

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

FUEL AND PURCHASED POWER
COST RECOVERY CLAUSE WITH
GENERATING PERFORMANCE INCENTIVE
FACTOR.

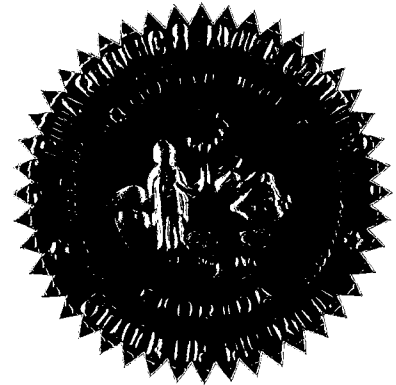
DOCKET NO. 060001-EI

PETITION TO RECOVER NATURAL GAS
STORAGE PROJECT COSTS THROUGH
FUEL COST RECOVERY CLAUSE, BY
FLORIDA POWER & LIGHT COMPANY.

DOCKET NO. 060362-EI

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

DOCKET NO. 041291-EI



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VOLUME 7

Pages 915 through 999

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LISA POLAK EDGAR
COMMISSIONER J. TERRY DEASON
COMMISSIONER ISILIO ARRIAGA
COMMISSIONER MATTHEW M. CARTER, II
COMMISSIONER KATRINA J. TEW

DATE: Wednesday, November 8, 2006

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TIME: Commenced at 10:20 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, CRR, RPR
Official FPSC Reporter
(850) 413-6734

APPEARANCES: (As heretofore noted.)

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I N D E X

WITNESSES

NAME: PAGE NO.

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CERTIFICATE OF REPORTER 999

EXHIBITS

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(Exhibits for Docket 060362 as follows:)

NUMBER:		ID.	ADMTD.
6	PWM-1	942	
7	PWM-2	942	

P R O C E E D I N G S

(Transcript follows in sequence from Volume 6.)

CHAIRMAN EDGAR: Good morning.

MR. BUTLER: Good morning.

CHAIRMAN EDGAR: We will go back on the record and begin. I appreciate everyone's patience. We had a couple of scheduling things that we were trying to look at; always difficult.

When we concluded our business last evening, we were at the point, Mr. Butler, for you to call your next witness.

MR. BUTLER: Thank you. That's right. It's Ms. Dubin, who has been previously sworn. And as with Mr. Yupp, her testimony on direct on this subject is part of the testimony dated September 1, 2006, that was previously inserted into the record. And unlike Mr. Yupp, she has no separate exhibits relevant to this docket. So pretty much her testimony on this subject is already in the record. And if it's okay then, I will simply ask her to summarize that portion of the testimony.

CHAIRMAN EDGAR: Yes, please.

MR. BUTLER: Thank you.

KOREL M. DUBIN

was called as a witness on behalf of Florida Power & Light Company and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

1 BY MR. BUTLER:

2 Q Ms. Dubin, please state your name and address for the
3 record.

4 A My name is Korel M. Dubin. My business address is
5 9250 West Flagler Street, Miami, Florida 33174.

6 Q And by whom are you employed and in what capacity?

7 A I'm employed by Florida Power & Light Company as
8 Manager of Regulatory Issues in the Regulatory Affairs
9 Department.

10 Q I would ask you, please, to summarize the portion of
11 your testimony dated September 1, 2006, that was previously
12 entered into the record in Docket 060001 that relates to the
13 gas storage projects.

14 A Yes. Good morning, Commissioners. My testimony
15 presents for Commission review and approval FPL's proposal to
16 recover FPL's projected costs for MoBay and Bay Gas storage
17 projects through the fuel cost recovery clause and explain why
18 the recovery is appropriate and consistent with Commission
19 practice.

20 The parties have stipulated that most of the costs
21 associated with the MoBay and Bay Gas storage projects are
22 properly recovered through the clause, so I will focus my
23 summary on the two categories of costs that remain in dispute:
24 Base costs at MoBay and stored gas carrying costs at MoBay and
25 Bay Gas.

1 Regarding base gas or otherwise referred to as pad
2 gas, the tenants at the MoBay gas storage facility are required
3 to provide or pay for a quantity of gas that will be injected
4 into the storage reservoir to help maintain pressure in the
5 reservoir and, hence, facilitate injection and removal of the
6 working volume of gas. This base gas remains in the reservoir
7 until the end of the storage agreement term, at which time it
8 is either physically removed or sold to a subsequent tenant.
9 In either case, FPL's customers would get the benefit of the
10 base gas at that time. Base gas is, thus, analogous to
11 nonrecoverable oil that sits at the bottom of a storage tank.
12 This oil is commonly referred to as tank bottoms.

13 Nonrecoverable oil is needed to keep the level in the
14 tank high enough for the working volume of oil to be removed by
15 the suction piping in the tank. Nonrecoverable oil remains in
16 the tank until it is periodically cleaned, at which time the
17 oil is removed and burned as fuel.

18 Pursuant to Order Number 12645 dated November 3rd,
19 1983, FPL and other utilities have been authorized to charge
20 the cost of nonrecoverable oil to the fuel clause when the oil
21 is loaded into the tanks, with a credit to the fuel clause when
22 it is ultimately removed and burned. This is precisely the
23 treatment that FPL seeks with respect to base gas costs.

24 Regarding carrying costs for the stored gas, the
25 MoBay and Bay Gas storage projects are physical hedges. That

1 is, they will substantially increase FPL's ability to hedge the
2 physical supply of natural gas, resulting in a significant
3 increase in system reliability and a reduction in natural gas
4 volatility.

5 Stored natural gas is not fuel inventory in the
6 conventional sense. Storing the gas serves the purpose of
7 hedging rather than meeting ordinary operational needs of FPL's
8 gas-fired plants. Because the purpose of storing gas is to
9 effect a physical hedge, the gas storage carrying costs are
10 appropriately considered hedging costs that are recoverable
11 through the fuel clause pursuant to the hedging resolution
12 approved by the Commission in Order Number PSC-02-1484 dated
13 October 30th, 2002. Said another way, FPL's proposal to
14 recover the gas storage carrying costs associated with the
15 MoBay and Bay Gas storage projects through the fuel clause is
16 fully appropriate and consistent with the hedging resolution.

17 Recovery of the stored gas carrying costs through the
18 fuel clause is also fully consistent with the 2005 rate case
19 stipulation and subsequent stipulation in the 2005 fuel docket
20 that states, I quote, FPL's continued recovery of incremental
21 hedging costs through the fuel and purchased power cost
22 recovery clause during the term of the rate stipulation is
23 reasonable and consistent with the intention of the parties to
24 the rate stipulation, end quote.

25 Therefore, the parties specifically intended and

1 agreed that FPL would be permitted to recover hedging costs
2 through the fuel clause throughout the term of the 2005 rate
3 stipulation, which will continue until at least December 31st,
4 2009. Because the gas carrying costs are properly considered
5 to be hedging costs, the recovery through the fuel clause is
6 appropriate and consistent with the 2005 rate stipulation and
7 subsequent stipulation in the 2005 fuel docket approved by the
8 Commission. This concludes my summary.

9 MR. BUTLER: Thank you, Ms. Dubin.

10 I would tender the witness for cross examination.

11 CHAIRMAN EDGAR: Thank you.

12 Mr. Beck.

13 MR. BECK: Thank you, Madam Chairman.

14 CROSS EXAMINATION

15 BY MR. BECK:

16 Q Good morning, Ms. Dubin.

17 A Good morning, Mr. Beck.

18 Q Ms. Dubin, during your summary you mentioned the
19 carrying cost for stored gas, and I believe you also addressed
20 that beginning at Page 14 of your testimony.

21 A Yes.

22 Q Could you turn there? Could you tell us what the
23 term "carrying cost" means?

24 A Carrying cost is the time value of money on the
25 amount of fuel that's supplied --

1 Q Okay.

2 A -- in storage.

3 Q Does it apply a cost of capital to your cost of the
4 fuel to get to what the carrying costs are?

5 A Yes.

6 Q Okay. What are O&M expenses?

7 A Operation and maintenance expenses.

8 Q Is that the same as carrying costs or different?

9 A It is different. In the hedging resolution it talks
10 about all different types of costs that are recoverable through
11 the clause.

12 Q I was wondering if you could just in plain language
13 tell us the difference between carrying costs and O&M costs.

14 A O&M costs are operation and maintenance costs and
15 carrying costs are the time value of money on the stored
16 inventory.

17 Q So they're really completely different items, are
18 they not?

19 A They're all related to the gas storage.

20 Q But as far as types of expenses, carrying costs are
21 different.

22 A They're different types, they're different types of
23 expenses. Yes.

24 Q Okay. You address at the bottom of Page 14 in your
25 testimony as well as in your summary the hedging order; is that

1 right?

2 A Yes.

3 Q Would it be fair to say that the hedging order
4 changed some of the criteria used by the Commission in its fuel
5 order back in 1985? You're familiar with the fuel order?

6 A Yes.

7 Q Okay. And the fuel order is one of the basic or one
8 of the original orders of the Commission that distinguished
9 between what goes in fuel and what goes in base charges, does
10 it not?

11 A Yes.

12 Q Okay. The hedging order amended some of those things
13 that are contained in the fuel order, didn't it?

14 A It was an addition to, I would say.

15 Q Let me -- if we could, I'd like to pass out the fuel
16 order, if we could, I know it's been discussed previously in
17 the hearing, and go through that. And then after that, let's
18 go through the hedging order and the way that it changed the
19 fuel order.

20 MR. BUTLER: Mr. Beck, are you planning to make this
21 an exhibit or just handing it out for informational purposes?

22 MR. BECK: Just for informational purposes since it's
23 a PSC order. And I'm not opposed to it, if you would like.

24 MR. BUTLER: No. No. That's fine. But since it's
25 not going to be an exhibit, would you mind identifying it by

1 order number on the record?

2 MR. BECK: I am about to.

3 MR. BUTLER: Okay. Thanks.

4 BY MR. BECK:

5 Q Ms. Dubin, do you have Order Number 14546 issued
6 July 8th, 1985, before you?

7 A I do.

8 Q Okay. And you're familiar with this order?

9 A Yes, I am.

10 Q And this is one of the very fundamental orders issued
11 by the Commission that distinguishes between what types of
12 costs belong in the fuel clause and what types of costs belong
13 in base charges; is that right?

14 A Yes, Mr. Beck. In fact, I participated in this, in
15 this docket.

16 Q Okay. Could you turn to Page 2 of the order, and
17 specifically Paragraph 2?

18 A Yes.

19 Q Okay. Could you read the first sentence in
20 Paragraph 2?

21 A "Prudently incurred fossil fuel related expenses
22 which are subject to volatile changes should be recovered
23 through an electric utility's fuel adjustment clause."

24 Q So you would agree, would you not, that at least in
25 the 1985 order volatility was one of the criteria used to

1 determine whether a cost belonged in fuel or in base charges?

2 A Yes.

3 Q Okay. And then Paragraph 2 after that goes on to
4 describe some of the types of volatile charges that are there,
5 does it not?

6 A Yes. And I would comment then that the hedging
7 resolution was there to help reduce volatility and that's --

8 Q We're getting there.

9 A Okay.

10 Q Okay. At the end of Paragraph 2 it says, "All other
11 fossil fuel related costs should be recovered through base
12 rates"; is that right?

13 A Yes.

14 Q Okay. Could you turn to Page 3? And the very first
15 underlined paragraph discussed O&M expenses at plants, storage
16 facilities and terminals, does it not?

17 A Yes, it does.

18 Q In the fuel order it determines that O&M expenses at
19 storage facilities properly belong in base rates, does it not?

20 A Yes.

21 Q And the reason it gives is that they're relatively
22 fixed and not volatile.

23 A Yes.

24 Q Okay. Now what I'd like to do is pass out the
25 hedging order, which again is Order Number PSC-02-1484-FOF-EI,

1 issued October 30th, 2002.

2 Ms. Dubin, this is the order which you described at
3 the bottom of Page 14 of your testimony, is it not?

4 A Yes, it is.

5 Q Okay. And this order adopted a proposed resolution
6 of issues to deal with hedging costs, did it not?

7 A Yes, it did.

8 Q Could you turn to Page 5 of the order? And I'd like
9 to direct your attention to Paragraph 3 to begin with, which is
10 at the bottom of Page 5.

