BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the matter of: DOCKET NO. 041291-EI

PETITION FOR AUTHORITY TO RECOVER PRUDENTLY INCURRED STORM RESTORATION COSTS RELATED TO 2004 STORM SEASON THAT EXCEED STORM RESERVE BALANCE, BY FLORIDA POWER & LIGHT COMPANY.

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VOLUME 3
Pages 275 through 379

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN BRAULIO L. BAEZ COMMISSIONER J. TERRY DEASON COMMISSIONER RUDOLPH "RUDY" BRADLEY COMMISSIONER CHARLES M. DAVIDSON COMMISSIONER LISA POLAK EDGAR
DATE:	Wednesday, April 20, 2005
TIME:	Commenced at 9:30 a.m. Recessed at 5:35 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	MARY ALLEN NEEL, RPR

APPEARANCES: (As heretofore noted.)

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P R O C E E D I N G S

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Thereupon,

JAMES A. ROTHSCHILD

called as a witness on behalf of the Citizens of the State of Florida, continues his testimony under oath as follows:

CROSS-EXAMINATION

BY MR. WRIGHT:

Q Good afternoon, Mr. Rothschild.

A Good afternoon.

Q We have met. I'm Schef Wright, and I represent the Florida Retail Federation.

Is it correct that at your testimony at pages 6, 7, and 13, you've testified that FPL's customers have paid FPL shareholders millions of dollars as compensation for the shareholders taking risks? Is that accurate?

A Yes.

Q Is it reasonable to characterize those payments as a risk premium?

A Yes.

Q How would you calculate the risk premium that FPL's shareholders have been paid and are being paid by their customers?

A Well, in the stipulation it's a little bit --
it's more difficult to be absolutely precise, because the stipulation set the 10% minimum, and the company is allowed to earn more. If we take the 10% low end minimum and compare that to, for example, what long-term Treasury bonds are paying today, it -- in my prefiled testimony it was 4.58%, and as luck would have it, I checked earlier today, and it was 4.58%. And that's, of course, a coincidence, but it nevertheless is correct.

So if we take the difference between 4.58% and 10%, we end up with a little bit more than 5%, 5.4%. We take that 5.4% as the risk premium that the company is, at a minimum, being allowed to earn under the stipulation.

And if we look at the most recent surveillance report, we'll see that the common equity balance reported in there is approximately $5 billion. And if we take the 5 billion and multiply it by the 5.4%, we end up with 250-plus million, a little more than that -- I'm just rounding down to five, so a little more than that. And then we gross that up for income taxes, and it's going to be roughly, in round numbers, somewhere around $400 million a year that is being provided by ratepayers as a risk allowance. Now, of course, the company investors get less than -- get the after-tax number, the 250-ish million dollar number, because they do have to pay income taxes.

Q Would it follow, and would you apply the same analysis if the company were earning something in the range of 12.8 to 13%? Would you do the same analysis that you just used based on the difference between 10 and 5.4?

A Yes. In that case, in that particular year, that would be the amount the company was in fact earning, being allowed to earn under the terms of the stipulation on an after-tax basis.

Q Okay. I have one clarifying question. You just referred to a long-term Treasury bond rate at 4.58%. At page 6 of your testimony you've got 4.85, and then at page 10 you've got 4.58. Is the number on page 6 just a typo, in line 20?

A I would have to go back and see. I looked on-line today to see that the 4.58 was the same and saw the 4.58 in my testimony. I don't know which one -- I would have to check with you. I didn't realize there were the two different numbers in there.

Q Okay.

A Actually, when I looked at the graph, I did observe that interest rates were declining, so I was surprised to see that I had the same number, so maybe it is indeed a typo.

Q Okay. Do I understand your testimony correctly that a 10% return on equity would be generous or conservatively high for 2004?

A Yes.

Q Do you have an opinion as to whether the same rate, 10%, would be generous or conservatively high, or something else, for 2005?

A My answer would be the same. For 2005, in both cases, the cost of equity allowance of 10% is a comfortably high allowance.

MR. WRIGHT: Thank you very much. That's all the questions I have. Thank you, Mr. Chairman.

CHAIRMAN BAEZ: Mr. Twomey.

MR. TWOMEY: No questions.

CHAIRMAN BAEZ: Mr. Litchfield.

MR. LITCHFIELD: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. LITCHFIELD:

Q Good afternoon, Mr. Rothschild.

A Good afternoon, Mr. Litchfield.

Q Now, would you turn to your testimony at page 3. Now, on page 3 you outline the settlement agreement which concluded FPL's last base rate proceeding. Am I right about that?

A I provided a summary, yes.

MR. LITCHFIELD: That is marked for identification in this proceeding as Exhibit 30, I believe, Mr. Chairman. I have extra copies here to the extent that anybody does not have ready access to that. It is included as an exhibit to Mr. Dewhurst's rebuttal testimony.

CHAIRMAN BAEZ: I think we should have it at this point.

MR. LITCHFIELD: You should have it. If you have Mr. Dewhurst's rebuttal testimony, it will be an attachment. But I have copies of that to the extent that anybody would like to have one.

CHAIRMAN BAEZ: Does the witness have the exhibit that's being referred to?

THE WITNESS: I don't have the one that's marked the exhibit, but I believe I have a copy of the --

MR. LITCHFIELD: Let's work from the one that I'm going to hand out to you, because it is a reproduction of the actual exhibit to Mr. Dewhurst's testimony.

CHAIRMAN BAEZ: And just so that I can be clear, Mr. Litchfield, that's MPD-1?

MR. LITCHFIELD: Yes, Mr. Chairman.

CHAIRMAN BAEZ: Thank you.

BY MR. LITCHFIELD:

Q Do you have a copy in front of you, Mr. Rothschild?

A Yes.

Q Is the document identified as MPD-1, Hearing Exhibit 30, the same document to which you refer in your testimony?

A On quick review, it appears to be, yes.

Q Now, in your testimony, beginning on line 5 of page 3, you indicate that as part of the settlement, FPL was to lower its rates by 250 million; correct?

A Yes.

Q Those were base rates; correct?

A Yes.

Q And to your knowledge, FPL in fact did lower its base rates by $250 million?

A I haven't specifically studied that, but I would presume that somebody would be complaining if they found that they didn't. But that's not -- I don't want to -- on the one hand, I don't want to leave people with the feeling that -- I mean, I simply haven't looked at that. It's probably been done.

Q Will you accept that subject to check?

A Yes.

MS. CHRISTENSEN: Objection.

THE WITNESS: I'm sorry.

BY MR. LITCHFIELD:

Q Now, that would mean that in any given year, other things equal, the company would have $250 million less to cover the cost of operations and its cost of capital. Would you agree with that?

A Less than what? Less than what would have happened without a stipulation? No, I can't agree with that, because I don't know what the ruling would have been by the Commission. The Commission -- absent a stipulation, the Commission might have ruled a $300 million reduction, might have ruled a $100 million reduction, might have ruled an increase, might have ruled a $500 million reduction. We don't know.

Q That's the nature of a settlement, isn't it?

A Well, yes, it certainly is the nature of a settlement that -- what do they say? A good settlement is both sides are a little bit unhappy?

Q All right. Well, let's assume we're only talking about the effect of the settlement here, and it says FPL will reduce its base rates by $250 million. Would you agree then that that means, other things equal, the company has $250 million less in any given year to cover the cost of operations and the cost of capital?

A Other things -- I don't understand about other things being equal, because to me, other things being equal is the company was facing a decision from the Commission.

Q Well, other things equal such as revenues.

A Again, I'm having trouble understanding other things being equal, because the company -- to my knowledge, nobody could have put a gun to the company's head to accept that $250 million reduction. It must have done so -- and I'm speaking with experience from being involved in many stipulations. The company must have felt that it was a good deal for it, or it would not have signed. In that good deal, I'm sure it considered what otherwise it felt might have happened if there was a decision from the Commission.

Q Well --

A In consideration with all of the other terms and factors associated with the stipulation.

Q I'm just really asking as a matter of arithmetic. I'm really not trying to complicate the question, Mr. Rothschild. In my mind, other things equal means hold everything else constant. And as a matter of arithmetic, does the company have $250 million less to cover the cost of operations and the cost of capital, yes or no?

A When you say other things equal, I can't -- I don't know what other things equal means here, because the company was facing a decision. If you say to me if rates had been $250 million lower over the prior year, would the company have collected $250 million less, of course, the answer to that is yes. But once you start saying other things being equal, we would have to -- you're asking me to ignore the dynamics of the rate filing and the rate proceeding and what was going on at that point in time. If you want me to ignore that, okay, but I'm not sure what the answers are going to mean once we start ignoring that.

Q Okay. We'll move on a little bit here.

Would you agree that a revenue reduction of that magnitude is a substantial benefit for FPL's customers?

A Well, again, in relation to what? Are the customers in aggregate $250 million better off if rates are $250 million lower? Well, assuming those rates are still fair and reasonable so the company can provide safe and adequate service, then yes. But if we compare that to what otherwise the Commission might have done, then the answer is maybe, because I don't know if the Commission would have decided a smaller or a larger rate reduction at that point in time.

Q Okay. Well, let me follow up on that. Are you aware that one of the nonsignatories to that settlement agreement appealed this Commission's decision approving the settlement agreement to the Florida Supreme Court? Are you aware of that?

MS. CHRISTENSEN: Objection. Beyond the scope of his testimony.

MR. LITCHFIELD: Mr. Chairman, I'm simply following up on an answer he just gave.

CHAIRMAN BAEZ: I'll allow it.

BY MR. LITCHFIELD:

Q Are you aware of that fact, Mr. Rothschild?

A I am not aware of any appeals to the stipulation, no.

Q Do you know whether the Office of Public Counsel in connection with that stipulation and settlement advocated it before this Commission or anybody as to whether it was a good deal or not? Do you know?

MS. CHRISTENSEN: Objection. Beyond the scope of his testimony, and also --

CHAIRMAN BAEZ: Now, I think he answered the major question, and if he doesn't know about --

MR. LITCHFIELD: Fair enough.

CHAIRMAN BAEZ: -- the appeal, then we can move on.

BY MR. LITCHFIELD:

Q Now, on lines 6 through 8 of your testimony, still on page 3, you acknowledge that the settlement agreement implements a revenue sharing arrangement in lieu of an authorized range of return on equity capital during the term of the stipulation; correct?

A Yes.

Q In fact, if you look at paragraph 3 of the agreement, it states that FPL won't have an authorized ROE range, open quote, for the purpose of addressing earnings levels, close quote, doesn't it?

A That's what's stated in paragraph 3.

Q Okay.

A Of course, there's an opener, if earnings fall below 10 percent, which is --

Q I'm going to ask you about that section.

Now, also in paragraph 3, with respect to the revenue sharing arrangement to which you refer in your testimony, the settlement agreement states that, open quote, the revenue sharing mechanism herein described will be the appropriate and exclusive mechanism to address earnings levels. Am I reading that correctly?

A That's what those words say, yes.

Q Now, this revenue sharing arrangement that you identify in your testimony, would you agree that that is another benefit to FPL's customers?

