

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

PETITION TO DETERMINE NEED FOR DOCKET NO. 020262-EI
AN ELECTRICAL POWER PLANT IN
MARTIN COUNTY BY FLORIDA POWER &
LIGHT COMPANY

PETITION TO DETERMINE NEED FOR DOCKET NO. 020263-EI
AN ELECTRICAL POWER PLANT IN
MANATEE COUNTY BY FLORIDA POWER &
LIGHT.

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VOLUME 5

PAGES 543 THROUGH 680

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LILA A. JABER
COMMISSIONER J. TERRY DEASON
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI
COMMISSIONER RUDOLPH "RUDY" BRADLEY

DATE: Thursday, October 3, 2002

TIME: Commenced at 8:30 a.m.

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

REPORTED BY: TRICIA DeMARTE
Official FPSC Reporter
(850) 413-6736

APPEARANCES: (As heretofore noted.)

FLORIDA PUBLIC SERVICE COMMISSION

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NUMBER:

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22 WEA-1 and WEA-2

585

P R O C E E D I N G S

(Transcript continues in sequence from Volume 4.)

CHAIRMAN JABER: Let's go ahead and get back on the record. FPL, you want to call your next witness?

MR. NIETO: We call Dennis Brandt.

CHAIRMAN JABER: Mr. Brandt, were you sworn?

THE WITNESS: No, ma'am, I wasn't.

C. DENNIS BRANDT

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

DIRECT EXAMINATION

BY MR. NIETO:

Q Could you please state your name and business address, Mr. Brandt.

A My name is Dennis Brandt, and my address is 9250 West Flagler Street, Miami.

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

A I work for Florida Power & Light, and I'm the director of product development and management.

Q Have you prefiled direct testimony consisting of 23 pages and prefiled documents DB-1 to DB-5?

A Yes, I have.

Q Were the testimony and exhibits prepared by you or under your direction and control?

A Yes, they were.

1 Q Is the information in your exhibits true and correct?

2 A Yes, they are.

3 MR. NIETO: Madam Chairman, I'd ask that the next
4 exhibit number, which I believe is 21, be assigned to
5 Mr. Brandt's documents DB-1 to DB-5.

6 CHAIRMAN JABER: Okay. Let's insert the testimony
7 first. The prefiled direct testimony of C Dennis Brandt shall
8 be inserted into the record as though read.

9 And hearing Exhibit 21 is identified for DB-1 through
10 DB-5?

11 MR. NIETO: Yes.

12 (Exhibit 21 marked for identification.)

13

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **DIRECT TESTIMONY OF C. DENNIS BRANDT**

4 **DOCKET NOS. 020262-EI, 020263-EI**

5 **JULY 16, 2002**

6
7 **Q. Please state your name and business address.**

8 A. My name is C. Dennis Brandt, and my business address is 9250 West
9 Flagler Street, Miami, Florida 33174.

10
11 **Q. By whom are you employed and what position do you hold?**

12 A. I am employed by Florida Power & Light Company (FPL) as Director
13 of Product Development and Management.

14
15 **Q. Please describe your duties and responsibilities in that position.**

16 A. I am responsible for the development and life cycle management of
17 FPL's Demand Side Management (DSM) products and services. This
18 includes overseeing the development, implementation, training, and
19 tracking of the various DSM programs offered to residential and
20 business customers.

21
22 **Q. Please describe your education and professional experience.**

1 A. I received a Bachelor of Science Degree in Industrial Engineering
2 from the University of Miami in 1978. I also received my Masters
3 Degree in Industrial Engineering from the University of Miami in
4 1984. I am a certified Professional Engineer in the State of Florida. I
5 was hired by FPL in 1979 in the Materials Management department
6 and have worked in positions of increasing responsibility in the areas
7 of Load Management, Commercial and Industrial Marketing,
8 Residential and General Business Marketing, and Sales & Marketing
9 Product Support. In 1991 I was promoted to the position of Manager
10 of Residential and General Business Marketing Support. I held this
11 position until 1993, when I became the Manager of
12 Commercial/Industrial Marketing Support. In late 1996 I became the
13 Manager of Sales & Marketing Product Support, and in 1999 I
14 assumed my current position.

15
16 **Q. Are you sponsoring an exhibit in this case?**

17 A. Yes. I am sponsoring an Exhibit that consists of the following
18 documents:
19 ▪ Document DB-1, which is Order No. PSC-99-1942-FOF-EG,
20 approving FPL's current demand side management goals.
21 ▪ Document DB-2, which is FPL's Commission-approved DSM
22 goals for 2000 through 2009 with actual performance through
23 2001.

- 1 ▪ Document DB-3, which is my testimony in Docket No. 971004-
2 EG, Adoption of Numeric Conservation Goals
- 3 ▪ Document DB-4, which is FPL's currently approved Demand Side
4 Management Plan.
- 5 ▪ Document DB-5, which is Order No. PSC-00-0915-PAA-EG,
6 approving FPL's current Demand Side Management plan.

7

8 **Q. Are you sponsoring any part of the Need Study in this proceeding?**

9 A. Yes. I am sponsoring Section VI and Appendix O of the Need Study.

10

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

12 A. My testimony has five main points. First, I will provide a historical
13 overview of FPL's DSM initiatives. Second, I will discuss the current
14 maturity of DSM and its future potential on FPL's system. Third, I
15 will outline the process used for setting DSM goals. Fourth, I will
16 provide an overview of FPL's current DSM programs and research and
17 development efforts. Fifth, I will provide a conclusion on whether
18 there are any available DSM options that could defer the need for
19 either Martin Unit 8 or Manatee Unit 3.

20

21 **I. Historical Overview of FPL's DSM Initiatives**

22

23 **Q. How does FPL classify its DSM related activities?**

1 A. FPL's DSM efforts consist of activities in several areas: conservation,
2 load management, energy audits for all classes of customers, and
3 research and development activities.

4
5 **Q. When did FPL begin its DSM efforts, and how have they**
6 **progressed over time?**

7 A. FPL has a long history of identifying, developing and implementing
8 DSM resources to avoid or defer the construction of new power plants.
9 FPL first began offering DSM programs in the late 1970's with the
10 introduction of its Watt-Wise Home Program. An increasing number
11 of additional DSM programs were offered throughout the 1980's and
12 1990's. These programs have included both conservation and load
13 management programs, targeting the residential, commercial and
14 industrial markets.

15
16 FPL's portfolio of DSM programs has evolved over time. FPL
17 continually looks for new DSM opportunities in its research and
18 development activities. When a new DSM opportunity is identified
19 and projected to be cost-effective, FPL attempts either to implement a
20 new DSM program or to incorporate this DSM opportunity into one or
21 more of its existing DSM programs. In addition, FPL has modified
22 DSM programs over time in order to maintain the cost-effectiveness of
23 the programs. This allows FPL to continue to offer the most cost-

1 effective programs available. On occasion, FPL has also terminated
2 DSM programs that were no longer cost-effective and could not be
3 modified to become cost-effective.

4

5 **Q. How effective has FPL been in implementing DSM, and what are**
6 **the resulting impacts of these efforts?**

7 A. FPL has been very successful in cost-effectively avoiding new power
8 plant construction using DSM. Since the inception of our programs,
9 we have achieved 3,076 MW (at the generator) of summer peak
10 demand reduction, 2,680 MW (at the generator) of winter peak
11 demand reduction, 19,713 GWh hours (at the generator) of energy
12 savings and completed more than 1,730,000 energy audits of our
13 customers' homes and facilities.

14

15 This amount of peak demand reduction has eliminated the need for the
16 equivalent to 9 power plants of 400 MW summer capacity each
17 (including the impacts for reserve margin requirements). Most
18 importantly, FPL has achieved this level of demand reduction without
19 penalizing customers who are non-participants in its DSM programs.
20 FPL has been able to avoid penalizing non-participating customers by
21 offering only DSM programs that reduce electric rates for all
22 customers, DSM participants and non-participants alike.

23

1 **Q. How do FPL's DSM efforts compare to those of other utilities?**

2 A. The U.S. Department of Energy reports on the effectiveness of utility
3 DSM efforts through its Energy Information Administration. DSM is
4 broken down to include both conservation and load management.
5 Based on the most current data available, which is for the year 2000,
6 FPL is ranked number one nationally for cumulative conservation
7 achievement and number two in load management.

8
9 Another important indication of the success of DSM in Florida and
10 FPL's service territory was the outcome of a benchmarking study
11 conducted by the State of Florida Energy Office in 1992, entitled
12 "Electricity Conservation and Energy Efficiency in Florida." That
13 study found that since the early 1980's, FPL had been actively
14 involved in DSM programs and had been an industry leader in DSM
15 application. It further found that: "The Florida utilities have been
16 extremely successful in reducing peak capacity requirements. The
17 Florida utility peak capacity savings are generally higher than those
18 obtained by other utilities. While the Florida utilities have been
19 focusing their efforts on load management, they have been among the
20 leaders in achieving energy savings."

21

22

23

1 **II. Current Level of Maturity for DSM Initiatives**

2

3 **Q. Of the potential markets available to FPL for DSM initiatives,**
4 **which technologies and/or market segments are currently reaching**
5 **saturation?**

6 A. There are several areas where DSM-related technologies are reaching
7 market saturation. FPL's load management programs are a prime
8 example. For these types of programs it is critical to determine how
9 much load management is actually "usable" for an individual utility.
10 Consideration must be given to the system load shapes and
11 characteristics of load management measures including control
12 strategies (cycling loads versus continuous interruptions), length of the
13 control periods and the payback effects once load control is released.
14 Based on FPL's analysis, we are very close to the maximum usable
15 amount of load management and, in fact, our plans for 2002 through
16 2009 show only a modest growth of just 102 MW.

17

18 **Q. Are there other technologies nearing saturation?**

19 A. Yes, interior lighting for commercial and industrial facilities is another
20 technology nearing saturation. The introduction and quick market
21 acceptance of T-8 fluorescent lighting as a DSM measure resulted in
22 significant market penetration of this technology. However, its rapid,
23 widespread acceptance has limited the potential for future reduction in

1 this area. FPL has evaluated various other lighting technologies,
2 including daylight dimming and T-5 lamps, neither of which has
3 significant market appeal or penetration. Until there is another
4 breakthrough in lighting technology related to energy efficiency, there
5 will not be another mass-market opportunity in this area.

6
7 Yet another area where the market potential continues to decrease over
8 time is installation of ceiling insulation for residential customers.
9 FPL's research has found that for the vast majority of our customers
10 ceiling insulation levels above R-19 provide minimal additional energy
11 savings. In 1982, the State of Florida Energy Code was changed to
12 require all new homes have at least R-19 levels of ceiling insulation.
13 FPL's residential building envelope program has focused on that finite
14 market of homes built prior to this code change. As a consequence,
15 the eligible market shrinks as more pre-1982-built homes participate in
16 our program.

17
18 **Q. How do other changes in Energy Codes impact FPL's DSM**
19 **potential?**

20 A. FPL's heating, ventilating and air conditioning (HVAC) programs for
21 both residential and commercial/industrial customers are designed to
22 encourage customers to install equipment that is typically a minimum
23 of ten percent more efficient than is required by the State Energy

1 Code. As the minimum efficiency in the Code is raised, the
2 effectiveness of programs like FPL's are diminished. The goal of a
3 utility HVAC program should be to encourage customers to install
4 more efficient equipment than they would without the program. When
5 the Code minimum efficiency level approaches that of the utility's
6 program, then the impact of the utility program is greatly diminished
7 because the baseline energy efficiency level is raised. This results in
8 smaller impacts for incremental efficiency gains for the utility program
9 at a relative increased cost. In many cases this results in programs no
10 longer being cost-effective.