11 A Yes.

12 Q It begins, does it not, that, "Each investor-owned
13 electric utility shall be authorized to charge credit to the
14 fuel and purchased power cost recovery clause its
15 nonspeculative, prudently incurred commodity costs and gains
16 and losses associated with financial or physical hedging
17 transactions for natural gas, residual oil and purchased power
18 contracts tied to the price of natural gas"? Do you see that?

19 A Yes.

20 Q And then it lists some examples of what types of
21 transaction costs that are included within that definition,
22 does it not?

23 A Yes. And that's what they are, examples.

24 Q Okay.

25 A The -- Mr. Beck, I also participated extensively in

1 the, in the resolution of issues on, in hedging as well. And
2 those transaction costs were listed as a list of examples, not
3 a, a list of exactly the types of costs that were, were to be
4 recovered. They are an example of lists. They didn't
5 encompass everything that could be considered a hedging
6 transaction cost.

7 Q But you would agree with me that among -- the
8 examples do not include anything like carrying costs on
9 inventory.

10 A They don't specifically spell that out. As I think
11 everyone is aware, this hedging was, was evolving, the hedging
12 programs were evolving at the time. It was very important to
13 FPL when we were going through this hedging resolution to make
14 sure that we included physical hedging in, in this resolution.
15 And the types of transaction costs there are an example of
16 those types of costs.

17 Q Let me ask you, Ms. Dubin, because all I asked you
18 was if they were examples on there.

19 A Okay.

20 Q It talks about physical hedging transactions, does it
21 not?

22 A Yes, it does.

23 Q Okay. Is it FPL's contention that ownership of fuel
24 inventory over the 15-year contract is, is a continuing
25 transaction?

1 A Our position is, is that the, the storing of natural
2 gas is to effect a physical hedge. And the carrying costs on
3 that, on that stored supply of gas are a necessary cost of
4 that. The purpose is, is to effect a hedge and --

5 Q That's not my question.

6 A Okay.

7 Q My question is is it a continuing transaction? In
8 other words, is a transaction something that happens and it's
9 over or is it something that you think is just continuous
10 throughout the entire period for the contract?

11 A It's continuous.

12 Q Okay. So you don't -- for example, if you buy a
13 house, you have a closing transaction, do you not, for a house?

14 A Yes.

15 Q And there are certain costs associated with the
16 transaction of buying a house.

17 A Yes.

18 Q Okay. The analogy that you would say is that it's
19 not just the transaction, it's the closing, it's the
20 continuation -- the transaction is the entire ownership of the
21 house over the entire period; is that what you're --

22 A Well, what I would say here is that the purpose of
23 our gas storage would be to effect the physical hedge, so the
24 transactions associated with that, including what would be a
25 carrying charge, we'd have to pay that in order to effect that

1 hedge, and that that should be included as part of the
2 transaction costs.

3 Q Okay. Let me go on to Paragraph 4, if we could, of
4 the order.

5 A Uh-huh.

6 Q Paragraph 4 addresses incremental operating and
7 maintenance expenses, does it not?

8 A Yes, it does.

9 Q And allows those types of costs for hedging
10 transactions; is that right?

11 A Yes, it does.

12 Q And that's different than the fuel order, is it not?
13 The fuel order said that O&M expenses are generally fixed and
14 not -- do you agree with that?

15 A Yes. And the intent here was that, that everyone was
16 in agreement, and I think we were trying to encourage hedging
17 as a way to reduce volatility to customers, and that the intent
18 of the order was to remove disincentives that the utilities
19 were facing in order to be able to effect hedges.

20 Q Okay. Okay. So this is an example, is it not,
21 specifically where the hedging order amends the treatment in
22 the fuel order? The fuel order said O&M is, is a base rate
23 item. This says for hedging transactions, incremental O&M will
24 be allowed through the fuel cost.

25 A It's additive. It gives a specific example, yes.

1 Q Now is there a similar provision in this order for
2 carrying costs?

3 A I would say that when we're talking about the, the
4 hedging order all throughout, it specifically talks about
5 physical as well as financial hedging, and it talks about
6 hedging transactions and lists out examples of them. It wasn't
7 to be an all-inclusive list; it was to give examples.

8 Q None of those examples include carrying costs, does
9 it?

10 A No. But -- they don't include carrying costs
11 specifically here. But I might add that, you know, since the
12 hedging resolution was passed, FPL has always considered its,
13 its gas storage as a physical hedge. And in all our reports on
14 hedging in 2002, 2003, 2004 and 2005, we've included the
15 results of gas storage in those hedging reports.

16 Q So you'll agree with me then that carrying costs are
17 not listed in the, in the order.

18 A They are not listed specifically, no.

19 Q Okay. Do you think the hedging order changed the
20 treatment for the carrying costs related to your oil inventory?

21 A No.

22 Q Okay.

23 A But we don't use that as, as a physical hedge. The
24 gas storage is not inventory in the conventional sense. It's,
25 it's, it's gas that's, that's stored there in order to effect a

1 hedge, which is different than oil storage which is for
2 operational needs.

3 Q Okay. Ms. Dubin, let me ask you a little bit about
4 nonrecoverable oil.

5 A Okay.

6 Q And you discussed that at Page 13 of your testimony,
7 is that right, toward the bottom of Page 13?

8 A Yes, I believe so.

9 Q With regard to your gas and the working gas versus
10 base gas, yesterday Mr. Yupp told us that the base gas is about
11 half of the total gas, is it not?

12 A Yes, it is.

13 Q Okay. And you agree with that?

14 A Yes, it is.

15 Q What percent of the oil in a tank more or less is the
16 base oil?

17 A Mr. Beck, I'm not, I'm not sure. That might be a
18 question for Mr. Yupp later.

19 Q Okay. Do you know why it's called nonrecoverable
20 oil?

21 A Because it's below the -- we call it tank bottoms.
22 It's the oil below the, below the suction level.

23 Q Okay. If you know, is it a small fraction of the
24 total amount in the tank or do you just not know?

25 A I'm not sure. I think I'd leave that to Mr. Yupp.

1 Q Okay. How often are the tanks cleaned for the oil
2 tanks?

3 A I also would defer that to Mr. Yupp.

4 Q Okay. Do you know whether any of the nonrecoverable
5 oil contains sediment or water?

6 A There's definitely some, there is some of that
7 included in it. Again, Mr. Yupp would be better to address
8 those questions.

9 Q Okay. Do you know whether it requires processing
10 before it can be burned?

11 A I know it's burned, but I'm not sure what kind of
12 process it goes through.

13 Q Let me ask you about Page 18 of your testimony,
14 beginning at Line 18 on Page 18.

15 A Yes.

16 Q You say, "Until now FPL has inadvertently failed to
17 include in the fuel cost recovery clause the carrying costs
18 associated with the natural gas stored at the Bay Gas
19 facility." Do you see that?

20 A Yes, Mr. Beck. We, we, inadvertently left it out.
21 We should have been including it.

22 Q What do you mean by "inadvertently"? I don't
23 understand what that means.

24 A Well, we've been reflecting all the other gas storage
25 in fuel adjustment, including the results of the gas storage

1 hedging, in our, in our hedging report filed every year. We
2 did not include the component of carrying costs on the stored
3 gas. It was an oversight, an inadvertent mistake. We should
4 have been including it.

5 Q Has FPL been expensing the gas associated with the
6 Bay Gas facility as you purchase the gas?

7 A I'm sorry. Could you repeat your question?

8 Q Has Florida Power & Light been expensing the Bay Gas
9 as you purchase it?

10 A It's charged as it's burnt.

11 Q So not as you purchase it? You've been doing
12 after -- only as it's burned and not when you've been
13 purchasing it?

14 A Yes.

15 Q So you've been having carrying costs.

16 A I'm sorry. I'm --

17 Q I guess my question is going to whether you've had
18 any carrying costs with Bay Gas.

19 A We have had carrying costs. What we, what we have
20 done is we inadvertently left that out of fuel adjustment.
21 Those costs should have been included as part of our hedging
22 transaction costs in fuel adjustment. And, and we have
23 included all other costs, all other results of those hedging
24 Bay Gas contracts in the fuel clause, but we did not include
25 the carrying costs. We made a mistake.

1 Q Okay. How long has this inadvertence been
2 continuing?

3 A Since 2003 when, when, when, when the Bay Gas
4 contract occurred.

5 Q Okay. And it wasn't until now that you discovered
6 this? This has been going on for at least a couple of years.

7 A Yes. We made a mistake, Mr. Beck.

8 Q Okay. And to the extent you've been incurring
9 carrying costs, you've had to recover them through your --

10 A The company has, has not included them in fuel
11 adjustment, no.

12 Q So you've had to recover those costs through your
13 base rates?

14 A They're certainly not reflected in fuel.

15 MR. BECK: Okay. Thank you, Ms. Dubin. That's all I
16 have.

17 CHAIRMAN EDGAR: Other questions from staff?

18 MS. BENNETT: Yes, Madam Chair, I have one.

19 CROSS EXAMINATION

20 BY MS. BENNETT:

21 Q Ms. Dubin, isn't it true that the carrying costs
22 associated with the Bay Gas storage are not in FPL's projected
23 2007 fuel cost?

24 A That is correct.

25 MS. BENNETT: Thank you.

1 CHAIRMAN EDGAR: Commissioners?

2 MR. BUTLER: Thank you, Madam Chairman.

3 REDIRECT EXAMINATION

4 BY MR. BUTLER:

5 Q Just a couple on redirect, Ms. Dubin.

6 Would you turn to Order 14546 that Mr. Beck had
7 handed to you?

8 A Yes.

9 Q To Page 3. He had referred you to a paragraph that
10 is entitled "O&M Expenses at Plants, Storage Facilities and
11 Terminals."

12 A Yes.

13 Q Do you see that?

14 Just to clarify, the carrying costs that we are
15 discussing here would not be O&M expenses at plants, storage
16 facilities or terminals, would they?

17 A No, they would not.

18 Q Do you know whether there is volatility in the dollar
19 value of gas stored from year to year at FPL's storage
20 facilities?

21 A I'm sorry, Mr. Butler. Could you repeat the
22 question?

23 Q Do you know whether there is volatility in the dollar
24 value of the gas stored or that will be stored at FPL's gas
25 storage facilities?

1 A Volatility in the price of gas stored?

2 Q In the sort of total dollar volume of it, right,
3 because of the price times the volume that's in the storage.

4 A Yes.

5 MR. BUTLER: Okay. Thank you. That's all that I
6 have.

7 CHAIRMAN EDGAR: Commissioner Arriaga.

8 COMMISSIONER ARRIAGA: Just one quick question,
9 please.

10 Could you clarify for me the difference between
11 carrying costs and O&M expenses as just referred to by
12 Mr. Butler? What is the difference between carrying costs and
13 O&M expenses, referring to the question Mr. Butler just asked
14 you?

15 THE WITNESS: Yes. The carrying costs on the, on the
16 stored gas is the time value of money of the, of the supply of
17 gas, the cost of the supply of gas that's in storage. And, I'm
18 sorry, Commissioner, O&M expenses?

19 COMMISSIONER ARRIAGA: The difference between
20 carrying costs and O&M expenses. I don't seem to grasp the
21 difference. And I think Mr. Butler was just asking you a
22 question trying to clarify that there is a difference. Am I
23 correct, Mr. Butler?

24 MR. BUTLER: That's right. And if I understand
25 correctly, you're just asking her to explain the difference

1 between carrying costs on the one hand and O&M expenses as sort
2 of accounting concepts are.

3 COMMISSIONER ARRIAGA: I just want to know a
4 difference, whichever concept.

5 MR. BUTLER: Okay.

6 THE WITNESS: O&M expenses are just the normal
7 operation and maintenance expenses associated with, with a
8 transaction. It could be anything from hiring a hedging
9 analyst, someone to do that work, those types of things, versus
10 the actual return, the time value of money of the stored gas.

11 COMMISSIONER ARRIAGA: Okay. Thank you.

12 CHAIRMAN EDGAR: Commissioner Deason.

13 COMMISSIONER DEASON: Ms. Dubin, I need some
14 clarification on the response you gave to Mr. Butler concerning
15 the volatility of the price of gas that's in storage.

