

State of Florida



## Public Service Commission

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TALLAHASSEE, FLORIDA 32399-0850

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

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**DATE:** June 4, 2015

**TO:** Office of Commission Clerk (Stauffer)

**FROM:** Division of Accounting and Finance (Maurey) *ALM*  
Office of the General Counsel (Barrera) *JC*

**RE:** Docket No. 150001-EI – Fuel and purchased power cost recovery clause with generating performance incentive factor.

**AGENDA:** 06/18/15 – Regular Agenda – Post-Hearing Decision – Participation is Limited to Commissioners and Staff

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Graham

**CRITICAL DATES:** None

**SPECIAL INSTRUCTIONS:** None

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#### Case Background

On June 25, 2014, Florida Power & Light Company (FPL or Company) petitioned the Commission for a determination that it is prudent for FPL to acquire an interest in a natural gas reserve project (the Woodford Project) and that the revenue requirement associated with investing in and operating the gas reserve project is eligible for recovery through the Fuel Clause (Petition). FPL further requested that the Commission establish guidelines under which FPL could participate in future gas reserve projects without prior Commission approval and recover the costs through the Fuel Clause, subject to the Commission's established process for reviewing fuel-related transactions in Fuel Clause proceedings. FPL requested that the Commission consider these elements of its Petition at the Commission's October 22-24, 2014 Fuel Clause hearing.

On August 22, 2014, by Order No. PSC-14-0439-PCO-EI, the gas reserve issues were bifurcated from the Fuel Clause proceeding.<sup>1</sup> The gas reserve issues were scheduled to be heard at a separate hearing on December 1-2, 2014.

On August 22, 2014, the Office of Public Counsel (OPC) filed a Motion to Dismiss FPL's Petition on the grounds that the Commission does not have subject matter jurisdiction. On August 29, 2014, FPL filed its response in opposition to OPC's Motion. The Commission heard oral argument on the Motion to Dismiss at the Commission Conference on November 25, 2014. On December 17, 2014, the Commission issued Order No. PSC-14-0697-PCO-EI denying OPC's Motion.<sup>2</sup>

The hearing was held on December 1-2, 2014, at which FPL, OPC, the Florida Industrial Power Users Group (FIPUG), and the Florida Retail Federation (FRF) all participated. At the conclusion of the hearing, the Commission scheduled Issues 1, 2, 3, 6, and 8 related to the Woodford Project for consideration at the December 18, 2014 Commission Conference. The Commission deferred consideration of Issues 4, 5, 7, and 9 related to FPL's request for approval of investment guidelines to a future Commission Conference.

The Commission voted on the Woodford Project issues at the December 18, 2014 Commission Conference. By Order No. PSC-15-0038-FOF-EI issued January 12, 2015, the Commission found the Woodford Project in the public interest and the costs recoverable through the Fuel Clause.<sup>3</sup>

On January 15, 2015, OPC filed a Notice of Appeal in the Florida Supreme Court of Commission Order No. PSC-14-0697-PCO-EI, denying OPC's Motion to Dismiss for lack of subject matter jurisdiction (Florida Supreme Court Case No. SC15-95). On January 20, 2015, OPC filed a Notice of Appeal in the Florida Supreme Court of Commission Order No. PSC-15-0038-FOF-EI, approving the Woodford Project for cost recovery through the Fuel Clause (Florida Supreme Court Case No. SC15-113). Also on January 20, 2015, OPC filed a Notice of Appeal in the Florida Supreme Court of Commission Order No. PSC-14-0701-FOF-EI, approving the fuel and purchased power cost recovery factors for all Florida investor-owned electric utilities, including FPL (Florida Supreme Court Case No. SC15-115).<sup>4</sup> On February 10, 2015, FIPUG filed a Notice of Appeal in the Florida Supreme Court of Commission Order No. PSC-15-0038-FOF-EI, approving the Woodford Project (Florida Supreme Court Case No. SC15-274). On March 30, 2015, the Florida Supreme Court consolidated OPC's three appeals and the FIPUG appeal into a single case (Florida Supreme Court Case No. SC15-95). Also on March 30, the Florida Supreme Court dismissed OPC's petition for a writ of prohibition seeking to restrain

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<sup>1</sup> See Order No. PSC-14-0439-PCO-EI, issued August 22, 2014, in Docket No. 140001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>2</sup> See Order No. PSC-14-0697-PCO-EI, issued December 17, 2014, in Docket No. 140001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>3</sup> See Order No. PSC-15-0038-FOF-EI, issued January 12, 2015, in Docket No. 150001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>4</sup> See Order No. PSC-14-0701-FOF-EI, issued December 19, 2014, in Docket No. 140001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor. Order No. PSC-14-0701-FOF-EI addresses issues not related to the Woodford Project or the proposed Guidelines.

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the Commission from proceeding on FPL's petition to establish guidelines for FPL's participation in future gas reserve projects and granted the Commission's motion to relinquish jurisdiction authorizing the Commission to continue its proceedings on FPL's Petition.

The parties' post hearing briefs addressing Issues 4, 5, 7, and 9 related to FPL's proposed Guidelines were filed on January 12, 2015. This recommendation addresses these issues.

The Commission has jurisdiction over this subject matter pursuant to the provisions of Chapter 366, Florida Statutes (F.S.), including Sections 366.04, 366.05, and 366.06, F.S.

### **Discussion of Issues**

**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?

**Recommendation:** Yes. (Maurey)

### **Position of the Parties**

**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.

**OPC:** No. FPL's Proposed Guidelines violate the guiding principles and policy decisions announced by the Commission in Order No. 14546 and its progeny. It further violates the "case-by-case" prudence review required by these orders by requesting presumptive eligibility for recovery and prudence of every project that purports to "satisfy" the Guidelines. FPL is attempting to increase its rate base in unregulated, non-jurisdictional investments, outside the traditional rate-regulated electric monopoly utility functions of "generation, transmission, and distribution" expressly recognized in statute. If approved, it would open the door for every other investor owned utility to seek a risk-free way to expand rate base without a determination of need and without much scrutiny. Further, FPL's proposed investments in gas reserves projects: (1) is not hedging; (2) does not satisfy the definition of hedging as established by the Commission's hedging orders and hedging policy and (3) will not reduce fuel price volatility to the *benefit* of FPL's customers. Any fuel price volatility experienced by the customers is already, and effectively, mitigated by the annual resetting of the fuel factor in the Fuel Clause. That irrefutable fact belies the truth of FPL's assertion that fuel price volatility is something that must be mitigated through speculative, and risky natural gas reserves investments.

**FIPUG:** No. FIPUG joins and adopts the arguments of the Office of Public Counsel.

**Staff Analysis:** By Order No. PSC-15-0038-FOF-EI, the Commission found that an investment in a working interest in a natural gas reserve project (the Woodford Project), in the manner described in FPL's Petition and evidence on the record, is expected to produce customer benefits and is in the public interest.<sup>5</sup> The Commission also found that the revenue requirement associated with the investment in the Woodford Project is eligible for recovery through the Fuel Clause.

