost Recovery Clauses, including the
7 preparation of Discovery and audit responses. Finally, I am responsible for the
8 oversight of FPL's optimization activities associated with the Incentive
9 Mechanism approved by the Commission.

10 **Q. What is the purpose of your testimony?**

11 A. The purpose of my testimony is to present and explain FPL's position on natural
12 gas hedging and whether hedging continues to be in the best interest of
13 consumers. My testimony also addresses FPL's recommended hedging
14 approach to protect customers against large price increases while minimizing
15 paper losses if the Commission decides that hedging should continue.

16 **Q. Are you sponsoring any exhibits for this proceeding?**

17 A. Yes, I am sponsoring the following exhibits:

- 18 • GJY-1: 2016 Henry Hub Daily Natural Gas Spot Prices
- 19 • GJY-2: Comparison of Risk-Responsive and OTM Call Option Strategies

20

21 **PURPOSE AND BENEFITS OF NATURAL GAS HEDGING**

22

23 **Q. What is the purpose of natural gas hedging?**

24 A. FPL's consistent position for more than 15 years has been that the primary

1 objective of hedging is to reduce fuel price volatility. This objective was clearly
2 defined in Item 1 of the Proposed Resolution of Issues that was approved in
3 Order No. PSC-02-1484-FOF-EI, dated October 30, 2002, which states, “Each
4 investor-owned utility recognizes the importance of managing price volatility in
5 the fuel and purchased power it purchases to provide electric service to its
6 customers.

7 **Q. Should hedging involve speculative strategies aimed at “out guessing”**
8 **the market?**

9 A. No. FPL has consistently taken the position, and the Commission has likewise
10 determined, that IOU fuel hedging programs should not be aimed at
11 outguessing the market. Section IV, part b, of the guiding principles of the
12 Hedging Order Clarification Guidelines approved in Order No. PSC-08-0667-
13 PAA-EI, dated October 8, 2008 reinforces this point and states that, “The
14 Commission finds that a well-managed hedging program does not involve
15 speculation or attempting to anticipate the most favorable point in time to place
16 hedges.” This point is further substantiated in Section IV, part d, which states,
17 “The Commission does not expect an IOU to predict or speculate on whether
18 markets will ultimately rise or fall and actually settle higher or lower than the
19 price levels that existed at the time hedges were put into place.”

20 **Q. Does FPL believe that hedging against natural gas price volatility**
21 **continues to make sense?**

22 A. Yes. While the decision on whether to continue hedging is ultimately a policy
23 decision that the Commission must make, FPL believes that hedging natural
24 gas price volatility continues to make sense. A substantial portion of FPL’s fuel

1 costs are driven by the cost of natural gas. While natural gas prices have been
2 low for several years, there is no assurance that they will remain low.
3 Furthermore, volatility within the natural gas market is not eliminated in a low
4 price environment. For example, Exhibit GJY-1 shows that the average daily
5 spot prices at Henry Hub in 2016 was \$2.52 per MMBtu, certainly a price level
6 that would be considered within the definition of a “low price environment.”
7 Actual spot prices, however, ranged from \$1.49 per MMBtu to \$3.80 per MMBtu
8 within the year, which represents a 155% increase on an intra-year basis. This
9 data shows that volatility continues to exist even in a low price environment.
10 This type of sharp increase in unhedged natural gas prices would have a
11 substantial impact on customers’ bills, and, while the annualized fuel factor
12 lessens the short-term impact of natural gas prices, ultimately customers bear
13 the full amount of price increases in the absence of hedging.

14
15 To demonstrate the significant impact that natural gas price movements have
16 on FPL’s total cost of natural gas, FPL offers the following example: FPL
17 currently consumes approximately 600 BCF of natural gas on an annual basis.
18 Therefore, every \$0.25 per MMBtu increase in the annual average price of
19 natural gas roughly equals a \$150 million increase in total annual natural gas
20 costs (about \$1.50 on a typical, 1,000-kWh monthly residential bill).