16 As I understand it, base gas is inserted into the
17 storage and it is there to maintain a certain volume or
18 pressure to be able to utilize working gas. And once it's
19 placed in there, that volume of gas is not extracted during
20 normal operations. So would not the price of that gas stay
21 fixed during the period of the contract under which you as the
22 tenant would be utilizing that facility?

23 THE WITNESS: Yes, Commissioner Deason. Thank you.
24 I believe I misspoke when I answered Mr. Butler's question.
25 That is correct. It would be -- it would not be volatile.

1 COMMISSIONER DEASON: At least the base gas; correct?

2 THE WITNESS: Yes.

3 COMMISSIONER DEASON: Okay.

4 CHAIRMAN EDGAR: Commissioner Tew.

5 COMMISSIONER TEW: Thank you. Hi, Ms. Dubin.

6 THE WITNESS: Good morning.

7 COMMISSIONER TEW: Can you tell me whether the
8 carrying costs of the Bay Gas storage contract were in your
9 last filed MFRs?

10 THE WITNESS: No, they were not. They were not
11 included in our MFR filing.

12 CHAIRMAN EDGAR: Mr. Butler.

13 MR. BUTLER: If I might, I would like to clarify the
14 question that Commissioner Deason asked to my witness because I
15 think there was some confusion in what I was trying to ask and
16 perhaps what it came across as my asking.

17 CHAIRMAN EDGAR: All right. Under the circumstances,
18 I'll allow.

19 BY MR. BUTLER:

20 Q Ms. Dubin, to clarify what I was trying to ask you
21 about earlier is about the dollar volume of the working gas
22 that is in gas storage, not the base gas that is in the gas
23 storage, for the working gas, would you expect there to be a
24 volatility over time in the dollar value of the amount of the
25 working gas that is in gas storage?

1 A I'm sorry, Mr. Butler. One more time.

2 Q Would you expect there to be volatility in the dollar
3 value of the working volume of gas that is stored in a gas
4 storage facility as opposed to the base gas volume, which is
5 what Commissioner Deason had asked you about?

6 A Yes.

7 MR. BUTLER: Thank you. That's all that I have.

8 CHAIRMAN EDGAR: Okay. The witness may be excused.

9 THE WITNESS: Thank you.

10 CHAIRMAN EDGAR: Thank you.

11 And, Mr. Beck, your witness next.

12 MR. BECK: Thank you. We call Patricia Merchant.

13 And, Madam Chairman, Ms. Merchant was not previously sworn when
14 you swore in witnesses.

15 CHAIRMAN EDGAR: Ready? Let's go ahead and swear you
16 in. If you'll stand and raise your right hand.

17 PATRICIA W. MERCHANT

18 was called as a witness on behalf of the Office of Public
19 Counsel and, having been duly sworn, testified as follows:

20 DIRECT EXAMINATION

21 BY MR. BECK:

22 Q Ms. Merchant, would you please state your full name
23 and state by whom you're employed.

24 A Patricia W. Merchant, and I'm employed by the Office
25 of Public Counsel.

1 Q What position do you hold with the Office of Public
2 Counsel?

3 A I'm a Senior Legislative Analyst.

4 Q Did you prepare direct testimony in this case dated
5 September 22, 2006?

6 A Yes, I did.

7 Q And do you have any changes to make to your testimony
8 as filed?

9 A No, I don't.

10 Q Okay. If I were to ask you the same questions today
11 under oath, would your answers be the same?

12 A Yes.

13 MR. BECK: Okay. I would ask that Ms. Merchant's
14 testimony be inserted into the record as though read.

15 CHAIRMAN EDGAR: The prefiled testimony will be
16 entered into the record as though read.

17 BY MR. BECK:

18 Q Ms. Merchant, you also have two exhibits attached to
19 your testimony; is that correct?

20 A Correct.

21 MR. BECK: And I'm not sure if these have been
22 previously identified or not.

23 CHAIRMAN EDGAR: I believe they are numbered as 6 and
24 7 in the comprehensive exhibit list.

25 (Exhibits 6 and 7 marked for identification.)

DIRECT TESTIMONY

OF

PATRICIA W. MERCHANT, C.P.A.

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 060001-EI

Introduction

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Patricia W. Merchant. My business address is Room 812, 111 West Madison Street, Tallahassee Florida, 32399-1400.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am a Certified Public Accountant licensed in the State of Florida and employed as a Senior Legislative Analyst with the Office of Public Counsel (OPC). I began my employment with OPC in March, 2005.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. In 1981, I received a Bachelor of Science degree with a major in accounting from Florida State University. In that same year, I became employed with the Florida Public Service Commission (PSC) as an auditor in the Division of Auditing and Financial Analysis. In 1983, I joined the PSC's Division of Water and Sewer as an analyst in the Bureau of Accounting. From May, 1989

1 to February, 2005 I was a regulatory supervisor in the Division of Water and
2 Wastewater which evolved into the Division of Economic Regulation.

3

4 Q. ARE YOU SPONSORING ANY EXHIBITS IN THIS CASE?

5 A. Yes. I am sponsoring 2 exhibits, which are attached to my testimony. Exhibit
6 PWM-1 is a summary of my regulatory experience and qualifications. Exhibit
7 PWM-2 is entitled Gulf Power Company Rate Case MFRs – Docket No.
8 010949-EI – Schedule of Fuel Inventory.

9

10 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA
11 PUBLIC SERVICE COMMISSION?

12 A. Yes. I have also testified before the Division of Administrative Hearings as
13 an expert witness.

14

15 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

16 A. The purpose of my testimony is to discuss the proper regulatory treatment of
17 the gas storage costs which Florida Power & Light Company (FPL) seeks to
18 recover through the fuel cost recovery clause (fuel clause). I recommend that
19 the fuel transportation costs (Monthly Storage Reservation, Incurred
20 Injection/Withdrawal and Monthly Insurance Charges) and one-fifteenth of
21 the base gas requirement are appropriate to be recovered through the fuel
22 clause. I also testify that the carrying costs associated any unamortized
23 balance of base gas and carrying costs for the gas inventory costs should be
24 recovered through base rates, not the fuel clause.

25

1 Q. HAVE YOU REVIEWED FPL'S PETITION TO RECOVER THE COSTS
2 OF THE GAS STORAGE COSTS THROUGH THE FUEL DOCKET?

3 A. Yes. FPL filed a petition for recovery of costs associated with its gas storage
4 project through the fuel clause. While Citizens agree that the gas storage
5 project is worthwhile, some of the requested costs are properly recovered
6 through base rates, not the fuel clause as proposed by FPL.

7

8 Q. PLEASE EXPLAIN THE DETAILS OF FPL'S REQUEST TO RECOVER
9 GAS STORAGE COSTS THROUGH THE FUEL COST RECOVERY
10 CLAUSE.

11 A. In its petition, FPL requested recovery of the following items as incremental
12 transportation or hedging costs associated with the gas storage project:

13 Monthly Storage Reservation Charge

14 Injection/Withdrawal Charges

15 Monthly Inventory Insurance Charge

16 Total Amount of Base Gas Injected into Storage Facility in year One

17 Carrying Costs of MoBay Gas Working Inventory

18 Carrying Costs of Existing Bay Gas Working Inventory

19

20 Monthly Storage Reservation, Injection/Withdrawal and

21 Monthly Insurance Charges

22 Q. PLEASE EXPLAIN THE COMPANY'S REQUESTED GAS STORAGE
23 CHARGES FOR RESERVATION, INJECTION, WITHDRAWAL AND
24 INSURANCE.

25 A. FPL witness K. M. Dubin, in her testimony filed on September 1, 2006,

1 testified that the monthly storage reservation charge, the injection/withdrawal
2 charges, and the insurance charges are gas transportation charges and
3 appropriately included in the fuel clause. (Page 13, line 2-7). In its
4 recommendation filed on August 3, 2006, in Docket No. 060362-EI,
5 Commission staff recommended that FPL be allowed to recover the monthly
6 storage reservation, the injection/withdrawal, and the monthly insurance
7 charges through the fuel clause.

8

9 Q. WHAT WAS STAFF'S RATIONALE FOR RECOVERY OF THE ITEMS
10 THROUGH THE FUEL CLAUSE?

11 A. Staff stated that these charges are directly related to the volume of gas
12 available to be consumed for the purpose of generating electricity and should
13 be considered as a cost of gas recovered through the fuel clause. Further,
14 these types of charges currently flow through the fuel clause for the electric
15 utilities that currently have natural gas storage. I agree with the company and
16 staff that these types of costs should be included for recovery in the fuel
17 clause.

18

19 Base Gas Injected Into the Storage Facility

20 Q. PLEASE EXPLAIN THE BAS GAS REQUIREMENT IN THE MOBAY
21 PRECEDENT AGREEMENT.

22 A. Ms. Dubin states that the base gas is required to maintain sufficient pressure in
23 the Gas Storage Facility to permit gas withdrawals as needed. FPL is required
24 by its Precedent Agreement to either provide or lease from MoBay for 50

1 percent of the amount of FPL's gas storage capability (3 million dekatherms¹)
2 as an anchor tenant. FPL's petition states that based on MoBay's pricing
3 information, it is less expensive for FPL to provide its own base gas than to
4 lease it from MoBay.

5
6 Q. WHAT REGULATORY TREATMENT HAS FPL REQUESTED FOR THE
7 BASE GAS REQUIREMENT?

8 A. Ms. Dubin has testified that the total amount of base gas injected should be
9 expensed in the fuel clause in year one of the contract and reversed in year
10 fifteen at the conclusion of the contract. She states that the base gas is similar
11 to the "non-recoverable oil" that sits at the bottom of oil storage tanks, and
12 should be accounted for similarly through the fuel clause. Pursuant to PSC
13 Order No. 12645, issued November 3, 1983, in Docket No. 830001-EU, "non-
14 recoverable oil" should be charged to the fuel clause when the tanks are filled
15 and removed from the clause when the oil is removed and burned.

16
17 Q. WHAT IS THE POSSIBLE PRICE IMPACT OF FPL'S REQUEST TO
18 RECOVER THE COST OF THE BASE GAS IN THE FIRST YEAR OF
19 THE MOBAY CONTRACT?

20 A. Using a price of \$7 per MMBtu, the cost of 3,000,000 dekatherms of gas
21 would cost \$21 million. If FPL were to lease the base gas from MoBay, the
22 monthly lease cost would be approximately \$120,000, or \$1.44 million
23 annually, using the example provided in the Precedent Agreement (FPL's

¹ 1 dekatherm = 1 MMBtu = 1,000,000 Btu. The Precedent Agreement states the firm storage capacity in dekatherms. Natural gas prices are typically stated as dollars per MMBtu.

1 Petition, Attachment 2, page 22 of 23).²

2

3 Q. DID COMMISSION STAFF AGREE WITH FPL'S PROPOSED
4 TREATMENT TO EXPENSE THE BASE GAS REQUIRMENT IN YEAR
5 ONE THROUGH THE FUEL CLAUSE?

6 A. No. In its recommendation filed in Docket No. 060362-EI, at page 5, staff
7 stated:

8 Staff does not believe that this is an appropriate treatment for
9 the cost of base gas. This treatment ignores the fact that the
10 purpose, use, benefit and cost of base gas is applicable to the
11 entire 15 year term of the storage agreement, not just the day
12 that it is injected into storage. There is also the issue of
13 possible intergenerational inequity. Today's ratepayers would
14 be required to pay for the total cost of base gas that will benefit
15 current and future ratepayers over the next 15 years. It is also
16 possible that many of today's ratepayers will not be the
17 ratepayers that benefit from the reduction in expense when FPL
18 is compensated for the base gas at the end of the storage
19 agreement.

20 Staff instead recommended that the base gas be deferred and amortized over
21 the 15-year life of the contract, with the annual amortization flowing through
22 the fuel docket. The staff also added that base gas is similar to base coal
23 instead of non-recoverable oil. Base coal is capitalized and amortized over a
24 set period, whereas, non-recoverable oil is expensed when the tank is cleaned

² The Base gas requirement of 3 million dekatherms is multiplied by the price of gas (\$7.00 per Dth) and the Monthly Base Gas Interest Rate (Prime Rate of 5% + 2%/12).

