

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

**In re: Review of Florida Power
Corporation's Earnings, Including Effects
of Proposed Acquisition of Florida Power
Corporation by Carolina Power & Light**

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**DIRECT TESTIMONY
OF
JAVIER J. PORTUONDO

ON BEHALF OF
FLORIDA POWER CORPORATION**

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**DIRECT TESTIMONY OF JAVIER J. PORTUONDO
ON BEHALF OF FLORIDA POWER CORPORATION**

1 **I. Introduction and Summary.**

2 **Q. Please state your name, position, and business address.**

3 A. My name is Javier J. Portuondo. I am Manager of Regulatory Services for Florida
4 Power Corporation (“Florida Power” or the “Company”). My business address is
5 Florida Power Corporation, 100 Central Avenue, St. Petersburg, Florida, 33701.

6

7 **Q. Please describe your educational and employment background.**

8 A. I have a Bachelors of Science degree in accounting from the University of South
9 Florida. I have been Florida Power’s Manager of Regulatory Services since 1996.
10 Prior to my employment as the Manager of Regulatory Services, I have held a
11 number of various financial positions with the Company throughout the
12 Company’s controller department.

13

14 **Q. What are the responsibilities of your present position?**

15 A. As the Manager of Regulatory Services for the Company my responsibilities
16 include the regulatory accounting, fuel accounting, and pricing departments
17 within the Company.

18

19 **II. Purpose and Summary of Testimony.**

20 **Q. What is the purpose of your testimony?**

1 A. I am providing testimony relevant to the issues whether a refund ought to be
2 ordered at the conclusion of this rate case, and, if so, how much should be
3 ordered.

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

6 A. In its ruling, the Florida Public Service Commission (the "Commission") directed
7 that \$97,970,532 of revenues collected by Florida Power during the interim period
8 (during the pendency of this rate case) will be subject to refund at the conclusion
9 of the case, if Florida Power exceeds its authorized earnings range established in
10 this case for prospective rates. It is my understanding that the Commission
11 ordered that these monies be collected subject to refund based on a concern that
12 three expenses taken in 2000 might not have continuing impacts and thus might
13 be "nonrecurring" expenses. These three expenses are (1) \$64.6 million in merger
14 costs, (2) \$63 million in accelerated amortization of the Tiger Bay regulatory
15 asset, and (3) \$10.7 million in additional amortization of regulatory assets for
16 previously flowed through taxes and the equity component of prior period
17 Allowances for Funds Used During Construction.

18
19 Based on information available to the Company, however, I can now state
20 that two of these expenses (merger costs and accelerated amortization of the Tiger
21 Bay regulatory asset) will in fact have continuing impact on the Company's
22 earnings.

23

1 Finally, in calculating whether or to what extent a refund may be
2 warranted, the Commission should determine the amount of earnings that would
3 place the Company inside the maximum end of whatever range is established
4 prospectively, as opposed to the mid-point of the range since the very idea of the
5 range is to recognize that in any given year, due to normal year-to-year variations
6 in revenues and expenses, the Company might earn just above or just below the
7 mid-point while still earning a fair and reasonable rate of return.

8
9 **III. Recurring Impact of Disputed Expenses.**

10 **Q. Are the merger costs recorded by Florida Power for the 12-month period**
11 **ending February 28, 2001, representative of continuing expenses of the same**
12 **nature?**

13 **A.** Yes. We recorded \$64.6 million in merger costs during that period, in December
14 2000, to be precise, reflecting the amount of severance expenses that the
15 Company incurred to bring about the consolidation of programs and functions
16 made possible by its recent merger. The \$64.6 million in merger costs recorded in
17 December 2000 was then excluded from the year 2000 for earnings surveillance
18 purposes and included in 2001 to match the cost savings (merger synergies)
19 resulting from the merger. As explained more fully in the Direct Testimony of
20 Mark A. Myers, filed September 14, 2001, our ability to reduce labor costs was a
21 major advantage of the merger, and it will produce cost savings (merger
22 synergies) for years to come. In fact, it is important to view these severance costs
23 as just part of the costs that the Company had to incur in order to bring about the

1 merger. The costs may not be viewed in isolation from the merger. This fact may
2 be appreciated by recognizing that we would not have been able to eliminate or
3 consolidate the number of positions we did without the merger and our
4 corresponding ability to rely upon the combined resources and economies of scale
5 of the newly combined companies.