21
22
23
24

1 **RECOMMENDED HEDGING APPROACH**

2

3 **Q. If the Commission decides that IOUs should continue fuel hedging, what**
4 **hedging approach does FPL recommend?**

5 A. FPL understands that the Commission would prefer a hedging approach that
6 reduces customer exposure to hedging “losses” when fuel prices decline
7 relative to the price at which hedges were placed. Based on that
8 understanding, if the Commission decides to continue fuel hedging, then FPL
9 recommends an out of the money (“OTM”) call option approach rather than the
10 risk-responsive approach that has been presented to the Commission
11 previously by Michael Gettings. I will explain the reason for this
12 recommendation below.

13 **Q. Please summarize FPL’s understanding of Mr. Gettings’ risk-responsive**
14 **hedging approach.**

15 A. At a high level, the Gettings approach would continue to rely primarily upon
16 financial swaps, but would have IOUs initially hedge only a small percentage of
17 their projected natural gas consumption (the “programmatic” element). Then,
18 Mr. Gettings proposes that utilities continue to monitor the value at risk (“VaR”)
19 of their natural gas portfolio throughout the year, and either enter into additional
20 swaps if the VaR data indicate an increased likelihood of large price increases
21 (the “defensive” element) or else stop entering into swaps, unwind existing
22 swaps, and/or purchase put options if the VaR data indicate an increased
23 likelihood of large price decreases (the “contingent” element). Mr. Gettings
24 analyzed data from 2002 through 2011 and concluded that his approach would

1 be as effective at controlling customer exposure to price increases as the IOUs'
2 traditional fixed-volume hedging approach and would be better at allowing
3 customers to benefit from price declines.

4 **Q. Does FPL believe that there are flaws in that risk-responsive hedging**
5 **approach?**

6 A. Yes. The methodology is complex and unavoidably requires the exercise of a
7 considerable amount of discretion in determining when and to what extent to
8 take action in the defensive and contingent elements. From the initial hedge
9 percentage to the trigger levels at which defensive or contingent hedges would
10 be placed, each IOU would have to use its own discretion to set these
11 parameters. This would take the IOUs and, indirectly, the Commission into the
12 realm of "outguessing" the market, a function that is neither practicable nor
13 desirable from a policy standpoint, as has been discussed in prior Commission
14 orders. Furthermore, while Mr. Gettings has showed benefits in a "backcasted"
15 application of his approach, the reality is that the IOUs will not have the benefit
16 of hindsight in applying his methodology. Unfortunately, the selection of these
17 discretionary parameters appears critical to the outcome of the risk-responsive
18 approach. FPL is not confident that it – or any utility – would have enough
19 information available to make correspondingly astute discretionary decisions on
20 a real-world, forward-looking basis. In addition, the risk-responsive approach
21 does not necessarily accomplish the Commission's goal of reducing customers'
22 exposure to large hedging losses. I will explain this point in further detail below.

23
24

1 **Q. Are there any IOUs in the United States that have experience with risk-**
2 **responsive hedging?**

3 A. FPL has not identified any IOUs that have fully implemented risk-responsive
4 hedging. The one utility that has begun adopting elements of the risk-
5 responsive approach into its hedging plan (Avista) has not yet incorporated the
6 contingent element. Interestingly, that is the element that is responsible for
7 delivering the increased participation in declining market prices that this
8 Commission is especially interested in securing.

9 **Q. Has any public utility regulatory commission adopted risk-responsive**
10 **hedging for IOUs within its jurisdiction?**

11 A. As far as FPL is aware, the only regulatory commission to adopt risk-responsive
12 hedging for *any* type of utility is the state of Washington Utility and
13 Transportation Commission (“WUTC”), which issued an order on March 13,
14 2017 directing natural gas local distribution companies to move toward the
15 integration of risk-responsive hedging over a period of up to 30 months. FPL
16 has three major concerns over the WUTC’s order:

- 17 • The WUTC provides no guidance over how risk-responsive hedging is
18 supposed to be implemented. Rather than giving the utilities a road map, it
19 essentially tells them to go find one.
- 20 • The WUTC provides no guidance or comfort as to what would be deemed
21 prudent operating parameters for a risk-responsive hedging program,
22 leaving the utilities extremely vulnerable to second-guessing if it turns out
23 that customers would have benefited from either more or less hedges than
24 the utility ended up placing.