1 and refilled.³

2

3 Q. WHAT WAS STAFF'S RECOMMENDED TREATMENT FOR THE
4 UNAMORTIZED BALANCE OF THE REGULATORY ASSET FOR THE
5 BASE GAS?

6 A. Staff recommended that the rate of return on the unamortized balance of the
7 base gas should be recovered on a temporary basis through the fuel clause
8 until the current base rate settlement period expires. After that, the return on
9 the unamortized balance of the base gas would be considered a base rate item
10 and would no longer be eligible for recovery through the fuel clause.

11

12 Q. DO YOU AGREE WITH STAFF'S RECOMMENDED TREATMENT FOR
13 THE BASE GAS?

14 A. Yes and no. I fully support staff's recommendation that the base gas should
15 be recovered over the life of the contract and amortized through the fuel
16 clause over a 15-year period. The decision to expense or capitalize an item
17 should be directly matched with the period in which the cost incurred provides
18 a benefit. Because the gas has to remain in storage for the full length of the
19 contract and cannot be burned it should be capitalized and amortized over that
20 same time period.

21

22 I also agree with staff that the base gas correlates closer with base coal than
23 non-recoverable oil. Base coal is used to support the coal pile and is not
24 burned. Non-recoverable oil is removed as often as the storage tank is

³ Order No. 12645, issued November 3, 1983 in Docket No. 830002-EU.

1 cleaned, and represents a minimal amount of the total capacity of the storage
2 tank. Because base gas represents 50% of the storage capacity, it contrasts
3 with the minimal percentage of the oil under the intake pipe of a ground
4 storage tank.

5

6 Q. DO YOU AGREE WITH STAFF'S RECOMMENDATION TO INCLUDE
7 THE RATE OF RETURN OF THE UNAMORTIZED BASE GAS IN THE
8 FUEL CLAUSE?

9 A. No, I do not. I believe that purchasing this base gas is a capital asset similar
10 to gas inventory, and the unamortized balance is not a regulatory asset as staff
11 proposed in its recommendation. Inventory costs (coal, oil, gas, meters, etc.)
12 are normally included in base rates as a component of the working capital
13 calculation and included in rate base to which the company's rate of return is
14 applied. Regardless of what the assets are labeled, regulatory assets or
15 inventory, those amounts are normal base rate recovery items and as such do
16 not belong in the fuel clause. I will address this issue further in the next
17 section of my testimony when I address why it is inappropriate to include
18 inventory carrying costs in the fuel clause.

19

20 Carrying Costs of Gas Inventory

21 Q. PLEASE EXPLAIN FPL'S REQUEST TO RECOVER THE CARRYING
22 COSTS OF GAS INVENTORY COSTS THROUGH THE FUEL DOCKET?

23 A. FPL has requested that the carrying costs (rate of return) of the MoBay and
24 Bay Gas inventory balances be recovered through the fuel clause as an
25 increase to the weighted average cost of gas burned. Ms. Dubin states that

1 because the gas storage projects are physical hedges, these carrying costs
2 qualify as hedging costs pursuant to the Hedging Order, and, as such, should
3 be recovered through the fuel clause. She states that stored gas is not “fuel
4 inventory” in the conventional sense because this gas is used for hedging
5 rather than ordinary operational needs of FPL’s plants. (Direct testimony
6 page 14, lines 11-20). Ms. Dubin also testifies that recovery of hedging costs
7 through the fuel docket is consistent with the 2005 rate case settlement to
8 which all parties in the rate case agreed.

9

10 Q. HOW DID STAFF TREAT THE CARRYING COSTS FOR THE GAS
11 INVENTORY IN ITS RECOMMENDATION?

12 A. Staff recommended that the carrying costs on the annual gas inventory
13 balances should temporarily be included in the fuel clause. Staff stated that
14 fuel inventory is a traditionally and historically included in base rates and also
15 addressed the language in FPL’s rate case settlement that would preclude
16 inclusion of these costs in the fuel clause. Regardless, staff recommended that
17 given the beneficial purpose and unique nature, the inventory carrying costs
18 should be recovered as fuel costs until the end of the current base rate
19 settlement period of December 31, 2009. At that time, the carrying costs
20 should be moved out of the fuel clause and recovered through base rates.

21

22 Q. HOW ARE CARRYING COSTS ASSOCIATED WITH INVENTORY
23 TREATED FOR RATE SETTING PURPOSES?

24 A. Fuel inventory historically is recovered through base rates and is included as a
25 component of working capital. Gas is no different than any other fuel

1 inventory in which a utility invests. By its very nature, all inventory
2 purchased is a physical hedge for supply as well as cost. Accordingly, I
3 disagree with Ms. Dubin's testimony that storing gas is solely for hedging not
4 ordinary operating purposes, and as such separates the gas from the other fuel
5 inventory balances. Even FPL's petition on page 4, paragraph 8, states that
6 "gas storage also allows FPL to better manage and respond to intra-day
7 changes in its natural gas requirements due to load variance, unit outages,
8 etc." Thus, FPL's petition regarding these "ordinary operational needs" for
9 gas storage contradicts Ms. Dubin's testimony on page 14, lines 15-17.

10

11 Q. HAS GAS INVENTORY PREVIOUSLY BEEN INCLUDED IN WORKING
12 CAPITAL AS PART OF RATE BASE FOR FPL OR OTHER ELECTRIC
13 UTILITIES IN FLORIDA?

14 A. Yes. The Commission approved Gulf Power's inclusion of gas inventory in
15 working capital in Gulf's last base rate case, Docket No. 010949-EI. The gas
16 inventory was related to Gulf's gas storage agreement with Bay Gas. Exhibit
17 PWM-2, attached to my testimony, is a copy of the Gulf minimum filing
18 requirements from that rate case showing the Bay Gas storage in fuel
19 inventory for the projected test year. The final order in that docket made no
20 comment about the gas inventory and thus approved Gulf's request as filed.

21

22 Q. CAN YOU ADDRESS WHAT TYPES OF COSTS THE COMMISSION
23 ALLOWS RECOVERY OF THROUGH THE FUEL CLAUSE?

24 A. PSC Order No. 14546, from the 1985 fuel clause docket, addresses the cost
25 recovery method for fuel-related expenses. Prudently incurred fossil fuel-

1 related expenses subject to volatile changes are recovered through the fuel
2 clause, specifically; those incurred prior to the delivery of fuel to the utility's
3 dedicated storage facilities. The order states that all other fossil fuel-related
4 costs should be recovered through base rates. Inventory costs were to be
5 considered in the fuel clause only to the extent the amounts related to volume
6 and/or price adjustments. Further, other fossil fuel-related costs normally
7 recovered through base rates could be considered in the fuel clause only to the
8 extent that that those costs resulted in fuel savings to the customers. FPL has
9 not alleged any fuel savings related to the gas storage project in its petition.

10

11 Q. ARE THE GAS STORAGE CARRYING COSTS VOLATILE?

12 A. No. Carrying costs for a stable amount of fuel contained in a storage facility
13 are not "volatile" and therefore should be recovered through base rates.
14 Carrying costs are simply the rate of return earned on the utility's investment,
15 which in this case is the investment in fuel contained in a storage facility.

16

17 Q. DID THE HEDGING ORDER ALLOW ADDITIONAL TYPES OF COSTS
18 TO BE INCLUDED IN THE FUEL CLAUSE?

19 A. Yes. In Order No. PSC-02-1484-FOF-EI ("Hedging Order"), the Commission
20 accepted the parties' proposed settlement regarding the implementation of
21 financial hedging transactions and electric utilities' risk management policies
22 and procedures. On page 2 of the Hedging Order, the Commission stated:

23

Further, the Proposed Resolution of Issues appears to remove

24

disincentives that may currently exist for IOUs to engage in

25

hedging transactions that may create customer benefits by

1 providing a cost recovery mechanism for prudently incurred
2 hedging transaction costs, gains and losses, and incremental
3 operating and maintenance expenses associated with new and
4 expanded hedging programs.

5
6 The hedging settlement agreement refers to both financial and physical
7 hedging transactions, however, the examples cited refer to the hedging costs
8 related to financial hedging transaction, as follows:

9 3. Each investor-owned electric utility shall be authorized
10 to charge/credit to the fuel and purchased power cost recovery
11 clause its non-speculative, prudently-incurred commodity costs
12 and gains and losses associated with financial and/or physical
13 hedging transactions for natural gas, residual oil, and purchased
14 power contracts tied to the price of natural gas. Examples of
15 such items include transaction costs associated with derivatives
16 (e.g., fees and commissions), gains and losses on futures
17 contracts, premiums on options contracts, and net settlements
18 from swaps transactions....

19 4. Each investor-owned electric utility may recover
20 through the fuel and purchased power cost recovery clause
21 prudently-incurred incremental operating and maintenance
22 expenses incurred for the purpose of initiating and/or
23 maintaining a new or expanded non-speculative financial
24 and/or physical hedging program designed to mitigate fuel and
25 purchased power price volatility for its retail customers....

1 (Emphasis added)

2

3 Q. MS. DUBIN TESTIFIES THAT THE HEDGING ORDER REFERS TO
4 BOTH PHYSICAL AND FINANCIAL HEDGING TRANSACTIONS AND
5 AS SUCH, THE CARRYING COSTS ARE APPROVED FUEL COSTS.
6 DO YOU AGREE?

7 A. No, I do not. The Hedging Order addresses non-speculative commodity costs
8 and gains and losses associated with financial and/or physical hedging
9 transactions. It gives specific examples of types of hedging transaction costs
10 and specifically mentions incremental operating and maintenance costs
11 incurred to initiate or maintain a hedging program. In the past fuel dockets,
12 these incremental hedging operating and maintenance expenses have been for
13 labor costs for employees engaged in trading activities that were not included
14 in base rates. The Hedging Order does not address any other incremental
15 costs, such as interest, profit, depreciation, or income taxes.

16

17 Q. MS. DUBIN STATES THAT AS PART OF THE 2005 RATE CASE
18 SETTLEMENT AND THE 2005 FUEL DOCKET STIPULATION, THE
19 CONSUMER PARTIES AGREED THAT INCREMENTAL HEDGING
20 COSTS WOULD CONTINUE TO BE RECOVERED THROUGH THE
21 FUEL CLAUSE. IS THIS CORRECT?

22 A. In part, this is correct, but the costs that the parties were agreeing to be
23 included were the same types of costs that were allowed by the Hedging
24 Order. I believe that it is important to look back at both of those agreements
25 and compare the language to that agreed to by the parties in the Hedging

1 Order. On page 16 of her testimony, Ms. Dubin states that when the rate case
2 settlement was signed, the parties inadvertently did not address the recovery
3 of hedging costs. This is true. In Order No. PSC-05-902-S-EI (Rate Case
4 Settlement Order), the Commission stated that: FPL currently recovers
5 incremental hedging costs through the Fuel Clause; the parties intended to
6 maintain the status quo; and the parties would memorialize this in the
7 upcoming 2005 fuel docket. Thus, rate case settlement was consistent with
8 the Hedging Order language.

9
10 Q. WHY WAS IT NECESSARY TO ADDRESS THE INCREMENTAL
11 HEDGING COSTS IN THE FUEL DOCKET?

12 A. In the Hedging Order, the inclusion of incremental hedging operating and
13 maintenance expenses through the fuel clause was set to expire as of
14 December 31, 2006, or the date of utility's next rate case, whichever came
15 first. Because the 2005 rate case settlement did not address this issue, the
16 parties agreed in the 2005 fuel docket⁴, to continue this treatment until the
17 expiration of the base rate settlement in 2009. The "incremental hedging
18 costs" referred to in the Fuel Order are only those incremental hedging costs
19 allowed by the Hedging Order. It did not expand on or change the types of
20 costs that were allowed by the Hedging Order.

21
22 Q. DO YOU BELIEVE INCLUDING THE INVENTORY CARRYING COSTS
23 IN THE FUEL CLAUSE WOULD VIOLATE THE 2005 RATE CASE
24 SETTLEMENT?

