BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Progress Energy Florida, Inc.

Docket No. 050078-EI

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REBUTTAL TESTIMONY OF

EARL M. ROBINSON

ON BEHALF OF
PROGRESS ENERGY FLORIDA

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EARL M. ROBINSON

I. Introduction and purpose.

Q. Please state your name and business address.

A. My name is Earl M. Robinson and my business address is Weber Fick & Wilson Division of AUS Consultants – Utility Services, 275 Grandview Avenue, Camp Hill, Pennsylvania.

Q. Are you the same Earl M. Robinson that prepared the Depreciation Study on behalf of Progress Energy Florida, Inc. ("PEF" or the "Company") that was filed in this proceeding and sponsored by Mr. Bazemore?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address the positions taken and statements made by the Office of Public Counsel ("OPC") and Florida Industrial Power Users Group's ("FIPUG") witness, Jacob Pous. In addition I will address comments and positions taken by Mr. Hugh Larkin and Mr. Michael Gorman.

Q. Do you have any exhibits to your rebuttal testimony?

A. Yes. I have prepared or supervised the preparation of the following exhibits:

- Exhibit No. ___ (EMR-1), a chart of the relationship between the Company's cost of removal and average age of retirement for FERC account 364.

- Exhibit No. ___ (EMR-2), a schedule of the Company's depreciation analyses for 1997, 2002, and 2005.
- Exhibit No. ___ (EMR-3), a schedule of Florida Power & Light Company ("FPL"), Gulf Power Company ("Gulf"), and PEF net salvage parameters.
- Exhibit No. ___ (EMR-4), excerpts of the Public Utility Depreciation Practices, Staff Subcommittee on Depreciation of the National Association of Regulatory Utility Commissioners ("NARUC") Finance and Technology Committee of the NARUC, August 1996.

These exhibits are true and correct.

II. Rebuttal testimony to witness Jacob Pous.

Q. What is the order of your rebuttal testimony with regard to Mr. Pous?

A. For ease of reference, my rebuttal to Mr. Pous' testimony generally follows the manner in which Mr. Pous' testimony was organized.

Q. What do you understand are the criticisms of Mr. Pous with regard to your depreciation study?

A. I understand Mr. Pous' criticisms of my study are as follows:

1. That the study does not contain sufficient detail and documentation in support of the study recommendations.
2. That the variance between the Company's book depreciation reserve and theoretical depreciation reserve is being addressed within the study via the use of an Average Remaining Life depreciation approach as opposed to an

amortization of the variance over four (4) years.

3. Mr. Pous disputes the net salvage factors proposed for eleven (11) transmission and distribution ("T&D") accounts.

Q. Do you agree with Mr. Pous' criticisms?

A. No, I do not.

Q. Are the depreciation proposals set forth in your comprehensive depreciation study relative to PEF's plant in service reasonable and appropriate?

A. Yes. The Company's proposed depreciation rates resulting from an analysis of the Company's property investments as of 12-31-2003 and 12-31-2005 are well founded and fully supported by a detailed analysis of the history of the Company's plant in service and the factors anticipated to impact the Company's property over the remaining lives of the asset groups. In contrast, while the Company's remaining asset categories comprise the majority of the Company's extensive investment in Production, Transmission, Distribution, and General Plant accounts, Mr. Pous chose to address only his claimed resulting book depreciation reserve excess adjustment plus the net salvage parameters relative to eleven (11) property categories within the Company's T&D functions. It appears that Mr. Pous addressed only portions of those eleven (11) property categories because these are areas where he could most easily affect the greatest impact on the Company's depreciation proposal.

Q. Mr. Pous provides an overview of his testimony. What comments do you have in response to his statements?

A. Mr. Pous states that the Company has understated as well as failed to address the treatment of the excess variance in the Company's accumulated provision depreciation ("reserve"). Mr. Pous further states that he identified an additional reserve excess and subsequently proposed an amortization of that depreciation reserve variance over a period of four (4) years.

Mr. Pous not only misinterpreted the Company's level of future net salvage (that can be anticipated relative to the Company's property) in developing his extensive level of book versus theoretical depreciation reserve, but likewise seems to imply that the Company did something imprudent or improper in not proposing an amortization period consistent with the additional reserve variance he sets forth in his proposal. That is, while Mr. Pous initially accepted the Company's proposed recovery of its unrecovered property investments over their average remaining life, he is proposing to amortize his calculated additional book versus theoretical depreciation reserve variance over an extremely short four (4) year period. There simply is no rational support for his calculated depreciation reserve variance or his amortization proposal.

The Florida Public Service Commission ("FPSC" or the "Commission") requires that a theoretical depreciation reserve study be prepared and provided as part of the Company's depreciation study. In the process of preparing the theoretical depreciation study the currently estimated depreciation parameters (average service lives, Iowa Curves, and future net salvage factors) are utilized

with the current surviving vintage investment to identify the accrued depreciation that theoretically should be on the Company's accounting books as of December 31, 2005. The proposed depreciation parameters reflect the current best estimates of the present and anticipated usage, and the related recovery of the cost of the Company's property. While the information is interesting as a general reference, the fallacy of the theoretical reserve is that the calculation assumes that the current depreciation parameters have been utilized since day one of the current plant in service. Clearly this has not been the case and this underlying assumption therefore contributes to the difference between the book and theoretical depreciation reserve. As a result, it would be pure coincidence if the book and theoretical depreciation reserve were ever equal. While there will always be a book versus theoretical depreciation reserve variance, the FPSC has no mandate for companies under their jurisdiction to provide any special treatment of the variance. The standard and normal treatment of the depreciation reserve variance is to recover the amount over the average remaining life of the company's property.

In fact, the Company's filed depreciation study does address what Mr. Pous claims is a large book versus theoretical depreciation reserve variance. That is, the Company is addressing the existing depreciation reserve variance (as it has done in all prior depreciation studies) through the continued use of the Average Remaining Life (ARL) depreciation rates, which has been the historical basis of the Company's depreciation rates for many years and has been indirectly used to remedy past reserve variances resulting from prior studies. In the discipline of

depreciation the use of the ARL depreciation technique is widely recognized as an excellent and appropriate approach to recover a company's unrecovered investment over the remaining useful life of a company's plant in service. Likewise, the FPSC has supported the use of ARL depreciation rates for the recovery of utility property for essentially most, if not all, companies under its jurisdiction.

Next, the book versus theoretical depreciation reserve variance as set forth on Table 5-F of Section 2 of the depreciation study totals approximately $504 million, and is approximately twelve (12) percent of the Company's book depreciation reserve as of the proforma December 31, 2005 test year book depreciation reserve of $4,122 million. Almost ninety (90) percent of the variance is attributable to the Company's production plants. For example, the Company's depreciation study includes a first time assumption for a life extension at the Company's Crystal River Unit No. 3 nuclear plant ("CR3"), thus, the theoretical depreciation reserve variance reflects this assumption and further assumes that this CR3 life extension assumption was in place from day one (1) of the plant's operations. While the Company anticipates receiving approval for the life extension, no formal action has yet been taken by the Nuclear Regulatory Commission ("NRC") nor is it a certainty that the approval will be received. To the extent that approval is not received a sizable portion of the reserve variance will instantaneously disappear. To illustrate this impact, excluding the reserve variance related to CR3 reduces the book versus theoretical depreciation reserve variance from twelve (12) percent to eight (8) percent; hardly a large or

significant book versus theoretical depreciation reserve variance. Even if the CR3 license extension is granted by the NRC there is no assurance that the plant will operate the full additional period of years. It may simply become uneconomical to make additional required investment nearer to the anticipated end of life. Similarly, if the plant does not operate the full life extension portions of the perceived reserve variance will disappear.

Furthermore, to attain the full life extension of CR3, the Company will need to add a considerable level of investment that ultimately will need to be recovered over a very short time period compared to the original life span of the generating facilities. Accordingly, it would be imprudent to rapidly adjust the Company's book depreciation reserve downward through Mr. Pous' accelerated amortization proposal, only to then need to increase the level of depreciation expense for the significant level of new investments. This demonstrates that the nature of the theoretical reserve variance is fluid and should not be the basis of Commission's policy affecting the Company's capital recovery, particularly without a full and clear understanding of the reasons for all the the parameter changes within the study. For these reasons, the Company's ARL proposal is the most logical approach to addressing the point in time theoretical to book variance caused by the changes in the Company's depreciation parameters.

Q. Please comment on Mr. Pous' claim that your statement in the study that you considered the Company's experience and expectations are "meaningless generalizations." (Pous testimony, page 9).

A. I did consider the Company's experience and future expectations in the course of my analysis of the Company's detailed historical analysis and preparation of the future net salvage forecast. Mr. Pous simply fails to acknowledge the fact that the Company will experience additional levels of end of life negative net salvage relative to the property currently in service.

For example, in Account 364- Poles, the Company's historical net salvage data identifies that the average net salvage was only approximately negative six (6) percent. In addition, the historical analysis further identified that historical gross salvage averaged approximately fifty-two (52) percent and historical cost of removal averaged fifty eight (58) percent. In further analyzing the underlying detailed data, the Company's historical gross salvage data did experience periods of high levels of gross salvage that simply are not anticipated with regard to the entire population of the Company's poles because poles routinely generate little or no salvage value at the end of their lives. Based on this future expectation, these historic levels of gross salvage were discounted in the estimation of future net salvage. Conversely, in the review of the historical data, the recent years' cost of removal notably was far higher than the overall historical experience due to ongoing historical cost increases. Recognizing that the cost of removal is essentially labor driven, and will continue to increase in future years until the end of the property's future life, this increasing level of recent removal costs was given greater weight in determining the future net salvage. All of this Company experience, and the anticipated future expectations, were considered in arriving at my estimation of a negative ninety percent (90%) future net salvage for this

property account. There are various other illustrations of factors considered in the net salvage analysis that were provided during my deposition but this is an example of how I considered both the Company's experience and future expectations in estimating future net salvage.

Q. What comments do you have regarding Mr. Pous' criticism of the future net salvage forecast model included with the company's net salvage analysis? (Pous Testimony, Page 9 and Pages 40 to 42).

A. Mr. Pous' criticisms regarding the inclusion of the net salvage forecast analysis model within the depreciation study are unfounded and unsupported. Mr. Pous criticizes the use of linear analysis in the process of preparing my future gross salvage analysis and the inclusion of the inflation factor in determining the end of life removal costs. The use of the future forecasting approach is appropriate because it is a tool that enables a depreciation professional to identify and understand the drivers behind the future end of life property costs. It is very important to understand that the tools are not applied blindly through a simple mathematical formula, but professional judgment must be exercised based on the depreciation professional's experience and the Company's experience with and knowledge about the properties.

In more recent years, within the preparation of depreciation studies, increased focus has been placed on the full recognition of the recovery of all applicable plant costs (both the beginning and end of life costs) for each property group being depreciated. Therefore, in recent studies, forecasts of future net salvage have been calculated and included with the depreciation study analysis.

These forecasts assist in determining a reasonable estimate of the level of future net salvage that is anticipated to occur at the end of the life of the existing plant in service. This information is simply an additional analytical tool and source of information to be considered in arriving at the future net salvage estimate.

Furthermore, the results of the forecast analysis serve to reinforce the fact that the current level of experienced net salvage should routinely be the floor or minimum level for the estimated future net salvage percent. Future net salvage is a required component in the development of ARL-based depreciation rates. Accordingly, the development of the future net salvage is a forward looking analysis that must identify the level of end of life cost that will be incurred for the property being studied. Because the average age of the property that produced the historical net salvage is routinely far less than average service life, the remaining future retirement at an older age can be anticipated to generate lower levels of gross salvage and higher levels of cost of removal, hence lower levels of positive net salvage or higher levels of negative net salvage than historically experienced. Also, because cost of removal is affected principally by labor costs, and labor costs routinely increase over time, future removal costs by their very nature will be higher than that incurred in prior years.