11
12 This is exactly what happened to FPL's Watt Wise program. This
13 program was launched in the late 1970's. This program was very
14 successful but was discontinued in 1984 when it became the model for
15 the State's Energy Code.

16
17 **Q. How would you summarize the overall maturity of FPL's DSM**
18 **programs?**

19 A. FPL has numerous programs that have been in existence for several
20 years. These programs have continued to be modified based on
21 changing cost-effectiveness, market conditions and feedback from our
22 customers. These programs address the major end-uses of electricity
23 of our customers that can be implemented in a cost-effective manner.

1 Although FPL continues to be successful in program design and
2 delivery, it is becoming increasingly difficult to meet our DSM
3 objectives.

4
5 **III. FPL/FPSC DSM Goal Setting Process**

6
7 **Q. Why are DSM goals established?**

8 A. FPL establishes DSM annual goals for two major purposes. The first is
9 to be responsive to the Florida Administrative Code, Rule 25-17.0021,
10 which states “The Commission shall establish numerical goals for each
11 affected electric utility, as defined by s. 366.82(1), F.S., to reduce the
12 growth rates of weather-sensitive peak demand, to reduce and control
13 the growth rates of electric consumption, and to increase the
14 conservation of expensive resources, such as petroleum fuels.”

15
16 The second purpose of establishing annual DSM goals is for use in
17 planning to meet the future capacity needs of our customers. Our
18 DSM goals are key inputs into FPL’s annual Integrated Resource
19 Planning (IRP) process.

20
21 **Q. How frequently are FPL’s DSM goals established?**

22 A. Every five years each utility submits for Commission approval goals
23 for a ten-year period that address overall residential kW and kWh

1 goals and overall commercial/industrial kW and kWh goals. FPL
2 currently has Commission-approved goals for 2000 through 2009.

3

4 **Q. When were FPL's current Commission-approved DSM goals**
5 **established?**

6 A. As shown in Document DB-1, FPL's current goals were approved on
7 August 17, 1999, in FPSC Order No. PSC-99-1942-FOF-EG.

8

9 **Q. What are FPL's current DSM goals, and how is the Company**
10 **performing?**

11 A. Document DB-2 shows FPL's current Commission-approved DSM
12 goals and actual cumulative performance through 2001 (at the meter).
13 Although FPL fell short of several goals in 2000, by the end of 2001
14 FPL was successful in meeting all of its FPSC-approved goals.

15

16 **Q. How did FPL develop its current DSM goals that were approved**
17 **by the Commission?**

18 A. Document DB-3, which is my testimony in Docket No. 971004-EG,
19 Adoption of Numeric Conservation Goals, details the multi-step
20 process used to develop its DSM goals. A summary of the process is
21 presented here.

22

1 The first step was to determine which measures should be evaluated
2 for cost-effectiveness. Based on input from the Commission, the
3 Commission staff, other interested parties and FPL, 169 separate DSM
4 measures were identified for screening. In the next step of the process,
5 all selected measures were then screened for cost-effectiveness
6 utilizing the Rate Impact Measure (RIM) test with an assumption of no
7 incentives. The assumption of no incentives gives each measure the
8 highest probability of passing the RIM test. The RIM passing
9 incentive level was determined for each measure and cost-
10 effectiveness was then determined using the Participant test. For those
11 measures that were found to be cost-effective as determined by the
12 RIM and Participant tests, annual market acceptance rates, or the
13 achievable potential, was identified based on cost-effective incentive
14 levels. The results obtained in this phase of the process were further
15 analyzed to identify the most cost-effective DSM portfolio for FPL's
16 customers as part of FPL's IRP process.

17
18 In summary, the goals FPL developed reflected the cost-effective
19 achievable potential projected by FPL for utility program measures
20 analyzed under the RIM and Participant tests.

21
22 **Q. How do FPL's DSM goals relate to FPL's FPSC-approved DSM**
23 **plan?**

1 A. As part of the goal determination just discussed, FPL found 56
2 measures to be cost-effective under the RIM and Participant Cost tests.
3 Those 56 measures were packaged into comprehensive FPL programs
4 as part of the Company's DSM Plan. This DSM Plan, along with the
5 supporting testimony, was submitted to the FPSC on December 29,
6 1999. This Plan was approved in Order No. PSC-00-0915-PAA-EG on
7 May 8, 2000. FPL's approved DSM Plan and the order approving it
8 are included as Documents DB-4 and DB-5, respectively.

9
10 **Q. What is the expected timing for the next FPSC DSM goal setting**
11 **process?**

12 A. The Florida Administrative Code requires goals to re-assessed every
13 five years. Our current goals cover the time period 2000 through
14 2009, with 2004 being the fifth year. Based on past experience, FPL
15 expects the goal setting process to be started no later than 2003.

16
17
18 **IV. FPL's Current DSM Initiatives**

19
20 **Q. What are FPL's current Commission-approved DSM programs?**

21 A. FPL's current DSM Plan consists of six Residential DSM programs
22 and eight Commercial/Industrial DSM programs.

23

1 The residential DSM programs are as follows:

2

3 **Residential Conservation Service:** This is an energy audit program
4 which assists residential customers in understanding how to make their
5 homes more energy efficient through the installation of conservation
6 measures/practices.

7

8 **Residential Building Envelope:** This program encourages the
9 installation of energy-efficient ceiling insulation in residential
10 dwellings that utilize whole-house electric air conditioning.

11

12 **Duct System Testing and Repair:** This program encourages demand
13 and energy conservation through the identification of air leaks in
14 whole-house air conditioning duct systems and by the repair of those
15 leaks by qualified contractors.

16

17 **Residential Air Conditioning:** This is a program which encourages
18 customers to purchase higher efficiency central cooling and heating
19 equipment.

20

21 **Residential Load Management (On Call):** This program offers load
22 control of major appliances/household equipment to residential
23 customers in exchange for monthly electric bill credits.

1 **New Construction (BuildSmart):** This program encourages the
2 design and construction of energy-efficient homes that cost-effectively
3 reduce coincident peak demand and energy consumption.

4
5 FPL's current commercial/industrial DSM programs are as follows:

6
7 **Business Energy Evaluation:** This program encourages energy
8 efficiency in both new and existing commercial and industrial facilities
9 by identifying DSM opportunities and providing recommendations to
10 the customer.

11
12 **Commercial/Industrial Heating, Ventilating, and Air Conditioning:**

13 This program encourages the use of high-efficiency heating,
14 ventilating, and air conditioning (HVAC) systems in
15 commercial/industrial facilities.

16
17 **Commercial/Industrial Efficient Lighting:** This program encourages
18 the installation of energy-efficient lighting measures in
19 commercial/industrial facilities.

20
21 **Business Custom Incentive:** This program encourages
22 commercial/industrial customers to implement unique energy
23 conservation measures or projects not covered by other FPL programs.

1 **Commercial/Industrial Load Control:** This program reduces peak
2 demand by controlling customer loads of 200 kW or greater during
3 periods of extreme demand or capacity shortages in exchange for
4 monthly electric bill credits. (This program was closed to new
5 participants in 2000.)

6
7 **Commercial/Industrial Demand Reduction:** This program (which
8 started in 2001) is similar to the Commercial/Industrial Load Control
9 program mentioned above. Its objective is to reduce peak demand by
10 controlling customer loads of 200 kW or greater during periods of
11 extreme demand or capacity shortages. In exchange for giving FPL the
12 right to exercise load control, participants receive monthly electric bill
13 credits.

14
15 **Commercial/Industrial Building Envelope:** This program encourages
16 the installation of energy-efficient building envelope measures such as
17 window treatments and roof/ceiling insulation for
18 commercial/industrial facilities.

19
20 **Business On Call:** This program offers load control of central air
21 conditioning units to both small non-demand-billed and medium
22 demand-billed commercial/industrial customers in exchange for
23 monthly electric bill credits.

1 **Q. Has FPL continued to refine and improve these DSM programs?**

2 A. Yes, since implementing its latest DSM Plan in 2000, FPL has made
3 changes to existing programs. These include revising incentive
4 schedules for several programs as well as enhancing eligibility
5 requirements to encourage additional participation.

6

7 **Q. Has FPL continued to look for new DSM opportunities?**

8 A. Yes. Historically, FPL has performed extensive DSM research and
9 development. FPL has continued such activities not only through its
10 Conservation Research and Development Program, but also through
11 individual research projects. These efforts examine a wide variety of
12 technologies, which build on prior FPL research, where applicable,
13 and will expand the research to new and promising technologies as
14 they emerge. FPL's current initiatives are:

15

16 **Conservation Research and Development Program:** FPL's
17 Conservation Research and Development Program is designed to
18 evaluate emerging conservation technologies to determine which are
19 worthy of pursuing for program development and approval. FPL has
20 researched a wide variety of technologies and, from that research, has
21 been able to develop new programs such as Residential New
22 Construction, Commercial/Industrial Building Envelope and Business
23 On Call.

1 **Cool Communities Research Project:** Cool Communities is a
2 concept developed by American Forests to demonstrate the extent to
3 which strategic tree planting and surface color lightening can cool
4 ambient air temperature and impact energy consumption. This research
5 project is designed to evaluate emerging conservation technologies and
6 practices associated with residential structures to determine which are
7 worthy of pursuing for program development and approval. The
8 project, which consists of data gathering, statistical regression analysis
9 and economic evaluation, will quantify savings from lightened roof
10 color and tree shading of homes. This project was recently completed
11 and is being evaluated as a potential future DSM offering.

12
13 **Low Income Weatherization Retrofit Project:** This R&D project is
14 investigating cost-effective methods of increasing the energy
15 efficiency of FPL's low - income customers. The research project
16 addresses the needs of low - income housing retrofits by providing
17 monetary incentives to various housing authorities, including
18 weatherization agency providers and non-weatherization agency
19 providers. These incentives are used by the housing authorities to
20 leverage their funds to increase the overall energy efficiency of the
21 homes they are retrofitting. FPL conducts a home energy survey, trains
22 housing authority employees to perform FPL home energy surveys,
23 accepts the National Energy Audit Tool (NEAT) (as supplemented to

1 capture water heating recommendations not included in the NEAT
2 audit), or approves similar FPL-approved audits conducted by
3 weatherization providers to determine the need for energy-efficient
4 retrofit measures for each home. FPL has designed this project so as to
5 minimize extra work for the retrofit housing authorities.

6
7 **Photovoltaic Research, Development and Education Project:**

8 Photovoltaic (PV) roof-tile systems are a relatively new technology
9 which directly replaces existing roofing materials such as shingles and
10 standing-rib roofing with PV materials. These PV materials have the
11 same waterproofing characteristics as conventional roofing materials.
12 This project is consistent with the Federal Government's Million Solar
13 Roofs initiative. However, based on FPL's research to date, a primary
14 hurdle to the physical installation of PV systems, whether roofing
15 materials or flat plate collectors, is the lack of awareness,
16 understanding and acceptance by local building officials. For the most
17 part, these officials are unclear about how these systems work and how
18 to address these systems as part of the building permitting and
19 inspection process. This creates barriers toward the use of this
20 technology. This project will provide key understanding of the
21 operation, performance, costs, and interconnection issues of this
22 technology.
23

1 **Green Energy Project:** FPL completed an R&D project addressing
2 customer acceptance of “green energy,” in which donations were used
3 as the funding mechanism for the purchase and installation of utility
4 grid connected PV systems. This project raised in excess of \$89,500
5 and a 10.1 kW (dc) PV system has been constructed at FPL’s Martin
6 power plant site.