A I'm sure we've both been involved in enough stipulations that talk about different pieces of a stipulation, some that go one way, some that go the other way, and if somebody takes one thing out, the stipulation no longer applies. And, in essence, what you're doing here is saying -- if you ask me the question is normal ratemaking something that provides revenue sharing, no. And if everything else were equal, which of course it wouldn't be, are ratepayers better off to have an opportunity to share in revenue growth, well, yes, of course. That's a benefit. But you have to look at the pluses and the minuses. And I'm sure that that's what both sides did in entering into the stipulation in good faith.

MR. LITCHFIELD: Mr. Chairman, I did get a yes at the end of that question, but in the interest of moving things along, if the question is susceptible to a yes or no, I'm wondering if the witness could provide that answer and then qualify it.

CHAIRMAN BAEZ: Well, and I'll so instruct the witness, but also remember that he can --

MR. LITCHFIELD: Absolutely.

CHAIRMAN BAEZ: I mean, we've got to give some latitude. And, Mr. Rothschild, you have whatever opportunity you want to clarify your answer. Answer yes or no if you can, and then you can go ahead and elaborate.

THE WITNESS: Thank you, Commissioner.

CHAIRMAN BAEZ: To your heart's content.

BY MR. LITCHFIELD:

Q Now, again, this revenue sharing arrangement provides that revenues realized by the company above certain thresholds are refunded 100% to customers; isn't that right?

A Is there a specific -- I don't remember specifically the place --

CHAIRMAN BAEZ: Mr. Litchfield, can you direct him to a paragraph, if what you're referring to is the settlement agreement?

MR. LITCHFIELD: I will, if I can first ask the witness to state for the record that you're not certain of the answer to that question.

THE WITNESS: I do not remember specifically. I did not specifically study that aspect of the stipulation, so I don't remember. And I would rather give you an accurate answer than a guess, so if you would show me where it is in the stipulation, I'll be happy to respond.

BY MR. LITCHFIELD:

Q Okay. Would you look at paragraph 7, which begins on page 3 and carries over to page 4? Are you there?

A Yes.

Q Okay.

A Yes, I see where the stipulation says above a certain amount, the revenues will be refunded to retail customers on an annual basis, and below a certain amount there's a one-third/two-thirds sharing.

Q All right. Now, would you look back to subsection 1 on page 3? Do you see the word "revenue cap" there?

A Yes.

Q Would you take a look at that section and tell me if you agree that that provides an effective cap on revenues at the thresholds stated therein?

A And I haven't -- I have not attempted to interpret this part of the stipulation as part of preparing my testimony, and also I'm starting to feel like I'm playing lawyer a little bit more here than maybe I am. I mean, the words are what they are, and I'm not trying to be the one interpreting them. I don't know that I --

CHAIRMAN BAEZ: I'm sure Mr. Litchfield is not going to allow you to play lawyer.

THE WITNESS: Good.

CHAIRMAN BAEZ: So don't be afraid.

BY MR. LITCHFIELD:

Q Now, in your summary statement when you took ~~the stand, you indicated that the company under the~~ stipulation and settlement agreement could have unlimited earnings. Do you recall making that statement?

A Yes, because there's no specific upper limit in which the company could be forced to lower its revenues simply because earnings got that high.

I fully recognize as a practical matter there's just so many things that a regulated electric utility can do over several years, and I'm not suggesting there's any realistic way that earned return on equity is going to get to 25 or 50% or some very high number like that. But even if it did hypothetically, that result in and of itself would not trigger an opportunity for somebody to say the company must lower its rates prior to December 31st, 2005.

Q You would agree, would you not, though, that the extent to which the company has or is subject to revenue sharing thresholds, and indeed, revenue caps under the settlement agreement, that that provides a practical ceiling on the earnings of the company during the term of the agreement, would you not?

A Well, there are practical ceilings anyway, but not necessarily, because when you're talking pure theory, there are other opportunities available to the company to increase the earned return on equity. One would be through expense savings. Cost of debt could go down, which would be an expense savings, but a capital related expense savings. Capital structure changes. If the company leveraged up, used a lot more debt, the return on equity could go higher.

So if you ask me theoretically what's the highest it could possibly get, is there a very high number, yes. As a practical matter, I don't want anybody to think that I think that the return on equity could go to 30% over the time period that we're talking about, or numbers that high.

Q And indeed, that's why I used the term "practical" in my question. Thank you.

Now, you indicated that there are other things in your last response that the company could do to increase earnings, such as lower operating costs; correct?

A Yes.

Q It could increase productivity; correct?
A Well, that would be one form of lowering operating expenses, but, yes.
Q So that would allow it to increase its earned return during the term of the settlement agreement?
A In theory, that could happen, yes.
Q You would agree that there's nothing in this agreement that actually precludes FPL from earning 11% or 12%, or even 13% return on equity during the term of the agreement, wouldn't you?
A That's correct. Eleven, 12, 13 is -- in fact, in the mid-12s, mid to upper 12s is indeed what the surveillance reports have reported.
Q Now, on page 3 of your testimony, you actually cite paragraph 8, I believe, of the settlement agreement, do you not, on pages 12 through 16?
A Yes, that's correct.
Q And then in the lines that follow, beginning on 19, you indicate that you were advised by the Office of Public Counsel that their position is that the 10% criterion of the stipulation is applicable to storm damage expenses and that the legal effect of the stipulation is such that the source for amortization of the negative balance storm damage reserve must first come from earnings to the extent that 2004 earnings

exceed 10% on equity. Did I read that correctly?
A Yes.
Q Has FPL's retail base rate earnings fallen below 10% ROE as reported on an FPSC adjusted or pro forma basis on an FPL monthly earnings surveillance report during any month in 2004?
A Not as long as the storm damage expense is deferred. But if the storm damage expense recovery were to occur, then the effect would be different.
Q If the storm damage recovery were to occur, or do you mean if Public Counsel's proposal in this docket were accepted?
A Well, I view them as essentially the same. There could be other variations, of course, from what Public Counsel has proposed that would also get you there. But once there's some form of recovery of the storm damage expenses, that recovery I would expect would show up in the income statement. And in so doing, in matching revenues and expenses, you would pick up the expense.
Q Now, in preparing your testimony, you did not review Commission Rule 25-6.0143, subsection (4), within the Florida Administrative Code, did you?
A I don't have -- I have reviewed numerous documents. I do not -- my memory doesn't permit me to

file things by the numbers, so I don't know.

Q Well, this was the same rule that was referred to you during the Progress hearing a couple of weeks ago relative to the Commission's treatment of storm damage costs on the books of the company. Do you recall that rule?

A I am aware -- I talked about in my testimony what -- I believe I mentioned in my testimony the Commission's ruling on storm damage. I'm aware of the fact that the Commission has ruled that the company booked storm damage expenses to the deferral account, and if the amount in the account, the amount that has been collected for storm damage in advance is insufficient, then the company is specifically ordered to carry a negative balance, and then the Commission makes a determination on what to do about those expenses at some future time.

Q You don't cite that rule anywhere in your testimony, do you?

A I don't remember if I do. I don't know.

Q You didn't identify that rule as any of the materials or documents upon which you relied or referred to in preparing your testimony when you responded to discovery in this case, did you?

A Well, as I've explained to you, it's impossible for me to -- when I'm doing any case, not just this case, I don't sit down with a note pad listing each and every thing that I've looked at, and so it's impossible for me to provide a response to everything I've looked at in preparing a testimony. Was I aware of and am I aware of the process I just discussed when preparing my testimony? Yes.

Q You didn't ask to see any Florida Administrative Code rules in preparing your testimony, did you?

A I was aware of this accounting procedure. I think -- I don't remember which document or documents I saw to make myself aware of it. It possibly was something I read that was disclosed in an SEC report either of Progress or of FP&L, or both, or perhaps it was in some other documents that were given to me by my client. I don't know. But I was and am aware of that procedure.

Q Let me read your answer to me in your deposition last Friday. I think -- this is a question. "I think in the Progress docket you agreed that you hadn't reviewed Rule 25-6.0143(4) in filing your testimony; is that correct?"

Answer: "I don't remember. I have no idea. I don't know what that number means."

Question: "You don't remember. Did you review any rules from the Florida Administrative Code prior to filing your prefiled testimony in this case?"

Answer: "I don't specifically remember. I don't know. I wasn't trying to testify on what the Commission's rules are."

Question: "You didn't ask to see any rules, I take it."

Answer: "Not that I remember."

A Okay. As I remember, that interchange in the deposition was before I knew what you were talking about. And I am aware of the accounting principle and procedure that was set by this Commission for dealing with storm damages. So all you're doing, in my mind, is -- and hopefully it's clear to everybody else. I don't remember the numbers of a order, but I do remember this concept and that I did review it. I was aware of it and am aware of it.

Q And when you say you reviewed that concept, you're referring to which order of the Commission?

A I still don't remember the number, but if you'll tell it to me again, I'll write it down, and then maybe I'll know what it is next time. I don't know the rule number. What I do know is the procedure and the approach for dealing with the storm damage expenses.

Q Now, as recently as last Friday when we spoke when you were deposed, you didn't know whether FPL's reserve was funded or not, did you?

A That's correct. I answered to you I don't know if it's funded. I'm not sure what you meant by the term. If what you mean is was there a sufficient amount of money to cover the storm damage that occurred from the three hurricanes, I'm aware that there was not enough for that. But I believe I said to you I'm not sure what you mean by funded in that context.

Q And you don't think we cleared up that confusion in your mind?

A I don't remember any follow-through from that. I'm just telling what you I remember. Again, I'm not sure what you meant by funded. Sometimes some people mean by funded was the money put aside in a bank account somewhere. So I just didn't know what you meant when you said that. And my recollection is that we went on to another topic.

Q You have an M.B.A., do you not?

A I have an M.B.A., yes.

Q Now, getting back to section 8 of the agreement, which you cite on page 3 of your testimony, would you agree that a plain reading of that section would appear to give FPL the right to, open quote, petition the FPSC to amend its base rates notwithstanding the provisions of section 5, close quote? Do you agree with that?

MS. CHRISTENSEN: Objection to the extent it calls for a legal conclusion, but he can answer to the extent he --

CHAIRMAN BAEZ: I'm going to allow him to answer, but we've already clarified that Mr. Rothschild is not a witness and therefore unable to give legal conclusions.

You can go ahead and give answers as best you can, sir.

A My understanding is that if the return on equity falls below 10%, that gives Florida Power & Light the right to request an increase, even though section 5 says they can't.

Q And is it your understanding --

A And that indeed is -- the basis for what I'm saying is, that's the floor, the safety net.

Q Is it your understanding, Mr. Rothschild, that the company's request for recovery in this docket is indeed a request to amend its base rates pursuant to section 8 of the settlement agreement?

A The effect, to me, giving you a non-legal response, is yes. It is a change in base rates.

Whether or not somebody's finding or looking for some legal loophole to characterize it something else, I don't know, but I'm just talking about what the substantive effect is.

Q Now, even if that were true and that were the effect, as you say it, is it your position, based on your testimony, that in such an instance, the company could only request such an amendment in its base rates sufficient to restore it to an ROE of 10%? You characterized it as a floor earlier, and I'm simply trying to ask you to confirm that position.

A I guess -- and I'm speaking again not as an attorney. I think it could be interpreted a couple of ways. It could be interpreted that once earned return falls below 10%, then that would set a trigger to look at things.

