

**BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION**

In re: Fuel and purchased power cost recovery ) Docket No. 150001-EI  
clause with generating performance incentive factor ) Filed: November 13, 2015

**POST-HEARING BRIEF AND STATEMENT OF ISSUES AND POSITIONS  
OF WHITE SPRINGS AGRICULTURAL CHEMICALS, INC.  
d/b/a PCS PHOSPHATE – WHITE SPRINGS**

Pursuant to the Commission’s Order Establishing Procedure in this docket, Order No. PSC-15-0096-PCO-EI, issued February 10, 2015, White Springs Agricultural Chemicals, Inc. d/b/a PCS Phosphate – White Springs (“PCS Phosphate” or “PCS”), files its Post-Hearing Brief and Statement of Issues and Positions in the above matter. Except as described below, the PCS Phosphate positions on issues remain as stated in the Prehearing Order No. PSC-15-0512-PHO-EI, issued October 29, 2015.

**I. Background**

This proceeding is the Commission’s annual fuel and purchased power cost recovery clause and generating performance incentive factor proceeding. Utilities must justify and support any proposed cost recovery and policies, and they maintain the burden of proof on all issues in the proceeding.

**II. Overview**

PCS Phosphate generally supports the positions taken by the Office of Public Counsel (“OPC”) and specifically endorses OPC’s position that the utilities’ current natural gas hedging practices, which have cost Florida consumers billions of dollars in net losses over the last decade, are no longer warranted and should be discontinued.

Because its operations are very electricity intensive, PCS is concerned with both the level of its electric power costs and the volatility of those costs. In the prevailing environment that

exists today, however, Duke Energy Florida, Inc.'s ("DEF" or "Duke") hedging practices are halfway measures that have proven to be an ineffectual approach that imposes substantial increased fuel costs on Duke's consumers. OPC has established that, over the last decade, the hedging losses associated with Duke's natural gas hedging practices have resulted in significant costs to Duke ratepayers, including PCS. Moreover, there is nothing in consensus energy outlooks for domestic oil and natural gas production that points to a sustained upswing in price or volatility that would warrant continuation of that flawed hedging approach. Accordingly, PCS urges the Commission to reject Duke's proposed risk management plan.

Also, the combination of DEF's increased reliance on natural gas for electric generation and the new-found but now-entrenched abundance of domestic production means that gas-fired generation will be on the margin for DEF during both peak and off-peak periods and that the corresponding dispatch costs for the utility during peak and off-peak periods will not exhibit the variation historically shown when DEF's baseload generation was primarily nuclear or coal-fired. This circumstance will flatten fuel clause peak and off-peak prices and mute the price signals that aim to help mitigate growth in peak demand, which is a key and express statutory goal under Florida's Energy Efficiency and Conservation Act ("FEECA"), Section 366.80, *et. seq.*, F.S. PCS requests that the Commission instruct DEF to assess in its 2016 clause filings alternative fuel peak and off-peak pricing approaches that will better serve FEECA's objectives.

Finally, PCS joins OPC, the Florida Retail Federation, and FIPUG in opposing FPUC's proposal to recover capital investment costs related to a proposed transmission interconnection through its fuel clause. The fuel clause is not an ersatz substitute for base rates, and FPUC has not established a basis for such inappropriate and extraordinary rate treatment.

### III. Specific Issues

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

**PCS Phosphate:** \*No. PCS agrees with the Office of Public Counsel. For the facts and reasons described in the testimonies of OPC witnesses Noriega and Lawton and in OPC's basic position, it is not in the best interest of the customers for the Companies to continue natural gas financial hedging activities.\*

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

**PCS Phosphate:** \*PCS agrees with the Office of Public Counsel. For the reasons described in the testimonies of OPC witnesses Noriega and Lawton and in OPC's basic position, the Commission should deny the Company's risk management plans as it relates to natural gas financial hedging activities and should suspend and end the practice of natural gas financial hedging.\*

**ISSUE 2B: Should the Commission approve DEF's 2016 Risk Management Plan?**

**PCS Phosphate:** \* No. PCS agrees with the Office of Public Counsel. The plan should not be approved as filed inasmuch as it would authorize the company to continue the financial hedging of natural gas.\*

### Argument

**A. The proposed utility risk management plans should be rejected as they do not benefit consumers.**

Based upon historic performance, utility fuel hedging practices reflected in their respective risk management plans are indefensible and have long outlived their utility to Florida consumers. Duke and other Florida utilities apply a largely mechanical process of hedging in increments the majority of their projected fuel burn for oil and natural gas burning generators.<sup>1</sup> The current process aims to reduce volatility in the fuel costs that are billed to consumers but makes no effort to optimize fuel costs.<sup>2</sup> This approach stands in stark contrast to the practices of power market participants which commonly employ hedging to mitigate volatility as well as

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<sup>1</sup> Tr. 470-72.

