BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

DOCKET NO. 050045-EI
FLORIDA POWER & LIGHT COMPANY

MARCH 22, 2005

IN RE: PETITION FOR RATE INCREASE BY
FLORIDA POWER & LIGHT COMPANY

TESTIMONY & EXHIBITS OF:

MORAY P. DEWHURST

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

DIRECT TESTIMONY OF MORAY P. DEWHURST

DOCKET NO. 050045-EI

MARCH 22, 2005

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?

A. I serve as 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 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 an exhibit consisting of 1 document, MPD-1, which is attached to my direct testimony.

Q. Are you sponsoring or co-sponsoring any MFRs in this case?

A. Yes. I am sponsoring the following MFRs:

D-2, Cost of Capital – 5 Year History

D-3, Short-Term Debt

D-4a, Long-Term Debt Outstanding

D-5, Preferred Stock Outstanding

D-7, Common Stock Data

D-8, Financing Plans - Stock and Bond Issues

D-9, Financial Indicators – Summary

Additionally, I am co-sponsoring the following MFRs:

A-1, Full Revenue Requirements Increase Requested

B-14, Earnings Test

C-8, Detail of Changes in Expenses

C-41, O&M Benchmark Variance by Function

D-1a, Cost of Capital – 13 Month Average

D-4b, Reacquired Bonds

Q. Are you sponsoring or co-sponsoring any 2007 Turkey Point Unit 5 Adjustment schedules or any of FPL's 2007 Forecast schedules in this case?

A. Yes. I am co-sponsoring the following 2007 Turkey Point Unit 5 Adjustment schedules:

A-1, Full Revenue Requirements Increase Requested

D-1a, Cost of Capital – 13 Month Average

Additionally, I am co-sponsoring the following 2007 Forecast schedule:

D-1a, Cost of Capital – 13 Month Average

Q. What is the purpose of your testimony?

A. My testimony will support and supplement the testimony of Dr. Avera on the appropriate Return on Equity (ROE) that should be established in this proceeding, and it will present and support the proposed ROE performance incentive of 50 basis points and the appropriate capital structure for the Company. I will then discuss the drivers of the increase in insurance costs for FPL both historically and on a projected basis, as well as the need for an increase in the annual accrual for the Company's Storm Damage Reserve. Lastly, my testimony will support the need for a subsequent year base rate adjustment in 2007 to cover the revenue requirements associated with Turkey Point Unit 5 scheduled to be placed in service in mid-2007.

FPL'S CURRENT FINANCIAL CONDITION

Q. Please describe FPL's current financial position and credit profile.

A. Our current financial position is strong. FPL currently has high-quality investment grade ratings from the three major credit rating agencies. Standard and Poor's (S&P) maintains an issuer rating of "A" with a negative outlook for FPL. Moody's Investors Service (Moody's) has an "A1" issuer rating with a stable outlook. FitchRatings (Fitch) rates FPL unsecured debt at "A+" with a stable outlook. Additionally, both Moody's and Fitch rate FPL's secured debt at "Aa3" and "AA-," respectively, which is one notch higher than the issuer rating. FPL's strong financial position is confirmed in the financial markets by the extremely tight trading spreads of the Company's first mortgage bonds in the secondary market.

FPL's commercial paper program is currently rated "A-1/P-1/F1," providing excellent access to commercial paper at very attractive rates even when the financial markets are stressed. The commercial paper program provides FPL with the flexibility to respond to the unexpected and the ability to cushion the impact of any significant change on customer bills.

FPL's maintains a $1.5 billion credit facility to back up commercial paper issuance and support the credit requirements of the fuel hedging program.

Q. How do FPL's ratings and financial situation compare to the industry as a whole?

A. The industry has experienced a significant decline in credit quality over the past several years. The financial problems faced by California's utilities starting five years ago, the Enron debacle four years ago, the August 14, 2003 Northeast blackout, and the financial turmoil experienced by some of the non-regulated and regulated energy companies during the recent past have altered the views of rating agencies and investors with regard to the entire utility sector. This can be seen in the dramatic number of ratings downgrades that occurred during that time period. For example, S&P downgraded 81 utility holding companies and subsidiaries versus 29 upgrades in 2001 and downgraded an unprecedented 182 companies versus only 15 upgrades in 2002.

Although the ratings decline continued in 2003 with S&P downgrading 139 utility companies versus just 8 upgrades, the pace of downgrades slowed considerably as the industry began to stabilize. Many companies were successful in improving their liquidity position by refinancing bank facilities to push out near-term maturities and selling selective assets. According to an S&P report dated January 24, 2005, U.S. utility downside rating actions moderated significantly in 2004, with S&P recording only 33 downgrades of holding companies and operating subsidiaries, compared with 18 upgrades. The stabilization of the industry in 2004 was due to stronger balance sheets, rising free cash flow, improved liquidity,

sizeable common stock issuances, expectations of sustained profitability, and a back-to-basics approach for certain companies.

In general, companies that over-extended and over-leveraged themselves, and/or those that took on excessive merchant generation or trading exposure in relation to their overall size, saw their credit positions suffer most significantly during this period. Additionally, companies that do not operate in constructive regulatory environments have seen their credits suffer as "ratemaking has become a more prevalent ratings driver in certain jurisdictions..... Regulatory rulings were meaningful factors in the downgrades of DTE Energy Co. (BBB/Stable/A-2) and IDACORP Inc. (BBB+/Stable/A-2)." (Standard & Poor's Research: U.S. Utility Downside Rating Actions Moderated Significantly in 2004 dated January 24, 2005). Companies that took on significant exposure in many foreign markets – in particular those in Latin America – also were negatively affected. On the other hand, some companies such as FPL whose investment programs have been well tailored to their available cash flow and balance sheet strength have been much less affected, as have those that have pre-emptively supported their growth plans through the issuance of new equity or equity-linked securities. As a result, today there is a wide range of credit and balance sheet strength in the industry.

FPL's ratings are towards the upper end of the industry range. As of December 31, 2004, approximately 35% of companies in the utility industry currently maintain ratings at a level of "A-" or above, 48% of the industry maintains ratings

in the "BBB" category and 17% of the industry is rated below investment grade. (Standard & Poor's Research: U.S. Utility Downside Rating Actions Moderated Significantly in 2004 dated January 24, 2005).

Q. Why is it important to maintain a strong financial position?

A. The primary benefits of a strong financial position are flexibility and security. Flexibility is a crucial element of FPL's ability to manage risk. The statutory obligation to serve all customers at their desired level of demand, coupled with the uncertainty inherent in unforeseen events, means that FPL must go to the capital markets as service needs dictate rather than at the point in time that might be the most advantageous from a market perspective. The inability to time market entry is somewhat offset by a strong financial position. Balance sheet strength and flexibility are also manifested in the ability to absorb unexpected financial shocks.

A strong financial position also provides security. In this respect it acts much like insurance to provide security against relatively low odds but high negative outcome events. Unfortunately, FPL experienced such an event with last year's unprecedented storm season. However, our financial strength provided us with the market access to enable us to fund expenditures in excess of the Storm Damage Reserve without a detrimental impact to our overall credit position. Since the markets understand that FPL has ample coverage for events like these and anticipate ultimate recovery, they are willing to give us a certain degree of

leeway. Of course, if ultimate recovery were ever in doubt, the market would not provide us this same degree of leeway.

Utilities, like other large corporations, generally depend on commercial paper to provide a large, inexpensive and liquid source of funds and to meet seasonal short-term cash needs. Investors in commercial paper generally rely on short-term ratings provided by the credit rating agencies. Companies with "A-1/P-1/F-1" ratings and above typically have excellent access to commercial paper, even during times of market stress. Companies with "A-2/P-2/F-2" ratings generally find a smaller pool of investors, as many investors are restricted to purchase only "A-1/P-1/F-1" paper. A smaller pool of investors typically indicates higher rates and reduced availability of funds. Some companies in our industry whose short-term ratings have fallen below "A-2/P-2/F-2" have been essentially shut-out from the commercial paper market as a source of short-term liquidity and forced to access more expensive bank markets and hold cash to fund short-term requirements.