7
8 FPL is now investigating potential customer acceptance of green
9 pricing rates in its Green Energy Project. Under this project, FPL will
10 purchase electric energy generated from new renewable resources
11 including solar-powered technologies, biomass energy, landfill
12 methane, wind energy, low impact hydroelectric energy or other
13 renewable resources. Participating customers will be charged higher
14 “green” electric rates for using electric energy derived from these
15 sources. FPL has performed an evaluation to determine the
16 availability of renewable supply sources in Florida and customer
17 acceptance of the program concept. As part of this evaluation, in late
18 2001, FPL developed an RFP in order to determine the type,
19 availability and potential costs of renewable energy. FPL received
20 four bids from this process. Several bids were received from
21 Qualifying Facilities (QF) at a cost higher than FPL’s avoided cost.
22 FPL currently has pending before the Commission a petition for a
23 declaratory statement that FPL may, pursuant to a Green Energy

1 program, pay renewable energy QFs in excess of its avoided cost. If
2 FPL secures its requested declaratory statement, FPL anticipates
3 moving forward with a Green Energy program.
4

5 **Real-Time Pricing:** Although not part of FPL's approved DSM
6 Plan, FPL continues to research new conservation/efficiency options
7 such as Real-Time Pricing. This option is an experimental service
8 offering for large C/I customers designed to evaluate customer load
9 response to hourly, marginal cost-based energy prices provided on a
10 day-ahead basis.
11

12 **Q. What would FPL's need for additional capacity be without the**
13 **benefits of post-2001 DSM?**

14 A. FPL's goals call for an additional 354 incremental MW (at the meter)
15 of summer peak reduction during the 2002 through 2006 time frame.
16 Without this additional DSM, FPL's future capacity needs would have
17 significantly increased. In fact, FPL's capacity needs would have
18 advanced a year from 2005 to 2004 if the incremental DSM MW
19 called for in the Goals were not implemented. This 2004 need would
20 have been approximately 400 MW.
21
22
23

1 V. **Conclusion**

2

3 Q. **Do the Commission-approved goals and FPL's efforts to meet**
4 **those goals capture FPL's reasonably achievable DSM?**

5 A. Yes. The Commission has previously determined that FPL's current
6 DSM goals represent the reasonably achievable, cost-effective level.
7 This determination was made based on a comprehensive analysis and
8 record. FPL has been successful in meeting or exceeding these goals,
9 while maintaining cost-effectiveness.

10

11 Q. **Has FPL identified any DSM option that would lead to a**
12 **significant increase in DSM penetration in sufficient time to defer**
13 **capacity identified in this determination of need?**

14 A. No. FPL has already identified its reasonably achievable DSM
15 potential and used this as input to its reliability assessment that
16 resulted in the need to add 1,722 MW of supply side resources.
17 Therefore, FPL's analysis has already captured the cost-effective DSM
18 available on FPL's system, and it was determined that FPL still needs
19 additional capacity resources. Therefore, there is no available DSM
20 potential that could mitigate the need for Martin Unit 8 or Manatee
21 Unit 3.

22

1 Even if there were some modest potential for additional DSM on
2 FPL's system, it is totally unrealistic to conclude that FPL could add
3 significant incremental quantities during the next three years to
4 mitigate the need for even Martin Unit 8, the smaller project, on an
5 incremental capacity basis. The Martin conversion will add 789 MW
6 by the summer of 2005. The Commission previously determined that
7 there was only 765 MW of achievable cost-effective DSM for the
8 entire ten years, 2000 to 2009. It is unrealistic to conclude that FPL
9 could achieve an additional 789 MW of DSM in the next three years,
10 above and beyond its existing goals.

11
12 **Q. Does this conclude your testimony?**

13 **A. Yes, it does.**

1 BY MR. NIETO:

2 Q Could you please summarize your testimony.

3 A Good afternoon, Madam Chairman, and Commissioners.

4 I'd like to take a few minutes to update you on FPL's demand
5 side management activities and how they are used in this study
6 to maximize the benefit to our customers.

7 FPL used a comprehensive analysis to capture all the
8 cost-effective DSM, and this was used as an input to determine
9 FPL's future needs. FPL has a long history of DSM. We started
10 our initial programs in the late 1970s, and we have continued
11 to add additional programs throughout the years.

12 FPL is a leader in DSM. The most recent Department
13 of Energy study found that FPL was ranked number one among
14 utilities in cumulative conservation, number two in load
15 management. FPL has been very successful in implementing DSM
16 to avoid new power plant construction. We've done more than
17 1.7 million energy audits. We've deferred more than 3,000
18 megawatts of peak demand reduction, and this has resulted in
19 the elimination of the need for nine new power plants.

20 FPL's DSM initiatives are driven by two key
21 complementary drivers. The first is to be responsive to Rule
22 25-17.0021, which is a rule that sets DSM goals, and the second
23 is a plan to meet the future capacity needs of our customers in
24 the cost-effective manner. A multistep process was used for
25 determining our current Commission-approved DSM goals. The

1 first step of that process was to determine which measures to
2 be evaluated.

3 In FPL's most recent analysis, we looked at more than
4 160 measures. The selected measure would then screen for
5 cost-effectiveness using the rate impact measure and the
6 participant test, and for those that were found to be
7 cost-effective, annual market acceptance rates where achievable
8 potentials were determined. The cost-effective measures and
9 their achievable potential further analyze to identify the most
10 cost-effective DSM portfolio for FPL's customers. The
11 resulting programs that FPL currently has to support these
12 goals are six residential programs and eight
13 commercial/industrial programs. These programs address audits,
14 air-conditioning, duct system testing or repair, building
15 envelope, lighting, new construction, and load management.

16 In summary, FPL's current Commission-approved DSM
17 goals which include 354 megawatts of additional DSM from 2002
18 to 2006 capture the reasonably achievable cost-effective
19 potential. This determination was made based on a
20 comprehensive analysis and record. We have been successful in
21 meeting these goals while maintaining cost-effectiveness.
22 Based on our goals and achievement to date, it was determined
23 that FPL still needs the additional capacity resources we're
24 seeking in this proceeding. Thank you very much.

25 CHAIRMAN JABER: Thank you.

1 MR. NIETO: Thank you. I skipped over one small
2 housekeeping matter.

3 BY MR. NIETO:

4 Q Mr. Brandt, are you sponsoring any portions of FPL's
5 Need Study in this proceeding?

6 A Yes, I'm sponsoring Section VI.

7 Q And are you sponsoring any of the appendices to the
8 Need Study?

9 A I'm sponsoring Appendix O.

10 Q Are the portions of the Need Study and the appendix
11 that you sponsored true and correct, to the best of your
12 knowledge and belief?

13 A Yes, they are.

14 MR. NIETO: I tender Mr. Brandt for
15 cross-examination.

16 CROSS EXAMINATION

17 BY MR. MOYLE:

18 Q I have a few questions for you, if I could. DSM,
19 explain, if you would, what your understanding is with respect
20 to the goal or the purpose of DSM.

21 A I believe the purpose of the goal is -- of the goal
22 proceeding is to determine what is the reasonably achievable
23 cost-effective potential for DSM in a utility's service
24 territory.

25 Q Would I be wrong in believing that one of the goals

1 of DSM would be to do what you could to conserve energy, so you
2 could forestall the construction of new power plants?

3 A Yes, sir, I believe you are correct. Obviously, a
4 key there is making sure what you're doing is cost-effective.

5 Q And you talked a little bit about your goals. Have
6 you ever exceeded your goals with respect to DSM to date?

7 A Some years we've been over your goals, and actually,
8 some years we've been below our goals.

9 Q What years, if you recall, have you been over your
10 goals?

11 A Well, our most recent goals were for the years 2000
12 through 2009, and in the year 2000 we were under our goal, and
13 the year 2001 we were above our goal.

14 Q How much were you above your goal in 2001?

15 A I believe around 40 megawatts.

16 Q Four-zero?

17 A Four-zero, yes, sir.

18 Q You know, we've had a lot of talk about these
19 15 megawatts and whatnot. To the extent that actual reality
20 exceeded what you had forecast, would you take that into
21 account when determining FPL's need?

22 A I didn't take that into account in determining FPL's
23 need. Obviously, our achievements to date was an input into
24 how much future capacity might be needed, and obviously, our
25 going-forward goals was considered an input to this process.

1 Q You said that you had eliminated nine power plants.
2 You saved enough to represent nine power plants; is that
3 correct?

4 A Yes, sir, that's correct.

5 Q Is it a goal to either defer or eliminate power
6 plants through a DSM process of FPL's?

7 A Yes, that's one of our objectives.

8 Q Okay. So would you agree that if 15 megawatts could
9 be found somewhere within FPL's system, an amount that I think
10 represents less than one-tenth of 1 percent of FPL's overall
11 generating ability, and 15 megawatts could be found to defer
12 the construction of the Martin unit, that that would be
13 consistent with FPL's DSM goals?

14 A It would be consistent to the extent that it was
15 found to be cost-effective.

16 Q You were here for the testimony of Mr. Green, were
17 you not?

18 A Yes, I was.

19 Q Okay. And I asked him a question about FPL
20 projecting a peak demand that's not adjusted for incremental
21 conservation or load management. And conservation and load
22 management, that's kind of your area of expertise, is it not?

23 A Determining the impacts of conservation and load
24 management is my area of expertise, yes, sir.

25 Q FPL has the ability, does it not, to do kind of an

1 ongoing look at DSM to figure out how it's doing in terms of
2 meeting its goals?

3 A Yes, sir, we do do that.

4 Q Okay. Do you believe that there's an additional
5 15 megawatts of DSM that could be found through conservation
6 and load management or any other thing that's under your
7 purview that could account for 15 megawatts in 2005?

8 A I think the answer is yes. However, I want to
9 quantify that by saying that if the objective is to defer
10 Martin Unit Number 8 from 2005 to 2006, you know, one of things
11 we'd have to look at is what's the benefit of doing that. And
12 I think several witnesses have already testified to the extent
13 that deferring Martin Unit Number 8 from 2005 to 2006 actually
14 increased the costs to our customers.

15 So from a DSM perspective, our goal is to try to
16 defer or avoid units. And if we're looking at Martin Number 8,
17 there's really not much benefit there, or any benefit there, by
18 deferring that from 2005 to 2006. So doing incremental DSM
19 above this 15 megawatts that there seems to be a lot of
20 discussion around, all it's really doing is adding additional
21 costs to the overall plan to our customers.

22 Q And your job responsibilities, you had just described
23 cost-effectiveness and whatnot. That's not part of what you
24 do, is it? That's what others do?

25 A That's correct. My primary job is to understand the

1 impacts of DSM programs, to market those programs, and make
2 sure that we're operating them as effectively as possible.

3 Q So the answer you gave my question about the
4 cost-effectiveness, that was based at least in part on your
5 being here while other witnesses were asked those types of
6 questions; correct?

7 A Yes, to that extent. And, you know, as part of our
8 DSM evaluation, we get involved on a day-to-day basis in
9 reviewing the output of cost-effectiveness runs.

10 MR. MOYLE: I have no further questions. Thank you.

11 CHAIRMAN JABER: Mr. McGlothlin.

12 MR. MCGLOTHLIN: Thank you.

13 CROSS EXAMINATION

14 BY MR. MCGLOTHLIN:

15 Q Mr. Brandt, I'm looking at Page 22 of your prefiled
16 testimony, the portion called "Conclusion." The last question
17 posed to you on that page asks, "Has FPL identified any DSM
18 option that would lead to a significant increase in DSM
19 penetration in sufficient time to defer capacity identified in
20 this determination of need?"

