BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power Corporation's Earnings, Including Effects of Proposed Acquisition of Florida Power Corporation by Carolina Power & Light	DOCKET NO. 000824-EI Submitted for Filing: February 11, 2002

REBUTTAL TESTIMONY
OF
ROBERT H BAZEMORE

ON BEHALF OF
FLORIDA POWER CORPORATION

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REBUTTAL TESTIMONY OF ROBERT H. BAZEMORE, JR.

ON BEHALF OF FLORIDA POWER CORPORATION

I. Introduction

Q. Please state your name.

A. Robert H. Bazemore, Jr.

Q. Did you submit Direct Testimony in this case on November 15, 2001?

A. Yes, I did.

Q. Have you reviewed the pre-filed testimony filed by witnesses sponsored by OPC witnesses Kimberly Dismukes and Donna Deronne in this docket?

A. Yes, I have.

Q. What is the purpose of the testimony you are filing at this time?

A. I am submitting this testimony to rebut the pre-filed testimony of those witnesses.

Q. Are you sponsoring any exhibits to your rebuttal testimony?

A. Yes, I am sponsoring one rebuttal exhibit. RHB 5 is a composite exhibit consisting of a letter, an e-mail, and an analysis relating to Nuclear Electric Insurance Limited ("NEIL") insurance.

II. Cost Allocation

Q. Witness Kimberly Dismukes argues that the Service Company has allocated costs too heavily to Florida Power, causing the Company's ratepayers to subsidize Progress Energy's non-regulated business interests. Is she correct?

A. No, she is not correct, for several reasons. First, it is important to recognized that the Service Company allocates costs to affiliates based on the extent to which they benefit from a particular product or service. In general, the regulated businesses are more highly centralized around common systems and technology platforms than non-regulated affiliates. These regulated businesses have similar needs and reporting structures, making centralization possible. By contrast, our non-regulated businesses as a rule have their own corporate and administrative functions and do not utilize the Service Company to meet those needs. Accordingly, the Service Company naturally allocates more charges to the regulated affiliates than to non-regulated affiliates.

Ms. Dismukes assumes that each of the non-regulated businesses will be served fully by the Service Company. For the reasons I have given, this is not the case. For example, she cites Westchester Gas Properties as an example of growth on the non-regulated side. But this deal has not yet closed, and Progress Energy has made no determination regarding which services the Service Company might provide to Westchester in the future.

Second, Ms. Dismukes assumes that any growth on the non-regulated side would be absorbed through existing capacity in the Service Company (if the

Service Company provides any support at all), meaning that the total original cost pool would not increase with the addition or expansion of affiliates. This is not an accurate assumption. Both the allocation metrics and Service Company departmental budgets would need to be recalibrated for a significant expansion.

Third, while it is true that Progress Energy's non-regulated business interests are expanding, Progress Energy is enjoying substantial growth on the regulated side as well. The test case allocation data that we filed with the Commission does not reflect anticipated growth of Florida Power's capital expenditures, which are forecasted annually to be in the range of $400-$500 million per year.

Q. Ms. Dismukes also argues that Florida Power's cost allocation should be reduced by $8 million to take into account changes pertinent to the 2002 test year. Do you agree?

A. No, I do not. That would not be appropriate. Ms. Dismukes' proposed adjustment is not based on a fair or accurate assessment of the actual facts. The basis of her calculation was to use the asset method currently proposed by Progress Energy to the SEC. Contrary to what Ms. Dismukes proposes, we may not use the asset method for allocating costs at this time because the SEC has not yet approved our request to adopt that method.

In addition, her analysis does not consider that many elements of the cost structure can change. For example, there has been an $8 million increase in pension expense (due to a decrease in the pension credit) since the date we filed testimony in November 2001. The test case data were filed with the best information available at the time. Florida Power has committed to provide the Commission our final 2002 budget.

Q. Ms. Dismukes contends that an adjustment should be made to disallow $1.4 million in costs allocated to Florida Power for executive use of aircraft. Do you agree?

A. Yes, we accept this proposed adjustment. We included it in our filing through inadvertence.

III. <u>Administrative and General Operating and Maintenance Expenses</u>

<u>*Salaries and Wages Expense*</u>

Q. Ms. Deronne argues (at pp. 25-34) that 2002 projected salary and wage expenses do not incorporate the full impact of cost savings that will likely result from employee reductions. Do you agree?

A. No, I do not. The full impact of the cost savings resulting from headcount reductions are incorporated in the 2002 salary projections in the rate case. The Company incorporated $58.7M of cost savings triggered by the merger in the 2002 projected test year, and to the extent those cost savings represent reductions in salaries and wages they have been reflected in the 2002 projections.