Q. How do customers benefit from FPL's strong financial position?

A. FPL's strong financial position provides the Company with the financial flexibility necessary to fund the Company's long-term capital requirements as well as to meet short-term liquidity needs at an economical cost to customers.

Our strong financial position gives FPL excellent access to capital markets at attractive rates. For instance, FPL has issued over $1.2 billion of debt with

coupon rates below 6% and maturities in excess of thirty years since December 2002 to retire higher cost debt and fund future capital requirements. Our credit spreads (the additional cost FPL pays in excess of U.S. Government securities) are among the lowest in the industry. Customers will benefit from these attractive debt financings for many years to come. In addition, the current forecast anticipates issuance of approximately $2 billion of new debt securities over the next several years to help finance capital expenditure requirements of approximately $5.2 billion and refinance maturing debt. The ability to support our extensive capital expenditure program requires access to capital. Customers benefit because we have this access at very attractive rates.

FPL maintains credit facilities to back-up its commercial paper program and trading obligations related to the fuel hedging program. This fuel hedging program is key to reducing the volatility of customer bills by locking in fuel prices for a portion of FPL's fuel requirements. The Company could not execute such a large program without extensive credit support. FPL's strong financial position enabled us to recently upsize our credit facility by $500 million to $1.5 billion to accommodate the recently expanded hedging program at extremely attractive rates. FPL's credit facility, combined with our current ratings and strong financial position, allow us to support collateral calls related to our fuel hedging program primarily with company guarantees and low-cost letters of credit instead of cash collateral required of many companies whose financial positions are weakened.

In addition to reducing the volatility of customer bills through the fuel hedging program, FPL has also been able to amortize $518 million of under recovered fuel costs over a longer period of time to lessen the immediate impact of rising fuel prices on customer bills.

Most recently, FPL was able to temporarily fund the deficiency in the Storm Damage Reserve without suffering significant financial consequences.

Our ability to take advantage of these options, which facilitated substantial cost savings and reduced rate volatility to our customers, is largely due to our strong financial position.

Q. What conclusion should the Commission draw about FPL's current financial position?

A. Our current financial position provides adequate financial strength and flexibility to accommodate the inherent uncertainties of the industry, taking due regard of the risk factors affecting the industry and the Company today, and is of benefit to our customers. It should be maintained through the provision of an adequate allowed return on equity and an appropriate equity ratio, as reflected in the recommendations made later in my testimony. Weakening in any of these areas would clearly be perceived by investors as a decline in our overall financial strength, thereby affecting our access to capital at reasonable rates at a time when external financing requirements will be substantial. This would increase

financing costs as well as jeopardize the Company's ability to use its financial strength to reduce volatility in customer bills through activities such as fuel hedging or the extension of amortization periods for recovery of fuel costs and would ultimately undermine our ability to provide highly reliable service at costs below industry averages. The increase in base rates requested will ensure financial stability and continued financial viability.

RETURN ON EQUITY

Q. What is your recommendation for a return on equity?

A. I have reviewed the analysis performed by Dr. Avera and concur with his recommended fair rate of return on equity of 11.8%. In addition, we request that the Commission approve a performance incentive of 50 basis points to recognize the Company's superior performance and to provide an incentive for future superior performance. A performance incentive is fully warranted on the merits, and is consistent with past Commission action. Adding this performance incentive yields a midpoint for the allowed ROE of 12.3%, which is within Dr. Avera's fair rate of return range. A 1% band should be established on either side of the midpoint, resulting in a return on equity range of 11.3% to 13.3%.

Q. What should the Commission consider in determining the Company's ROE?

A. A company's ROE is an important indicator both of the economic return that the company can provide to its equity holders and the overall financial strength of the enterprise. It is axiomatic that any company must provide a prospective return to shareholders that is at least as good as the return that the shareholders could

expect to earn on an investment of equivalent risk characteristics. Failure to do so will result in a loss of equity value and the inability to access capital markets at a reasonable cost. As I understand the Commission's task, it is, among other things, to look at risk through the eyes of current and potential equity investors and to set an allowed ROE that, if achieved by the Company, will induce the needed level of investment at the lowest reasonable cost and fairly compensate equity holders for the utilization of their assets. This level of ROE, if achieved by the Company, coupled with prudent management of the capital structure, will also satisfy investors' requirements for financial strength.

Investors' requirements at any particular point in time are set both by general conditions and risks and by company-specific conditions and risks. Virtually all conditions affect both debt holders and equity holders; however, they may affect these classes of investors differently. Therefore, the Commission should look to all the risk factors affecting a company when setting an allowed ROE, but should emphasize those that have the greatest impact on equity holders. In the following responses I have addressed these factors.

Q. What general risk factors should the Commission consider in determining the Company's ROE?

A. There are three general risk factors which should be considered. The first two factors have not significantly changed since the 1999 and 2002 rate proceedings, while the third risk factor is somewhat greater today than in past rate proceedings.

The financial success of most companies will be influenced by the growth rate of the economy, the inflation rate, and general unemployment levels. As I mentioned in my 2002 testimony, the economy began to experience a sharp slowdown starting in the second half of 2000 and into 2001, as businesses reduced spending and investment. The terrorist attacks in September 2001 prolonged the impact, and today uncertainties still exist from the war in Iraq. The active 2004 hurricane season creates further uncertainty due to the future possible adverse effects on tourism and the number of relocations to Florida. Economic events tend to have a disproportionate effect here in Florida, a tourist dependent state, which relies greatly on intangibles like consumer confidence as a driver of economic activity. Overall, this general risk factor has not changed significantly since 2002.

The second general factor is industry structural changes. From an investment perspective, *all* geographic areas have experienced an increase in uncertainty both because the future path of regulation is unclear and because the likely effects of a particular regulatory scheme are now understood to be much less predictable than previously thought. Although the regulated electric utility industry in Florida has not undergone significant restructuring, uncertainty surrounding the implications of FERC's Regional Transmission Organization policy and its potential impact on customers and utilities in Florida creates uncertainty in investors' eyes. Again, this general risk factor has not changed significantly since 2002.

The third general factor, which has increased the uncertainty and risk associated with the utility industry overall, is the changing nature of the industry. Changes in technology, uncertainty of long-term fuel supply, increased fuel price volatility, stricter environmental control regulations for items such as carbon dioxide and mercury, strained transmission grids and events such as the August 14, 2003 Northeast blackout augment industry risk and create an expectation that substantial investment will be required of regulated utilities in the foreseeable future. In a FitchRatings report titled "Outlook 2005: U.S. Power and Gas" published December 16, 2004, the Agency notes that it "expects capital expenditures for the regulated utilities and the generators over the next five years to increase above current industry projections. Higher expenditures will involve new investments for greater reliability of electric transmission and distribution systems as well as investments in gas storage and liquefied natural gas (LNG) terminal facilities. Also, electric utility operating companies and generators will face higher expenditures to meet stricter or new environmental standards for sulfur dioxide, nitrogen, mercury and greenhouse gasses."

Q. Please identify and describe company-specific risk factors that are important in determining FPL's ROE.

A. There are five company-specific risk factors that must be addressed in determining FPL's ROE:

Growth

The interaction of general economic uncertainty and the underlying strong growth of our service territory create a particular set of risks for FPL. We expect to

continue to experience growth in the number of customers moving into our service territory; however, the recent hurricanes have forced us to lower our expectations and at the same time increase the range of outcomes that we must prepare for. While our expectations for customer growth in the short-term may be reduced, significant capital expenditures will still be necessary over the next few years to ensure adequate and reliable supply under a more uncertain range of outcomes.

All three rating agencies have expressed their concerns over the risk associated with these significant capital expenditures. In a report dated May 7, 2004, S&P stated that their concerns include "the need to construct new generation capacity to meet growth needs and reserve margins." Moody's lists "capital expenditures to remain high to meet demand growth and reserve margin requirements" as a risk/weakness for Florida Power & Light in an October 2004 report. FitchRatings lists "ongoing capital expenditure requirements" as a key credit concern for the Company in a September 23, 2003 report and states that "new generation investments will pressure customer rates" in a report dated February 4, 2005.

