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	DOCKET NO. 000824-EI Submitted for Filing: February 11, 2002

REBUTTAL TESTIMONY
OF
MARK A. MYERS

ON BEHALF OF
FLORIDA POWER CORPORATION

REDACTED

JAMES A. MCGEE
FLORIDA POWER CORPORATION
Post Office Box 14042
St. Petersburg, FL 33733-4042
Telephone: (727) 820-5184
Facsimile: (727) 820-5519

Gary L. Sasso
Jill H. Bowman
W. Douglas Hall
CARLTON FIELDS
Post Office Box 2861
St. Petersburg, FL 33731
Telephone: (727) 821-7000
Facsimile: (727) 822-3768
Attorneys for Florida Power Corporation

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	DOCKET NO. 000824-EI Submitted for Filing: February 11, 2002

REBUTTAL TESTIMONY
OF
MARK A. MYERS

ON BEHALF OF
FLORIDA POWER CORPORATION

REDACTED

JAMES A. MCGEE
FLORIDA POWER CORPORATION
Post Office Box 14042
St. Petersburg, FL 33733-4042
Telephone: (727) 820-5184
Facsimile: (727) 820-5519

Gary L. Sasso
Jill H. Bowman
W. Douglas Hall
CARLTON FIELDS
Post Office Box 2861
St. Petersburg, FL 33731
Telephone: (727) 821-7000
Facsimile: (727) 822-3768
Attorneys for Florida Power Corporation

TABLE OF CONTENTS

REBUTTAL TESTIMONY OF MARK A. MYERS
ON BEHALF OF FLORIDA POWER CORPORATION

I. <u>Introduction</u>

Q. Please state your name.

A. Mark A. Myers.

Q. Did you submit Direct Testimony in this case on September 14, 2001 and November 15, 2001?

A. Yes, I did.

Q. Have you reviewed the pre-filed testimony filed by witnesses sponsored by the Office of Public Counsel ("OPC") and the intervenors in this docket?

A. Yes, I have.

II. <u>Purpose of Testimony</u>

Q. What is the purpose of the testimony you are filing at this time?

A. I am submitting this testimony to rebut the pre-filed testimony of OPC witnesses Donna Deronne, David Dismukes, Kimberly Dismukes, and Steven Stewart; FIPUG witness Michael Gorman; and Publix witness Sheree Brown.

Q. Are you sponsoring any exhibits to your rebuttal testimony?

A. Yes, I am sponsoring the following two rebuttal exhibits:

Exhibit MAM-8 calculates synergy savings after correcting for an error in Ms. Brown's calculations.

Exhibit MAM-9 demonstrates that 2000 was an aberrational year and shows that 1998 provides a more appropriate baseline for making comparisons with the 2002 test year for the purpose of identifying synergy savings.

III. Acquisition Adjustment

Q. Certain witnesses have argued that Florida Power is seeking to raise rates to recover the entire amount of the premium that Progress Energy paid to acquire Florida Power, while offering customers only $5 million in benefits. Is that a fair characterization of the Company's proposal?

A. Absolutely not, for at least three reasons. First, our customers will not pay one cent more in rates than they were paying <u>before</u> the merger as a result of recovery of the acquisition premium. This is true because we are proposing to fund recovery of the premium out of savings that were made possible by the merger in recognition of the fact that bringing about these savings had a real cost. I can illustrate this with a simple example:

> Suppose customers of Acme Power are paying $100 million in rates. BestCo then buys Acme for a premium of $10 million. As a result of economies of scale, BestCo is able to reduce the operating costs of Acme by $15 million. If BestCo is permitted to recover the amount of its

premium out of the amount of those savings, Acme's customers will end up paying $95 million in rates after the merger. The net result of the merger is that Acme's customers are $5 million better off after the merger than before the merger.

The same is true here. It is contrary to fact and logic to argue that Florida Power is proposing somehow to raise its customers' rates to fund the acquisition adjustment. That is like arguing that I'm charging you a nickel if I trade you a dime for five cents. Very few rational people would reject that kind of trade. However tempting it might be to keep the dime that is tendered and give back no change, that would be over-reaching, and that is exactly what the intervenors and OPC are proposing in this case.

There can be no question that if this merger took place in an unregulated context the acquiring company could capture the entire difference between pre-merger and post-merger operating costs (i.e., synergy savings) for the shareholders of the acquiring company in order to defray the acquisition cost. That is the way the competitive market operates, and that is what makes mergers possible. In the case of a regulated utility operating in a cost-of-service environment, we believe that it is reasonable to ask the Commission to recognize that bringing about significant economies of scale has a real cost. We are asking simply that this cost be netted against the benefits, and we are willing to share the net benefits that remain with our customers, though in an unregulated context the shareholders would reap all of those benefits as a reward for the risk they had taken in bringing together the two companies. The bottom line is that, under our proposal, our customers are made better off as a result of the merger.

Second, Florida Power is not proposing to recover the entire amount of the premium paid by Progress Energy for Florida Progress. Progress Energy has allocated to Florida Power only a portion of the total acquisition price paid for Florida Progress, erring on the side of the customers. This is true because the allocation of the premium was determined in proportion to the allocation of expected merger synergies, and Progress Energy has assumed that $45 million of the total estimated synergies of $175 million are attributable to revenues that Progress Energy might achieve through its unregulated businesses, such as the development of electric power plants. It is highly likely that CP&L could have developed these unregulated projects even without the merger. By including these revenue goals in the total estimated synergies, Progress Energy has therefore understated the amount of the purchase price fairly allocable to Florida Power and fairly recoverable by the Company.

Third, we are not offering only $5 million in benefits to our customers. The customers are getting greater benefits in the short-term and the long-term. In the short-term, the customers are benefiting from the fact that the Company will have stronger managerial, operational, and financial resources with which to serve its customers, the Company will be able to provide superior service, and it will be better positioned to hold costs down. In the long-term, the merger enables the Company to continue to provide superior service at lower costs and to offer the opportunity for greater rate reductions (or lesser rate increases) after the acquisition costs are recovered.

Q. Certain witnesses argue that the driving influence for the merger was Progress Energy's interest in improving its competitive position and achieving non-regulated revenue enhancement, and therefore customers should not be asked to subsidize the premium price paid for Florida Progress. Is this contention well founded?

A. No, it is not. This contention is based on an erroneous premise. These witnesses have quoted selectively from certain statements made to shareholders to create the misimpression that the combination of the regulated utilities was unimportant and that non-regulated potential was the preeminent concern of the merging companies. The documents do not support this. Progress Energy's emphasis, for example, on becoming "bigger and stronger," "solidifying our role as a regional total energy provider," "building on the success of our energy-related subsidiaries," and developing an enhanced "post-closing organizational framework" (Direct Testimony of K. Dismukes, pp. 16-18) apply with full force to Progress Energy's regulated electric utility subsidiaries. These qualities contribute directly to the synergies I discussed in my Direct Testimony filed September 14, 2001, e.g., lower cost of capital, improved resources, economies of scale.

What is equally important is that we have accounted for the non-regulated component of synergies in making our proposal. As I just described, we assumed that $45 million of the total estimated synergies are attributable to non-regulated initiatives even though CP&L could have pursued these revenue opportunities without the merger. Separate consideration was paid by Progress Energy—in the form of contingent value obligations ("CVOs") valued at approximately $49.3 million—for the value of Florida Progress's non-regulated, four synthetic fuel plants purchased by Florida Progress in October 1999. We are not asking for any recognition of this additional acquisition cost for purposes of determining appropriate treatment of merger costs.

