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Matthew M Childs P.A.

November 3, 1997

Ms. Blanca S. Bayó, Director
Division of Records and Reporting
Florida Public Service Commission
4075 Esplanade Way, Room 110
Tallahassee, FL 32399

RE: DOCKET NO. 970410-EI

Dear Ms. Bayó:

In accordance with the directives of Order No. PSC-97-1035-PCO-EI, enclosed for filing please find the original and fifteen (15) copies of the Rebuttal Testimony of Hugh Gower filed on behalf of Florida Power & Light Company in the above referenced docket.

Very truly yours,

Matthew M. Childs, P.A.

MMC:ml

ACK

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cc: All Parties of Record

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**CERTIFICATE OF SERVICE
DOCKET NO. 970410-EI**

I HEREBY CERTIFY that a true and correct copy of Florida Power & Light Company's Rebuttal Testimony of Hugh Gower has been furnished by Hand Delivery (*), U.S. Mail and Courier (**), and U.S. Mail (***) this 3rd day of November, 1997, to the following:

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Matthew M. Childs, P.A.

ORIGINAL

**BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION**

**DOCKET NO. 970410-EI
FLORIDA POWER & LIGHT COMPANY**

NOVEMBER 3, 1997

**IN RE: PROPOSAL TO EXTEND PLAN FOR
THE RECORDING OF CERTAIN EXPENSES
FOR THE YEARS 1998 AND 1999 FOR
FLORIDA POWER & LIGHT COMPANY**

REBUTTAL TESTIMONY OF:

H. A . GOWER

DOCUMENT NUMBER-DATE

11290 NOV-35

FPSC-RECORDS/REPORTING

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **REBUTTAL TESTIMONY OF HUGH A. GOWER**

4 **DOCKET NO. 970410-EI**

5 **NOVEMBER 3, 1997**

6

7

8

9

Q. Please state your name and address.

10

**A. My name is Hugh Gower and my address is 195 Edgemere Way, S., Naples,
11 Florida 34105.**

12

13

Q. Have you previously filed direct testimony in this proceeding?

14

A. Yes, I have.

15

16

Q. What is the purpose of your rebuttal testimony?

17

**A. The purpose of my rebuttal testimony is to respond to certain erroneous and
18 misleading assertions contained in Mr. Mark A. Cicchetti's testimony on behalf
19 of AmeriSteel Corporation. Also, I will point out how his conclusions
20 misconstrue the purpose of the plan contained in Order No. PSC-97-0499-
21 FOF-EI and ignore key facts as well as the benefits to customers who will be
22 served by FPL for the longer term.**

23

24

Q. What erroneous assertions does Mr. Cicchetti make about the plan?

1 A. First, Mr. Cicchetti asserts (page 7, lines 11-13 and page 15, lines 21-23) that
2 "The plan allows FPL to accelerate expenses that are appropriately attributable
3 to future periods..." and that the purpose of the plan is to eliminate "...potential
4 stranded costs." (page 16, lines 7-8). These assertions completely fail to
5 recognize that depreciation reserve deficiencies, fossil plant dismantlement
6 reserve deficiencies, nuclear plant decommissioning reserve deficiencies and
7 prior years' income tax flow through amounts -- the majority of the costs
8 addressed by the plan -- are all costs which are attributable to prior years. Had
9 information been available at the time, FPL (with the Commission's approval)
10 would have recovered these costs in prior years. Since these costs were not
11 recovered in prior years, they remain to be recovered now, and the plan
12 proposes to correct for the prior cost underrecoveries as quickly as
13 economically practicable. Misunderstanding the nature of these items would
14 be a prerequisite for asserting these items "... are appropriately attributable to
15 future periods."

16
17 Second, Mr. Cicchetti's assertion that the purpose of the plan is the elimination
18 of potential stranded costs is nothing but an unsupported interpretation. As the
19 Commission's order states, the plan addresses prior cost underrecoveries.
20 Neither does Order No. PSC-97-0499-FOF-EI mention stranded costs nor has
21 any determination of stranded costs been made.

22
23 Q. Is Mr. Cicchetti's claim (page 7, lines 13-15) that the plan "...removes
24 incentives for management efficiency inherent in traditional ratemaking
25 practices..." correct?