Customer Base

The majority of our revenues come from our residential and commercial customers. Compared to utilities in other states, Florida has a low industrial load. From an investor perspective, this reduces risk. There have been no major changes in our customer base over the last few years, so this risk factor remains the same as it has been for many years.

Florida Economy

As indicated earlier, the Florida economy has been particularly affected by the current economic uncertainty and the possibility of adverse effects from the 2004 hurricane season, in large part because of the heavy reliance on tourism. As a service provider to all segments of the Florida economy, we naturally absorb the consequences of this uncertainty, which from an investor perspective represents additional company-specific risk. While there has been no change in the level of risk exposure in this area, investor sensitivity to this risk has increased due to the heavy coverage of the storms by the media. At virtually every meeting with equity investors during the last several months they have focused on this issue.

Nuclear Generation

FPL has four nuclear generating units: Turkey Point Units 3 and 4 and St. Lucie Units 1 and 2. Together, these contribute 15.5% of available capacity and approximately 21% of actual supply, owing to their high reliability and their low-cost position in the economic dispatch. FPL has the highest percentage of generation from nuclear resources of any utility in the state. While our customers have enjoyed cost savings over the years from these units, the investment community assigns a higher level of risk to a utility that has nuclear units in its generating portfolio.

As discussed in Mr. Stall's testimony, recent events have caused an increase in the level of risk inherent in the nuclear industry. The Nuclear Regulatory Commission is taking a much more directive role in its oversight of the industry

following the Davis-Besse incident causing concern over increased compliance costs for the industry as a whole. Additionally, heightened concerns surround the future of spent fuel storage due to continued controversy and lack of progress in the development of storage at Yucca Mountain. The delay in Yucca Mountain poses a risk to the industry, as nuclear plants are running out of room to store nuclear fuel on-site. Furthermore, security costs have increased due to the heightened level of concern over terrorist acts. Finally, while the license extension of many nuclear plants will clearly provide future benefits to both investors and customers, those benefits come with increased risk of large capital requirements for maintenance, as illustrated by the recent need for reactor vessel head replacements and steam generator replacements. These considerations are discussed further in Mr. Stall's testimony.

On a total cost basis (i.e., including depreciation and a fair allowance for capital recovery and assuming a risk premium for nuclear) our cost per kWh for nuclear-produced power is significantly less than the equivalent cost for fossil-fueled plants. Recent estimates of fuel cost savings alone, comparing the fuel costs of our nuclear and natural gas units, show that the nuclear units save approximately $1 billion per year in fuel cost. It would be an inconsistent use of the rate setting process to take advantage of the very large customer savings in variable cost without also compensating equity holders for the risk premium associated with nuclear power.

Geographic Position

Florida's geographic position combined with an increasing reliance on natural gas exposes the Company to certain additional risk factors related to gas supply. Currently, FPL obtains gas supply via one of two pipelines, Florida Gas Transmission or Gulfstream pipeline, both of which are sourced from the Gulf of Mexico. Disruptions of gas supply in the Gulf of Mexico due to a hurricane or other unforeseen event create additional risk in the eyes of investors and the rating agencies (S&P FPL Group Research Article dated October 21, 2003). This risk is partially mitigated through the use of fuel-switching capability, which has had the additional benefit of keeping fuel costs lower than they otherwise would have been. However, our dependence on natural gas has increased in recent years and will continue to increase as the Martin and Manatee and Turkey Point expansions are complete.

As discussed in our rate proceeding in 2002, Florida's geographic location exposes our electrical systems to a higher likelihood of adverse weather events. As evidenced in 2004, FPL's service territory experienced an unprecedented amount of storm activity, taking direct hits from Hurricanes Charley, Frances, and Jeanne. Concerns prevail over whether we may be entering into a more active hurricane period over the next few years and uncertainty prevails regarding the potential impact of El Nino/Southern Oscillation on future adverse weather events. While the Storm Damage Reserve has historically provided substantial mitigation of this risk, investors are still at risk for loss of revenues and other

impacts during adverse weather conditions. All other factors being equal, Florida's greater likelihood of adverse weather events increases risk. Should the Commission deviate from its past policy and practice in allowing the recovery of prudent and reasonable storm restoration costs, risks to investors would significantly increase beyond the level that has been factored into the ROE submitted by FPL in connection with its request for an increase in base rates.

Q. What conclusion should the Commission draw from these qualitative risk factors?

A. I believe it is important for the Commission to be aware of these risk factors as it considers both the appropriate level of ROE and the capital structure that we have maintained at FPL. Clearly, an analysis of the risk factors indicates that FPL operates in a riskier environment today than in 1999 and 2002. In my judgment, Dr. Avera has appropriately evaluated the impact of these uncertainties on investors' willingness to supply capital and considered the implications for FPL's financial integrity. An 11.8% ROE would fairly account for the exposures that investors attribute to FPL, while ensuring the Company's ability to attract capital even under adverse circumstances, assuming no material deviations in the regulatory framework, particularly as it relates to the recovery of excess storm restoration costs.

ROE PERFORMANCE INCENTIVE

Q. Please explain the ROE performance incentive sought by the Company in this proceeding.

A. FPL is requesting that the Commission increase the midpoint of the Company's authorized ROE band by 50 basis points to 12.3%. The purpose of the incentive is to recognize FPL's past superior performance and to encourage continued strong operational performance over the long-term. Such an action has the additional benefit of providing a signal to other companies that outstanding performance will be encouraged, recognized and rewarded.

Q. Why would a performance incentive be necessary given the Company's obligation or duty to serve?

A. The obligation or duty to serve requires that the Company be physically and financially capable of providing electric service to all those within a certain geographic area who request it, and to meet that demand with adequate and reliable resources. In return, a utility is entitled to "just and reasonable" rates that provide a return of and on its investment. This regulatory regime generally has worked very well in the United States, producing utility systems and services that are among the most modern, efficient and reliable in the world. However, traditional cost-of-service based regulation has a shortcoming in that it fails to provide incentives for utilities to achieve more efficient levels of service over a long period of time. Instead, the primary incentives are to avoid challenges by regulators or intervenors, which is not conducive to attempts to reach higher levels of cost-effectiveness.

To illustrate this point, consider two hypothetical utilities. Utility A plans and operates its system in a way that is principally intended to avoid adverse regulatory consequences such as imprudence disallowances. It operates with adequate reliability, but it attains that reliability primarily through volume of spending, not through process innovation. Its spending is clearly not imprudent, yet its overall cost-effectiveness is inferior to industry averages. Utility B, on the other hand, sets high standards for both reliability and cost levels. Over time, through process improvements and innovation, it is able to reduce the level of cost needed to attain top quartile reliability. Assuming the two utilities had similar service territories, load profiles, risk profiles, and other characteristics, and were entitled to the same ROE range, "just and reasonable" base rates for Utility A would be higher than for Utility B. Yet Utility B, a better managed utility producing lower base rates and better overall service for customers, earns no more than Utility A. It is therefore clear that conventional ratemaking provides no incentive to encourage companies to seek to become "Utility B." Yet, as in every other field of human endeavor, it is always easier to adopt the "safe" path of adequate but not outstanding performance.

Q. Is it your impression that certain utilities explicitly choose to plan and operate their systems at minimum acceptable levels?

A. No. I have no reason to believe that such an approach would be contemplated by or acceptable to any particular management team. Nevertheless, it is obvious that, for whatever reason, there is a gradation of performance levels among investor-

owned utilities throughout the country. The point of my example is simply to indicate the need for some variation on conventional rate of return regulation to promote and reward better operational performance which ultimately benefits customers. The difference to customers between "adequate" (e.g. industry average) and "outstanding" performance is very substantial, yet conventional regulation offers little inducement to companies to accept the risks involved in seeking outstanding performance.