<sup>2</sup> Tr. 465.

other risks. As is explained below, the formulaic, largely judgment-free hedging approach now employed in Florida in the declining cost fuel marketplace that has prevailed for quite a number of years – and is generally expected to continue for the foreseeable future—has shackled the state’s electric consumers with billions in net hedging losses passed through in rates through the fuel clause. The hedges are flawed because the process is flawed, and that practice should be discontinued.

With or without hedging, consumers bear the entire risk of fuel price fluctuations because all prudently incurred actual utility fuel costs are billed to consumers. The questions of whether to hedge, to what extent and the timing of hedging transactions requires an assessment of market trends and risks as well as the expected quantity of fuel to be burned. DEF’s witness McCallister explained that DEF regularly tracks relevant fuel developments and trends, including rig counts, economic factors affecting demand, forecasted production, and potential federal actions that would enable or facilitate oil and natural gas exports,<sup>3</sup> but that information and informed judgment are not reflected in the utility’s hedging actions.<sup>4</sup> As a result, DEF, and other Florida utilities, have continually locked in money-losing hedges as domestic oil and gas production accelerated and fuel market prices steadily dropped.

OPC has accurately noted that setting of an annual fuel factor based on average costs effectively smooths short term fuel price swings.<sup>5</sup> Duke also has conceded that it would not continue hedging as provided under its Risk Management Plan if the utility was in any way at risk with respect to the outcome (*i.e.*, if shareholders had any stake in the success of hedging

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<sup>3</sup> Tr. 481-84.

<sup>4</sup> *Id.*

<sup>5</sup> Tr. 828-29.

practices.<sup>6</sup> Thus, there are really two questions presented:

1. Under current market conditions, is there any value to consumers in continuing hedging at all?
2. If utilities continue to hedge fuel costs, do their current hedging practices benefit or burden consumers?

The record demonstrates that there is little continued justification for substantial hedging of oil and natural gas costs and that DEF's approach described in its risk management plan is wholly inadequate in any event.

OPC witness Lawton catalogued oil and gas developments that are obvious to all. Oil and natural gas prices have significantly declined, and overall fuel price volatility has declined as well as shale-driven domestic oil and gas production has overwhelmed demand.<sup>7</sup> OPC demonstrated that prevailing hedging practices have mechanically locked in prices in a falling price environment and consequently saddled consumers with serious net hedging costs when common sense would have dictated reduced hedging levels in response to these otherwise highly favorable trends. This circumstance mandates a reassessment of the value to consumers of hedging in general as well as current hedging practices. A skeptic might suggest nonetheless that the hedging losses incurred as fuel prices declined may be offset someday by hedging benefits realized if and when those prices begin to rise or demonstrate material volatility. The problem is that this requires some value judgment concerning the risks and likelihood that either or both of those eventualities recurring. The record in this case simply does not provide a rational basis for such findings. In fact, OPC has persuasively established that volatility risks have effectively been abated by abundant domestic production.

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<sup>6</sup> Tr. 490.

<sup>7</sup> See generally Lawton testimony at Tr. 820-72.

As a country, the United States had become over the past twenty years accustomed to being an oil and gas debtor nation. For many years, domestic production had been on the wane, rising levels of oil imports were a constant concern and a national security problem, and numerous proposals were proposed prior to 2010 to construct liquefied natural gas port facilities for the purpose of importing LNG to meet the nation's growing demand for gas, with most of that increased demand being tied to the electric generation sector. In almost breathtaking fashion, that picture has been shattered by successful deployment of horizontal drilling techniques. Today, the U.S. is literally awash in economically recoverable domestic oil and natural gas, and all competent forecasts of those resources and pertinent market forces point to continued excess of supply through the next decade.<sup>8</sup> Among the many permutations of this startling turn of events is the fact that although short term fuel price run-ups could occur in response to unusual weather or other discrete events, substantial fuel price volatility cannot reasonably be expected to persist in the face of the country's excess supply and production capabilities. As a consequence, the value proposition for Florida consumers of the utilities' current hedging practices is wholly lacking.

Moreover, because the utilities studiously avoid applying informed judgment in their hedging decisions today, the Risk Management Plans are structurally deficient. There is no dispute in this proceeding that current natural gas hedging practices have resulted in large costs to consumers in the form of higher fuel costs than would have been incurred absent the companies' natural gas hedges. Duke, for example, incurred over one billion dollars in hedging losses from 2002 to 2014.<sup>9</sup> These losses, which represent real costs to consumers in fuel clause

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<sup>8</sup> Tr. 857-61.

<sup>9</sup> Tr. 474-75.

charges, are borne entirely by Duke customers.<sup>10</sup>

To be clear, PCS strongly supports both lowering overall utility fuel costs and reducing fuel price-induced volatility in consumer electric bills. Both are important goals. Moreover, PCS certainly does not conceptually oppose hedging approaches designed to advance both objectives. However, current practices that only seek to mitigate fuel price volatility at a time when volatility simply is no longer the concern it once presented imposes a cost burden that cannot be justified.

