ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 041291-EI
FLORIDA POWER & LIGHT COMPANY

IN RE: FLORIDA POWER & LIGHT COMPANY'S PETITION FOR AUTHORITY TO RECOVER PRUDENTLY INCURRED STORM RESTORATION COSTS RELATED TO THE 2004 STORM SEASON THAT EXCEED THE STORM RESERVE BALANCE

March 8, 2005

REBUTTAL TESTIMONY AND EXHIBIT OF:

MORAY P. DEWHURST

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

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Q. Please state your name and business address.

A. My name is Moray P. Dewhurst. My business address is Florida Power & Light Company, Finance Division, 700 Universe Boulevard, Juno Beach, Florida 33408-0420.

Q. What is your employment capacity and position at Florida Power & Light Company?

A. I am Senior Vice President of Finance and Chief Financial Officer of Florida Power & Light Company ("FPL" or the "Company").

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for all the major financial areas of the Company, including the accounting and control functions, tax, treasury, budgeting and forecasting, and risk management. I oversee the establishment and maintenance of the financial plans, controls and policies for FPL. I am also responsible for establishing and maintaining effective working relations with the investment and banking communities, and for communicating the results of our operations to investors.

Q. Please describe your educational background and professional experience.

A. I have a bachelor's degree in Naval Architecture from MIT and a master's degree in Management, with a concentration in finance, from MIT's Sloan School of

Management. I have approximately twenty years of experience consulting to Fortune 500 and equivalent companies in many different industries on matters of corporate and business strategy. Much of my work has involved financial strategy and financial re-structuring. I was appointed to my present position in July of 2001.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring Exhibit MPD-1 which is a copy of the 2002 Stipulation and Settlement Agreement.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to refute Mr. Rothschild's direct testimony, including his reliance on Office of Public Counsel's (OPC) purported interpretation of the Stipulation and Settlement that was executed by all parties in this proceeding, including OPC, in Docket No. 001148-EI, and approved by the Commission in Order No. PSC-02-0501-AS-EI, issued April 11, 2002, (2002 Stipulation and Settlement or Settlement Agreement). I also will explain why Mr. Rothschild's and OPC's positions reflect very short-sighted objectives that are inconsistent with established public policy and detrimental to the interest of both state and local government and, ultimately, Floridians. Further, I will explain why the retroactive policy change in the method of accounting for storm costs recommended by Mr. Majoros would produce undesirable results, for both investors and customers.

I. OPC'S INTERPRETATION OF THE 2002 STIPULATION AND SETTLEMENT

Q. Mr. Rothschild's direct testimony describes OPC's interpretation of the 2002 Stipulation and Settlement. Do you agree with the interpretation he describes in his testimony?

A. No. OPC's interpretation is wrong. Not only does it completely ignore key provisions of the Stipulation and Settlement, it effectively deprives the Company of a significant portion of the protections and benefits the Company was to receive in exchange for agreeing to a $250 million annual reduction in base rates that included a withdrawal of its request to increase the amount of the annual storm accrual by $30 million. Moreover, OPC's interpretation of the Stipulation and Settlement is inconsistent with established public policy in the State of Florida that favors prompt and safe restoration of electric service in the wake of storms affecting Floridians.

Q. Were you Senior Vice President of Finance and Chief Financial Officer at FPL at the time FPL negotiated and received management approval to sign the Stipulation and Settlement?

A. Yes.

Q. Describe your involvement and role in connection with FPL Management's approval of the Stipulation and Settlement.

A. As Chief Financial Officer (CFO) I was responsible for the evaluation of the financial and risk management consequences of any agreement we might enter into. During the negotiations on the specific terms of the Stipulation and

Settlement leading up to the Settlement Agreement with OPC, I met periodically with Paul Evanson, then President of FPL, to review and evaluate the substantive terms proposed or counter-proposed by ourselves and OPC. While Mr. Evanson had the primary accountability for seeking to reach a negotiated agreement satisfactory to FPL, he required and sought my input and concurrence prior to agreeing to any final set of terms. In particular, Mr. Evanson and I jointly evaluated the issues surrounding the storm fund, as those issues had significant implications for the financial integrity of FPL, for which I was then and remain primarily responsible.

In this role I was fully aware of, and approved, the exchange of concessions or quid pro quo by which the Settlement Agreement was reached and which included our agreement to a $250 million annual base rate reduction that involved, among other things, the Company's agreement to withdraw its prior request for an increase in the annual storm accrual in order to offer the magnitude of base rate decrease sought by OPC.

Q. What was the involvement of Mr. Rothschild or Mr. Majoros in the negotiation of the 2002 Stipulation and Settlement?

A. None.

Q. What involvement did the lawyers appearing in this case on behalf of OPC have in the negotiation of the 2002 Stipulation and Settlement?

A. None.

Q. What key provisions of the Stipulation and Settlement does OPC's position ignore?

A. OPC's position ignores, or at least subsumes into irrelevance, two key provisions in the 2002 Stipulation and Settlement. For reference, I've attached that document to my testimony as Document No. MPD-1. The two key provisions to which I am referring are found in paragraphs 3 and 13. Paragraph 3 states that FPL would "no longer have an authorized Return on Equity (ROE) range for the purpose of addressing earnings levels" and that "the revenue mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels." (emphasis added).

Paragraph 13 of the 2002 Stipulation and Settlement states:

> "In the event there are insufficient funds in the Storm Damage Reserve and through insurance, FPL may petition the FPSC for recovery of prudently incurred costs not recovered from those sources. The fact that insufficient funds have been accumulated in the Storm Damage Reserve to cover costs associated with a storm event or events shall not be evidence of imprudence or the basis of a disallowance...."

Q. Please explain why you characterize these as key provisions of the 2002 Stipulation and Settlement.

A. I refer to them as "key" because they were essential conditions necessary to secure FPL's acceptance of the 2002 Stipulation and Settlement. Pursuant to that settlement OPC and its constituents received annual base rate decreases of $250 million, and an opportunity for refunds should FPL's revenues exceed certain threshold amounts. As a result of these concessions, FPL's customers will have realized approximately $1 billion in savings and refunds through calendar year 2005, the end of the Stipulation and Settlement.

But, in exchange for these benefits, FPL sought and obtained certain protections in the form of conditions. Three of those conditions are particularly relevant to this discussion. First, as noted above, FPL was to "no longer have an authorized Return on Equity (ROE) range for the purpose of addressing earnings levels." In fact, it was clearly agreed that "the revenue mechanism ... [was to] be the appropriate and <u>exclusive mechanism</u> to address earnings levels." See paragraph 3. Second, FPL sought a general level of protection by reserving the right to petition the Commission for rate relief due to earnings falling below 10%. See paragraph 8. Third, FPL needed specific assurance that excess storm costs, to the extent reasonably and prudently incurred, could be recovered during the term of the 2002 Stipulation and Settlement. See paragraph 13. To support its position, OPC focuses only on the second, ignoring the purpose and effect of the other two conditions.

Q. As FPL's CFO, would you have authorized execution of the 2002 Stipulation and Settlement without the benefit of each of the conditions identified above? If not, why not?