21 And on the next page, the portion of your answer that
22 speaks to Martin 8 says, "The Martin conversion will add
23 789 megawatts by the summer of 2005. The Commission previously
24 determined that there was only 765 megawatts of achievable
25 cost-effective DSM for the entire ten years, 2000 to 2009. It

1 is unrealistic to conclude that FPL could achieve an additional
2 789 megawatts of DSM in the next three years, above and beyond
3 its existing goals."

4 So with respect to that question and answer, you were
5 answering in terms of whether it was realistic to try to find
6 enough DSM to match the Martin capacity megawatt for megawatt,
7 a total of 789; is that correct?

8 A Yes, sir, that's correct.

9 Q At the time you wrote the testimony, were you aware
10 that it required less than 789 megawatts to defer Martin 8?

11 A No, I did not know that at that time.

12 Q When Dr. Green was on the stand, he sponsored
13 testimony indicating that he predicts the load growth on this
14 system will increase in coming years. Do you recall that
15 testimony?

16 A Yes, sir, I remember him saying that.

17 Q Would a larger number of customers and increases in
18 the consumption by those customers provide some opportunity for
19 increased DSM levels?

20 A It basically -- what that does is increases the
21 potential number of participants. It doesn't necessarily mean
22 you can do more cost-effective DSM.

23 Q You have a larger pool of possibilities to work with,
24 do you not?

25 A That's correct.

1 Q And some of those may provide you candidates for DSM
2 programs?

3 A They might be candidates, but let me give you an
4 example. We have a load management program that we have -- you
5 know, we basically have a large population of customers that
6 are eligible. Although, that program if you look from a
7 realistic perspective, only so many customers -- there's a
8 fixed number of customers or participants of that program that
9 really make sense. So just because I have more eligible people
10 doesn't necessarily mean I'll automatically imply you'll get
11 more DSM out of them.

12 Q But in any event, more customers means more
13 candidates that may or may not prove to be good candidates for
14 DSM?

15 A I can agree with that statement, yes, sir.

16 Q The question and answer to which I referred in your
17 prefiled testimony, you answered in terms of whether the
18 capacity could be deferred without getting into the additional
19 subject of whether that would be good or bad for customers; is
20 that correct?

21 A Yes, sir.

22 Q I'll ask you to answer this question in same mode,
23 looking simply at whether DSM is available to displace
24 otherwise planned capacity. Did I understand you to say to
25 Mr. Moyle that it's your view that it's possible to find

1 15 megawatts of cost-effective DSM?

2 A No, I don't believe I said it was cost-effective DSM.
3 I said I thought it's possible to get 15 more megawatts of DSM
4 if cost-effectiveness wasn't a concern.

5 Q When you introduce cost-effectiveness, do you have in
6 mind the RIM test which is your gauge, or do you have in mind
7 the questions and answers and the debate about whether it's
8 beneficial to defer Martin 8?

9 A I think the proper way to answer that question would
10 be, first, you would have to understand what is the unit that
11 we're trying to defer or avoid. Without that being clearly
12 specified, I'm not sure I could give you a clear answer. So if
13 your answer was in the context of Martin Unit Number 8, in
14 which case that's the unit we're trying to defer one year, then
15 I would say it would be very difficult to get cost-effective
16 DSM.

17 Q Typically, when you analyze DSM programs and apply
18 the RIM test, is that on a unit-specific basis?

19 A Typically -- first of all, let me clarify. I don't
20 do that -- I don't pick the avoided user to do that part of the
21 analysis. I am primarily someone that provides inputs to the
22 analysis. But it's my understanding you would have a supply
23 side expansion plan, and then you'd come up with your best
24 guess or estimates of what DSM can do as compared against that
25 supply-side-only plan to determine the benefits of doing DSM.

1 Q If the question were posed in this way, considering
2 only whether the DSM could displace plant capacity such that
3 it's not required in 2005 but it's required in 2006, is it your
4 view that one could find additional 15 megawatts of DSM that
5 would pass a RIM test?

6 A I don't believe so, no, sir.

7 MR. McGLOTHLIN: All right. That's all the questions
8 I have.

9 MR. PERRY: No questions.

10 CHAIRMAN JABER: Mr. Twomey.

11 MR. TWOMEY: Thank you, Madam Chairman.

12 CROSS EXAMINATION

13 BY MR. TWOMEY:

14 Q Good afternoon, Mr. Brandt.

15 A Good afternoon.

16 Q I just have a question or two. At Page 21 of your
17 prefiled direct testimony at Line 14 you answer a question, and
18 you say, "FPL's goals call for an additional 354 incremental
19 megawatts (at the meter) of summer peak reduction during the
20 2002 through 2006 time frame." That's correct, isn't it?

21 A Yes, sir, that's what it says.

22 Q Okay. Now, with respect to that particular time
23 frame, if you measure the 15 megawatts we've been talking about
24 for the last day or two, or however long it's been, that's only
25 about 4.2 percent of the total program, is it not?

1 A I don't have a calculator with me, sir, so I'm not
2 sure I could actually --

3 Q Just --

4 A It sounds close, sounds reasonable.

5 Q Subject to check, 4.23 percent. So is it your
6 testimony that cost-effective DSM couldn't be found in that
7 time period?

8 A Yes, sir, it is, assuming that the objective is to
9 move Martin Number 8 from 2005 to 2006, because we've already,
10 I think, discussed that there's really no benefit to our
11 customers from moving Martin from 2005 to 2006. It actually
12 increases the costs to our customers.

13 Q Again, that last testimony as Mr. Moyle pointed out,
14 I think, based upon what you heard the other witnesses say
15 vis-a-vis the purported savings of building the two units at
16 the same time; is that right?

17 A Yes, sir. But remember, you know, before I can
18 answer a question about cost-effectiveness, we need to
19 understand what we're shooting at on the supply side.

20 MR. TWOMEY: Okay. Thank you. That's all.

21 CHAIRMAN JABER: Thank you, Mr. Twomey.

22 Staff.

23 MR. HARRIS: We have no questions.

24 CHAIRMAN JABER: Commissioners?

25 Okay. Redirect.

1 MR. NIETO: I just have one question.

2 REDIRECT EXAMINATION

3 BY MR. NIETO:

4 Q You were asked a series of questions by Mr. Moyle
5 about FPL's past performance with regard to DSM. Going
6 forward, will it be less difficult or more difficult for FPL to
7 meet or exceed its DSM goals?

8 A I believe it's actually going to be more of a
9 challenge going forward. There's lots of things going on in
10 the market that will make hitting our goals more difficult.
11 Examples of those are: Some of our programs have been around
12 for a while and are reaching maturity. We're finding that the
13 efficiencies of air-conditioners, for example, out in the
14 market is accelerating faster than was originally forecast. I
15 talked briefly already about the issue about load management
16 kind of reaching an effective cap. So all those things
17 combined will make it more and more difficult to go forward and
18 meet the goals that we've agreed to with the Commission.

19 MR. NIETO: That's all I have.

20 CHAIRMAN JABER: Thank you. Thank you, Mr. Brandt.

21 I have -- FPL, you've got one exhibit, 21, DB-1
22 through DB-5. Without objection, Exhibit 21 is admitted into
23 the record.

24 (Exhibit 21 admitted into the record.)

25 CHAIRMAN JABER: Can you call your next witness,

1 please.

2 MR. HILL: We call Mr. William Avera.

3 May we have Mr. Brandt excused so that he may leave
4 the proceedings at this point?

5 CHAIRMAN JABER: Yes.

6 MR. HILL: Thank you.

7 (Witness excused.)

8 CHAIRMAN JABER: Mr. Hill, are there witnesses here
9 today that have not been sworn?

10 MR. HILL: I don't believe Mr. Avera --

11 MR. AVERA: I have been sworn.

12 CHAIRMAN JABER: Anyone else? Why don't I go ahead
13 and have you stand and rise your right hand, please.

14 (Witnesses collectively sworn.)

15 CHAIRMAN JABER: Thank you.

16 MR. MOYLE: CPV witness Finnerty is also here but he
17 was out of the room.

18 CHAIRMAN JABER: Mr. Moyle, I'm sorry. I couldn't
19 hear you.

20 MR. MOYLE: I'm sorry. CPV witness Mr. Finnerty is
21 also here, but he was out of the room and was not sworn, so
22 we'll just have to remember to swear him.

23 CHAIRMAN JABER: Mr. Litchfield, is this your
24 witness?

25 MR. LITCHFIELD: Yes, Madam Chairman, it is.

1 WILLIAM E. AVERA

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

4 DIRECT EXAMINATION

5 BY MR. LITCHFIELD:

6 Q Dr. Avera, would you state your name and business
7 address for the record?

8 A William E. Avera, FINCAP, Incorporated, 3907 Red
9 River Street, Austin, Texas.

10 Q And you were engaged by Florida Power & Light Company
11 for purposes of this proceeding?

12 A Yes, sir.

13 Q And you have before you direct testimony dated
14 July 16th, 2002 prefiled in this docket consisting of 23 pages?

15 A Yes, sir.

16 Q And do you have documents WEA-1 and WEA-2 attached to
17 that testimony before you?

18 A Yes, sir.

19 MR. LITCHFIELD: Madam Chairman, I'd ask that the
20 next exhibit number be assigned to Dr. Avera's documents
21 WEA-1 and 2 as a composite exhibit.

22 CHAIRMAN JABER: Hearing Exhibit 22 will be
23 identified for WEA-1 and WEA-2.

24 (Exhibit 22 marked for identification.)

25 BY MR. LITCHFIELD:

1 Q You have previously been sworn, have you not,
2 Dr. Avera?

3 A Yes, I have.

4 Q Do you have any changes to this prefiled direct
5 testimony?

6 A No, sir, I do not.

7 Q If I were to ask you the questions that are
8 identified here in your prefiled direct testimony, would your
9 answers to those questions be the same as set forth in the
10 testimony?

11 A Yes, they would.

12 Q Would you please summarize your direct testimony.

13 MR. MOYLE: Before we get to that, I just would like
14 to make an objection for the record. I think I made it
15 yesterday as well. But anything related to what Moody's or
16 Standard & Poor's does with respect to the equity penalty, I
17 would maintain is based on hearsay and that it be so noted, so
18 long as it's not being used as the primary basis to prove, you
19 know, what equity -- what Moody's or Standard & Poor's does
20 with the equity penalty, similar to the letter that
21 Mr. Caldwell wrote that Mr. Guyton objected to.

22 CHAIRMAN JABER: Mr. Moyle, the objection is that the
23 reliance on citing the ratings used for the equity penalty is
24 hearsay.

25 MR. MOYLE: Yes, ma'am.

1 CHAIRMAN JABER: Mr. Litchfield, your response.

2 MR. LITCHFIELD: Madam Chairman, I think under the
3 APA in the first instance, there is a slightly wider latitude
4 afforded to information that might otherwise be hearsay under
5 conventional civil rules of procedure. And in this particular
6 case in the APA, these materials are of the nature and type of
7 materials that typically people in Dr. Avera's position, i.e.,
8 a financial expert, would rely upon in formulating opinions and
9 conclusions.

10 I think the reports in fact that are referenced and
11 the statements that are referenced in his testimony come from
12 in some instance the same types of reports that Mr. Maurey is
13 citing in his testimony. And I think if we're going to
14 characterize things like that as hearsay, we're going to spend
15 a long time today arguing about that and in future proceedings
16 as well.

17 I think this clearly falls within the scope of
18 nonhearsay for purposes of administrative proceedings, and
19 otherwise, it is corroborated by their evidence in this case.
20 But I think I've given you a sufficient basis to rule.

21 CHAIRMAN JABER: Yeah, the ruling is this, Mr. Moyle:
22 I'm going to allow all of those questions and give you latitude
23 to ask and establish whether the evidence you're concerned with
24 is hearsay.