Additionally, selecting a more conservative net salvage amount than that generated by the forecast analysis does not mean the forecast analysis was flawed. It simply means that it is prudent not to move all at once to the results indicated by the analysis and is simply a reflection of how conservative the estimate used in developing the proposed depreciation rate for each of the applicable plant

accounts is. Gradualism, such as this, is a concept specifically endorsed by Mr. Pous in his testimony.

Q. Mr. Pous further claims that many factors beside inflation impact the historical level of net salvage and must be taken into account. How do you respond? (Pous Testimony, page 41).

A. Mr. Pous never identifies the "many" factors besides inflation that he claims must be considered. As a result, it is hard for me to specifically respond to his claim. However, other factors that may affect the historical cost generally do not impact the future net salvage because the historical cost of removal is an accumulation of a diverse range of factors within the property groups that can be expected to be reflected in the future costs. The one factor that will increase and impact future costs is inflation.

Mr. Pous does claim that future economics of scale will drive down future costs of removal. Mr. Pous would have us believe that the Company's property retirement process is similar to a production line, with the employees gaining significant efficiencies through improved knowledge, experience, and workflows. Such productivity benefits simply will not occur, in that retirements will continue to occur in a random fashion throughout the Company's large distribution area. Furthermore, work crews will continue to change and there are regularly circumstances encountered that complicate the retirement process, such as soil conditions and other utility infrastructure in the affected area.

Mr. Pous' argument that my approach still produces a "mismatch that

results when one requires cost of removal expressed in future dollars to be collected from current customers in current dollars," (Pous Testimony, page 39), is a mischaracterization of real world events. The relationship of cost of removal (retirement) always has been, and always will be, end of life cost as it relates to beginning of life cost. Recovery of invested capital through depreciation rates must appropriately reflect the recovery of the total life cost of the assets that are being consumed by the Company's customers in the process of receiving Company services. Depreciation expense is, in fact, the mechanism designed to collect anticipated future costs of retirement from current customers. Net present value concepts, proposed by Mr. Pous and Mr. Gorman, therefore, have no application to depreciation principles.

Finally, with respect to his criticism of the linear trend analysis of the historical gross salvage, the analysis is performed for 5, 10, 15, and 20 year periods and is the product of actual company experience for those periods. The analysis is simply prepared to identify trends that have occurred over the period of years. Under certain circumstances, based upon the gross salvage trends that the Company has experienced, the mathematical results yield negative results, although I recognize that future gross salvage cannot be less than zero (0) percent. In such situations, a correction of an anomaly in the historical data reasonably may have caused the linear analysis to yield a negative result. Mr. Pous agreed that such an occurrence is a plausible explanation. Accordingly, such occurrences are appropriately considered when future net salvage estimates are made. Mr. Pous, however, has repeatedly implied in his testimony that the estimation process

deviated from the calculation model. This is totally false because the specific future net salvage factor is not simply extracted from a mathematical model. The group of analysis tools, of which the future net salvage is one component, are all utilized together in the professional analysis and data assessment in arriving at the recommended net salvage factor for each property group. This is no different than the basis of Mr. Pous' estimates, except that Mr. Pous routinely fails to recognize the factors that will impact the level of net salvage that the Company can be anticipated to experience in future years. That is, he gives no consideration to the future end of life cost of the property in his future net salvage estimates.

Q. Mr. Pous finds fault with the manner in which the Company chose to file the prepared Depreciation Study in its current proceeding. What are your comments? (Pous testimony, page 11-12)

A. Mr. Pous expounds at length about the manner in which the Company chose to file its depreciation study, going so far as to imply that the Company did something inappropriate in not having me initially file testimony in support of the study. The Company simply chose to have its accounting witness initially sponsor the study with full knowledge that if intervenors desired to further investigate the study that the author of the study would be available to support the study results. The actual comprehensive depreciation study was prepared and filed with full acknowledgment that I performed the depreciation study for the Company. Mr. Pous claims that the study contained inadequate documentation

and presentation notwithstanding the three volumes of information that comprised the study. The depreciation study contained an extensive complement of depreciation summaries along with a narrative of depreciation methods, procedures, study results, graphical charts, and underlying supporting depreciation calculations. The depreciation study is fully consistent, both in quality and quantity, with not only prior depreciation studies filed by the Company before the FPSC, but also with studies that I have prepared and filed for an extensive number of clients in various regulatory jurisdictions throughout the United States.

Q. Does Mr. Pous correctly define net salvage? (Pous Testimony, Page 14)

A. Yes. Mr. Pous quotes the NARUC definition that, "Net salvage value means the salvage value of property retired less the cost of removal. The cost of removal results whether the retirement reflects demolition of the item of plant or only the accounting transaction for retiring an item of property abandoned in place."

However, Mr. Pous fails to properly recognize the true cost to retire assets at the ultimate end of their life in his proposed future negative net salvage factors for the eleven T&D accounts for which he provides alternative estimates. That is, Mr. Pous' recommendations are based upon the Company's historical experience with no consideration of the anticipated future costs incorporated into his future net salvage estimates.

Q. Mr. Pous implies that the information provided by the Company is inadequate to support the Company's proposed negative net salvage factors. Do you agree? (Pous testimony page 16).

A. No. The Company's net salvage data, provided in response to Mr. Pous' data request, was a full and complete database of all of the Company's available historical net salvage data for the period 1976-2003. Furthermore, the depreciation study contains the detailed historical analysis plus the forecasted net salvage calculations for all categories of the Company's depreciable property. Mr. Pous is incorrect in his assertion that the historical and forecast analysis of net salvage trends does not provide adequate support for the proposed net salvage factors.

In addition, my recommended net salvage factors are based on Company specific data, with specific consideration given to the anticipated level of future net salvage, and are comparable to the analysis results produced in the Company's internally completed 2002 depreciation study summarized in Exhibit No. ___ (EMR-2). Exhibit No. ___ (EMR-2) is a summary schedule comparing the 1997 FPSC-approved net salvage factors, the 1997 depreciation study analysis results, and the 2005 proposed net salvage parameters in the PEF 2003/2005 study, OPC's proposed net salvage parameters, the net salvage parameters proposed in the PEF 2002 depreciation study, and the normal net salvage parameters from the 2002 depreciation analysis, as well as the total net salvage parameters. The normal net salvage parameters reflect true net salvage (exclusive of abnormal events) and appear to have been used by the FPSC when developing the 1997

approved net salvage parameters.

Not only are my recommended net salvage parameters conservative when compared to the forecasted net salvage in the current depreciation study, but in reviewing Exhibit No. ___ (EMR-2), one can quickly see that my proposed net salvage parameters are consistent with the analysis in the Company's study performed during 2002. For example, my proposed 2005 net salvage factor is negative ninety (90) percent net salvage for Account 364-Poles and, using the 2002 normal net salvage analysis in the 2002 study, there is a negative net salvage of one hundred eleven (111) percent for the 5 year average and negative ninety-eight (98) percent for the 10 year average net salvage for Account 364-Poles. Even more compelling is a comparison of my proposed negative twenty-five (25) percent net salvage for Account 365-Overhead Conductors and Devices to the negative one hundred two (102) percent for the 5 year average and negative one hundred twenty four (124) percent for the 10 year average net salvage derived for the same account from the Company's 2002 depreciation analysis. This demonstrates that my proposed net salvage for this account is conservative based on the Company's most recent depreciation analysis. A further review of the Exhibit will demonstrate that, in all other property accounts, my proposed net salvage parameters are similar to or more conservative than the Company's 2002 depreciation analysis. The Company's net salvage recommendations in 2002 varied somewhat from its analysis but the indisputable fact is that my proposed net salvage parameters are consistent with or more conservative than the Company's expected future net salvage analysis in 2002.

Q. Do you have a general comment regarding Mr. Pous' net salvage recommendations?

A. It appears that Mr. Pous is most concerned with the level of the change in the depreciation expense rather than what level of net salvage is appropriate. That is, Mr. Pous made a point to identify how much of a reduction to depreciation expense his proposed net salvage adjustments produce as opposed to spending more time to investigate and understand the underlying data.

Q. Do you have any comments on Mr. Pous' question concerning whether the recovery of capital through depreciation is a precise process? (Pous testimony, page 17).

A. In response to his own question he indicates that it is not an exact science –as all depreciation professionals acknowledge. But following that acknowledgement, Mr. Pous discusses the development of a theoretical depreciation reserve and somehow reaches the conclusion that the theoretical reserve calculation is exact enough to recommend that a calculated excess variance of the book reserve versus the theoretical depreciation reserve should be flowed back to ratepayers over a very short time period of four (4) years. This is in contrast to the Company's proposal to use ARL-based depreciation rates to correct any ultimate reserve variance relative to the plant in service over its remaining useful life. It must be recognized that much, if not most of the book versus theoretical depreciation reserve variances are routinely caused by changes in the estimates of useful

service life and net salvage factors. The fallacy of the calculation of theoretical depreciation reserve is that the calculation is prepared on a prospective basis and makes the assumption that the currently estimated depreciation parameters have been in place since the inception of the property investment -- that is clearly not the real world situation. To the extent that depreciation parameters (average service lives and net salvage factors) change in future studies, the variances will continue to fluctuate. In the meantime, the use of ARL-based depreciation rates will serve to mitigate any such variances on a rational basis. The use of the ARL-based depreciation rates recover both the applicable portion of the undepreciated plant in service investment which may include a reserve variance over the average remaining life. The result is that by the end of the property life, the depreciation reserve variance will have been eliminated and the customers will have paid their fair share of the costs in each period.

Q. What comments do you have regarding Mr. Pous' recommendation for his theorized calculated reserve variance? (Pous Testimony, Pages 20-21)

A. First, Mr. Pous reaches his level of a reserve variance by inappropriate estimates of future net salvage. Second, the calculated book versus theoretical reserve variance developed in the Company's depreciation study is twelve (12) percent of the total reserve, and only eight (8) percent if the significant portion of the variance generated by the Company's decision to seek a license extension for CR3 is considered. The drastic action Mr. Pous proposes is totally inappropriate and inconsistent with the long standing use of ARL-based depreciation rates both

by the Company and the FPSC. In addition, such action will do unjustified financial harm to the Company and ultimately to the Company's customers through higher future customer rates. That is, it causes higher customer rates due to the retention of a higher rate base which results in both higher future depreciation expense and a higher return on rate base.

Q. Mr. Pous cites various prior Commission orders in his attempt to find support for his recommendation to amortize his additional reserve variance over a short period of 4 years. Are the orders cited by Mr. Pous consistent with his amortization position? (Pous Testimony, Pages 21-22)

A. No. Essentially, all of the orders cited are simply related to reserve transfers between plant functions and/or plant accounts or recovery schedules for items such as PCB contaminated equipment. The only order in which a five year amortization schedule was referenced was the General Telephone Company of Florida case (Docket No. 840049-TL; Order No. 14929). In that order, the Commission ordered a five (5) year amortization of unrecovered costs relative to obsolete telecommunications equipment. None of the circumstances in these orders are applicable to Mr. Pous' recommendation to inappropriately amortize a calculated book versus theoretical reserve variance (part or all of which simply could go away in future studies), over a short period of four (4) years.

Reserve transfers have absolutely no relevance to the current case because they are simply the movement of dollars from one account balance to another account. Equally irrelevant are adjustments for the recovery of obsolete

equipment. Neither situation is in any way comparable to a normal book versus theoretical depreciation reserve variance. Obsolete equipment, for example, is subject to current or rapid retirement because the property no longer provides any service to the Company's customer. With regard to the Company's reserve variance, the property will continue to provide customer service for many years.