A. No. Each of the three conditions identified above was essential to FPL's willingness to agree to a $250 million annual base rate reduction, but I would like to focus briefly on the language in paragraph 13. It is a matter of fact that the third condition was added late in the negotiations as part of the final quid pro quo that enabled an agreement to be struck. Without this third condition there would have been no agreement.

As with any negotiations there was a degree of give and take throughout. OPC was insistent that there be a large base rate reduction – far larger than we felt was possible under the prevailing circumstances. To permit the large base rate reduction required to obtain a settlement, FPL had to agree to withdraw its then pending request to increase the annual storm accrual by $30 million. By withdrawing this request, effectively we were able to agree to $30 million more in rate reductions, albeit at the cost of incremental risk associated with a potentially inadequate storm fund. Although willing to accept the risk of general changes in revenues and expenses within the ranges and parameters established in the Settlement Agreement, FPL was not willing to accept the specific risk of excess storm restoration costs while under a fixed base rate agreement, --even under a draft agreement that already contained a general mechanism for relief if ROE dropped below 10%. Therefore, we proposed, and OPC accepted, adding the third condition reflected in paragraph 13.

Had we not desired the independent right to seek relief for extraordinary storm losses during the term of the 2002 Stipulation and Settlement, we might well have been satisfied with the 10% ROE floor. Of course, if OPC's contention is correct that the 10% threshold applies also to extraordinary storm losses, then the specific language reflected in paragraph 13 would have been totally unnecessary. But as I indicated, we would not have been satisfied with the Settlement Agreement without preserving such rights in addition to the 10% threshold. Mr. Evanson made this abundantly clear at the Commission's Special Agenda Conference held March 22, 2002. There, the following exchange was had between Commissioners and Mr. Evanson:

> Commissioner Baez: ... [I]s Section 13 creating a right of recovery that didn't exist before? ... [I]s the agreement offering you the ability to come back and, [] recover prudently incurred costs in excess of whatever the Storm Reserve was that didn't exist before?
>
> Mr. Evanson: ... Well, no, it doesn't change, I think, what was there before. Actually, what makes the most economic sense, and I think what we came in and requested some time ago from the Commission after Hurricane Andrew was, was an agreement or a rule from the Commission that to the extent that there were losses, significant losses from the storm, that we would have the ability to recover them via a clause over a three-to-five year period. ... But the Commission at that time said that that logic made a lot of sense and, to the extent you are short, why don't you come in and we'll talk about it then? And I think what this is doing is continuing that same logic. So there's not a change in my mind in the substance of where we were before that provision.
>
> ...
>
> Commissioner Bradley: [S]o then the Commission should assume then that you have sufficient funds to cover a catastrophic event at this time in this particular reserve fund?
>
> Mr. Evanson: No. [W]e have what we think is adequate for most occurrences. But I could tell you surely if a storm like Hurricane Andrew hit Miami and came right up the east coast through Palm Beach, there would not be nearly enough assets in that fund and insurance and it would be a significant impact to the company, and there's no doubt I would be here before you asking for some kind of special relief on it because you could be talking about billions of dollars in that case.

See Tr. Special Agenda Conference, Docket 001148-EI, Friday March 22, 2002, at 41-42.

Q. What is the relationship of the 10% condition to paragraph 13 of the 2002 Stipulation and Settlement?

Neither the 10% condition in paragraph 8 nor paragraph 13 refers to one another in the 2002 Stipulation and Settlement. The 10% condition is quite general: it encompasses <u>all</u> factors that might cause the ROE to drop below 10%. Thus, even in the absence of paragraph 13, FPL would already enjoy all the rights that OPC now is willing to concede: i.e., the right to petition for relief in the event that the storm fund balance becomes negative <u>and</u> FPL's ROE drops below 10%. But if the specific language in paragraph 13 addressing the right to seek rate relief is to be given any meaning, it should be capable of applying even if the 10% condition is not met. And that is exactly what was intended -- that FPL would have the right to petition for rate relief, even during a period of otherwise fixed base rates, if storm restoration costs caused the Storm Damage Reserve balance to become negative, regardless of the then prevailing ROE level.

That this was everyone's understanding is clear from the discussion at the Special Agenda, referenced in my prior answer. Indeed, Mr. Shreve, Public Counsel at the time who negotiated the 2002 Stipulation and Settlement and recommended it for approval by the Commission, did not take exception to anything that had been discussed relative to paragraph 13. He did not, for example, attempt to clarify that FPL's right to seek relief for extraordinary storm costs was limited or conditioned by the 10% threshold. In fact, immediately following the exchange with Mr. Evanson relative to paragraph 13, the Chairman asked OPC to comment on what had been communicated to the Commission relative to the terms and conditions of the Settlement Agreement.

> "CHAIRMAN JABER: Mr. Shreve, we've had some discussion this morning. Is there anything that you've heard this morning that changes your opinion or your involvement in this settlement being, in your opinion, a good settlement?
>
> MR. SHREVE: No, Commissioner, there's not".

<u>See</u> Tr. Special Agenda Conference, Docket 001148-EI, Friday March 22, 2002, at 42.

Each of the two paragraphs was included to provide FPL with certain rights under the Settlement Agreement in exchange for the large base rate reduction to which FPL agreed. It is fundamentally wrong for OPC to interpret these provisions in a way that would allow OPC to use one of the paragraphs to circumscribe the benefits provided under the other. In other words, OPC is using paragraph 8 to make FPL worse off than if paragraph 8 did not exist at all, even though the inclusion of paragraph 8 was intended only to protect FPL.

Q. Why were you so concerned with the question of storm accrual and Storm Damage Reserve balance?

A. At the time we had recently completed in depth studies on these issues. From these studies we were well aware both that the annual storm accrual was too low for the statistically expected annual losses from tropical storms and hurricanes and that the Storm Damage Reserve balance would not support an extreme hurricane year. Signing on to a fixed rate agreement in which our base rates did not cover the full expected cost of providing electric service and withdrawing our request to increase the reserve was not acceptable to FPL, without also making clear that FPL retained the right to seek extraordinary relief for excess storm costs during the term of the agreement. We were – reluctantly – willing to concede the very large rate reduction on which OPC insisted, but only in exchange for protection in the event that our fears about hurricane risk were borne out. Thus, we insisted on adding the third condition to protect against this eventuality, and OPC agreed. Without that third condition there would have been no Settlement Agreement providing a $250 million per year base rate reduction.

Q. You indicated previously that OPC's position deprives the Company of key benefits that were essential conditions to FPL's willingness to sign the Stipulation and Settlement. Please explain.

Our explicit agreement was that we would concede the $250 million per year rate reduction, but only on condition that OPC agree that FPL would have the right to "petition the FPSC for recovery of prudently incurred costs not recovered from [the Storm Damage Reserve and insurance coverage]," that "[t]he fact that insufficient funds have been accumulated in the Storm Damage Reserve to cover costs associated with a storm event or events shall not be … the basis of a disallowance" and that "the revenue mechanism herein described [--not excess storm restoration costs--] will be the appropriate and exclusive mechanism to address earnings levels." But if OPC's position is accepted, FPL would: (a) have no right to rate relief without reference to a 10% earnings level, (b) be faced with a significant disallowance, the effective result of not having had sufficient funds accumulated in the Storm Damage Reserve, and (c) have its earnings levels "addressed," if not lowered, by reference to something other than the Settlement Agreement's revenue mechanism. These are key benefits that were conditions to FPL's acceptance of the Settlement Agreement.