1 A. No, contrary to Mr. Cicchetti's claim, the requirement of the plan is that FPL
2 record additional expenses which, based on the experience in 1995, 1996 and
3 1997 under Order No. PSC-96-0461-FOF-EI will be significant in amount. The
4 effect of this requirement is that the Commission has "captured" these
5 amounts of potential revenue growth for the customers' benefit and that
6 revenue growth is therefore not available to offset expense increases. This
7 heightens -- not eliminates -- the pressure to control expenses or suffer
8 earnings below authorized levels. Operating expenses applicable to base
9 rates include operation and maintenance, depreciation, taxes other than
10 income and income taxes. Of these categories, operations and maintenance
11 expenses are the only costs controllable by management in the short run. But
12 since operations and maintenance constitute only 42% of the total, this task is
13 more daunting than it might seem to the uninformed. Further, Mr. Cicchetti's
14 assertion ignores the substantial efforts of FPL's management, now ongoing
15 for several years, to control and reduce its costs. These efforts have reduced
16 operation and maintenance expenses for 1996 below 1988 levels while FPL
17 produced 31% more kilowatt hours and served 20% more customers. These
18 efforts have also reduced debt cost rates 17% from 1988 to 1996 while FPL
19 met the need to increase total invested capital by more than \$1,250,000,000
20 ---and avoided any increase in base rates--- during that same period.

21
22 Q. Will implementation of the Commission's plan in this docket result in FPL
23 having "unreasonable rates" as Mr. Cicchetti claims (page 7, line 17)?

24 A. No, it will not. As Mr. Cicchetti himself notes (page 17, lines 21-24), FPL's
25 rates are presently low relative to Florida and the Southeast. Beyond that,

1 according to surveys of the Florida Electric Cooperative Association and the
2 Florida Municipal Electric Association, FPL's rates are below the average rates
3 for Florida's municipal and cooperative electric distributors --- none of which
4 has federal or state income taxes as operating expenses as does FPL. In
5 addition, surveys by the Public Utility Commission of Texas and Jacksonville
6 Electric Authority show FPL's rates are lower than many utilities located
7 outside the Southeast.

8

9 Further, although FPL's surveillance reports are continuously audited by the
10 FPSC Staff, no major questions regarding the allowability of expenses has
11 been raised. This, together with earnings within the Commission's allowed
12 ranges, suggests rates are reasonable.

13

14 Since under the Commission's plan in this docket FPL's rates will not change,
15 they will remain reasonable --- not become unreasonable.

16

17 **Q. Is Mr. Cicchetti's claim (page 7, lines 17-18) that the plan will result in**
18 **"excessive compensation" to FPL correct?**

19 **A.** No, it is not. As the Commission and Mr. Cicchetti are both aware, under cost-
20 based rate regulation, investors are entitled to "return of" and "return on" the
21 capital they provide. By definition, "compensation" cannot be "excessive"
22 unless the returns achieved on investors' capital is beyond reasonable limits,
23 usually denoted by the allowed rate of return. As should be obvious, the plan
24 in this docket deals with the "return of" investors' capital. And the additional
25 expenses recorded by FPL pursuant to the Commission's directives in Docket

1 No. 950359-EI and which may be recorded pursuant to the directives in this
2 docket have not, and will not, provide any additional "return on" the capital
3 provided by FPL's investors. What the additional recorded expenses have and
4 will provide is the "return of" investors' capital. The only effect the additional
5 expenses recorded under the plan have had or will have on compensation to
6 FPL's investors is to reduce it... unless FPL's management can succeed in
7 controlling the Company's other expenses and avoid reductions in achieved
8 earnings below authorized levels.

9
10 Q. Mr. Cicchetti states (page 7, lines 17-19, page 18, lines 18-23 and page 19,
11 lines 1-8) that the plan in this docket "...results in... Intergenerational
12 inequity." Is this correct?

13 A. On the contrary, this plan corrects "intergenerational inequity". As is obvious
14 from reading Order No. PSC-97-0499-FOF-EI, the majority of the items
15 addressed by the plan represent costs which should have been recovered in
16 prior years when customers received the service to which the costs relate.
17 (Specifically, I refer to depreciation reserve deficiencies, prior year income tax
18 flow through amounts, nuclear plant decommissioning and fossil plant
19 dismantlement reserve deficiencies.) As to these costs, the "intergenerational
20 inequity" has already occurred and, if not corrected by the plan, would only
21 become more inequitable.

22
23 Yet, the only item Mr. Cicchetti seems willing to discuss in connection with
24 "intergenerational equity" is the cost of reacquiring high cost debt -- the only
25 item covered by the plan for which "intergenerational equity" is the least

1 applicable.

2

3 Q. Why is "intergenerational equity" less applicable to the cost of
4 reacquiring debt than other items covered by the plan?