But I didn't see the company coming in and claiming a different cost of equity. And I'm certainly well aware that there's a good reason for that, because responsible testimony at this day and age would conclude that the cost of equity is less than 10 percent. But I felt that since the cost of equity, while it's less than 10%, is not such a huge amount below 10%, that it was just more appropriate and in keeping with a good-faith effort to follow through with the stipulation to stay with the 10% as what the company would be allowed to earn.

Q But you would agree, however, with me, would you not, that the actual language that you cite in your testimony relative to section 8 doesn't say FPL may petition the FPSC to amend the base rates to the extent necessary to return it to a position of earning 10% on equity, does it? It simply says FPL may petition the FPSC to amend its base rates, doesn't it?

A If the earnings fall below 10%, then the company may petition the Commission to amend its rates. That's what it says. It doesn't -- I agree with you. The words you just said are not in the stipulation word for word anywhere.

Q Would you agree that Florida Power & Light is not relying upon paragraph 8 for purposes of its request to recover the deficit in the storm damage reserve?

If you don't know, that's fine.

MS. CHRISTENSEN: I'm going to object. It calls for speculation.

CHAIRMAN BAEZ: Sustained.

THE WITNESS: I'm sorry.

MR. LITCHFIELD: Do you know -- I'll ask another question, Mr. Rothschild.

CHAIRMAN BAEZ: This is a new question,

Mr. Rothschild.

THE WITNESS: Okay. Thank you.

BY MR. LITCHFIELD:

Q Do you know whether the company is relying upon section 8 or section 13 of the settlement agreement for purposes of its recovery request in this proceeding?

MS. CHRISTENSEN: Same objection. Calls for speculation.

CHAIRMAN BAEZ: You know, he's looking at the stipulation agreement, and there has been some discussion about it. He can answer he doesn't know or point to a paragraph. The witness can answer.

A I have seen -- I don't want to mislead anybody into saying that I have attempted to review every legal document filed in this proceeding, because I haven't. But I have seen some documents filed by the company in which it has claimed paragraph 13 as its basis, yes.

Q Could you read paragraph 13 into the record for us, please?

A "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 damage 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."

Q Now, you filed testimony in the Progress Energy Florida docket for the recovery of storm costs, did you not?

A I did.

Q It was essentially identical to the testimony you filed in this proceeding relative to FPL, is it not?

A Conceptually, yes, and most of the words are the same, yes.

Q I think you were even clearer than that in your deposition. You agreed with me that you had used it as a template, didn't you?

A I used one as a template; that's correct.

Q You used your testimony in the Progress docket as a template for your testimony in the FPL docket; correct?

A I believe that's -- whichever one was first. I believe the Progress one was first, so, yes.

Q And you agreed with me that there were few, if any, changes, other than references to the company and specific numbers relative to each; correct?

A Right. The concepts are the same.

Q Well, the words are the same.

A In most cases, the words are the same.

Q Now, you also would agree that you didn't review anything different in substance in the Progress docket relative to what you reviewed in this docket; correct?

A To the best that I can recall, that's right.

Q Now, you did not participate in the settlement negotiations that led to the settlement agreement that we've just been discussing, did you?

A Well, I believe as I explained to you in the deposition, I did not sit down and was not part of the interchange. I don't remember. It's very common for a client to call me up and ask about a certain cost of capital related number as it interfaces with the stipulation. And I don't remember whether Mr. Howe or Mr. Shreve or anybody else called me specifically on that. It's very possible they did, but I wouldn't remember.

Q Well, here was your answer in the deposition. Question -- I'm at page 31.

"You had no involvement in the negotiation of the stipulation and settlement agreement, did you?"

Answer: "Well, I was involved in providing testimony in that docket. I did not personally participate in the specific settlement negotiations, no."

Is that an accurate statement?

A Well, I think what you just read is the same as ~~what I just said, with the possibility of a slightly~~ more precise clarification.

Q And relative to paragraph 13 that exists in the Florida Power & Light Company settlement agreement, you did not ask anyone at Public Counsel about paragraph 13, did you?

A I have discussed paragraph 13 in terms of preparing this testimony. Did I discuss paragraph 13 back then? I don't remember.

Q You didn't ask anyone who actually negotiated the agreement on behalf of Public Counsel about the intent or the effect of paragraph 13 in the FPL settlement agreement, did you?

A In preparing -- more recently, in terms of trying to refresh my memory as to what happened then, no, I did not do that. It's not --

Q At any point.

A Well, you're asking me to remember what happened in 2002, and I don't know. I don't remember if

I was involved in that or not.

Q All right. At page 3, line 19 of your testimony, you indicate that you are advised of the Office of Public Counsel's position, and you go on to state that position. We read that a little bit ago. Do you recall that?

A Yes.

Q Who at Public Counsel so advised you?

A That would be Mr. McGlothlin.

Q Okay. Now, you state in your testimony that you accepted that position and then answered specific questions given to you by Public Counsel, which you summarize or outline on page 4 of your testimony; is that right?

A Yes.

Q And to restate that position, storm restoration costs that constitute the deficit in the storm damage reserve must first be borne by shareholders to the extent that 2004 earnings exceed 10% on equity; correct?

A Yes.

Q Now, am I right that that is nonetheless your position, irrespective of whether the Commission agrees with Public Counsel's interpretation of the settlement agreement? Correct?

A If there were no settlement agreement, or if for whatever reason the Commission decided on a different interpretation so that it wanted to allow storm damage recovery up to the current cost of equity, then it could do so in full confidence that the 10% is not too low. If anything, it's -- I would -- I guess for this purpose I would say it's comfortably high.

Q Well, turn to page 13 of your testimony, just so that you're focused on exactly what you did say. Beginning on line 15, you state, "I recommend that the Commission use the 10% ROE criterion to quantify the portion of FPL's negative storm damage reserve balance for which FPL's shareholders should be responsible. While this position flows from OPC's position regarding the effect of the ratemaking stipulation to which FPL is a party, in my opinion, it would be an appropriate basis for assigning the company's responsibility even in the absence of a stipulation." Did I read that accurately?

A Yes.

Q Now, if that position is applied in this case, FPL's earnings for 2004 would be reduced to 10%; correct?

A Yes, that's correct.

Q And FPL would have to restate its earnings for 2004; correct?

A I would expect that's the case. I haven't specifically examined whether that would be recorded as a restatement or some other accounting approach.

Q Okay. Now, earlier we were discussing the opportunity that the company has during the term of the settlement agreement to improve productivity or realize other operational efficiencies that could have the effect of increasing its return on equity during the term of the settlement. Do you recall that discussion?

A I do.

Q Now, for the sake of the next question or two, I would like you to assume for me that in a particular jurisdiction, there are two utilities, utility A and B. Their cost structure and circumstances are identical in every respect, except the ones that I'm going to identify for you. All right?

A Okay.

Q Now, assume that both utility A and utility B are subject to a settlement agreement that is identical to the agreement we've been discussing this morning, that is, it includes paragraph 13. Are you with me?

A Yes.

Q All right. Now, assume that utility A had achieved greater efficiency in its operations in 2004 and will earn 12% return on equity compared to --

A I'm sorry. I didn't get the number. Twelve?

Q Twelve.

A 12.0. Okay.

Q Will earn 12.0 return on equity compared to 11% return on equity for utility B. Are you with me?

A Yes. Got you.

Q Now, assume that in 2004 the jurisdiction experiences an unprecedented hurricane season, and as a result, utility A and B each incur storm damage restoration costs in the amount of $500 million. Are you with me?

A Yes.

Q Now, I want you to assume that all of those storm damage restoration costs were found to have been reasonable and prudently incurred, and I want you to assume that each of utility A and B therefore are left with a storm damage reserve deficit of $200 million. Now, assume for me that 100 million translates into 100 basis points or a 1% ROE.

Now, assume that that jurisdiction applies Public Counsel's interpretation of the settlement agreement or the alternate sharing approach described in your testimony, both of which would reduce earnings to 10% to pay for storm costs. Okay?

A Yep.

Q Based on this scenario, and here's my question, utility A, which had realized greater efficiences in its operations for 2004, would have its earnings reduced by 200 basis points or 2%; correct?

A Mechanically, just looking at it in this one dimension that you've defined, and which, of course, you're leaving a whole lot out, but arithmetically, yes, that would be correct.

Q And that's all I'm looking for. I appreciate that.

Now, utility B, on the other hand, which had not realized higher efficiencies in its operations in 2004, would only have its earnings reduced by 100 basis points or 1%; right?

A Sure. That's the nature of the safety net in the stipulation. What you have here is a stipulation that said at the time that if a company -- on the one hand, the company has an opportunity to earn lots of money, and in exchange for that opportunity to earn lots of money and an opportunity to get there however it gets there, it's going to agree to a rate reduction, which it might have felt would have been higher than the Commission allowed. It might have felt that it was a good deal and lower than the Commission would have allowed. I don't know.

And also, it is willing to give revenue sharing to a certain level to get that benefit. And in exchange for that, it's saying, "Well, we're giving all these things, but we have a nice upside, but we want to have this -- and we're willing to, in essence, play the game here and see how well we can do as long as that safety net is there."

~~And indeed that's what the 10%, I interpreted~~ it as, as a safety net. I think it's a very generous -- for a safety net, I think it's a very generous high level, but that's what it is. And so it's there, and it provides -- whether the company did somewhat well and earned 11% or did very well and earned 10% -- did very well and earned 12%, excuse me -- the safety net is still there. The safety net was further below where the company was for company A in your example than company B, but it's a safety net.

I think what you're doing in your example is losing sight of the importance of the safety net. There's the opportunity, and the opportunity could be great, could be mediocre, could be nothing, but you have to put it in the context of the safety net.

Q Well, you can understand why the company might not want you, Mr. Rothschild, holding its safety net; right?

A No. Actually, no. I don't --

CHAIRMAN BAEZ: You don't have to answer that, Mr. Rothschild.

THE WITNESS: I would like to if you'll let me.

CHAIRMAN BAEZ: Well, no, it's your -- you're the witness. It's your choice. I'm just letting you know that you don't have to answer it. That's not a valid question.

THE WITNESS: Believe me -- let me say this in absolute sincerity. Ratepayers are harmed if rates are too low. Ratepayers want electricity. They want safe and adequate service, and they also want it at a reasonable price. You want me to hold the safety net. There have been many, many discussions I've had with clients over the years about not going too far. So absolutely, you do, more than you think.

Thank you.

BY MR. LITCHFIELD:

Q All right. Let me ask you this. Let's assume for me that the magic number to reduce FPL's earnings to 10% for 2004 is $100 million. Okay? Can you make that assumption for me?

A Okay.

Q Now, assume for me that FPL's performance in this past storm season had been very poor. Are you willing to make that assumption for me?

A Hypothetically.

Q Hypothetically. And as a result, this Commission found $100 million of costs to have been unreasonable or imprudently incurred. Are you with me?

A I'm not sure. Let me make -- back up a ~~minute. You said that it was a poor year, but --~~

Q No. Let me start again.

A Okay.

Q It takes $100 million -- that's the magic number -- to reduce FPL's earnings in 2004 to 10% return on equity.

A Okay. From whatever return on equity was achieved.

Q Correct.

A Ten plus X.

Q Correct.

A Okay.

Q All right. I want you to assume that the company's performance in restoring service following the impact of the hurricanes in 2004 was poor.

A Okay. Now I'm with you.