⁴Order No. PSC-05-1252-FOF-EI, Docket No. 050001-EI

1 A. Yes, I believe that it would. As I previously testified, inventory carrying costs
2 are traditionally and historically included in base rates as part of working
3 capital. The 2005 rate case settlement order stated the following:

4 During the term of this Stipulation and Settlement ... FPL will
5 not petition for any new surcharges ... to recover costs that are
6 of a type that traditionally and historically would be, or are
7 presently, recovered through base rates. (Paragraph 3)

8 Thus it is clear to me that including inventory carrying costs or the carrying
9 costs associated with the unamortized balance of base gas would violate the
10 terms of FPL's rate case settlement.

11

12 Q. WHAT IS THE DOLLAR IMPACT OF YOUR RECOMMENDATION?

13 A. My recommendation to amortize the estimated \$21 million base gas cost over
14 15 years results in an annual cost of \$1.4 million with a reduction to the first
15 year fuel cost of \$19.6 million. The carrying costs on the unamortized
16 balance of base gas for the first year would be about \$3.8 million and would
17 gradually decrease as the amount of base gas is amortized.⁵ FPL has
18 estimated that the annual carrying costs for the MoBay working gas inventory
19 would be \$5.9 million with an additional \$1 million in carrying costs for the
20 Bay Gas inventory⁶. In total, the annual carrying costs at issue in this docket
21 are approximately \$11 million per year.

⁵ See FPL response to late filed data request 8.

⁶ Staff Recommendation at page 4, paragraph e.

1 Summary

2 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

3 A. I agree that FPL's gas storage contract appears reasonable based on the
4 information presented by FPL in its petition and that the charges for monthly
5 storage reservation, injection/withdrawal and insurance should be included in
6 the fuel clause. I agree also with staff that the base gas should be amortized
7 over the life of the 15-year contract with the annual amortization expensed
8 through the fuel docket.

9
10 Further, the estimated \$11 million in annual carrying charges are not
11 appropriate to be recovered through the fuel clause for several reasons. First,
12 these costs are carrying costs on fuel inventory, which are typically and
13 historically base rate items and, as such, inappropriate to include in the fuel
14 clause. Second, these costs do not result in any fuel savings, nor are they
15 volatile or related to inventory adjustments, as required by Order No. 14546.
16 Third, the physical hedging costs allowed by the Hedging Order were hedging
17 transaction costs or incremental operating and maintenance expenses. The
18 Hedging Order did not provide for rate of return components on fuel inventory
19 to be recovered through the fuel docket. Finally, requesting recovery of costs
20 which would typically and historically be recovered in base rates violates the
21 2005 Rate Case Settlement approved by the Commission.

22

23 Q. DOES THIS COMPLETE YOUR TESTIMONY?

24 A. Yes, it does.

1 BY MR. BECK:

2 Q Ms. Merchant, would you please provide a summary of
3 your testimony?

4 A Yes. Good morning, Commissioners. The purpose of my
5 testimony is to discuss the proper regulatory treatment of the
6 gas storage costs that FPL has requested to be recovered
7 through the fuel clause.

8 Let me point out up-front the areas where I agree
9 with FPL's request. First and foremost, we agree that the gas
10 storage projects are reasonable and prudent to be incurred.
11 Secondly, I agree that the storage reservation charges, the
12 injection and withdrawal charges and the monthly insurance
13 charges should be considered fuel costs. These charges are
14 directly related to the volume of gas available to be consumed
15 for generating electricity and also are currently recovered
16 through the fuel clause for other utilities that have natural
17 gas storage.

18 Where I disagree with FPL relates to the treatment of
19 the base gas requirement for the MoBay contract and the
20 recovery of the rate of return or the carrying cost component
21 with the MoBay and the Bay Gas working gas.

22 I fully support staff's PAA recommendation that the
23 base gas should be recovered over the life of the 15-year
24 contract and amortized through the fuel clause. How you
25 account for an item should be directly matched with the benefit

1 that that cost provides. Because the gas has to remain in
2 storage for the full length of the contract and cannot be
3 burned, it should be capitalized and amortized over that same
4 period. Expensing this 15-year allowance in year one is
5 clearly inappropriate.

6 Further, I believe that purchasing this 50 percent
7 base gas requirement is a capital asset similar to gas
8 inventory, and the unamortized balance would normally be
9 recovered in working capital and included in base rates.

10 I also recommend that FPL's request to recover
11 carrying costs on the gas inventory, and that's the working
12 gas, through the fuel clause is inappropriate for several
13 reasons. Carrying costs on fuel inventory are typically and
14 historically base rate items. Gulf Power included gas
15 inventory in its working capital calculation in its last rate
16 case.

17 These carrying costs also do not result in any fuel
18 savings and are certainly not volatile or related to inventory
19 adjustments as required by Order Number 14546, and that's the
20 fuel order that they referenced earlier.

21 FPL's theory that these costs are fuel related is
22 based on the statement that gas storage is a physical hedge,
23 and physical hedging costs are allowed by the hedging order.
24 Where FPL's argument is flawed is that the hedging order
25 specifically addressed fuel recovery of hedging transaction

1 costs and gains and losses on financial hedging transactions.
2 The order also provided temporary fuel recovery of incremental
3 operating and maintenance expenses associated with implementing
4 a hedging program until December 31st, 2006, or until the
5 company's next rate case, whichever came first.

6 Other than the transaction costs in the specified
7 incremental O&M expenses, no other types of costs were
8 contemplated. The crucial point made here is that once the
9 physical -- excuse me. Once the financial or physical hedging
10 transaction occurs, only the incremental O&M expenses
11 associated with implementing the program would be recovered
12 through the fuel clause. And, further, settlements to FPL's
13 2005 rate case and the 2005 fuel docket didn't in any way
14 change the meaning of the hedging order as the parties agreed
15 to.

16 I have no disagreement with FPL that procuring gas
17 storage is a physical hedge and that any transaction costs
18 associated with procuring the storage would be considered fuel
19 cost. However, once the gas is purchased and stored, the
20 hedging transaction has ended and the gas, the purchased gas
21 then becomes fuel inventory, just like coal or oil. There is
22 no difference. Contrary to what FPL witnesses contend, my
23 testimony is that FPL should be allowed to recover these
24 carrying costs on the gas inventory, but that recovery belongs
25 in base rates, not in the fuel clause.

1 The last point that I would like to emphasize is that
2 allowing the gas inventory carrying costs to be recovered
3 through the fuel clause violates the 2005 rate case settlement.
4 In that settlement, FPL agreed not to request recovery of any
5 new surcharges that would typically and historically be
6 recovered through base rates. It is my opinion that requesting
7 recovery of inventory carrying costs through the fuel clause
8 does just that.

9 In conclusion, my testimony, simply stated: Fuel
10 costs should belong in the fuel clause and base rate items
11 should stay in base rates. Accordingly, the base gas should be
12 amortized over 15 years, with the amortization included in the
13 fuel docket, and the carrying costs on both the unamortized
14 balance of base gas and the working gas of about \$11 million
15 should be included in base rate recovery. And that concludes
16 my summary.

17 MR. BECK: Thank you. We tender Ms. Merchant for
18 cross-examination.

19 CHAIRMAN EDGAR: Thank you.

20 Mr. Butler.

21 MR. BUTLER: Thank you.

22 CROSS EXAMINATION

23 BY MR. BUTLER:

24 Q Good morning, Ms. Merchant.

25 A Good morning, Mr. Butler.

1 Q Ms. Merchant, I'm going to ask you a little bit first
2 of all about your background. You worked with the Public
3 Service Commission from 1981 to 2005; correct?

4 A Correct.

5 Q Okay. Did you participate on behalf of the Public
6 Service Commission staff in Docket 850001-EI-B in which Order
7 Number 14546 was issued?

8 A No, I did not.

9 Q Okay. Did you participate on behalf of the Public
10 Service Commission staff in Docket Number 011605-EI in which
11 Order Number PSC-02-1484-FOF-EI was adopted?

12 A No, I did not.

13 Q Okay. During your tenure with the Public Service
14 Commission staff did you have responsibility for any fuel
15 adjustment related issues?

16 A When I first started with the Commission I was an
17 auditor and I audited the fuel docket, the fuel for Gulf Power
18 for about two-and-a-half years.

19 Q Is that the extent of your involvement with fuel
20 adjustment issues when you were at the Public Service
21 Commission?

22 A That's correct.

23 Q Okay. Let me ask you to turn to Page 5 of your
24 testimony. I believe in your testimony and in your summary you
25 indicated that FPL should be allowed to recover through the

1 fuel adjustment clause the monthly storage reservation charges
2 associated with the gas storage projects; is that correct?

3 A That's correct.

4 Q Do you know whether part of the fuel, I'm sorry, of
5 the storage reservation charge for the Bay Gas facility is
6 intended to cover the cost of Bay Gas providing base gas for
7 its facility?

8 A I don't know that particularly, but I've read some
9 discovery that FPL answered that said that there was a
10 component of that. But I did not see that in the Bay Gas
11 contract.

12 Q So you don't have any independent knowledge one way
13 or the other?

14 A No.

15 Q In your mind is there any reason why FPL or others
16 who use the Bay Gas facility should not be allowed to recover
17 the Bay Gas storage reservation charges through the fuel clause
18 if they include a portion that is intended to recover Bay Gas's
19 cost of providing base gas?

20 A Could you repeat that question one more time, please?

21 Q That would be hard, but I'll try.

22 Is there any reason why FPL or others who use the Bay
23 Gas facility should not be allowed to recover Bay Gas storage
24 reservation charges through the fuel clause if it is the case
25 that those storage reservation charges include a component that

1 covers the cost of Bay Gas providing base gas for its facility?

2 A I think that's consistent with my testimony that the
3 1/15th of the base gas would be included in the fuel clause.

4 Q Do you know whether the charge that Bay Gas includes,
5 or the amount that Bay Gas includes in its storage reservation
6 charge also recovers Bay Gas's cost of money, its carrying
7 costs for the base gas that it provides?

8 A I don't know that directly. But if that was a cost
9 incurred by another entity to charge a fair cost to people
10 using the service, then that's a reasonable -- and it's
11 directly related to storing the gas, then that would be a
12 reasonable charge to include.

13 It's different if the entity purchases the base gas
14 and invests in it themselves. It's similar to rent versus
15 owning is how I would see it. When you rent any type of item,
16 you pay the fair share of the costs that the owner has and
17 you're not going to see the breakout of those types of costs.
18 But one would assume that there's profit or rate of return or
19 other expenses included in that rent. But when you buy it,
20 then you have an investment in that.

21 Q So if you rent the gas, the base gas, even if that's
22 a higher cost, that would be recoverable. But if you instead
23 make arrangements to provide the gas yourself and in doing so,
24 even with the carrying costs, it would be a lower cost to
25 customers, you should be allowed to recover the first but not

1 the latter.

2 A I think you should be able to recover the costs.
3 It's not the issue of recovering the cost. It's how you
4 recover the cost.

5 The fuel clauses for volatile cost base rates is for
6 nonvolatile costs. I'm certainly not recommending that they
7 not recover any cost in this docket. It's just how you recover
8 it: Do you get it through fuel, which is volatile, or do you
9 get it through base rates?

10 Q Would there be any difference in the volatility in
11 the two examples we just described?

12 A I think renting it, you have -- if you buy, if you
13 buy an asset, then you're more in control of the cost, the
14 long-term cost. If you rent something, it could certainly be
15 more volatile over the life of the asset.

16 Q If you had a contract that specified what that rental
17 charge was going to be over the life of the contract, that
18 wouldn't be very volatile, would it?

19 A That would not, if it were a contract for an annual
20 fee that didn't change or had a stated basis of how it would
21 change. But you'd have to consider that in whether to buy it
22 or to rent it. That would be in your cost-benefit analysis
23 that you performed at the beginning.

24 Q You've mentioned that the carrying costs associated
25 with base gas, and I assume the same answer would be true for

1 the working volume of stored gas, should be recoverable, but
2 it's just appropriately recoverable through base rates. Is
3 that your position?

4 A That's correct.

5 Q Okay. If the Commission were to make that
6 determination with respect to FPL's costs on its gas storage
7 projects, told FPL to recover it through base rates, would
8 FPL's base rates change in any respect the day after that
9 decision compared to what they are today?

10 A If I could get you to clarify the question. You're
11 talking about in today's circumstances for FPL specifically or
12 generic?