FPL's proposed Guidelines do not represent an actual cost that would be requested for recovery through the Fuel Clause. Instead, evidence in the record indicates that the proposed Guidelines are a set of parameters by which other, similar projects will be evaluated and assessed

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<sup>5</sup> See Order No. PSC-15-0038-FOF-EI, issued January 12, 2015, in Docket No. 150001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor, p. 6.

for consideration as possible candidates for future investment. (TR 123; FPL BR 5) The Commission has found that the revenue requirement associated with the Woodford Project is eligible for recovery through the Fuel Clause. If guidelines are approved, FPL's request for recovery of costs for similar investments approved by the Commission under the guidelines would satisfy the criteria for consideration in the fuel cost recovery clause proceeding. Whether FPL's proposed Guidelines, modified guidelines, or no guidelines are appropriate for approval at this time is the subject of Issue 5.

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

**Recommendation:** No. Due to the magnitude of the investments, the length of the commitments required, and the presumption of prudence that would attach, staff recommends any requests for approval of future gas reserve projects be considered on a case-by-case basis. It would be appropriate to have more experience with this form of investment and the magnitude of costs requested for recovery before the Commission approves guidelines for the proposed investment program with prudence attached. However, if the Commission finds it is appropriate to establish guidelines at this time, staff recommends the modifications attached to the end of this recommendation as Attachment A. (Maurey)

### **Position of the Parties**

**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.

**OPC:** No. FPL's Proposed Guidelines are one-sided, and completely favor FPL and its shareholders at the expense of FPL's 4.5 million customers. They should be rejected outright. While OPC maintains the Commission does not have subject matter jurisdiction to approve any gas reserves investments, let alone the Proposed Guidelines, OPC believes that the Commission's staff's suggested 50/50 sharing of risk and rewards or OPC Witness Ramas' hypothetical suggestion "up to the market price of gas" are much better than what FPL has proposed. Either option would put some of FPL's "skin into the game" and would align FPL customer and shareholder incentives. FPL would be motivated under those scenarios to perform a level of due diligence not currently required by the Proposed Guidelines. However, OPC maintains that the better regulatory policy decision would be to reject FPL's Proposed Guidelines.

**FIPUG:** No. Consistent with section 120.54, Florida Statutes, the Commission should engage in rulemaking to adopt any policy statements regarding the exploration and production of oil and natural gas.

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**Staff Analysis:** FPL's request for approval of guidelines for investment in natural gas reserve projects has significant policy implications. (TR 739-740, 947-948, 961, 965) The program of preapproved investment contemplated under the proposed Guidelines has never been done before in Florida or by any electric utility in the country. (TR 208, 388, 593, 644, 651, 904, 916) In addition, it would represent the first time non-regulated investments would be recovered through regulated rates with a predetermination of prudence. (TR 739-740, 947-948, 961, 965)

### PARTIES' ARGUMENTS

#### FPL

FPL witness Forest testified that the Woodford Project approved by Order No. PSC-15-0038-FOF-EI represents an example of just one agreement in a broad market. (TR 119) FPL has proposed the Commission establish guidelines under which FPL could participate in future gas reserve projects and recover the associated costs through the Fuel Clause without prior Commission approval, subject to the Commission's established process for reviewing fuel-related transactions in the Fuel Clause proceeding. (TR 88) Due to the amount of the investment and the length of the commitments required, witness Forest testified that FPL must have a presumption of prudence from the Commission before proceeding. (TR 88, 973)

FPL has proposed a set of Guidelines that it contends provides a framework to allow FPL to consummate other transactions in the future that meet these Guidelines, without having to seek prior approval from the Commission. (TR 121) As explained by witness Forest, most counterparties to date have been unwilling to wait the length of time necessary for regulatory approval in order to execute an agreement. (TR 121) Without assurance from the Commission that it concurs with FPL's approach, witness Forest testified that FPL cannot justify making such significant financial commitments. (TR 88)

Witness Foster testified that adoption of guidelines would be consistent with how the Commission administered FPL's financial hedging program. (TR 122) He noted how the Commission worked with FPL and the other investor-owned utilities (IOUs) in a collaborative effort to develop and implement a process and eventually guidelines for what should and should not be part of the financial hedging programs. (TR 122) Similar to the guidelines adopted for financial hedging programs, he suggested the Commission could establish a framework whereby the Company could enter into several transactions that were within a range of predetermined guidelines. Finally, witness Foster testified that, similar to the guidelines set forth for the financial hedging programs, "the Commission should acknowledge that there are potential drilling/production risks with pursuing gas assets and as long as the transaction was within the guidelines, it cannot be deemed imprudent based on the results." (TR 123; FPL BR 7)

Witness Foster testified that the proposed Guidelines will enable FPL to act in real time to secure gas reserve projects for the benefit of FPL customers. However, he stated that the drilling and production sector of the natural gas industry is not accustomed to waiting months for a potential counter-party to obtain regulatory approval to decide whether to close on a transaction. Witness Foster testified that without the presumption of prudence provided by FPL's proposed Guidelines, FPL will not be able to bring such projects to fruition for the benefit of its customers. (TR 973, 1037)

In its brief, FPL argued that it 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 the allowed transactions or narrowed the scope of eligible investments. (FPL BR 13-14) However, FPL argued that approval of guidelines is essential in order for the Company to deliver the benefits to customers FPL believes are available through its proposed program of investment in gas reserve projects. (FPL BR 22)

### OPC

OPC argued that the Commission lacks subject matter jurisdiction to approve for recovery from customers the costs associated with investments in the non-regulated natural gas drilling and production industry. (OPC BR 1) In its brief, OPC argued that approval of the proposed Guidelines would impermissibly shift the investment risks from FPL’s shareholders to its customers and would represent a new way of reducing shareholder risk and enhancing shareholder returns. (TR 558; OPC BR 1-2)

OPC witness Lawson testified that FPL’s proposal in this docket reflects FPL’s decision to diversify into a separate, non-regulated industry. (TR 686, 731) The Company is requesting the Commission expand the traditional Fuel Clause so that FPL can import investments in gas reserve projects and require customers bear the investment risk associated with natural gas drilling and production. (TR 680) Witness Lawson testified that the end result of FPL’s proposal would be that the risk of natural gas drilling and production typically borne by market participants such as PetroQuest Energy, Inc. (PetroQuest), would be shifted by PetroQuest through FPL and/or its non-regulated affiliate directly to FPL’s customers. (TR 725-726)

Witness Lawson argued that FPL’s proposed Guidelines are one-sided to the benefit of FPL and are not fair or equitable to its customers. (TR 737-738) He noted that FPL’s proposed Guidelines only require the projection of fuel savings for customers at a point in time, but does not guarantee any savings. (TR 692) In contrast, if FPL’s proposed Guidelines and the presumption of prudence that would attach are approved, the Company would be assured of earning its midpoint return on equity (ROE) on these investments regardless of the outcome of the investment or whether any fuel savings actually materialized as long as the Company demonstrated that the investment complied with the Guidelines at the time the investment was entered. (TR 161, 693-694, 736-738; OPC BR 7)

With respect to FPL’s testimony regarding the need for the Company to have the ability to act quickly to take advantage of these investment opportunities, witness Lawson testified that the Commission should take caution from FPL’s claim. (TR 739) He posited that “if gas reserve market participants must act within a month or two window as market prices fluctuate, why would this Commission or any other regulator consider the Woodford Project or any future gas reserve investment where the economic viability rests primarily on a 50-year forecast of market prices, and more than a two-month delay may change the economics of the deal?” (TR 739)

Finally, witness Lawson testified that the true purpose of FPL’s proposed gas reserve investment program is a new earnings platform for the Company and NextEra Energy, Inc.