Apart from its synfuel subsidiaries, what other value did Florida Progress offer? The answer is obvious: Florida Progress's main asset and operating subsidiary was Florida Power, and the opportunity to acquire and combine <u>that regulated subsidiary</u> supplied the value for that part of the consideration paid that we are asking the Commission to consider. In fact, it defies reality to argue that the non-regulated business interests of Progress Energy predominated before, during, or after the merger. Florida Power was Florida Progress's core business interest, and the Carolina electric utility was CP&L's core business interest. After the merger, these regulated electric utilities continue to be the core business interests of Progress Energy. Florida Power alone accounts for 35 percent of the assets and personnel of Progress Energy. So it is quite reasonable and conservative to claim 30.9 percent of the merger synergies for Florida Power. (As

I have explained, by erring on the conservative side in allocating these synergies, Progress Energy has understated Florida Power's share of the acquisition premium and thus reduced the amount that we seek to recover in this proceeding.) To argue, as OPC and the intervenor witnesses argue, that the non-regulated business interests of the merging companies drove the merger and account for the real value of the transaction is to have the tail wagging the dog.

Finally, to the extent that these witnesses ask this Commission to consider what benefits, if any, the merger might provide to Florida Power or its parent in the event of deregulation, this consideration is both speculative and out of line in a rate case. Unless and until deregulation occurs, the Commission has neither the policy directive nor the factual basis to make rate decisions based on conjecture that deregulation will occur or about the consequences to any of the stakeholders should deregulation occur. At this point in time, we have no idea when or if deregulation will occur, or how restructuring legislation will treat the interests of the various stakeholders if it does occur.

Q. Ms. Brown argues, in particular, (at pp. 10-11) that Progress Energy expects to achieve substantial shareholder benefits from power marketing transactions that will outweigh benefits to the customers. What is your response to this argument?

A. She is mistaken about the facts. In making this argument, Ms. Brown relies on documents that we provided in discovery that discuss activities by CP&L and

Florida Power trading centers. The problem is that she fails to recognize that (1) regulatory treatment of power marketing transactions differs in North Carolina and Florida, and (2) CP&L has greater access to transmission than Florida Power does and thus has more opportunities to take advantage of market transactions.

When our integration teams studied the operations of the power trading functions of the combined companies, they understood that Florida Power's customers would benefit from the Company's efforts to optimize its generating capacity. In contrast, shareholders will benefit from power sales in North Carolina, subject to regulatory ROE limits. BEGIN CONFIDENTIAL.

REDACTED

END CONFIDENTIAL.

Q. Ms. Brown argues (at p. 11) that Progress Energy acknowledged in internal statements BEGIN CONFIDENTIAL REDACTED

REDACTED **END**

CONFIDENTIAL Is she correct?

A. BEGIN CONFIDENTIAL.

REDACTED

END

CONFIDENTIAL.

Q. Certain witnesses argue that, under the Company's proposal, customers will pay for the original capital investment in the Company's assets and then will pay again for those assets by subsidizing Progress Energy's acquisition costs. Do you agree?

A. Not at all. This would occur (and then only figuratively) if we were asking the Commission to incorporate goodwill into the Company's rate base, which we are not proposing. "Goodwill" is a term of art and should not be confused with the subject of our proposal. Goodwill is the difference between book value and the price paid, which in this case is about $3.4 billion. If this goodwill were added to the Company's rate base, the customers would permanently be expected to subsidize a return of this investment and a reasonable rate of return for the Company's shareholders on the entire, adjusted rate base, as though goodwill were a part of the real capital assets of the Company. Our proposal is fundamentally different. We are simply asking the Commission to recognize the economic reality that there is no such thing as a free lunch. Every benefit has a cost.

In this case, the benefit of being able to reduce the headcount at Florida Power, achieve economies of scale, and bring about other cost reductions and business improvements came at a very real price, namely, the expenditure of significant transaction and transition costs. Rather than ask the Commission to imbed $3.4 billion of goodwill in our rate base, and to authorize a reasonable return on that adjusted rate base, we are simply asking the Commission to recognize the economic reality that the apparent "savings" must be netted against the cost of bringing about those savings to come up with the true net savings available to be shared with customers.

This may be illustrated by another simple example. Suppose Acme utility buys a labor-saving machine that has operating costs of $1,000 but, by doing so, the utility is able to displace $2,000 in labor costs. No one would contend that revenue requirements should be lowered by $2,000. Rather, they might be lowered only by the net difference, namely $1,000. That is the nature of the proposal we are making.

Contrary to what OPC and intervenor witnesses argue, we are not seeking a shareholder profit (return) on the merger transaction and transition costs. We are not asking that any interest rate be applied to transition costs over the 15 years that we propose to recover these costs. As for the transaction costs (Florida Power's allocated share of the acquisition premium) we are asking to recover only the 4.6 percent, after-tax interest <u>carrying costs</u> that Progress Energy is incurring to finance this costs. Seen correctly, we are seeking a <u>cost offset</u>; not a shareholder profit.

Q. Your proposal has been criticized on the further ground that you have not proven that all the synergy savings you claim would not have occurred "but for" the merger. Is this a valid criticism?

A. No, it is not. OPC and intervenor witnesses are attempting to hold the Company to an impossible burden of proof while engaging in rank speculation themselves. For example, without offering any proof whatsoever, OPC witness Kimberly Dismukes conjectures that "many" of the service quality improvements that we are achieving as a result of the merger "could have taken place" absent the merger; that "many" of the improvements to Florida Power's managerial, financial, technical, and operational resources "could have been initiated without the merger," and that lower operating costs "remain to be seen." (At the same time she acknowledges that Florida Power's conclusion that the merger will increase its ability to attract capital "may be true.") (Direct Testimony of K. Dismukes, pp. 14-15). The only substantiation she offers is that some of the practices Florida Power has adopted as a result of the merger "existed at CP&L prior to the merger." (Id.) To that I say, precisely.

One of the central benefits of the merger is to enable a utility like Florida Power to gain access to inside information about the workings and experience of its merger partner and to adopt the best practices of both utilities suited to the merged companies. Further, as I have explained part of the benefit of the merger is that it has enabled the merging electric utilities to combine and integrate their systems in a way that was not possible before, to achieve economies of scale, to improve efficiencies, and to improve service quality, for example by enabling work crews from each utility to back up each other to deal with major outages and other operational issues. By definition, this type of integration could only be achieved by combining two strong utilities.

Ms. Dismukes is quick to say that "[c]ertainly, FPC did not hire and retain an unqualified staff prior to the merger."" (Id.). I agree with that, too, and it helps prove our point. Prior to the merger, Florida Power was in fact competently and prudently managed, and we were in fact diligent in looking for and acting upon opportunities to control or lower costs and to maintain or improve service quality. To that end, the Company initiated a substantial reduction in force in the mid-'90s, reducing headcount as much as feasible without compromising service quality. The Company reorganized, seized every opportunity to lower costs, and was constantly alert for opportunities to improve efficiency and quality. Despite these efforts, there were limits to what we could achieve as a stand-alone company. We were not privy to the kind of proprietary and detailed information that we learned about CP&L in the course of the merger, and we did not enjoy the kind of scale and scope that we obtained through the merger.

As for the point that lower operating costs "remain to be seen," my response is that, in 2001, we met and exceeded our expectations about our ability to lower operating costs through the merger, and we have seen every indication that we will achieve our target of $58.7 million in merger savings in 2002. Moreover, we have imbedded this figure in our budgets. This means that we lashed ourselves to the helm and are fully committed to staying on course to achieve significant cost savings through the merger.