13 Q About FPL at this point in time.

14 A FPL's rates are in a settlement and they will remain
15 the same until the end of 2009. So, no, FPL's base rates would
16 not change. However, what gets recovered through base rates is
17 a very fluid process. Revenues increase with growth and
18 consumption changes, expenses change, earnings change on a
19 regular basis. So what gets recovered through base rates is
20 just very fluid.

21 Q Do you know what FPL's current level of fuel
22 inventory is, not talking about just gas, total fuel inventory,
23 compared to the level that was projected in its 2006 MFRs?

24 A No, I don't have the current fuel balances, fuel
25 inventory balances.

1 Q Would it surprise you to learn that FPL's current
2 fuel inventory balance is considerably higher than what is
3 reflected in the 2006 MFRs?

4 A I would have no information of that. I haven't seen
5 any documentation on it.

6 Q And you didn't seek information on that subject in
7 preparing your testimony, I assume?

8 A No, I didn't.

9 Q Okay. Would you turn to Page 7 of your testimony.
10 I'd direct your attention to your discussion of base coal at
11 the bottom of Page 7.

12 A Yes.

13 Q You say here that base coal is capitalized and
14 amortized over a set period. Do you see that, Line 23?

15 A Yes, I do.

16 Q Okay. Do you know if that's actually what the order
17 that you are referencing says?

18 A I believe that it does say that.

19 Q Do you have a copy of Ms. Dubin's rebuttal testimony
20 available to you?

21 A Yes. If you'll give me just a moment.

22 Q Okay.

23 A What page?

24 Q Page 5.

25 A Okay.

1 Q If you look at the top of the page there, would you
2 agree that actually the treatment that was approved was for the
3 base coal to be capitalized in Account 312 and depreciated over
4 the life of the plant?

5 A That's what she says here, yes.

6 Q Well, it's not actually her saying it. She's quoting
7 from Order Number 12645 in Docket 830002-EU; correct?

8 A That's correct.

9 Q And do you recognize that order as being the sort of
10 controlling Commission decision on this issue of base coal
11 recovery? To save you time, I think you quote it in a footnote
12 on Page 8 of your testimony.

13 A Right. I was just looking at the order.

14 Yes, that's what it says.

15 Q Do you know -- is Account 312, that's a
16 plant-in-service account; is that right?

17 A I don't know which one it is. I believe it is a
18 plant account.

19 Q Okay. And so in the ordinary course there would be a
20 return earned on the sort of remaining undepreciated investment
21 in that account by virtue of the utility's authorized rate of
22 return being applied to that account balance; correct?

23 A Correct. Plus the depreciation on it.

24 Q That's right. Thank you.

25 Would you turn to Page 8 of your testimony?

1 A Okay.

2 Q At the bottom of the page, Line 23, you talk about
3 base coal being used to support the coal pile. You say, and it
4 is not burned -- or "and is not burned." Do you see that?

5 A Yes.

6 Q Is it your understanding that base gas ultimately
7 will be removed from storage and burned for the benefit of the
8 storing utility's customers or sold to some subsequent tenant
9 so that the customers of the storing utility would get the
10 benefit of that sale?

11 A I think there's several options that the company has
12 stated. It could be burned at the end in regular operations,
13 it could be sold to somebody else who goes into the gas storage
14 agreement, or if the gas storage agreement remains in effect,
15 it could stay there if they extended the contract.

16 Q But it wouldn't remain part of the ground analogous
17 to the base coal as you describe it here, would it?

18 A No. But it's part of the storage facility. Which if
19 you think of a coal pile as part of a storage facility also,
20 just similar to --

21 Q But the point is that the base coal never gets
22 burned, does it?

23 A No. It stays on the bottom.

24 Q So customers never get the benefit of that base coal
25 as a source of fuel to them, do they?

1 A No. But they pay for it over -- as depreciation and
2 rate of return.

3 Q Right. But I'm exploring your analogy of stored gas,
4 or of base gas to base coal. And would you agree that a
5 difference is that, with respect to base gas, the utility
6 storing gas in that facility is either going to get the gas out
7 of the facility at the end of the day and be able to burn that
8 for the benefit of the customers, or it's going get paid when
9 it sells that base gas to somebody else and customers will
10 benefit from the proceeds of that sale?

11 A It will remain base gas for the full length of that
12 contract. It can't be burned during that time frame, and
13 that's a substantially long time, 15 years. So for the purpose
14 that it needs to be in the storage facility, it has to be there
15 and can't change. But as far as after that, then it's going to
16 be burned just like any other gas. It's no longer gas storage.

17 Q But that wouldn't be true with the base coal;
18 correct? Base coal is just, it's sort of mashed into the
19 ground and stays there.

20 A Well, base coal is also a very small component, but
21 it's a fixed cost that has to be there for storage. It has to
22 remain there to be able to maintain the coal pile.

23 Q Right. But, again, it will never be taken out of the
24 ground and burned; correct?

25 A I'm not an expert in coal. But according to my

1 reading of the order, it's going to remain there.

2 Q Okay. Thank you.

3 I'd like you to turn to Page 9 of your testimony.
4 And you have a sentence starting on Line 9, "I believe that
5 purchasing this base gas is a capital asset similar to gas
6 inventory." Is base coal treated as inventory?

7 A No. It was considered part of the plant. It's kind
8 of a -- I don't think that they really had a place to put it.
9 They recognized that it was a long-term asset, they recognized
10 that the utility had an investment in it, and they wanted to
11 provide a way for the utility to receive rate of return on that
12 and recover their cost. So that is where they decided to put
13 it. I think that's why they decided to have a special order on
14 it. Otherwise, it wouldn't have -- if the uniform system of
15 account had specific instructions on it, they wouldn't have
16 needed to have an order.

17 Q So the prior page, you're analogizing the base gas to
18 base coal, but the analogy shifts now to the subject of
19 inventory, which, in fact, base coal is not; correct?

20 A No. But they're both investments that the utility is
21 making. Inventory is more of a short-term investment. A plant
22 item is a long-term investment. I'm saying that base gas is a
23 long-term investment. It's not plant per se because it's not a
24 physical plant. But buying this amount of gas, the utility
25 owns it. It's certainly not appropriate to expense it in year

1 one if it has a 15-year life.

2 Q I'd like to ask you about regulatory assets. In your
3 experience, is it typical practice to allow a return on the
4 unamortized value, I'm sorry, the unamortized balance of a
5 regulatory asset?

6 A Yes. A regulatory asset is created when the
7 Commission allows a utility to record an asset that would
8 otherwise be treated differently according to generally
9 accepted accounting principles. So the Commission allows the
10 utility to earn a rate of return and amortize that over a
11 certain period.

12 Q Do you know whether -- I'm sorry. Do you know
13 whether FPL's 2006 MFRs reflect any return on an unamortized
14 regulatory asset for base gas?

15 A I don't think that they recorded any inventory for
16 base gas in their 2006 MFRs. In fact, I looked at their MFRs,
17 and they showed all of their natural gas going in and going out
18 in each month through the three years that they showed for
19 their working, working inventory balances. So that showed to
20 me that they expensed all of their gas. If the balance being
21 purchased every month was equal to the amount that was burned
22 every month, there was no investment in gas inventory.

23 Q So just playing that out, that means that as shown in
24 the MFRs there would be no increment to the working capital
25 calculation for storing gas because the assumption was none of

1 it was being stored; correct?

2 A I'm not sure about the assumption that none of it was
3 being stored. But none of it was being capitalized through
4 working capital. It was being put in in the beginning of the
5 month and taken out at the end of the month, so there was no
6 balance of inventory at the beginning and at the end. So my
7 assumption is if that was the case, then it was expensed. So
8 there is no necessary carrying cost on that.

9 Q Okay. Okay. On Page 11 of your testimony you talk
10 about the, about Gulf Power's treatment of stored gas in
11 working capital. Do you see that discussion starting on Page,
12 I'm sorry, on Page 11, Line 11?

13 A Yes, I see that.

14 Q Do you know when the decision was made in the Gulf
15 rate case that you cite here in Docket Number 010949?

16 A Do I know --

17 Q The date of the decision.

18 A I don't think I have that with me. No, I don't.

19 Q Would you accept, subject to check, that the decision
20 was made May 8th, 2002, with an order issued June 10, 2002?

21 A Subject to check, yes.

22 Q And if that's correct, would you agree that that
23 decision was prior to the Commission's approval of the hedging
24 resolution in Docket Number 011605?

25 A Yes.

1 Q Okay. Turning to Page 12 of your testimony, do you
2 know whether the price of gas that is stored as the working
3 volume of gas in a gas storage facility varies from year to
4 year as gas is removed and new gas replaces it?

5 A Certainly the price of gas is volatile. The amount
6 of storage that they have in the gas storage would remain the
7 same, assuming that they don't increase their contract, the
8 amount of gas that they are allowed to put into storage. But I
9 would think that the -- depending on how they burn the gas out
10 of gas storage would tell you how volatile the change in the
11 value is. Once they put gas in, it's at a stated price, and
12 any carrying costs on that would remain the same.

13 Q But if the gas, sort of, the first load of gas is
14 removed, it is replaced by other gas at a different price.
15 That would change the dollar value of the inventory or the, you
16 know, amount that is stored in the gas storage facility,
17 wouldn't it?

18 A Assuming it was not the same price. But it just
19 depends on the different prices they were and how much gas they
20 took out. There are a lot of variables in that. It could be
21 the same, it could be different, just depending on what the
22 circumstances are.

23 Q Let me ask you to turn to the hedging order that
24 we've talked about previously, Order Number PSC-02-1484. Do
25 you have a copy of that?

1 A Yes, I do.

2 Q Okay. Can you point to anything in the hedging order
3 that limits cost recovery to the specific types of costs that
4 are set out as examples in the hedging resolution that's
5 attached to it?

6 A I think in Paragraph 3 of the settlement, the
7 proposed resolution of issues which is on Attachment A,
8 Paragraph 3 talks about the types of charges, and it
9 specifically spells out nonspeculative, prudently incurred
10 commodity costs and gains and losses associated with financial
11 and physical hedging transactions for natural gas, residual oil
12 and purchased power contracts. So that -- and then it goes on
13 to tell about the examples of transaction costs. Nowhere in
14 here does it mention carrying costs. And I don't even believe
15 that a carrying cost would even be part of a transaction cost.

16 The next paragraph underneath that, Number 4, only
17 talks about the incremental O&M expenses, the operating and
18 maintenance expenses associated with implementing that program.
19 And those charges are salaries, benefits and related employment
20 expenses associated with those folks that work on the hedging
21 program.

22 Q You've referenced what it specifically refers to.
23 What I'm trying to ask you about, Ms. Merchant, is if you look
24 at Order 14546 that we'd also talked about earlier, the order
25 that sets out kind of the types of costs that are recoverable

1 through the fuel clause, would you agree that it then goes on
2 to say there are other types of costs that are not recoverable
3 through the fuel clause, and those are base rate items and kind
4 of enumerates costs that would be in that category?

5 A Yes. Order Number 14546 talks about what items are
6 appropriate to go through the fuel clause and what items are
7 not appropriate.

8 Q Right. And I'm asking you whether you see anything
9 in the hedging order that is sort of the counterpart to the
10 latter portion of what we were just describing in Order Number
11 14546 that would say these types of costs are not properly
12 recoverable through the fuel clause.

13 A I think what the hedging order does is it goes
14 through and it amplifies that hedging costs are now going to be
15 considered fuel costs. They are, they are considering the
16 transaction costs of hedging to be volatile, and that is where
17 they're trying to spell it out that they want to encourage
18 utilities to implement programs.

19 But going into specifics as to volatile or not
20 volatile, it doesn't address that. But it's pretty specific
21 that it's talking about the transaction cost of hedging. And
22 then it goes on to talk about the O&M costs that are
23 incremental, and that's just to encourage the implementation.

24 Q Okay. But, again, you're pointing out what it says
25 is recoverable. Would you agree that there is nothing in it

1 that sort of turns around and says what is not recoverable as a
2 proper form of hedging related costs?

3 A The order -- the hedging settlement does not say what
4 is not appropriate. But I think that the hedging order was
5 amplifying what the original fuel order said and it didn't need
6 to go in and say what was not. But I believe it's pretty clear
7 that they were talking about financial. Most of the examples
8 that they give are financial hedging transaction costs, and it
9 was pretty clear that that's what they were talking about
10 implementing, the hedge itself, those types of costs.