25 MR. MOYLE: Okay. Thank you.

1 CHAIRMAN JABER: And I think, Mr. Litchfield, you
2 were about to ask me to insert the prefiled direct testimony
3 into the record as though read.

4 MR. LITCHFIELD: Yes, I was. Thank you.

5 CHAIRMAN JABER: It shall be inserted into the record
6 as though read.

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **DIRECT TESTIMONY OF WILLIAM E. AVERA**

4 **DOCKET NOS. 020262-EI, 020263-EI**

5 **JULY 16, 2002**

6
7 **Q. Please state your name and business address.**

8 A. William E. Avera, 3907 Red River, Austin, Texas, 78751.

9
10 **Q. By whom are you employed and in what capacity?**

11 A. I am a principal in Financial Concepts and Applications, Inc. (FINCAP), a
12 firm engaged in financial, economic, and policy consulting to business and
13 government.

14
15 **Q. Describe your educational background, professional qualifications, and
16 prior experience.**

17 A. I received a B.A. degree with a major in economics from Emory University.
18 After serving in the U.S. Navy, I entered the Ph.D. program in economics at
19 the University of North Carolina at Chapel Hill. Upon graduation, I joined the
20 faculty at the University of North Carolina and taught finance in the Graduate
21 School of Business. I subsequently accepted a position at the University of
22 Texas at Austin where I taught courses in financial management and
23 investment analysis. I then went to work for International Paper Company,

1 Inc. in New York City as Manager of Financial Education, a position in which
2 I had responsibility for all corporate education programs in finance,
3 accounting, and economics.

4
5 In 1977 I joined the staff of the Public Utility Commission of Texas (PUCT)
6 as Director of the Economic Research Division. During my tenure at the
7 PUCT, I managed a division responsible for financial analysis, cost allocation
8 and rate design, economic and financial research, and data processing
9 systems, and I testified in a number of cases on a variety of financial and
10 economic issues. Since leaving the PUCT in 1979, I have been engaged as a
11 consultant. I have participated in a wide range of analytical assignments
12 involving utility-related matters on behalf of utilities, industrial customers,
13 municipalities, and regulatory commissions. I have testified before the Federal
14 Energy Regulatory Commission (FERC), as well as the Federal
15 Communications Commission (FCC), the Surface Transportation Board (and
16 its predecessor, the Interstate Commerce Commission), the Canadian Radio-
17 Television and Telecommunications Commission, and regulatory agencies,
18 courts, and legislative committees in 28 states.

19
20 With the approval of then-Governor George W. Bush, I was appointed by the
21 PUCT to the Synchronous Interconnection Committee to advise the Texas
22 legislature on the costs and benefits of connecting Texas to the national
23 electric transmission grid. Currently, I am serving as an outside director of

1 Georgia System Operations Corporation, the system operator for electric
2 cooperatives in Georgia.

3
4 I have served as Lecturer in the Finance Department at the University of
5 Texas at Austin and taught in the evening graduate program at St. Edward's
6 University for twenty years. In addition, I have lectured on economic and
7 regulatory topics in programs sponsored by universities and industry groups. I
8 have taught in hundreds of educational programs for financial analysts
9 sponsored by the Association for Investment Management and Research, the
10 Financial Analysts Review, and local financial analysts societies. These
11 programs have been presented in Asia, Europe, and North America, including
12 the Financial Analysts Seminar at Northwestern University. I hold the
13 Chartered Financial Analyst (CFA) designation and have served as Vice
14 President for Membership of the Financial Management Association. I was
15 elected Vice Chairman of the National Association of Regulatory
16 Commissioners (NARUC) Subcommittee on Economics and appointed to
17 NARUC's Technical Subcommittee on the National Energy Act. I have also
18 served as an officer of various other professional organizations and societies.
19 A resume containing the details of my experience and qualifications is
20 attached as Document WEA-2.

21
22 **Q. What is the purpose of your testimony?**

23 **A.** As a result of the comprehensive review of Florida Power & Light Company's

1 (FPL or the Company) capacity alternatives described in the Need Study, FPL
2 recently completed a solicitation for competitive power supplies in order to
3 identify the most cost-effective alternatives for new resources. My firm was
4 retained to consult with FPL regarding financial issues related to the
5 solicitation. The purpose of my testimony is to examine the impact of power
6 purchase contracts on FPL's financial position and present to the Florida
7 Public Service Commission (FPSC or the Commission) the method FPL used
8 to account for these impacts in its economic evaluation of capacity
9 alternatives submitted in response to its Supplemental Request for Proposals
10 (Supplemental RFP).

11
12 **Q. Please summarize the basis for your conclusions concerning the issues on**
13 **which you are testifying in this hearing.**

14 A. To prepare my testimony, I used information from a variety of sources that
15 would normally be relied on by a person in my capacity. I am familiar with
16 the organization, finances, and operations of FPL through the pre-filed
17 testimony that I prepared previously on behalf of the Company in conjunction
18 with the FPSC's recent review of FPL's rates (Docket No. 001148-EI). I also
19 reviewed information relating specifically to my opinions in this proceeding,
20 including bond rating agency reports, and prior regulatory proceedings and
21 orders, and articles in the trade press. These sources, coupled with my
22 experience in the fields of finance and utility regulation, have given me a
23 working knowledge of FPL and are the basis for my conclusions.

1 **Q. What are your conclusions regarding the impact of purchased power**
2 **contracts on FPL's financial position?**

3 A. Investors regard purchased power contracts as off-balance-sheet obligations
4 that increase the financial leverage of the purchaser. To maintain bond ratings
5 and financial flexibility, utilities must offset purchased power obligations with
6 increased equity. This equity requirement has been recognized in past orders
7 of the Commission and bond rating agency reports for FPL. Consideration of
8 the cost of additional equity required when FPL increases its purchased power
9 commitments is consistent with FPSC orders and the treatment afforded these
10 obligations by the major rating agencies. FPL's equity penalty calculation
11 correctly accomplishes this adjustment.

12
13 **Q. What portion of FPL's power requirements are met through long-term**
14 **purchased power contracts?**

15 A. With a summer 2002 combined capacity of approximately 21,140 megawatts
16 (MW), FPL's system capacity consists of 17,860 MW from company-owned
17 facilities and approximately 3,280 MW through firm purchased power
18 contracts. Take-or-pay purchased power contracts with the Jacksonville
19 Electric Authority and with subsidiaries of The Southern Company provide
20 approximately 1,310 MW of power through mid-2010 and 382 MW thereafter
21 through 2021. FPL also has various firm contracts to purchase approximately
22 900 MW of capacity and energy from certain cogenerators and qualifying
23 facilities. Expiration dates on these agreements range from 2002 through

1 2026. In addition, during 2001 FPL entered into agreements with several
2 other electricity suppliers to purchase an aggregate of up to approximately
3 1,300 MW of power with expiration dates ranging from 2003 through 2007.
4 FPL's purchased power resources represent approximately 16 percent of FPL's
5 total capacity resources for 2002.

6
7 **Q. How do these long-term purchased power commitments impact FPL's**
8 **financial position?**

9 A. While purchased power resource strategies do not involve direct capital
10 investment, they nonetheless have financial implications that must be
11 considered to allow for a meaningful comparison between supply alternatives.
12 When a utility contracts for firm, long-term purchased power, the associated
13 fixed cost components imply additional financial risks. FPL's existing power
14 purchase agreements, as well as those proposals submitted in response to its
15 Supplemental RFP, also obligate the Company to make certain capacity and
16 minimum contractual payments. These relatively greater fixed charges
17 associated with purchased power contracts are akin to those associated with
18 other financial obligations, such as long-term debt. As a result, these
19 commitments are equivalent to an off-balance sheet liability, and
20 incorporating the debt equivalent of obligations under purchased power
21 contracts would have the effect of increasing financial leverage.

1 **Q. Have these attributes of purchased power been recognized by the**
2 **financial community?**

3 A. Yes. The implications of purchased power commitments for a utility's
4 financial risks have been repeatedly cited by major bond rating agencies. As
5 early as 1992 Standard & Poor's Corporation (S&P) observed in a ratings
6 report for FPL that "a utility incurs certain risks when entering into a long-
7 term contract with fixed-cost capacity component" (*CreditWeek*, April 6,
8 1992). As S&P observed in "Buy Versus Build Debate Revisited"
9 (*CreditWeek*, May 24, 1993):

10

11 When a utility enters into a long-term purchased power
12 contract with a fixed-cost component, it takes on financial risk.
13 Heavy fixed charges reduce a utility's financial flexibility and
14 long-term contractual arrangements represent – at least in part
15 – off balance sheet debt equivalents. (pp. 1-2)

16

17 S&P's assessment of purchased power obligations is analogous to investors'
18 views of other industries that rely on off balance sheet financing, such as
19 airlines.

20

21 Moody's Investors Service (Moody's) has also recognized the risk impact of
22 purchased power [*Electric Utility Week*, October 8, 1990]:

1 Analysts Thomas Marshella and Julia Doetsch noted that a
2 "presumed" benefit to a utility in contracting to buy power
3 rather than build its own plant "is the apparent avoidance of the
4 detrimental balance sheet and fixed-charge coverage impact
5 that would have resulted had the new capacity been utility built
6 and debt financed." Moody's questioned the "generally
7 accepted accounting practices that usually treat purchased
8 power commitments as off-balance-sheet liabilities. "Clearly,
9 construction risk is often reduced, however, significant
10 operating, financial, and regulatory risks may remain and
11 outweigh perceived benefits," they continued, adding that the
12 commitments typically erode a utility's financial flexibility.

13
14 Because the capacity and minimum contractual payment obligations under
15 these agreements are analogous to those associated with traditional debt
16 financing, investors consider these commitments in evaluating FPL's financial
17 risks. Accordingly, incorporating the debt equivalent of FPL's obligations
18 under its purchased power contracts would have the effect of increasing its
19 financial leverage.

20
21 **Q. Is it appropriate to consider these financial implications in an economic**
22 **evaluation of power supply alternatives?**

23 **A. Yes. In order to conduct a meaningful economic comparison between buying**

1 power and self-build options, it is necessary to recognize the financial risks
2 associated with power purchase contracts. Otherwise, the analyses will not
3 reflect the true cost of entering into purchased power agreements and any
4 comparison of the economics between alternative proposals will be flawed.
5 S&P noted that "[u]tilities need to take these 'financial externalities' into
6 account so that buy and build options are evaluated on a level playing field"
7 (*CreditWeek*, May 24, 1993) and emphasized the importance of reflecting the
8 financial realities associated with purchased power commitments in any
9 economic analyses of competitive options (*CreditWeek*, November 1991):

10
11 ...there are indeed benefits to purchasing power, but there are
12 also risks that are too often overlooked. Only by thoroughly
13 examining the risks – as well as the benefits – can a utility
14 choose correctly.

15
16 **Q. What implications do relatively greater amounts of purchased power**
17 **have for a utility's financial flexibility?**

18 A. Because investors perceive additional financial risks with obligations under
19 purchased power contracts, as reliance on these sources increases, the utility
20 must offset the associated debt equivalent by incorporating a higher equity
21 component in the capital structure or through higher returns on equity. As
22 S&P has recognized, because of purchased power, it has been necessary for
23 FPL to maintain a relatively greater proportion of equity capital in order to

1 maintain its credit standing. In a December 3, 1998 report in RatingsDirect,
2 S&P noted that:

3
4 Florida Power & Light has a sizeable amount of fixed payment
5 purchased-power contracts, a portion of which is imputed by
6 Standard & Poor's as an off-balance-sheet obligation, and has
7 maintained a higher amount of equity capital on the balance
8 sheet to counter this off-balance-sheet debt obligation. (p. 2)

9
10 Absent financial policies that recognize the leverage implicit in purchased
11 power contracts, the associated investment risks would place downward
12 pressure on utilities' creditworthiness and debt ratings and the greater leverage
13 implied by a lower common equity ratio would increase investors' required
14 rate of return for both debt and equity securities.