(NextEra). (TR 694, 793) If the proposed Guidelines are approved as filed, he argued that FPL would be able to grow rate base and earnings through the Fuel Clause without regard to whether the customers received any benefit from the investments. (TR 694, 741) In conclusion, witness Lawson recommended that FPL's proposed Guidelines be denied and that any future gas reserve projects be addressed on a case-by-case basis. (TR 738-739)

### FIPUG

FIPUG opposes FPL's efforts to have its customers fund natural gas drilling and production ventures as contemplated in FPL's proposed Guidelines. (FIPUG BR 1-2) In its brief, FIPUG argued that policy is set by the Legislature and that the Commission should not implement policy by adopting "guidelines." (FIPUG BR 2) FIPUG recommended that the Commission not act on FPL's proposed Guidelines but instead hold workshops or other proceedings with wider participation before implementing "policies governing future investor-owned utility proposed and ratepayer-funded oil and gas exploration/drilling/production ventures." (FIPUG BR 7, 15)

FIPUG witness Pollock testified that the Commission should reject FPL's proposed Guidelines. (TR 644) He argued that FPL's proposed Guidelines do not address the sharing of risk between FPL and its customers nor do they impose any obligation on FPL to demonstrate that its customers have benefitted from investments in gas reserve projects. (TR 655-656) If FPL's proposed Guidelines are approved as filed, witness Pollock testified that FPL would recover its investment and earn its mid-point ROE irrespective of whether FPL's customers receive any benefit. (TR 648)

Witness Pollock also raised other concerns regarding FPL's proposal. Noting that approval of FPL's Guidelines would be the first time a regulated electric utility would be permitted to recover non-regulated investments through regulated rates, he cautioned the Commission regarding the significant policy implications of combining regulated and non-regulated investments in an integrated utility. (TR 651) He also expressed concern regarding the expansion of rate base through the Fuel Clause. While the benefits to FPL under its proposal are apparent, he argued the proposal holds only marginal or questionable benefits for FPL's customers. (TR 648, 651) In conclusion, witness Pollock recommended that FPL's proposed Guidelines be denied. (TR 658)

### ANALYSIS OF PARTIES' ARGUMENTS

FPL's proposed Guidelines were sponsored by and attached to witness Forest's direct testimony. (TR 123; EXH 10). While initially filed under confidential treatment, at FPL's request, the document was later declassified.<sup>6</sup> Generally, the Guidelines outline the parameters under which FPL proposes to enter future agreements for gas reserve projects. The Guidelines include provisions which describe the limits to FPL's participation in projects. Namely, the provisions specify the percentage of average daily burn the aggregate output from the projects may represent, the composition of the natural gas (percentage of methane versus natural gas liquids) that FPL can pursue, and the maximum annual capital expenditure FPL may invest in

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<sup>6</sup> See Document No. 06432-14 in Docket No. 140001-EI.

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these projects. (TR 123; EXH 10) Finally, the Guidelines specify the terms under which any agreements FPL enters will be evaluated by the Commission to determine if the investments are consistent with the Guidelines. (TR 123; EXH 10; FPL BR 6-7)

In its Petition, FPL requested that, similar to the financial hedging guidelines, the Commission establish a framework whereby the Company could enter into several transactions if they are within a range of predetermined terms/guidelines. (TR 84-85, 121, 909; FPL BR 18-19) FPL witness Forest further explained that adopting guidelines for gas reserve investments would be consistent with how the Commission has administered the financial hedging programs of the IOUs. (TR 122)

While the financial hedging program and the proposed physical hedging program do share certain similarities, there are also certain differences between the two programs as well. (TR 115, 122-123, 619-620) First and foremost are the duration of the financial exposure and the form of cost recovery granted. The financial hedging program involves the recovery of incremental operation and maintenance (O&M) costs through the Fuel Clause associated with short-term financial instruments (12-24 months). (TR 85) The proposed physical hedging program involves the recovery of incremental O&M costs as well as recovery of a rate of return on capital through the Fuel Clause associated with long-term capital investments (30 years or more). (TR 125, 203; EXH 9)

An additional difference between the two programs is the window of time being proposed for the Commission's consideration of guidelines that will attach prudence to these investments. (TR 901-902) The Commission's initial policy regarding risk management and hedging of fuel prices is embodied in Order No. PSC-02-1484-FOF-EI (Hedging Order).<sup>7</sup> This order approved a settlement agreement, reached between each of the four generating IOUs, FIPUG, and OPC, which established a framework for risk management of fuel procurement by FPL, Florida Power Corporation (now Duke Energy Florida), Tampa Electric Company, and Gulf Power Company.<sup>8</sup> After the issuance of the Hedging Order, each of the four IOUs developed financial hedging programs.

It is important to note the timeline that led to the Commission's adoption of guidelines for the financial hedging program. In approving the settlement agreement, the Hedging Order provided flexibility for each IOU to create the type of risk management program for fuel procurement that it finds most appropriate while allowing the Commission to retain the discretion to evaluate, and the parties the opportunity to address, the prudence of such programs at the appropriate time. Unlike FPL's request for approval of proposed Guidelines in the instant docket, a presumption of prudence did not automatically attach to financial hedging transactions as a result of the framework approved in the Hedging Order issued in 2002.<sup>9</sup> (TR 84-85, 130, 973; FPL BR 7)

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<sup>7</sup> See Order No. PSC-02-1484-FOF-EI, issued October 30, 2002, in Docket No. 011605-EI, In re: Review of investor-owned electric utilities' risk management policies and procedures.

<sup>8</sup> See Order No. PSC-02-1484-FOF-EI, p.p. 1-2.

<sup>9</sup> See Order No. PSC-02-1484-FOF-EI, p.p. 2,5.

After the IOUs developed their respective financial hedging programs and the Commission gained experience with the companies' practices under the framework established in the Hedging Order, the Commission issued Order No. PSC-08-0667-PAA-EI, which clarified the Hedging Order and provided guidelines for detailed risk management plans.<sup>10</sup> Unlike the instant case which involves only one IOU and a limited number of interested parties, the establishment of guidelines for financial hedging programs was a collaborative effort open to all four IOUs and interested parties.<sup>11</sup> (FPL BR 19) Also unlike the instant case, the Commission had a number of years of actual experience with the IOUs' investment practices and the range of costs they would request for recovery through the Fuel Clause before it considered guidelines with presumptive prudence attached.<sup>12</sup> (TR 130) While a framework for financial hedging was approved in 2002, the guidelines for financial hedging were not approved until 2008.