Q. Have customers received the benefits intended under the 2002 Stipulation and Settlement?

A. Yes. Consistent with the 2002 Settlement Agreement, FPL reduced base rates by $250 million per year immediately upon approval. In addition, customers received refunds of $11 million for 2002 and $3 million for 2003. The current 2002 Settlement Agreement will have provided customers with total savings of $730 million through December 2004, and total estimated savings of approximately $1 billion through December 2005, the end of the 2002 Stipulation and Settlement Agreement. Having reaped the benefits of the Settlement Agreement, OPC now wants to escape from the quid pro quo without which there would have been no Settlement Agreement. I believe this is both unfair and bad policy.

II. REGULATORY PLAN TO ADDRESS STORM RESTORATION COSTS

Q. Irrespective of the 2002 Stipulation and Settlement, would OPC's position regarding recovery of storm costs be consistent with the regulatory plan or framework established by the Commission?

A. No. I believe the Commission has established and consistently endorsed an overall framework that acknowledges that the costs associated with restoring service after tropical storms and hurricanes are a necessary cost of doing business in Florida and as such are properly recoverable from customers. Further, I believe the Commission has approved a sound framework governing recovery in the absence of commercially available insurance. This consists of three main parts: (1) an annual storm accrual, adjusted over time as circumstances change; (2) a funded Storm Damage Reserve adequate to accommodate most but not all storm years; and (3) a provision for FPL to seek recovery of costs that go beyond the Storm Damage Reserve. This framework does not and should not make an earnings test a condition for recovery. It does, and should, make prudence a condition for recovery.

Q. How were storm restoration costs recovered prior to the impact of Hurricane Andrew?

A. Prior to Andrew, FPL had a small storm damage reserve and maintained commercial insurance coverage for its T&D network in the amount of $350 million per occurrence. The costs of carrying this insurance, a bona fide cost of doing business, were recovered through base rates. The cost of storm restoration, therefore, was borne by customers through the cost of insurance.

Q. How was the regulatory framework altered following Hurricane Andrew?

A. Following Andrew, commercial insurers recognized that they had fundamentally misunderstood the nature of utility windstorm coverage and effectively withdrew from the market. In the absence of commercial coverage, FPL, with the Commission's approval, instituted an approach that relied more heavily on the Storm Damage Reserve, the existence of which pre-dated Andrew. In 1993 FPL initially proposed an automatic revolving storm clause, but this was rejected by the Commission. Instead, the Commission endorsed an approach which consists of three parts: (1) an annual storm accrual, adjusted over time as circumstances change; (2) a funded Storm Damage Reserve adequate to accommodate most but not all storm years; and (3) a provision for utilities to seek recovery of costs that go beyond the Storm Damage Reserve. These three parts act together to allow FPL over time to recover the full costs of storm restoration, while at the same time balancing potentially competing customer interests: as small an ongoing impact on customer bills as possible; minimal volatility of "rate shock" in customer bills because the reserve is insufficient; and intergenerational equity. To affect this balance requires periodic adjustment in the main components of the framework – the annual accrual and the target reserve balance – in light of changing storm experience and the growth of FPL's Transmission & Distribution network. The annual accrual can be reduced if a period of favorable loss experience leads to a build-up in the Storm Damage Reserve above the target level, while conversely, a period of unfavorable loss experience will lead to depletion of the reserve and a need to increase the rate of annual accrual.

Over the years, the Commission periodically has reviewed the levels of the target reserve amount and the annual accrual and, in some instances, has increased those amounts. In 1998, the Commission explicitly considered the adequacy of the $20 million dollar annual accrual then (and still) in effect as well as the target amount of the storm damage reserve. In weighing the types of interests I have described above, the Commission concluded that no changes in those amounts were needed at that time. However, consistent with the Post-Andrew regulatory framework, the Commission acknowledged that

> "[i]n the event FPL experiences catastrophic losses, it is not unreasonable or unanticipated that the reserve could reach a negative balance.... The December 1997 balance of $251.3 million, is, we believe, sufficient to protect against most emergencies. In cases of catastrophic loss, FPL continues to be able to petition the Commission for emergency relief, as reflected in Order No. PSC-95-1588-FOF."

In re: Petition for authority to increase annual storm fund accrual commencing January 1, 1997 to $35 million by Florida Power & Light Company, Docket No. 971237-EI, Order No. PSC-98-0953-FOF-EI, at 3 (issued July 14, 1998). In that decision, the Commission also affirmed that:

> "the costs of storm damage incurred over and above the balance in the reserve and the costs of the use of the lines of credit would still have to be recovered from ratepayers."

Id. (emphasis added).

These are the precepts that, to date, have governed the actions of FPL, both in planning for and carrying out storm restoration activities, and the perceptions of its investors.

Q. Is the 2002 Stipulation and Settlement consistent with the Commission's regulatory framework for addressing storm restoration costs?

A. Yes, it is entirely consistent and effectively superimposed that framework onto all other elements of the Settlement Agreement, which was the intent. FPL maintained an annual accrual to the Storm Damage Reserve – known to be too low for the statistically expected level of annual costs associated with storm restoration in the clear expectation that relief would be available in the event the

Storm Damage Reserve were exhausted. FPL maintained its existing Storm Damage Reserve – adequate to cover most years, but not the more extreme years of storm activity. And, crucially, FPL retained the right to petition for recovery of prudently incurred restoration costs in excess of the Storm Damage Reserve during the period of the base rate freeze under the Settlement, irrespective of its earnings levels. Thus, there was no change to the pre-existing framework. The Stipulation and Settlement merely grafts that framework onto a structure which governs all the other aspects of base rates and which provides both an upper bound on FPL's profitability through revenue sharing and a mechanism for re-adjustment in the event that factors other than storms should cause profitability to fall unacceptably low.

Q. Has this framework operated effectively in your view?

A. Yes. Since Andrew this framework has operated to keep customer rates lower than they otherwise would have been, because the annual accrual has been significantly less than the expected annual costs of restoration, even while the Storm Damage Reserve increased. However, this has only been possible because of the very favorable storm experience over the last decade. Simply put, Florida has been fortunate, and thus the restoration costs actually incurred over this period, which have all been funded by the Storm Damage Reserve even while that reserve has increased, have been well below the long-run expected values. Thus, to date, FPL has never had to call on the third part of the framework, the right to petition for relief in the event the reserve is exhausted. 2004 is the first time this has happened, for which we should all be very thankful.

Q. On page 6 of his direct testimony, Mr. Rothschild contends that FPL should bear a "portion of the risk associated with extraordinary storm casualty losses" and that this is "fully consistent with the nature of business risks and investments." Do you agree?