15
16 Apart from the immediate impact the debt-equivalent portion of purchased
17 power costs has on the utility's financial risk, heavy fixed charges also reduce
18 ongoing financial flexibility and the utility may face other uncertainties, such
19 as potential replacement power costs in the event of supply disruption.
20 Moreover, these risks are magnified as the utility's reliance on purchased
21 power increases. Considering that the 1,700 MW increase in purchased power
22 contemplated under FPL's Supplemental RFP would constitute a greater than
23 60 percent increase in the Company's firm purchased power capacity,

1 investors' focus on the financial ramifications and other uncertainties of
2 purchased power would undoubtedly intensify.

3
4 **Q. Has the financial impact of purchased power been previously recognized**
5 **by the FPSC?**

6 A. Yes. For example, in connection with Florida Power Corporation's (FPC)
7 petition for approval to construct the Hines Unit 2 power plant, FPC
8 incorporated an adjustment to recognize the debt equivalent associated with
9 purchase alternatives. The FPSC agreed, noting in Order No. PSC-01-0029-
10 FOF-EI (January 5, 2001) that:

11
12 We find that for long-term debt, we should allow some
13 consideration of imputed debt. Imputed debt is an actual
14 consideration by bond rating agencies. We note that we have
15 allowed limited consideration of imputed debt in past cases.

16
17 Indeed, in Docket No. 990249-EG, Standard Offer Contract for Florida Power
18 & Light Company, the FPSC concluded that "[w]e find it is appropriate to
19 include an equity adjustment when determining FPL's proposed standard offer
20 contract payments" (Order No. PSC-99-1713-TRF-EG, p. 7, September 2,
21 1999). While the Commission chose not to address the broader policy issue of
22 who should bear the incremental cost of additional equity to compensate for
23 purchased power contracts, the FPSC recognized (*Ibid.* at p. 7-8) that:

1 Buying power increases the utility's fixed charges, which, in
2 turn, can reduce financial flexibility. Standard & Poor's (S&P)
3 notes that, "regardless of whether a utility buys or builds,
4 adding capacity means incurring risk." ... In including this
5 equity adjustment, FPL is reflecting the cost, in the form of less
6 financial flexibility, that is imposed on electric utilities with
7 purchased power contracts.

8
9 Rule 25-22.081(7), F.A.C., relating to the contents of a petition for
10 determination of need, also requires the utility to consider the implications of
11 purchased power on its financial position:

12
13 If the generation addition is the result of a purchased power
14 agreement between an investor-owned utility and a nonutility
15 generator, the petition shall include a discussion of the
16 potential for increases or decreases in the utility's cost of
17 capital, the effect of the seller's financing arrangements on the
18 utility's system reliability, any competitive advantage the
19 financing arrangements may give the seller and the seller's fuel
20 supply adequacy.

21
22 Since 1999, the FPSC has recognized the financial leverage implicit in
23 purchased power contracts in the approach used for surveillance reporting

1 requirements. The current Revenue Sharing Agreement in effect for FPL
2 included in Order No. PSC-02-0501-AS-EI, April 11, 2002, incorporates by
3 reference the following provision from the Stipulation and Settlement
4 approved by the Commission in 1999 (Order No. PSC-99-0519-AS-EI, March
5 17, 1999):

6
7 [FPL's] adjusted equity ratio equals common equity divided by
8 the sum of common equity, preferred equity, debt and off-
9 balance sheet obligations. The amount used for off-balance
10 sheet obligations will be calculated per the Standard & Poor's
11 methodology as used in its August 1998 credit report.

12
13 **Q. Would you please comment on the current level of attention given by the**
14 **investment community to properly considering the financial impacts of**
15 **purchased power commitments?**

16 **A.** S&P noted in 1993 that purchased power can have a debilitating impact on a
17 utility's investment risks (*CreditWeek*, May 24, 1993):

18
19 Over the past few years, several ratings have been lowered due
20 to purchased power obligations. In other cases, S&P did not
21 raise ratings. Still others are lower than they might otherwise
22 be owing to purchased power liabilities.

1 In light of investors' recent tribulations with Enron Corporation (Enron), the
2 investment community is likely to be even more sensitive to the impact that
3 off-balance sheet obligations can have on a company's financial position. As
4 the *Wall Street Journal* reported in a recent article entitled *Rating Agencies*
5 *Crack Down on Utilities* (December 19, 2001, p. C1), bond rating agencies are
6 closely scrutinizing debt levels on power company balance sheets in the wake
7 of Enron's collapse. Moody's reportedly launched a comprehensive review to
8 better assess the potential impact of off-balance sheet financing, requesting
9 detailed information from as many as 4,200 companies that the firm rates
10 ("Moody's Trains Eye on Data Off the Sheet", *The Wall Street Journal*, p. A2,
11 January 21, 2002). As a result of this intensified focus, there is a greater
12 potential that higher financial leverage – whether on or off the balance sheet –
13 will lead to ratings downgrades, reduced access to capital, and increased
14 borrowing costs. The *Wall Street Journal* article went on to note the crucial
15 role that financial flexibility plays in ensuring the utility's wherewithal to meet
16 customers' needs:

17
18 All the belt-tightening spells bad news for continued
19 development of the nation's energy infrastructure. Companies
20 that can borrow more money and stretch their dollars, quite
21 simply, can build more plants and equipment. Companies that
22 are increasingly dependent on equity financing – particularly in
23 a bear market – can do less.

1 **Q. Please describe the methodology used by S&P to reflect the financial**
2 **impact of purchased power obligations.**

3 A. While other rating agencies have expressed similar concerns regarding the
4 financial impacts of purchased power commitments, S&P is largely unique in
5 having a defined quantitative analysis to account for the additional risks
6 associated with these contractual commitments. This methodology begins by
7 quantifying the potential off-balance sheet obligation attributable to long-term
8 power purchase contracts. The first step in this process involves calculating
9 the net present value of the remaining capacity payments over the life of the
10 agreement.

11
12 S&P's method also recognizes that power purchase agreements have different
13 characteristics that impact their degree of firmness. Contracts that are
14 relatively more firm in terms of their payment obligations would be
15 considered more debt-like than others. Within the S&P analytical framework,
16 this difference in the relative debt characteristics of purchase power
17 obligations is accommodated using a risk spectrum ranging from 0 to 100
18 percent.

19
20 By evaluating the characteristics of a utility's purchased power contracts, S&P
21 places each agreement on the risk spectrum according to the degree to which
22 payments under the contract resemble the fixed obligations of traditional debt
23 instruments, such as long-term bonds. Obligations on the lower end of the

1 scale would have fewer debt-like characteristics and would be considered less
2 firm than the obligations placed at the high end of the scale. This risk factor
3 represents the proportion of the obligations' net present value to be considered
4 off-balance sheet debt. For example, if S&P determines that the risk factor for
5 a specific purchased power contract is 50 percent, S&P considers 50 percent
6 of the net present value of the related capacity payments as a debt equivalent
7 and adds this to reported obligations. Thus, the major bond rating agencies
8 look to the nature of the purchased power arrangement to determine the
9 portion of this present value to consider as debt in analyzing relative financial
10 risks.

11
12 In determining the risk factor, S&P considers a variety of qualitative factors
13 related to the purchased power contract, including its market, operating, and
14 regulatory risks and the extent to which they are borne by the utility. For
15 example, S&P would view a sale/leaseback of a major generating plant as the
16 virtual equivalent of debt (*i.e.*, risk factor of 100 percent) because of the
17 strategic importance of the facility and the ironclad nature of the payments.
18 Obligations under take-or-pay contracts, which are generally unconditional as
19 to acceptance and availability of power would fall lower down the risk
20 spectrum compared to a sale/leaseback, although unit-specific purchase
21 contracts under a firm take-or-pay agreement may warrant a risk factor of up
22 to 80 percent. Take-and-pay contracts that require capacity payments only if
23 power is available would come next on the scale, with risk factors in the range

1 of 10 to 50 percent.

2

3 **Q. Please describe the method FPL used to reflect the greater financial risks**
4 **associated with purchased power in its economic evaluation of the**
5 **alternative proposals.**

6 A. In order to recognize the financial implications associated with the off-balance
7 sheet debt attributable to purchased power contracts, FPL included an "equity
8 penalty" in its economic evaluation of alternative proposals submitted in
9 response to the Supplemental RFP. Consistent with the fact that investors
10 view some portion of a utility's capacity payment obligations as the equivalent
11 of debt on the balance sheet, FPL's quantitative analyses reflected an
12 adjustment to incorporate the additional costs associated with the greater
13 equity that would be required to rebalance its capital structure.

14

15 For each year under the proposal, the cumulative net present value of the
16 remaining annual demand charges was calculated using a 7.4 percent discount
17 rate reflective of the incremental cost of debt. This cumulative net present
18 value was then multiplied by a risk factor of 40 percent to arrive at the debt
19 equivalent portion of these demand charges in each year. In order to offset the
20 greater financial leverage associated with this obligation, FPL must replace a
21 portion of this off-balance-sheet debt with equity, calculated as the product of
22 the debt equivalent and a 55 percent equity ratio. The incremental cost
23 associated with this rebalancing was then computed by multiplying the

1 amount of capital implicitly shifted from debt to equity by the difference
2 between the pre-tax cost of the two capital sources. Thus, the equity penalty
3 represents the incremental costs in each year that would be required to hold
4 FPL's financial leverage constant in the face of the higher off-balance-sheet
5 liabilities attributable to the purchased power proposals. These annual costs
6 were then converted to a present value using an 8.5 percent discount rate,
7 computed as the weighted average after-tax cost of debt and equity.

8
9 An illustration of the method described above is contained in Document
10 WEA-1, assuming annual fixed capacity charges of \$1,000 over a five-year
11 horizon. As shown there, the first step is to compute the cumulative net
12 present value of the capacity charges remaining in each year using the 7.4
13 percent debt cost rate. Step 2 converts these cumulative balances to an annual
14 debt equivalent by applying the 40 percent risk factor. In Step 3, the debt
15 equivalent in each year is multiplied by the 55 percent equity ratio to
16 determine the amount of capital rebalanced from debt to equity as a result of
17 the purchased power agreement. The annual equity penalty is calculated in
18 Step 4 by multiplying the rebalanced equity by the 11.6 percent differential
19 between the pre-tax costs of debt and equity. These annual amounts were then
20 discounted at 8.5 percent (the after-tax cost of capital) to arrive at the \$252 net
21 present value of the equity penalty.

1 **Q. Is the methodology underlying the equity penalty calculation consistent**
2 **with the approach adopted by S&P and in prior FPSC proceedings?**

3 A. Yes. The equity penalty calculation employed by FPL is directly analogous to
4 the methodology used by S&P in its analyses of FPL's credit standing. While
5 there are distinctions between the details of the calculations due to differences
6 between generic assumptions and FPL specific data, the underlying approach
7 used to develop the debt equivalent portion of the purchase power obligations
8 is the same. S&P's focus is primarily on balance sheet adjustments designed
9 to recognize the credit implications of heightened financial risks associated
10 with purchased power, while FPL's analyses quantifies the implicit costs of
11 rebalancing between debt and equity to offset these risks. Nevertheless, the
12 methodology used by FPL is consistent with S&P's approach. Likewise, the
13 methodology FPL used to make the equity penalty calculations is the same as
14 that approved by the FPSC in Order Nos. PSC-01-0029-FOF-EI and PSC-99-
15 1713-TRF-EG discussed earlier.