11 Q Okay. But you didn't participate in any of the
12 discussions that led to the decision on what the hedging
13 resolution would say or what was intended to be approved by the
14 hedging order, did you?

15 A No, I didn't. But I think that the order is quite
16 clear on its face and it's easy to read in that regard.

17 Q And in that regard, again, it says nothing comparable
18 to what is said in Order Number 14546 spelling out types of
19 costs that would not properly be recoverable as hedging related
20 costs, does it?

21 A It doesn't say that, but I don't think that it needs
22 to do that. And I think that they already had that order, so
23 they didn't need to do that, and they were just trying to focus
24 on the hedging transactions.

25 Q You have said in your summary and in your testimony

1 that you believe recovery of carrying costs would be
2 inappropriate under FPL's 2005 rate case stipulation because
3 they are not properly considered hedging related costs that the
4 hedging order and resolution allows to be recovered; correct?

5 A No, that's not correct. What I said is it's not
6 appropriate to recover those costs through the fuel clause
7 because they are normal and historical base rate items. I am
8 not recommending denial of any recovery at all.

9 Q I'm sorry. That's not what I was meaning to ask you
10 about.

11 You have said that recovering the costs through the
12 fuel clause would violate the rate case stipulation if those
13 costs are not properly recoverable under the hedging order and
14 resolution; correct?

15 A If they were proper fuel costs, then it would, then
16 we would agree that they should go through the fuel clause.
17 If, if they're not hedging transaction costs and the
18 incremental O&M expenses associated with implementing the
19 hedging program, then you go back to the other order and, and
20 then you also go back to what's historically and traditionally
21 included in base rates. And that's where my testimony is is
22 that it's, you know, what's in fuel stays in fuel and what's in
23 base rates stays in base rates.

24 Q So if they're not properly hedging related costs that
25 ought to be recovered under the hedging order, then recovering

1 them through the fuel clause would violate the 2005 rate case
2 stipulation in your opinion?

3 A Any nonfuel costs would, yes.

4 Q Would you agree that the sort of flip side of that is
5 also true; that if the Commission were to determine that the
6 carrying costs could properly be recovered as hedging related
7 costs under the hedging order and hedging resolution, then
8 recovery of those costs through the fuel clause would not
9 violate FPL's 2005 rate case stipulation?

10 A If the Commission chose to allow recovery, then
11 that's the Commission doing it. But the settlement was that
12 FPL would not request recovery of historical and traditional
13 base rate items through any surcharge. And we don't
14 distinguish between a surcharge and fuel clause because that's
15 just taking things out of base rates and putting them into
16 other mechanisms.

17 Q But would you agree that if the Commission were to
18 determine that FPL's carrying costs were properly recoverable
19 pursuant to the hedging order and hedging resolution, then they
20 likewise would be properly recoverable through the fuel clause
21 under FPL's 2005 rate case stipulation and the subsequent
22 stipulation in the 2005 fuel adjustment clause docket?

23 A I don't, I don't believe that the limit is on the
24 Commission. The Commission can certainly put the cost in the
25 fuel clause if they so believe it's appropriate there.

1 But our -- my recommendation is that they analyze
2 what's appropriate to stay in fuel and what stays in base
3 rates, and that's where we would recommend that they draw the
4 line.

5 MR. BUTLER: Okay. Thank you. That's all the
6 questions that I have.

7 MR. BECK: Thank you, Madam Chairman.

8 REDIRECT EXAMINATION

9 BY MR. BECK:

10 Q Ms. Merchant, could you briefly tell us the
11 difference between O&M costs and carrying costs and what each
12 of them are?

13 A Well, operating and maintenance expenses are
14 salaries. There's -- they're the operating expenses of the
15 company. They're incurred every year. If they're not incurred
16 every year, they can be normalized. But they are salaries,
17 they are chemicals, they are all the costs incurred on an
18 annual basis to operate the company.

19 Carrying costs are the, it's the rate of return
20 component that the Commission allows the utility to earn on
21 their investment. And the carrying cost is debt, the recovery
22 of the interest cost, the rate of return on equity, the
23 inclusion of customer deposits, deferred income taxes; they're
24 all put in together to calculate the overall rate of return
25 that a utility is allowed to earn. And the Commission

1 determines that in a rate case or any other type of proceeding.
2 But that is the rate of return they're allowed on their
3 investment in utility plant-in-service.

4 Q Okay. Mr. Butler asked you some questions about the
5 Bay Gas contract that they have. Do you recall that?

6 A Yes.

7 Q Have you, have you looked at the Bay Gas contract
8 itself?

9 A I'm not sure that I have looked at FPL's Bay Gas
10 contract.

11 Q Okay. You were also asked some questions about costs
12 in the MFR. Do you recall that, Mr. Butler asking you some
13 questions related to that?

14 A Yes.

15 Q Okay. The agreement, the rate case settlement
16 agreement freezes base rates for a four-year period, does it
17 not?

18 A That's correct. Until 2009.

19 Q If Florida Power & Light incurs a new base rate type
20 of cost during the terms of the agreement that's not included
21 in the MFRs, does that mean that the company doesn't recover
22 that cost?

23 A Other than the ones that were specifically spelled
24 out in the settlement, any item that they add that's a base
25 rate type item or even an O&M expense item that they don't have

1 in their MFRs. Things change daily. There are expenses that
2 are included in the MFRs that go away after a rate case; there
3 are revenues included in the MFRs that might go up higher after
4 a rate case; there are all kinds of plant, lines, meters,
5 repairs, things that don't, that weren't originally projected
6 in the MFRs that happen daily after a rate case. Just because
7 they add new plant or they incur an incremental expense doesn't
8 mean they're earning a fair rate of return. You have to take
9 the whole picture as a whole and look at it and measure their
10 net income over their investment in their utility plant at a
11 certain point in time and see if they're earning a fair rate of
12 return. If they're not earning a fair rate of return, they're
13 not recovering their expenses, they're not recovering their
14 cost of capital, then that would be a different circumstance.
15 But if you're earning a fair rate of return and certainly
16 within the range of your last authorized rate of return, you're
17 recovering those costs even though they were outside of your
18 MFRs.

19 MR. BECK: Thank you. That's all I have.

20 COMMISSIONER DEASON: Madam Chairman, I have a
21 question.

22 CHAIRMAN EDGAR: Commissioner Deason.

23 COMMISSIONER DEASON: Yeah. I have a question. I
24 should have asked it earlier. I apologize.

25 Ms. Merchant, your recommendation for the base gas is

1 to amortize it over the 15-year period of the contract, and
2 that the unamortized balance just be considered a, a working
3 capital item that would be recovered in base rates; is that
4 correct?

5 THE WITNESS: That's correct.

6 COMMISSIONER DEASON: Okay. I think Mr. Butler asked
7 you about a decision the Commission made, and it was referenced
8 in Ms. Dubin's rebuttal testimony, it was Order Number 12645
9 and it addressed base coal, and that there was an amortization
10 period there that was utilized of five years. Are you, are you
11 familiar with that?

12 THE WITNESS: That's correct.

13 COMMISSIONER DEASON: Okay. Do you, do you know why
14 the Commission chose to amortize it over five years as opposed
15 to the life of the plant in that situation and -- that's the
16 first question.

17 The second question is is there any flexibility for
18 the Commission, if it were to follow your recommendation, to
19 amortize the base gas over a period shorter than 15 years?

20 THE WITNESS: The order does not state why they
21 changed and I don't have any information beyond that. It just
22 makes a statement at the end of the paragraph, we agree with
23 FPC, Gulf and Public Counsel -- excuse me. "However, we find a
24 shorter period of five years is more appropriate for the
25 depreciation of base coal," and it doesn't state why.

1 If the Commission so chose to do something less than
2 15 years, they could certainly do that. That's within your
3 discretion.

4 I was just recognizing that it has a 15-year life.
5 It's very similar to plant, you depreciate plant over the life
6 of that asset, and just matching it with the life that we know
7 that this contract has.

8 CHAIRMAN EDGAR: Commissioner Tew.

9 COMMISSIONER TEW: Thank you.

10 Hi, Ms. Merchant.

11 THE WITNESS: Good morning.

12 COMMISSIONER TEW: In your discussion with Mr. Butler
13 earlier there was a lot of discussion about the burning of base
14 coal versus the use of base gas. Do you remember that
15 exchange?

16 THE WITNESS: Yes, ma'am.

17 COMMISSIONER TEW: What would -- can you help me with
18 what would prompt the use of the base gas?

19 THE WITNESS: They can't use the base gas. The gas
20 is going to be in the storage container and you're not going to
21 be able to say this gas was burned. But they have to maintain
22 that allowance of the 50 percent in the cavern throughout the
23 life of the contract. So they can't burn it because it has to
24 stay in there to maintain the pressure for the rest of the
25 working gas. So physically the gas is going to move around,

1 the molecules are going to move around, so you won't be able to
2 measure that. But, but they will have to have some base gas
3 in, in the cavern the whole time.

4 COMMISSIONER TEW: Okay. Thank you.

5 Well, perhaps I misunderstood, but I thought what was
6 going on in that exchange was he was, he was asking you about
7 the difference in burning base coal, and I think that you said
8 that you would never burn the base coal, it stays on the pile,
9 but that there was a suggestion that there could be some point
10 where you would use the base gas.

11 THE WITNESS: Correct. That would be at the end of
12 the contract.

13 COMMISSIONER TEW: Okay.

14 THE WITNESS: They could burn it, they could sell it,
15 or they could keep it in there if they extended the contract,
16 but that's at the end of the contract.

17 COMMISSIONER TEW: Do you know if the same would be
18 true if -- at the end of the life of a coal plant, for
19 instance, would you burn the base coal?

20 THE WITNESS: I think I read that it's a different
21 type of quality coal. I don't know. I'm not an expert in
22 coal. But if you got rid of the coal pile, I'm not really sure
23 what you would do with it.

24 COMMISSIONER TEW: That's all I have. Thanks.

25 CHAIRMAN EDGAR: Commissioner Deason.

1 COMMISSIONER DEASON: Is it your understanding that
2 Florida Power & Light had the option of either purchasing the
3 base gas and supplying that or just having MoBay have the base
4 gas inserted and just included within the cost of renting the
5 storage?

6 THE WITNESS: Yes, they had that option. It was
7 spelled out in their contract, and they could lease it. But
8 then it would be subjected to the price changes. And it was
9 basically a monthly charge or an annual charge, 12 months, for
10 using that base gas, for requiring the use of the base gas. So
11 it was, it was a period cost at that point in time, but it was
12 subject to fluctuations.

13 COMMISSIONER DEASON: Do you have an opinion as to
14 whether the option chosen by FPL was least-cost to ratepayers?

15 THE WITNESS: I think it was -- we really don't know
16 actually because of the price of gas. Because you don't -- we
17 don't know today what the price of gas is going to be in ten or
18 15 years. But it's certainly less volatile to buy it.

19 COMMISSIONER DEASON: Less risky then?

20 THE WITNESS: Less risky. Well, you know the price.
21 It's like you know the price that you're paying. It's a
22 certain cost at a certain price, a certain volume, so -- as
23 opposed to waiting on to see what the price of gas would do in
24 the future. You just don't know.

25 COMMISSIONER DEASON: So would you agree then that

1 FPL's decision to supply its own base gas was consistent with
2 the intent of the hedging order to, to eliminate or to control
3 volatility?

4 THE WITNESS: Yes. I think it was reasonable to
5 implement or to purchase the base gas or to make the decision
6 to do that, so.

7 CHAIRMAN EDGAR: Commissioner Arriaga.

8 COMMISSIONER ARRIAGA: My question is for Mr. Beck.
9 Would you please -- I heard you during the opening statement
10 and I heard Ms. Merchant say that there's a potential violation
11 of the settlement agreement between FPL, OPC and other
12 intervenors. Is that correct?

13 MR. BECK: Yes.

14 COMMISSIONER ARRIAGA: Who is violating -- let's say
15 this Commission approves what FPL is requesting. Where is the
16 violation?

17 MR. BECK: The --

18 COMMISSIONER ARRIAGA: Or let me -- I'm sorry. Let
19 me finish because another thought just came to my mind. Or is
20 the fact that FPL is requesting this a violation in itself? I
21 don't understand the violation.