Q. Is the book versus theoretical reserve variance the product of improper depreciation rates being used or other improper action taken by the Company?

A. No. The level of annual depreciation rates utilized by the Company to record depreciation in prior years has been investigated and approved by the FPSC. Furthermore, the useful average service lives and net salvage percentages vary over time and, therefore, require modifications from one depreciation study to the next to reflect updates for current experience. As previously noted, to the extent that such changes in depreciation parameters occur over time, the resulting level of the theoretical depreciation reserve variance increases or decreases with each change. This is exactly why the Commission requires that depreciation studies be performed on a regular basis. The required depreciation studies and resulting recommendations are reviewed and approved by the Commission.

Q. On page 28 of his testimony Mr. Pous states that he is aware of one jurisdiction that has quantified a 5% difference between the theoretical and book reserve as the point at which a correction process will be implemented.

Do you have any comments regarding Mr. Pous' statement?

A. Yes. Mr. Pous is wrong. The jurisdiction that Mr. Pous is referring to is Alberta, Canada, although he did not identify it in his testimony. (Pous deposition, page 148, line 8). Mr. Pous claims that this jurisdiction uses 5% percent as a test of the appropriateness of a company's book depreciation reserve and then takes appropriate action. This is simply not true.

The fact is that utility depreciation within Alberta is calculated using EGL/Whole Life based depreciation rates. In addition, each company also calculates a theoretical depreciation reserve using ELG/Whole Life procedure and technique. Then after preparing the theoretical reserve calculation, to the extent that the variance between the book and theoretical reserve exceeds five (5) percent, the company amortizes the variance over a Broad Group procedure based on Average Remaining Life. Furthermore, irrespective of the length of the remaining life, the minimum remaining life for the amortization period for the reserve variance is five years for short lived assets. This is clearly not a test of the company's book depreciation reserve -- it is simply a regulatory modification of the Average Remaining Life depreciation technique. Also it needs to be noted that Alberta uses ELG based depreciation rates which routinely produce higher depreciation rates than the Broad Group/ARL-based depreciation upon which PEF rates are calculated. Mr. Pous' statement and implied support for his reserve adjustment proposal is incorrect and misleading.

Q. On page 31 of his testimony, Mr. Pous raises the question whether the use of

ARL-based depreciation rates adequately address the intergenerational inequity that exists for current customers. What is your response?

A. First and foremost there is no intergenerational inequity. The level of depreciation recovery is the product of the Company's application of Commission-approved depreciation parameters to the applicable plant in service investments. The reserve variance that exists is simply the product of depreciation parameters that change over time. For example, the estimate of the life of the CR3 unit was extended from forty (40) to sixty (60) years. The continued use of the long approved and utilized ARL-based depreciation rates will provide full recovery of the Company's total plant in service investment cost over the average remaining useful life. To simply propose a drastic amortization of Mr. Pous' perceived reserve variance over an unsupported very short amortization period is unwarranted and potentially harmful to both the Company and its customers. Doing so, would result in increased customer rates due to the retention of a higher rate base and depreciation expense.

Q. What comments do you have regarding Mr. Pous' statement on pages 31 and 32 of his testimony that the current reserve variance could not turn around?

A. In his testimony Mr. Pous discusses his perceived $1.2 billion reserve variance as if it is fact, when in reality it is not. Seven hundred million dollars of Mr. Pous' $1.2 billion is simply the product of Mr. Pous' misinterpretation and incorrect net salvage estimates for the Company's future net salvage recoveries. Mr. Pous' $1.2 billion variance even includes a further proposal to refund a portion of the

Company's legally required external nuclear decommissioning fund that cannot be distributed for any purpose other than for nuclear decommissioning.

As noted by Mr. Pous on page 17 of his direct testimony, he acknowledges that capital recovery is not a precise process. As such estimates routinely change over time and variances between the book and theoretical reserve increase and decrease. In fact, approximately ninety (90) percent of the Company's calculated $504 million reserve variance is related to the Company's Production Plant accounts, which Mr. Pous admitted in deposition (page 111, lines 4 and 5) that he did not review. Various Production Plant reserve variances are the product of current estimates using the same process used for the T&D account estimates that he challenges. Of course, the reserve variance will fluctuate in future years for not only the production plant accounts but also for the remaining T&D and General Plant accounts where changes occur. The use of the ARL depreciation technique is a longstanding and appropriate approach to address any such ongoing variances.

Q. **On page 37 of his testimony, Mr. Pous states that under the Company's position, "PEF contends it must collect $1.4 billion, or 16%, more than its original investment in plant to recoup its capital investment". What comment do you have regarding Mr. Pous' statement?**

A. In reading Mr. Pous' statement, as written, it could be interpreted that Mr. Pous is implying that the Company is estimating that future net salvage is equal to one hundred sixteen (116) percent of the Company's original cost investment. If that

conclusion is drawn from Mr. Pous' statement, that conclusion is clearly not true. The Company's depreciable original cost investment is $8.671 billion and the estimated future negative net salvage is $1.419 billion or 16.4 percent of original cost. This level of future negative net salvage is not at all unusual. For example, electric industry depreciation studies completed in recent years in various jurisdictions including South Carolina, Kentucky, Indiana, and North Dakota have included net salvage factors in the range of negative 18 to negative 29 percent. Conversely, the AGA/EEI depreciation statistics survey that Mr. Pous relies on cannot support his statement. The problem with the AGA/EEI depreciation survey (which was completed as of 1998), is that much of the information within that document is very outdated in that it is relative to depreciation studies that were completed many years earlier, some of which date back to the early to mid 1980's. Therefore, one cannot reliably rely on the AGA/EEI depreciation survey for current net salvage factors.

Q. Is Mr. Pous' data plotting of the forecast analysis, as discussed on pages 41 and 42 of his direct testimony and shown on Exhibit No. ___ (JP-7), correct?

A. Absolutely not. Mr. Pous states, "if [my] overall model had any validity it would be easy to plot the historical cost of removal in relation to its age of retirement and see a constantly upward sloping relationship." (Pous Testimony, page 41). His first error is his use of net salvage in lieu of cost of removal in developing the property retirement age to cost of removal relationship. The use of net salvage (including gross salvage) does not represent the cost of removal and incorrectly

skews the relationship by understating the cost of removal. Secondly, and equally important, is the fact that the Company's cost of removal data does not permit identification of age specific cost of removal data. However, this is not unique to PEF. The manner in which the Company's net salvage data is recorded is consistent with that used by all types of utilities. Utility records, therefore, do not provide a direct link between the specific age and dollar amount of a retirement to the corresponding cost of removal amount. The information within the salvage data is simply the accumulation of the yearly cost of removal transaction data. That data is then compared to the year's aged retirements. It is apparent that the data is an accumulation of retirements of different ages and costs of removal of differing levels. That is, the cost of removal experience within the Company's data is related to average retirements (for example with an average age of 20 years), but the specific cost of removal may be applicable to underlying retirements that occur at 10 and 30 years (which result in a 20 year average age). Since the cost of removal is not identified by specific age, therefore, specific age analysis cannot be performed.

Nevertheless, correctly capturing the relationship of the Company's cost of removal data and the average age of retirements with a linear regression analysis does produce a line sloping upward as age increases, as shown in Exhibit No. ___ (EMR-1). Thus, the linear forecast of cost of removal is, in fact, valid. Mr. Pous simply used incorrect data to complete his analysis.

Q. On pages 43 to 44 of his testimony, Mr. Pous claims you failed to explain

differences between your study and PEF's internal depreciation study prepared in 2002? What are your comments?

A. I was engaged by the Company to perform an independent depreciation study relative to PEF's plant in service as of 12-31-2003, with an update to 12-31-2005. In preparing the study my focus was simply that, to prepare an independent study. In the normal process of preparing such a study, a depreciation professional starts with an analysis of the Company's historical data to develop initial assessments of the Company's property and the experience that has been achieved to date. Subsequent to the completion of the historical analysis, on site meetings are held with Company management to gain an understanding of current and anticipated future events that will impact the useful life and future net salvage parameters that can be anticipated for each of the Company's property groups.

In completing the study, a general review was completed of the Company's 1997 Depreciation Study because the Company's current depreciation rates were based on that study. The present depreciation rates and underlying depreciation parameters from the 1997 study were included with the current depreciation study. During the course of completing the current study, references were made to a depreciation study prepared as of 12-31-2002 but the rates proposed in that study were not the basis of the presently-approved depreciation rates. Accordingly, no specific comparisons were made to the recommendations within the Company's 12-31-2002 study. In finalizing the current study, discussions were held with Company personnel to discuss the reasonableness of the proposed depreciation rates set forth in the current depreciation study relative

to the Company's December 31, 2003 plant in service.

Subsequently, I have compared the Company's 12-31-2002 study analysis and the proposed parameters under the current depreciation study. In the 2002 study, there is a significant variance in various accounts between the net salvage analysis and the net salvage parameters ultimately proposed in that study. The actual normal net salvage analysis set forth in the 2002 depreciation study is very consistent with the net salvage parameters proposed in the current depreciation study. In fact, in several cases, the level of experienced negative net salvage exceeds even the levels that I have proposed in the current depreciation study. Apparently the Company chose at the time not to incorporate the higher levels of negative net salvage into its 2002 recommendations. However, it is indisputable that the net salvage experience in the 2002 study supports my recommended net salvage parameters. Mr. Pous simply chooses to ignore this analysis in the 2002 study.

Q. What are your comments regarding Mr. Pous' discussion on pages 44 and 45 of his testimony regarding your alleged failure to check the reasonableness of the study results with industry data?

A. While industry data is a gauge to determine applicable levels of depreciation parameters if sufficient specific Company data is not available, it should not supplant specific Company data where such data is available. The industry data, while a useful tool, has limitations. That is, the industry data is simply an average of many companies and in no way specifically relates to the Company's operating

plant. Equally, if not far more important, is that fact that the latest available statistics were prepared in 1998 and they include various studies that are significantly more dated -- some information is from studies completed in the earlier to mid 1980's.

Q. What are your comments regarding Mr. Pous' discussion regarding anomalous data? (Pous Testimony, page 45)

A. While there appear to be some inconsistencies within the net salvage data, one must recognize that the underlying net salvage data is comprised of extensive cost data that occurred over a wide range of years. The anomalous data is minor, involving several negative transactions that generally occurred during earlier vintages in some of the T&D accounts. Because the entries are generally of early vintage years, specific, detailed records are not available. However, understanding the way transactions are booked and various accounting corrections are made, the negative amounts are very likely the result of corrections of prior year activity. In any event, these anomalous entries are few in number and they do not have a material impact upon a reasonable assessment of the net salvage results in the study. Mr. Pous is simply overreacting to items within the salvage analysis that are not material.

Q. How do you respond to Mr. Pous' assertion that there are inconsistencies in your net salvage analysis? (Pous Testimony, pages 45 to 47)

A. Mr. Pous states that my salvage analysis is inconsistent. That statement is totally false. The process utilized is consistent across the study of net

salvage for the Company's entire range of accounts. Mr. Pous simply does not like the results of the estimates made relative to estimated future net salvage in certain of the T&D accounts.

In completing the analysis, consideration is given to the range and level of historical activity (gross salvage and cost of removal), the content of the account, and the likely and/or potential for generating gross salvage at the end of the property's useful life. Such factors must be considered in estimating future net salvage otherwise an improper level of net salvage will be estimated if only the raw historical data is analyzed and an estimate made from an arithmetic calculation. My analysis process is totally consistent with the process used by the Company in prior depreciation studies in making a professional assessment regarding the make up of the historically experienced gross salvage. Likewise this type of assessment was recognized and acknowledged by the FPSC in its consideration and approval of prior net salvage parameters.