A. No, for several reasons. First, Mr. Rothschild conveniently conflates two quite distinct concepts in his testimony: risk and cost. What is at issue here is the treatment of the entirely foreseeable <u>costs</u> of restoring power after a tropical storm. These costs are an integral part of the cost of providing electric service in Florida, a region susceptible to tropical storms and hurricanes. As such, they are legitimately recoverable from customers under basic principles of regulation. The simple fact is that we do not now (and have not since Andrew) recovered through base rates the full expected costs of restoring service after storms, a fact which Mr. Rothschild and OPC simply ignore. Nor do we recover through base rates the amounts that would be necessary to compensate for the risk capital that would need to be supplied were investors to assume an insurance function, which is what OPC and Mr. Rothschild are effectively proposing. There is a good reason we do not do so: the current regulatory framework is a much less costly means of attaining the same end. But an integral part of that framework is the ability of the utility to recover prudently incurred costs in excess of whatever Storm Damage Reserve balance happens to exist at the precise moment that hurricanes strike, for this balance is inevitably a matter of chance.

OPC and Mr. Rothschild would like to pretend that investors are fully paid for the cost of restoration when this is not in fact the case. Again, with customers having enjoyed a long period when rates were lower than they otherwise would have been had FPL been permitted to recover the full cost of storm restoration, OPC and Mr. Rothschild now want to drop the other side of the regulatory bargain and oppose full recovery of excess restoration costs, when it was quite predictable (and indeed was predicted by FPL) that there would surely come a day when the storm fund would be exhausted.

In addition to conflating cost and risk, Mr. Rothschild also conveniently glosses over the important question of whether investors have been compensated or are compensated to take on the specific risks that he proposes. It is trivial to say that "investors understand that the companies in which they invest are exposed to a variety of risk." Rothschild direct testimony at page 6. The question is: have they accepted the specific risks being discussed here and have they been fairly compensated for them? In this case, the answer is clearly no. A reasonable reading of the history of Commission orders would clearly not lead a prudent investor to conclude that the Commission was employing the framework now proposed by OPC and endorsed by Mr. Rothschild.

Q. **What are the expectations of investors relative to the recovery treatment of excess storm restoration costs in Florida?**

A. Even a casual reading of investor and analyst discussions about Florida utilities should be enough to show that investors fully anticipate the kind of recovery treatment I have described. I have reviewed numerous analyst reports, and none of them have indicated or suggested that they do not expect the recovery of reasonable and prudently incurred storm costs. For example, a Lehman Brothers equity research report dated January 21, 2005 stated: "FPL received interim approval on 1/18 to begin recovering storm fund costs which are now expected to be $890M for 2004's 3 hurricanes, up from $710M previously. This recovery is subject to a prudency review in April which we do not expect will be a problem."

Investors rely on the existence and continuation of reasonable regulatory frameworks in many areas, of which storm restoration is just one example. Mr. Rothschild's analysis could just as easily be used to support the position that, say, a rise in fuel costs should only be passed through to customers after an earnings test had been passed, and it would be just as erroneous in that situation, too. The longstanding existence of the fuel clause, and the obvious principle that fuel is a necessary cost of generating electricity, are reasonably relied on by investors as part of the general risk framework by which they evaluate FPL. It is quite possible that investors might continue to provide capital if the fuel clause were arbitrarily stripped away, but it is certain that it would require a higher return on their investment to compensate for the additional risk. The same is true with the storm cost recovery framework.

It is important to recognize that a key element of investors' risk perception includes the degree of confidence that investors have regarding the regulatory framework being adhered to. If the "rules of the game" are changed to the utilities disadvantage after the fact, investors will sense a significant increase in risk in the regulatory environment in Florida.

Q. Mr. Rothschild asserts that enforcing the 10% ROE criterion would not cause the rating agencies to downgrade the Company. Do you agree?

A. I do not agree with Mr. Rothschild's assertion. Weakening of credit would occur, as indicated conversely in an S&P bulletin dated January 19, 2005 which stated that "The Florida Public Service Commission's approval of a two-year, $354 million surcharge on customers to recover the costs for the 2004 hurricanes in excess of the Storm Damage Reserve fund is favorable for Florida Power and Light Co. (Florida Power; A/Negative/A-1), a wholly owned subsidiary of FPL Group, Inc. This approval will not change the consolidated rating or outlook on Florida Power and FPL Group."

Even more telling, although not specifically related to Florida Power & Light, the recent downgrade of Progress Energy Florida clearly demonstrates that issues surrounding hurricane cost recovery could lead the rating agencies to lower a company's rating. Moody's Investors Service downgraded Progress Energy Florida from A1 to A2 on February 11, 2005. Regulatory risks associated with the "timing of hurricane cost recovery" were listed as one of the reasons for the downgrade. Moody's also lists "an unexpected adverse regulatory outcome with respect to base rates or hurricane cost recovery" as an item that could lower Progress Energy Florida's rating further. Additionally, S&P revised the outlook on Progress Energy to negative from stable on October 14, 2004, listing "uncertainties regarding the timing of the recovery of hurricane costs," as one of the reasons behind the outlook change. Progress Energy's short-term credit ratings were lowered to 'A-3' from 'A-2' on October 25, 2004 due to these same uncertainties.

Q. Mr. Rothschild claims that an ROE of 10% is adequate to provide a fair return to investors and to enable FPL to raise capital on reasonable terms. Do you agree?

A. No. First of all, as I have already explained, his position is inconsistent with the terms of the Settlement Agreement that provides "the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels." However, even in the absence of the Settlement Agreement my answer would still be no, as demonstrated by Dr. Avera's rebuttal testimony, Mr. Rothschild's analysis contains numerous errors that together render it suspect.

But even if his analysis were sound, his premise is a dangerous one from a public policy viewpoint. The new approach that he and OPC are proposing includes an ex post earnings test – i.e., at the time a request for recovery of prudently incurred costs is made the Commission should re-determine what a "fair" rate of return is. If implemented, this approach would introduce yet another source of risk from the investor's perspective. In the absence of any other agreement this would be tantamount to providing interveners a free option to challenge both the company's cost structure and its ROE. If conditions had changed adversely to the Company since the prior determination of ROE, interveners would of course argue that the existing ROE band should be applied. If conditions had changed favorably, they would argue that the analysis should be updated. This is in effect what Mr. Rothschild states when he says "if the 10.0% maximum earnings threshold requirement [sic] were updated to reflect current conditions, the minimum required before rate relief should be approximately 9.0%." Similarly, interveners would have a "free option" to challenge the utility's existing cost structure, arguing that the reported ROE was understated and that certain items should be excluded before applying the earnings test. No one would suggest that the Company recover their actual storm costs, plus a mark-up, if FPL were earning below a fair rate of return. Similarly, OPC should not be permitted to "discount" FPL's actual storm costs, solely to reduce its earnings to what OPC contends is a fair rate of return.