6
7 We booked the entire amount of this one category of costs (severance
8 benefits) in 2000 because GAAP rules required the Company to recognize the
9 costs in the year that they were quantifiable. However, the Company cannot
10 spread these costs past the year in which they were incurred without regulatory
11 approval. But the fact is there are other merger costs that must be fairly taken into
12 account for the year 2001 and beyond in order to arrive at a fair and realistic
13 understanding of the costs and benefits of the merger, and to arrive at appropriate
14 rate treatment of these costs and benefits. As Mark Myers and Dr. Charles J.
15 Cicchetti explain more fully in their Direct Testimony of September 14, 2001, the
16 Commission should net merger costs against merger benefits to arrive at “net”
17 synergies for ratemaking purposes. As they further explain, if Florida Power’s
18 share of merger costs is spread over a 15-year period, as Dr. Cicchetti proposes,
19 the annual acquisition adjustment (necessary to offset synergies prior to net
20 benefits) will equal \$58.7 million, beginning in 2001. If Dr. Cicchetti’s proposal
21 is accepted, this means that the Company will be recognizing merger costs for
22 purposes of ratemaking in the amount of \$58.7 million per year for 15 years. By
23 any measure, these costs are clearly recurring.

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Accordingly, of the \$64.6 million recorded in 2000, only \$5.9 million would be technically “non-recurring” (constituting the difference between \$64.6 million and \$58.7 per year). Under the Commission’s ruling, \$58.7 million should be taken out of the total funds held subject to refund.

Q. Will the Company accelerate the amortization of the Tiger Bay regulatory asset during the interim period?

A. Yes. We are anticipating accelerating approximately \$30 million in 2001 and \$9 million in 2002 during the pendency of the rate case. Accordingly, the acceleration of amortization of the Tiger Bay regulatory asset is also recurring, at least to the extent of this \$39 million. Under the Commission’s order, the amount of funds subject to refund should be reduced by this \$39 million.

IV. Calculation of Refund Using Maximum End of Range.

Q. In the event the Commission orders a refund, should the Commission calculate the refund to reduce Florida Power’s earnings to the mid-point of any new earnings range established in this proceeding, or to an amount falling within the maximum of the range found to be fair and reasonable on a prospective basis?

A. The latter; otherwise, the Commission would be ordering the Company to refund revenues that it would be free to earn in any other year under the Company’s new rate structure. In the past, the Commission has calculated refunds based on the

1 maximum of the new range. In 1990, for example, the Commission ordered
2 Florida Power & Light (“FP&L”) to hold \$26.5 million subject to refund pending
3 the conclusion of an earnings review.
4

5 In the earnings review, the Commission determined that the top of the return
6 on equity (“ROE”) range should be 13.30 percent (with a 12.8 percent mid-point).
7 A review of FP&L’s financial data for 1990 showed that the utility earned an
8 ROE of 12.7 percent, “which [was] below the 13.30% ceiling.” The Commission
9 concluded “[t]herefore, we will not require the utility to refund any 1990
10 earnings” and that “since there will be no earnings refund, we will no longer
11 require the utility to hold the[] funds subject to refund.” In re: Review of the
12 rates and charges of Florida Power & Light Co., 91 FPSC 5:26, 1991 Fla. PUC
13 LEXIS 676, *2, Order No. 24460, Docket No. 900038-EI (PSC May 1, 1991)
14 (emphasis supplied).
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16 In 1995, the Commission reached the same result in a water and
17 wastewater case. The Commission had previously investigated possible
18 overearnings by Marion Utilities and ordered that Marion collect funds subject to
19 refund. Staff then proposed certain adjustments to rate base, along with a refund
20 and rate reduction. The utility made an offer of settlement that adopted the staff’s
21 proposed refund. In the utility’s last rate case in 1983, the overall rate of return
22 was set at 16.18 percent. In its 1995 order, the commission found that the
23 “appropriate range for the return on equity is 9.72 percent to 11.72 percent. We