Q. Conversely, what comment do you have regarding Mr. Pous' inconsistent analysis results and recommendations?

A. While Mr. Pous severely criticizes the presentation of the net salvage forecast analysis and the supposed inconsistency in the development of the future net salvage estimates in the Company's depreciation study for selected accounts for which he proposes alternative net salvage factors, he readily accepts the results of the net salvage study analysis for all the remaining accounts. It is clearly obvious

that there is an inconsistency in his actions.

Q. Please provide your responses to Mr. Pous' net salvage analysis comments and resulting net salvage proposals.

A. For ease of reference, I will respond to Mr. Pous' net salvage analysis by specific account in the same order that he does in his testimony. Specifically, I address his comments and recommendations on an account-by-account basis for the eleven (11) T&D property groups for which he provides alternative proposals.

To begin with, however, I have some general comments on the net salvage analysis Mr. Pous performed on the eleven (11) T&D accounts. Mr. Pous criticized the results of the depreciation study for not considering the results of the Company's 2002 study, but he ignores the very net salvage information that is contained in that 2002 study in his net salvage analysis. The 2002 study provides specific Company information that was developed relative to abnormal and normal net salvage for each of the Company's T & D accounts that Mr. Pous has critiqued and for which he has proposed alternative net salvage parameters. Similar net salvage information was provided to the FPSC at the time of the completion of the 1997 study and was incorporated into the FPSC-approved net salvage parameters. The analysis from the 2002 and 1997 study are contained in Exhibit No. ___ (EMR-2). In general, as noted before, the information in Exhibit No. ___ (EMR-2) clearly demonstrates that the net salvage parameters in the current depreciation study are reasonable.

Throughout his net salvage analysis Mr. Pous makes reference to Electric

Industry depreciation statistics. As previously noted, inherent shortcomings exist with the overall industry data because of the age of the survey data and underlying depreciation studies and because the statistics include many companies that are far removed from the Company's location and have different operating characteristics. The more reasonable industry comparison with the Company's depreciation study results, are recently completed depreciation studies in the Company's general location. In this regard, a comparison was prepared between the proposed net salvage parameters in the current PEF depreciation study with the net salvage parameters for the same T&D accounts in the most recent Gulf and FPL depreciation studies. These other utility net salvage parameters were also compared to the net salvage parameters proposed by Mr. Pous. This comparison is included in Exhibit No. ___ (EMR-3). As shown there, Mr. Pous' proposed net salvage parameters are "way off the mark" from the parameters proposed by the Company's depreciation study and the average of Gulf and FPL's depreciation studies. In contrast, the Company's proposed net salvage parameters are consistent with the net salvage parameters for Gulf and FP&L.

As noted, Mr. Pous relies on the 2002 Study several times in making his recommendations. I have since reviewed the Company's 2002 study's net salvage analysis and have banded the 2002 study salvage and removal cost data into 5 and 10 year bands to further illustrate the Company's trends over this period of time. This is illustrated as part of Exhibit No. ___ (EMR-2) and is referred to throughout my testimony. The analysis in the 2002 study defines normal salvage as the salvage received when the asset is disposed of and sold/scrapped.

Abnormal salvage is defined as accounting generated salvage such as insurance proceeds, reimbursements/relocations, and re-use. While I believe insurance proceeds and reimbursements should be considered normal, consistent with the NARUC definition, these amounts are relatively modest when compared to the total abnormal salvage amounts. Because accounting generated salvage, such as returns to stores, are non-cash entries, I have discounted them when establishing net salvage parameters. Generally, I have found the levels of normal salvage in the Company's prior depreciation analyses to be consistent with my view that future gross salvage for these T&D accounts will be minimal at best.

It should be clear, then, from all of these sources that my net salvage estimates for the Company were conservative and gradually move the Company from its prior net salvage parameters to net salvage parameters more in line with the Company's experience and the experience of other Florida investor owned utilities.

I now address Mr. Pous' recommended net salvage parameters for each of the T&D accounts for which he proposes alternative net salvage parameters to the parameters in the Company's study.

Account 353.1 – Transmission Station Equipment

My proposed net salvage parameter for this account is zero (0) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative nine (9) percent and negative nine (9)

percent, respectively, were identified for both periods. Mr. Pous' recommended net salvage is positive ten (10) percent net salvage.

Mr. Pous simply ignored both the actual net salvage analysis that was provided in the current study as well as the detailed analysis information that is contained in the 2002 depreciation study. In the analysis process, the level of achieved gross salvage was significantly discounted in my analysis in arriving at my proposed zero (0) percent net salvage. The historical cost of removal has averaged eight percent which would imply negative eight (8) percent if one assumed zero (0) percent gross salvage. However, it was anticipated that some minor level of future net salvage may be received from the disposal of the retired station equipment. Accordingly, future net salvage was therefore estimated a conservative zero (0) percent net salvage.

While the Company's proposed net salvage in the 2002 study was 10 percent positive net salvage, the recommendation was overly conservative in comparison with the actual study analysis results. The Company's 2002 study contained a detailed analysis demonstrating that normal net salvage for the most recent five and ten year period was negative nine (9) percent, which fully supports the proposed zero (0) percent net salvage proposed in the current study. Mr. Pous simply ignored the detailed information in the 2002 depreciation study that was provided to him. The detailed analysis in the Company's 2002 study supports my recommendation.

Account 355 – Transmission Poles & Fixtures

My proposed net salvage parameter for this account is negative twenty-five (25) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative fifty (50) percent and negative forty-seven (47) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative fifteen (15) percent net salvage.

While the historical net salvage analysis averaged approximately positive five (5) percent net salvage, the net salvage experience is being driven by a level of gross salvage which is clearly not representative of what can be anticipated in connection with the ultimate retirement of the property group's assets. Retirement poles simply have no value at the end of their life.

The net salvage forecast indicates that end of life cost of removal is anticipated at over one hundred percent and that gross salvage is calculated at approximately fifty (50) percent (a level that simply will not occur). While there may be a minor level of third party damages for the pole account throughout the property's life, it is not realistic that this category of salvage receipts will come anywhere close to fifty (50) percent.

The net salvage factor underlying the current depreciation rate (and approved by the FPSC) is negative thirty (30) percent. It can be anticipated that the future net salvage of this property category will be driven more by the cost of removal than the gross salvage activity. Because the three year rolling average cost of removal from Section 8 of the Company's study declined somewhat

during several recent bands, a slight reduction was proposed to the current negative thirty (30) percent to negative twenty-five (25) percent net salvage.

For this account, Mr. Pous simply ignored both the recommended negative twenty-five (25) percent salvage proposed in the 2002 study as well as the actual 5 and 10 year normal net salvage of negative 50 and 47 percent, respectively, in developing his proposed negative fifteen (15) net salvage for Transmission Poles. The detailed analysis within the 2002 study supports my recommendation.

Account 356 – Transmission Conductors & Devices

My proposed net salvage parameter for this account is negative thirty (30) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative sixty (62) percent and negative thirty-nine (39) percent, respectively, was identified. Mr. Pous' recommended net salvage is negative ten (10) percent net salvage.

In this account, while the three year rolling bands from Section 8 of the Company's study are positive for most years, various individual years during recent periods experienced considerable levels of negative net salvage. With the exception of a couple of recent years, the level of cost of removal has been escalating over time. Future cost of removal trended to in excess of one hundred twenty-five (125) percent and gross salvage trended to nearly seventy (70) percent. Again this level of gross salvage will simply not occur at the end of the property's life. While some level of scrap value will be received, any such

salvage will be limited because most of the property is aluminum conductors as opposed to more valuable copper conductors. Given the currently increasing cost of removal and gradualism, future net salvage was conservatively estimated at negative thirty (30) percent.

In this account, since the 2002 study negative salvage recommendation was beneficial to Mr. Pous' position he quoted the study's recommended negative fifteen (15) percent net salvage. However, the recommendation was clearly overly conservative in comparison with the actual analysis in the study. The Company's 2002 study contained a detailed analysis which demonstrates that normal net salvage for the most recent five and ten year period was negative sixty-two (62) percent and negative (47) percent, respectively. These study results demonstrate just how conservative the current depreciation study recommendation is. Again, Mr. Pous ignored the detailed information that was provided to him.

Account 362 – Distribution Station Equipment

My proposed net salvage parameter for this account is negative fifteen (15) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative seven (7) percent and negative six (6) percent, respectively, were identified. Mr. Pous' recommended net salvage is zero (0) percent net salvage.

The overall average experience does not begin to indicate the real

expectation with regard to the anticipated future net salvage for this property group. The gross salvage has averaged approximately thirty-five (35) percent over the historical experience but has declined rather dramatically during the last several years. Accordingly, the gross salvage was discounted to zero (0) percent. Likewise, while the cost of removal has historically averaged approximately ten (10) percent, it has declined during several recent years and then turned up to seventeen (17) percent in the most recent year. Cost of removal through the end of the useful service life of the property group forecasted to in excess of twenty-six (26) percent. The historical experience is not anticipated in the future, nevertheless, some minor level of end of life gross salvage (e.g. scrap, etc) was anticipated to be received at the end of life of the property.

With regard to cost of removal, this is a continual and ongoing factor. Sizable portions of the investments in this property groups are related to the station transformers which can either be retired and/or moved from one location to another. Retirement and/or relocation of these facilities is anticipated to occur at much greater frequency for distribution facilities and for transmission facilities (for which zero percent net salvage was estimated). With the occurrence of this retirement/relocation activity there will be a significant work effort and costs incurred in connection with those tasks. All of the above factors were considered in estimating the proposed negative fifteen (15) percent net salvage for this property group.

While the Company proposed positive five (5) percent net salvage in its 2002 depreciation study, from the study analysis a negative seven (7) and

negative five (5) percent net salvage, respectively, for the past five (5) and ten (10) year periods can be identified. Again, Mr. Pous simply ignores both the underlying historical data and the Company's 2002 study analysis data that was provided to him at his request. The detailed analysis in the 2002 study is consistent with my recommendation.

Account 364 – Distribution Poles, Tower & Fixtures

My proposed net salvage parameter for this account is negative ninety (90) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative one hundred eleven (111) percent and negative ninety-eight (98) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative thirty-five (35) percent net salvage.

While the historical net salvage for this account averaged approximately negative six (6) percent, the average by itself is misleading. Likewise the gross salvage forecasted to in excess of 380 percent and is also misleading. Both are the product of an anomalous gross salvage percent which occurred during 2001 which I will discuss below. The gross salvage and cost of removal that was booked during 2001 is most likely a delayed accounting transaction. The levels of gross salvage recorded for various other years will not be achieved at the end of the life of the property group.

The net salvage forecast indicates that end of life cost of removal is anticipated at over one hundred (100) percent and that gross salvage is calculated

at a level that simply will not occur. While there will be a certain level of third party damages for the pole account throughout the property's life, it is not realistic that these salvage receipts will reoccur to a significant degree.

The Company's cost of removal experience is the true driver of the anticipated future net salvage. The cost of removal has been continuously increasing in recent years and can be anticipated to continue to do so in future years. While the historical average cost of removal was approximately sixty (60) percent that level does not begin to recognize the actual cost of removal experienced in more recent years. The experience in recent years is in excess of one hundred (100) percent cost of removal. Considering all of these facts, I estimated future net salvage of negative ninety (90) percent for the Company's distribution poles.