By Order No. PSC-15-0038-FOF-EI, the Commission found that an investment in a working interest in a natural gas reserve project (the Woodford Project), in the manner described in FPL's Petition and evidence on the record, is expected to produce customer benefits and is in the public interest.<sup>13</sup> The Woodford Project has been described by FPL "as an excellent candidate" for the first gas reserve project. (TR 42). Witness Forest testified that this transaction "is projected to be highly beneficial for FPL's customers" and has an 85 percent probability of producing fuel savings for customers. (TR 114, 333, 1043) The investment in the Woodford Project was initially recorded on the books of FPL's non-regulated affiliate, USG. FPL witness Ousdahl testified that upon a Commission determination that FPL's investment in the Woodford Project is prudent and the costs are recoverable through the Fuel Clause, USG will transfer the investment to FPL at net book value. (TR 354, 376-377) With the approval of the Woodford Project, the Commission has the means to gain meaningful experience regarding precisely how this type of investment will perform over time and a better understanding of the range and magnitude of costs FPL will propose for recovery through the Fuel Clause associated with an investment in a natural gas drilling and production operation. (TR 970-971, 984-985)

Finally, an examination of the specific guidelines, as discussed below, shows that there are a number of questions and concerns surrounding FPL's proposed program of gas reserve investments. The Guidelines proposed by FPL, along with modifications in a type-and-strike format, are attached to the end of this recommendation as Attachment A.

### ANALYSIS OF PROPOSED GUIDELINES

In Guideline I.A, FPL has proposed maximum percentages of average daily burn of 15 percent, 20 percent, and 25 percent for 2015, 2016, and 2017, respectively. (EXH 10) In Guideline I.B, FPL has proposed to provide an annual update to this three year window "informing the Commission of the relative percentage of average daily burn the aggregate output of all gas reserve projects represent." (EXH 10) It is unclear from this statement if FPL is

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<sup>10</sup> See Order No. PSC-08-0667-PAA-EI, issued October 8, 2008, in Docket No. 080001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>11</sup> See Order No. PSC-08-0667-PAA-EI, p.p. 3-4.

<sup>12</sup> See Order No. PSC-08-0667-PAA-EI, p. 1.

<sup>13</sup> See Order No. PSC-15-0038-FOF-EI, issued January 12, 2015, in Docket No. 150001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor, p. 6.

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proposing that the 25 percent level in 2017 will be the ceiling or if this limit will increase in the future. (TR 1059) FPL customers may suffer a high degree of risk exposure associated with these non-regulated investments. (TR 558, 654, 725-726) If guidelines are determined to be appropriate in the future, staff believes the maximum volume as a percentage of average daily burn should be reduced to limit the customers' exposure to this form of non-regulated risk.

In Guideline I.D., FPL has proposed an investment cap of \$750 million per year in the aggregate on gas reserve projects over the course of any one calendar year. (TR 976; EXH 10) At this level of investment, FPL could add the equivalent of a new combined cycle power plant to rate base every other year. (TR 278) When asked, FPL's witness was unable to identify what level of investment in gas reserve projects would represent a risk to the Company's on-going utility operations. (TR 279) If guidelines are determined to be appropriate in the future, staff believes such guidelines should limit the customers' exposure to this form of non-regulated risk by capping the allowed annual investment at a more modest level.

Section II of FPL's proposed Guidelines is titled Customer Savings. OPC raised concerns that FPL's proposed program for investing in gas reserve projects is designed more for the benefit of FPL and NextEra shareholders than for FPL customers. (OPC BR 2) NextEra, through its non-regulated subsidiary USG, has been investing in gas reserve projects since 2010. (TR 136-137, 355, 582, 1023) FPL witness Taylor testified that the Woodford Project became available to FPL because USG had already reached its budget limit for investments for the period. (EXH 57, p. 66) However, the Guidelines proposed by FPL are silent on how it will be decided which future gas reserve projects will be recorded on the books of USG and which projects will be recorded on FPL's books. (TR 256-257, 260-261, 306-308; EXH 10)

This Guideline also raises the concern, expressed by both OPC and FIPUG, that these investments are intended more for NextEra's corporate diversification rather than to produce fuel savings for customers or reduce fuel price volatility. (TR 643, 731; OPC BR 34) FPL's proposed Guidelines are silent on the issue of how it will demonstrate that the deals entered on FPL's behalf are as good as or better than the deals entered on NextEra's own account. OPC witness Lawton testified that FPL's "Guideline proposals are one-sided, favoring FPL at every opportunity with no real equity for customers." (TR 738) The Guidelines proposed by FPL do not provide a methodology that ensures transparency nor demonstrates that FPL's customers are receiving the greatest opportunity for fuel savings associated with investments in gas reserve projects. There is no mechanism for reporting the results of all gas reserve projects entered by FPL, USG, and/or any other affiliate or subsidiary of NextEra in a transparent manner and presented on a comparable basis, so that FPL can address the concern that the investments made on behalf of FPL's customers are as good as or better than the gas reserve projects made on NextEra's own account. (TR 260-261; OPC BR 34)

Guideline II.A provides that the Commission's evaluation of the prudence of FPL having entered into a new gas reserve project will be based on a showing that the project is estimated to generate fuel savings for customers on a net present value basis, relying solely on information relative to these Guidelines available to FPL at the time the transaction was entered, including the use of an independent third party reserve engineering report and FPL's standard fuel price forecasting methodology. (EXH 10) The proposed Guidelines grant a presumption of prudence

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without holding FPL to the generally accepted standard of what information was reasonably available to the Company at the time it made the decision to invest. (TR 972-973; OPC BR 30) This omission is not appropriate in this instance as the decision to invest is based on a set of assumptions at a single point in time but the presumed benefits for customers are dependent on the outcome of a natural gas drilling and production operation over multiple decades. (TR 268-269, 715, 739)

The proposed Guidelines do not include a requirement for FPL to engage an independent auditor, involve Commission staff in the development of the audit scope, nor the use of subaccounts for purposes of recording FPL's transactions related to gas reserve projects. (FPL BR 17; OPC BR 23) During the hearing, the ability of the Commission to effectively audit gas reserve investments was vigorously debated. With the approval of the Woodford Project, the Commission will have the opportunity to perform audits to determine the actual ease or difficulty of the audit process and will be in a better informed position to assess what terms may be necessary to include in the guidelines at a future time. In addition, if guidelines are approved in the future, such guidelines should be consistent with all mandates specified in Order No. PSC-15-0038-FOF-EI related to the Woodford Project.