Q. Has the Commission employed alternatives to conventional cost-of-service based regulation?

A. Yes. This Commission has approved such alternative regulatory approaches in the past. Specifically, in the case of FPL, the Commission has approved revenue sharing plans in 1999 and in 2002. Under these plans, the current of which expires at the end of 2005, the Company has operated under certain revenue sharing thresholds, providing refunds to customers where those thresholds were exceeded due to unusually hot weather, for example, but being allowed to enhance its earnings through efficient management without reference to an ROE ceiling. The results of these two agreements have been very positive from the standpoint of customers. Since 1999, FPL has been able to lower its retail base rates by $600 million in annual revenue requirements and has provided refunds of more than $220 million, which will result in a total of nearly $4 billion in direct savings to customers through the end of 2005.

Although these revenue sharing agreements have provided positive benefits to customers, today, with utilities generally having to make very large investments in infrastructure to continue providing reliable service and facing other significant cost increases, such agreements hold much less appeal. Therefore, some other type of incentive mechanism would be appropriate.

Q. In what specific ways has the Company earned the opportunity for an incentive of this nature?

A. The Commission should evaluate FPL's performance in three key areas:

1. Reliability of Service
2. Quality of Customer Service
3. O&M Costs

Other witnesses in this proceeding will testify in detail about the Company's specific achievements in each of these areas. I will indicate who these witnesses are with a brief comment and then go on to discuss the magnitude of the performance incentive and the potential impact on customers. I should point out that there is an independent source that the Commission should consider when examining these areas, namely Mr. Landon's testimony.

Q. Please comment on the Company's achievements in reliability.

A. The focus here should be on the excellent reliability of our operating system: generating, transmission, and distribution. The Company's fossil and nuclear availability rates are above the industry average and the average amount of time customers were without power in 2003 was less than half the industry average. Additionally, in 2003 and 2004, FPL's results for average annual outage time, as

measured by the System Average Interruption Duration Index (SAIDI), were the best in Florida. In their testimonies, Witnesses Stall, Yeager, Mennes, and Williams provide the specifics of these achievements within their respective areas.

Q. Please comment on the Company's achievement in quality of customer service.

A. FPL has improved an already excellent record of customer service with, for example, our state-of-the-art Customer Care Centers. FPL earned the prestigious Center of Excellence certification from Purdue University's Center for Customer-Driven Quality - the first electric utility to be so honored and was awarded the ServiceOne award by PA Consulting a leading management, systems and technology consulting firm that recognizes utilities that provide exceptional service to their customers as determined by a set of measures of excellence in customer care developed by a panel of industry experts. These achievements are detailed in the testimony of Mrs. Santos.

Q. Please comment on the Company's achievement in controlling O&M costs.

A. As outlined in the Company's test year letter, FPL achieved unprecedented reductions in operating expenses during the decade of the 1990s. Since 1985 the Company has succeeded in lowering its non-fuel O&M expenses per kWh by approximately 29%, while the number of customers served through 2003 increased by 57%. During the decade of the 1990s, FPL actually reduced total annual non-fuel O&M by over 15%. After a decade of steady reductions, costs

have grown only modestly over the last few years despite the increased costs of nuclear maintenance, healthcare, and insurance.

Q. Does the Company expect an increase in its O&M expenses in 2006?

A. Yes, but O&M costs per kWh are still at low levels, especially compared with industry averages. As indicated in Mr. Landon's testimony, FPL's average O&M expenses over the six-year period beginning in 1998 were 41 percent lower than the benchmark group on a per customer basis, and 22 percent lower on a per kWh basis. The current and prospective cost pressures – driven to some extent by unusual economic circumstances – should not obscure the much larger overall point, which is the huge magnitude of the overall performance improvement over the last decade. FPL has a consistent track record of achieving O&M costs per kWh that are well below the industry average. Had FPL not undertaken these extraordinary expense reductions, the level of expense included in test year calculations would have been much higher. Furthermore, the current upward pressure on O&M costs is common to the industry, mainly due to increased nuclear costs, employee benefits, and insurance. What FPL seeks to be acknowledged for is the exceptionally low base on which test year expenses are built.

Q. Why do you recommend that the performance incentive be 50 basis points?

A. A performance incentive should be large enough to motivate FPL's continued performance improvement over the long-term, yet not so large as to negate the benefits of performance improvements for the customer. A 50 basis point

performance incentive equates to approximately $50 million in revenue requirements.

One way to evaluate the annual benefits customers receive from FPL's performance improvements is to compare FPL's performance in major cost areas to an industry or peer group average and calculate the impact to customers if FPL simply operated at the cost and efficiency levels of the industry average versus the actual levels attained. Fuel costs are set by the market and beyond FPL's control, however; O & M and capital costs are a substantial portion of the total cost customers pay for electricity. As illustrated in Mr. Landon's testimony, FPL's O&M and gross plant have consistently been significantly lower than the average for its peer group on both a kWh and per customer basis. In other words, FPL has consistently collected less money from customers for the operation and maintenance of plants, depreciation, financing costs and investor return than its industry peer group. If FPL had operated based on the peer group average, costs for O&M and depreciation alone during the 1998 through 2003 period would have averaged approximately $400 million higher per year (calculated on a per kWh basis). See Exhibit MPD-1. The savings are even more significant on a per customer basis. This estimated savings does not account for the cost of capital associated with the increase in rate base. A 50 basis point performance incentive equates to roughly 13% of the annual average cost savings.

Q. Would customers continue to benefit from lower costs if the Commission granted FPL's request for a rate increase in this docket?

A. Yes, even with the rate increase requested for 2006 and the supplemental adjustment requested for Turkey Point Unit 5 requested for 2007, FPL's O&M costs and gross plant balance (expressed on a cents per kWh basis) are lower than customers in FPL's peer group average for 2003. See Exhibit MPD-1.

As mentioned earlier, FPL's customers will have realized direct savings of almost $4 billion as of December 31, 2005, as a result of the two rate reductions and associated refunds implemented by the Company. The efforts of a strong management team and a quality-driven workforce have succeeded in delaying as long as possible increases in FPL's retail base rates, while keeping pace with Florida's rapid growth and demand for power. After many years, an increase in retail base rates now is necessary to ensure that FPL can continue to provide reliable, cost-effective electric service at the levels its customers have come to expect and that are consistent with the Company's past record of performance.

Q. What does FPL's proposed performance incentive imply for allowed ROE?

A. As noted earlier, the addition of a proposed 50 basis point performance as an incentive to recognize the superior management performance that the Company has achieved over a sustained period of time and a method to encourage FPL management to continue this exceptional performance leads to our recommendation of a midpoint allowed ROE of 12.3%. A 1% band on either side

of the midpoint should be established. Therefore, I recommend a range of return on equity of 11.3% to 13.3%.

Q. What would be the impact of the performance incentive on FPL and other companies subject to the Commission's jurisdiction?

A. A performance incentive that shifted the allowed range up 50 basis points would be a positive incentive for the Company to continue its excellent performance. At the same time a performance incentive to FPL would be an important signal to other companies as to the importance of, and the Commission's willingness to recognize, performance and service achievements in establishing a utility's rates. In Docket No. 010949-EI, Commission rewarded Gulf Power Company (Gulf) with a 25 basis point adder to the mid-point ROE in recognition of Gulf's past performance and as an incentive for Gulf's future performance. Without commenting on whether a 25 basis point adder was sufficient in light of Gulf Power's achievements, I believe a 50 basis point adder is a relatively modest award considering FPL's track record and the amount of value the Company's efforts have realized for customers.

CAPITAL STRUCTURE

Q. What is FPL's current equity ratio?

A. Since the 1999 Revenue Sharing Agreement took effect we have maintained our equity position over time, on an adjusted basis, at approximately 55.83%, though the pattern of seasonal cash flows may drive the ratio slightly up or down on a short-term basis.