1 • The 30-month implementation timetable is a long time to wait for an effective
2 hedging program to be in place, but the WUTC has nothing to offer as a
3 viable interim strategy.

4 **Q. Does FPL agree that implementation of a risk-responsive hedging**
5 **approach would take several years to implement?**

6 A. Yes. Given the complexity and lack of existing industry experience with the risk-
7 responsive approach, FPL does not believe that it could adequately prepare to
8 implement this approach in less than two years. FPL would first need to build
9 its in-house capabilities to make the necessary evaluations and decisions on
10 executing the defensive and contingent elements, then would need to simulate
11 its implementation for a year or more to gain experience before commencing
12 implementation with actual customer money at stake.

13 **Q. Does FPL believe that the risk-responsive approach could increase the**
14 **cost of hedging for customers?**

15 A. Yes. The complexity of this approach would likely require additional resources,
16 which would increase the cost of the hedging program to customers.

17 **Q. Does FPL have any other concerns related to the risk-responsive hedging**
18 **approach?**

19 A. Yes. FPL is concerned that the complexity of this approach would make the
20 review and approval of risk management plans and their execution difficult for
21 the Commission and discomfiting for the IOUs. Put simply, the large amount of
22 discretion that inescapably must be exercised by an IOU in implementing this
23 approach is fundamentally at odds with the process that has worked so well
24 under the Commission's 2008 hedging guidelines: specify a plan for hedging in

1 the upcoming year; direct the IOU to implement the approved plan; and then
2 audit the IOUs implementation to ensure that it conformed to the plan. If a risk
3 management plan says essentially “we’ll stay flexible about how much to hedge
4 depending on how things turn out,” it is nearly impossible for the Commission to
5 make a straightforward decision on whether the IOU appropriately followed that
6 plan, or for the IOU to know how it can ensure that its discretionary decisions
7 will be found prudent. Again, such a plan would put the IOUs in a position of
8 having to outguess the market, and the Commission in a position of having to
9 decide whether in fact the IOUs did so prudently. Neither the IOUs nor the
10 Commission is equipped for such tasks.

11 **Q. Given all of the reasons you have mentioned, what is FPL’s position on**
12 **risk-responsive hedging?**

13 A. FPL does not recommend a risk-responsive hedging approach and in fact, is
14 strongly against the implementation of such a methodology.

15 **Q. Does FPL believe that there is simpler and better approach?**

16 A. Yes. FPL believes that there is a better approach that would address the
17 Commission’s objective of protecting customers against large price increases
18 while allowing them to participate more fully in the benefits of a declining
19 market, without the delays, expense and uncertainty associated with risk-
20 responsive hedging. If the Commission wants the IOUs to reduce their exposure
21 to hedging loss risk, then FPL believes that a call option strategy is a superior
22 way to do so. The Commission’s objective of protecting customers against
23 large price increases while allowing them to participate more fully in the benefits
24 of a declining market describes almost exactly the purpose of a call option.

1 **Q. Please describe a call option.**

2 A. A call option is a financial instrument in which the holder pays a premium and
3 then is allowed, but not required to buy a commodity at a specified price on a
4 specified future date. For example, an IOU could buy a call option that would
5 allow it to buy natural gas at \$3.00 per MMBtu for July 2017. If natural gas
6 settles at \$3.50 for July 2017, the IOU would exercise the call option, receive a
7 financial settlement of \$0.50 per MMBtu which would be applied to the IOUs
8 physical purchase of natural gas at the market price of \$3.50 per MMBtu (thus
9 creating an effective natural gas cost of \$3.00 per MMBtu on the applicable
10 volume). On the other hand, if natural gas settles at \$2.50 per MMBtu for the
11 month of July, then the IOU would not exercise the call option but instead would
12 simply buy gas at the market price. Customers are thus protected against price
13 increases and, at the same time, the IOU can participate fully in market
14 declines.