The third bullet point under the heading, Section III. Supply Diversity, maintains that FPL intends to transact with a wide range of suppliers to minimize concentration of supply with any one producer and to reduce credit exposure to any one entity. (EXH 10) Staff shares FIPUG's concern regarding counterparty risk of participants in the natural gas drilling and production industry. (FIPUG BR 13) The Guidelines fail to provide measures for minimizing counterparty risk such as a limitation to only transact with producers that are also producers for existing gas reserve projects held by one or more NextEra affiliates or subsidiaries.

Guideline III. A specifies that FPL will only pursue onshore gas reserve projects located in areas that have a well-established history of gas production. (TR 123; EXH 10) FPL witness Taylor testified that the Securities and Exchange Commission (SEC) uses three standard categories for classifying gas reserves for public company reporting. (TR 499) Proved Reserves are those reserves with reasonable certainty (90 percent probability) that the predicted quantity of gas can be commercially recovered under current technical, contractual, economic, and regulatory conditions. (TR 499) Probable Reserves are those reserves with some uncertainty (50 percent probability) that the predicted quantity of gas can be commercially recovered under current technical, contractual, economic, and regulatory conditions. (TR 500) Possible Reserves are those reserves with high uncertainty (10 percent probability) that the predicted quantity of gas can be commercially recovered under current technical, contractual, economic, and regulatory conditions. (TR 500). Witness Taylor testified that "a typical gas reserve investment portfolio would appropriately be comprised of a wide range of projects, including reserves that fall within each of the major SEC categories of Proved, Probable, and Possible." (TR 502)

Despite the stated primary purpose of FPL's proposed gas reserve investment program to secure a physical source of natural gas, FPL's proposed Guidelines are silent on the appropriate or permissible mix of reserves, Proved, Probable, or Possible, that FPL may pursue. (EXH 10) While FPL witness Forest testified that FPL's proposed Guidelines are intended for the Company to pursue proven reserves, he admitted that the guidelines as submitted would not

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prohibit exploration or “wildcatting.” (TR 1057) If guidelines are determined to be appropriate in the future, staff believes such guidelines should require FPL to focus on those gas reserve projects with the most certainty around production in order to better ensure the program secures a physical source of natural gas. (TR 501)

The final paragraph of FPL’s proposed Guidelines offers a means by which the Guidelines could be modified in the future and provides the flexibility for FPL to present gas reserve projects that may deviate from one or more of the Guidelines for consideration for recovery on a case-by-case basis. (TR 1032-1033; EXH 10) However, this final guideline fails to clarify how this requested flexibility will be administered. If guidelines are determined to be appropriate in the future, staff believes further elaboration on how requested modifications to the guidelines or requests for case-by-case consideration will be addressed is required.

Finally, on a macro level, staff believes that the distribution of benefits to FPL and its customers is not equitable under FPL’s Guidelines as proposed. The anticipated benefits to the customers, namely, possible fuel savings and a reduction in price volatility, are entirely dependent on the outcome of the underlying investment in natural gas drilling and production and the movement in the market price of natural gas. In addition, these benefits will not be known until many years, perhaps decades, in the future. In contrast, the anticipated benefits to FPL, namely, the opportunity to grow earnings and rate base through the Fuel Clause and the opportunity to recover non-regulated investments through regulated rates, are entirely independent of the aforementioned underlying investment or the movement in the market price of natural gas. In addition, under FPL’s proposed Guidelines, the Company’s benefits are assured and will be known at the time the investment is made. This disparity in both the timing and assurance of benefits flowing from FPL’s proposed investment program should be addressed before guidelines, which would grant presumptive prudence for recovery of non-regulated investments through the Fuel Clause, are approved.

### CONCLUSION

Just as FPL cannot justify undertaking such a sizable financial commitment without assurance from the Commission of presumptive prudence, staff cannot recommend approval of guidelines for a new program with such significant policy implications without actual experience of how these non-regulated investments will perform and the magnitude of costs FPL will seek to recover through the Fuel Clause. (TR 964-966) With the approval of the Woodford Project, the Commission has the means to gain meaningful experience regarding precisely how this type of investment will perform over time and a better understanding of the range and magnitude of costs FPL will propose for recovery through the Fuel Clause associated with an investment in a natural gas drilling and production operation. (TR 970-971, 984-985) While staff is not suggesting the Commission necessarily needs seven years of experience as it had before considering guidelines for the financial hedging program, staff does believe it would be appropriate to have more experience with this form of investment and the magnitude of costs requested for recovery before the Commission approves guidelines for the newly proposed investment program with prudence attached.

In addition, staff believes that the distribution of benefits to FPL and its customers is not equitable under FPL's Guidelines as proposed. The anticipated benefits to the customers in the form of fuel savings and a reduction in price volatility are entirely dependent on the outcome of the underlying investment and the movement in the market price of natural gas. In addition, these benefits are not assured and will not be known until years in the future. In contrast, the anticipated benefits to FPL in the form of growing earnings and rate base through the Fuel Clause and the recovery of non-regulated investments through regulated rates are entirely independent of the outcome of the underlying investment or the movement in the market price of natural gas. In addition, under FPL's proposal as filed, the Company's benefits are assured and will be known at the time the investment is made. Therefore, for the reasons outlined above, staff believes it is premature to approve guidelines for the proposed investment program at this time. Staff recommends any requests for approval of future gas reserve projects be considered on a case-by-case basis.

However, if the Commission finds it is appropriate to establish guidelines at this time, staff recommends the Commission consider the modifications attached to the end of this recommendation as Attachment A. While the suggested modifications do not address the inequity in the distribution of benefits discussed above, they may serve to mitigate some of the risk that customers will be exposed to and would add clarity to certain provisions of FPL's proposed Guidelines that were silent on key parameters related to this new investment program.

**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?

**Recommendation:** No. If the Commission adopts guidelines, it is not required to engage in rulemaking. First, the proposed Guidelines are not rules under the definition in Section 120.52(7), F.S. Second, the Commission is exempt from rulemaking pursuant to the provisions of Section 120.80(13)(a), F.S., applicable to cost-recovery clauses, factors, or mechanisms. (Barrera)

### **Positions of the Parties**

**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.

**OPC:** No. The Commission lacks the express statutory authority to do rulemaking. Further, even if the Commission has jurisdiction, FPL may state there is an exception to rulemaking for recovery of costs through the Fuel Clause. See Section 120.80(13)(a), F.S. First, the Commission, not FPL, must assert this exemption from rulemaking. Second, there is nothing in the exemption from rulemaking that prohibits the Commission from establishing a rule to provide guidelines for gas reserves investments that will change customer rates. Third, notwithstanding this exemption from rulemaking, Section 366.06(1), F.S., specifically mandates that all applications for changes in rates shall be made under the rules and regulations as prescribed by the Commission.<sup>14</sup> This specific mandate controls over Section 120.80(13)(a), F.S., general exemption from rulemaking for clause proceedings.<sup>15</sup> Requesting approval for the Guidelines is de facto a pre-application for changes in customer rates on an automatic, going-forward basis for gas projects that meet the Guidelines. Therefore, any Guidelines approved for FPL and established without rules violate the mandate of Section 366.06(1), F.S. Since there is no express authority to allow investor owned monopoly electric utilities to recover costs associated with obtaining natural gas at the “wellhead” from gas reserves investments, FPL’s proposal cannot get past first base (statutory authorization) let alone second base (rulemaking). As the Regulator, the Commission should state that FPL’s has struck-out with its overreaching proposal.