Q All right. And as a result, this Commission reviewed that performance and the costs incurred and disallowed $100 million based on a finding of

unreasonableness or imprudence. Are you with me now?
A I think so. I'm not sure. Go ahead. It --
Q I haven't asked the question yet.
A Okay. All right.
Q Okay. So the Commission has disallowed $100 million of costs based on a finding of unreasonableness or imprudence.
Now, assume for me the same facts, except that the company performed very well in restoring service in the '04 storm season, and this Commission found no disallowance based on any finding of unreasonable or imprudent costs. Can you assume that for me?
A Okay.
Q If the Commission adopts Public Counsel's approach, however, the financial result for the company is identical in case A and case B, is it not?
A Well, in the very narrow, very special example you gave, the answer is yes. But if -- again, that's the nature of a safety net. But if -- and you asked me in the deposition, and I remember I corrected you on that, and I gathered from your body language you agreed with me.
Q I'll object to that.
A I'm giving you my interpretation, obviously.
If the expenditures had -- and nobody is saying

the company didn't do a good job, but if the company had done an even better job somehow, miraculously avoided having the lights go out even for two minutes, as implausible as that might be with three hurricanes, and it incurred more money to do that, and that money was deemed by the Commission to be reasonable, under OPC's proposal, the company would have collected every additional dollar that was found reasonable.

So you can make the examples any way you want, but is the stipulation perfect in absolutely every respect? Of course not. Is it reasonable overall and is it staying within the intent of it? I think the answer is absolutely yes.

Q It is your testimony, is it not, that the stipulation and settlement agreement absolutely should be adhered to?

A Yes. An exception might be if -- the old "cut off your nose to spite your face" argument. If the cost of equity had climbed to 25% and the stipulation had a 10% safety net that didn't work any more, it wouldn't be in the best interests of investors or ratepayers. But absent an extreme situation like that where everybody would agree it makes sense, of course you should abide by the stipulation.

Q Would you agree that a reasonable definition of regulatory risk is, open quote, the risk of predictability of what a particular commission is going to do, close quote?

A Sounds very familiar to me. Yes.

Q That was your deposition testimony, in fact?

A That's where I remember it. Sounds accurate.

Q Now, you believe stipulations should be honored; right?

A Yes.

Q You want the investment community to have that respect and customers to have that respect and the companies to have that respect; correct?

A Yes.

Q Now, an investor who wanted to assess a company's regulatory risk -- getting back to the prior question, Mr. Rothschild, an investor who wanted to assess a company's regulatory risk with respect to a particular matter would review Commission orders on that matter, would he not?

A Well, when you say investors, you can't expect every investor to do that. There must be some investors who have purchased stock in FP&L who don't even know what state it operates in, but --

Q I'm just talking about the one who wants to assess the company's regulatory risk.

A Yes. If somebody is doing a thorough job of analyzing the company, I would hope that that person was aware of Commission orders, both with regard to that company and others, yes.

Q Now, in preparing your testimony, Mr. Rothschild, you did not review any FPSC orders other than the one cited in your testimony, did you?

A Well, I have been involved in ratemaking in Florida for many years, and I'm aware of the general approaches used by this Commission and didn't have to specifically review orders to understand the dynamics of this Commission. It has been done already, doing it as a matter of course.

Q So the answer to my question is no?

A I don't know how I can answer that question yes or no.

Q I'll ask another question. You didn't review any of the orders on storm damage accruals or storm cost recovery other than the one that you cite in your testimony; correct?

A I reviewed the one in my testimony, and I was aware of the accounting procedure, as we've discussed earlier today.

Q I assume that Public Counsel did not give you any orders other than the one you cited in your testimony. Am I right about that?

A I don't remember others of note at this point. It's possible that there others. I don't specifically remember anything that I felt was different --

Q In preparing -- I'm sorry.

A -- from what I was able to understand from what I have seen. And there's also the explanation of the orders in the company's reports to the Securities and Exchange Commission, which I did review.

Q In preparing your testimony, you did not review any equity analysts' reports regarding FPL, did you?

A Not that I specifically remember. I did read bond rating agency reports, and I did read Value Line, so depending on what category you want to put those in.

Q You read the bond rating reports before and in connection with preparing your testimony, Mr. Rothschild, or after?

A I think it was before.

Q But you don't remember?

A My recollection is it was before, but do I have notes to tell you the date I reviewed it? No. So I can't be 100% sure, but I think so.

Q In preparing your testimony, you did not do any research to see what the investment community was expecting FPL to earn in 2004, did you?

A I did review what Value Line was reporting, earnings for 2004, which was based upon three quarters of actual returns and one quarter estimated.

Q You looked at projected returns in Value Line?

A Value Line --

Q Or actual?

A You asked me for 2004, and what I looked at for 2004 was the most current Value Line report I had at the time, which I believe was the December 3rd issue, 2004. And that report showed earnings per share for FPL Group, and the earnings for FPL Group were based on three quarters of actual returns and one quarter estimated.

Q Is that the extent of your research in that respect?

A I don't specifically remember any other reports that I saw.

Q Okay. You cannot point to any investment report prior to the 2004 storm season that says FPL and its shareholders bear the risk of not recovering the costs of any storm damage reserve deficit, can you?

A Well, I haven't looked for that. I wouldn't -- and I think it's important to note that in terms of making my recommendations in this testimony, I wouldn't go about it that way. I think it would be very, very bad regulation if the Commission turns things around and looks to the investment community to tell it what to do. The Commission's decision on what it was going to do were made, and they're there. A lot of times -- and you have to be very careful about analysts' reports. Analysts' reports oftentimes are based upon what the company tells it, and any one analyst might or might not have read those prior decisions. If the analyst did, the only way we could tell is if it was specifically discussed.

Q There's no difference in your mind, is there, between the nature of the storm costs that would be covered by the existing reserve and those that exceed the balance in the reserve, are there?

A Well, I think there's a big difference when you have a stipulation which needs to be honored. That makes a big difference.

Q I'm just really asking you to compare a dollar here and a dollar there. There is a certain amount of money that is covered by the existing reserve, and then there is a deficit. Is there any difference in the nature of those costs in your mind?

A I don't know. I haven't looked at it specifically that way. But to the extent that the stipulation is binding, it certainly makes a difference. And if you had a large expense that was already covered by the amount in the reserve, whether or not it would make a difference I don't know. I have not looked at that.

Q Now, if investors wanted to determine the magnitude of risk that you might assert that they bore with respect to not recovering some or all of a deficit in the storm damage reserve, they would probably want to know the amount in the storm damage reserve, wouldn't they?

A Well, yes, but that could be for reasons beyond the topics in this proceeding. The more that's in the reserve, the less that the company has to lean on or might choose to lean on or might be permitted to lean on ratepayers to make up a difference. And more and more in electric utility ratemaking now, the overall level of rates is relevant. And if a company has to -- however legitimate it might be and however appropriate it might be and within the confines of the stipulation it might be, if it has to recover more rates from ratepayers, it becomes that much more problematic. It depends on the magnitude and the size of the dollars we're talking about, and so forth.

Q Let me ask it more simply. Let's assume, Mr. Rothschild, that I tell you that you will bear the risk of a deficit in a particular account. Okay?

That's a fact. You're going to bear that risk.

A I'm the insurance company?

Q Pardon me?

A I'm the insurance company, in essence, for this?

Q It makes no difference.

A Well, I'm just --

Q You, Mr. Rothschild, as an individual, you're going to bear the risk of a potential deficit in account X.

A I would probably sell my house and move out of the territory so I wouldn't have to bear that risk. You're making me scared.

Q All right. You would want to know how much -- probably one of the first questions you would ask me is, "Well, Mr. Litchfield, how much is in that reserve today"; right?

A Well, I'm not sure that would be a first, but we can agree that that would a relevant discussion. And what's in the reserve if not necessarily dollars parked in a bank somewhere. So just because it's booked in the reserve as one thing, it doesn't mean that the ability to pay is or isn't there just because it's in the reserve.

Q Excellent. So you might want to also know, "Well, Mr. Litchfield, is that a funded reserve or is it an unfunded reserve?" That might be another question you would want to ask me; correct?

A If I was going to be assuming the insurance function I might, yes, again, depending on magnitude and so forth.

Q Okay. Well, whether you characterize it as an insurance function or not I'm not really sure, but you're bearing the risk, however you're bearing it. Okay?

A Okay.

Q Now, let's go back to an actual context here, where we have a reserve, there is an amount in the reserve that either is funded or not, which we've already discussed you're not sure whether it's funded. And there's an accrual base rates; correct?

A Yes.

Q Okay. So do you think that the investor would want to know what the level of the accrual is in base rates currently?

A Well, again, it depends on the magnitude and the dynamics. The insurance company stepping in would want to know that, because it's focusing very much on that level of risk. The investor who's looking at a whole bunch of interchange of other things, I think that becomes less glaring, and it might not be as necessary to be that precise.

Q Okay. Well, let's go back to the individual example, Mr. Rothschild, because I think it will make it a little clearer for you.

Let's assume that I'm going to contribute a certain amount of money every month to that reserve. Now, a relevant question for you, if you were going to be asked to bear any or all of the potential deficit in that account, is, "Well, Mr. Litchfield, how much money are you going to contribute on a monthly basis to that reserve, so that I can know the magnitude of the risk that I'm bearing?" Would you agree with that?

A Again, looking at the insurance function, which I don't -- if that's what that is, if you're concentrating on somebody's going to make up an amount of money that's not there in the fund, that would matter, but it might not -- it depends on the magnitude of the risk. It's hard to answer that in a vacuum, because if you're going into a storm season, and if the annual accrual is relatively small in relation to the standard deviation of what could be expected for storm damage expense, then the annual accrual for that point in time might not be important. So it's hard to -- without knowing some of the other factors, I can't tell you it's not relevant, but it could be sufficiently small that it doesn't necessarily impact the decision that I'm understanding you're asking me to -- or the position you're asking me to be in.

Q Now, another question you might want to ask me is, "Well, Mr. Litchfield, what would happen to cause this reserve to go into a deficit?" You would ask me that; right?

A Well, I don't know if I have to ask you that. I understand what would cause this reserve to go into a deficit. That would be three hurricanes.

Q Okay. We're back -- you want to go back to the real context now?

A Well, I think the reason we're talking about this isn't for academic purposes.

Q Okay. So you might want to know what that risk is, and we agree it's the impact of hurricanes.

Now, would you want to know the expected annual costs of storm damage associated with hurricanes?

A Well, if I'm looking at a stipulation that says I've got a 10% floor, then these things become a lot less important. If I don't have that protection, if there were a stipulation that said whatever happens happens, I might be much more uncomfortable.

Q So is your answer --

A My answer, really, it depends on the rest of the environment. You're asking questions that could become important. They could be very important or unimportant, depending upon the rest of the context.

Q And I'm really just asking you to focus on -- as I recall, the question was, we're talking about a particular investor who wants to know what the particular risk or the magnitude of the particular risk is relative to having to bear a portion of a deficit in the storm damage reserve. Did you misunderstand that that was the predicate?

A Well, if we're talking -- I'm understanding this to be relevant to this case, and relevant to this case to me includes the existence of the stipulation and the existence of the regulation and what would happen if there were no stipulation, all of those things. So --

Q And you're free to qualify your answer. I'm just looking for an answer from you as to whether you agree or disagree with the premise.