The danger in this approach from a public policy viewpoint is two fold: first, it runs the risk that each application for relief becomes a form of rate case, a lengthy, costly and resource intensive exercise likely to produce a distortion of incentives; and second, it increases the risk as seen through investors' eyes. As I noted earlier, investors want and need clarity around the regulatory framework that will be applied. The greater the number of opportunities for using new information effectively to adjust for what has already happened, the greater the perceived risk.

III. PUBLIC POLICY CONSIDERATIONS

Q. What is your understanding of the public policy and interest of the State of Florida relative to the restoration of power following the 2004 hurricanes?

A. The policy of state and local governments with respect to restoration of electric power was very clear. Electric utilities were expected to take all necessary actions and deploy every available resource to restore power as quickly as possible in the interest of the citizens of the State of Florida.

Governor Bush and Secretary Castille of DEP, the Governor's designee on utility restoration efforts, continuously urged FPL and other utilities to take all necessary actions to restore electric service as expeditiously as possible. It was quite clear that quicker restoration was the highest priority.

Similarly, local governments had the same expectations.

Government also took actions in order to meet this priority. For example, the State granted weigh station waivers, provided law enforcement escorts, mapped routes around damaged bridges, expedited permits, and many other actions to facilitate more rapid restoration.

Clearly, the priority of government, from the Governor down, was to spend and take whatever actions were necessary to restore service as rapidly as possible.

Q. What public policy considerations should the Commission consider in weighing OPC's position in this case?

A. At the highest level, in addition to ensuring that the treatment of FPL's petition is balanced, fair and consistent with sound regulatory principles, I believe that the Commission should: (1) carefully consider the impact that any decision may have on future settlements; (2) avoid introducing into the current regulatory framework any element of "second guessing;" and (3) continue to ensure that the message communicated to utilities is one that encourages the prompt and safe restoration of electric service to customers, unburdened by economic decisions during restoration activities, and consistent with the obvious public interest expressed by government at all levels in this past hurricane season. Whatever decisions are rendered will set an important precedent for the future, will have a clear impact on investor perceptions of risk, and will likely influence the behavior of all investor-owned utilities as they prepare for and conduct restoration activities after tropical storms and hurricanes.

For all the reasons discussed elsewhere in my testimony I believe OPC's proposed new framework for treating shortfalls in the Storm Damage Reserve is a poor one. However, even if the Commission were to conclude that it was preferable to the existing framework, I believe as a matter of public policy it would be wise only to apply it prospectively. This is because, as I have earlier described, investors will perceive a change such as the one OPC is proposing as a significant increase in risk, not just as it relates to storm costs, but as it relates to the entire regulatory climate in Florida.

Q. Are there principles that the Commission can use in considering how to address the public policy considerations you have described?

A. Yes. First, it is essential to recognize that restoration is a cost of doing business in Florida. As such, in order to be consistent with basic principles of regulation, the Commission must either allow utilities to recover the full cost of restoring power in the wake of tropical storms and hurricanes, or make some other explicit adjustment, such as an increase in the allowed ROE, which would compensate utilities for those costs which will not be recovered through rates. We must recognize that major storm events are both predictable and unpredictable, but their unpredictability is fundamentally limited to timing. Over a long period of time we know with virtual certainty that we will incur costs for restoring power. Risk arises primarily from the uncertainty around the impact on any particular sub-period.

Second, the short-term risk from tropical storms and hurricanes is completely asymmetrical: FPL can only incur costs; it can never see benefits. As Mr. Davis testifies, the existing accounting methodology approved by the Commission in Order No. 95-0264 results in the Company only recovering actual costs, with no increase to investment or rate base. Consequently, any regulatory framework that transfers some portion of these costs onto shareholders guarantees that over time the utility will always earn less than its allowed return, all other things equal, unless a separate and specific factor allowing for this asymmetry is added to the allowed return. This is a simple matter of mathematics and is contrary to the basic principles of regulation.

Third, as a general rule one particular generation of customers should not bear the full cost of a sub-period of unfavorable storm experience. Since storms will occur and only their timing is uncertain, the true cost of providing service includes an allowance for the expected level of restoration activity, regardless of whether or not a particular period of time experiences that expected level of storm activity. Just as a customer pays homeowner insurance premiums each year regardless of whether or not a storm strikes, so should each 'generation' of customers make some contribution to the inevitable costs of restoration, even if no storm strikes in a particular year. This principle suggests that any regulatory framework should embody a substantial degree of smoothing in the manner in which restoration costs are recovered from customers.

Fourth, operating somewhat against the previous principle, "pre-funding" restoration costs sufficient to cover an extreme sub-period of storm activity (i.e. collecting from customers and building up a very large Storm Damage Reserve) is likely to be economically inefficient. If this is not done, however, then it is statistically guaranteed that at some point the Storm Damage Reserve will become exhausted, as eventually there will be a sub-period of particularly bad storm experience. Thus, some fair mechanism for recovery of the prudently incurred costs that exceed the Storm Damage Reserve is required.

Fifth, whatever framework is adopted should, as much as possible, be <u>independent of normal utility operations</u> – i.e. it should operate the same regardless of the current state of the utility. This is important because of the issue of incentives, combined with the fact that customers have very different interests during normal operations than they do after major storm events. In the storm environment, as we all know, customers want utilities to be highly focused on rapid restoration, almost to the exclusion of other considerations. In contrast, during normal operations customers have a far broader set of interests, and utilities have a far broader array of issues to manage. As a matter of policy, I believe we should all want a framework that focuses utilities very tightly on rapid restoration after major storms even at the expense of some efficiency. A framework that causes incentives to be inconsistent or even counter to this end is suspect. At very least, it will only lead to mistrust on the part of customers and frustration on the part of the utilities, and more likely it will lead to misallocation of resources. As a matter of public policy I believe the Commission should not want utilities' non-storm actions to be influenced by what situation they might find themselves in if a storm struck, and conversely the Commission should not want utilities' storm actions to be influenced by contemplation of whether or not a particular level of expenditure will be recoverable or not.

Sixth, consistent with earlier parts of my testimony, any framework must be predictable. Investors need to know in advance how recovery of storm costs will be treated and whatever framework is adopted must only be changed with fair notice to all parties.

Q. How does OPC's proposed new framework compare against these principles?

A. Very poorly, in my view. As presented through the direct testimony of Messrs. Rothschild and Majoros it appears to not recognize restoration costs as an ongoing cost of business, and it clearly neither contemplates full recovery nor proposes an offsetting increase in allowed ROE. It therefore very clearly violates the first and second principles. While in theory it could accommodate the third and fourth principles, in practice what OPC seeks is to under fund the ongoing accrual, thereby increasing the risk of Storm Damage Reserve shortfalls (as evidenced by the negotiations leading to the Stipulation and Settlement), which would then be borne in significant part by the shareholder without any compensatory adjustment. It clearly violates the fifth principle and would introduce very undesirable distortions in the incentives created for utilities both during normal operations and during storm restoration. Finally, while it could be adopted going forward it is clearly not the framework contemplated by prior Commission orders and its imposition today would therefore represent a very large break with predictability, contrary to the sixth principle, for the reasons I have described earlier.