All consumer representatives appearing in this docket share common concerns with PCS with respect to fuel price volatility and overall fuel clause costs. These parties, having reviewed the utilities' hedging practices and historical performance, uniformly oppose continuing a practice that imposes substantial costs without providing a remotely corresponding benefit. PCS agrees with OPC, FRF and FIPUG that the Commission should reject the outmoded proposed risk management plans as proposed by the utilities.

**ISSUE 4A: Should FPUC be permitted to recover the cost (depreciation expense, taxes, and return on investment) of building an interconnection between FPL's substation and FPUC's Northeast Division through the fuel recovery clause?**

**PCS Phosphate:** \*No. The Florida Public Utilities Company's proposal to recover the costs of an interconnection project through the fuel recovery clause would be an inappropriate use of the fuel recovery clause and should be denied.\*

PCS agrees with OPC, FIPUG and FRF that FPUC's request to recover the capital costs of a transmission interconnection with Florida Power & Light ("FPL") through its fuel clause should be rejected. As those parties have correctly explained, the recovery of transmission line investments are traditionally and properly addressed in base rates. The fuel recovery clause is a

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<sup>10</sup> Tr. 475.

funding mechanism intended to recover the costs of fuel, without profit, that the utility incurs.<sup>11</sup> Capital costs such as the costs of interconnection between FPL's substation and FPUC's Northeast Division are not related to fuel costs, even tangentially, in a manner that would allow them to be recovered through the fuel clause. FPUC seems to have conceded this fundamental rate-making point when it acknowledged that it planned to eventually move the project costs to base rates when the utility next files for base rates.<sup>12</sup>

Among a host of other concerns, transmission costs are typically allocated for cost recovery purposes using a demand allocator, while fuel clause charges are typically allocated and recovered on an energy basis.<sup>13</sup> Consequently, FPUC's proposal would have created a very basic misallocation of costs and cost recovery.

Finally, as other parties have addressed, FPUC has maintained that the proposed interconnection is a sound project that will benefit its consumers.<sup>14</sup> They have also established that no potential fuel savings could be realized under the project until the end of 2017. Thus, it would be imprudent for FPUC to defer the project until a new rate case is filed, and there is ample time for FPUC to prepare such a filing if the company deems it warranted. In sum, there is no credible basis for FPUC's request to recover the proposed project costs through its fuel clause, and the Commission should deny that request.

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<sup>11</sup> See *In Re: General Investigation of Fuel Adjustment Clauses of Electric Companies*, 1974 Fla. PUC LEXIS 70, Docket No. 74680-CI, Order No. 6357 at 6 ("It should be emphasized that a utility does not make a profit on its fuel costs.").

<sup>12</sup> Tr. 565-66.

<sup>13</sup> FPUC's witness was not familiar with how the proposed costs would be allocated for cost recovery purposes. Tr. 565.

<sup>14</sup> Tr. 599-601.

**ISSUE 23: What are the appropriate fuel cost recovery factors for each rate class/delivery voltage level class adjusted for line losses?**

**PCS Phosphate:** \*The loss of DEF’s nuclear generation and reductions in its coal-fired generation will lead to a shrinking differential between peak and off-peak fuel rates that is inconsistent with core statutory objectives set forth in FEECA. Section 366.81, F.S. The Commission should direct DEF to address this concern in its next fuel factor filing.\*

FEECA establishes a state policy to promote energy efficiency, renewable energy and other actions to encourage more efficient energy end use. The statute expressly stresses that “reduction in, and control of, the growth rates of electric consumption and of weather-sensitive peak demand are of particular importance.”<sup>15</sup> Also, the statute is to be liberally construed to accomplish FEECA’s core objectives. Certainly, improved price signals, particularly concerning usage during peak periods, is an important element that must be addressed. In DEF’s case, the utility develops time of use (on and off peak), voltage-adjusted fuel factors from its levelized fuel factor using TOU multipliers linked to its monthly on and off peak marginal costs.<sup>16</sup> As DEF increasingly relies upon gas-fired generation for baseload, intermediate, and peaking generation, the marginal fuel cost variance between on and off peak periods likely will shrink and diminish the price significance of TOU prices based on average annual costs. PCS is aware that Duke Energy employs different approaches for developing time of use fuel factors in other jurisdictions that it serves and asks the Commission to direct DEF to evaluate alternative approaches for setting time of use fuel factors that may better serve FEECA’s goals in its 2016 clause filings.

**IV. Conclusion**

For the reasons stated herein, PCS Phosphate urges the Commission to (i) reject the DEF

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<sup>15</sup> Section 366.81, F.S.

<sup>16</sup> See Exhibit 24, (CAM-2, Sch. E-1).

proposed risk management plan, (ii) reject FPUC's proposal to recover the cost of building an interconnection facility through the fuel recovery clause, and (iii) direct DEF to reevaluate its approach to developing time of use fuel factors in its 2016 clause filing.

Respectfully submitted,

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Dated: November 13, 2015

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a true copy of the foregoing has been furnished by electronic mail and/or U.S. Mail this 13th day of November, 2015, to the following:

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