Q. What is your recommendation for an equity ratio for FPL for regulatory purposes?

A. I recommend maintaining the adjusted equity ratio of 55.83%, which was established in FPL's 1999 Stipulation and Settlement Agreement (the Revenue Sharing Agreement) between FPL and the Office of Public Counsel that was approved by the Commission and was sustained in FPL's 2002 Stipulation and Settlement. As provided in both of the agreements, the adjusted equity ratio equals common equity divided by the sum of common equity, preferred equity, debt, and off-balance sheet obligations. Nothing has happened in the interim that would suggest that the ratio should be reduced, and in fact the current industry status would tend, if anything, to drive the required ratio in the opposite direction. It would certainly be inconsistent for the Commission to seek to reduce the financial strength of the Company at a time when many key risk drivers point to a period of increased risk. However, I believe that an adjusted equity ratio of 55.83% provides adequate financial strength for the current environment.

Q. Please explain your reference to FPL's equity position on an adjusted basis.

A. In evaluating the adequacy of the capital structure of any company, investors will take into account major financial commitments, whether these are reflected on the balance sheet or not. In the case of a utility that has an obligation to serve its customers, the financial community commonly takes into account obligations associated with purchased power agreements (PPAs). This fairly acknowledges the fact that a long-term contractual commitment to purchase firm capacity behaves economically much like debt, imposing fixed charges independent of a

company's revenues and, thus, should be taken into account in evaluating the financial strength of the company.

In the case of FPL, we have several long-term purchase contracts that supply about 20% of the energy we sell to our retail customers. These obligations significantly increase the fixed charge leverage of the Company and are generally understood by the investment community. They are explicitly evaluated by the rating agencies, who examine each contract and assign it a rating that dictates how much of the nominal total value of the contract will be added to FPL's debt obligations for rating purposes. The net effect is to increase the relative share of debt and debt-like instruments in the capital structure. Accordingly, FPL will need to maintain a higher unadjusted equity ratio to attain the same level of financial security with PPAs than without.

Q. **Please describe the basic methodology employed to determine the amount of imputed debt.**

A. While all of the rating agencies take off-balance sheet obligations into account when evaluating credit quality, S&P uses an approach that has both quantitative and qualitative aspects to value the debt component of off-balance sheet obligations. It involves first computing the net present value of the remaining capacity payments under the contract. A risk factor is then determined based primarily on the method of recovery of capacity payments. Once the risk factor is determined, it is then multiplied by the net present value of the remaining capacity payments to determine the amount of off-balance sheet obligation to

include as debt in the capital structure of the company for purposes of analyzing credit quality.

Q. Do you believe an adjustment of this type is appropriate?

A. Yes. In general I agree with the judgment of the financial community that an adjustment for off-balance sheet obligations should be made in assessing the financial condition of a utility. In addition, while our own calculation of the appropriate amount to include might be different, I believe that the rating agencies' overall assessment fairly represents the general investor viewpoint and is thus directly relevant. It is therefore reasonable for the Commission to make a comparable adjustment when it evaluates the financial strength of FPL.

Q. Why is it important that regulatory policy be consistent with the perspective of the financial community on this issue?

A. There are two reasons. First, as I understand the goals of regulatory policy, one of the Commission's tasks is to set rates such that investors have the prospect, though not the guarantee, of earning a reasonable rate of return. In doing so, the Commission must look to capital markets for evidence of investor requirements. Rating agencies, acting as independent risk assessors on behalf of investors generally, are an important source of evidence in this regard. The fact that they include off-balance sheet obligations should be strong evidence of the relevance of these obligations to financial risk.

In addition, however, there are sound fundamental economic reasons for viewing purchased power obligations as part of the financial profile. These obligations are

similar to debt from a financial perspective. Moreover, they represent avoided capacity – capital expenditures and rate base that would otherwise have been included like other assets – but with a fixed obligation. Whereas all other assets are supported by a cushion in the form of the most junior financial claim (common equity), which bears the ultimate risk of financial fluctuations, these PPAs have no such support. The Company is required to meet these obligations and cannot, in a weak year, return less than the contractual commitment. From the Company's perspective, it is as though the capacity represented by these contracts were 100% financed by debt. The major bond rating agencies include a portion of the present value of these contracts as debt in their analysis. Logically, this effect should be incorporated into the overall assessment of financial structure.

Q. Has the Commission previously recognized the financial market's imputation of debt in assessing the impact of purchased power on a utility's capital structure?

A. Yes. The Commission continues to recognize the financial leverage implicit in purchased power contracts in the approach used for surveillance reporting requirements. The current revenue sharing agreement in effect for FPL included in Order No. PSC-02-0501-AS-EI, April 11, 2002, incorporates by reference the following provision from the Stipulation and Settlement approved by the Commission in 1999 (Order No. PSC-99-0519-AS-EI, March 17, 1999):

> (FPL's) adjusted equity ratio equals common equity divided by the sum of common equity, preferred equity, debt and off-balance sheet obligations.

The amount used for off-balance sheet obligations will be calculated per the Standard & Poor's methodology as used in its August 1998 credit report.

The Commission has also allowed consideration of imputed debt in approving FPL's Standard Offer Contract. More recently, the Commission has recognized this concept in accepting applications of an equity adjustment in Docket No.031093-EQ, *In re: Petition for approval of revised standard offer contract and revised COG-2 rate schedule by Florida Power and Light Company*, Order No. PSC -04-0249-TRF-EQ, dated March 5, 2004, and in Docket No. 040206-EI, *In re: Petition to determine need for Turkey Point Unit 5 electrical power plant, by Florida Power and Light Company*, Order No. PSC-04-0609-FOF-EI, dated June 18, 2004.

Q. How do the capital markets react to an adjusted equity ratio of 55.83% compare?

A. The capital market's reaction is positive - both the debt and equity markets react well. The market reaction supports our current ratings and overall credit profile as evidenced by the tight trading spreads on FPL's bonds in both the new issuance and secondary markets. FPL's performance and access in the market is good and is consistent with the strong end of the industry.

Q. What can you conclude about FPL's current adjusted equity ratio?

A. Our 55.83% equity ratio has been and continues to be well received by the markets. Maintaining this adjusted equity ratio will indicate to the Capital Markets the Commission's continued commitment to support the financial

integrity of the service providers subject to its jurisdiction. Furthermore, a strong capital structure is appropriate to current circumstances and offers flexibility and security, which enables us to serve our customers well.

STORM DAMAGE FUND

Q. What has FPL proposed as the annual accrual to the Storm Reserve to be reflected in base rates?

A. FPL has proposed that the Commission establish a target reserve level of $500 million and that the annual accrual in base rates be increased to $120 million. This amount includes $73.7 million, approximating the expected amount of annual storm losses, based on Mr. Harris' analysis. The remainder of the $120 million annual accrual would contribute toward the replenishment of the depleted storm reserve. Assuming an annual accrual of $120 million and a two year surcharge recovery of any negative storm damage reserve balances, the expected balance of the Storm Reserve would be approximately $367 million after five years, according to Mr. Harris' analysis.

Q. What regulatory framework underlies this request?

A. I believe the Commission has established and consistently endorsed an overall framework that acknowledges that the costs associated with restoring service after tropical storms are a necessary cost of doing business in Florida and as such are properly recoverable from customers. This framework consists of three main parts: (1) an annual storm accrual, adjusted over time as circumstances change; (2) a 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 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 competing customer interests: as small an ongoing impact as possible; minimal volatility of "rate shock" in customer bills because the reserve is insufficient; and intergenerational equity. 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 T&D network. The annual accrual can be reduced if a period of favorable loss experience leads to a build-up in the storm 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.

Q. If the regulatory framework did not provide for the full recovery of storm restoration costs over time, would your proposed annual accrual be the same?

A. No. The proposed annual accrual assumes FPL has the ability to recover prudently incurred storm restoration costs, whether there is a deficit in the Storm Damage Reserve or not. If FPL were not permitted to recover prudently incurred storm restoration costs, we would need to modify our accrual and overall rate request. The annual accrual would need to recover the annual expected cost of storm restoration, plus provide for the build-up of substantial reserves that could withstand an extreme storm season. In addition, investors would need to be

compensated for the additional risk capital that would be required to assume an insurance function with increased returns.

