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DUKE ENERGY FLORIDA

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VIA ELECTRONIC FILING

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

Re: *Fuel and purchased power cost recovery clause with generating performance incentive factor; Docket No. 160001-EI*

Dear Ms. Stauffer:

On behalf of Duke Energy Florida, LLC ("DEF"), please find enclosed the Rebuttal Testimony of Joseph McCallister for the above referenced docket.

Thank you for your assistance in this matter. Please feel free to call me at (850) 521-1428 should you have any questions concerning this filing.

Respectfully,

s/Matthew R. Bernier

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MRB/mw
Enclosures

Duke Energy Florida, LLC
Docket No.: 160001
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished via electronic mail this 30th day of September, 2016 to all parties of record as indicated below.

s/Matthew R. Bernier

Attorney

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DUKE ENERGY FLORIDA

DOCKET NO. 160001-EI

REBUTTAL TESTIMONY OF JOSEPH MCCALLISTER

September 30, 2016

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Joseph McCallister. My business address is 526 South Church Street, Charlotte, North Carolina 28202.

Q. Have you previously filed testimony in this docket?

A. Yes, I filed direct testimony on April 6, 2016 and August 18, 2016.

Q. Have your duties and responsibilities remained the same since you last testified in this proceeding?

A. Yes.

II. PURPOSE AND SUMMARY OF TESTIMONY.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide rebuttal to, and additional context regarding, the September 23, 2016, direct testimonies of Staff's witnesses Mr. Michael Gettings and

Mr. Mark Ciccheti, and the Office of Public Counsel's ("OPC") witness Mr. Daniel Lawton.

Q. Please summarize your rebuttal testimony.

A. Mr. Gettings' testimony summarizes a hedging definition and framework that represents a departure from this Commission's existing hedging policy, definition, and objectives. If the Commission decides to adopt in full or in part the concepts included in Mr. Gettings' testimony, the Company will comply with the Commission's directive and look at amending its hedging parameters on a prospective basis to provide natural gas cost risk mitigation while further attempting to minimize hedge costs utilizing risk parameters developed from those concepts. However, to accomplish this the Company believes more information and a workshop forum are needed to ensure a full understanding of the concepts and requirements, to ensure any updated hedging program parameters and reporting are consistent with any amended or new policies, and provide time for implementation. In addition, the form and content of future Commission reviews of any new or amended hedging program parameters need to be more fully developed and understood. Mr. Ciccheti endorses Mr. Gettings' proposal and provides a recommendation regarding the timeline for implementation, and therefore the same points above are applicable to his testimony. I also clarify one statement in Mr. Ciccheti's testimony. Lastly, I provide an observation on the testimony of Mr. Lawton.

Q. Are you sponsoring any exhibits to your testimony?

A. No.

III. REBUTTAL TESTIMONY.

Q. Please discuss the organization of your rebuttal testimony.

A. My rebuttal testimony will focus on three overall topics: First, Mr. Gettings' proposal, endorsed by Mr. Cicchetti, represents a shift away from this Commission's existing policy and goals for the approved hedging programs. Second, further details and analysis are needed to develop specific updated hedging parameters and approaches as outlined in Mr. Gettings' summary testimony to ensure the hedging parameters, execution activities, and any additional required reporting are consistent with the Commission's desired approach and are reviewed and approved prior to implementation. Third, given the current status of its hedging activities for 2017, the Company believes any prospective changes to hedging activities should occur beginning no sooner than the submittal of the 2018 Risk Management Plan. This will allow time for the Company to work collaboratively with the parties to further develop, review, and submit any necessary updates to its existing, approved Risk Management Plan.

Q. Do the policy and objectives outlined in Mr. Gettings' proposal match the Commission's current hedging policy and objectives as outlined in its previous orders?

A. No. The policy and objectives as summarized in Mr. Gettings' proposed approach represent a shift away from current Commission policy and objectives. In Order No. PSC-08-0667-PAA-EI, Attachment A, page 2 of 3, the Commission recognized appropriate guiding principles for hedging practices, including:

a. The Commission finds 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 purchase power energy costs) that the IOU must pay in order to provide electric service.

b. The Commission finds that a well-managed hedging program does not involve speculation or attempting to anticipate the most favorable point in time to place hedges. Its primary purpose is not to reduce an IOU's fuel costs paid over time, but rather to reduce the variability or volatility in fuel costs paid by customers over time.

c. The Commission endorses the goal of controlling volatility of fuel adjustment charges and finds that hedging is a useful tool for this purpose.

d. The Commission acknowledges that hedging can result in significant lost opportunities for savings in the costs to be paid by customers, if fuel prices actually settle at lower levels than at the time that hedges were placed. The Commission recognizes this as a reasonable trade-off for reducing customers' exposure to fuel cost increases that would result if fuel prices actually settle at higher levels than when the hedges were placed. The Commission does not expect an IOU to predict or speculate on whether markets will ultimately rise or fall and actually settle higher or lower than the price levels that existed at the time hedges were put into place.

