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Subject: Electronic Filing/Docket No. 080001-EI/FPL's Responses to Staff's Third Data Requests (revised filing)

Attachments: Response to Staff's Third Data Request.doc; Response to Staff's Third Data Request.pdf

Electronic Filing

a. Person responsible for this electronic filing:

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b. Docket No. 080001-EI

In Re: Fuel and Purchased Power Cost Recovery Clause with Generating Performance Incentive Factor

c. The document is being filed on behalf of Florida Power & Light Company.

d. There are a total of 5 pages.

e. The document attached for electronic filing is Florida Power & Light Company's responses to Staff's Third Data Requests, dated August 14, 2008. At the request of the Commission Clerk, the document has been revised from the one electronically filed yesterday to include an official signature of counsel on the document.

1. Order No. PSC-02-1484-FOF-EI allowed hedging for purchased power. FPL's proposed Hedging Order Clarification Guidelines address hedging for natural gas and fuel oil and for natural gas and fuel oil required to be provided under a purchased power agreement. Should directly hedging purchased power be excluded from the clarification guidelines? Please explain.

<u>Response:</u>
The clarification guidelines are not intended to restrict hedging activities to include only those related to purchased power agreements under which natural gas and/or fuel oil is self-provided. The guidelines are also intended to allow the inclusion of hedging activities related to purchased power agreements under which the purchasing utility does not provide the fuel but the pricing of the power is based on a fuel index. FPL would have no objection to clarifying the guidelines in this regard.

2. Please refer to Exhibit 1 and to IV.c. of the Hedging Order Clarification Guidelines.

   A. Since the beginning of 2003, has FPL's fuel price hedging activities reduced the volatility in the fuel factor? Please explain.
   B. Please provide calculations or other support for the idea that hedging activities reduce volatility in the fuel factor, i.e., reduce the period to period percentage change in the fuel factor.

<u>Response:</u>

A. As discussed further in response to Data Request 3 below, hedging reduces the volatility of fuel costs over time. This reduction in the volatility of *fuel costs* generally should be reflected in reduced volatility of the annual *fuel adjustment factors*. There can be exceptions, however, especially over the small number of years for which we have results to date. This is due to a variety of factors, but one of the more significant is the true-up mechanism, which can either dampen or increase the year-on-year changes in fuel factors depending on the pattern of fuel cost changes over time. The chart below shows the fuel adjustment charges that a residential customer would pay for 1000 kWh over the period 2003 to 2008 with hedges (i.e., the actual fuel factors approved for those years) and without hedges (i.e., using estimated factors in which the actual hedging results have been backed out). One can see that for most of the years shown, the increase or decrease in the fuel charges from one year to the next is considerably smaller with hedging than it would have been without hedging. While the increase in 2005-2006 was larger with hedging than it would have been without hedging, FPL considers this an anomaly.

	Hedging 1 year in advance ($/1000 KWh)	W/O Hedging ($/1000 KWh)
2003	37.11	40.63
2004	37.50	33.07
2005	40.09	42.76
2006	58.41	51.43
2007	52.95	48.87
2008(*)	52.27	57.14

(*) This study uses the 2008 pre-mid course correction fuel factors.
FPL also notes that hedges have reduced the need for mid-course corrections.

B. See response to part A above.

3. How can an IOU show that it has met the goal of controlling "volatility of fuel adjustment charges?" In other words, if a utility's results show "losses," but claims that the goal is not to have "gains" or avoid "losses," but rather, to control "volatility of fuel adjustment charges," how would the IOU show that it met that goal? Please include a measurement method that all parties can agree to as a fair measurement method.

Response:
When an IOU engages in hedging to fix the price of a portion of its natural gas and/or fuel oil requirements, by definition it has reduced the volatility of its fuel adjustment charges. For example, if an IOU engages in hedging transactions that fix the price of 50% of its natural gas requirements, the volatility on that 50% is reduced to zero as the price is known and will not change. Therefore, a percentage of its total fuel adjustment charge is no longer subject to market volatility. This percentage remains at a defined level. Whether an IOU hedges a small or large percentage of its fuel requirements it will have reduced volatility; however, as the volume of fuel hedged increases, the reduction in volatility increases.

4. Please refer to Exhibit 1 of the petition – Hedging Order Clarification Guidelines. Given the statement in IV. e., why is it necessary to have the following phrase in IV. b.?

"or attempting to anticipate the most favorable point in time to place hedges."