15
16 Of course there is no “free lunch.” The holder of a call option must pay a
17 premium for it, and the premiums can be substantial if the market is highly
18 volatile. However, the price for call options is much lower if the holder is willing
19 to buy them out of the money (“OTM”), meaning that the price at which the
20 holder may buy the commodity in question is higher than the current estimate of
21 the market price on the day that the option can be exercised. Using the
22 example above, suppose that the forward curve price for gas in July 2017 is
23 \$3.00 per MMBtu. If the IOU were willing to buy the call option at a strike price
24 of \$3.30 per MMBtu rather than \$3.00 per MMBtu, it would pay considerably

1 less for it. With this OTM call option, if natural gas turned out to cost \$3.50 per
2 MMBtu in July, the IOU would exercise the call option and effectively buy the
3 applicable volume of gas for \$3.30 per MMBtu, saving \$0.20 per MMBtu in the
4 process. On the other hand, if natural gas cost \$2.50 per MMBtu in July, then
5 the IOU would not exercise the call option but instead would simply buy gas at
6 the market price. The IOU thus is protected against price increase above \$3.30
7 per MMBtu on the applicable volume and could participate fully in market
8 declines.

9 **Q. Has FPL evaluated the OTM call option strategy against Mr. Gettings' risk-**
10 **responsive approach?**

11 A. Yes. FPL's evaluation uses data for the ten-year period from 2007 through
12 2016, which reflects the most recent actual market experience and includes a
13 period of rapid, large price swings (up and down) as well as a period of relative
14 market stability. The risk-responsive hedging strategy in the comparison is
15 based on the same parameters and action boundaries that Mr. Gettings used
16 for the illustrative program that he presented in the January 2017 meetings with
17 the IOUs and intervenors. The illustrative OTM call option strategy reflects the
18 purchase of call options for 60% of the projected annual natural gas burn, with
19 the options having a strike price that is 15% above the market price that is
20 projected for the date on which they are to be exercised. The illustrative
21 strategy applies to the following calendar year only (i.e., the options would be
22 bought throughout Year 1 to cover fuel purchases in Year 2).

23 **Q. Please describe the results of FPL's comparison.**

24 A. Exhibit GJY-2 shows the results of FPL's analysis. The table shows the

1 average annual cost of gas, inclusive of hedges, in dollars per MMBtu under the
2 risk-responsive strategy and OTM call option strategy for each year during the
3 2007-2016 period. As can be seen, the OTM call option strategy has a lower
4 net cost of gas in seven out of ten years and a lower average cost over the ten-
5 year period. While the risk-responsive strategy has a slightly lower gas cost in
6 periods of rising prices (2008, 2014, and 2016), the OTM call option strategy is
7 substantially better at allowing customers to participate in falling prices. For
8 example, in 2009, the OTM call option strategy would have resulted in gas costs
9 that were slightly more than \$1.00 per MMBtu lower than the risk-responsive
10 approach. This example clearly supports the goal of allowing customers to
11 receive the full benefit of declining prices. Overall, the OTM call option strategy
12 resulted in a net cost of gas that was, on average, \$0.28 per MMBtu lower than
13 the risk-responsive approach.

14
15 Thus, over the decade-long evaluation period, the OTM call option strategy
16 appears better suited than the risk-responsive strategy to meeting the
17 Commission's goal of providing a measure of protection against sharp price
18 increases while allowing fuller participation in the benefits of falling market
19 prices. Additionally, it can be implemented with far less complexity and
20 ambiguity, thus making it much more transparent for Commission review,
21 approval and auditing. Finally, the results shown on Exhibit GJY-2 also
22 demonstrate the fact that the risk-responsive hedging approach does not
23 eliminate customers' exposure to large hedging losses. For example, the risk-
24 responsive hedging approach resulted in gas costs that were \$0.73, \$0.78,

1 \$0.84, and \$1.57 per MMBtu higher than the market price of gas in 2012, 2010,
2 2007, and 2009, respectively.