Would we have been able to achieve these savings absent the merger? The answer is definitely no. As I have explained, we tried but could not do it as a stand-alone company based on the resources and information we were able to marshal. To identify these synergies, we deployed integration teams from CP&L and Florida Power, the very existence of which was a merger synergy. These teams enjoyed the extraordinary benefit of being able to draw on the experience, expertise, resources, and innovation of both companies to forge a new way of doing business that was better, stronger, leaner, and more efficient than either utility was able to achieve previously. They engaged in a rigorous process, poring over every aspect of every business unit in the Company to look for ways to reduce headcount; consolidate, integrate, and improve operations; and to exploit best practices to maximum advantage. Based on their analysis and reports, we imbedded the projected savings into our budgets and tasked our managers with the job of making these projections a reality, which they are on track to achieve. We were not on a track to achieve these savings or to implement these initiatives absent the merger.

Are these synergy savings real? As I have explained, they are imbedded in the budgets that we operate under day in and day out. Some of them have been painful to achieve, including the displacement of many, many employees in Florida. We can see, feel, and touch these savings. They are very real.

Certainly, with the benefit of hindsight it is easy to assert that somebody could have thought of the light bulb sooner. Certainly, there were many able individuals who had the brains and motivation to invent one. But sometimes it takes an extraordinary person, an extraordinary catalyst, or extraordinary resources to effectuate innovation and improvements. In this instance, that extraordinary catalyst was the merger.

Q. Certain witnesses insist that the claimed cost synergies are illusory because they are offset by significant cost increases. Is that true?

A. No, it is not. The reduction of 675 jobs in Florida is not illusory. The consolidation of numerous functions and the closing of numerous facilities are not illusory. Progress Energy's economies of scale are not illusory. These are all tangible business synergies.

OPC and intervenor witnesses are making this argument by pointing to false comparisons and ignoring important facts. Principally, they compare O&M costs for 2001 with O&M costs for 2000, the year the merger was being consummated. For example, Publix witness Brown asserts that, putting administrative and general ("A&G") O&M expenses on a comparable basis as 2000 and 1999, the Company's costs go up $37 million from 2000 to 2002, amounting to 22 percent per year (and 35.5 percent per year if no synergies had been achieved). She further states that Florida Power's benefits were brought into line with CP&L's, increasing costs by $4.7 million. There are a number of problems with these arguments.

First, in making her calculations, witness Brown excludes the credit in FERC account 92200 of $15.68 million from her analysis of the 2002 budget. This is an incorrect assumption because the offsetting debit for the reclass entry is FERC account 92020, another A&G account. To compare apples to apples, we cannot exclude the amount in 92200. The impact of making this correction is to reduce the supposed $37 million increase in A&G expenses from 2000 to 2002 to $21 million.

Second, she states that the synergy amount for A&G is $24.8 million, and then she adds this amount back into total A&G expenses to show what the increases would have been without synergies. But a large portion of the synergies are in the benefits area, and she excludes this area from her analysis. So using the $24.8 million amount is not valid. This should be reduced by the amount of synergies arising from the Company's conversion from a defined benefit plan to a cash balance plan, or $15 million.

Third, although we have increased the cost of employee benefits by $4.7 million, costs in this area remain well within the Public Service Commission benchmark despite rising costs in the medical insurance area. These dollars represent enhancements to the employee benefit package, aimed at attracting and retaining the employee base needed to support our customers.

Finally, it is not appropriate to benchmark using the year 2000. The actual financial data for 2000, and 1999 for that matter, reflect O&M costs that are artificially low due to employee departures after the merger was announced. After we consummated the merger, we moved to achieve appropriate staffing and cost allocation to reflect more accurately the ongoing needs and costs of running the Company. A more appropriate comparison is between 1998 and 2002. The year 1998 represents the last calendar year period before the merger was announced and its impact (employee attrition) began to impact O&M costs. I am including an exhibit (MAM-8) to show the synergy savings in total A&G costs, using the proper adjustment described above. I am also including an exhibit (MAM-9) demonstrating that 2000 was an aberrational year and showing that 1998 provides a more appropriate baseline for making comparisons over periods. In Exhibit MAM-9, we have shown that synergies have been achieved from our ongoing O&M costs when properly adjusted for inflation, new power plant costs, pension costs impacted by stock market performance, and the additional Energy Delivery reliability programs we have initiated. The savings are real, and Florida Power is on track to realize its synergy target for 2002.

Q. OPC witness Deronne asserts that the Company should not be able to claim $58.7 million in merger savings because a large portion of this cost reduction has already been achieved and the Company is seeking to recover from customers costs that it does not plan to incur. Do you agree?

A. Definitely not. I do not follow the logic of her argument, and I do not accept its factual premise. We are claiming $58.7 million in merger synergies because these are the savings that we expect to realize <u>annually</u>. So we hope that we have achieved savings at or near that magnitude in 2001. The fact that we have done so, however, does not diminish the fact that we will achieve that level of savings again in the 2002 test year and each year thereafter. Contrary to what witness

Deronne contends, we are not seeking to recover costs that we do not plan to incur. Rather, we are seeking to recover costs that have in fact been incurred by Progress Energy, and are being incurred by Progress Energy annually in the form of debt service, to bring about the merger savings. The linkage to the $58.7 million is that this amount represents the reduction in O&M costs of Florida Power made possible by the amortized and allocated portion of acquisition and transition cost incurred to bring about the merger.

Q. FIPUG witness Gorman, however, argues that Florida Power might have achieved the claimed cost reductions some other way, such as by outsourcing certain of its functions. Do you agree?

A. No, I do not. I confirmed after my deposition that Florida Power has in fact explored outsourcing various functions over the years and generally rejected this option, with few exceptions (which the Company pursued). For example, we explored outsourcing numerous administrative and general functions, including remittance processing, accounting (including accounts payable, payroll, and benefits accounting), meter reading, investor services (we did in fact outsource most activities in this area), and management of our savings plan. In fact, we have constantly considered various options to reduce costs and improve efficiency, including outsourcing various functions and services. In this connection, we participated in benchmarking studies conducted by Andersen Consulting in the early to mid-'90s to help us assess whether we had opportunities to reduce costs and improve operations. We were not able to obtain satisfactory assurance that we would improve either our cost efficiency or service quality by resorting to outsourcing options. Among other negatives associated with outsourcing services or functions, we were concerned that we would lose the advantage of control, ownership, and the use of common systems, while subsidizing whatever profit the provider of services would command. I have every confidence that we were doing the best we could as a stand-alone utility, and that it took this merger to get us to the next level.

Q. Publix witness Brown contends that the Company's internal documents from a 2000 Strategic Planning meeting prove that Florida Power would have proceeded to implement a number of the same initiatives if the merger fell through. Is that correct?

A. It is neither correct nor pertinent. Witness Brown is referring to a document titled BEGIN CONFIDENTIAL

REDACTED

END CONFIDENTIAL.

The fact is, absent the merger, the Company was not able or committed to bring about the synergy improvements it has been able to achieve through the merger. Without combining with CP&L, Florida Power would have had neither the scale nor the scope to achieve these savings. BEGIN CONFIDENTIAL.

REDACTED

END CONFIDENTIAL.

It is artificial and unfair to cite examples of initiatives that Florida Power learned about <u>through its integration</u> efforts to argue that Florida Power could have achieved these initiatives even without the merger. That is like saying anybody could design a light bulb after talking to Thomas Edison about how to do it. The fact is, Florida Power and its customers benefited enormously from the Company's ability to undertake these integration efforts with CP&L, the point of which was to effectuate the merger (not steal ideas from CP&L and then break off discussions). And in point of fact, the merger did not fall through, and the Company was able to achieve these initiatives because of the merger.