**FIPUG:** Yes. Florida Statutes provides that statements of policy should be adopted through rulemaking. Rulemaking affords affected parties notice and the opportunity to participate in the development of any oil and gas exploration and production policy that would be applied prospectively. Such wide-ranging policy pronouncements should be put in place through

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<sup>14</sup> . . . All applications for changes in rates shall be made to the commission in writing under rules and regulations prescribed, and the commission shall have the authority to determine and fix fair, just, and reasonable rates that may be requested, demanded, charged, or collected by any public utility for its service. . . . Section 366.06(1), F.S.

<sup>15</sup> Commission legal and technical staff have recognized the need for a rule when a utility applies for a change in rates, even in the Fuel Clause. See Case Background recommending approval of Rule 25-6.0424, F.A.C., Petition for Mid-Course Correction, in Docket No. 100084-EI. (<http://www.psc.state.fl.us/library/FILINGS/10/03779-10/03779-10.pdf>) The “Purpose and Effect” of this rule clearly recognizes that the “. . . specific language of Sec. 366.06(1), F.S., [] requires that all applications for changes in rates shall be made to the Commission in writing under prescribed rules and regulations. . . .” See Order No. PSC-10-0332-NOR-EI, issued May 25, 2010 at 2.



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rulemaking. FPL's "guidelines" are tantamount to proposed rules and should be considered in an appropriately noticed proceeding in accord with chapter 120, Florida Statutes.

**Staff Analysis:** This analysis addresses whether adoption of FPL's proposed Guidelines are applicable to all other IOUs and, if so, whether the Commission is required to engage in rulemaking to adopt the guidelines.

In its petition FPL proposed a detailed set of guidelines FPL asserts are designed to establish a framework whereby FPL can participate in future gas reserve projects and recover its costs through the fuel clause without prior Commission approval. (FPL BR 1) FPL takes the position that no rules are required to adopt its guidelines. (FPL BR 23) In support, FPL cites Order No. PSC-14-0665-PCO-EI, denying FIPUG's motion to strike FPL's request to establish guidelines related to oil and gas based on a finding by the Prehearing Officer that cost recovery clauses are specifically exempt from rulemaking under Section 120.80(13)(a), F.S.<sup>16</sup> (FPL BR 23)

OPC admits that the Commission is exempt from "some aspect of rulemaking" but that certain Commission orders, such as the order setting hedging guidelines<sup>17</sup> are "de facto or surrogate rules."<sup>18</sup> (OPC BR 39) OPC argues that the provisions of Section 366.06(1), F.S., providing that all applications for changes in rates shall be made under the rules and regulations as prescribed by the Commission, controls over the exemption in Section 120.80(13)(a), F.S. (OPC BR 40) In support, OPC cites language from a staff recommendation in a proceeding involving the promulgation of Rule 25-6.0424, F.A.C., setting requirements for filing a petition for mid-course correction, in Docket No. 100084-EI.<sup>19</sup> (OPC BR 39) A petition for mid-course correction seeks a change to fuel factors and is typically filed in fuel clause proceedings. OPC contends that requesting approval for the guidelines is de facto a pre-application for changes in customer rates on an automatic, going-forward basis for gas projects that meet the guidelines. Therefore, OPC argues, the Commission violates the mandate of Section 366.06(1), F.S., if it adopts the FPL guidelines without promulgating rules. (OPC BR 39-40)

FIPUG takes the position that the Commission should engage in rulemaking, because FPL's guidelines are tantamount to proposed rules and should only be considered in an appropriately noticed proceeding in accord with Chapter 120, F.S. (FIPUG BR 3, 6) FIPUG argues that rulemaking affords affected parties notice and the opportunity to participate in the development of a prospective application of a policy regarding the issues raised by FPL's petition to adopt guidelines for future oil and gas exploration and production ventures. (FIPUG BR 6) FIPUG recommends that the Commission pursue rulemaking either directly or through

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<sup>16</sup> See Order No. PSC-14-0665-PCO-EI, issued on November 17, 2014, in Docket No. 140001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>17</sup> See Order No. PSC-08-0667-PAA-EI, issued October 8, 2008, in Docket No. 080001-EI, In re Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>18</sup> The term "de facto" or "surrogate rule" is not found in any provision of Chapter 120, F.S.

<sup>19</sup> Document No. 03779-10, filed May 6, 2010, Revised Recommendation for May 13, 2010 Agenda. Staff notes that language in a staff recommendation does not constitute Commission action. Order No. PSC-10-0332-NOR-EI, issued May 25, 2010, in Docket No. 100084, In re: Initiation of rulemaking to adopt Rule 25-6.0424, F.A.C., Petition for Mid-Course Correction, does not address this portion of the staff's recommendation.

incipient policy on a case-by-case approach. (FIPUG BR 4) FIPUG also argues that such wide-ranging policy pronouncements should be put in place through legislative enactment. (FIPUG BR 2) FIPUG further states that the adoption of FPL's guidelines will establish precedent for other utilities to request approval of projects similar to FPL's gas reserves project. (FIPUG BR 2)

The first question is whether FPL's proposed Guidelines, if adopted, are rules. Section 120.52(7), F.S., defines a rule as an agency statement of general applicability that implements, interprets, or prescribes law or policy, or describes the procedure or practice requirements of an agency and includes any form which imposes any requirement or solicits any information not specifically required by statute or by an existing rule.

When deciding whether a challenged action constitutes a rule, a court analyzes the action's general applicability, requirement of compliance, or direct and consistent effect of law. Fla. Dep't of Fin. Servs. v. Capital Collateral Reg'l Counsel-Middle Region, 969 So. 2d 527, 530 (Fla. 1<sup>st</sup> DCA 2007). The analysis is predicated on whether the action has a direct effect on the other regulated utilities, adversely affects any substantive right, constitutes a denial or withdrawal of a right, imposes any new or additional requirements, or has the direct and consistent effect of law. Volusia County Sch. Bd. v. Volusia Home Builders Ass'n, Inc., 946 So. 2d 1084, 1089 (Fla. 5th DCA 2006).

In Florida Public Service Com. v. Central Corp., 551 So. 2d 568, 569 ( Fla. 1<sup>st</sup> DCA 1989), the court held that a Commission interim rate order imposing a temporary "hold subject to refund" requirement was an invalid unpromulgated rule because the order specifically stated that the requirement applied to all alternate service providers furnishing operator-assisted long distance telecommunications services, not just Central Corporation. The court determined that the order was a rule as it imposed an immediate requirement not otherwise required by statute or existing rule because the providers either had to change previously approved rates to match those charged by local exchange companies, or set monies aside to cover the potential refund obligation.