5 A. The main point of equity related to the cost of reacquiring high cost debt is this:
6 since customers will get the benefit of lower debt costs, investors are entitled
7 to recover the capital they have provided to finance the reacquisition. The
8 question of when investors get recovery and when and how much benefit
9 customers get is less critical. This latter aspect is reflected in different
10 Commission decisions which have alternatively directed (a) immediate write-
11 off, (b) immediate write-off for part and amortization for part, and (c)
12 amortization over the remaining life of the reacquired security.

13

14 Under the "amortization over the remaining life" plan, investors' capital
15 recovery is effected over perhaps 20 years and customers benefit from part of
16 the savings (reduced interest less reacquisition cost amortization) from the
17 date of the reacquisition. The plan in this docket would merely effect recovery
18 of investors' capital much sooner -- without increasing FPL's rates -- and lower
19 capital costs included in cost of service by eliminating the amortization of debt
20 reacquisition costs. This preserves the main point of equity related to the
21 treatment of debt reacquisition costs. Investors still recover their capital and
22 customers still get the interest savings but the full interest savings will be
23 reflected in a reduced cost of service sooner. This result is achieved by the
24 Commission's action which not only maintains rate stability but also lowers
25 future costs by allowing the recovery of capital investments which financed

1 reacquisition of debt on an accelerated basis as it has in selected other cases.

2

3 Q. In what other cases has the Commission allowed accelerated recovery of
4 capital investment?

5 A. The Commission has allowed recovery of capital investments on an
6 accelerated basis in cases where such capital investments provide savings to
7 customers and such investments are not covered by base rates. A good
8 example is the Oil Backout Cost Recovery Factor approved by the Commission
9 in Order No. 11188, dated September 23, 1982. This rule was designed to
10 encourage reduced reliance on expensive oil-fired generation and directed that
11 two-thirds of the "oil/non-oil" savings from eligible projects be recorded as
12 additional depreciation, thus accelerating the recovery of capital invested in oil
13 backout projects. An extension of this policy was reflected in Order No. PSC-
14 94-1106-FOF-EI issued September 7, 1994. In that decision the Commission
15 approved FPL's recovery through the Fuel and Purchased Power Cost
16 Recovery Clause of the cost of converting two of its generating units to have
17 the capability to burn Orimulsion. Similar to Order No. 11188, this decision
18 directed that one-half of the associated fuel savings be recorded as additional
19 depreciation.

20

21 Similarly, the Commission has authorized accelerated recovery through the
22 Fuel and Purchase Power Cost Recovery Clause of the cost of plant
23 modifications which result in significant savings in fuel costs. Recovery
24 periods are accelerated over as little as six months. Examples would include
25 Order No. PSC-95-0450-FOF-EI in which the Commission authorized FPL's

1 recovery of \$2,754,502 of plant modification costs during the April through
2 September 1995 period. Likewise, in Order No. PSC-97-0359-FOF-EI, the
3 Commission authorized recoveries of plant conversion and modification costs
4 by both Florida Power Corporation ("FPC") and FPL. In FPC's case, recovery
5 was authorized over 5 years and in FPL's case over 3 years.

6
7 The Commission has also approved payments to qualifying facilities by utilities
8 pursuant to standard capacity and energy purchase contracts. Payments may
9 commence at any time after the specified early capacity payment date (an
10 approximation of the lead time required to site and construct the avoided unit)
11 and before the anticipated in-service date of the avoided unit. Such
12 "prepayments" are recoverable currently by the utility under the Capacity Cost
13 Recovery Clause.

14
15 In each case just cited, the Commission's approval of accelerated capital
16 recovery meant increased current billings to customers. In contrast, the
17 accelerated recovery of debt reacquisition costs directed in this docket will not
18 require price changes.

- 19
20 Q. Mr. Cicchetti argues (page 16, lines 9-19) against making the capital
21 recovery corrections in the manner proposed in this docket because the
22 book value (cost less accrued depreciation) of FPL's nuclear and fossil
23 generating units is below industry average book values. Is this relevant?
24 A. No, neither the fact that the book value of FPL's nuclear and fossil generating
25 units is below industry averages nor how well-suited FPL may be to meet

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future competition are relevant to the issues in this docket.

The relevant issue regarding depreciation of FPL's generating units is (regardless of their cost) how much should have been depreciated as of the date of the last required comprehensive depreciation study. Staff's calculations show that at January 1, 1994, FPL's generating units were "under-depreciated" by \$235,642,000.