The 4,200 headcount number referenced on MFR Schedule C-33 was not used to develop the payroll expense included in the test year. The payroll expense dollars included in the test year were estimated by starting with the 2001 budget, incorporating any additional synergies expected in 2002, applying a merit increase factor, and adding expenses related to changes in business practices or work scope.

There was no specific headcount information for 2002 available at the time of the rate filing. The 4,200 was an estimate based on the staffing level at that time. Although we agree that additional positions remained to be eliminated in 2001 and 2002, we also had vacant positions to fill over the same time period. The Florida Energy Delivery business unit alone was reporting 170 vacant positions at that time. The actual 2001 year-end headcount for total regular employees was 4,240.

Employee Benefits—Medical Expense

Q. Based on her contention that Florida Power is likely to terminate additional employees, Ms. Deronne argues (at p. 34) that employee benefits must be correspondingly reduced. What is your response?

A. I do not agree. The Company's forecast for medical expense should not be adjusted. Ms. Deronne in part bases her adjustment on a November 30, 2001 headcount of 4,176 compared to the Company's forecasted average for 2002 of 4,200. She fails to acknowledge that changes in month-to-month headcount are frequently driven by routine employee turnover and the lag in filling vacant positions. The regular full-time employee headcount increased in December 2001 to 4,210 compared to November's 4,176. Statistically, the Company's forecast of 4,200 appears reasonable and should not be adjusted.

More specifically to medical expense, a number of variables are required in arriving at an overall determination of forecasted medical expense, *e.g.*, headcount, claim activity, the rate of inflation in health care costs, etc. Ms. Deronne is attempting to reduce the Company's estimate selectively, based on a small fluctuation in a single variable.

The reasonableness of the Company assumption that 4,037 employees would participate in the medical plan is borne out by looking at the January 2002 participation rate of 3,990 employees, representing a 1 percent variance from our estimate. The participation during the year 2002 is not expected to change dramatically from the 3,990 in either direction.

<u>Employee Benefits—FAS 106</u>

Q. Ms. Deronne proposes (at p. 35) an adjustment on Schedule C-6 for Employee Benefits (FAS 106) to bring them in line with the most current actuarial results. Do you agree?

A. Yes, I agree with Ms. Deronne's adjustment because the amount to be recorded by the Company in 2002 under FAS 106 is normally based on an annual specific actuarial study. We are unaware of any information that would cause the results for 2002 to vary significantly from the updated actuarial forecast provided by the Company in response to Citizens' Interrogatory No. 150.

I would also point out that, consistent with Ms. Deronne's FAS 106 adjustment, the Company has just received an updated actuarial forecast for Pension Expense FAS 87 for 2002 based on actual "Pension Plan Assets" as of December 31, 2001. These year-end asset values will be used in the development of the final Actuarial Report for 2002 that will be the basis to record Pension Expense (Benefit). The continuing decline in the Pension Plan asset value from the November 15, 2001 update in Exhibit MAM-5, page 1 of 3 will result in a further decrease of $8.8 million (system) in the forecasted Pension Benefit for 2002. The latest Actuarial Forecast for Pension Expense (Benefit) is projecting a benefit of $22.6 million (system) for 2002 compared to the $54.5 million (system) in the September 14, 2001 MFR C-66 and the $31.4 million (system) effectively contained in Exhibit MAM-5 through the adjustment of the September 14, 2001 MFR filing by $23.1 million (system).

Employee Benefits—FAS 112

Q. **Ms. Deronne further suggests (at pp. 35-36) that Florida Power has miscalculated projected Employee Benefits (FAS 112 health benefits for disabled employees and salary continuation costs) for the 2002 test year, and she proposes to remove the Company's projected 2002 test year increase in**

miscellaneous employee benefit expense for FAS 112 costs. What is your response?

A. I disagree with Ms. Deronne's position. The FAS 112 cost projections are entirely appropriate. Ms. Deronne has apparently misunderstood our response to Citizen's Interrogatory No. 84. The Company was not claiming that it provided no benefits to the disabled. The Company's pre-2002 benefit plan provided for the disabled to become "retired employees" subject to normal pension and retiree health and life coverage. Therefore, the costs related to those who were disabled prior to 2002 are reflected in FAS 87 expenses for pension and FAS 106 expenses for health and life. Beginning in 2002, newly disabled employees are subject to a separate disability plan and are not considered retired. Accordingly, the costs for the newly disabled must be accrued under FAS 112 rather than reflected in FAS 87 and FAS 106 expenses. So there is no double-counting of costs.