3 **Q. Do the results shown in Exhibit GJY-2 account for the premiums**
4 **associated with the call options?**

5 A. Yes. The OTM call option strategy would have been less expensive for
6 customers in 2007-2016 than Mr. Gettings' risk-responsive hedging approach
7 *after* fully taking into account the cost of premiums for the call options. Thus,
8 any criticism of the OTM call option based simply on the associated premiums
9 would be meaningless. It is those very expenditures that allow customers to
10 participate more fully in declining market prices and facilitate the favorable
11 economics of the OTM call option strategy in comparison to the risk-responsive
12 hedging approach.

13 **Q. Your Exhibit GJY-2 shows that, while the average cost of natural gas in**
14 **2007-2016 would have been lower under the OTM call option strategy than**
15 **under risk-responsive hedging, both had a higher average cost than the**
16 **average market settlement price for that time period. Doesn't this suggest**
17 **that the best strategy for customers is to discontinue hedging?**

18 A. Not necessarily. Keep in mind that the fundamental objective of hedging is to
19 mitigate volatility in natural gas prices. In practice, this refers to limiting
20 customers' exposure to unexpected, sustained price increases, because that is
21 what would drive up their electric bills substantially. Meeting all of FPL's gas
22 requirements with unhedged purchases at market prices would have provided
23 no protection against such increases. The fact that there were no periods of
24 sustained, large gas price increases in 2007-2016 does not mean that they

1 could not have occurred, or that it would not be useful and appropriate to protect
2 against them. By analogy, buying an insurance policy does not become a bad
3 decision simply because the policyholder does not experience the type of loss
4 against which it insures.

5 **Q. If the Commission approves the use of an OTM call option strategy, what**
6 **elements of that strategy does FPL recommend including in an IOU's Risk**
7 **Management Plan?**

8 A. Essentially, the risk management plan would specify the following:

- 9 • the duration to be covered by the call options (e.g., one year out or two
10 years out);
- 11 • the percentage of the projected gas burn to be covered with the options;
- 12 • how much out of the money the options would be (i.e., how much will
13 the options' strike price be above the projected gas price);
- 14 • what the IOU's authorized budget would be for buying the options; and
- 15 • what steps the IOU would take if market conditions change such that the
16 authorized budget is insufficient to purchase the options contemplated
17 by the risk management plan.

18 As can be seen from this list of key elements, the OTM call option strategy
19 could be quite straightforward to implement, with key parameters specified in
20 advance so that an IOU's adherence to those parameters could be readily and
21 objectively confirmed by the Commission.

22 **Q. Please summarize FPL's position on hedging and the strategy that should**
23 **be employed moving forward.**