Q. Please explain why OPC's framework would distort utilities' incentives?

A. Under OPC's proposal, utilities operating under normal ratemaking (i.e., in the absence of some rate agreement) would see odd incentives during restoration activity, depending upon the pre-existing level of the Storm Damage Reserve, the magnitude of the restoration effort, and their existing ROE. For restoration efforts modest in magnitude relative to the Storm Damage Reserve, the incentives would remain as today: to restore power as rapidly as practical, even at some cost in efficiency, which is consistent with customer interests. If the restoration effort were likely to be large enough to exceed the Storm Damage Reserve, though, there would be an incentive to slow down the rate of restoration in order to keep costs from exceeding the reserve. An illustrative example might be electing to wait two extra days for crews to travel a further distance if their overall cost was expected to be lower than crews originating from closer locations. Such an incentive is not in our customers' interests, is not an acceptable position to a utility attempting to meet both customer and shareholder needs, and makes for poor public policy. Perversely, under OPC's framework, <u>the better the utility performs in terms of rapidly restoring power, the greater the share of restoration costs imposed on shareholders</u>.

Q. Can you offer examples of regulatory frameworks that would be consistent with the principles you have articulated?

A. Yes, I can suggest at least three approaches that would be very consistent with most if not all the principles, although I believe only one of these is practical today.

The first is the use of third party insurance, with the cost of the insurance recovered through base rates. In this approach, the full costs are recovered over time, the utility is still afforded a meaningful opportunity on average to attain its allowed ROE, each generation of customers pays approximately its fair share of the long-term cost and the recovery framework is independent of normal operations. Unfortunately, commercially reasonable insurance with adequate coverage limits is not available.

Second, the utility or an affiliate could in theory form a dedicated insurance subsidiary and charge the utility a pre-determined premium which would then be recovered through base rates. Unfortunately, because restoration is really a cost rather than a risk, there is little possibility of risk pooling, and therefore such an approach would require capitalizing an entity such that it could always cover the most extreme loss year and still have resources to cover an additional period with at least average losses. As a practical matter, for a utility such as FPL, this would require total capital resources well in excess of $1 billion and probably closer to $2 billion. This capital would have a return requirement on the order of $200 million per year net of taxes. In other words, premiums earned less expected losses less expected earnings on the entity's investment portfolio, net of taxes, would have to be on the order of $200 million per year. Because of the nature of storms, the investment portfolio would have to be of relatively short duration, thus limiting the potential return. Obviously, this would be far costlier to the customer over time than the current approach. Incidentally, this rough analysis shows why commercial insurance is unavailable at reasonable rates.

The third alternative is in essence the current framework: the combination of an annual accrual recovered through base rates, a funded Storm Damage Reserve, and the ability to seek recovery of prudently incurred restoration costs if and when the reserve balance becomes negative. Depending upon the balance maintained among these three elements, it is possible to fine tune this approach to deal with differing preferences for the third and fourth principles I described earlier.

In order for this third approach to meet the principles I have laid out, particularly the second and the fifth, it is absolutely necessary that full recovery of prudently incurred restoration costs be allowed. The introduction of an earnings test, in the absence of any compensating adjustment to allowed ROE, guarantees that both the second and fifth principles will be violated, while even the introduction of a compensating increase in allowed ROE will not address the problem of potentially conflicting incentives.

In considering this approach, it may be helpful to recognize that the role of the third component of the framework – the ability to seek full recovery of prudently incurred restoration costs when the Storm Damage Reserve is exhausted – acts very much like a retrospective premium in a mutual insurance company. It is well understood in insurance circles that a retro can be a very efficient way of creating the capital capacity to support high magnitude/low odds outcomes, since the alternative ties up large quantities of capital, on which a return must be earned, for extended periods of time.

Q. Mr. Majoros contends that FPL has adopted accounting that "would abuse the Storm Reserve and mistreat customers." Do you agree?

A. No. I defer specific responses to most of Mr. Majoros' contentions to FPL witness K. Michael Davis. However, there are several points that call for a response here because of the policy issues raised.

FPL has consistently followed a set of accounting principles in dealing with storm restoration costs, as Mr. Davis's direct and rebuttal testimony clearly show. These principles were laid out in a study submitted in October 1993 (Exhibit No. KMD-3). Mr. Majoros acknowledges that the Commission in Order No. 95-0264 declared that the study was "adequate," yet he contends that "the Commission did not "bless" FPL's approach to the extent FPL now claims." Majoros Direct Testimony at page 15. Instead, Mr. Majoros now seeks to justify applying now a completely different set of accounting principles than those previously employed in addressing storm restoration – which were never objected to by OPC, by Mr. Majoros, or by any other party in any Commission proceeding until now, following the catastrophic 2004 storm season.

Any prudent investor who reviewed Order No. 95-0264 and who was aware that the accounting policies detailed in the study declared "adequate" by the Commission in that order were consistently followed by FPL in every storm thereafter, without objection from anyone, would naturally expect that they would be followed in 2004. For the Commission to change this approach now would clearly be another example of the kind of ex post risk that I described earlier and that can cause large increases in investor perceptions of overall regulatory risk.

On page 15 of his direct testimony, Mr. Majoros also notes that the Commission in Order No. 95-0264 said that it was "considering the appropriateness of opening a rulemaking proceeding to establish uniform guidelines for determining when the storm damage reserve should be charged and what costs should be charged to it." While I fully respect the Commission's right to open such a proceeding, the fact remains that, to date, they have not found it necessary to do so. Therefore, Company can only rely upon the policies and methodologies outlined in the study addressed in Order No. 95-0264. But even if the Commission were inclined to revisit the accounting policies and methodologies contained in the study, I respectfully submit that the time to do so would be after the current proceedings are resolved, and the right thing to do now is to resolve the current proceedings using the rules that everyone – investors and customers alike – who have familiarized themselves with the regulatory record have clearly been led to expect.

Q. Do you agree with the accounting principles proposed by Mr. Majoros?

A. No. For reasons stated in Mr. Davis's rebuttal testimony I believe that the principles currently used by FPL are appropriate. The fundamental principle underlying the current accounting for storm costs is one of *restoration*. Costs are incurred to *restore* the network to its pre-storm condition. The conceptual error underlying much of Mr. Majoros' direct testimony is the belief that the post-restoration network is significantly enhanced or more valuable than the pre-restoration state. With few exceptions, this is unfortunately not the case. In general, those costs that Mr. Majoros would propose to capitalize (which of course would increase rate base and, ceteris paribus, future base rates) merely represent the necessarily inefficient replacement of existing components of the network to get it back to its pre-storm condition. Only rarely do they noticeably improve the longevity of the post-restoration network. Much of the cost that Mr. Majoros would propose to capitalize on page 5 of his direct testimony is labor paid at double time rates, and the cost of re-setting a pole is conceptually indistinguishable from the cost of setting a new pole when the result is merely to get the network back to where it was. In this area, Mr. Majoros' accounting model does not conform well to the facts and if adopted would lead to future generations of customers paying higher rates. The net effect of his proposed approach would be to <u>increase</u> total customer costs (since additions to rate base will be recovered at the company's overall cost of capital, while the storm surcharge includes only a short-term interest charge) but to spread them out over future periods.