A If you had a company that were not a utility and had substantial assets in Florida and was unable to get insurance, and those assets were of the kind that could be readily harmed by a storm, I would treat that differently than if I were looking at a regulated utility which had the protection of regulation and/or the safety net included in the stipulation. They're very different results.

Q Mr. Rothschild, assume that storm damage restoration costs are prudent and reasonable. Would you agree then that they are part of the cost of providing electric service?

~~A Well, you're leaving out -- I mean, that's an~~ important factor, but you're leaving out the nature of ratemaking and how it's done. Ratemaking is prospective in nature, and in setting up rates prospectively, it can be done numerous ways. The way it's done, my understanding is, in Florida is that there is a reserve set prospectively, and then there is the accounting procedure we've talked about which is set up should there be a storm, and then at some point in time the Commission can look at what to do with that reserve. It would normally be looked at in part of a base rate proceeding.

And in the case of the stipulation, we have a procedure that was established, as I understand the stipulation and as was explained to me by counsel, that if earnings would fall below 10%, then the company has an opportunity to recover that, which is a very -- in terms of a safety net, that's very generous.

Q Mr. Rothschild, I asked you that question verbatim in your deposition with respect to storm restoration costs.

Question: "Well, let's assume they are prudent and reasonable" -- I'm on page 180, for your reference. Question: "Let's assume they are prudent and reasonable, so then they're a part of the cost of providing electric service."

The answer is on page 181, line 1, "Yes."

COMMISSIONER DAVIDSON: That's the type of answer, yes or no, I like to hear.

Just sort of as an aside, how long was that deposition?

MR. LITCHFIELD: How long is the deposition in terms of pages?

COMMISSIONER DAVIDSON: In terms of pages.

MR. LITCHFIELD: It is 200 and -- I'm sorry. Including the reporter's certificate, 220.

COMMISSIONER DAVIDSON: Mr. Rothschild, just as one Commissioner, it would help a lot if you could try and speed up your answers a little bit. Start with a yes or a no. You're free to disagree with everything the attorney asks, but really start with that and try and limit your responses. I mean, they really are quite lengthy. And I understand you feel there's a lot to say, and that may be the case, but if you can try and tighten it up a little bit just for my benefit, I would appreciate it.

THE WITNESS: I'll do the best I can.

BY MR. LITCHFIELD:

Q Now, in preparing your testimony, you did not review or attempt to calculate the amount of the accrual in base rates, the expected annual costs of storm damage, or any other similar element, did you?

A For the reasons explained, no. I didn't go to that level of detail. It was not necessary.

Q In fact, as recently as Friday, you did not know the amount of the accrual for storm damage reflected in FPL's base rates, did you?

A I don't know the specific amount.

Q Would you agree that the theory behind ratemaking is that the company recovers the reasonable and prudently incurred costs to provide electric service?

A Is given an opportunity to recover prospectively.

Q And an opportunity to get a fair return of and on their investment; correct?

A Yes.

Q Okay. The return to shareholders includes a component to compensate the shareholder for risks associated with the investment; correct?

A It includes a component to provide -- yes, the cost of capital includes an allowance for risk.

Q Is it your view that the risk component of the total return on equity covers any and all risks for a utility?

A Essentially, yes, any risks that aren't specifically taken away or protected otherwise through regulation or other legal means.

Q Assume that FPL currently accrues $20 million a year in base rates toward the storm damage reserve. Are you with me?

A Okay.

Q Assume that the expected annual loss associated with storm damages is approximately 70 million.

A Seven zero.

Q Seven zero, yes.

A Yes.

Q Are the expected storm costs therefore built into FPL's base rates in that example?

A 20 million a year, when the expected every year is 70 million?

Q The average annual expected loss is 70 million. And my question is, are the expected storm costs built into base rates in that example?

A No, not if that were the only factor considered in the give and take of ratemaking. Just on the example you gave me, that would be a $50 million loss on average.

Q Now, assume that there is a year with no hurricanes or storm damage whatsoever. In that event, do FPL's shareholders profit from the storm damage reserve?

A Just because there happens to be one year?

Q I'm asking you to assume no damage is incurred, no hurricane strike, no storm restoration costs are spent. And the question is, do FPL's shareholders profit from the storm reserve in that year?

A I'm not sure I understand the question. In that particular -- just for clarity, you're saying the $70 million is still the appropriate average, even though there happened to be a year where there were no storms?

Q Correct.

A And in that particular year, there would be the $20 million of expenses, which is money that was put aside, and -- and so that would be what happens. But there would be no expenses that were incurred. But would there be a profit from that? No.

Q No profit. Okay.

Do you know whether FPL books accrued storm reserves as earnings?

A The storm reserve would be an expense.

Q They're not booked as earnings, are they?

A The charge to the reserve would be an expense.

Q And therefore, the charge to the reserve does not increase FPL's earnings, does it?

A The charge to the reserve -- there is an amount which was built into rates prospectively, and so the rates are that much higher to cover whatever the reserve allowance was, and then the expense is charged to the reserve.

Q So earnings do not go up for FPL in a year in which no storm strikes and FPL books the accrual to the reserve; is that a true statement?

A Probably. I mean, there's -- because it's beyond the scope of my testimony, so I haven't looked at other things I might look at. For example, I don't know if the reserve allowance was set up as a specific dollar amount each year or as a percentage of revenues, and if revenues are growing, is the company then collecting more, if it was set one way or the other. I don't know. You're just way beyond my testimony, so --

Q You didn't look to see how the storm reserve operates in the case of FPL?

A Not at the level so that I could answer your question precisely, no.

Q Not at the level that would allow you to determine whether earnings go up or down in a year in which FPL accrues $20 million, but there's no impact from storm?

~~MS. CHRISTENSEN: Objection. Asked and~~ answered.

MR. LITCHFIELD: I'll ask another question.

CHAIRMAN BAEZ: Move along, Mr. Litchfield.

BY MR. LITCHFIELD:

Q Are you aware of any investment analyst or bond rating agency report that specifically cites FPL's storm reserve as a potential opportunity for FPL's shareholders to profit?

A No. I never said that it was an opportunity -- that the storm reserve was an opportunity to profit.

Q I'm sorry. Could you repeat that answer?

A No. I never said the storm reserve was an opportunity to profit.

Q Okay. Now, your testimony is that 10% is a fair rate of return on equity for FPL in 2004, albeit possibly on the high end of the range that you would consider fair. Is that an accurate characterization of your testimony?

A More likely than not, if I were testifying on the cost of equity today, it would be less than 10% for Florida Power & Light. So in keeping with the stipulation and moving things along, it was -- I felt it was reasonable to still look at that 10% as an appropriate number, even if the Commission for whatever reason would decide that the stipulation doesn't apply in this instance.

Q Now, you haven't been engaged by Public Counsel in connection with the FPL base rate proceeding, have you?

A That's correct.

Q If you were going to file testimony in a full base rate proceeding, you would have included a discounted cash flow analysis, wouldn't you have?

A Yes, if I were filing cost of capital testimony, I would include the details of a DCF analysis.

Q Okay. Would a 1% rate of return on equity be fair to FPL?

A In today's environment, a 1% cost of equity?

Q Uh-huh.

A No. That would be certainly too low.

Q All right. How about 100 basis points above the risk-free rate? Would that be a fair rate of return on equity to FPL?

A So many people use different things for risk-free rate.

Q What do you use for risk-free rate? What did you use in your testimony? Let's use that.

A In my testimony, I talked about a risk premium based upon 30-year Treasuries. That is not a risk-free rate. It is a rate that is risk-free with regard to the payment as promised over 30 years.

Q All right. Let's use that as our baseline rate. Would you agree that if the company received 100 basis points above that rate as a return on equity that that would be a fair rate of return for the company?

A Would I agree that it would be a fair rate of return?

Q Yes.

A No. That would be too low.

Q Is that because it wouldn't include all of the risks that the company's stockholders bear?

A Well, it would be because when I look at what investors are communicating based upon the interrelationship between stock price and expected cash flows, whether I'm using a DCF analysis or a risk premium analysis, investors -- the return you're suggesting would be too low to attract capital. So it's the end result of what investors have concluded, however they get there.

Q Now, could you look at your Exhibit JAR-1 at the end of your testimony? And I have just a few questions, and I think you'll find them fairly straightforward, that I would like to ask you with respect to that exhibit.

A I'm not sure I have the identical copy to what you have, but --

Q I'm looking at the copy included with your testimony.

A The copy of the testimony I have doesn't have that in the back of it, but I think I've got what's probably the same as what you have.

Q I'm sorry. Your copy of the testimony does not have that exhibit?

A The copy I brought with me does not have that, right. I have another -- I have the exhibit which was handed out to me in the deposition, which I believe, if memory serves me correctly, is the same in the first several columns.

Q Okay. Well, just so that we're on the same page, this is entitled "Value Line Estimated Earned Return on Equity in 2004." Do you see that?

A Yes.

Q Okay. And it lists 23 companies?
A Yes.
Q Now, some of these entities operate in deregulated environments; correct?
A Yes, they operate in environments in which the generation has been deregulated, that's true.
~~Q And some of them operate~~
A Some.
Q Some of them operate in jurisdictions such as Florida; correct?
A Yes.
Q Some of these entities only have transmission and distribution assets that remain regulated under conventional cost-of-service regulation; correct?
A Yes.
Q The generation portfolios of each of these companies is different; correct?
A Yes.
Q There are differences in the regulatory jurisdictions among these companies; correct?
A Sure. The purpose of this exhibit is to show the variation in actual earned returns in 2004 for the electric industry.
Q So indeed, you looked at these to determine whether reducing FPL's earnings to 10% in 2004, to 10%

ROE would be reasonable relative to what the industry was earning; correct?

A Yes. And does 10% stick out as a number that looks like an outlier to what is the normal dispersion in 2004, or is the actual dispersion in 2004, what the industry is earning? And the 10% is in the middle of the pack.

Q There's no discounted cash flow analysis as part of your testimony in this proceeding, is there?

A As I explained to you in the deposition, I did not prepare a specific discounted cash flow for this proceeding. However, I'm well aware of what discounted cash flow results for electric companies show, because I have done them recently with regard to other companies.

Q I think you said it was in your head, right, but not in the testimony filed in this docket, if I recall your answer clearly from your deposition; is that right?

A I don't remember the exact words that I gave you in the deposition, but what I just told you is accurate, and I'm sure is in keeping with the concepts of what I explained in the deposition.

Q All right. I won't take you back to your deposition.

If the average earned return for your group of electric utilities on this Exhibit JAR-1 had been 13% in 2004, would that demonstrate, in your mind, that 10% was an insufficient rate of return for Florida Power & Light?

A It would -- that would be a big difference. I would wonder what else is going on. It might or it might not, because the analysis is not just one-dimensional. I can't give you an answer, because implied in your question is assume everything else is equal, and I would have to ask myself the question what's going on that the earnings were that much higher, and how did that compare to what occurred when the stipulation was set, and so forth. So --

Q If I were to ask you the same question using 11% or 12%, would your answer you just gave me be the same?

A Well, it's an analysis that fits together. And as it turns out here, the 10% number is well within the range of the pack. If all of the companies were earning more than 10%, then I would want to know more. I would want to know what was the -- how did that compare to what the environment was when the stipulation was entered into, in answering the question what would you do if the stipulation didn't apply.