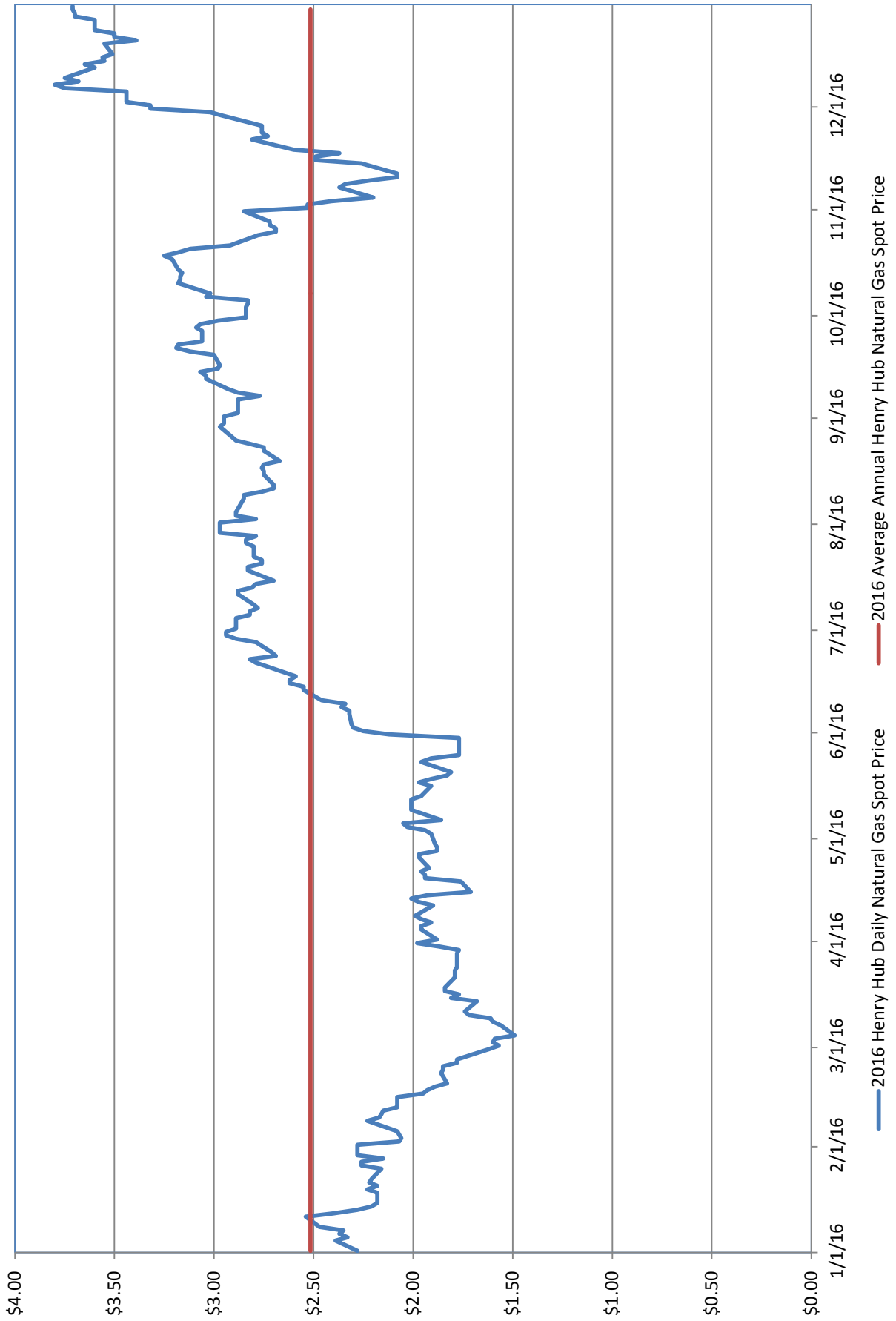
24 A. FPL recommends that natural gas hedging continue and that the Commission

1 authorize IOUs to implement a hedging program utilizing OTM call options as
2 described above. FPL urges the Commission not to require that IOUs
3 implement a risk-responsive hedging program because of the delay, expense
4 and uncertainty it would entail.

5 **Q. Does this conclude your testimony?**

6 A. Yes.

2016 Henry Hub Daily Natural Gas Spot Price



Year	Market Settlement Prices	Hypothetical Risk-Responsive Approach Results	Hypothetical OTM Call Options Approach	Difference in Average Annual Cost Between Hypothetical Risk-Responsive Approach and OTM Call Options Approach
	\$/MIMBtu	\$/MIMBtu	\$/MIMBtu	\$/MIMBtu
2007	\$6.86	\$7.70	\$7.48	(\$0.22)
2008	\$9.03	\$9.07	\$9.24	\$0.17
2009	\$3.99	\$5.56	\$4.42	(\$1.14)
2010	\$4.39	\$5.17	\$4.76	(\$0.41)
2011	\$4.04	\$4.47	\$4.33	(\$0.14)
2012	\$2.79	\$3.52	\$2.91	(\$0.61)
2013	\$3.65	\$3.92	\$3.81	(\$0.11)
2014	\$4.42	\$4.28	\$4.45	\$0.17
2015	\$2.66	\$3.27	\$2.78	(\$0.49)
2016	\$2.46	\$2.57	\$2.58	\$0.01
2007-2016 Average	\$4.43	\$4.95	\$4.68	(\$0.28)