Response:

FPL acknowledges that the quoted phrase from Section IV.b overlaps with the subject matter of Section IV.e. FPL and the other IOUs felt that it was important to include the quoted phrase, however, because otherwise Section IV.b would refer only to the fact that a well-managed hedging program would not involve "speculation." The 2002 Hedging Resolution includes a definition of "speculative" which refers to "physically and/or financially purchasing more of a commodity than one is expected to consume, or physically and/or financially selling more of a commodity than one owns." This is a narrower usage of "speculation" than FPL and the other IOUs were intending to convey in Section IV.b, so FPL added the quoted phrase to make it clear that a well-managed hedging program also does not involve attempting to anticipate market conditions when placing hedges.

5. Regarding Section I.a., what is the level of detail your utility expects to report for Items 1, 3, 4-9, and 13-15?

Response:
FPL plans to include a level of detail that is consistent with recommendations in Staff's recent *Review of Fuel Procurement Hedging Practices of Florida's Investor-Owned Electric Utilities.* FPL's future Risk Management Plans will contain highly detailed information related to internal policies and procedures, risk evaluations, reporting, hedging strategies, hedge quantities and oversight. These topics are all covered in Items 1, 3, 4-9 and 13-15.

6. Regarding Section I.a., why does the guideline not include Items 2, 10, 11, and 12 of TFB-4 required by Order No. PSC-02-1484-FOF-EI?

Response:
Paragraph 2 of the Hedging Resolution that was approved in Order No. PSC-02-1484-FOF-EI sets forth the item numbers from Exhibit TFB-4 that are to be addressed in IOUs' risk management plans. Paragraph 2 directs IOUs to address Items 1, 3, 4-9 and 13-15 of Exhibit TFB-4 but does not include Items 2, 10, 11 or 12.

7. Regarding Section IV.b., is it correct that a utility's efforts to flexibly determine within any particular month the volume to be hedged during that month cannot be expected to reduce the volatility of fuel price hedging? As an example, is it correct that hedging a pre-set volume of natural gas purchases during a month when forward prices are at an historical high is not expected to increase fuel price volatility for the utility, even when the volume of natural gas hedged by all other hedgers in the nation declines substantially?

Response:
FPL's hedging program is currently designed to place hedges programmatically over a period of time one year prior to delivery. FPL's intention is to use strict and independent Risk Management oversight to avoid "outguessing the market" behavior, while retaining a measure of flexibility within a month to meet the pre- determined monthly hedge percentage targets. FPL does not have access to information that would be needed to benefit consistently from adjusting monthly hedging percentages in response to expected market conditions. Market prices during the last few years have repeatedly set new highs. Any attempt to pick a "top of the price curve" point and then not hedge or reduce hedging activities thereafter could have resulted in incremental costs to customers.

8. Regarding Section IV.g., does the guideline contemplate that the volume of the hedge will vary within the utility's implementation of this guideline only according to changes in the forecast of fuel burn and no other reason? Please explain.

Response:
FPL expects that the volume of its hedges will generally vary according to changes in the forecast of fuel burns. However, each IOU will have the flexibility to adjust hedge volumes based on other reasons as it deems necessary or appropriate.

9. Regarding Section IV.e., does the guideline contemplate that that the utility will base its hedge volume on a percentage basis rather than a volume basis?

Response:
FPL intends to base its hedge volume on a percentage of expected fuel requirements, but the guidelines are flexible to allow an IOU to use a volume basis instead.

10. Regarding Section IV.e., does the guideline contemplate a specific percentage to hedge rather than a percentage range to hedge for any fuel type?

Response:
The guideline is intended to provide sufficient flexibility to each individual IOU to determine whether it should hedge a specific percentage or within a percentage range for each fuel type.

11. Provide any documentation, including studies, reports, and risk management literature relied upon by your utility to support the idea that dynamically adjusting the volumes to be hedged based upon latest market conditions:

    A. Does not reduce fuel price volatility,

    B. Does not increase hedging gains, and

    C. Does not decrease hedging losses.

    Response:
    A-C. FPL does not have materials or evidence to show that dynamically adjusting the hedge volumes based on the latest market conditions is better or worse than the current programmatic hedging approach in terms of reducing price volatility, increasing or decreasing hedging outcomes. FPL has always stated that its hedge program does not try to time or "outguess" the market. FPL's hedge program does incorporate the latest fuel burns and adjust the hedge volumes through its rebalancing program.

Respectfully submitted,

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By: *_/s/ John T. Butler_*
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