If the stipulation applies, then it would be somewhat different. Then you would want to say are you within a zone where you would be cutting off your nose to spite your face. And I know in this current environment, you're just not near there. Ten percent is a very sustainable number for the company between now and when the decision comes out in the base rate case which has already been filed.

Q Now, these earned returns on equity reflected in the exhibit that we're looking at, these are earned rates of return from holding companies, are they not?

A Yes, they are. They are from the holding companies.

Q So all of these entities have operations other than just a regulated utility; correct?

A Yes, to varying degrees, that's correct. And it's standard practice when applying DCF analyses to apply those to holding companies, because you can't get the stock prices of the regulated entities. They're not traded.

Q In fact, none of these is a stand-alone utility?

A That's correct, but it is in keeping with the way cost of equity is set, where the holding company data is used. And the net result of that is to have a conservatively high result, because in virtually every instance, if not every instance, the cost of equity is going to be higher for the holding companies because the holding companies have more risk.

Q None of these figures, earned returns on equity, is an authorized rate of return for any utility within any of these holding companies; is that correct?

A If it was the authorized return, it would be by coincidence. The intent here is to show the end result of what's happening and to see whether or not the safety net in the stipulation is at a reasonable level. And if companies in the industry are functioning at a median level right around the 10%, that suggests to me that as a safety net, that's high.

I'm used to seeing safety nets, things more like, well, if the coverage ratio falls to 2, 2.0, or something like that, where you could start running into a situation where a company might not be able to issue new bonds and have some serious short-term problems. I didn't set the safety net, and in fact, it was given to me, what the stipulation says. And is that reasonable? It's very reasonable.

Q Now, you've got a figure for TECO Energy on line 22 of that exhibit as 0.51% earned return on equity in 2004. Do you see that?

A Yes.

Q Did you update your analysis at all?

A No.

Q Okay. I'm going to ask that someone hand you a copy of the Value Line dated March 4, 2005.

Now, is the 0.51% figure that you include in your testimony consistent with Value Line's most recent report for TECO?

CHAIRMAN BAEZ: Mr. Litchfield, is there a particular line that we should be looking at?

MR. LITCHFIELD: Yes, Mr. Chairman. If you would look in the column "Relative P/E Ratio," there's a number 15.5. Look all the way down and then cross over with "Pfd. Stock." There is a cell there that includes the figure 12.7%.

BY MR. LITCHFIELD:

Q Do you see that, Mr. Rothschild?

A Yes, I do.

Q Is that consistent with what you reported in your testimony?

A I'm having trouble with saying consistent with. I look back on the December 3, 2004 Value Line, which was the most current one as of the time I prepared the schedule, and at that point in time, Value Line was showing earnings per share for TECO at 5 cents. And in what you've handed me, they have changed that to 79 cents.

Q Now, earned --

A So what happened in that interim I don't know, but for whatever reason, between those three months, Value Line changed the result for 2004.

MR. LITCHFIELD: Mr. Chairman, I would like to mark this for identification. And by the records in front of me, it would be 35, but I'll stand corrected. We're way past that?

MS. FLEMING: Forty.

CHAIRMAN BAEZ: I'm holding Number 40. And you had dated this Value Line --

MR. LITCHFIELD: March 4, 2005 Value Line report for TECO Energy, Inc.

(Exhibit 40 was marked for identification.)

CHAIRMAN BAEZ: Show that marked as Exhibit 40.

BY MR. LITCHFIELD:

Q Indeed, Mr. Rothschild, earned returns will reflect variations in weather, won't they?

A Earned returns vary. That's the purpose of me showing you the schedule, and weather is one item that can impact the earnings of electric utility companies, yes.

Q And we agreed earlier that management and operational performance can affect the earnings of a company; correct?

A Certainty.

Q Extraordinary writeoffs could affect the earnings of a company; correct?

A Yes.

MR. LITCHFIELD: Okay. Now, I would like to show you two or three documents, and I'll ask those to be distributed right now. I'll ask to mark the first one for identification as Tampa Electric Company earnings surveillance report, December 2004.

CHAIRMAN BAEZ: As soon as I get it, we can mark it.

MR. LITCHFIELD: And if you receive two, I'll mark the second as well at the same time.

CHAIRMAN BAEZ: Is there any reason you need to mark them separately?

MR. LITCHFIELD: Actually, no.

CHAIRMAN BAEZ: No? Okay. We'll mark it as a composite and show Exhibit 41 a composite consisting of TECO and Progress Energy earnings surveillance reports for December 2004.

(Exhibit 41 was marked for identification.)

BY MR. LITCHFIELD:

Q Now, Mr. Rothschild, I need only to have you look at the first page of each document and tell me what the return on common equity is for, first, Tampa Electric, and second, Progress Energy Florida, for the period in question.

A You want the line G?

Q Yes.

A And that's FPSC adjusted basis. It would 11.80 for Tampa Electric. Is that what you're looking for?

Q And line F on the Progress document is what?

A FPSC adjusted basis, 13.48.

MR. LITCHFIELD: Okay. Now, Mr. Chairman, I have -- in the interest of time, I have three other documents here that I'm happy to take the witness through. Alternatively, I would like to offer them and ask him to accept, subject to check, various reported rates of return for the three entities, if there's no objection from counsel.

MS. CHRISTENSEN: I'm sorry. You're asking --

MR. LITCHFIELD: I would like to distribute some additional documents, which I could have marked as an additional composite exhibit, and ask Mr. Rothschild simply to accept, subject to check, the reported returns on equity for those companies, in the interest of time.

CHAIRMAN BAEZ: Are those earnings surveillance reports that you're --

MR. LITCHFIELD: Yes.

CHAIRMAN BAEZ: Other earnings surveillance reports?

MR. LITCHFIELD: Well, one for Duke Power, one for Savannah Electric, and one for Gulf Power.

MS. CHRISTENSEN: From? Surveillance reports from where? I mean, I obviously have no objection to surveillance reports filed here with this Commission. I'm not --

CHAIRMAN BAEZ: Mr. Litchfield, I appreciate your interest in our time, but why don't you just go ahead and walk him through it so we don't have to get into an argument over whether they're out of state or not.

MR. LITCHFIELD: All right. That's fine. Let me just ask that the remaining documents be distributed.

At your convenience, Mr. Chairman, I'm happy to start identifying them. I'm just not sure whether everybody has copies yet.

CHAIRMAN BAEZ: Just so that I can make sure, I'm showing five earnings surveillance Reports, Duke Power North and South Carolina, Gulf Power, Georgia Power, and Savannah Electric.

MR. LITCHFIELD: Those would be marked as Composite 41, Mr. Chairman?

CHAIRMAN BAEZ: Forty-two.

(Exhibit 42 was marked for identification.)

BY MR. LITCHFIELD:

Q Do you have those in front of you Mr. Rothschild?

A If you'll go through them again, I'll tell you what I have in front of me. I'll tell you what I have. I have Savannah Electric. I have a Georgia Power. I have a Gulf Power.

Q And you should have two from Duke, one for North Carolina and one for South Carolina.

A Yes.

Q All right. Let's look at -- let me first ask you, are these the types of surveillance reports that you routinely review in connection with your professional experience and consulting business?

A Generally, no. When I get involved, it's in a rate proceeding where there's much more detail and an entire rate filing. I can't say that I never review surveillance reports, but routinely, probably not.

Q Okay. But you have reviewed them?

A On occasion I've reviewed some.

Q All right. Which one do you have in front of you on the top of the stack?

A Savannah Electric.

Q All right. Let's do that one first. Would you turn to the second page of that document, which is listed as page 1 of five, and look at item number 7. Does that indicate that the regulated jurisdictional ROE as booked was 12.81% for the period?

A I'm sorry. We're looking at -- okay. Item number 7, that's what that says. I don't know what that means in terms of how it relates to the rate case or anything else, but that's what that paragraph says.

Q Which is the next document on your stack?

A I have a Georgia Power document.

Q Okay. Dated March 1, 2005, as a cover letter. And if you turn to the back page of that document, which is page 1 of four of an attachment, the retail return on equity shown there is 12.54%, is it not?

A That's what that shows. Of course, that has nothing to do with what the end result to investors is and where the cost of equity is, how it is determined and how capital is raised, and so on and so forth. But the document you have showed me says what you say it says.

Q All right. What's the next one on your stack?

A Gulf Power, December 2004.

Q Okay. And turn one page into that document. Do you see on line G, return on common equity, 11.91%?

A Yes.

Q Okay. Which one do you want to look at next, South Carolina or North Carolina?

A Do I want to look at? I don't think these have anything to do with my analysis, so I don't want to look at any of them. But whichever one you would like me to look at, I will.

Q ~~All right. Look at the North Carolina~~ document, page 3. And do you see on line 11 --

A I'm sorry. We're looking at which one? North Carolina?

Q We're looking at the third page of the North Carolina document.

A Partial document, unaudited. That's the one?

Q Okay. Do you see line 11, common equity, four columns over, is 13.63%? Do you see that?

A Yes. Again, this is a completely different analysis than I've done or think should be done or relates to the way that capital is raised in the financial market. But what you're showing me with your selectively picked portions of the companies, some of the companies and portions of their businesses, that's what it shows.

Q But these are the utility portions of the holding company returns, are they not?

A It's the utility companies of some of the holding companies that I've presented.

And the point to remember is, when we're looking at the adequacy of a safety net, what is -- what's happening in terms of the way money is raised in the capital markets. And the way to look at that is on the consolidated entity, not what any one individual company might earn. This is a safety net concept.

And if you were going to do the analysis like you're doing, there's so much -- I don't know where you would be going. You would end up looking at various pieces and whether they fit together or whether they don't fit together, and so forth. And you would have to carry this through the way ratemaking is done, which it isn't done that way. Ratemaking looks at the holding company results and applies the DCF analysis to them.

Q Where does Duke serve?

A Excuse me?

Q What service territories does Duke serve on a retail electric basis?

A It includes North Carolina, and I'm not sure where else.

Q How about South Carolina? Do you know?

A I'll look and see what Value Line says.

Q Well, why don't we look at, in fact, the last document on your stack? This is a fax from --

A Answering your question, I see that Duke Power supplies electricity to 2.1 million customers in a 22,000-square-mile area of North and South Carolina.

Q And on the second page of that attachment right behind the fax transmittal sheet, line 3, you'll see a cost of -- or a return on equity of 12.19%; correct?

A We're looking at -- I'm not sure which -- we're looking at the North -- you're looking at Duke Power North Carolina? Is that what you asked me to look at?

Q Pardon me?

A Did you ask me to look at Duke Power North Carolina?

Q No, we were looking at Duke Power South Carolina, and --

A All right. I'm sorry. I didn't hear that. Duke Power South Carolina.

Q Right. That's the only document that we had not yet reviewed. And on the page just inside the fax transmittal, it shows 12.19% earned return on equity, correct, line 3?

A It says embedded cost/return, 12.19. I don't know what that means in this context.

Q Okay.

A I see on the next page 14.11 for common equity. I don't know what that means. I haven't seen these documents. I don't know what I would do with these documents. Again, it's not relevant for the safety net, which is all about can a company raise capital on reasonable terms. You're addressing a different question, and you're only addressing it in a partial way, so I don't know what I would do with these documents.

Q Well, in your review, you looked at the earned returns for 23 companies that you indicated earlier were holding companies; is that correct?