The net salvage factor underlying the current depreciation rate (and approved by the FPSC) is negative thirty-five (35) percent. The future net salvage of this property category will be driven more by the occurrence of cost of removal than the gross salvage activity. The Company's 2002 study contained a detailed analysis from which one can determine that normal net salvage for the most recent five and ten year periods were negative one hundred eleven (111) percent and negative ninety-eight (98) percent, respectively, which fully supports the proposed negative ninety (90) percent net salvage proposed in the Company's current study. Again, Mr. Pous simply ignores both the underlying historical data and the Company's 2002 study analysis data that was provided to him.

In his analysis Mr. Pous singled out an anomalous entry, which I agreed

was anomalous, as representative of the Company's historical experience. The single, anomalous entry does not represent the true Company experience. One needs to look more closely at the data and recognize that the cost of removal dollars in that entry are most likely the result of delayed activity and accounting transactions from prior years. The activity did occur, the funds were expended, and there, of course, is a reasonable explanation. It is simply a matter of the timing of the activity. No adjustments are appropriate and/or warranted.

Account 365 – Distribution Overhead Conductors & Devices

My proposed net salvage parameter for this account is negative twenty-five (25) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative one hundred two (102) percent and negative one hundred twenty-four (124) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative fifteen (15) percent net salvage.

The Company's net salvage averaged approximately positive four (4) percent, but many of the factors contributing to the positive salvage occurred during the period 1975 to 1985, with some high levels of gross salvage during the late 1990's, specifically 1997 to 1999. Such salvage was likely not true salvage. Because the gross salvage dropped off significantly during the most recent years, the gross salvage was interpreted as zero (0) percent. Cost of removal has historical been high and averaged approximately ninety-three (93) percent but, likewise has dropped off during the last couple of years. The forecasted end of

life cost of removal aggregated approximately 188 percent. Because cost of removal dropped off some from the prior high level, a modest decline in the current level of future net salvage of negative thirty-five (35) percent to negative twenty-five (25) percent was proposed for this property group.

The Company had actually proposed negative twenty-five (25) percent net salvage for this account in its 2002 study. Mr. Pous did not specifically mention the net salvage recommendation in the study. Mr. Pous also did not mention the fact that the 2002 study contained an analysis from which normal average net salvage levels of negative 102 percent and negative 124 percent net salvage for the five and ten year periods, respectively, can be determined. Both the Company's 2002 and the current depreciation study net salvage proposals are very conservative in comparison to the actual net salvage being experienced by the Company.

Mr. Pous, on various occasions, including for this account, has relied rather heavily on industry statistics, even though the Company has extensive level of salvage analysis data specific to its property. While industry statistics are a reference point, significant weight should only be placed upon such data when specific Company information is not available. Furthermore, as discussed earlier in my testimony, the industry depreciation statistic (in general) have various shortcomings, one of which is the fact that many of the studies underlying the industry data are quite dated and therefore are increasingly unreliable. More recently, completed depreciation studies for Florida investor owned utilities and well as other utilities tend to demonstrate increasing levels of negative net

salvage.

Mr. Pous even goes so far as to state that his recommended negative fifteen (15) percent net salvage "is more representative of the industry average." This statement simply is not true. The industry average net salvage for this property group is negative twenty (20) percent, which is midway between Mr. Pous' negative fifteen (15) percent and the Company's study which proposes negative (25) percent. All of the above data support my recommendation.

Account 367 – Distribution Underground Conductors & Devices

My proposed net salvage parameter for this account is negative fifteen (15) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative four hundred three (403) percent and negative two hundred forty-six (246) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative five (5) percent net salvage.

The Company's historical net salvage has averaged approximately negative eight (8) percent net salvage, in which the resulting negative net salvage is being significantly mitigated by the continuous positive net salvage up through the early 1990's. Since that period of time the net salvage has turned significantly negative. During the late 1990's, notwithstanding the fact that significant levels of gross salvage were recorded, negative net salvage remained very high.

Future gross salvage was discounted to zero (0) percent because the high levels of gross salvage during the late 1990's dropped off significantly in recent

years. While various levels of gross salvage have been received in connection with third party damage of limited portions of the Company's property and will continue to be experienced, it is extremely unlikely that levels anywhere near the levels recorded will be applicable to the "total property group" throughout the property's life.

Conversely, with regard to the cost to retire this property, ongoing costs can be anticipated to continue throughout the life of the property at increasing levels. Cost of removal for this property group actually forecasts to in excess of two hundred sixty (260) percent. The 2002 study likewise acknowledges extremely high levels of net negative salvage. Accordingly, future net salvage was modestly increased from the current zero (0) percent net salvage to negative fifteen (15) net salvage.

Mr. Pous references the 2002 study comment that "abandonment in place is the preferred method of retirement" and then states that, because of the abandonment in place, cost of removal should diminish. First, while abandonment in place may be the preferred method of retirement, retirements are not necessarily limited to that approach. Second, even with abandonment in place, the Company still incurs costs to isolate and disconnect the assets from the operating distribution system.

Now in this property account, when the net salvage recommendation in the 2002 study zero (0) percent is beneficial to his proposed negative five (5) percent net salvage, Mr. Pous specifically mentions the net salvage parameter in the 2002 study. Even more important, however, the 2002 depreciation study demonstrates

that this property class is experiencing extremely high levels of negative net salvage. From the 2002 study one can see that, during the recent five (5) and ten (10) year periods, the property group has experienced negative four hundred and three (403) percent and negative two hundred forty eight (248) percent net salvage. Mr. Pous simply chose to ignore this information when he recommended his negative five (5) net salvage and criticized the proposed negative fifteen (15) percent net salvage recommended in the current depreciation study. Again, all of this data supports my recommendation.

Account 368 – Distribution Line Transformers

My proposed net salvage parameter for this account is negative ten (10) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative nineteen (19) percent and negative fifteen (15) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative five (5) percent net salvage.

Historically, the Company has experienced average net salvage of approximately negative seven (7) percent for this property group. Gross salvage has averaged twelve (12) plus percent and cost of removal has averaged nineteen (19) percent. The forecasted gross salvage is two (2) percent, which is being driven by the recent decline in the gross salvage experience. Likewise, while the cost of removal level has also experienced declines during the last several years (which lowers the overall average cost of removal), the future forecast cost of

removal level is still at more than thirty (30) percent. Given that the level of cost of removal has declined over the last several years, a modest reduction from the net salvage parameter of negative fifteen (15) percent underlying the present depreciation rate, to negative ten (10) percent net salvage was currently estimated for this property group.

Mr. Pous references the potential impact of PCB related costs being associated with the disposal of earlier PCB contaminated facilities. While such costs may have occurred during earlier years in the Company's experience, this activity would not have occurred during the late 1990's when the Company experienced negative net salvage ranging from negative ten (10) to negative eighteen (18) percent net salvage.

Furthermore, the proposed net salvage for this account in the Company's 2002 depreciation study was negative ten (10) percent net salvage. Mr. Pous does not mention that fact in his analysis. Also, from the Company's 2002 depreciation study analysis it can be determined that the Company's normal net salvage for the five and ten year periods was negative nineteen (19) and negative fifteen (15) percent, respectively, again, data which Mr. Pous simply ignored. This data supports my recommendation.

Account 369.1 – Distribution Services

My proposed net salvage parameter for this account is negative seventy-five (75) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and

ten (10) year average net salvage of negative four hundred twenty-six (426) percent and negative three hundred fifty-six (356) percent, respectively, were identified. Mr. Pous' recommended net salvage is negative fifty (50) percent net salvage.

The Company's historical net salvage in this account averaged negative one hundred sixteen (116) percent. Gross salvage averaged ninety-six (96) percent and the cost of removal averaged in excess of two hundred (200) percent. Both the gross salvage and cost of removal were nonexistent during the two most recent years due to a delay in the booking of retirements. Gross salvage forecasted to approximately one hundred ninety two (192) percent, while cost of removal forecasted to more than four hundred (400) percent. While future customer relocations will likely generate some level of gross salvage, nothing near the overall recorded levels of gross salvage will be experienced for the Company's total plant. Conversely, cost of removal levels will continue to increase over time. Considering the high levels of both historic and even higher future cost of removal factors, I very conservatively estimated an increase in negative net salvage from negative fifty (50) percent to negative seventy-five (75) percent net salvage.

Mr. Pous claims the "almost total elimination of gross salvage is questionable.....". I did not "eliminate" salvage. In reality, the net of forecasted gross salvage and cost of removal is nearly negative two hundred fifty (250) percent net salvage. The proposed negative seventy-five (75) percent net salvage demonstrates how conservative the recommendation really is.

Mr. Pous selectively quotes the Company's proposed net salvage factor of negative fifty (50) percent since it seems to support his net salvage proposal of negative fifty (50) percent. What Mr. Pous fails to mention is the fact that the same 2002 depreciation analysis demonstrates that the Company has experienced normal net salvage of negative four hundred twenty six (426) percent and negative three hundred fifty-six (356) percent net salvage over the past five (5) and ten (10) years, respectively. Accordingly, while the Company's proposed net salvage in the 2002 study was set forth at negative fifty (50) percent net salvage, the net salvage recommendation (within the 2002 study) was overly conservative in comparison with the actual study analysis results. This data supports my recommendation.

Account 369.2 – Distribution Services

My proposed net salvage parameter for this account is negative twenty-five (25) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of three (3) percent and negative five (5) percent, respectively, were identified. Mr. Pous' recommended net salvage is zero (0) percent net salvage.

The Company's historical net salvage for this account averaged approximately four (4) plus percent, which is influenced by the significant levels of positive salvage during the 1970's and early 1980's. While gross salvage averaged approximately fifteen (15), the gross salvage forecast was assumed to be

zero (0) percent. While various levels of gross salvage have been received relative to swimming pool construction and third party damage, it is extremely unlikely that future levels will be anywhere near the past levels recorded throughout the total property's life.

The historical cost of removal averaged eleven percent and forecasted to in excess of twenty-six (26) percent. Using the Company's 2002 depreciation study, it can be determined that normal negative net salvage of nine (9) and (8) percent, respectively, occurs for the most recent five (5) and (10) year periods. While it can be argued that much, if not most of the underground services will be abandoned in place, the Company will still incur cost to disconnect the services from the distribution system at the end of the life. Giving consideration to the historical experience, the results of the forecast analysis which identifies that cost will continue to escalate in future years, future net salvage for this account was estimated at negative twenty-five (25) percent.

Account 373 – Distribution Street Lighting

My proposed net salvage parameter for this account is negative twenty (20) percent. From the Company's experience, the depreciation analysis data within the Company's 2002 depreciation study was summarized and a five (5) and ten (10) year average net salvage of negative sixty-two (62) percent and negative thirty-eight (38) percent, respectively, were identified. Mr. Pous' recommended net salvage is zero (0) percent net salvage.

While the Company's historical net salvage in this account averaged a

positive fifteen (15) percent, the average was driven by large positive values during the 1970's and 1980's. More recent years routinely experience negative net salvage.

The historic gross salvage averaged thirty three (33) percent which forecasted to approximately thirty-four (34) percent. Company management specifically indicated that no municipalities had recently acquired street light systems and no street lighting system acquisitions are anticipated for future years. Conversely, historical cost of removal averaged more than eighteen (18) percent and forecasted to twenty five (25) percent due increased future costs.

Mr. Pous discusses the occurrence of the 2001 cost of removal and implies that this cost of removal entry influences the cost of removal. The vintage level of cost of removal has no impact on the cost of removal forecast because the calculation is based upon the overall average cost of removal. This high cost of removal entry is simply a matter of the timing of the recording of the expenditure. Mr. Pous would have us make an adjustment when, in fact, the Company actually expended those dollars in connection with the retirement of plant in service.