Unlike the Commission order at issue in Central Corp. or the order establishing the hedging guidelines,<sup>20</sup> the FPL proposed Guidelines, if adopted, affect only FPL. The guidelines neither have a direct effect on the other electric utilities that are parties in the fuel clause proceedings, adversely affect any of their substantive rights, impose any new or additional requirements, nor have the direct and consistent effect of law. Thus, the guidelines are not a statement of general applicability and do not rise to the level of a rule under the provisions of Section 120.52(7), F.S.

In 1991, the Florida Legislature enacted Section 120.54(1)(a), F.S., which provides that rulemaking is not a matter of agency discretion and requires each agency statement defined as a rule by Section 120.52 to be adopted by the rulemaking procedure provided in Chapter 120, F.S. as soon as feasible and practicable. See: Department of Highway Safety and Motor Vehicles v.

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<sup>20</sup> See Order No. PSC-08-0667-PAA-EI, issued October 8, 2008, in Docket No. 080001-EI, In re Fuel and purchased power cost recovery clause with generating performance incentive factor.

Schluter, 705 So. 2d 81 (Fla. 1st DCA 1997). However, Section 120.80(13)(a), F.S., specifically exempts the Commission from the mandatory rulemaking requirements of Section 120.54(1)(a), F.S. The exemption applies to any Commission statements that relate to cost-recovery clauses, factors, or mechanisms implemented pursuant to Chapter 366, F.S., relating to public utilities. The Commission has, in the past, established guidelines and procedures for fuel clause proceedings that have general applicability through Commission orders without promulgating rules.<sup>21</sup> The Commission specifically addressed the Section 120.80(13)(a), F.S., exemption in Order No. PSC-99-1741-PAA-EI when it ruled that, despite containing agency statements of widespread applicability, an order issued as part of the fuel and purchased power cost recovery clause is exempt from the rulemaking requirements of Chapter 120, F.S.<sup>22</sup>

OPC's argument that Section 120.80(13)(a), F.S., does not control because the petition for approval of the guidelines "is de facto a pre-application for changes in customer rates" under Section 366.01, F.S., is inapposite to the issue at hand and misapprehends the statutory interpretation of the relevant statutory sections.<sup>23</sup> Rule 25-6.0424, F.A.C., setting requirements for petitions for mid-course correction involves petitions for change in rates. The petition to adopt guidelines is clearly not an application for a change in rates. Adopting OPC's argument, the Commission would be required to promulgate rules to implement *all* Commission orders setting procedures, factors or mechanisms in cost-recovery clauses and renders the provisions of Section 120.80(13)(a), F.S., meaningless. A basic rule of statutory construction is that the Legislature does not intend to enact useless provisions, and courts avoid readings that would render part of a statute meaningless. American Home Assurance Co. v. Plaza Materials Corp., 908 So. 2d 360, 366 (Fla. 2005); Kasischke v. State, 991 So. 2d 803, 808 (Fla. 2008) (holding that a court must avoid interpreting a statute so as to render the statute meaningless).

In conclusion, if the Commission adopts guidelines, it is not required to engage in rulemaking. First, the guidelines are not rules under the definition in Section 120.52(7), F.S. Second, the Commission is exempt from rulemaking under the provisions of Section 120.80(13)(a), F.S., applicable to cost-recovery clauses, factors, or mechanisms.

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<sup>21</sup> See Order No. PSC-08-0667-PAA-EI, issued October 8, 2008, in Docket No. 080001-EI, In re Fuel and purchased power cost recovery clause with generating performance incentive factor.

<sup>22</sup> See Order No. PSC-99-1741-PAA-EI, issued September 3, 1999, in Docket No. 990771-EI, In re: Petition by Florida Power Corporation for approval of regulatory treatment associated with the sale of replacement capacity and energy to the City of Tallahassee.

<sup>23</sup> Section 366.06(1), F.S. does not address "pre-applications" for a change in rates.

**Issue 9:** Should this docket be closed?

**Recommendation:** No. The Fuel and Purchased Power Cost Recovery Clause is an on-going docket and should remain open. (Barrera)

**Staff Analysis:** The Fuel and Purchased Power Cost Recovery Clause is an on-going docket and should remain open.

## FPL GAS RESERVES GUIDELINES<sup>24</sup>

Florida Power and Light Company's ("FPL" or "the Company") goals in purchasing natural gas to supply its power plants are reliability, price stability and low cost. Participating in gas reserve projects through a joint development agreement is a form of long-term hedging that can be a valuable supplement to FPL's existing short-term hedging program.

The Florida Public Service Commission ("Commission") previously has found "that the purpose of hedging is to reduce the impact of volatility in the fuel adjustment charges paid by an IOU's customers, in the face of price volatility for the fuels (and fuel price-indexed purchased power energy costs) that the IOU must pay in order to provide electric service." Further, the Commission found the primary purpose of hedging is to "reduce the variability or volatility in fuel costs paid by customers over time." (*Order No. PSC-08-0667-PAA-EI, Attachment A, page 2*)

Because of the natural depletion rate of shale-based gas production, it is understood that FPL will need to continue pursuing new gas reserve project opportunities to compensate for declining production from existing projects, as well as to expand the percentage of FPL's gas requirements that are hedged long-term. Moreover, it is clear that market participants and potential counterparties expect and value the ability to respond to opportunities quickly. Accordingly, a successful market strategy requires an established framework within which FPL may negotiate and consummate transactions.

### **I. SCOPE OF GAS RESERVE PROJECT PARTICIPATION**

- Gas reserve projects will help reduce the overall portfolio price volatility and supply risk. The transactions will lessen the impact to customers if gas prices spike or rise and stay high for an extended period of time. Even though each transaction individually will represent a very small percentage of the Company's supply portfolio, collectively these transactions would help dampen the effects of price volatility.
- Guideline 1A: Overall, the estimated aggregate output of all gas reserve projects will not exceed the following percentages of FPL's projected average daily natural gas burn:

Year	Maximum Volume as a Percentage of Average Daily Burn
2015	<del>15%</del> <u>5%</u>
2016	<del>20%</del> <u>7.5%</u>
2017	<del>25%</del> <u>10%</u>

<sup>24</sup> As discussed in Issue 5, staff is recommending the Commission not approve FPL's proposed Gas Reserves Guidelines. However, if the Commission finds it is appropriate to establish guidelines at this time, staff recommends the modifications reflected in the type-and-strike format presented in Attachment A.

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- Guideline I.B: FPL will provide an annual update ~~to the three year window presented in Guideline I.A~~ informing the Commission of the relative percentage of average daily burn the aggregate output of all gas reserve projects represent as part of its Risk Management Plan filed in early August each year with the Estimated/Actual Testimony filing. The maximum volume as a percentage of average daily burn will be capped at 10 percent until such time the Commission considers this Guideline in a future proceeding.
- Guideline I.C: Because gas reserve transactions provide a hedging benefit for FPL and its customers, the estimated aggregate volumes of natural gas from all gas reserve transactions in each calendar year will be netted against the amounts that FPL forecasts to hedge pursuant to FPL's annual Risk Management Plan. FPL will hedge the net amount as prescribed in the Risk Management Plan.
- Guideline 1.D: FPL will not obligate itself to invest more than ~~\$750~~ \$250 MM in the aggregate on gas reserve projects over the course of any one calendar year.