A Yes, because those are the companies that are used for cost of equity analyses, DCF analyses and CAPM analyses, and because those are the companies that are -- if you look at a Standard & Poor's report, it's where Standard & Poor's focuses for bond ratings, and it's where a company has to have its integrity when it raises equity in the public market and raises debt in the public market. And for the purposes of a safety net, that's what's important.

As I've said before in the deposition, if I'm determining the cost of equity, it's a different approach. I'm not looking only at earned returns. I'm looking at what earned returns demand in order to be willing to provide capital. And on that basis, then the result would be lower than the 10%, because DCF results in electric companies these days come out lower than 10%. But we're sticking within the stipulation and we're testing whether or not it's reasonable, and it is reasonable. It's reasonable because a company can raise capital on reasonable terms on that basis.

Q You didn't do a capital asset pricing model either in connection with preparing your testimony did you?

A I didn't have to do one in connection with preparing the testimony, because I have done them and routinely do them, and because I'm not recommending a revision of the cost of equity in this proceeding. I know that since the parameters in the stipulation were set, costs have dropped. Interest rates are lower. So why burden everybody with an analysis that's unnecessarily detailed? The answer is correct anyway.

Q On page 11 of your testimony, you discuss a projection published by the Social Security Administration that purports to estimate the long-term returns in the stock market over the next 75 years. Do you see that, specifically on line 11?

A Let me get to my document now. Page 11.

Q Line 11.

A Line 11. I'm with you. I'm sorry. May I have the question, please?

Q That number, 6-1/2% over the inflation rate, that's a number that you have borrowed from the recent projections of the Social Security Administration; correct?

A Their chief actuary, yes.

Q Now, it's true, is it not, that to your knowledge, that estimate has only been used by yourself and one other person in expert testimony as a basis to estimate a fair rate of return on equity for a utility? Am I right about that?

A Well, we discussed that in the depositions. You asked me if I knew specifically any person, and I knew one other. But I haven't looked for that. I don't -- virtually all the time, the other testimonies that I see are company witness testimonies, and so I wouldn't know if there are other people who are using this or not. And it's a relatively recent number, so that it would have to be -- even if I had done such an analysis, it would have to have been done very, very recently.

So the answer to your question is no, I don't know any others other than one, but --

Q And that other --

A -- I wouldn't know if there were thousands.

Q And that other one person is your son; correct?

A Yes, that's correct.

Q Now, you agree that you are not challenging the reasonableness or prudence of the costs incurred by FPL; correct?

A That's out of the scope of my testimony. I have not looked at that.

Q Now, assume for me that a utility business was ~~completely deregulated in Florida. It's a region prone~~ to hurricanes, you would agree; correct?

A (Nodding head.)

Q How would a new entrant into the Florida public utility business have to factor in the impact of hurricanes? They would have to factor in expected annual losses; right?

A Certainly that would have to be considered if one were making a decision on going into business. I'm trying to understand when you say deregulated what all that would entail, but I'm so far -- one way or the other, the possibility of hurricanes remains a reality for Florida, and anybody with assets in Florida has to -- who's careful would recognize that possibility.

Q And they would have to charge a price that would be expected to cover those losses; correct?

A Well, what would happen in an unregulated environment is that in order to attract capital, there would have to be a reasonable opportunity for the perceived expense to be recovered. And whether or not last year changes that perception or would have been included in the perception before the fact I don't know, but maybe not.

And as I go back through the history of hurricanes in Florida prior to somewhere around 1993, commercial insurance was available, so that insurance companies at that point in time perceived the risk to be one they were willing to bear, and then I guess it was after Hurricane Andrew, they changed their perceptions. So what's important in accurately answering your question is, it comes down to the perception of the investor or group of investors at the time the investment is made.

Q So if I restate my question just slightly, can you give me a yes answer? Do they factor in expected annual losses and charge a price that is expected to cover the expected losses? Would you agree with that statement?

A I would agree that smart investors should do that.

Q And they would need to do that in order to attract capital, I think you indicated earlier; right?

A In a broader sense, if it was a public market, I would expect that to be true, yes.

Q Now, in years where this entity -- excuse me. In years where the losses were less than the expected losses, earnings for that company would be higher; correct?

A That would depend on the accounting procedure that was implemented.

Q Well, assume normal accounting.

A I don't know what array of accounting procedures would be available, whether or not the unregulated entity could set up the reserves. I would think they could, and therefore smooth out the impact of a hurricane from any one year.

Q Now, if the amount that the company was charging turned out to be less than the expected annual loss, it would have to procure insurance for the balance to the extent insurance were available; right?

A I'm sorry. I'm not following you.

Q If the amount turned out -- if the amount that that company was charging turned out to be less than the expected annual loss, that company would have to procure insurance for the balance, if that insurance were available; right? That's one way that they could address that risk?

A Well, I think there are many different ways, but what you're saying is -- I'm not following you.

You're saying the company is going to be putting aside a certain amount of money that's less than the average.

Q No. If the price that the company charged did not -- was not sufficient to cover the expected annual loss, then it could address that risk by procuring insurance; right? That's one thing they could do?

A Well, I guess -- okay. Not necessarily. If the company buys insurance, the insurance is going to increase expenses, and if the cost of the insurance wasn't in the price, then there would still be a shortfall. So I'm not following you.

Q Okay. So then it would have to charge more. That's another option. It would have to raise its price?

A Well, if it could. If it's a competitive environment --

Q It's a competitive environment

A If it's a competitive environment, then the question becomes, is the particular company -- the investors in that company, is their perception of the risk allowance greater or less than the perception of its competition. So you're looking at -- and that same thing would have to also be put into balance with everything else. So if we go to the "assume all other things being equal," then maybe. But it's --

Q Well, would you agree --

A In the real world, people have different perceptions. Your perception of the likelihood of insurance expense over the next 10 years might be different than mine. I'm not trying to tell you that I know or even have a personal opinion as to what it's going to be over the next 10 years. I don't. But I recognize the possibility of hurricanes in Florida over the next 10 years is real.

Q All right. Let's assume that the expected losses are more than either the price that the company can charge to cover those expected losses or the availability of insurance to cover those losses, or a combination of either. Are you with me? In that --

A Yes, but -- I'm with you, but why is this company -- where are we in the process? I mean, they've raised the capital, or is this a new entity that's going to be going into business? Because it changes the dynamics here. In theory, if a company --

Q Let's assume they haven't raised the capital. Let's assume they've done their analyses. Let's assume that they have estimated the annual expected storm losses. Let's assume that they have estimated the price that the market would bear for this service. Let's assume that they have, based on those analyses, concluded that their options were to either charge more, which as I just indicated is not a practical option, or to find insurance to the extent insurance is available. And if insurance is not available, would you agree with me that their only remaining option is to not enter the market?

A Or decide to earn a lower return. I partially was having trouble with your prior analysis, prior discussion because that last option was missing. If a company -- in theory, if a company cannot earn a sufficient return to keep its investors happy, it cannot attract the capital on a prospective basis. Not to say that it's going to necessarily occur as what is perceived, but starting out, the opportunity to earn the return has to be there or the capital isn't raised. Investors say, "No, thank you," and invest in something else instead.

MR. LITCHFIELD: I have no further questions.

CHAIRMAN BAEZ: Mr. Keating.

MR. KEATING: Just a couple of follow-up questions.

CROSS-EXAMINATION

BY MR. KEATING:

Q Mr. Rothschild, Mr. Litchfield asked you to look at recent earnings surveillance reports for several utilities in Florida and the Southeast and verify the reported earned returns for each utility. Do you know if those earned returns are within the ranges of reasonable returns established for each utility by the relevant regulatory bodies?

A No, I do not know what authorized returns were ~~granted. I do not know if there was a range, no.~~

Q Do you know if any of those utilities are in an overearnings posture?

A I do not know.

Q Can you identify any utilities in that group that may be operating under an arrangement similar to FPL's current arrangement where there is no ROE cap, but a revenue sharing plan?

A I cannot. I have not studied the details of any of those companies.

Q Thank you.

A I guess with the exception of Progress.

MR. KEATING: Thank you.

CHAIRMAN BAEZ: Commissioners, questions?

COMMISSIONER DEASON: Mr. Chairman, I have a question.

CHAIRMAN BAEZ: Go ahead, Commissioner Deason.

COMMISSIONER DEASON: Mr. Rothschild, is it your opinion that the investment community generally, when they make their investments in a Florida regulated utility, that they expect that ratepayers will pay the full amount of storm restoration costs, or that stockholders will be responsible, or that there will be a combination of the two, or do you have an opinion as to what the investors expect when they make that investment?

THE WITNESS: I think what the investors expect is that the stipulation that exists for those companies that have a stipulation will be adhered to. And I think that they expect that the Commission will abide by its statements of taking a good hard look at storm damage expenses and allowing recovery of those which are reasonably incurred within the parameters of any stipulations or other ratemaking principles that it might have.

COMMISSIONER DEASON: Do you have any opinion as to what the investment community's interpretation of the settlement agreement is?

THE WITNESS: I haven't seen anything in the investment community that goes to the level of detail that I know specifically what they have or haven't said about the stipulation or the other specifics of anything that the Commission has done. I can only -- I think the safest thing to do, rather than looking at any one or any 10 investment reports is say what would a reasonable person do, kind of stepping in that position and looking at the documents, and making the assumption that they're intelligent, thinking, thorough people.

COMMISSIONER DEASON: When the latest stipulation was reached and was approved by the Commission, was that information received well by the investment community, or was it received in a skeptical manner?

THE WITNESS: Since the only way that I know of that you can really look at that level of detail over a market reaction would be bond prices or stock prices, I don't think I could look at it, or I don't think anybody could look at it sufficiently, that sufficiently fine to say whether or not investors were or were not happy with that.

I can tell you that I know other experiences, that investors, particularly bond investors, tend to respond very favorably to safety nets such as those that are in the stipulation.

COMMISSIONER DEASON: Assume for purposes of this question that the investment community when making the investment in Florida Power & Light assumed that the stipulation and the policies of this Commission would be that prudently incurred restoration costs would be a cost of doing business and passed through to customers. Just make that assumption, that that was in the investors' mind. If we adopt your recommendation to utilize the 10% as the sharing mechanism, do you think that perception will change for those investors in the future?

THE WITNESS: I don't think there's any reason that it should change, because the 10% is still -- even if you throw out the stipulation, as I explained in my testimony, the 10% is still a comfortably high number as a cost of equity. So, in other words, if you wanted to go back and say forget the stipulation, it doesn't exist, and we're going to allow full recovery, part of that analysis I think would include a cost of capital analysis. And once you did that, you still end up with the 10% as being reasonable.

CHAIRMAN BAEZ: Commissioners, any others questions?

Redirect.

MS. CHRISTENSEN: Yes.

REDIRECT EXAMINATION

BY MS. CHRISTENSEN:

Q Mr. Rothschild, you were asked a lot of questions regarding the stipulation. I wanted to draw your attention to paragraph 8, which talks about the 10%

ROE safety net, as you've been referred referring to it; correct?

A Yes.

Q Okay. Under your understanding of how that safety net would operate, would FPL be necessarily guaranteed to earn above 10% if they came in and petitioned for some relief for base rates under that provision? Is it necessarily an outcome that they would get 10% or greater? Could they possibly get a lower ROE established by the Commission under that provision?

A They could get higher or lower if the 10% were being revisited.

Q Okay. And you're not asking to have that 10% figure revisited in this case?