Mr. Pous relies on my deposition statement regarding the 1997 and 1998 net salvage entries that "it doesn't make sense". After a further look at the data, "it clearly does make sense". It is quite obvious, even to the untrained eye that the calculations are being impacted by the timing of transactions within the data. That is, within the data there are clearly corrections that lead to adjustments between 1997 and 1998. Netting the two years data to account for the timing of the adjustment would bring the net salvage well within the range of the other

year's activity.

In this account Mr. Pous referenced the recommendation in the Company's 2002 depreciation study of negative five (5) percent net salvage. But he again failed to mention that the same study provides the information necessary to demonstrate that the Company has experienced normal net salvage of negative sixty-two (62) percent and negative thirty-eight (38) percent net salvage over the past five (5) and ten (10) years, respectively, a fact that fully supports the proposed negative twenty (20) percent net salvage within the current depreciation study. The Company's 2002 depreciation study net salvage recommendation was overly conservative in comparison with the actual study analysis results.

III. REBUTTAL TESTIMONY TO WITNESS MICHAEL GORMAN

Q. What do you understand are the criticisms of Mr. Gorman with regard to your depreciation study?

A. I understand Mr. Gorman's criticism of my study to be as follows:

1. He claims a variance exists between the Company's book depreciation reserve and theoretical depreciation reserve and proposes an immediate five year flow back of $250 million of the reserve variance.
2. He claims that including the Company's proposed future net salvage parameters in the depreciation rates produces excessive depreciation rates.
3. He claims that the recovery of the net salvage component of depreciation should be recovered on a cash basis as opposed to the standard depreciation accrual basis.

Q. Do you agree with Mr. Gorman's criticisms?

A. No, I do not.

Q. Mr. Gorman is proposing an accelerated reserve adjustment. Is his proposal reasonable or appropriate?

A. No. Just as with Mr. Pous' proposed adjustment, Mr. Gorman is proposing an accelerated adjustment to the Company's annual depreciation rates and expense for a perceived excess depreciated reserve variance. Mr. Gorman's proposal is inconsistent with depreciation practices and procedures that have been continuously used and applied by the Company and the FPSC for recovery of the Company's plant investments for many years. The perceived excess depreciation reserve is not unusual by any means. Furthermore, the variance that currently exists was exacerbated by the fact that the Company, in the calculation of its current theoretical depreciation reserve, incorporates the proposed license extension of CR3 even though an extension has not yet been received. Even assuming that the license extension is granted, there is no assurance that the plant will operate until the end of the proposed life extension. To the extent that the plant does not operate to the full end of life, the calculated reserve variance would be reduced.

Q. Does Mr. Gorman understand what causes the alleged depreciation reserve surplus?

A. Yes. As Mr. Gorman stated "The theoretical book depreciation reserve reflects the size of the book depreciation reserve if the proposed depreciation parameters (average service lives, survivor curves, remaining lives, and net salvage ratios) had been in place over the entire asset lives." That is the exact issue. The current depreciation parameters have not been utilized over the entire life of the property. The resulting depreciation reserve variance is simply a snap shot in time and will change upwards or downwards depending upon the ongoing change in the proposed depreciation parameters. The depreciation reserve has been built up over the life of the asset and therefore should continue to be adjusted using the average remaining life rates over time (the average remaining life of the property).

Q. Mr. Gorman states that the Company's net salvage estimates produce depreciation rates that are excessive. Do you agree?

A. No. The Company's proposed net salvage factors and related depreciation rates are reasonable and appropriate. The depreciation rates, inclusive of net salvage, are designed to recover the unrecovered original cost of the investment minus end of life positive or negative net salvage over the average remaining life of each of the property groups. In doing so the annual depreciation expense will, by design, in the early years recover far more of the net salvage depreciation component than the Company receives or expends because such net salvage activity does not generally occur until the end of the property's useful service life. To defer the recovery of the end of life cost until it occurs is inconsistent with accrual accounting concepts, straight line depreciation based accounting, and is therefore

totally inappropriate. This is one answer to Mr. Gorman's criticism that the Company's proposed net salvage parameters are different from the Company's books.

Q. Does Mr. Gorman's Table 2 demonstrate that the Company's proposed net salvage parameters are excessive?

A. No. Mr. Gorman's table is misleading because the positive salvage amounts incorporated into his schedule include return to stores salvage amounts along with the normal cash salvage amounts and are, therefore, significantly overstated. Furthermore, the accounting entries for return to stores are a far more limited portions of the Company's plant retirements and will not apply to the larger portion of the Company's overall plant investments.

Q. Is Mr. Gorman's conclusion that "what causes the disparity between net salvage expense included in depreciation rates and actual net salvage experience" is the product of inflation and economies of scale correct?

A. Absolutely not. As previously discussed in my testimony, the reason for the variance between the net salvage per books and that included in the depreciation rates is that the depreciation rates, by design, must include the proportional recovery of end of life net salvage cost in the current depreciation rates. Furthermore, Mr. Gorman's conclusion that inflation was improperly included in the net salvage estimate is also incorrect. The net salvage estimating process does not inflate future net salvage, but simply defines the true end of life cost (net salvage percent) as it relates to the current plant in service investment serving the

Company's customers.

Mr. Gorman's comment with regard to potential future economies of scale is also unfounded. Mr. Gorman would have us believe that the Company's property retirement process is similar to a production line, with the employees gaining significant efficiencies through improved knowledge, experience, and workflows. Such benefits simply will not occur, in that retirements will continue to occur randomly throughout the Company's large distribution area. Furthermore, work crews will continue to change and there are regular circumstances encountered that complicate the retirement process such as soil conditions and other utility infrastructure in the affected area.

Q. What comments do you have regarding Mr. Gorman's example of the impact on net salvage associated with including future inflation in the development of net salvage ratios?

A. Mr. Gorman's testimony is partially correct, but for the most part incorrect and misleading. To the extent that inflation will occur over the remaining years until the end of the life of the property (and the occurrence of the end of life costs), such increased costs must be included in the net salvage estimate. This situation is no different than what has historically occurred. The inflation included in the future calculation is not inflating the historical cost, but is only used to define the true future end of life cost that will be incurred. The depreciation rate must recognize the total beginning of life and end of life cost if it is going to properly recover such costs. Mr. Gorman then discusses applying a discount rate to the

future cost of removal as if the Company has a cash sinking fund upon which it can earn a return. There is no cash sinking fund. More importantly, to calculate a straight line depreciation rate (as opposed to a sinking fund based depreciation rate), the depreciation rate calculation must be based upon the yearly proportional recovery of the total cost over the average remaining life rate.

Q. On pages 12 and 13 of his testimony Mr. Gorman provides an illustration of the revenue requirement of a $1,000 investment with a negative 25 net salvage percentage at end of life. What are your comments?

A. While it is true that, as a result of including the negative 25 percent net salvage in depreciation rates, the rate base will temporarily go negative near the end of the property's life, such an event must occur if the Company is to recover its full cost of the property proportionately and correctly from the customers who benefited from the use of the property. Otherwise, the Company's plant would reach the end of its life and the Company would be faced with the cost of removal of the plant with no customers from which to recover the cost.

Q. Please provide your comments regarding Mr. Gorman's proposal to use current expensing (cash accounting) of net salvage. (Gorman Testimony, pages 13 and 14).

A. Mr. Gorman's position to amortize historic levels of net salvage is incorrect and unwarranted. The fallacy of Mr. Gorman's proposal is that the proposed five (5) year average net salvage is a back-end loaded recovery mechanism. First, his

proposal uses five years of experience which ignores ever increasing cost of removal in the Company's recovery amounts. Therefore, the Company fails to begin recovering its full cost of removal at the beginning of life which means customers are not paying their fair share of the end of life plant cost that was utilized in providing service. The result is a dramatic mismatch between the provision of service and the payment for the service provided. This proposed net salvage approach totally fails to recognize the basic matching principle that underlies the fairness doctrine inherent in rate making principles.

Mr. Gorman's incorrect and inappropriate approach will result in the Company facing dramatic under-recovery of its total life asset costs. If Mr. Gorman's proposal were adopted, the Company will find itself in a position where property is routinely being taken out of service and the Company will not receive the recovery of the retirement cost until after the fact. This approach is totally inconsistent with any accounting and rate making principles.

A simple illustrative test to demonstrate the unreasonableness of Mr. Gorman's recommended net salvage approach can be provided. To make the demonstration clear, concise, and simple, consider the following basic depreciation principles and facts:

1. The customer should pay all the Company's plant related cost incurred in providing service to the customer.
2. The plant used to provide the service to one (1) customer has an initial original cost of $1,000.

3. The useful service life is 10 years after which the customer will no longer exist.

4. The end of life retirement cost is $500.

Under Mr. Gorman's proposal the customer would pay annual depreciation expense of $100 per year for 10 years to recover the $1,000 initial original cost investment. After 10 years the customer leaves and no longer exists. The Company retires the plant and has been made whole for the initial investment. However, in the process of retiring the plant the Company must expend $500 to retire the plant that has previously served the customer. Given that the customer no longer exists, there is no one to pay for the retirement cost.

The true annual cost of providing the customer service was actually $1,000 plus $500 (cost to retire) = $1,500 divided by 10 years = $150 per year. The customer only paid $100 per year or 1/3 less than he should have paid. Furthermore, the Company has expended $500 for the asset retirement and has no available source of recovery. If new customers are assumed to be added, this illustration demonstrates that future customers will incorrectly and inappropriately pay for plant cost from which they received no benefit. That is, these new customers would end up paying the $500 negative net salvage incurred to retire the facility that the prior customers used.

By using the appropriate depreciation rate approach (under which depreciation rates are routinely calculated), the annual depreciation relative to the above illustration would be $150 per year during the 10 years which the company was providing service. After 10 years the company would retire the plant and

expend the $500 for retirement cost with the result that the company would have been made whole and the customer who received the benefit would have paid the appropriate level for annual depreciation expense.

Q. Mr. Gorman states that his proposal is supported by industry trade publications. Is he correct?

A. While the quote provided by Mr. Gorman is included in the NARUC Depreciation Practices Manual, the quote is taken out of context. The complete reference to the net salvage discussion in the NARUC text is included as Rebuttal Exhibit No. ____ (EMR-4). The generally accepted depreciation practice, referenced on page 18 of the NARUC publication, is as follow:

> "Net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired. The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative, that will be obtained when the asset is retired. This concept carries with it the premise that property ownership includes the responsibility for the property's ultimate abandonment or removal. Hence, if current users benefit from its use, they should pay their pro rata share of the costs involved in the abandonment or removal of the property and also receive their pro rata share of the benefits of the proceeds realized."

> "This treatment of net salvage is in harmony with generally accepted accounting principles and tends to remove from the income statement any fluctuations caused by erratic, although necessary, abandonment and removal operations. It also has the advantage that current consumers pay or receive a fair share of costs associated with the property devoted to their service, even though the costs may be estimated."

> "The practical difficulties of estimating, reporting, and accounting for salvage and cost of retirement have raised questions as to whether more satisfactory results might be obtained if net salvage were credited or charged, as appropriate, to current operations at the time of retirement instead of being provided for over the life of the asset. The advocates of such a procedure contend

that salvage is not only more difficult to estimate than service life but, for capital intensive public utilities, it is typically a minor factor in the entire depreciation picture."

The full NARUC discussion supports the annual recognition of net salvage consistent with generally accepted accounting and depreciation principles followed in the Company's study.

IV. REBUTTAL TESTIMONY TO WITNESS HUGH LARKIN

Q. What do you understand are the criticism's of Mr. Larkin with regard to your depreciation study?

A. I understand Mr. Larkin's criticism of my study to be as follows:

1. He claims that there is significant Commission precedent supporting the amortization of the variance between the Company's book depreciation reserve and theoretical depreciation reserve over an accelerated basis as opposed to the Company's proposed recovery of the unrecovered cost using ARL depreciation rates.