Q, What incentives are created by the new accounting principles that Mr. Majoros proposes?

A. By trying to "fine tune" the sub-categorization of the overall restoration effort, Mr. Majoros' principles would also introduce undesirable incentives. Under the existing framework, FPL's incentive is straightforward: to restore power as quickly as practical. To this end we mobilize virtually the entire organization in one way or another. The normal work of those who are assigned directly to storm support either is performed by others "doubling down," or is done later, usually with overtime. If regular base compensation is disallowed against the Storm Damage Reserve, clearly the incentive is not to utilize so many FPL resources but instead to leave them to perform their regular work and increase the utilization of contractors and foreign utilities. This would not only slow overall restoration efforts, since FPL resources can be mobilized more quickly than third parties can be brought in, but would also be "penny wise and pound foolish," since the unit cost of outside resources is significantly higher, on average, than FPL's costs, as the data from Hurricanes Charley, Frances and Jeanne clearly show.

Similarly, Mr. Majoros' statement on page 20 of his direct testimony that "[o]nce normal operations have resumed . . . any remaining storm-recovery activities should be performed in the normal course of business and should not be booked to the storm account" betrays a misunderstanding of the nature of the storm restoration effort and would, if followed literally, lead to a longer, more costly restoration effort. The practical reality is that in the immediate restoration period, all effort is focused on getting customers back in service quickly. Often, repairs must be quickly made, and not all damage is addressed immediately. Repairing damage to connections or components that do not fail but that nonetheless need repair is storm restoration work just as surely as fixing those that do fail; yet customers would be ill served if we afforded equal priority during the days immediately after a storm to these activities. Yet this is the incentive that Mr. Majoros' proposal would create: fix anything and everything that is damaged before sending outside contractors home and releasing employees back to normal work. I do not believe this would be good public policy.

Q. What additional public policy concerns does OPC's position in this case present?

A. The possibility of a single hurricane season, or even one storm, completely exhausting the Storm Damage Reserve and our conclusion that higher annual accruals were called for had been extensively documented in the Company's filings in the general rate proceeding that led up to the negotiations. As a general principle, I believe the resolution of regulatory issues through equitably negotiated agreement is desirable. In the first place, litigated results rarely leave all parties content, often resulting in further litigation. Further, negotiated agreements can serve to reduce investor perceptions of risk; and they can provide better incentives for utilities than are available under a framework where every issue is resolved through litigation and confirmed by order. Thus, negotiated outcomes can lead to desirable results for customers over time.

However, the necessary corollary is that agreements must be adhered to. In my experience, which includes hundreds of direct conversations with major investors, one of the greatest sources of investor perceptions of regulatory risk is the idea that the "rules of the game" may be changed to the utility's disadvantage after the fact. Investors are generally able to evaluate the risks of pre-defined frameworks quite well. They are quite unable to evaluate the risks of arbitrary, ex post changes in framework, and where they suspect the probability of such changes may be significant they discount 'promised' outcomes severely. One of the key reasons that Florida is presently acknowledged by most investors to have a good regulatory environment is that there have been few examples of this kind of ex post re-interpretation.

In this instance, OPC is asking the Commission to reinterpret the Settlement Agreement after OPC and its constituents have enjoyed the benefits of its past two agreements (1999 and 2002) through rate reductions and refunds to customers totaling nearly $4 billion through the end 2005. Quite apart from the factual and equity issues involved, I believe this would be bad policy. In addition, utilities will be naturally reluctant to enter into new agreements if they feel they cannot rely on the plainly expressed terms of those agreements being upheld.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of the retail rates of Florida Power & Light Company.	)	Docket No. 001148-EI Dated: March 14, 2002

JOINT MOTION FOR APPROVAL OF STIPULATION AND SETTLEMENT

The Citizens of the State of Florida, through the Office of Public Counsel, the Florida Retail Federation, the Florida Industrial Power Users Group, Publix Supermarkets, Inc., Dynegy Midstream Services LP, Lee County, Thomas P. and Genevieve Twomey, and Florida Power & Light Company jointly move the Florida Public Service Commission to review and approve no later than March 22, 2002, the attached Stipulation and Settlement as full and complete resolution of all matters pending in this docket in accordance with Section 120.57(4), Florida Statutes (2001), and to enter a final order reflecting said approval on an expedited basis, so that the rate changes reflected in the Stipulation and Settlement can be implemented by FPL effective April 15, 2002, immediately following the conclusion of the currently approved stipulation and settlement on April 14, 2002.

WHEREFORE, the undersigned parties respectfully urge the Florida Public Service Commission to approve the attached Stipulation and Settlement in all respects and within the time period described above.

DATED this 14th day of March, 2002.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by United States Mail this 11th day of March, 2002, to the following:

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JTC John T. Butler, P.A.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Review of the Retail Rates)
of Florida Power & Light Company)
)

DOCKET NO. 001148-EI

STIPULATION AND SETTLEMENT

WHEREAS, the Florida Public Service Commission (FPSC) has initiated a review of retail rates for Florida Power & Light Company (FPL);

WHEREAS, the Office of Public Counsel (OPC), The Florida Industrial Power Users Group (FIPUG), Publix Super Markets, Inc. (Publix), Thomas P. and Genevieve Twomey, Dynegy Midstream Services LP, Florida Retail Federation and Lee County have intervened, and have signed this Stipulation and Settlement;

WHEREAS, FPL has provided the minimum filing requirements (MFRs) as required by the FPSC and such MFRs have been thoroughly reviewed by the FPSC Staff and the Parties to this proceeding;

WHEREAS, FPL has filed comprehensive testimony in support of and detailing its MFRs;

WHEREAS, the parties in this proceeding have conducted extensive discovery on the MFRs and FPL's testimony;

WHEREAS, the Parties to this Stipulation and Settlement have undertaken to resolve the issues raised in this review so as to effect a prompt reduction in base rates charged to customers, to maintain a degree of stability to FPL's base rates and charges, and to provide incentives to FPL to continue to promote efficiency through the term of this Stipulation and Settlement;

WHEREAS, FPL is currently operating under a stipulation and settlement agreement (Current Agreement) agreed to by OPC and other parties, and approved by the FPSC by Order PSC 99-0519-AS-EI;

WHEREAS, the Current Agreement provided for a $350 million permanent annual rate reduction for retail customers commencing April 15, 1999 and a revenue sharing plan under which $128 million in refunds have been provided to retail customers to date, with $84 million in additional refunds projected for the twelve-month period ending April 14, 2002; and

WHEREAS, an extension of revenue sharing through 2005, and an additional permanent rate reduction will further be beneficial to retail customers;

NOW THEREFORE, in consideration of the foregoing and the covenants contained herein, the Parties hereby stipulate and agree:

1. Upon approval and final order of the FPSC, this Stipulation and Settlement will become effective on April 15, 2002 (the "Implementation Date"), and continue through December 31, 2005.