## II. CUSTOMER SAVINGS

To ensure transparency and to demonstrate that FPL's customers are receiving the greatest opportunity for fuel savings associated with investments in gas reserve projects, FPL will provide an annual detailed comparison of all gas reserve projects entered into on behalf of FPL, USG, and/or any other affiliate or subsidiary of NextEra Energy as part of its Risk Management Plan filed in early August each year with the Estimated/Actual Testimony filing. This annual filing will provide the same information for each gas reserve project entered into by any affiliate or subsidiary of NextEra Energy that was used to support or justify the appropriateness of each gas reserve project entered into by FPL during the reporting period. In particular, this filing will show all material assumptions relied upon to support each gas reserve project including the capital investment amount, will calculate the associated revenue requirement for each gas reserve project, and will provide the net present value savings for each gas reserve project entered into by any affiliate or subsidiary of NextEra Energy.

- Investment in gas reserve projects can offer significant price stability for the volumes produced, while also providing customer savings in a market of rising gas prices. A benefit of a well-managed gas reserves investment program is secure low-cost natural gas for our customers for years into the future that delivers an expected pricing discount relative to the forward curve. Since typical wells produce for 40 to 60 years, gas production joint ventures can provide stable pricing for decades to come, thus helping to achieve the Commission's stated goal for hedging to reduce price volatility for customers.
- Transactions of this type can result in 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 the gas reserves investments were made. However, since only a portion of FPL's fuel requirements is procured through gas reserves investments, FPL maintains the ability to purchase low priced fuel when the opportunity arises. Moreover, in some projects it may be possible to delay the drilling plan and/or reduce the production

volume from existing wells in the event of unexpected price declines. Conversely, when fuel prices settle at higher levels than at the time the gas reserves investments were made, increased customer savings are a direct result of the gas production joint venture.

- Guideline II.A: Evaluation of the prudence of FPL's having entered into a new gas reserve project will 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 relative to these Guidelines available to FPL at the time the transaction was entered, as well as any information FPL should have known at the time, including the use of an independent third party reserve engineering report and FPL's standard fuel price forecasting methodology. As part of the annual filing to the Risk Management Plan discussed above, FPL will provide the same showing of results (gains or losses) for every gas reserve project entered and/or held by any affiliate or subsidiary of NextEra Energy. The results for all gas reserve projects will be evaluated using the same forecast of natural gas prices used to project customer fuel savings for FPL gas reserve projects.

For any gas reserve projects secured pursuant to these guidelines, FPL will use an independent third party auditor in performing the audits of the associated transactions. FPL will work with Commission staff to develop the scope of these audits. In addition, FPL will use the necessary subaccounts, under the FERC system of accounting, which will correspond on a one-on-one basis with the oil and gas system of accounts used by the Gas Reserve Company set up to record FPL's investments in gas reserve projects.

### **III. SUPPLY DIVERSITY**

- Gas reserve projects will provide beneficial geographic diversity of fuel supply. Catastrophic events, such as hurricanes, affect FPL's ability to procure and deliver fuel. Investments in multiple gas reserves across various regions will reduce the impact of a single event disrupting FPL's entire fuel supply.
- Gas reserve projects also will increase the diversity of FPL's supply from a physical perspective, as well as a financial one. The longer time frame of these investments offers diversity when compared to the current financial and physical contract lengths in the existing hedging program.
- FPL intends over time to transact with a wide range of suppliers so as to minimize concentration of supply with any one producer. This will allow FPL to transact in multiple regions and will also provide for reduced credit exposure to any one entity. To minimize counterparty risk, FPL will only transact with producers that are also producers for existing gas reserve projects held by one or more NextEra Energy affiliates or subsidiaries.
- Guideline III.A: FPL will only enter into transactions for onshore gas reserve projects, located in areas with reserves that have a well-established history of gas production. Florida does not meet these criteria. In addition, FPL will only enter into transactions for gas reserve projects that involve wells classified as "Proved Reserves" or "Probable Reserves" as defined by the Securities and Exchange

Commission for public company reporting. Because one of the primary purposes of gas reserve projects is a physical source of supply to serve its natural gas needs, at least 50 percent of the wells in each gas reserve project must be classified as “Proved Reserves.” FPL will not enter into transactions for gas reserve projects that involve wells classified as “Possible Reserves.”

- Guideline III.B: Because one of the primary purposes of gas reserve projects is a physical source of supply to serve its substantial gas needs, 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. Texas, Louisiana, Oklahoma, Arkansas, Mississippi, Alabama, West Virginia, Ohio, and Pennsylvania currently meet this criterion. FPL will make use of its transportation portfolio, along with considering new physical paths. The costs of any new transportation needed to deliver gas from a gas reserve project will be taken into consideration when analyzing the economics of that project.

#### IV. CHARACTERISTICS OF GAS RESERVES

- Natural gas production consists of a combination of hydrocarbons, which can include methane, natural gas liquids (“NGLs”), and oil. The composition of natural gas production varies region by region and within individual regions.
- FPL’s natural gas plants burn primarily methane and can accommodate only a very small percentage of other hydrocarbons. However, there are active third party markets for purchase and sale of NGLs and oil.
- There are 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. FPL’s gas reserve portfolio would appropriately be comprised of a wide range of projects, including reserves that fall within each of those categories.
- Guideline IV.A: Although there is significant customer value in the production and sale of NGLs and oil, the purpose of FPL’s gas reserves program is to provide a source of physical supply of natural gas to serve its power plants. For that reason, FPL will only enter into a transaction for a gas reserve project if the estimated output of the wells in the project contains at least 50% from methane by volume.
- Guideline IV.B: All NGLs and oil produced from a gas reserve 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. The projected revenues from NGLs and oil produced from a gas reserve project will be taken into consideration when analyzing the economics of that project.

Flexibility to respond to market opportunities is in the best interest of FPL and its customers. Therefore, it is understood that FPL may (i) propose modifications to these guidelines in the annual update provided pursuant to Guideline I.B above, and (ii) seek Fuel Clause recovery for a project that deviates from one or more of the guidelines upon a showing that the project nonetheless is expected to benefit FPL



customers. In order to provide due process to all parties, any proposed modifications to these guidelines filed in August will be the subject of the hearing in the following year's Fuel Clause proceeding. To be considered in the current year's Fuel Clause hearing, any proposed modifications to the guidelines must be filed by March 1. Eligibility for Fuel Clause recovery of any gas reserve project that deviates from one or more of the guidelines will be considered on a case-by-case basis. Such projects must be filed with the Commission by March 1 to be considered in that year's Fuel Clause proceeding.