A That's correct, even though capital costs have dropped since the 10% was determined.

Q Okay. And do you know whether or not it would be likely that the -- if an ROE is being set today for an FPL type company, whether or not that would be greater or lower than 10%?

A Well, I'm 100% confident that, based upon the analyses I've done and in consideration of the high percentage of common equity in Florida Power & Light's capital structure, meaning low financial risk, that the cost of equity I would recommend would be less than

10%.

Of course, nobody is ever sure what a Commission is going to decide, and I wouldn't presume to tell the Commission what it would find. And another dimension as well is that between now and when the Commission renders its decision, while I'm confident the capital markets will change, I don't know in which direction. So that would be another unknown. Perhaps capital costs will be lower than they are today; perhaps they'll be higher.

Q You were asked about a DCF study, a cash flow analysis for cost of equity, and my understanding of your testimony is you did not believe that was necessary in this case; is that correct?

A Yes. I think it was unnecessary for me to recommend to you to spend your money and for the Commission to spend its time on that extra DCF analysis, because we know that interest rates have dropped since the stipulation was entered into. And while people might argue over how much the cost of equity has dropped in the face of a particular drop in interest rates, the direction is irrefutable. If long-term interest rates drop, the cost of equity has dropped.

Q Okay. And you used the Value Line composite of 23 holding companies as a what? A mark of what is reasonable on the threshold? Am I correct on that?

A Well, to show one dimension, to show specifically what the industry is earning. And I chose Value Line reports on electric utilities in three different editions. There's a western edition, a central edition, and an eastern edition. I chose the eastern edition because that's where Florida is. And I put those down. I didn't do other analyses and decide one looked better than the other and see if I looked at them all -- I just did one, and that was it. And I felt that 23 was enough companies to be reasonably representative of the industry.

Q Okay. And you were shown an exhibit relating to TECO Energy's earnings and the restating of the 2004 earnings. I believe it has been marked for identification as Hearing Exhibit 40.

A Yes.

Q And it's supposed to represent a significant change from when you originally did your analysis for Value Line. Do you believe that this has any impact on the analysis that you did for the 23 companies?

A No. It shows what the 23 companies were reported by Value Line as of the December 3, 2004 report. And I should make it clear that what I reported here is what Value Line had reported in December 2004.

And for whatever reason, there is a marked change in what the document that was handed to me shows. And why it's different, what might have changed since then, I don't know.

Q In looking at your overall analysis based on the 23 Value Line companies, would this change in this one company have caused you to change your analysis?

A No. That one company change would not change the fact that 10% is still a reasonably representative result for the predominant number of companies in the group and is a comfortably high safety net.

Q Am I gathering also from your answer that you would want more information before you could determine what --

MR. LITCHFIELD: I'll object. That's a leading question.

CHAIRMAN BAEZ: Rephrase it, if you would.

BY MS. CHRISTENSEN:

Q What level of information would you like to have regarding the document you were just handed about TECO to be able to respond to any differences between what you're showing there?

A Well, since you asked me look at the documents before, I've had an opportunity in the seconds between the questions to look at this a little bit more, and I note that Value Line was forecasting a book value per share for TECO of $9.80 in the report that I used, the December 3, 2004 report. And that number, the book value has been reduced to $6.45. So apparently what has happened is, there was some kind of an extraordinary writeoff that was taken, but excluded from earnings in -- excluded from hurting earnings in the more recent report. So it has to do with the -- it doesn't even appear to be an inaccurate number as reported by Value Line, but a recategorization.

And when you start talking about the actual impact to investors, investors are impacted not only by normal recurring earnings, but they're also impacted by an extraordinary event, even though, in fairness, I should point out that certainly rating agencies tend to look through an extraordinary event if it's something that it isn't inclined to be recurring. And what that item was, I don't know. Before it being handed to me today, I hadn't seen the more recent TECO report from the Value Line.

Q Okay. Let me -- you were shown Composite Exhibit 42, which was a supposed composite exhibit of some surveillance reports to various commissions by the company, for various companies. Are you familiar -- before today, have you become familiar with any of these surveillance reports?

A I have seen prior surveillance reports for Progress Energy. Is that one in the -- let's see if that's in -- I don't know if that's in the exhibit.

Q Well, maybe it would be better to just go company by company and --

A Other than -- Duke Power, no. Gulf Power, have I ever seen a surveillance report for Gulf Power? Perhaps some years ago, not recently. Georgia Power, if I saw one, it was a long time ago. And Savannah Electric, I don't think I've ever done anything relating to Savannah Electric.

Q Okay. So would it be correct to say that you are not familiar with these surveillance reports?

A That's correct.

Q Mr. Rothschild, I just want to -- can you clarify whether or not these are the types of surveillance reports or information for return on costs -- or excuse me, return on equity that you would use to evaluate whether or not the safety net is appropriate?

MR. LITCHFIELD: Object. It's leading.

BY MS. CHRISTENSEN:

Q Would you use these surveillance reports to determine the appropriateness of a safety net?

MR. LITCHFIELD: Still leading.

CHAIRMAN BAEZ: You know what, Mr. Litchfield? I'm not going to start playing in semantics or syntax, or whichever one of those it is. Go ahead and answer the question.

THE WITNESS: Thank you.

CHAIRMAN BAEZ: Which I believe he stated clearly beforehand. I mean, I don't know what the point of that question is, but go ahead and answer.

THE WITNESS: You're right, Commissioner, I did answer that question before, and my answer is the same. The safety net is about being able to raise capital. Raising capital is relevant to the holding companies, not just any one company within the group.

BY MS. CHRISTENSEN:

Q Mr. Rothschild, you were given a hypothetical early on in your cross-examination talking about a utility A and utility B, and you were asked to suppose that they had similar cost structures and everything being the same, and to assume that they were hit by the same storm in 2004. Assuming that those utilities, the theoretical A and B utility represent Florida Power & Light and Progress, would it be correct that Florida Progress and Florida Power & Light have similar cost structures, or do they have similar cost structures?

A I'm confused now as to what's hypothetical and what's real, so I'm not --

Q You were given a hypothetical where you were given an example of A and B company, and they were both hit by hurricanes in the 2004 season.

A Yes. And I was given that hypothetically company A earned 12%, was earning 12% before the hurricane, and company B was earning 11%.

Q I guess the question is, how likely is it that two utility companies have the same capital structure?

A Exactly the same? Virtually impossible.

Q Okay. Mr. Rothschild, you were asked several questions about what reports you did or did not review. For the purposes of your testimony, do you believe there were any other reports aside from Value Line and the other ones identified in your testimony that were necessary to support your testimony?

A No.

Q And you were asked quite a lot of questions about investors' expectations regarding risk. Is the risk of hurricanes the only risk that investors take into account when they're investing in regulated utilities?

A No, of course not. Hurricanes are a risk, and anybody that has been in hurricane winds knows not to treat them lightly. But there are many other risks that all businesses face, including regulated utilities.

Q If FP&L absorbs storm costs through earnings, has it recovered those storm damage costs?

MR. LITCHFIELD: I'm going to object. I don't think that has anything to do with any of my cross.

CHAIRMAN BAEZ: I don't think this witness did storm reserve.

MS. CHRISTENSEN: Commissioners, I believe he testified regarding the 10% and why it would be fair for it to be --

CHAIRMAN BAEZ: I stand corrected. I'll allow the question.

BY MS. CHRISTENSEN:

Q So let me ask the question again. Mr. Rothschild, if FP&L absorbs storm costs through its earnings, it was brought down to the 10%, would it have recovered for those storm damage costs?

A Will it have recovered?

Q Yes.

A Yes, it will have recovered, in part through the excess earnings made possible through the implementation of the stipulation, and in part through what your office is proposing, by implementing the safety net.

Q Okay.

A And I would argue that anyway, they're recovering because the cost of equity is no more than 10%. So absent the stipulation, they're recovering anyway.

Q You said that ROE would decline after deferral ends and recovery begins. Would you clarify what you mean by recovery?

A ROE -- I'm sorry.

Q Let me try it one more time and we'll see if we can get it clarified. You said the ROE would decline after deferral ends and recovery begins. Would you clarify what you mean by recovery, if you can recall that statement?

A I'm trying to remember the context. ROE declines when recovery ends, and --

Q I can withdraw that question.

A Okay. I don't remember it, but, okay.

MS. CHRISTENSEN: No further questions.

CHAIRMAN BAEZ: Exhibits?

MR. LITCHFIELD: Mr. Chairman, I would move 40, 41, and 42. I believe those are all of the exhibits I marked. If I'm wrong about that, I would move all the others as well.

CHAIRMAN BAEZ: That's a good one. Without objection -- or are there any objections to 40, 41 --

MS. CHRISTENSEN: Objection.

CHAIRMAN BAEZ: Okay.

MS. CHRISTENSEN: I would object to the admission of 42, which is the surveillance reports from other commissions outside of this jurisdiction. Mr. Rothschild clearly testified that he has no knowledge of these surveillance reports, so there's a lack of foundation, and they're irrelevant.

CHAIRMAN BAEZ: Well, and let's stop for a second. Maybe you want to modify it, because to the extent -- if your basis is that the reports are out of their jurisdiction, then we have an ESR from Gulf. So do you want to modify your objection?

MS. CHRISTENSEN: Well, to the extent that it applies to other jurisdictions than the Florida jurisdiction.

CHAIRMAN BAEZ: Okay. Mr. --

MR. LITCHFIELD: Well, I would simply note that this is really what we all do here. I mean, we regulate utilities, and surveillance reports are used throughout this country in regulation. Staff here reviews, to my way of thinking, surveillance reports from other jurisdictions.

Mr. Rothschild may not have reviewed these particular reports dated these particular dates, but he has reviewed surveillance reports in the past. And I think the Commission could accept them, place whatever -- he qualified his answers -- and place whatever weight the Commission deems appropriate on them.

CHAIRMAN BAEZ: I'm going the allow the exhibit, Ms. Christensen, for this reason. There was an exhibit attached -- we had a lot of talk on the Value Line exhibit. And although the numbers may not translate point for point, I think it was used to establish some sense of reality, or at least to drive the point home as to what kind of numbers of return we're talking about. And I believe that they're analogous to the use that these exhibits were put forth for, so I'm going to allow it. They are relevant.

Did you have an objection to the others?

MS. CHRISTENSEN: No, Commissioner, not to the others. I would ask to move Mr. Rothschild's exhibits to his testimony, and I believe those are Exhibits 11 and 12.

CHAIRMAN BAEZ: I have them as 11 and 12. Without objection, show Exhibits 11 and 12. And without further objection, show Exhibits 40, 41, and 42 admitted into the record.

(Exhibits 11, 12, 40, 41, and 42 were admitted into evidence.)

CHAIRMAN BAEZ: Ladies and gentlemen, this is as good a time as any to adjourn for the evening. We plan on starting at nine o'clock tomorrow. Set your alarms accordingly. And we're in recess. Good night.

(Proceedings recessed at 5:35 p.m.)

(Transcript follows in sequence in Volume 4.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, MARY ALLEN NEEL, do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter transcribed under my supervision; and that the foregoing pages numbered 275 through 378 are a true and correct transcription of my stenographic notes.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, or relative or employee of such attorney or counsel, or financially interested in the action.

DATED THIS 21st day of April, 2005.

Mary Allen Neel

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