Q. OPC witness Kimberly Dismukes argues that the Progress Energy merger does not present "extraordinary" circumstances warranting recognition by the Commission of the costs of acquisition, principally because Florida Power was not a "troubled utility." How do you respond to that?

A. I disagree with her contention. She recognizes that the Commission has approved acquisition adjustments in the case of mergers between healthy utilities, and she also recognizes that the Commission defines "extraordinary" by the presence of the five factors that I discussed in my Direct Testimony of September 14, 2001. As I explained in that testimony, each of those five attributes is present in this merger. So this merger meets the "test."

In addition, I would like to point out three big-picture facts that the intervenor witnesses tend to overlook or minimize in this discussion. First, the Commission has set the high hurdle of showing "extraordinary" circumstances when a utility is seeking to adjust its <u>rate base</u> to add <u>goodwill</u>. Here, goodwill amounts to $3.4 billion. We are not seeking to add that to rate base, and we are not seeking a shareholder profit on that amount. What we are asking for is much more modest, and, correspondingly, the hurdle for gaining favorable regulatory treatment should not be set as high. Although we believe that all the indicators of an "extraordinary" merger are present here even under the Commission's test for making rate base adjustments, it stands to reason that we have shown more than enough to obtain the lesser regulatory treatment that we are requesting in our proposal.

The second big-picture point is: How many mergers like this have taken place in the electric utility industry in Florida in the last 20 years? The answer is none. This truly is an extraordinary merger precisely because it concerns two substantial, healthy utilities. Bringing these utilities together and integrating them to achieve the synergies I have described was a daunting task.

Finally, we should not lose sight of the central question the Commission must resolve in determining whether to approve our proposal, which is, should the Commission act to encourage or discourage mergers of this nature? The meaning of any "test" will ultimately depend upon the context in which it is used. As I understand it, the Commission's central concern in the context of deciding regulatory treatment of merger costs is whether the transaction is sufficiently beneficial to customers and to the regulated functions of the utility as to warrant regulatory <u>encouragement</u>. We have shown that this merger has had and will continue to offer considerable benefits for Florida Power's customers and for the Company's regulated functions. There is no good reason for the Commission to adopt a regulatory stance that, at best, penalizes the Company for bringing about these benefits, and at worst, impairs the financial standing of Florida Power and affirmatively discourages other utilities from pursuing this kind of merger.

Q. Publix witness Brown maintains that, if Progress Energy really needed to obtain recovery of its merger costs to encourage the merger, Florida Power would have petitioned the Commission prior to the merger for favorable regulatory treatment. Is she right?

A. No. That would not have been feasible. As witness Kimberly Dismukes reports in her testimony, the Commission told us at the time of the Sebring merger that it did not ordinarily "preapprove" acquisitions or acquisition adjustments "outside a rate case." (Direct Testimony of Kimberly Dismukes, p. 11, quoting Order PSC-92-1468-FOF-EU). Attempting to initiate a process for which this state has no laws, rules, or established procedures in the context of a merger of the size and scope of the Progress Energy merger, and possibly triggering a full requirements rate case in the middle of the proceeding, would have jeopardized our ability to complete an already incredibly complicated transaction that promised very substantial short-term and long-term benefits for our customers. At a minimum, this would have significantly delayed our ability to bring home the synergies to our Company and our customers. We had to trust that the Commission would agree with us that the merger was a true win-win for the Company and its customers, and that it would recognize the true economic costs of bringing about these benefits.

Q. Focusing specifically on the "transition" cost (e.g., severance payments) component of what you are seeking to recover, witness Kimberly Dismukes

suggests that Florida Power had given assurances that certain transition costs, BEGIN CONFIDENTIAL REDACTED REDACTED **END CONFIDENTIAL would not be borne by Florida Power's customers. (Direct Testimony of K. Dismukes, pp. 26-27). Are you reneging on that assurance?**

A. No. We have excluded cost of control severance payments made to Florida Progress executives from the transition costs that we are seeking to recover.

Q. Ms. Dismukes argues (at pp. 24-26) that Florida Power's proposal to recover severance payments made to terminated Florida Power employees conflicts with the Public Service Commission's stated policy prohibiting the capitalization of merger transfer costs. Is she correct?

A. No, she is not. None of the orders she discusses involved severance payments. The orders merely make clear that the Commission will not allow a utility to capitalize organization costs associated with a merger, particularly where ratepayers do not benefit from the transaction. We are not seeking to capitalize (i.e., add to rate base) any merger transition costs, and, in any event, we have shown that our ratepayers will clearly benefit from our merger.

Q. OPC and intervenor witnesses argue that customers should not be expected to bear the cost of severance packages paid to terminated Florida Power executives because they are unreasonably high. How do you respond to that?

A. These severance arrangements were a necessary and reasonable cost of doing business and bringing about the merger and therefore should be recovered as part of the costs of bringing about the merger synergies. It is important to recognize that a company like Florida Power cannot operate without high caliber executive officers. These officers had to be given the incentive to manage the Company while pursuing merger opportunities that might prove beneficial to the Company's customers and shareholders even if such a merger might compromise the personal interests of the executives (because, in all likelihood, it would result in their termination). Once an attractive merger opportunity was identified, it was critical to be able to retain these executives throughout the period when the merger was being negotiated and consummated.

In determining the amount of these severance packages, Florida Power's Compensation Committee obtained the advice of experts in executive compensation and supplemental executive retirement plan ("SERP") matters (including Towers Perrin and MCG Northwest), obtained information concerning SERP and change-in-control programs of a cross-section of publicly held utility companies, reviewed the before- and after-tax costs of both the amended SERP and change-in-control program, and considered the recommendations of Florida Power's chief executive officer regarding the proposed SERP and change-in-control program. Upon completion of this evaluation process, the Committee concluded that the proposed plan and program were reasonable.

Q. **Witness Deronne argues that Florida Power should not be able to recover the severance costs because they were expensed in 2000, and the Company still was able to earn a reasonable rate of return, and they have been included in surveillance reporting for 2001, without impairing the Company's rate of return. Is that correct?**

A. No, it is not correct. Although we expensed these costs in 2000 for accounting purposes (as we were required to do under GAAP, absent regulatory authorization of some other treatment), we backed them out of *surveillance* for that year for purposes of calculating our regulatory ROE. Therefore, it makes no sense to say that the Company earned a reasonable rate of return in 2000, despite booking these expenses. The transition expenses were simply *ignored* (and thus not charged to customers) in 2000 in calculating our ROE. So of course they had no adverse impact—for that matter, no impact of any kind—on the ROE we reported. In the absence of those expenses, we accelerated the amortization of the Tiger Bay regulatory asset, which provided a direct customer benefit by advancing the date when customers will enjoy an immediate reduction of pass-through expenses now being charged to recover the cost of that asset.

We temporarily added the transition expenses back into our surveillance report for 2001 as a place holder for the acquisition adjustment that we are seeking in this case. Again, we backed out those expenses for surveillance reporting at the end of 2001, and we are requesting that the Commission approve the acquisition adjustment we have requested to take the place of those expenses.

As I described in my Direct Testimony of September 14, 2001, we are proposing that we spread the recovery of these transition costs over a 15-year period, without interest.

Q. Witness Deronne further contends that, instead of accelerating the amortization of Tiger Bay, the Company should have incurred additional expenses to fund the improvements in reliability and service that Florida Power is now treating as merger synergies. Do you agree?