Q. Why should customers pay for storm restoration costs? Isn't this a risk of doing business for FPL?

A. To address these questions, one must first recognize that they embody two distinct concepts: cost and risk. In fact, from a business perspective, the primary risk around tropical storms is simply their timing. We will incur costs to restore power after tropical storms and what is at issue here is the treatment of those entirely foreseeable costs 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.

At present we do not recover (and have not recovered since Hurricane Andrew) through base rates the full expected costs of restoring service after tropical storms. 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. 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 reserve balance happens to exist at the precise moment that hurricanes strike, for while the long term

expected costs are relatively predictable, the adequacy of this balance is inevitably a matter of chance.

Q. How is this different than, for example, an accident at one of FPL's generating plants?

A. In many respects it is not. It is true that even an organization such as FPL, with a good track record, will from time to time incur losses from accidents. These losses are a part of the cost of providing electric service and as such a fair average level of costs is reasonably recoverable from customers. The fundamental difference, however, is that extraordinary losses from plant outages are covered by insurance, the cost of which is recovered through base rates. So, the costs of such extraordinary losses, effectively, are borne by customers. This is not the case today with storm costs, since commercial insurance is unobtainable at reasonable expense.

Q. Why doesn't FPL purchase insurance for storm losses?

A. The substantial losses associated with Hurricane Andrew in 1992 essentially eliminated the commercial market for storm insurance in anything like the amounts needed to provide adequate protection to FPL's extensive network of assets and its ability to quickly restore reliable service. Though FPL continues to explore the market for insurance for storm damage losses, it has been forced to seek other methods to ensure that it would have adequate available resources for the costs of repairing and restoring its T&D system in the event of a hurricane, storm damage, or other natural disaster.

Q. How has FPL paid for storm damage repairs and restoration since 1993?

A. Following Andrew, FPL, with the Commission's approval, over time developed an approach that relied more heavily on the Storm Damage Reserve, the existence of which pre-dated Andrew. In 1993 FPL initially proposed a perpetual storm clause, but this was rejected by the Commission at that time. Instead, the Commission endorsed the composite approach I discussed earlier. We have consistently applied this framework ever since.

Q. Has this framework operated effectively in your view?

A. Yes. Since Hurricane Andrew the current framework has operated to keep customer rates lower than they otherwise would have been, since 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, until this year, 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.

Q. After three hurricanes hit FPL territory in the unprecedented 2004 storm season, was the Storm Damage Reserve adequate to cover storm restoration and repair costs?

A. No. The current estimated cost for all three storms, net of insurance proceeds is $890 million (total system). Payment of these costs has completely depleted the Storm Damage Reserve of $354 million as of December 31, 2004 and created an approximate $533 million (jurisdictional) deficit in the reserve.

Q. Does this indicate a failure in the current regulatory framework?

A. No. The current framework contemplated the potential that the existing Storm Damage Reserve would not be sufficient to cover restoration costs in all circumstances. What it does indicate is that the annual accrual was not set sufficiently high, resulting in the need for the type of special assessment contemplated by Order No. 93-0918, and requested by the Company in Docket No. 041291-EI, in light of the extraordinary storm season of 2004. Higher levels of annual accruals prior to 2004 would obviously have meant a higher Storm Damage Reserve going into 2004 but would also have meant higher rates during that time.

Q. Explain FPL's proposal to recover the deficit.

A. FPL has requested Commission approval in Docket No. 041291-EI to recover the deficit through a monthly customer surcharge. The Commission authorized FPL to implement the storm surcharge effective February 17, subject to refund pending the outcome of hearings scheduled in April 2005. Another potential option for the recovery of the storm deficit is the issuance of securitized bonds. This option

would require legislative action as well as the issuance of a financing order by the Commission, and my testimony is not predicated upon a securitization approach.

Q. If FPL's request to recover the deficit in the Storm Damage Reserve in Docket No. 041291-EI is approved, will you still need to increase the annual accrual to the Storm Damage Reserve?

A. Yes. Recovery of the current deficit in the Storm Damage Reserve would put the Reserve back to zero. The current annual accrual of $20.3 million is not, and has not been for some time, sufficient to cover expected annual storm losses. With the depletion of the Storm Damage Reserve from the 2004 hurricane season, the annual accrual must now not only fund annual expected losses (because there are no existing reserves to rely on), but also contribute to the rebuilding of the Storm Damage Reserve to a prudent level over a reasonable period of time.

Q. What are the fundamental regulatory objectives that should be considered in establishing the annual storm accrual and target reserve balance?

A. FPL believes that the regulatory objectives should be the following: (1) achieve the lowest long-term customer costs; balanced with (2) dampen volatility of the reserve (i.e., reduce reliance on special assessments/rate increases); and (3) cover the costs of most storms, but not those from the most catastrophic events.

Q. How should the Commission determine the appropriate level of annual accrual?

A. Assuming that the current deficit in the storm fund is recovered through a special surcharge, and that the regulatory framework continues to provide for the recovery of prudently incurred storm costs in excess of storm reserves in periods

of high storm activity, the goal of the accrual over the next several years should be to cover the expected value of annual windstorm losses and make some progress in reestablishing the Storm Damage Reserve to a level adequate to fund most but not all windstorm losses. On the other hand, if the current deficit in the Storm Damage Reserve is not recovered from customers or the prospective regulatory framework were altered in a way that did not provide for the recovery of prudently incurred storm costs in excess of the Storm Damage Reserve in periods of high storm activity, FPL would have to reevaluate both the level of the annual accrual requested in this filing as well as the overall required investor return.

Q. Has FPL performed a study to determine the annual amount of expected losses from windstorms?

A. Yes. FPL commissioned studies to calculate the annual amount of expected windstorm losses, as well as the expected value of the storm fund given various funding levels. The studies were prepared by and are being sponsored by Mr. Harris of ABS Consulting.

Q. What direction was provided by FPL to ABS Consulting in the preparation of the studies?

A. FPL requested that ABS Consulting determine the levels of losses to which the Company and its customers are statistically exposed and to develop average annual cost estimates associated with repair of storm damage and service restoration over a long period of time. Additionally, FPL requested ABS to

provide a probabilistic analysis of expected results for the Storm Damage Reserve Balance over five years at various levels of annual accrual.

Q. What does the analysis conclude regarding the expected annual long-term cost for service restoration and repair of storm damage to FPL's assets?

A. The ABS Consulting analysis concludes that the expected average annual cost for windstorm losses is approximately $73.7 million. Windstorm losses include costs associated with service restoration and system repair of FPL's Transmission and Distribution (T&D) system from hurricane, tropical and winter storm losses. Also included are storm staging costs and windstorm insurance deductibles attributable to non-T&D assets. The $73.7 million expected annual loss is obviously much greater than the current approved $20.3 million annual accrual, which has not been sufficient to cover expected annual losses for some time.

Q. Does the analysis recommend a target reserve level?

A. No. There is no single correct target reserve balance. The target reserve level depends largely on the regulatory framework for storm cost recovery and the point at which the Commission decides to balance the customer interests that I referred to earlier. Obviously, the lower the Storm Damage Reserve balance, the more likely that storm losses will exceed the funds available in the Storm Damage Reserve and therefore the greater the reliance on special assessments. The higher the Storm Damage Reserve Balance, the less likely windstorm losses will exceed the funds available in the Storm Damage Reserve. If the regulatory framework were to be changed such that FPL could not recover prudently incurred restoration costs in excess of the Storm Damage Reserve, then the balance in the Storm

Damage Reserve would have to be maintained at substantially higher levels to ensure that FPL could recover the full cost of providing electric service over the long-term.

Q. What target reserve level does FPL recommend?

A. Under the assumption that the regulatory framework would provide for recovery of prudently incurred costs that go beyond the Storm Damage Reserve (in other words, continuing the Commission's existing policy) a target reserve level should be set that is large enough to withstand the storm damage from most but not all storm seasons. FPL recommends a $500 million target reserve level. According to the aggregate damage exceedance probabilities presented in Table 5-2 on page 5-6 of Mr. Harris' Storm Loss Analysis, Document SPH-1, the chance that losses over five storm seasons will exceed $500 million in any one of those seasons is approximately 23.6%.