2. FPL will reduce its base rates by an additional permanent annual amount of $250 million. The base rate reduction will be reflected on FPL's customer bills by reducing all base charges for each rate schedule, excluding SL-1 and OL-1, by 7.03%. FPL will begin applying the lower base rate charges required by this Stipulation and Settlement to meter readings made on and after the Implementation Date.

3. Effective on the Implementation Date, FPL will no longer have an authorized Return on Equity (ROE) range for the purpose of addressing earnings levels, and the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels.

4. For surveillance reporting requirements, FPL's achieved ROE will be calculated based upon an adjusted equity ratio as provided for in the Current Agreement.

5. No party to this Stipulation and Settlement will request, support, or seek to impose a change in the application of any provision hereof. OPC, FIPUG, Publix, Thomas P. and Genevieve Twomey, Dynegy Midstream Services LP, Florida Retail Federation and Lee County will neither seek nor support any additional reduction in FPL's base rates and charges, including interim rate decreases, to take effect prior to the expiration of this Stipulation and Settlement unless such reduction is initiated by FPL. FPL will not petition for an increase in its base rates and charges, including interim rate increases, to take effect before the end of this Stipulation and Settlement, except as provided for in Section 8.

6. During the term of this Stipulation and Settlement, revenues which are above the levels stated herein will be shared between FPL and its retail electric utility customers -- it being expressly understood and agreed that the mechanism for earnings sharing herein established is not intended to be a vehicle for "rate case" type inquiry concerning expenses, investment, and financial results of operations.

7. Commencing on the Implementation Date and for the remainder of 2002 and for calendar years 2003, 2004 and 2005, FPL will be under a Revenue Sharing Incentive Plan as set forth below. For purposes of this Revenue Sharing Incentive Plan, the following retail base rate revenue threshold amounts are established:

I. Revenue Cap - Retail base rate revenues above the retail base rate revenue cap will be refunded to retail customers on an annual basis. The retail base rate revenue cap for 2002 will be $3,740 million. For 2002 only, the refund to customers will be limited to 71.5% (April 15 through December 31) of the retail base rate revenues exceeding the cap.

The retail base rate revenue caps for 2003, 2004 and 2005 will be $3,840 million, $3,940 million and $4,040 million, respectively. Section 9 explains how refunds will be paid to customers.

II. Sharing Threshold - Retail base rate revenues between the sharing threshold amount and the retail base rate revenue cap will be divided into two shares on a 1/3, 2/3 basis. FPL's shareholders shall receive the 1/3 share. The 2/3 share will be refunded to retail customers. The sharing threshold for 2002 will be $3,580 million in retail base rate revenues. For 2002 only, the refund to the customers will be limited to 71.5% (April 15 through December 31) of the 2/3 customer share. The retail base rate revenue sharing threshold amounts for calendar years 2003, 2004 and 2005 will be $3,680 million, $3,780 million and $3,880 million, respectively. Section 9 explains how refunds will be paid to customers.

8. If FPL's retail base rate earnings fall below a 10% ROE as reported on an FPSC adjusted or pro-forma basis on an FPL monthly earnings surveillance report during the term of this Stipulation and Settlement, FPL may petition the FPSC to amend its base rates notwithstanding the provisions of Section 5. Parties to this Stipulation and Settlement are not precluded from participating in such a proceeding. This Stipulation and Settlement shall terminate upon the effective date of any Final Order issued in such proceeding that changes FPL's base rates.

9. All refunds will be paid with interest at the 30-day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code, to retail customers of record during the last three months of each applicable refund period based on their proportionate share of base rate revenues for the refund period. For purposes of calculating interest only, it will be assumed that revenues

to be refunded were collected evenly throughout the preceding refund period at the rate of one-twelfth per month. All refunds with interest will be in the form of a credit on the customers' bills beginning with the first day of the first billing cycle of the second month after the end of the applicable refund period. Refunds to former customers will be completed as expeditiously as reasonably possible.

10. In Order No. PSC 99-0519-AS-EI, FPL was authorized to record an amortization amount of up to $100 million per year for each of the three years of the settlement agreement which was to be applied to reduce nuclear and/or fossil production plant in service. Under this provision, FPL recorded $170,250,000. Starting with the effective date of this Stipulation and Settlement, FPL may, at its option, amortize up to $125,000,000 annually as a credit to depreciation expense and a debit to the bottom line depreciation reserve over the term of this Stipulation and Settlement. The amounts so recorded will first go to offset the $170,250,000 bottom line amortization amount that has previously been recorded, with any additional amounts recorded to a bottom line negative depreciation reserve during the term of this Stipulation and Settlement. Any such reserve amount will be applied first to reduce any reserve excesses by account, as determined in FPL's depreciation studies filed after the term of this Stipulation and Settlement, and thereafter will result in reserve deficiencies. Any such reserve deficiencies will be allocated to individual reserve balances based on the ratio of the net book value of each plant account to total net book value of all plant. The amounts allocated to the reserves will be included in the remaining life depreciation rate and recovered over the remaining lives of the various assets. Additionally, depreciation rates as addressed in Order Nos. PSC 99-0073-FOF-EI, PSC 00-2434-PAA-EI and PSC 01-1337-PAA-EI will not be changed for the term of this Stipulation and Settlement.

11. Employee dental expenses are considered to be a prudently incurred expense and will be treated as such, including for surveillance reporting, as of the Implementation Date.

12. Additional amortization expense which is being recorded as an offset to the ITC interest synchronization adjustment shall no longer be recorded after the Implementation Date of this Stipulation and Settlement.

13. FPL will withdraw its request for an increase in the annual accrual to the Company's Storm Damage Reserve. In the event that there are insufficient funds in the Storm Damage Reserve and through insurance, FPL may petition the FPSC for recovery of prudently incurred costs not recovered from those sources. The fact that insufficient funds have been accumulated in the Storm Damage Reserve to cover costs associated with a storm event or events shall not be evidence of imprudence or the basis of a disallowance. Parties to this Stipulation and Settlement are not precluded from participating in such a proceeding.

14. On April 15, 2002, FPL shall effect a mid-course correction of its Fuel Cost Recovery Clause to reduce the fuel clause factor based on projected over-recoveries, in the amount of $200 million, for the remainder of calendar year 2002. The fuel adjustment clause shall continue to operate as normal, including but not limited to, any additional mid-course adjustments that may become necessary and the calculation of true-ups to actual fuel clause expenses. FPL will not use the various cost recovery clauses to recover new capital items which traditionally and historically would be recoverable through base rates.

15. This Stipulation and Settlement is contingent on approval in its entirety by the FPSC. This Stipulation and Settlement will resolve all matters in this Docket pursuant to and in accordance with Section 120.57(4), Florida Statutes (2001). This Docket will be closed effective on the date the FPSC Order approving this Stipulation and Settlement is final.

16. This Stipulation and Settlement dated as of March 12, 2002 may be executed in counterpart originals, and a facsimile of an original signature shall be deemed an original.

In Witness Whereof, the Parties evidence their acceptance and agreement with the provisions of this Stipulation and Settlement by their signature.

Florida Power & Light Company
700 Universe Boulevard
Juno Beach, Fl 33408

By: ______________________
W. G. Walker, III

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