1 find that the appropriate rate of return in calculating the refund amount is 11.72
2 percent, the high end of the range” In re: Investigation of rates of Marion
3 Utilities, Inc. in Marion County for possible overearnings, 95 FPSC 9:344, 1995
4 Fla. PUC LEXIS 1334, *4, Order No. PSC-95-1193-FOF-WS, Docket No.
5 950170-WS, (Fla. PSC Sept. 22, 1995). The Commission further stated, “We find
6 on a prospective basis, the appropriate rate of return on equity is 10.72 percent,
7 the midpoint of the range.” (Id.).

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9 In 1988, the Commission initiated an investigation for possible
10 overearnings by Sunshine Utilities and then required the utility to file a bond in
11 the event a refund was required. The Commission then found that the utility was
12 overearning and that more revenues should be held subject to refund. The
13 Commission therefore increased the revenues held subject to refund based on an
14 ROE of 15.43 percent. The Commission stated, “This 15.43% represents the
15 percentage of revenues the utility may be overearning, using the *high end* of the
16 utility's authorized return on equity. Although we required the utility to reduce its
17 rates on a going forward basis by 16.97% by Order No. 21629, that rate reduction
18 was based on the midpoint of the utility's return on equity using the current
19 leverage graph.” In re: Investigation of rates of Sunshine Utilities in Marion
20 County for possible overearnings, 89-9 FPSC 602, 1989 Fla. PUC LEXIS 1378,
21 *3, Order No. 21958, Docket No. 881030-WU, (Fla. PSC Sept. 27, 1989)
22 (emphasis supplied). See also In re: Investigation of rates of Sunshine Utilities in
23 Marion County for possible overearnings, 89-7 FPSC 589, 1989 Fla. PUC LEXIS,

1 *14, Order No. 21629, Docket No. 881030-WU (Fla. PSC July 31, 1989) (“For
2 purposes of determining the appropriate amount of the refund for overearnings,
3 we utilized Sunshine’s capital structure consisting of 2.06% long term debt at
4 9.96%, 1.09% customer deposits at 8.00% and 98.86% equity at 15.65%, the high
5 end of the utility’s last authorized range of return on equity.”); In re: Review of
6 the level of earnings of Florida Public Utilities Company’s Fernandina Beach
7 Electric Division, 84 FPSC 158, 1984 Fla. PUC LEXIS 251, Order No. 13677,
8 Docket No. 840100-EI (Fla. PSC Sept. 13, 1984) (ordering refund of excessive
9 net operating income “[b]ased upon the 10.37% high required rate of return ...
10 .”); In re: Review of the level of earnings for Florida Public Utilities Company’s
11 Fernandina Beach Electric Division, 82 FPSC 206, 1982 Fla. PUC LEXIS 861,
12 Order No. 10605, Docket No. 810271-EU (Fla. PSC February 17, 1982) (ordering
13 refund based on the Division’s “9.46% ceiling of the rate of return range” for the
14 resulting excessive net operating income). Cf. In re: Investigation into 1999
15 earnings of Florida Public Utilities Company -- Fernandina Beach Division, 00
16 FPSC 10:163, 2000 Fla. PUC LEXIS 1203, Order No. PSC-00-1883-PAA-EI,
17 Docket No. 001147-EI (Fla. PSC October 16, 2000) (finding that, “[u]sing the top
18 of the range of 12.60%,” the weighted average cost of capital is 8.96%. This is
19 the rate of return to be used to measure excess earnings.”).

20
21 We believe that the Commission should apply the same standard in this
22 case, if and to the extent that a refund is appropriate. This would ensure that the

1 Company earns no more and no less than the range that the Commission will
2 establish in the proceeding as a range of permissible earnings.

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