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **TESTIMONY OF RENAE B. DEATON**

4 **DOCKET NO. 170057-EI**

5 **JULY 3, 2017**

6
7 **Q. Please state your name, business address, employer and position.**

8 A. My name is Renae B. Deaton. My business address is 700 Universe Boulevard,
9 Juno Beach, Florida 33408. I am employed by Florida Power & Light Company
10 (“FPL” or “the Company”) as the Director, Cost Recovery Clauses, in the
11 Regulatory & State Governmental Affairs Department.

12 **Q. Please state your education and business experience.**

13 A. I hold a Bachelor of Science in Business Administration and a Master of Business
14 Administration from Charleston Southern University. Since joining FPL in 1998,
15 I have held various positions in the rates and regulatory areas. Prior to my current
16 position, I held the positions of Senior Manager of Cost of Service and Load
17 Research and Senior Manager of Rate Design in the Rates and Tariffs
18 Department. I have previously testified before this Commission in base rate and
19 clause recovery proceedings. I am a member of the Edison Electric Institute
20 (“EEI”) Rates and Regulatory Affairs Committee, and I have completed the EEI
21 Advanced Rate Design Course. I have been a guest speaker at Public Utility
22 Research Center/World Bank International Training Programs on Utility
23 Regulation and Strategy. In 2016, I assumed my current position as Director,
24 Cost Recovery Clauses, where I am responsible for providing direction as to

1 appropriateness of inclusion of costs through a cost recovery clause and the
2 overall preparation and filing of all cost recovery clause documents including
3 testimony and discovery.

4 **Q. What is the purpose of your testimony in this proceeding?**

5 A. The purpose of my testimony is to address the issue of whether large-demand
6 customer classes should be allowed to opt-out of an Investor-Owned Utility's
7 ("IOU's") hedging program ("Hedging Opt-out Option").

8 **Q. Does FPL believe that implementing a Hedging Opt-out Option is fair or**
9 **feasible?**

10 A. No. FPL has explored this concept and concluded that this type of program could
11 allow opt-out customers to continue benefitting in certain respects from the
12 hedging program without paying for the cost of hedging. A Hedging Opt-out
13 Option would also be costly and administratively burdensome.

14 **Q. Please explain how opt-out customers could continue to benefit from the**
15 **hedging program.**

16 A. The primary goal of the Commission's hedging policy has been to mitigate
17 volatility in the customer fuel charge. This stability in the fuel portion of
18 customer bills provides a material benefit to customers. To the extent that opt-out
19 customers' unhedged fuel cost represents a small percentage of total retail fuel
20 cost, which likely would be the case, the opt-out share of unhedged fuel is
21 unlikely to impact the ability of a properly planned and executed hedging program
22 to achieve this benefit by mitigating the likelihood and number of mid-course
23 corrections. As a result, the opt-out customers would share in the bill stability

1 benefit achieved by the hedging program while paying none of the associated
2 hedging costs.

3 **Q. Could this undesirable result be avoided?**

4 A. Yes, but only at a considerable increase in cost and administrative burden. FPL
5 would need to separately track the recovery position of opt-out customers' fuel
6 cost. Midcourse corrections for opt-out customers would need to be filed
7 separately and possibly more frequently. This would require duplicating the
8 monthly A-Schedules and would increase the administrative burden not only on
9 FPL, but also on the Commission and FPSC staff. This additional step would
10 likely be required if the opt-out customers' energy and unhedged fuel cost became
11 a high enough percentage of total fuel cost to drive the need for a midcourse
12 correction that would not otherwise be required absent the Hedging Opt-Out
13 Option.