A. No, I do not. First, let me repeat that our decision to accelerate the amortization of the Tiger Bay regulatory asset did not benefit our shareholders; rather, it directly benefited our customers. As soon as that regulatory asset is retired, our customers will get immediate rate relief, without any action by the Commission, through a reduction of monies recovered under the fuel and capacity cost recovery clause. In choosing between spending money on infrastructure or "spending" money to accelerate the amortization of Tiger Bay, the Company was exercising a business judgment about <u>which</u> way to benefit our customers, not about <u>whether</u> to benefit our customers. The Company must constantly make judgments about how much is too much when it comes to spending money on infrastructure, and it has made great efforts to stretch the customers' dollars as far as they can reasonably go.

The Company has now made a judgment that spending additional dollars to improve reliability and customer service is warranted and appropriate. We are not claiming that spending more money is itself a merger "synergy." We are stating that the merger is enabling Florida Power to get more bang for its buck in the areas of improving reliability and customer service. It must be recognized that, prior to the merger, Florida Power's energy delivery system was operating at acceptable levels. The merger provided Florida Power with opportunities to identify best practices in this area and brought CP&L's focus of top-quartile quality of service to Florida. With the benefit of best practices obtained from CP&L and the integration of various management, financial, and operational functions, the Company is able to take significantly greater strides in these areas in a more cost-effective way.

Q. Publix witness Brown argues that your proposed 15-year recovery period is too short, and FIPUG witness Gorman contends that this recovery period is too long. How do you defend your decision to propose this 15-year period?

A. We selected this period exactly because it does steer a middle course between a longer period that would burden the customers for too great a time and a shorter period that would require recovering an unduly large amount on an annual basis. The Commission approved 15 years for cost recovery of our Sebring merger based on the same analysis. In addition, 15 years represents the average term of the debt that Progress Energy is using to finance the acquisition costs, and it is the period that the Federal Tax Act prescribes for amortizing a premium paid over book to acquire assets.

IV. <u>Capital Structure</u>

<u>CR 3 Adjustment</u>

Q. OPC witness Deronne contends (at pp. 6-7) of her testimony that the Commission's Order approving the CR 3 stipulation does not contemplate continuation of the CR 3 equity adjustment after a rate case. Do you agree?

A. I agree that the Order does not direct that the adjustment be continued after a rate case, no matter what the outcome of the rate case. Nor does not the Order indicate that the adjustment should be <u>discontinued</u> after a rate case, no matter what the outcome. As Ms. Deronne acknowledges, however, the Order does contemplate that the CR 3 adjustment should be made for purposes of earnings surveillance. What Ms. Deronne overlooks is the fact that the earnings surveillance reporting requirement is an abbreviated form of rate case reporting, requiring the Company to make all the same adjustments and jurisdictional allocations that are required in a rate case, but on a monthly basis.

Through this reporting requirement, the Commission is able to monitor whether the Company's revenue requirements and Return on Equity are within the authorized rates set in the last formal rate case. Through its Order approving the CR 3 adjustment, the Commission acknowledged that revenue requirements and rates need to be sufficient so as not to harm or distort Florida Power's financial performance in the future. This can be accomplished only through the continuation of the adjustment to common equity and its consideration in the rate-setting process.

Q. FIPUG witness Gorman contends (at pp. 19-22) that the Company's proposed CR 3 equity adjustment should be rejected for the reason that the Company's capital structure includes too much equity. What is your response?

A. His conclusion is mistaken. He is able to reach that conclusion only by ignoring Florida Power's off-balance sheet obligations, namely, power purchase agreements. As the Commission is well aware, Florida Power dutifully entered into numerous power purchase agreements in the early '90s to comply with the directives of the Public Utility Regulatory Policies Act ("PURPA") and this Commission's implementing rules. These contracts create payment obligations virtually indistinguishable from debt-service obligations under promissory notes. (In fact, entering into such contracts is analogous to building a power plant using only debt financing.) Accordingly, Standard & Poors (a rating agency) imputes additional debt to our balance sheets to account for these power purchase agreements. This is indicative of how investors evaluate the capital structure of the Company in determining the investment risk associated with it. Thus, the existence of these off-balance sheet obligations increase the Company's cost of capital. The Commission has recognized this fact as recently as its Order approving the Hines 2 project. (PSC Order No. PSC-01-0029-FOF-EI). Florida Power witness Scott Wilson provides a detailed explanation of why Mr. Gorman is mistaken.

V. Rate Base

Closed Business Offices

Q. Ms. Deronne contends (at pp. 21-22) that the Company failed to remove from the 2002 test year all the impacts of the 33 business offices that the Company has closed, and so she proposes to reduce plant in service by $13,684,000, accumulated depreciation by $3,147,000, and depreciation by $419,000. Is she correct?

A. Only partly. We accept an adjustment reducing depreciation by $419,000. Beyond that, however, we do not agree with her recommended adjustments. As of this time, the Company has not finalized the disposition of these offices. Some offices are being converted for other operational purposes (e.g., training) or may have a future use benefit. Accordingly, it is appropriate to carry the plant and accumulated depreciation in rate base.

VI. Net Operating Income

A. Operating Revenues

Miscellaneous Service Revenues—Account 451.0

Q. Ms. Deronne proposes (at 22-23) to increase Miscellaneous Service Revenues (amounts collected for changing, connecting, and disconnecting service) based on her argument that recent actual experience suggests that the Company is inappropriately projecting a decline in these revenues. Do you agree with this adjustment?

A. No, I do not. The Company makes its projections based on historical trends tempered with any known, probable future changes. This account balance trend over the last five years shows a zero growth rate, with some years having positive growth rates and some having negative growth. The year-end 2001 balance in this account was projected to have a two percent decrease, using the first five months of actuals and the last seven months of budget. As this balance has not had a decline for two consecutive years, the projected year 2002 was held flat with no growth. This is sound forecasting methodology that attempts to normalize the going forward revenue expectations while still incorporating any known probable future changes.

<u>Other Electric Revenues—Account 456.20</u>

Q. Ms. Deronne (at pp. 24-25) proposes to adjust Other Electric Revenues by $64,195 (derived primarily from remittance processing revenues for third parties and non-FPC bill collection revenues) based on her view that some decline in this account is likely but not at the level projected by the Company. Is she correct?

A. No, she is not. The revenues recorded in account 456.20 are primarily from remittance processing revenues for third-parties and non-FPC bill collection revenues. There was $144,372 recorded in this account in 2000 for processing fees—release of easements for third parties and lease of rights-of-way. The Company is not forecasting to collect as much in revenues for these services in 2002. In fact, the Company has seen a decline in revenues over the prior year of

$75,000 in 2000, $185,000 in 1999, and $1,395,000 in 1998. This continued decline supports the Company's forecast.

<u>Fuel Revenue and Expenses</u>

Q. FIPUG witness Gorman (at pp. 13-14) argues that the Company has inappropriately reduced net operating income by removing recoverable fuel revenue and expenses from total projected operating expenses, in order to cover interest on the Tiger Bay regulatory asset. What is your response?

A. Mr. Gorman's premise is flawed. In the Commission's Order approving the Company's purchase of Tiger Bay and the termination of the five power purchase agreements, the Commission authorized the Company to continue to collect revenues from customers through the fuel and capacity clause as though the five power purchase agreements were still in effect. The Commission then directed the Company to apply those revenues to the actual fuel cost of the plant, which is now part of the Company generating fleet, to interest expense based on the balance of the unamortized regulatory asset, and finally to apply any remaining revenues to the amortization of the regulatory asset.