While the information Mr. Cicchetti cites here is a positive statement regarding FPL's ability to manage its construction costs which should please those of its customers concerned with the price of electricity, FPL's relative position in the industry insofar as exposure to competition is irrelevant to proper depreciation accounting as long as FPL remains subject to cost-based price regulation.

Q. Please respond to Mr. Cicchetti's claim (page 14, lines 21-23) that depreciation reserve deficiencies are normally corrected over the life of the associated facilities.

A. While there are many cases in which the corrections are made over the remaining life, there are also numerous cases (cited in my direct testimony and not repeated here) in which the Commission has made such corrections over much shorter periods. Further, making such corrections promptly without changing prices seems prudent because it avoids compounding risk associated with future uncertainties by deferring known deficiencies to future periods.

1 Q. Mr. Cicchetti argues (page 26, lines 9-11) that "there is no demonstrated
2 need to allow the write-off of... reserve deficiencies..." for nuclear plant
3 decommissioning and fossil plant dismantlement. Is this true?

4 A. No it is not. The demonstration of this need is evidenced by the Commission's
5 orders approving the accrual rates for these costs. According to Order No.
6 PSC-95-1531-FOF-EI at the date of the latest decommissioning cost studies,
7 the estimated current cost had increased 77% over the estimate made 5 years
8 earlier. FPL's nuclear units, on average, have been in service for 50% of their
9 estimated useful lives, but at December 31, 1996 the decommissioning reserve
10 amounted to less than 12% of the estimated total future expenditures to be
11 made for decommissioning costs. The need to address this reserve deficiency
12 is rather obvious. A similar but smaller problem exists for fossil plant
13 dismantlement since accruals were not begun until 1987, while the in-service
14 dates of many of the units was 20 years prior to that. Faced with this
15 knowledge, it would be irresponsible to delay correction of these
16 underrecoveries as Mr. Cicchetti suggests.

17
18 Q. Mr. Cicchetti further argues against the plan in this docket (page 17, lines
19 7-17) on the basis that New England Electric System ("NEES") recently
20 sold 4000 MW of generating assets at a price which suggests the value of
21 FPL's generating assets is "...almost \$3 billion over their book value". Is
22 this true?

23 A. It is true that NEES recently contracted to sell 3,962 MW of fossil and
24 hydroelectric generating facilities and 1,155 MW of purchased capacity to US
25 Generating Co. (a subsidiary of Pacific Gas & Electric Company) for a price of

1 \$1.59 billion or \$311 per KW. While this is true, it is neither relevant to the
2 issues addressed by the plan in this docket, nor true that it suggests that FPL's
3 generating assets are undervalued.

4
5 **Q. Why doesn't the NEES sale suggest that FPL's generating assets are**
6 **undervalued?**

7 **A. First, the NEES sale was motivated by the terms of the industry restructuring**
8 **plans in the states in which it operates. The terms of the restructuring plans**
9 **may affect values, but since there are no industry restructuring terms**
10 **applicable to Florida, no valid inference can be drawn.**

11
12 Second, generating asset competitive values in NEES' service territory are
13 influenced by the costs or values of competitive power sources. Whatever
14 those are in New England is very likely to be different from the costs or values
15 of competitive power which might become available in Florida.

16
17 Thirdly, the marginal operating costs of the generating assets in question
18 relative to the costs of competitive power sources influence values. We don't
19 know the operating costs of the generating assets NEES sold, but we do know
20 that the operating costs of the 1,167 MW of hydroelectric generating capacity
21 NEES sold will be substantially different than the operating costs of any of
22 FPL's generating units.

23
24 For all of these reasons, the price realized by NEES cannot be "translated" into
25 a value for FPL's generating assets as Mr. Cicchetti suggests. But more

1 importantly, whatever the NEES sale does suggest is irrelevant to this
2 proceeding.

3
4 **Q. Why would values suggested by sales of other utilities generating assets
5 be irrelevant to this proceeding?**

6 **A.** Because, as pointed out earlier, this proceeding deals with issues of cost
7 recoveries under the terms of cost-based price regulation. Only historical
8 recorded costs and capital investments enter into consideration --- not market
9 values. But if Mr. Cicchetti's asserted market value for FPL's generating
10 assets were correct, those of its customers concerned with electricity prices
11 --including Ameristeel-- should be delighted with the bargain provided by
12 original cost-based prices.