16
17 **Q. What was the source of the risk factor that FPL assigned to the purchased**
18 **power proposals?**

19 A. As noted earlier, FPL's analyses of the financial impact of purchased power
20 proposals incorporated a risk factor of 40 percent, indicating the portion of the
21 total net present value of annual capacity charges considered equivalent to
22 debt. This value was based on the bottom of the 40 to 60 percent risk factor
23 range determined independently by S&P based on the rating agency's review

1 and analyses of the specific terms contemplated in FPL's RFP. As S&P
2 concluded in reporting the results of its review:

3
4 We evaluated the RFP for purchased power and determined
5 that between 40-60% of the capacity payments would be added
6 to FPL's debt. While this contract is take and pay based on
7 performance, the RFP states that minimal level of performance
8 will be required. This provision increases the likelihood that
9 the payments will be made, making the capacity payment more
10 firm or "debt" like.

11
12 This 40 percent risk factor is also identical to that used by FPC to calculate the
13 equity penalty in its economic evaluation of purchased power alternatives to
14 the Hines Unit 2 (Docket No. 001064-EI, Corrected Testimony of John B.
15 Crisp at p. 14).

16
17 **Q. What capital structure and component costs of debt and equity did FPL**
18 **assume in calculating the equity penalty?**

19 A. The equity penalty was developed by rebalancing the capital structure to
20 maintain a 55 percent equity ratio. In computing the associated costs implicit
21 in this rebalancing, the equity penalty assumed a rate of return on common
22 equity of 11.7 percent and a debt cost of 7.4 percent.

1 **Q. Do you believe these assumptions are reasonable for purposes of an**
2 **economic evaluation of purchased power alternatives?**

3 A. Yes. The 55 percent common equity ratio incorporated in calculating the
4 equity penalty is consistent with FPL's adjusted 13-month average capital
5 structure for 2001 and 2002, as presented in my prefiled direct testimony
6 before the FPSC in the recent review of the Company's Minimum Filing
7 Requirements (Docket No. 001148-EI). Further, the current Revenue Sharing
8 Agreement arising from the stipulation in that proceeding retained the
9 adjusted capital structure for surveillance reporting requirements specified
10 under the terms of the prior agreement that expired in April 2002. This prior
11 agreement also embodied a 55.83 percent surveillance cap on the common
12 equity ratio.

13
14 With respect to the component costs of debt and equity, a 7.4 percent
15 incremental cost of debt is generally consistent with the current yields on
16 public utility bonds. Meanwhile, under the terms of the current Revenue
17 Sharing Agreement, FPL no longer has a benchmark authorized return on
18 equity range for the purpose of addressing earnings levels. Nevertheless, the
19 11.7 percent cost of equity is generally consistent with other authorized rates
20 of return in Florida, especially when considering the relatively greater risks
21 faced by FPL. Since the 11.7 percent cost of equity rate falls considerably
22 below the required rate of return I estimated for FPL in Docket No. 001148-
23 EI, it almost certainly results in a conservative estimate of the equity penalty

1 associated with the financial obligations inherent in purchased power
2 contracts.

3

4 **Q. Does the equity penalty calculation incorporate any adjustment to reflect**
5 **the relative credit quality of the individual counterparties?**

6 A. No. The terms of FPL's Supplemental RFP explicitly contemplated that
7 counterparties would maintain an investment grade bond rating or an
8 equivalent guarantee. Accordingly, in conducting the analyses used to
9 quantify the equity penalty, no adjustments were made to incorporate project
10 sponsor risk differences. Nonetheless, the financial wherewithal of the
11 counterparty may impact the risks faced by FPL, especially in extreme
12 instances. As S&P observed [*CreditWeek*, November 1991]:

13

14 [H]ighly leveraged NUGs are inherently less creditworthy than
15 less leveraged NUGs. And their financial health may affect
16 their reliability.

17

18 The risk spectrum used to calculate the equity penalty reflects the relative debt
19 characteristics of the off-balance sheet liability associated with the terms of a
20 purchased power contract. As such, it is distinct from any assessment of the
21 financial viability of a specific counterparty or that entity's ability to actually
22 meet the provisions of the agreement.

1 **Q. Does this conclude your direct testimony in this case?**

2 **A. Yes, it does.**

1 CHAIRMAN JABER: And, Mr. Avera?

2 THE WITNESS: Avera, yes.

3 CHAIRMAN JABER: Summarize your testimony, please.

4 THE WITNESS: Chairman Jaber, members of the
5 Commission, I'm an economist and financial analyst. I have
6 degrees from Emory University in Atlanta and the University of
7 North Carolina at Chapel Hill. After many years of teaching, I
8 entered the regulatory arena as director of economic research
9 and chief economist for the Texas Public Utility Commission.

10 Since that time, I've appeared before Commissions in
11 29 states and federal Commissions in the United States and
12 Canada. As you will see from my resumé, my representations
13 have included appearing on behalf of commissions, on behalf of
14 large industrial customers, independent power producers, as
15 well as utilities.

16 My testimony today deals with two financial issues.
17 Number one, the equity penalty and number two, the
18 appropriateness of financial viability as a consideration in
19 screening bidders. First, to the equity penalty. My testimony
20 gives the simple rationale for the necessity of an equity
21 penalty. When a utility enters a long-term power purchase
22 agreement with a power producer, having payments stretching
23 into the future, investors regard those fixed obligations as
24 off-balance sheet liabilities. And they impute a certain
25 amount of debt to the utility when the utility enters into

1 those arrangements. That has the effect of increasing the
2 leverage of the utility adding debt to the capital structure.

3 Now, in this case, FPL has evaluated the self-build
4 options assuming that those facilities would be financed with a
5 mix of debt and equity equal to the target capital structure of
6 55 percent equity, 45 percent debt. The component cost of debt
7 and equity are the incremental investing cost of those sources
8 of funds. So the utility-built option has a neutral effect on
9 the capital structure and capital cost of the utility, but the
10 purchased power options would have a negative effect on the
11 capital structure. So in order to make these two comparisons
12 equal, you have to adjust for the negative effect on the
13 capital structure that occurs because of these long-term
14 commitments.

15 Now, the logical way to do that is to add equity to
16 the capital structure just enough to offset the extra debt, and
17 that is what the equity penalty does. It adjusts the capital
18 structure effects so that we're looking at the same cost for
19 the purchased power option as we have for the utility-built
20 options.

21 Now, in my testimony, I describe the four steps that
22 FPL used in calculating the equity penalty. First, getting the
23 present value of the future payment obligations of the
24 contracts that were offered; second, adjusting the present
25 value for the relative risk of those purchased power

1 operations; third, figuring out how much equity would be
2 necessary to balance those off-balance sheet obligations; and
3 fourth, calculating the present value extra cost that FPL's
4 customers would pay because of the extra equity. That extra
5 cost is the equity penalty.

6 In my testimony, I explain why the assumptions and
7 calculations that FPL makes are reasonable, are consistent with
8 the way investors look at these kinds of off-balance sheet
9 obligations and, most importantly, are completely consistent
10 with the same assumptions that FPL uses in evaluating its own
11 self-build options. I also look at the calculations to show
12 that they are consistent with past decisions by this Commission
13 and the Commission's rules regarding financial effects in need
14 case determinations. So the equity penalty is a reasonable and
15 necessary adjustment to equilibrate and make an
16 apples-to-apples comparison between purchased power and
17 self-build.

18 The financial topic is financial viability. My
19 testimony explains why it's in the customers' interest that FPL
20 consider financial viability in looking at bidders. That,
21 Chairman Jaber, completes my summary.

22 CHAIRMAN JABER: Thank you.

23 MR. LITCHFIELD: I would tender the witness for
24 cross-examination, Madam Chairman.

25 CHAIRMAN JABER: Thank you, Mr. Litchfield.

1 Mr. Moyle.

2 CROSS EXAMINATION

3 BY MR. MOYLE:

4 Q Let me take that last point first. You said that
5 your testimony talks about financial viability and why it's
6 important that FPL assure that folks who it may do business
7 with are financially viable; is that right?

8 A That's correct.

9 Q And that was part of your scope of work, to consider
10 financial viability?

11 A To consider whether financial viability was an
12 appropriate consideration. When we were first retained by FPL,
13 we also were told that we might be asked to be involved in
14 financial viability analysis if the need arose. But as it
15 turned out, we were not called upon for that purpose.

16 Q So FPL never asked you your expert opinion regarding
17 the financial viability of any bidders who submitted bids?

18 A No, sir, they did not.

19 Q And they never asked you the financial viability of
20 any bidders who they decided not to negotiate with further?

21 A No, sir. In our consultations with FPL, we talked
22 about financial viability. We shared our views as to why it
23 was important, the type of considerations that might be
24 included, but as to the actual application of those
25 considerations to particular builders, we were not involved --

1 bidders, we were not involved.

2 Q Okay. You may have been in the room. You've heard
3 testimony. A couple of folks were eliminated from further
4 consideration, I believe, because of concerns related to
5 financial viability. Just so I'm clear, they never called you
6 and said, Mr. Avera, we're confronted with a decision here
7 about financial viability, and we'd like for you to give us
8 your opinion?

9 A No, sir, they did not.

10 Q Okay. Who came up with the term "equity penalty"?

11 A Not me. The term -- the first earliest use of the
12 term "equity penalty" that I saw was in some testimony that FPL
13 submitted that's actually attached to Mr. Maurey's testimony.
14 I think it was 1991 testimony.

15 Q Okay. And you used that term throughout your
16 testimony. Based on what you've heard, wouldn't you come to
17 the conclusion that the equity penalty works to penalize folks
18 who have submitted bids in this proceeding, outside bidders who
19 have submitted long-term power bids?

20 A No, sir, I don't believe it's a penalty. I don't
21 believe it works to penalize. I think it works to equilibrate,
22 to bring into evenness the capital structure effect of the
23 utility-build option with the purchased power arrangements that
24 are being contemplated in the bids. So I don't think it's a
25 penalty. I think it's a necessary adjustment so that you can

1 look at cost-effectiveness on equal terms.

2 And I must say, if I were inventing the term myself,
3 I wouldn't have invented the term "equity penalty," but it's
4 the term that I inherited.

5 Q Okay. Given that, I guess there's two choices. Who
6 would you view, as you sit here today, who it would penalize
7 more, the bidders or the incumbent utility?

8 A I don't believe it penalizes anyone. I think the
9 calculation of the equity penalty -- sometimes the Commission
10 has called it "equity adjustment." The calculation of the
11 equity adjustment is tied to the specific circumstances of the
12 bid. What are the stream of fixed payments that are associated
13 with a particular offer?

14 So it's a mathematical calculation of how large the
15 payments are and when they occur in the future. So when you
16 present value them back, how great is the off-balance sheet
17 obligation, and then when you adjust it to make it equivalent
18 to debt, what factor you used to make that adjustment.

19 Q What's CreditWeek?

20 A CreditWeek is a publication by Standard & Poor's.

21 Q Are they reliable, dependable?

22 A Yes. They are used by investors. We subscribe to
23 that publication at my firm. I think in most of my regulatory
24 practice, CreditWeek is usually in the Commission library. And
25 when I go to investment banking or brokerage firms, it's

1 usually available to investors.

2 Q Is your opinion here today based in part on things
3 you read in CreditWeek. You cite it in a number of places in
4 your testimony.