Q. Do you agree with Mr. Larkin's criticisms?

A. No, I do not.

Q. In his approximate ten (10) pages of testimony on the depreciation reserve amortization subject, Mr. Larkin cites numerous orders in which the Commission authorized the amortization of asset investments over

accelerated time periods. He also acknowledges that most of the referenced orders were relative to telecommunications. Please provide us with your comments.

A. The referenced telephone cases were applicable to telecommunications equipment that became rapidly obsolete due to technological changes and were either already retired from service and/or were subject to retirement from service during a very short time frame. Because the assets were either no longer providing service to the applicable company's customer or were subject to providing service for extremely short periods of time, the company was permitted to accelerate recovery of the cost of the obsolete equipment. Maintaining such residual telephone asset costs in rate base would have resulted in far higher costs to rate payers than the cost for providing a rapid recovery of those out of service asset costs.

Conversely, with the Company's current reserve variance, the assets are currently in service, and prospectively will continue to provide service to the Company's customers. The book versus theoretical depreciation reserve variance, relative to the assets in question, is not overly material given the current level of depreciation reserve. Since the Company's book depreciation reserve is somewhat higher than the theoretical depreciation reserve, rate base is lower than it would otherwise have been. Given the lower rate base, both the depreciation expense and return is lower, resulting in a lower cost to the Company's customers. This lower cost to current customers will continue until the book and theoretical depreciation reserve are at equilibrium.

Q. Do you believe that the Company's proposed treatment of retired meters supports Mr. Larkin's proposal to refund the variance between the company's theoretical and book reserve?

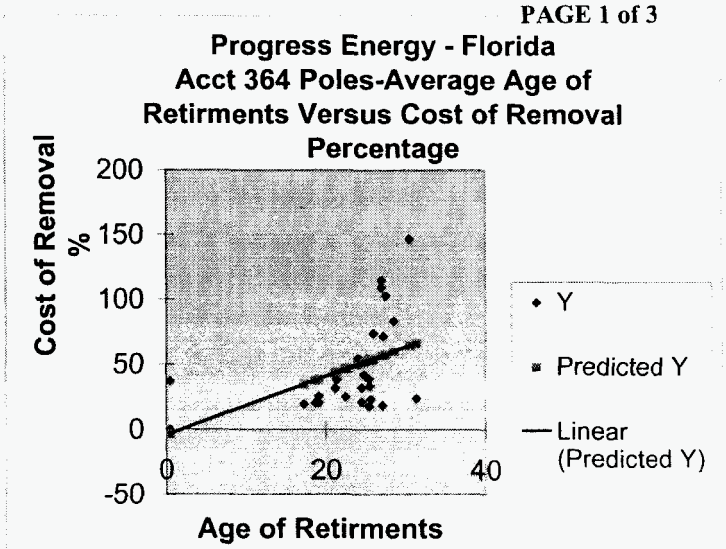
A. No. Again, the above amortization discussion is relative to the recovery of property investments that are no longer in service as opposed to the depreciation of assets that are continuing to provide service to the Company's customers. It would be imprudent, as well as costly to customers, to continue to carry un-recovered costs, relative to retired assets, on the Company's books for long periods of time after the property was removed from service.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.

Progress Energy - Florida
Account 364 - Poles

Avg Age of Retirements Plot X-Axis	Cost of Removal Percent Plot Y-Axis
0.5	0
0.5	37.19
17.3	19.43
18.7	20.29
19.1	20.53
19.1	25.43
21.2	31.67
21.4	38.32
22.5	24.94
22.8	47.47
24	54.63
24.5	21.19
24.5	32.08
24.8	42.02
25.1	54.26
25.4	17.81
25.4	38.93
25.5	33.26
25.6	23.12
25.9	73.82
27	108.92
27	114.78
27.1	18.58
27.2	71.69
27.5	102.42
28.5	83.11
30.5	146.58
31.3	23.84



SUMMARY OUTPUT

Regression Statistics

Multiple R	0.458997166
R Square	0.210678398
Adjusted R Sqı	0.180319875
Standard Error	32.04800634
Observations	28

ANOVA

	df	*SS*	*MS*	*F*	*ignificance F*
Regression	1	7127.569	7127.569	6.939679	0.014015
Residual	26	26703.94	1027.075		
Total	27	33831.51			

	Coefficients	*tandard Erı*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*ower 95.0%*	*Upper 95.0%*
Intercept	-4.427924405	20.57366	-0.215223	0.831273	-46.71769	37.86184	-46.71769	37.86184
X Variable 1	2.266435198	0.860347	2.634327	0.014015	0.497967	4.034904	0.497967	4.034904

RESIDUAL OUTPUT

Observation	*Predicted Y*	*Residuals*
1	-3.294706806	3.294707
2	53.13952963	-35.32953
3	56.99246947	-38.41247
4	34.78140452	-15.3514
5	37.9544138	-17.66441
6	38.86098788	-18.33099
7	51.09973795	-29.90974
8	53.59281667	-30.47282
9	66.5114973	-42.6715
10	46.56686755	-21.62687
11	38.86098788	-13.43099
12	43.6205018	-11.9505
13	51.09973795	-19.01974
14	53.36617315	-20.10617
15	-3.294706806	40.48471
16	44.07378884	-5.753789
17	53.13952963	-14.20953
18	51.77966851	-9.759669
19	47.24679811	0.223202
20	52.45959907	1.800401
21	49.96652035	4.66348
22	57.21911299	14.47089
23	54.27274723	19.54725
24	60.16547874	22.94452
25	57.89904355	44.52096
26	56.76582595	52.15417
27	56.76582595	58.01417
28	64.69834914	81.88165

1993	2746106	0.5	0
1991	2514976	25.4	17.81
1998	4060101	27.1	18.58
1975	1136166	17.3	19.43
1977	1053089	18.7	20.29
1976	957892	19.1	20.53
1992	2896079	24.5	21.19
1990	3758480	25.6	23.12
2003	576245.77	31.3	23.84
1982	1328414	22.5	24.94
1978	1120701	19.1	25.43
1979	1159045	21.2	31.67
1981	2065274	24.5	32.08
1988	3067333	25.5	33.26
1985	1951410	0.5	37.19
1980	1189092	21.4	38.32
1989	3140995	25.4	38.93
1986	1834171	24.8	42.02
1983	1274262	22.8	47.47
1987	2256345	25.1	54.26
1984	1157835	24	54.63
1999	2301634	27.2	71.69

1994	2111281	25.9	73.82
2000	1606786	28.5	83.11
1995	1703710	27.5	102.42
1997	1876729	27	108.92
1996	1781958	27	114.78
2002	194928.26	30.5	146.58
2001	501139	7.6	1090.82

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PROGRESS ENERGY FLORIDA
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Progress Energy - Florida

Salvage Analysis Comparison
2005 Depreciation Study

Accounts	Description	1997 FPSC Approved Net Salvage	1997 Depr. Study Net Salv. - Normal	1997 Depr. Study Net Salv. - Total	2005 Proposed Net Salvage PEF	2005 Proposed Net Salvage OPC	Proposed in 2002 Study Net Salvage	2002 Depr. Study Analysis Net Salvage - Normal 5 Yr Ave	2002 Depr. Study Analysis Net Salvage - Normal 10 Yr Ave	2002 Depr. Study Analysis Net Salvage - Normal Total	2002 Depr. Study Analysis Net Salvage - Total 5 Yr Ave	2002 Depr. Study Analysis Net Salvage - Total 10 Yr Ave	2002 Depr. Study Analysis Net Salvage - Total Total
	(Transmission)												
350.02	Land Rights	0%			0%		0%						
352.00	Structures and Improvements	-5%	-8%	-8%	-15%		-5%	-11%	-12%	-9%	-11%	-12%	-9%
353.10	Station Equipment	10%	-3%	30%	0%	10%	10%	-9%	-9%	-3%	45%	37%	35%
353.10	Station Equipment - Step Up Transformers				0%		0%						
353.20	Station Equipment - Station Control	0%			0%		0%						
354.00	Towers and Fixtures	-30%	-48%	-34%	-25%		-30%	0%	-5%	-32%	1%	-4%	-22%
355.00	Poles and Fixtures	-30%	-35%	2%	-25%	-15%	-25%	-50%	-47%	-37%	39%	25%	11%
356.00	Overhead Conductors and Devices	-20%	-13%	38%	-30%	-10%	-15%	-62%	-39%	-15%	55%	37%	41%
357.00	Underground Conduit	0%			0%		0%						
358.00	Underground Conductors and Devices	0%			-3%		0%						
359.00	Roads and Trails	0%			0%		0%						
Accounts	*(Distribution)*												
360.02	Land Rights	0%			0%		0%						
361.00	Structures and Improvements	-5%	-4%	-3%	-5%		-5%						
362.00	Station Equipment	15%	-5%	30%	-15%	0%	5%	-7%	-6%	-4%	26%	31%	29%
364.00	Poles, Towers, and Fixtures	-25%	-42%	7%	-90%	-35%	-25%	-111%	-98%	-54%	-68%	-49%	-7%
365.00	Overhead Conductors and Devices	-35%	-74%	-8%	-25%	-15%	-25%	-102%	-124%	-78%	53%	-1%	4%
366.00	Underground Conduit	0%	-32%	34%	0%		0%						
367.00	Underground Conductors and Devices	0%	-29%	56%	-15%	-5%	0%	-403%	-246%	-122%	-199%	-67%	-10%
368.00	Line Transformers	-15%	-15%	-8%	-10%	-5%	-10%	-19%	-15%	-16%	-6%	-7%	-7%
369.10	Services - Overhead	-50%	-149%	-100%	-75%	-50%	-50%	-426%	-356%	-171%	-299%	-296%	-117%
369.20	Services - Underground	-15%	-33%	0%	-25%	0%	-10%	3%	-5%	-15%	18%	12%	9%
370.00	Meters	-10%	-13%	-10%	-8%		-10%	-9%	-8%	-11%	-6%	-4%	-9%
370.10	Meters - Energy Conservation	0%			0%		0%						
371.00	Installation on Customers Premises	0%			0%		0%						
373.00	Street Lighting and Signal Systems	-10%	-7%	22%	-20%	0%	-5%	-62%	-38%	-16%	-17%	-6%	15%

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Progress Energy - Florida

Net Salvage Analysis Comparison (PEF with Gulf and FPL) Versus Pous Proposal
2005 Depreciation Study