Q. Will an annual accrual of $120 million ensure that there will be adequate funds in the Storm Damage Reserve to cover all windstorm losses?

A. No. The analysis indicates that even with an increase in the annual accrual to $120 million and the ability to recover a storm deficit through a two-year surcharge, there is still a 33% chance that losses will exceed the value of the Storm Damage Reserve over a five year period. Additionally, the assumptions used to develop the expected annual loss from windstorms did not take into account any increase in restoration costs due to inflation or future customer growth, much of which is projected to occur in coastal areas most susceptible to windstorm damage.

While there is a significant probability that an annual accrual of $120 will not be sufficient to cover all windstorm losses, it provides a reasonable level of coverage and, I believe, fairly meets the objectives stated by the Commission in Order No. PSC-95-1588-FOF-EI:

> "The annual accrual needs to be sufficiently low so as to prevent unbounded storm fund growth and yet large enough to reduce reliance upon emergency relief mechanisms in the event of catastrophic weather events."
>
> Order No. 95-1588-FOF-EI, issued December 27, 1995 in Docket No. 951167-EI, page 2.

Q. How can the Company ensure that the requested annual accrual of $120 million would prevent unbounded growth?

A. FPL proposes to file updated studies at least every five years for review by the Commission. Based on the ABS Consulting analysis, at an annual accrual level of $120 million, the probability that the storm fund will exceed $500 million in five years is approximately 39%, and there is a 5% chance that the reserve would reach approximately $634 million after five years, at which time the annual accrual and appropriate reserve level could be reevaluated.

Q. Has the Commission allowed for a 5-year review of other funded reserves?

A. Yes. For example, the Commission currently requires FPL to file a study that allows the Commission to review its nuclear decommissioning costs at least every five years.

Q. Can FPL change its storm fund accrual without Commission authorization?

A. No.

Q. Can funds collected from customers for storm restoration be used for any other purpose?

A. Funds collected can be used for any allowed purpose of the fund including costs associated with service restoration and repair of FPL's T&D system as a result of hurricanes, tropical storms and winter storms, storm staging costs, windstorm insurance deductibles attributable to non-T&D assets, and payments of nuclear retrospective premiums.

INSURANCE COSTS

Q. According to Mr. Stamm, insurance cost increases are a significant driver of increased operating and maintenance costs for FPL. What types of insurance costs is he referring to?

A. Mr. Stamm is referring to non-nuclear property insurance, nuclear and non-nuclear injuries and damage liability, nuclear property insurance, and nuclear outage insurance.

Q. How much are these insurance costs expected to increase from 2002 to the 2006 test year?

A. Insurance costs are expected to increase from a negative expense (i.e., contribution to income) of $10.0 million in 2002 to an expense of $20.6 million in 2006. This is an increase of approximately $30.6 million over this 2002-2006 time period, with approximately $24.5 million of the increase occurring in the

2002 through 2004 time period and an additional projected increase of $6.1 million in the 2005 -2006 projection. This number excludes the Storm Damage Reserve increase, which I have just discussed. By far the largest single contributor to this increase (approximately $16.5 million) relates to the cost to insure our nuclear assets. The largest driver for increased nuclear insurance costs has been a reduction in FPL's distributions from Nuclear Electric Insurance Limited (NEIL) (from a high of $26 million in 2002 to $12.9 million in 2004, a reduction of $13.1 million). We believe an increase in industry nuclear claims combined with three consecutive years of negative investment portfolio returns are the primary drivers of the reduction in distributions. NEIL has indicated that it is unlikely that distributions will return to their unusually high 2002 levels.

Non-nuclear insurance costs increased from $8.1 million in 2002 to $22.2 million in 2006, an increase of $14.1 million, with approximately $9.9 million of the increase occurring in the 2002-2004 time period, and an additional $ 4.2 million in the 2005-2006 projection.

Q. Are increases in insurances costs occurring globally?

A. Yes, they have in the time following September 11, 2001.

Q. Please describe some of the drivers behind this global issue.

A. Three primary drivers have been affecting insurance costs globally over the past several years: the impact of the events of September 11, 2001, the declining performance of insurer's investment portfolios, and payment of large losses,

particularly those associated with corporate governance issues (e.g., Enron, Worldcom, Adelphia, etc.).

September 11, 2001, was the largest insured loss in history. According to the Insurance Information Institute, the estimated insured loss estimate for 9/11 was $32.5 billion. After 9/11, many parties sought to increase their insurance coverage, while concurrently the supply of insurance decreased because of the large losses. In line with the basic principles of economics, this caused premiums to increase significantly. Furthermore, coverages began to narrow, as insurance carriers created more exclusions. Companies must purchase additional insurance to cover these exclusions. A prime exclusion example is related to terrorist insurance. After 9/11, insurance companies began to exclude terrorism from their policies. The federal government stepped in and created an insurance backstop program titled the Terrorism Risk Insurance Act (TRIA). With TRIA, insured companies had to purchase terrorism insurance (or do without it) which had previously been included in general property insurance. TRIA expires on December 31, 2005 and the future of terrorism insurance remains uncertain.

The second global driver behind the significant increase in insurance premiums is the decline of many insurers' investment portfolio returns. The drop in stock market returns and large payouts for disasters in recent years, have forced insurance providers to increase premiums to compensate for their loss of capital. Some concrete explanations on the loss of capital are described below.

- Net investment income for the insurance industry has declined from its peak in 1997 of $41.5 billion to an estimated $37.7 billion in 2004.
- As of 2004, loss reserve developments for the Property and Casualty insurance industry increased more than $49 billion for policy periods 2001 to 2003.
- Standard and Poor's estimates $250-$275 billion of capacity depletion in the insurance industry from 2001-2003 due to equity/credit losses, September 11, 2001, and reserve increases.

The third driver behind the rapid increase in insurance premiums is the rapid price increases associated with directors and officers (D&O) liability insurance. According to the Risk and Insurance Management Society Inc. Benchmark Survey, D&O premiums increased by an average of 206% in the twelve month period beginning the second quarter of 2002. D&O insurance liability costs contribute the single largest portion of FPL's total projected non-nuclear insurance increase.

Q. In addition to the global drivers, has FPL had any company-specific issues which would cause the significant increase in insurance costs?

A. Yes, there are several company–specific factors. First, the amount of assets the Company has to insure has increased and will continue to increase. From 2002-2006, the Company expects the value of its insurable non-nuclear assets to increase from $9 billion to approximately $11.0 billion. Secondly, while the Company has had an excellent overall long-term loss history, FPL submitted

several property loss claims in the 2002-2003 time period. Lastly, the Company had locked-in insurance rates for a multiyear period; as the lower locked-in rates began to expire, price increases were more dramatic over this 2002-2004 time period. The best example is in non-nuclear property insurance, where FPL had a fixed rate program from 1999-2002.

2007 ADJUSTMENT FOR TURKEY POINT UNIT 5

Q. Why is FPL requesting a subsequent year adjustment in base rates in 2007 for the incremental revenue requirements for Turkey Point Unit 5?

A. The addition of the Turkey Point 5 generating plant is a significant item with substantial operating and financing costs, the impacts of which are not reflected in FPL's projections for 2006 and will have an immediate, substantial, negative effect on FPL's earnings in 2007. Further, the Commission approved Turkey Point Unit 5 as the least cost resource option to meet the incremental needs associated with the rising demand for reliable power from our customers. Facing such a known and significant cost impact only a few months outside of the proposed test year, FPL believes that it is appropriate to consider that impact in this proceeding.

Certainly, everyone involved in this docket, including the Commission, will devote an enormous amount of resources this year in establishing new rates to be effective in 2006. By also considering in this proceeding the addition of Turkey Point Unit 5 in 2007, thereby mitigating the drop in the Company's rate of return

due solely to the addition of this generating unit, we may avoid a follow-up full revenue requirements proceeding in 2007 --one that would be largely duplicative of the review for 2006.