13
14 **Q. Does the estimate by Resource Data International, Inc. ("RDI") that FPL's
15 assets are undervalued by nearly \$900 million relative to their expected
16 value in a competitive generation market cited by Mr. Cicchetti (staring at
17 page 16, line 19) provide relevant data to this proceeding?**

18 **A.** No, it does not. This proceeding, contrary to Mr. Cicchetti's assertions, does
19 not deal with stranded costs but rather underrecoveries of historical costs in
20 prior years.

21
22 Just to set the record straight, estimates of stranded costs have been
23 published by Moody's Investors Service, Resource Data International, and
24 Smith Barney, to name a few. The estimates vary, ranging from RDI's
25 "negative" stranded cost of \$895 million to Smith Barney's stranded cost

1 exposure estimate of \$2.698 billion. Each of the studies is based on certain
2 assumptions and estimates and their accuracy depends on how closely
3 subsequent developments correspond to those assumptions and estimates as
4 well as the representational faithfulness of the information used in underlying
5 calculations.

6
7 No determination of stranded costs has been made, nor can it be made at this
8 time.

9
10 **Q. Mr. Cicchetti further criticizes the plan (starting at page 25, line 24) as**
11 **allowing FPL to "...manipulate its earnings and achieved return..." and**
12 **suggests FPL might "...incur an expense the Commission might not**
13 **normally allow..." (page 21, lines 1-7). Are these criticisms valid?**

14 **A.** No, they are not valid criticisms. Rather they are desperate, unsupported
15 claims made when no real customer-perspective complaint about the plan can
16 be identified. What possible motive would FPL have for incurring "unallowable"
17 or "illegitimate" expenses instead of the write-offs authorized by the plan (as
18 Mr. Cicchetti suggests on page 21) when a major focus of management for
19 several years has been to control and reduce costs? The obvious answer is
20 "none". (Even if FPL were so motivated, FPL's earnings and expenses are
21 subject to ongoing continuous review by the FPSC Staff.) And the
22 Commission's providing FPL some flexibility along with the requirement to
23 record substantial additional expenses is a far cry from "allowing FPL to
24 manipulate its earnings". The Commission's policy (evidenced by orders cited
25 in my direct testimony and not repeated here) of providing for recovery of costs

1 attributable to prior years "as fast as economically practicable" wisely
2 recognizes the need to allow reasonable earnings to investors. That policy
3 further recognizes that inconsistent earnings signal "risk" to investors and such
4 a signal would have adverse implications to the cost of capital. Insofar as Mr.
5 Cicchetti's claim that FPL might attempt to "manage" its earnings, only an
6 incompetent management would ignore the earnings consequences of its
7 actions. What FPL management has been able to do under the Docket No.
8 950359-EI plan through August 1997 is continue to control and reduce its costs
9 while absorbing \$441,541,000 of additional expense and achieving earnings
10 within the allowed range authorized by the Commission. What FPL, under the
11 Commission's direction, succeeded in managing was important capital
12 recovery, but a great deal remains to be done on that task.

13
14 **Q. Mr. Cicchetti also points (page 18, lines 10-14) to increases in FPL**
15 **Group's common stock prices and FPL's debt ratings as evidence there**
16 **is no need for the plan in this Docket. Do you agree?**

17 **A. No, I do not. While it's true that FPL Group's common stock price rose 41%**
18 **during the 5 year period ended September, 1997, during that same period the**
19 **Dow Jones Industrial Average ("DJIA") and the Russell 2000 Index increased**
20 **142% and 135%, respectively. This suggests that FPL's success in controlling**
21 **and reducing its costs together with the regulatory policies reflected in Docket**
22 **No. 950359-EI (as well as other Commission orders relative to cost recoveries)**
23 **have enabled FPL Group to realize some improvement in its share values, but**
24 **not nearly so great as the market as a whole. Improving the market value of**
25 **shares and maintaining good quality debt ratings is important because it can**

1 help keep capital costs from increasing and will be beneficial to customers
2 served by FPL for the longer term.

3

4 **Q. Please summarize your testimony.**

5 **A. My testimony has shown that the information offered by Mr. Cicchetti in his**
6 **testimony is either irrelevant or misinterpreted, and he has misconstrued the**
7 **purpose of the plan in this docket. Consequently, his conclusions are flawed.**
8 **The proposed agency actions in this docket should be approved by the**
9 **Commission because it will benefit the majority of FPL's customers whom it will**
10 **serve for the longer term since it corrects prior cost under-recoveries, reduces**
11 **the amount of investor supplied capital needed to finance the business and**
12 **mitigates future cost increases that might otherwise occur.**

13

14 **Q. Does this conclude your testimony?**

15 **A. Yes, it does.**