Against that background, it is evident that our proposed adjustment is correct. First, we removed the total revenue collected through the fuel and capacity cost recovery clauses. Second, we removed the expenses included in Net Operating Income that the revenues have been intended to recover. As demonstrated by MFR—C-3, those components are fuel expense, amortization and depreciation, federal and state income taxes, and taxes other than income taxes. The one component that is not part of Net Operating Income, but that is part of the revenues established by the Commission through the pass-through clauses, is interest. Interest on the Tiger Bay regulatory asset, as well as interest on any over or under recovery, is accounted for after Net Operating Income but before Net Income. Therefore, once the interest expense is taken into consideration, the pass-through clause adjustment is fully reconcilable.

<u>Sales Forecast</u>

Q. Mr. Gorman (at pp. 14-16) contends that the Company should use a "normalized" sales forecast for 2002 rather than a forecast that reflects actual, depressed economic conditions. Do you agree?

A. No. As Florida Power witness John B. Crisp explains in further detail in his rebuttal testimony, it would not be appropriate or conventional to "normalize" sales forecasts as Mr. Gorman proposes. Most simply put, if we were to "normalize" our forecast for 2002 for the purpose of "better" predicting economic conditions for the years <u>following</u> 2002, we would experience a revenue shortfall in the test year itself. It is important to get rates right for the test year at least. The Commission has the means to monitor future developments through the surveillance reporting mechanism.

B. Operating & Maintenance Expenses

Storm Damage Expense and Reserve

Q. Witness Brown (at pp. 29-30) proposes an adjustment to the Company's accrual of $6 million in storm damage expense, suggesting that the accrual should be reduced to $2 million annually. Do you agree?

A. No, I do not. Ms. Brown asserts that Florida Power's storm damage reserve and the annual expense is too high based solely on the Company's storm history. What Ms. Brown neglects to discuss is the purpose of this reserve. This reserve was established by the Public Service Commission to provide insurance to deal with catastrophic losses from acts of nature for which insurers worldwide will not write storm coverage. Therefore, the issue is not the average annual T&D damages associated historically with <u>non-catastrophic</u> storms, but the potential for <u>catastrophic</u> losses.

Statistics indicate that seven storms have hit Florida over the past 70-80 years that would be considered catastrophic. Each year, new T&D facilities are being built to meet growth in Florida Power's service territory, increasing the total potential costs associated with catastrophic storms.

It has been well publicized over the past several years that the frequency and intensity of storms affecting the U. S. coastal areas are expected to increase. Dr. William Gray, the most outspoken and well known hurricane forecaster, has written a number of articles regarding the changing weather patterns that will lead to increased storm activity over the next several years. There is every reason to believe that it is only a matter of time before a severe storm hits our service territory. The fact that insurers worldwide will not write storm coverage on T&D lines for U. S. coastal utilities is strong evidence that we are at risk of sustaining huge losses. In fact, based on these considerations, we could reasonably increase our annual accrual.

We need look no further than the service territory of Florida Power's affiliate, CP&L, for substantiation of the kind of losses catastrophic storms can bring about. The T&D costs associated with storms in CP&L's territory in recent years are as follows:

1996	Hurricane Bertha	$11,000,000
1996	Hurricane Fran	$95,000,000
1998	Hurricane Bonnie	$25,000,000
1999	Hurricane Floyd	$64,000,000

In addition SCANA and Duke each suffered T&D losses of approximately $60 million from Hurricane Hugo in 1989 and, from information in our files, it appears that the estimated total T&D damage suffered by FP&L from Hurricane Andrew in 1993 was $270,000,000.

Q. Ms. Brown (at pp. 30-31) contends that, should the Commission allow Florida Power to continue accruing $6 million a year for storm damages, the Company's recommended rate base offset should be adjusted. Do you agree?

A. No, I do not. When budgeting for this type of cost, the Company makes a conservative assumption that it will be subject to storm damage and therefore would need to draw upon funds from the reserve.

__Power Marketing Expenses__

Q. Ms. Brown (at pp. 31-33) proposes to allocate to Florida Power's shareholders 20 percent of the increase in 2002 in power marketing expenses over the three-year average from 1999-2001 (the increase being $2.385 million), allocating the balance of test year power marketing expenses to both the wholesale and retail jurisdictions. Is this an appropriate adjustment?

A. No, it is not. The 2002 projected $4.9 million in power marketing services expense includes natural gas and residual oil trading and supply service, power trading, trading support services and Energy Ventures management. The $4.9 million was determined by reclassifying portions of Fuel Supply expenses (FERC Accounts 501 and 547) into power marketing services (FERC Account 912). Furthermore, historical actuals with an escalation factor determined the 2002 projections. The increase between 2000 actuals and the 2002 projected expenses is due to the accounting reclassification and enhanced Information Technology systems and business management procedures. This area is heavily dependent on technology, and technology is expensive, but these increased costs should be balanced against the immediate benefits that customers gain through the fuel adjustment clause in lower fuel costs and higher margins on non-separated wholesale sales. See table below:

Contributions Made by Power Marketing

Year	Savings From Purchases	Savings From Sales	Total Savings
1994	$ 6,686,693	$ 1,917,723	$ 8,604,416
1995	3,930,277	3,299,416	7,229,693
1996	12,739,582	1,701,131	14,440,713
1997	9,215,965	4,094,564	13,310,529
1998	5,729,529	12,788,820	18,518,349
1999	2,120,470	13,947,695	16,068,165
2000	11,867,570	8,939,096	20,806,666
2001	4,027,490	10,283,714	14,311,204
	$ 56,317,576	$ 56,972,159	$ 113,289,735

Q. Ms. Brown points out (at p. 31) that Florida Power did not allocate any power marketing expenses to the wholesale side. What is your response?

A. We agree that power marketing expenses should have been allocated between the retail and wholesale jurisdictions. This omission was an oversight that we agree to correct. Nonetheless, given the proportionately small amount of wholesale business, the impact of this correction on retail customers will be minimal.

We disagree with Ms. Brown to the extent that she argues that the Company is attempting to recover all of its power marketing costs from retail customers. Between rate cases, shareholders carry the risk of annual changes in power marketing expenses, while our customers will always benefit from the margins on non-separated wholesale sales regardless of the changes in the costs of achieving those savings. Under the Commission's rules, 80 percent of the margin created from increased sales flows annually to retail customers through the fuel adjustment clause, and fuel rates are set by including a reduction for estimated benefits from this sales activity.

Q. Ms. Deronne (at pp. at 39-40) recommends that projected 2002 test year expenses associated with Power Marketing Services (Account 912.70) be reduced by $2,316,000 to reflect the actual historic test year amount of $2,581,000. Do you agree?

A. No, I do not, for the reasons I have just given.

General Advertising Expense

Q. Ms. Deronne (at pp. 41-44) recommends that expenses in Account 930.13—Other General Advertising be reduced by $4,693,000 from the Company's projection to reflect a four-year average level for this account of $456,000 based on her concern that the proposed increased in this category will be spent on imaging. What is your response?

A. Ms. Deronne is mistaken, and her recommendation should be rejected. She relies on discovery that is inclusive of both recoverable advertising and non-recoverable imaging to contend that the Company is proposing to use its budgeted advertising expenses for non-recoverable imaging. What she overlooks is the fact that the imaging activities the Company included in its overall advertising plan have already been recognized and adjusted out of the rate case in the amount of $4, 007,000. The remaining plan objectives (reflected in goals two and three of the three she mentions) are not related to building the Company's image as explained below:

- BEGIN CONFIDENTIAL.

REDACTED

END CONFIDENTIAL.