14 **Q. Could FPL's existing billing system accommodate a Hedging Opt-Out
15 Option?**

16 A. No, the implementation of a Hedging Opt-Out Option would require significant
17 system changes in order to bill opt-out participants separately.

18 **Q. Please summarize the system changes that FPL would need to make to
19 implement separate billing for hedging opt-out participants.**

20 A. System changes to implement separate billing for hedging opt-out participants
21 would require at least the following:

- 22 • Significant changes to the billing and tax calculation programs
- 23 • Modification to over 20 major system data files (tables) to store new
24 values

- 1 • Changes to over 30 customer information screens to enter and display
2 customer-specific information pertaining to the Hedging Opt-Out Option
3 and rate factors
- 4 • Changes to financial modules to recognize and record changes in the
5 General Ledger for new hedging opt-out clause revenues
- 6 • Changes to the billing statement programs to pass new values to the
7 customer bill statements
- 8 • Changes to over 60 financial reports to display detail and summary charge
9 amount information

10 Because of the high degree of automation and complexity of FPL's Customer
11 Information and Billing system, creating significant new functionality would
12 require substantial system changes and thorough testing to assure data integrity
13 and accuracy throughout the system.

14

15 FPL has estimated that these billing system modifications required to implement
16 an opt-out mechanism would cost approximately \$1.5 million, and the annual cost
17 to administer the program is estimated at \$200,000. This estimate assumes that
18 only customers in the largest rate classes (those served from the transmission level
19 or 2000 kW and above) would be eligible to participate in the program. Should
20 the program be expanded to allow more customers to qualify or to allow customer
21 load aggregation in order to qualify for the program, the cost would be higher.
22 This cost would need to be recovered in its entirety from the opt-out customers, as
23 it would be unfair to ask the general body of customers to help pay for system
24 changes that don't benefit them.

1 **Q. Are there additional systems that would need to be revised to accommodate**
2 **an Opt-Out Option for large customers?**

3 A. Yes. The fuel clause over/under accounting system and the fuel clause
4 projections system would need to be modified to account for opt-out customers'
5 revenue requirements and true-up calculations.

6 **Q. Does FPL see any other issues related to an Opt-Out Option?**

7 A. Yes. Beyond the administrative costs of implementing an opt-out mechanism,
8 FPL also believes that it would prove cumbersome. Typically, an IOU seeks
9 approval of a risk management plan in Year 1, pursuant to which it will actively
10 engage in placing hedges throughout Year 2 for natural gas purchases in Year 3
11 and potentially Year 4 and beyond. An opt-out customer would need to provide
12 sufficient notice in advance of Year 1 for the IOU to adjust the volumes of hedges
13 in its risk management plan. And then, the customer would not be able to change
14 its opt-out decision with respect to those hedges, which would be in place during
15 Year 3 and perhaps beyond. While this might not be difficult for a customer who
16 made a firm decision never again to participate in hedging, it would substantially
17 limit the ability of customers to move in and out of the hedging program from
18 year to year and could lead to customer confusion and dis-satisfaction.

19 **Q. If the Commission were to approve an Opt-Out Option, would it be**
20 **appropriate to develop an administrative adder to recover the associated**
21 **additional billing and customer service expenses?**

22 A. Yes. As previously mentioned, the proposals are not administratively efficient.
23 There would be several changes that would have to be implemented for the
24 proposal to be realized. For example, changes to the billing system would be

1 required to add a new fuel clause rate component and identify which customer
2 accounts would be exempt from the new rate. Cost causation principles would
3 require that the incremental costs associated with such a program be borne by the
4 beneficiaries through an administrative adder charged to opt-out customers. This
5 adder should be set and trued up annually during the normal fuel clause
6 proceedings.

7 **Q. Does this conclude your testimony?**

8 A. Yes.