Conducting a review of FPL's request for base rate relief associated with the addition of Turkey Point Unit 5 within this docket also would avoid the unintended consequence of economically discriminating against a low cost self-build option.

Q. Please explain further FPL's proposal for a limited scope adjustment due to the addition of Turkey Point Unit 5 in 2007.

A. The various cost factors that will impact the Company in 2006, as described by other FPL witnesses in this proceeding, are unabated in 2007. As shown by FPL's 2007 Forecast schedules and the testimony of Mr. Davis, FPL's revenue deficiency in 2007, assuming full relief is granted in 2006, will be $86 million. Of this overall 2007 deficiency, $66 million is attributable to the revenue requirements (i.e., added capital costs and O&M expenses) associated with placing Turkey Point Unit 5 into commercial operation, scheduled for June 1, 2007. In order to address the increase in 2007 revenue requirements, FPL proposes to adjust base rates effective 30 days after Turkey Point Unit 5 goes into commercial operation. FPL proposes to base the amount of the increase on the incremental revenue requirements for Turkey Point Unit 5, resulting in annualized revenue requirements of approximately $123 million.

This adjustment is a conservative proxy for the full increase in revenue requirements that FPL expects for 2007 and beyond, because it does not take into account increases in other costs of service. However, FPL is prepared to accept this understated measure of the additional rate relief in the interest of administrative efficiency, limiting the necessary regulatory review to the relatively narrow issue of Turkey Point Unit 5's revenue requirements. This will avoid burdening customers and the Commission, as well as FPL, with the time and expense of a full 2007 revenue requirements proceeding. Therefore, at this time, FPL is requesting that the Company's need for additional base rate relief in 2007 associated with the impact of Turkey Point Unit 5 be considered within the scope of the full requirements proceeding for 2006.

Q. Why should the Commission approve a subsequent year adjustment for Turkey Point Unit 5 if FPL projects that it will continue to earn a return within the range requested?

A. Assuming a base rate increase in 2006, the projected earned return on equity in 2007 is 11.5%, near the low end of the range of return of 11.3% to 12.3% requested in this proceeding. This projection includes only a portion of the annualized cost of adding Turkey Point Unit 5, as the unit is not expected to be placed in service until mid-year 2007. Consequently, there will be additional costs and a further drag on earnings in 2008. All other things equal, ROE would drop well below the bottom of the range in 2008. Had the unit been placed in service at the beginning 2007, the earned return would be below the range requested. Providing for a subsequent year increase properly compensates FPL

for costs incurred and maintains the earned return at a level which should delay the need to request further rate relief.

Q. What weighted average cost of capital is used to calculate the requested adjustment?

A. FPL used the projected incremental projected cost of debt, the cost of equity requested in this proceeding, and assumed a capital structure for the incremental costs that will maintain its overall capital structure on roughly a 45% debt /55% equity basis (assuming investor capital and adjusted for off-balance sheet obligations).

Q. Why is it appropriate to use an incremental weighted average cost of capital to determine the revenue requirements associated with Turkey Point Unit 5?

A. FPL is requesting a subsequent adjustment for a specific asset, not based on the overall results of a subsequent year. The incremental weighted average cost of capital represents the best estimate of the actual costs to be incurred to finance this asset. It is also consistent with the basis upon which respondent bids were evaluated during the RFP process. Using an embedded weighted average cost of capital would understate the cost of debt to be incurred and would provide for additional equity in the capital structure to offset the off-balance sheet impact of purchased power obligations when there has been no increase in such obligations.

Q. What if 2006 embedded cost of capital were used to calculate the annualized revenue requirement for Turkey Point Unit 5?

A. The weighted average debt cost included in the 2006 embedded cost of capital does not include the cost of financing Turkey Point Unit 5. If recovery is based

on this cost, FPL would not collect enough to pay the cost of debt financing and still provide a reasonable return.

Q. Please summarize your testimony.

A. FPL's overall financial position today is strong, although without the requested rate increase for 2006 and subsequent adjustment for Turkey Point Unit 5 in 2007 it will decline significantly. Our strong financial position is appropriate for the risks and circumstances we face and is beneficial to the customers.

In order to maintain an appropriate degree of financial strength and to offer investors an opportunity to earn a reasonable rate of return consistent with the the risks they assume, we are asking the Commission to approve: (1) the continuation of the 55.83% adjusted equity ratio; (2) an allowed rate of return of 12.3%, including a 50 basis point performance incentive to recognize and motivate continued superior performance; (3) a rate increase that will include sufficient allowance to enable us to increase the annual accrual to the Storm Damage Reserve from the amount of $20 million to $120 million; and (4) a subsequent year base rate increase in mid-2007 for the Turkey Point Unit 5.

These recommendations collectively would keep FPL in a strong financial position - able to protect our credit rating, attract equity investment on reasonable terms, finance future system expansion at a reasonable cost, and respond with the flexibility we need to unforeseen events. We would have an incentive that encourages us to build on the superior performance results we have achieved thus

far. Finally, my recommendation on the storm fund will allow FPL to achieve and maintain a reasonable plan for responding to major storms in our service territory. In the long run, all of these things add up to delivering reliable, adequate electric service at the lowest reasonable costs to our customers.

Q. Does this conclude your direct testimony?

A. Yes.

FPL O&M plus Depreciation Costs per kWh vs. Peer Group

		1998	1999	2000	2001	2002	2003	2004	2005	2006[2]	2007[2]
	O & M Cost per kWh										
1	Industry Average	$0.016	$0.016	$0.016	$0.017	$0.017	$0.018				
2	FPL	$0.014	$0.014	$0.013	$0.012	$0.013	$0.013	$0.012	$0.013	$0.015	$0.016
3	Savings vs. industry peer group	$0.002	$0.002	$0.004	$0.004	$0.004	$0.005				
4											
5	FPL Retail kWh Sales	85,130,914,000	84,601,566,000	87,959,342,000	90,211,730,000	95,522,890,000	99,495,659,000				
6											
7	**FPL Savings over industry peer group**	**$204,975,212**	**$192,502,774**	**$325,402,340**	**$401,843,098**	**$424,362,351**	**$519,696,184**				
8	**(line 3 x line 5)**										
9											
10	**Gross Plant per kWh**										
11	Industry Average	$0.208	$0.212	$0.213	$0.222	$0.223	$0.237				
12	FPL	$0.200	$0.205	$0.204	$0.205	$0.206	$0.213	$0.219	$0.222	$0.229	$0.233
13	Savings vs. industry peer group	$0.008	$0.006	$0.009	$0.017	$0.017	$0.024				
14											
15	FPL Retail kWh Sales	85,130,914,000	84,601,566,000	87,959,342,000	90,211,730,000	95,522,890,000	99,495,659,000				
16											
17	**FPL Savings vs. industry peer group**	**$723,097,253**	**$510,227,930**	**$820,881,558**	**$1,525,852,142**	**$1,606,917,190**	**$2,428,801,257**				
18	**(line 13 x line 15)**										
19											
20	**Value of FPL's Gross Plant Savings**										
21	**Depreciation @ 4.5%[1] (line 17 x 4.5%)**	**$32,539,376**	**$22,960,257**	**$36,939,670**	**$68,663,346**	**$72,311,274**	**$109,296,057**				
22											
23											
24											
25											
26											
27											
28	**Total Savings vs. industry peer group**	**$237,514,589**	**$215,463,030**	**$362,342,011**	**$470,506,444**	**$496,673,625**	**$628,992,241**				
29	(line 7 + line 21)										
30						**Average savings per year 1998 - 2003**	**$401,915,323**				
31						(average of line 28)					
32											

33 O & M Cost per kWh and Gross Plant per kWh for FPL and Industry Peer Group per Document Nos. JHL-6 and JHL-8 from Mr. Landon's testimony.

34

35 [1] Depreciation savings calculated at FPL's average rate of depreciation from 1998 through 2003 of 4.5%.

36 [2] Assumes rate increases requested for 2006 and subsequent annualized adjustment in 2007.

37

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FPL O&M plus Depreciation Costs per kWh vs. Peer Group