In comparison, Mr. Gettings summarizes "[t]he purpose of hedging is to minimize customer pain associated with energy-price (or customer-cost) increases[]" and further "[i]t is self-evident that the primary reason for hedging is to mitigate upside cost exposures, and the potential for hedge losses is an associated consequence which needs to be managed as well." (Gettings, p. 4, ll. 20-21 & p. 7, ll. 9-11). Therefore, the purpose or reason for hedging provided by Mr. Gettings is in conflict with the current policy.

DEF has designed and operated its existing, approved fuel-cost risk management activities to comply with the Commission's guidelines expressed in Order No. 08-0667, and this Commission has found DEF's hedging activities to be prudent towards achieving those goals. While the Commission retains its authority to alter its policies as it deems appropriate, a shift such as proposed by Mr. Gettings would redefine the current policy. In addition, specific risk, price, and/or cost parameters will need to be established to ensure the Company is operating within any new definition and policy that, if approved by the Commission, would include minimizing gas hedge costs while providing upside gas cost risk mitigation as a hedging program objective.

Q. On the second topic, can you elaborate on why the Company needs further details of Mr. Gettings' approach and assumptions?

A. Yes. If the Commission desires to adopt in whole or in part the policies, strategies, and concepts provided by Mr. Gettings, the Company will work with the Commission, staff, and other parties to develop specific updated hedging parameters and approaches to ensure the resulting updated risk management plans, execution activities, and any required reporting are consistent with the Commission's desired approach to allow for review and approval prior to implementation.

However, additional details and clarifications are necessary because the proposal as it appears in Mr. Gettings' testimony does not provide the specificity necessary to guide development of a workable hedging program. To establish an updated hedging plan that follows a new hedging policy and definition utilizing concepts outlined by Mr. Gettings, the Company believes clear risk and hedging parameters need to be vetted and established up front to ensure understanding before execution approaches are altered.

To provide some illustrative questions requiring further clarification on approach and regulatory reviews, the Company would need direction on items such as what minimal percentage of "programmatic hedges" would be accepted and for what term? Would all of the companies be expected have the same percentage level of programmatic hedges? For the risk metrics proposed, is there a preferred method to be used for performing the underlying VAR calculations and is the Company to use a certain holding period and confidence interval to calculate the metrics outlined, or is that left to the Company's discretion? Using these risk metrics, if the Company determines a certain upside price level becomes a new hedging price target, who determines if this is a prudent price level to establish a defensive hedging strategy trigger? Does this price level need to be reviewed and approved by the Commission before it is implemented? What hedge-cost projections or hedge-cost actuals would trigger the Company to execute a prudent, Commission-approved contingent hedge strategy response, possibly involving selling previously executed programmatic and defensive hedges and possibly repeating the buying and selling of hedges in this manner as prices and volatility continue to adjust? Because changes in the relative prices of gas, coal, and power prices, as well as load forecast, can impact periodic gas burn projections used to monitor hedge percentages at any given point in time, would other analyses of these factors also be required with respect to impacts on overall potential costs and the percentage of hedge positions at any given point in time?

These questions are not intended to be all inclusive and not intended to be critical of the concepts submitted by Mr. Gettings. However, if the Commission elects to move in the direction recommended by Mr. Gettings, from the Company's perspective these questions outline the importance of having clear and specific direction on the parameters before an updated framework can be fully developed and established to ensure prospective plans are consistent with the Commission's direction. The Company believes workshop forum sessions with the Commission staff, the other companies, and other interested stakeholders would benefit all parties to ensure any new approach is implemented in a desired and consistent fashion. This would also provide time for the Company's fuel, risk, and quantitative personnel to fully understand and evaluate the needed calculations to support any new requirements and verify that calculations can be performed in a manner consistent with the concepts and any reporting requirements. Finally, within the context of the concepts summarized by Mr. Gettings, these working sessions will provide the opportunity for companies to work closely with the stakeholders to outline other hedging instruments and parameters that could be employed to accomplish the objectives Mr. Gettings outlined.

Q. Can you elaborate on the status of the Company's hedging activities under its currently approved plan and how this would impact the timing of implementing changes to hedging protocols?

A. Yes. Currently, DEF is hedging consistent with its approved 2016 Risk Management Plan and is near its 2017 target hedging percentage outlined in that plan. Thus, any changes the Commission may desire to implement consistent with Mr. Gettings' proposal would need to begin with periods no earlier than 2018. Therefore, the Company agrees with Mr. Cicchetti that the Commission should approve its submitted 2017 Risk Management Plan, which incorporates further hedging target reductions from those DEF proposed in Docket No. 160096-EI.

In addition, as summarized above, the Company needs further clarification on the concepts and protocols summarized by Mr. Gettings and time to familiarize itself with those concepts. With respect to the potential time needed for reviews and implementation, the Company would like to have further discussions with the stakeholders after gathering additional details on hedging parameters, execution approaches, and regulatory reviews to ensure a reasonable implementation schedule. I note that Mr. Gettings' *White Paper Regarding Utility Hedging Regulation* ("*White Paper*"), provided to the Washington Utilities and Transportation Commission ("WUTC") as part of its hedging policy review docket, included a milestone summary that outlined a full implementation period of roughly two and a half years. Mr. Gettings' summary testimony in this docket did not include such a draft working milestone schedule. DEF believes that if the Commission desires to implement this approach, part of the stakeholders' review should include development of any needed milestone schedule after additional information and details have been discussed.