22 MR. BECK: All right. I'm not even sure I have the
23 settlement agreement in front of me.

24 The provision of the settlement agreement states
25 that, that FPL will not seek through, through new surcharges

1 costs that are traditionally and historically recovered in base
2 rates. We believe that by asking to recover the cost of gas
3 inventory, that that's what they're doing. They're seeking a
4 charge to recover an item that's normally recovered in base
5 rates. So there's -- you know, they contend not, we contend
6 they do, so there's the disagreement. We say that to do that
7 would violate the agreement. They say to do that does not.

8 COMMISSIONER ARRIAGA: So, in other words, just the
9 fact that we're here having this discussion, the violation has
10 occurred?

11 MR. BECK: I'd have to look at actual wording. If it
12 says seek, then it would have already occurred. I'd have to
13 look at -- I'm not sure. I think that's what it says, but I'm
14 not positive.

15 COMMISSIONER ARRIAGA: Do you have it with you?
16 Could you -- because to me it's a very important question.

17 MR. BECK: Somewhere in these papers.

18 John, do you have the paragraph number that it's on
19 or do you know? I mean, I've got the agreement here, but I've
20 got to simply find the --

21 MR. BUTLER: I do. I do. I think what we're
22 discussing, Commissioner Arriaga, is in Paragraph 3 of the
23 settlement, and it's the last sentence in Paragraph 3.

24 "During the term of this stipulation and settlement,
25 except as otherwise provided for in this stipulation and

1 settlement or except for unforeseen extraordinary costs imposed
2 by government agencies related to safety or matters of national
3 security, FPL will not petition for any new surcharges on an
4 interim or permanent basis to recover costs that are of a type
5 that traditionally and historically would be or are presently
6 recovered through base rates." I'm pretty sure that's the
7 provision that Mr. Beck is referring to.

8 MR. BECK: So, Commissioner Arriaga, if you're asking
9 me when did the violation of the agreement occur, you know, the
10 agreement, the agreement says FPL will not petition. So the
11 violation would have occurred at the time of the petition, if
12 that's your question.

13 COMMISSIONER ARRIAGA: That is the question. And
14 your answer is that the violation did occur?

15 MR. BECK: Yes, with the petition.

16 COMMISSIONER ARRIAGA: Okay. We're not part of that
17 agreement; right?

18 MR. BECK: The PSC approved the rate agreement. It's
19 not a signatory to it.

20 COMMISSIONER ARRIAGA: Right. And so wouldn't your
21 recourse be in the courts, not here?

22 MR. BECK: No.

23 COMMISSIONER ARRIAGA: There is a violation of an
24 agreement between two parties.

25 MR. BECK: We're not seeking a penalty or damages.

1 We're seeking to enforce the provisions by what you allow as
2 fuel costs and as base rate items. So we're not, we're not
3 going into court seeking damages for a violation. What we're
4 seeking is treatment of costs that's consistent with our
5 agreement.

6 COMMISSIONER ARRIAGA: May I continue, Madam Chair?

7 So if we did approve what FPL is requesting, your
8 next step would be to go to the court?

9 MR. BECK: Well, it would be to -- our next step
10 would be to appeal the order of the Commission, if we chose to
11 do that.

12 COMMISSIONER ARRIAGA: And we go ahead and say, yes,
13 we continue approving this request -- let's just say that --
14 I'm just going to hypothetical because to me, and you have
15 heard me say this before, the issue of settlements and the
16 Commission involvement in your settlements, to me, is an iffy,
17 very iffy situation. And here's a good example, here's a good
18 example of why I tend to have hands off the settlements. Who
19 violated and when?

20 MR. BECK: Commissioner, I think even without the
21 settlement we would have this disagreement with
22 Florida Power & Light that they're seeking to recover an item
23 through fuel that belongs in base rates. So settlement or no
24 settlement, we'd still have the disagreement.

25 Agreements are sometimes people differ. I mean,

1 reasonable minds can differ on the meaning of agreement. We
2 have a disagreement here, and it would be up to the Commission
3 to decide. I don't know what else I can tell you.

4 COMMISSIONER ARRIAGA: Thank you. It's complicated.
5 I appreciate your answer.

6 COMMISSIONER DEASON: Mr. Beck, maybe you should
7 reconsider your decision. If you sued for damages, you would
8 get attorney's fees if you won, would you not?

9 MR. BECK: I don't think -- is there a provision for
10 attorney's fees?

11 COMMISSIONER DEASON: I say that in jest, you know.
12 (Laughter.)

13 CHAIRMAN EDGAR: Commissioners, any further questions
14 for this witness?

15 Commissioner Carter.

16 COMMISSIONER CARTER: Thank you, Madam Chair.

17 I thought at the beginning you were talking about
18 legitimate costs should be recovered. Do you remember that
19 part when you first started out?

20 THE WITNESS: I beg your pardon, sir?

21 COMMISSIONER CARTER: You started off in your
22 discussion this morning of talking about, first of all, there's
23 some things that I agree with FPL on. The legitimate costs
24 should be recovered; right? Remember that?

25 THE WITNESS: Correct. Appropriate fuel-related

1 costs.

2 COMMISSIONER CARTER: Okay. Good. So you're saying
3 that this what they're requesting now is not an appropriate
4 fuel-related cost.

5 THE WITNESS: Correct. But I'm not saying that it
6 shouldn't be recovered. I'm saying this is a base rate type
7 item as opposed to a fuel type item. It's not that I'm saying
8 don't recover it. I'm certainly saying do recover it, and your
9 earnings are sufficient to recover it. But not through fuel,
10 just recover it through base rates.

11 COMMISSIONER CARTER: Permission to follow up, Madam
12 Chair.

13 So specifically how would they recover these costs?
14 You said they're legitimate costs, they just shouldn't be paid
15 under the current iteration of the payment schedule; right?

16 THE WITNESS: Through their base rates, yes. And
17 based on --

18 COMMISSIONER CARTER: But then, but then you can't
19 recover it through the base rates because of your agreement;
20 right?

21 THE WITNESS: No. We're saying they should recover
22 them through base rates and not pull them into fuel. That's --
23 it's a typical -- they can't ask for a surcharge outside of
24 base rates, that they should recover these costs through base
25 rates. And as of August, I looked at their surveillance

1 reports, and they're earning above the middle of the range a
2 very reasonable rate of return on their base rates. So these
3 costs would certainly be recovered and they'd still have, be in
4 the middle of the range of their rate of return on equity even
5 if these costs were allowed as of August of '06. So there's
6 certainly enough room in base rates for these types of costs to
7 be recovered and for them still to earn a reasonable and fair
8 rate of return on their debt and equity and overall carrying
9 costs.

10 COMMISSIONER CARTER: Were you listening to -- excuse
11 me, Madam Chair.

12 Were you listening to the questions from the bench in
13 the context of whether or not these -- I think in a response to
14 Commissioner Arriaga, just the mere request of these rates was
15 a violation of the agreement.

16 THE WITNESS: To take them out of base rate recovery.

17 COMMISSIONER CARTER: That's not what was said. Just
18 the requesting of these. Did I hear that right?

19 COMMISSIONER ARRIAGA: That is correct.

20 THE WITNESS: I don't believe that that's correct.
21 What we're saying is that they should be base rate recovery
22 items. And if they request recovery outside of base rates,
23 then that is a violation of the settlement.

24 COMMISSIONER CARTER: Commissioner Arriaga -- Madam
25 Chairman.

1 Commissioner Arriaga asked specifically the nature of
2 the violation. So he said, "Is the violation just the mere
3 fact that you ask for these?" And the answer was, "Yes,"
4 unless I misheard you.

5 MR. BECK: No. That's correct.

6 COMMISSIONER CARTER: Was I in the right room?

7 MR. BECK: The agreement, Commissioner, says FPL will
8 not petition for any new surcharges or interim permanent basis
9 to recover costs that are a type traditionally and historically
10 would be or presently recovered through base rates.

11 What we're telling you is that when they petition for
12 this, they're petitioning for a type of cost that traditionally
13 and historically would be part of base rates, which is what
14 your own staff told you in an earlier recommendation. So I
15 guess I don't really see the point of determining the exact
16 moment of the violation. Maybe I'm just missing it. We're
17 saying that by doing this, it's inconsistent with the
18 agreement.

19 COMMISSIONER CARTER: That's what I thought you said.

20 MR. BECK: Yes.

21 COMMISSIONER CARTER: Just the mere fact that they
22 asked for it is a violation of the agreement.

23 MR. BECK: Right. Because the agreement says FPL
24 will not petition. So when they petitioned, that would be the
25 moment of a violation, if you want to look at it that way.

1 Of course, as I also said, we'd be here regardless
2 even if it said that. We think they're seeking something that
3 traditionally and historically is a base rate item. So that
4 would be a violation of Commission policy as well. I mean,
5 that's what this is all about. That's what we've been talking
6 about, you know, whether, whether this is a, these are the
7 types of costs that historically and traditionally are base
8 rate items.

9 CHAIRMAN EDGAR: Commissioner Deason.

10 COMMISSIONER DEASON: Mr. Beck, when you had
11 Mr. Butler read the provision within the settlement that was in
12 question -- and if you have that in front of you now, certainly
13 refer to it. But as I recall, there was some, there was some
14 qualifying language, something to the effect as to the extent
15 not otherwise provided for within this order or within this
16 agreement. And I guess the question is that may be subject to
17 interpretation as to whether hedging costs are somehow
18 otherwise provided for within the agreement. I'm not making --
19 I'm not saying it is or is not part of hedging. But I guess
20 the question I have to you is could a reasonable person believe
21 that the request was covered by another provision within the
22 agreement? That's the question, and I'd like your take on
23 that.

24 MR. BECK: Yes. The provision in the agreement says,
25 "except as provided in Section 1." So, you know, by that kind

1 of wording, it says, if it's allowed elsewhere, that would be
2 allowed. I don't think that's where the dispute is. I think
3 everything we were litigating before you is the provision about
4 whether this is an item traditionally and historically
5 recovered through base rates, and that's what we, that's what
6 all the evidence --

7 COMMISSIONER DEASON: Could you read aloud again
8 that, that particular passage?

9 MR. BECK: You want the entire paragraph or the
10 provision?

11 COMMISSIONER DEASON: Could you read the entire
12 paragraph, please?

13 MR. BECK: Sure. "Except as provided in Section 1,
14 no party to the stipulation and settlement will request,
15 support or seek to impose a change in the application of any
16 provision hereof." And it lists all the parties, "will neither
17 seek nor support any reduction in FPL's base rates and charges,
18 including interim rate decreases, to take effect prior to the
19 end of the minimum term of the stipulation and settlement,
20 unless a reduction request is initiated by FPL. FPL will not
21 petition for an increase in its base rates and charges,
22 including interim rate increases, to take effect for meter
23 readings before the end of the minimum term except as provided
24 for in Section 6. During the term of this stipulation
25 settlement, except as otherwise provided for in this

1 stipulation and settlement, or except for unforeseen
2 extraordinary costs imposed by government agencies relating to
3 safety or matters of national security, FPL will not petition
4 for any new surcharges on an interim or permanent basis to
5 recover costs that are of a type that traditionally and
6 historically would be or are presently recovered through base
7 rates."

8 (Transcript continues in sequence with Volume 8.)

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1 STATE OF FLORIDA)
 :
2 COUNTY OF LEON) CERTIFICATE OF REPORTER

3

4 I, LINDA BOLES, CRR, RPR, Official Commission
Reporter, do hereby certify that the foregoing proceeding was
5 heard at the time and place herein stated.

6 IT IS FURTHER CERTIFIED that I stenographically
reported the said proceedings; that the same has been
7 transcribed under my direct supervision; and that this
transcript constitutes a true transcription of my notes of said
8 proceedings.

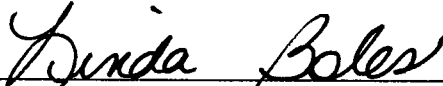
9 I FURTHER CERTIFY that I am not a relative, employee,
attorney or counsel of any of the parties, nor am I a relative
10 or employee of any of the parties' attorneys or counsel
connected with the action, nor am I financially interested in
11 the action.

12 DATED THIS 9th day of November, 2006.

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