Further, Ms. Deronne's analysis ignores the fact that Florida Power's advertising program was not as aggressive prior to the merger as it is today. As a result of the merger, we have learned from CP&L's positive experience in this area that we can achieve significant benefits from better informed customers. Our 2002 media campaign reflects a wide-ranging effort to reach all Florida Power customers with key messages of conservation, safety, storm preparedness, and customer service. Today, we are committed to reaching as many of our customers as possible with these important messages. Whereas much of our media efforts in the past were limited to certain major markets, we are now placing advertising to reach customers in all parts of our service territory. Our goal is to educate not only Florida Power's customers in major metropolitan areas about conservation and safety, but to reach equally important customers who live in smaller towns as well.

Finally, Ms. Deronne ignores the increasing costs of advertising. Advertising expenditures have increased much faster than the general rate of inflation. Since 1997, television advertising costs have risen 24 percent, newspaper advertising costs are up 26 percent, and radio advertising costs have increased 51 percent. Advertising production expenses have risen as well. Specifically, costs for creative time (including design and writing) are up 50 percent, photography costs have increased 50 percent, and printing costs are up 25 percent.

Last Core Nuclear Fuel and End-of-Life Materials and Supplies

Q. **Ms. Brown proposes (at pp. 33-36) that the Company should not amortize last core nuclear fuel expenses at this time based on her assumption that the Company will obtain extension of the operating license for CR 3. Is she right?**

A. No, she is not. There is no evidence in this proceeding, and none exists, to indicate that Florida Power has received approval from the Nuclear Regulatory Commission for a license extension, nor that Florida Power has completed any analysis that would indicate that a license extension is even cost effective. Ms. Brown is attempting to introduce unsubstantiated expectations of future events into the test year.

Even more important, the Commission has already reviewed these issues and approved our proposed amortization in Commission Order PSC-02-0055-PAA-EI, issued on January 7, 2002, in Dockets 991931-EI and 0001835-EI. All affected parties were afforded ample opportunity during the pendency of those proceedings to intervene and advance their issues and concerns.

Q. **Ms. Brown (at pp. 37-38) challenges the Company's amortization of Nuclear End-of-Life Materials and Supplies expenses. What is your response?**

A. This is no longer an issue, given Commission Order No. PSC-02-0055-PAA-EI, which establishes the annual accrual amount for end-of-life nuclear materials and supplies. The Company agrees to update its filing to reflect the Commission's Order.

Q. Ms. Deronne (at p. 46) points out that the Company has indicated in discovery responses that the amount is included for Nuclear Materials and Supply Inventory in Schedule C-1 ($1,667,000) is incorrect and should be $1,467,000. Is that right?

A. Pursuant to the Commission's Order, the annual accrual has been established at $1,500,000 on a retail basis.

Nuclear Decommissioning Expense

Q. Ms. Deronne (at p. 51) suggests that the amount Florida Power has included in its filing for nuclear decommissioning expenses should be reduced by $2,250,000 to reflect the current status of Docket No. 001835-EI. Do you agree?

A. No, I do not. The correct adjustment to the test year data is a reduction of $982,000 on a retail basis. This would be consistent with the Commission's Order.

Nuclear Energy Institute Dues—Lobbying

Q. Ms. Deronne (at p. 50) recommends that the amount of Nuclear Energy Dues associated with lobbying efforts, 20 percent of the total (or $25,600) be removed from the 2002 test year. Do you agree with this recommendation?

A. Yes. We accept this adjustment.

<u>Transmission Expenses</u>

Q. At pp. 38-40, Ms. Brown suggests that the Company's proposed transmission expenses should either be capitalized as a component of associated capital costs or amortized over a 10-year period. Do you agree?

A. No. As explained in greater detail in the rebuttal testimony of Florida Power witness Sarah Rogers, the Company's proposed transmission expenses reflect the Company's commitment to increase reliability to top-quartile performance and are indicative of ongoing, reliability expenditures that we will incur in the future. There is no more basis to capitalize these ongoing, O&M expenses than any others.

<u>Tiger Bay Accelerated Amortization</u>

Q. Ms. Brown (at p. 42), Ms. Deronne (at pp. 50-51), and Mr. Gorman (at pp. 16-17) state that the Company should not include the proposed $9 million accelerated amortization of the Tiger Bay regulatory asset in the test year revenue requirements. Do you agree?

A. No. In the course of completing the Company's MFRs, we included an amount in accordance with Commission Order No. PSC-7-0652-S-EQ, which "provides FPC the discretionary ability to contribute dollar amounts from its earnings to accelerate the amortization of the Tiger Bay Regulatory Asset," which we anticipated to be $9 million. The Tiger Bay regulatory asset is now expected to be fully amortized in 2003.

Property Tax Expense

Q. Ms. Derrone (at pp. 51-54) contends that the Company's estimated 4.5 percent increase in property tax expense for 2001 is too high and that the estimated increase for 2002 is likewise too high; so she recommends that the projected 2001 property tax expense be reduced by $3.6 million and that a growth factor of 3.51 percent be used to determine taxes for 2002. Do you agree?

A. No, I do not agree. Florida Power's estimate for 2001 was only 2.67 percent off from actual taxes paid. Accordingly, her proposed adjustment to 2001 taxes is misconceived and not supported by the facts. Ms. Deronne's projections for future tax increases are likewise too conservative and do not take into account the very real economic pressures that exist today.

Most of us would agree that up, until last year, the economy for both the nation and the state has been strong. Accordingly, property values for homeowners and other taxpayers have generally increased significantly as businesses added new equipment, and house values have risen. This has created a situation where local governments did not feel the need to raise mileage rates; in fact, they decreased these rates. This trend cannot continue, however, in light of the recession the state is experiencing and the pressures on taxing authorities to maintain revenue streams necessary to keep local governments functioning. Our projections take into account the current economic situation and are based on reasonable expectations of what the test year will bring.

__Rate Case Expenses__

Q. Ms. Brown argues (at pp. 43-44) that the Company should be allowed to exclude rate case expenses from 2001 only to the extent such amounts are applied to the Tiger Bay amortization (and otherwise be required to absorb 2001 rate case expenses) and amortize remaining expenses over a four-year period, given the time that appears to expire between rate cases. Do you agree?

A. No, I do not. The Commission's practice is that rate case expenses are deferred to the balance sheet until the Commission's decision on what amortization period should be applied.

With regard to the recovery period, the Florida Public Service Commission authorized a two-year amortization in the past in the two rate cases prior to the 1992 case, and a two-year period is eminently reasonable in this case. Certainly, if the Commission does not see fit to approve our request for a step increase effective November 2003 to recover the revenue requirements of Hines 2, we will be back before the Commission in another rate proceeding within two years, and the intervenor arguments for a longer amortization fall by the wayside.

Q. **Ms. Deronne contends (at pp. 46-49) that the Company's rate case expenses are unreasonably higher than expenses for Florida Power's 1992 rate case; that the Company should have retained cheaper consultants; and that consultant fees should be split 50/50 between the Company's customers and shareholders. Do you agree?**

A. No, our rate case expenses are reasonable. The difference between 1992 costs and current costs is explained not only by the simple passage of time and the escalation of costs outside our control, but also by the fact that we handled more of the responsibilities of the case in-house in 1992 than today. To reduce costs, we have out-sourced legal and professional consulting activities that we used to perform in-house, avoiding the need to maintain this infrastructure in between rate cases or other significant projects. We use outside consulting services with sufficient frequency that we have become highly familiar with the quality and costs of different consultants, and we believe that we have identified and retained consultants in this case who are well-suited to provide high quality, cost-effective service, ultimately to the benefit of our customers.