As Ms. Deronne points out, the projected FAS 112 costs were estimated based on corresponding costs incurred by CP&L. We determined that this approach was reasonable through discussions with our actuaries, due to the similarities in the two companies' employee age distributions, salary levels, and cost of health and life coverage.

With regard to the $807,528 of FAS 112 salary continuation costs, Ms. Deronne asserts that "no accounting has been made for the current benefits being received by disabled employees." Ms. Deronne is mistaken. This amount relates to employees who are newly disabled in 2002. (The costs for disabled employees prior to 2002 are reflected in FAS 87 costs.) Ms. Deronne misunderstands the requirements of FAS 112 and the salary continuation information she references. She states that a "disabled employee would receive an average annual salary continuation amount of $131,663.50 while that employee is disabled." That is not correct. FAS 112 requires that expense be accrued at the point of disability for the full amount to be incurred during the disability period (on a present value basis). Thus, the $131,663.50 does not represent "an annual average" amount, but represents the average full amount to be paid during an employee's disability period.

Therefore, Ms. Deronne's recommendation that FAS 112 costs be removed is clearly not appropriate.

<u>Miscellaneous Benefits—Change in Control Cash Payment</u>

Q. Ms. Deronne (at pp. 38-39) recommends that the projected 2002 executive benefits expense of $81,250 for Change in Control Cash Payments be removed. Is that acceptable to you?

A. Yes, we accept this adjustment.

<u>Nuclear Property and Liability Insurance Costs</u>

Q. Ms. Deronne recommends (at pp. 44-46) that the Company's projected 2002 NEIL credit ($4,585,097) be replaced with the actual 2001 credit amount

($6,285,895), since the latter is the most recent, known amount. Do you agree with her recommendation?

A. No, I do not. We have notification from NEIL stating that our distribution will be from a total base of $400 million. NEIL has provided an estimate of the Florida Power portion as $4,582,000. See my Exhibit RHB-5, which includes this notification and analysis.

IV. Conclusion

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

NEIL

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James A. Smith
Vice President &
Chief Financial Officer

302 573-2237 Direct
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302 888-3007 Fax

December 18, 2001

TO: NEIL MEMBER REPRESENTATIVES

RE: Distributions to Policyholders

In spite of recent market declines and the events of September 11, NEIL is still in very sound financial condition. As a result, at the December 14th Board meeting, the Board of Directors declared a distribution of $400 million for 2001 to be paid on March 29, 2002.

This distribution will be paid to Members of record as of December 31, 2001, and is, of course, subject to there being no major loss events prior to year-end. As we've done in the past, distributions will be reduced for any premiums due April 1st in order to minimize the level of equity liquidations necessary to fund the payment.

If you have any questions, please call me at 302-573-2237.

Best wishes for a happy holiday season and a prosperous New Year.

James a Smith

James A. Smith
Vice President and CFO

JAS/pj
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c: NEIL Insurance Advisory Committee Members

DOCKET NO. 000824
Witness: Robert H. Bazemore
Exhibit RHB 5

Little, Gary

From: Rod Lambert [RLAMBERT@nmlneil.com]
Sent: Wednesday, February 06, 2002 1:27 PM
To: Little, Gary Y.
Cc: Jim Smith
Subject: Estimated 2001 NEIL Distribution

2001_Estimated Distribution fo... distributions.pdf

Pursuant to your request, I've estimated the 2001 NEIL distribution for Crystal River (See attached schedule.) Please note that these numbers represent estimates as our books are currently being audited. The final figures will be available in March, 2002.

Also, I've attached the official NEIL distribution notice which is on Company letterhead and is signed by the Chief Financial Officer, Jim Smith. This notice confirms the total distribution amount as well as the payment date.

Please feel free to call me, if you would like to discuss this further.

Regards,

Rodney A. Lambert
Controller
Nuclear Electric Insurance Limited
302.573.2274
<<2001_Estimated Distribution for Florida Pwr Corp.xls>>
<<distributions.pdf>>

Nuclear Electric Insurance Limited
2001 Schedule of **ESTIMATED** Distribution
For: Florida Power Corporation

Program	Member Insured	Site	Policyholder Percentage @ 12/31/00	**ESTIMATED** 2001 Distribution Payable -3/02
Primary	Florida Power Corporation	Crystal River	0.00158%	$ 6,000
Bus. Int.	Florida Power Corporation	Crystal River	0.61260%	2,450,000
Excess	Florida Power Corporation	Crystal River	0.53159%	2,126,000

[redacted]

[redacted]