Accounts	Description	FPSC Approved Net Salvage			Proposed Salvage			Proposed Removal			Proposed Net Salvage			Proposed Net Salv		
		PEF	Gulf	FPL	PEF	Gulf	FPL	PEF	Gulf	FPL	PEF	Gulf	FPL	Averge Gulf/FPL	PEF	Pous
	(Transmission)															
350.02	Land Rights	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
352.00	Structures and Improvements	-5%	-5%	-5%	0%	0%	20%	-15%	-5%	-30%	-15%	-5%	-10%	-8%	-15%	
353.10	Station Equipment	10%	-5%	10%	10%	2%	20%	-10%	-7%	-15%	0%	-5%	5%	0%	0%	10%
353.10	Station Equipment - Step Up Transformers			10%		0%	20%		0%	-15%	0%	0%	5%	3%	0%	
353.20	Station Equipment - Station Control	0%	0%		0%	0%	0%	0%	0%		0%	0%	0%	0%	0%	
354.00	Towers and Fixtures	-30%	-30%	-15%	10%	0%	10%	-35%	-25%	-25%	-25%	-25%	-15%	-20%	-25%	
355.00	Poles and Fixtures	-30%	-40%	-45%	10%	0%	30%	-35%	-40%	-80%	-25%	-40%	-50%	-45%	-25%	-15%
356.00	Overhead Conductors and Devices	-20%	-30%	-30%	10%	5%	10%	-40%	-40%	-55%	-30%	-35%	-45%	-40%	-30%	-10%
357.00	Underground Conduit	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
358.00	Underground Conductors and Devices	0%	0%	0%	3%	0%	0%	-6%	0%	0%	-3%	0%	0%	0%	-3%	
359.00	Roads and Trails	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Accounts																
	(Distribution)															
360.02	Land Rights	0%			0%	0%	0%	0%	0%		0%	0%	0%	0%	0%	
361.00	Structures and Improvements	-5%	-5%	-5%	5%	0%	15%	-10%	-5%	-30%	-5%	-5%	-15%	-10%	-5%	
362.00	Station Equipment	15%	-5%	-10%	5%	0%	10%	-20%	-5%	-20%	-15%	-5%	-10%	-8%	-15%	0%
364.00	Poles, Towers, and Fixtures	-25%	-70%	-35%	10%	10%	40%	-100%	-85%	-80%	-90%	-75%	-40%	-58%	-90%	-35%
365.00	Overhead Conductors and Devices	-35%	-5%	-50%	15%	35%	30%	-40%	-45%	-80%	-25%	-10%	-50%	-30%	-25%	-15%
366.00	Underground Conduit	0%	0%	0%	30%	0%	10%	-30%	0%	-20%	0%	0%	-10%	-5%	0%	
367.00	Underground Conductors and Devices	0%	10%	0%	5%	20%	15%	-20%	-20%	-20%	-15%	0%	-5%	-3%	-15%	-5%
368.00	Line Transformers	-15%	-25%	-25%	10%	5%	5%	-20%	-30%	-40%	-10%	-25%	-35%	-30%	-10%	-5%
369.10	Services - Overhead	-50%	-25%	-60%	10%	10%	15%	-85%	-45%	-75%	-75%	-35%	-60%	-48%	-75%	-50%
369.20	Services - Underground	-15%	0%	-10%	30%	5%	0%	-55%	-10%	-10%	-25%	-5%	-10%	-8%	-25%	0%
370.00	Meters	-10%	0%	0%	5%	5%	0%	-13%	-5%	-30%	-8%	0%	-30%	-15%	-8%	
370.10	Meters - Energy Conservation	0%	0%	0%	0%		0%	0%	0%	0%	0%	0%	0%	0%	0%	
371.00	Installation on Customers Premises	0%	0%	-20%	0%		15%	0%	0%	-30%	0%	0%	-15%	-8%	0%	
373.00	Street Lighting and Signal Systems	-10%	0%	-35%	0%	10%	0%	-20%	-15%	-35%	-20%	-5%	-35%	-20%	-20%	0%

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Costs may also be distributed over production rather than over service life. This method, the unit of production method, distributes the costs as units are produced using a rate per unit developed from the total estimated units to be produced. It is similar to the straight-line method but is a function of production rather than a function of time.

Salvage Considerations

Under presently accepted concepts, the amount of depreciation to be accrued over the life of an asset is its original cost less net salvage. Net salvage is the difference between the gross salvage that will be realized when the asset is disposed of and the cost of retiring it. Positive net salvage occurs when gross salvage exceeds cost of retirement, and negative net salvage occurs when cost of retirement exceeds gross salvage. Net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired. The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative, that will be obtained when the asset is retired. This concept carries with it the premise that property ownership includes the responsibility for the property's ultimate abandonment or removal. Hence, if current users benefit from its use, they should pay their pro rata share of the costs involved in the abandonment or removal of the property and also receive their pro rata share of the benefits of the proceeds realized.

This treatment of net salvage is in harmony with generally accepted accounting principles and tends to remove from the income statement any fluctuations caused by erratic, although necessary, abandonment and removal operations. It also has the advantage that current consumers pay or receive a fair share of costs associated with the property devoted to their service, even though the costs may be estimated.

The practical difficulties of estimating, reporting, and accounting for salvage and cost of retirement have raised questions as to whether more satisfactory results might be obtained if net salvage were credited or charged, as appropriate, to current operations at the time of retirement instead of being provided for over the life of the asset. The advocates of such a procedure contend that salvage is not only more difficult to estimate than service life but, for capital intensive public utilities, it is typically a minor factor in the entire depreciation picture. The obvious exception, of course, is the huge retirement cost of decommissioning nuclear power plants. The advocates of recording salvage at the time of retirement further contend that salvage could properly be accounted for on the basis of known happenings at the date of retirement rather than on speculative estimates of factors, such as junk material prices, future labor costs, and environmental remediation costs in effect at the time of retirement.

One of the practical difficulties of estimating net salvage is that reported salvage is a mixture of salvage on items retired and reused internally, salvage on items sold externally as functional equipment, and salvage on items junked and sold as scrap. Because the likelihood of reuse is greater for items that are retired at early ages, the historical salvage is usually higher than the future salvage to be realized when the account begins to decline and there is little opportunity for reuse. Therefore, under these circumstances, book salvage may overstate the average salvage realized over the entire life of the account. This has led to the proposal to

redefine net salvage and retirements to eliminate the effect of reused material Reuse salvage is further discussed in Chapter III.

The sensitivity of salvage and cost of retirement to the age of the property retired is also troublesome. Due to inflation and other factors, there is a tendency for costs of retirement, typically labor, to increase more rapidly than material prices. In an increasing number of instances, the average net salvage is estimated to be a large negative number when expressed as a percentage of original cost, sometimes in excess of negative 100%. This may look unrealistic but is appropriate and necessary so that the required cost allocation occurs. Nonetheless, a careful analysis of retirements should be made to determine if such large negative net salvage values are due to unusual circumstances. An example is the retirement of old cast iron gas mains in congested metropolitan areas. Due to urban renewal, a utility may have a significant amount of such activity for a few years. Since most of the investment in this account may now be in plastic mains in rural or suburban areas where access is easier, the removal of old cast iron gas mains at today's cost may not be representative of the costs that can be expected for plastic mains.

While this situation should not impose insurmountable difficulties from a depreciation expense or cost allocation perspective, it presents an interesting problem from the standpoint of the rate base. Since rate base is generally the difference between book cost and accumulated depreciation, the provision for negative salvage further decreases the rate base. If the original book cost for old plant is less than the accumulated provision for depreciation, the rate base could be a negative amount.

As the foregoing discussion indicates, gross salvage, in contrast to service life, is usually small in its overall effect on calculating a depreciation rate. Cost of retirement, however, must be given careful thought and attention, since for certain types of plant, it can be the most critical component of the depreciation rate.

Group Plan

The group plan of depreciation accounting is particularly adaptable to utility property. Rather than depreciating each item by itself (unit depreciation) or depreciating one single group containing all utility plant, a group contains homogeneous units of plant which are alike in character, used in the same manner throughout the utility's service territory, and operated under the same general conditions.

Of course there will be different lives for individual units within groups. For example, poles are generally combined in a single group. Some poles will be retired because of storms or automobile accidents. Some will decay, some will be displaced due to road relocations and some will be retired because of underground replacements. However, they are combined in the same group because they are homogeneous units. Years ago when some poles were untreated, there was a need for a separate grouping as these poles were more susceptible to decay and termite infestation than treated poles. Likewise, concrete poles have unique characteristics and qualify to be grouped separately from wood poles. Buried, aerial, and underground (in conduit) cables are further examples of the same type of plant receiving different grouping because of

CHAPTER XI

ESTIMATING SALVAGE AND COST OF REMOVAL

General

A general discussion of salvage and cost of removal is presented in Chapter III. Before discussing the process of analyzing and estimating these factors, a review of definitions and discussion of general principles is presented below.

When depreciable plant facilities are retired from service and physically removed, costs may be incurred and/or cash or other value may be realized if they are sold or retained for reuse. The abandonment of utility property in place can also cause costs to be incurred, (e.g., the cost of filling an abandoned gas pipe line with an inert gas). The term gross salvage refers to the amount received for retired property sold or junked, reimbursement received from insurance or other sources, or the amount at which reusable material is charged to a utility's Material and Supplies Account.[1] Cost of removal is the expenditure incurred in connection with retiring, removing, and dispersing of property. Net salvage is the difference between gross salvage and cost of removal.

Historically, most regulatory commissions have required that both gross salvage and cost of removal be reflected in depreciation rates. The theory behind this requirement is that, since most physical plant placed in service will have some residual value at the time of its retirement, the original cost recovered through depreciation should be reduced by that amount. Closely associated with this reasoning are the accounting principle that revenues be matched with costs and the regulatory principle that utility customers who benefit from the consumption of plant pay for the cost of that plant, no more, no less. The application of the latter principle also requires that the estimated cost of removal of plant be recovered over its life.

Some commissions have abandoned the above procedure and moved to current-period accounting for gross salvage and/or cost of removal. In some jurisdictions gross salvage and cost of removal are accounted for as income and expense, respectively, when they are realized. Other jurisdictions consider only gross salvage in depreciation rates, with the cost of removal being expensed in the year incurred.

Determining a reasonably accurate estimate of the average or future net salvage is not an easy task; estimates can be the subject of considerable discussion and controversy between regulators and utility personnel. This is one of the reasons advanced in support of current-period accounting for these items. When estimating future net salvage, every effort should be made to ensure that the estimate is as accurate as possible. Normally, the process should start by

[1] Regulatory agencies generally require that reusable material consisting of retirement units be salvaged at original cost, while minor items may be salvaged at current prices new. Some regulatory agencies take into consideration the fact that depreciation has been sustained.

analyzing past salvage and cost of removal data and by using the results of this analysis to project future gross salvage and cost of removal.

When performing an analysis of net salvage data, certain considerations should be kept in mind. Generally, if transfers or sales of plant have contributed significantly to realized salvage, and such transactions are considered to be unrepresentative of the future, these transactions should be eliminated from the data. If the account consists of several categories of plant, such as several radically different types and sizes of buildings, the realized salvage should be analyzed to determine whether the related retirements are a representative cross-section of the account. The age of the retired plant, market conditions prevailing at the time of retirement, company policy regarding reuse in the past, environmental remediation costs, and reimbursements in instances of damage, condemnation or forced relocation resulting from highway construction should all be considered in preparation for projecting future net salvage.

It is frequently the case that net salvage for a class of property is negative, that is, cost of removal exceeds gross salvage. This circumstance has increasingly become dominant over the past 20 to 30 years; in some cases negative net salvage even exceeds the original cost of plant. Today few utility plant categories experience positive net salvage; this means that most depreciation rates must be designed to recover more than the original cost of plant. The predominance of this circumstance is another reason why some utility commissions have switched to current-period accounting for gross salvage and, particularly, cost of removal.

Analysis and Forecast

Data relative to gross salvage and cost of removal associated with past retirement of plant can be obtained from a variety of sources; the depth of the necessary analysis will depend on the particular circumstances surrounding the past retirement of plant from the account under analysis. Generally, a first cut can be obtained from data found in the utility's annual report filed with the state regulatory commission; that data should replicate the data contained in the utility's Depreciation Reserve or Accumulated Depreciation account records. The utility, however, may subdivide primary accounts into two or more classifications for depreciation purposes, while the data contained in its annual report to the regulatory commission may be for the entire primary account.

Frequently it is necessary to go beyond the summary information contained in utility annual reports. Internal utility reports that provide monthly and cumulative data on retirements, gross salvage, and cost of removal by sub-account or depreciation category are usually available. Review of these records, particularly monthly records, can be of great benefit in isolating the circumstances surrounding apparently abnormal data. It may be necessary to review specific work orders or estimates to determine whether particular data is correct and/or representative of the category and future activity. If the utility is using retirement work orders, and is using them properly, the salvage and cost of removal amounts appearing in a utility's Accumulated