Q. **Based on customer testimony given at the Winter Park service hearings (alluding to the Company's franchise litigation with that municipality), certain of the parties question whether legal fees incurred by the Company to negotiate and litigate its franchise disputes with Winter Park (or other municipalities) should be recoverable from all ratepayers, just those who live in the affected municipality, or not at all. What is your response?**

A. These fees are being prudently incurred for the benefit of all of our ratepayers, and they should be fully recoverable in the manner of other O&M expenses. These disputes concern efforts by certain municipalities to terminate Florida Power's right to serve customers in the affected areas and to acquire certain of the Company's facilities used to serve those customers. Even on the face of this, it is apparent that these municipalities are asserting a drastic claim that could, if successful, significantly diminish the Company's customer base. If they were to prevail, the result would be that the Company's fixed overhead costs would have to be borne by a smaller customer base, putting upward pressure on the rates paid by our remaining customers. That being the case, the Company has an obligation to take reasonable steps to defend against these claims, for the benefit of its customers as a whole. At the same time, as discussed more fully in the rebuttal testimony of Company witnesses Sipes, Rogers, and Barnwell, the Company is going to great lengths to ameliorate any underlying customer-service concerns that may be driving this litigation.

We are also litigating issues concerning whether municipalities can unilaterally impose fees amounting to a tax on the utility (and its customers) after a franchise has expired or in the absence of an effective franchise agreement, and we are negotiating new agreements with various municipalities that will avoid the need for litigation, thus removing the risks to customers that I have described and avoiding litigation expense.

The Company has retained highly experienced, able outside counsel to handle these matters on the Company's behalf. Florida Power does not enter any litigation lightly. The Company litigates only when it has strong grounds to do so, when it has reasonable positions available, and when it can be assured that it will be represented on a cost-effective basis. We have every assurance, based on our experience, that counsel handling these franchise matters are well-qualified to do so and are doing so on a cost-effective, ethical basis, asserting good faith positions that enjoy a reasonable prospect of success.

Over the years, a Company of the size and complexity of Florida Power will inevitably become involved in some kind of significant litigation every year. Regrettably, this is a recurring cost of doing business. When the franchise litigation is over, we will undoubtedly face future challenges. We make every effort to manage, control, and contain these costs through the oversight of skilled, highly professional in-house counsel working with responsible business managers and through the use, when necessary, of qualified and ethical outside counsel.

Accordingly, the concerns expressed about the franchise litigation and negotiation efforts are unmerited and should not be confused with a difference of opinion about the merits of any party's position, which is the job of the courts to resolve.

VII. Hines 2 Adjustment

Q. Ms. Deronne (at pp. 57-58) and Mr. Gorman (at pp. 16-18) argue that the Commission should not provide for a subsequent year increase in revenue requirements to account for the addition of Hines 2 in November 2003 to Florida Power's generation fleet because we have no assurance that there will not be offsetting increases in revenues or decreases in expenses. What is your response?

A. As a projected test year, 2002 is reasonably indicative of what future rate base, revenues, and expenses will be with one glaring exception: the Hines 2 power plant. We are asking the Commission to approve a subsequent year adjustment permitting the Company to recover the costs associated with Hines 2 because we have every reason to believe that these costs will stand out in 2003 from the otherwise representative revenues and expenses projected for the test year.

We are able to recognize the costs of Hines 2 at this time because they are both known and measurable, as demonstrated in my pre-filed Direct Testimony of November 15, 2001. Further, contrary to what Mr. Gorman implies (at p. 17), there is precedent to support our request. In Order No. 15451 (December 13, 1985), in Docket Nos. 850050-EI and 850246-EI, the Commission approved a subsequent year adjustment for TECO's power plant, Big Bend 4, which went into service after the conclusion of the test year. The Commission specifically adjusted 1984 test-year expenses to take into account projected 1985 and 1986 expenditures necessary to complete the plant (without treating the costs as construction work in progress).

VIII. Conclusion

Q. Please provide an overview of what you have told us.

A. With the exception of the very few corrections that I have noted in my testimony, and that the Company has noted elsewhere, we stand by the submissions we have made to date. Overall, I am pleased to say that the Company is well run, that we will continue to operate in a fiscally conservative manner, and that the budget we are proposing is both reasonable and necessary not only to enable the Company to continue to serve its customers safely and reliably, while improving the quality of our service and meeting the increasing expectations of our customers in the new millennium.

Our recent merger has positioned the Company to address this challenge. As a result of the merger, Florida Power is a stronger company and is better able to hold the line on costs, pass along net savings to customers, and increase the reliability and quality of its service. In fairness, we ask that the Commission recognize that the Company has not been able to slash O&M costs dramatically without incurring other attendant costs. There is no such thing as a free lunch. As I have described, however, even after our transaction and transition costs are netted against expected synergies, we are pleased to be able to assure our customers of an immediate rate credit of \$5 million and to continue to provide that credit each year for fifteen years.

Q. Does this conclude your testimony?

A. Yes, it does.

Docket No. 000824-EI
Exhibit MAM- 8
Witness: Mark A. Myers

(Thousands)		Variance	2002 BUDGET	1998 ACTUALS
Total Admin & General		$(44,255)	$46,453	$ 90,708
Adjustments recommended by Ms. Brown				
92200	Adm Exp Transferred-Cr	15,678	15,678	-
	Employee Pensions & Benefits	29,887	49,021	19,134
Witness Adjusted Total Admin & General		1,310	111,152	109,842
Corrections to adjustments recommended by Ms. Brown				
92200	Adm Exp Transferred-Cr (should not have been removed)	(15,678)	(15,678)	
Company Adjusted Total Admin & General		$(14,368)	$95,474	$109,842

FLORIDA POWER CORPORATION
Analysis of Operations and Maintenance to Demonstrate that the Budget does include the Synergies

Docket No. 000824-EI
Exhibit MAM-9
Witness: Mark A. Myers

Base Recoverable O&M - System Per Book Actuals / **Forecast**	1998	1999	2000	2001	**2002**	**2002 vs. 1998**
Total O&M	**$ 471.5**	**$ 465.9**	**$ 527.5**	**$ 433.0**	**$ 474.3**	**$ 2.8**
Adjustment						
Base Recoverable Fuel	$ (4.2)	$ (3.6)	$ (5.4)	$ (7.6)	$ (8.4)	$ (4.2)
Remove impact of inflation (CPI-U, '98 base yr)		$ (10.4)	$ (26.7)	$ (41.2)	$ (54.5)	(54.5)
Pension Credit - 100%	$ 27.0	$ 36.0	$ 55.0	$ 57.7	$ 54.5	27.5
Y2K expenditures		(9.2)				-
Hines 1	(0.6)	(4.6)	(8.9)	(8.8)	(10.7)	(10.1)
Tiger Bay	(7.8)	(4.6)	(5.4)	(5.3)	(7.3)	0.5
Intercession City 12-14			(0.1)	(1.3)	(1.5)	(1.5)
Accr Bus. Comb. Cost			(94.2)			-
CR3 Extended Outage	(5.0)					5.0
Energy Delivery Reliability Projects					(16.7)	(16.7)
Increase in General Advertising					(5.0)	(5.0)
Sub-total						**$ (59.0)**
Total Adjusted O&M	***$ 480.9***	***$ 469.5***	***$ 441.8***	***$ 426.5***	***$ 424.7***	**$ (56.2)**
					Total Synergies	**$ (58.7)**
					Variance	**2.54**
Annual Change		**$ (11.4)**	**$ (27.7)**	**$ (15.3)**	**$ (1.8)**	
		-2%	**-6%**	**-3%**	**0%**	

C:\Temp\Temporary Internet Files\OLKB\[MAM_rebuttal_OM_synergy_analysis1.xls]O&M Synergy Impact Analysis
2/9/2002 15:58