Q. If the Commission desires to implement the changes being proposed, would the workshop sessions you have discussed result in unnecessary delay?

A. No. As noted herein, Mr. Gettings' proposal lays out a new framework for the financial hedging of natural gas that differs from the Commission's current policies and direction. Moreover, the framework provided in his testimony requires additional detail, analysis and discussion before it can form the basis of modified hedging parameters, execution strategies, and regulatory review. If the Commission decides that the concepts he outlines should be implemented, in my opinion the best forum for all stakeholders to come together and work out the details of how they can be implemented is a workshop, not an evidentiary hearing. That said, it should be recognized that implementation of these changes, if desired, will likely take time. Although I am not familiar with the details of what has occurred in the WUTC review, I note from a review of Mr. Cicchetti's Exhibit No. _ (MAC-4), page 3 of 3, and the online docket listing that the WUTC's review into natural gas hedging practices appears to have been open and ongoing since October of 2013, and Mr. Gettings' *White Paper* was filed over 14 months ago.[1] I provide this information not to suggest that this is the timeline that should be expected in

[1] http://www.utc.wa.gov/docs/Pages/DocketLookup.aspx?FilingID=132019.

Florida, but simply to underscore the point that if these changes are going to be implemented, it will likely take some time to review and ensure it is done consistent with any objectives.

Q. Does Mr. Gettings discuss the form of regulatory review the Commission should use to determine prudence under his proposal?

A. Yes. He briefly outlines that his regulatory review process is to require contemporaneous weekly risk measurement and monitoring from the customers' perspective, provided to the Commission quarterly. He states that "the very existence of contemporaneous weekly risk metrics will change behavior and eventually inform prudence determinations . . . Strategy formulation would be left to utility management, but after one-year of reporting risk metrics, I would expect strategies to reflect lower programmatic hedge targets, relying more heavily on defensive hedge protocols and contingent response plans to constrain hedge loss potential." (Gettings, p. 29, ll. 18-24). He also states "Later as experience is gained, the Commission might consider making a policy statement indicating a rebuttable presumption of prudence if key strategy elements are incorporated in the risk management plans and then executed per plan." (Gettings, p. 30, ll. 13-15).

Q. Do you have any observations regarding this regulatory review framework?

A. Yes. First, it is a framework for review that does not necessarily have a standard of review until "experience is gained" at which point certain undefined "key strategy elements" can be incorporated into the plan and then actions taken pursuant to the plan would carry a rebuttable presumption of prudence. Prior to the point where experience exists to guide the Commission's review, there is no discussion of what the Commission should use as a standard for evaluating a Company's risk management plan or what standards will be used to evaluate the prudence of the Company's hedging program executed pursuant to that plan. This is another area where a workshop and further discussion would be beneficial for all stakeholders to gather additional information and specific criteria that would guide the Commission's review.

Q. Are the lack of clear and defined upfront standards described above your only observation?

A. No. I am also concerned that, given the proposed shift in goals from a reduction in fuel price volatility to a management of fuel cost risks while balancing both mitigation of upside cost risks as well as potential hedge costs, the annual fuel clause proceeding could become bogged down in an after-the-fact review of any and all individual hedging transaction decisions made by the Company, but with the benefit of perfect hindsight. Without some prescribed standards or specific objective parameters, this could require the Commission to perform a subjective review of potentially hundreds of transactions, after the fact, substituting its judgment for the previously approved hedging plans. This subjective review approach has the potential to call into question the importance of the approved risk management plan and a company's ability to rely on the parameters established in the approved plan, reducing regulatory certainty.

Q. What statement in Mr. Cicchetti's testimony did you want to address?

A. With respect to one comment made in Mr. Cicchetti's testimony, on page 16, lines 3-4, Mr. Cicchetti states that DEF's proposed 2017 Risk Management Plan does not reflect the modifications proposed in Docket No. 160096-EI, which could be misunderstood. To clarify, as described in the Plan itself, in light of the discussions held during the Agenda Conference approving the joint petition, DEF made further reductions from those proposed in the joint petition to its hedging target ranges for the 13-24 month and 25-36 month timeframes.

Q. Do you have any observations regarding Mr. Daniel Lawson's Testimony?

A. Yes. As part of effective fuel cost management, DEF believes managing fuel price volatility risk over time for a portion of its projected fuel costs is a prudent risk management practice given its fuel mix. It is proper for the Commission to review, and if it determines it is necessary to do so, to revise or eliminate its policies regarding financial hedging of natural gas. The Commission's hedging program acts to serve customer interests and not the interests of the Company. We agree that customer views and opinions on these policy issues are important for the Commission to consider. If the Commission determines that hedging should be changed, revised, eliminated, reduced in scope, or replaced with something new, DEF will comply with the Commission's will.

Q. Does this conclude your testimony?

A. Yes.