5 A Yes. I think that is one of the sources that
6 investors use. It's one of the sources that experts in a
7 position of evaluating utility investments and utility risk
8 use. So I use it as do other similarly situated experts.

9 Q Okay. I've noted in your testimony that CreditWeek
10 references appear on Page 7 at Lines 5, 9, and 22. Also, it
11 appears on Page 9 --

12 A Yes, sir.

13 Q -- at Lines 7, and 9. 13 -- Page 13 on Line 17, and
14 Page 22, Line 12.

15 A Yes, sir.

16 Q Am I correct in reading that the most recent
17 CreditWeek publication that you're relying on was published on
18 May 24th, 1993?

19 A That's true in my direct. In my rebuttal I come all
20 the way up to 2002.

21 Q But in your direct, all the references are to stuff
22 that was prior to 1993 or in 1993; correct?

23 A Specifically as to CreditWeek, I think they're
24 references to other publications that investors use that are
25 more recent. I think those original CreditWeeks are relevant

1 because that's when Standard & Poor's was originally
2 articulating the method it uses to determine off-balance sheet
3 liability.

4 Q What are the major credit rating agencies that you
5 rely on for your expert opinion?

6 A Well, the major credit rating agencies are: Moody's
7 and Standard & Poor's and Fitch, which there was at one time
8 Duff & Phelps, but I believe Duff & Phelps has been taken over
9 and absorbed into Fitch.

10 Now, that's not the only source of information about
11 credit and risk that I utilize in this case or my other
12 assignments.

13 Q Is it your testimony that all three of these rating
14 agencies that we just discussed apply the equity penalty in the
15 way you describe in your testimony?

16 A My testimony is that none of these credit agencies
17 apply the equity penalty. The equity penalty is a regulatory
18 concept, as I explained in my deposition. All credit rating
19 agencies, these three, as well as investment banking firms and
20 financial analysts who look at utilities, impute long-term
21 obligations as off-balance sheet obligations that are debt-like
22 in their effect on the utility.

23 So credit rating agencies whose job it is to advise
24 investors about the risk of the securities they are purchasing
25 tell investors to consider the off-balance sheet obligations.

1 And my experience is that investors do consider those
2 off-balance sheet operations. Now, that's the first two steps
3 of the equity penalty, which is to convert the obligations to
4 an off-balance sheet obligation.

5 The next two steps which we take in the regulatory
6 arena are to adjust that off-balance sheet obligation so that
7 it equilibrates the capital structure effect with what happens
8 to the self-build option. The equity penalty is a regulatory
9 concept, not a bond rating concept.

10 Q Okay. I appreciate that. Maybe I used the wrong
11 word. Is it your testimony that all three rating agencies view
12 the equity penalty in the same way? Or do you know?

13 A Again, we have the problem. All three rating
14 agencies, Mr. Moyle, view off-balance sheet obligations
15 associated with long-term power projects. Now, the same way, I
16 can't say. I mean, I think they each view them as off-balance
17 sheet liabilities.

18 Now, as to how they articulate their opinions and how
19 they reach their opinions and how they might evaluate a
20 particular circumstance, I think there are differences among
21 the rating agencies.

22 Q How do you know that -- how do you have information
23 as to how the rating agencies regard the equity penalty?
24 What's it based on? Is it based on conversations with analysts
25 for the people? Is it based on publications that these folks

1 come out with? What is your opinion based on?

2 A Again, your question, Mr. Moyle, relates to equity
3 penalty, and I think I've told you, they do not have opinion
4 about equity penalty because that's a regulatory concept.

5 Q Okay. Imputation of debt?

6 CHAIRMAN JABER: Hang on a second.

7 A Imputation of debt. Yes, it is based on all of the
8 above. I have in my career had a number of assignments where I
9 was asked to go to Wall Street and interview the rating
10 agencies. Once for the Public Utilities Commission of Hawaii;
11 once for ELCON, a group of large industrial customers; again
12 for Southwestern Bell, SBC Corporation.

13 And when I was on the Commission staff in Texas, it
14 was better because the rating agencies would come to me in
15 Austin, and we would talk about the considerations that they
16 used in evaluating utility securities. And in the course of
17 those conversations, I learned that they do pay attention to
18 these off-balance sheet liabilities, and they try to help
19 investors understand the import of these.

20 Now, also, I have looked at the numerous publications
21 like CreditWeek and the many other similar publications that
22 Moody's and Fitch and Duff & Phelps, when it was a freestanding
23 organization, published both as to general reviews of utilities
24 and then specific reviews of utilities.

25 I cite several specific reviews of FPL and so does

1 Mr. Maurey where the rating agencies talk about the relative
2 amount of off-balance sheet obligation that FPL has. So that's
3 the basis for my understanding.

4 Q Thank you for that.

5 CHAIRMAN JABER: Mr. Avera, I know some of these
6 questions might sound tedious, but this is a very important
7 issue, and frankly, I want to understand this issue, too. I
8 think Mr. Moyle is asking you very good questions. I want to
9 take a stab at it, too, to make sure that I understand the
10 difference between the regulatory concept as you describe it
11 and what it is with respect to the concern related to the
12 rating agencies. So forgive the repetition here, but walk me
13 through to make sure I understand.

14 As it relates to how the credit agencies look at
15 purchased power agreements as being debt, that's what you're
16 saying, that they consider it a liability of the company when
17 there's a purchased power agreement.

18 THE WITNESS: Yes, they do. Although, it's not
19 recorded on the balance sheet, it is an off-balance sheet
20 obligation that has the same characteristics as debt. It's a
21 fixed obligation.

22 CHAIRMAN JABER: To them it looks like, smells like a
23 debt.

24 THE WITNESS: That is true. So they think you ought
25 to consider it in evaluating the risk of the securities.

1 CHAIRMAN JABER: Okay. And the bottom line effect of
2 them considering it as a debt to evaluate risk for securities
3 is what? It affects your stock prices? It affects how shares
4 are sold at what price? Is that the bottom line effect?

5 THE WITNESS: All of the above, yes, that when
6 investors see that your capital structure has shifted toward
7 debt because you have undertaken new obligations, then all else
8 being equal, they will require higher returns on your equity
9 securities, and they will require higher returns on your debt
10 securities. And there may -- it may contribute in certain
11 circumstances to an actual downgrade of your bonds.

12 Now, the way to ameliorate those problems is to add
13 debt to the -- I mean, excuse me, equity to the capital
14 structure to offset the debt. So if you add just enough equity
15 so that you bring your capital structure back into balance,
16 those negative effects on your cost of equity and cost of debt
17 and financial flexibility do not occur.

18 CHAIRMAN JABER: So as a stockbroker who is trying to
19 advise the investor, that sort of reconciliation between debt
20 and equity gives them a full picture to say, they do have this
21 purchased power agreement, but they have also put in enough
22 equity to make up the difference.

23 THE WITNESS: That is correct. So they would advise
24 their clients to say -- you look at FPL, for example, and you
25 say, FPL as a utility has a certain capital structure, a

1 certain equity ratio on its books, but don't take that at face
2 value, Investor, because remember, FPL has a significant amount
3 of purchased power obligations. So in looking at their equity
4 ratio, you need to adjust for those off-balance sheet
5 obligations and realize that FPL's equity ratio is not as high
6 as it seems.

7 CHAIRMAN JABER: And that tradition of making the
8 off-sheet obligation equal, for lack of a better word, with
9 equity has become to be known as the equity penalty, the equity
10 adjustment, whatever it is you want to call it.

11 THE WITNESS: That is correct. That --

12 CHAIRMAN JABER: And that adjustment -- I don't think
13 as quickly as you do. And that adjustment is, obviously, you
14 need to do it for -- in your opinion, for the analysts so that
15 they can advise the investors, but the adjustment is also
16 something that you account for on your books as a regulatory
17 adjustment.

18 THE WITNESS: Not as a regulatory adjustment. What
19 it is, is when you move to the regulatory arena, where -- it's
20 very common in the regulatory arena to look over the shoulder
21 of investors and see how investors are thinking about the
22 world. We do that when we look at what the required return on
23 equity is, for example, in rate cases.

24 Well, we also do that when we're looking at a case
25 like this where we're trying to compare the self-build option

1 with purchased power options. And we say, now, if the utility
2 goes this purchased power option and it commits itself to this
3 long stream of firm payments, we know that investors are going
4 to pay attention to that. And in fact, investors are going to
5 say, because of those obligations, this utility has increased
6 its off-balance sheet debt, so the only way that as safe an
7 investment as it was before this happened is if they increase
8 their own balance sheet equity just enough to balance off that
9 off-balance sheet liability.

10 CHAIRMAN JABER: But that increasing the balance
11 sheet has come to be known in the regulatory arena as the
12 equity penalty or the equity adjustment.

13 THE WITNESS: That is correct.

14 CHAIRMAN JABER: Okay. Is there another way to give
15 those investors comfort to account for that off-sheet
16 obligation?

17 THE WITNESS: Well, yes. There are some ways to
18 reduce the amount of off-balance sheet obligation. And
19 Mr. Maurey talks about in his testimony how this Commission
20 has, for example, its policy of passing through cost. That
21 helps ameliorate the size of the off-balance sheet obligation.

22 So investors when they say, here are the payments.
23 What do they equilibrate to in terms of debt? They take into
24 account the regulatory environment because the regulatory
25 environment can make those obligations either scarier to

1 investors or less scary. So that's one way a regulatory body
2 such as this one has served to lower the impact of these
3 off-balance sheet obligations.

4 CHAIRMAN JABER: So if there was a clearly delineated
5 mechanism method showing by this regulatory agency that takes
6 care of the perception of an off-sheet debt obligation, would
7 you agree with me that the equity penalty would no longer be
8 necessary?

9 THE WITNESS: Yes, I would agree if the Commission
10 could do such a thing, but I don't believe the Commission can.

11 CHAIRMAN JABER: And that's what I need to understand
12 from you. I thought you just said that there were other ways.
13 And my question is this: What are those other ways, and are
14 those other ways items that can be provided by this agency?

15 THE WITNESS: I think the ways -- the more this
16 agency can do to give investors comfort about the ability of
17 the utility to collect the revenue to balance against these
18 obligations, the less investors will attribute -- you know, the
19 lower factor they will use in moving from the size of the
20 obligations to what that's equal to in terms of debt and,
21 therefore, how much equity you need to offset it. But I think
22 there are limits, and I think this Commission has gone a long
23 way in its past policies along the line of giving investors
24 some comfort, but I don't think this Commission has eliminated
25 investors' concern.

1 One of the reasons that you can't eliminate
2 investors' concerns is that investors have to think about the
3 future. When they buy stocks and bonds, they are investing for
4 the long term. Now, they might be very comfortable with this
5 Commission, and they may be very comfortable with the
6 legislation under which you operate, but they know that those
7 things are subject to change. In my experience, the Texas
8 Commission, at one point when we first started, we had a very
9 kind of full pass-through of virtually all fuel cost and all
10 purchased power cost. It became a very great political issue
11 in Texas. And in 1982 we passed a law -- the Legislature
12 passed a law that says, no pass-through clauses whatsoever.
13 And immediately investors changed their perception of the risk
14 of investing in Texas utilities very dramatically.

15 And we had -- at one point, we had a AAA utility,
16 Texas Utilities. Well, after that, they started sliding down.
17 Now, subsequently, the Texas Commission and the Legislature
18 have changed the rules to get back to more pass-through, and
19 you can see the risk going down, and the kind of risk that's
20 attributable to off-balance sheet obligations has a gotten
21 less. But investors know or at least the investors have to
22 worry about the rules changing and the Commission changing. So
23 a Commission can be very constructive, as I believe this one
24 is, and reduce and ameliorate that risk, but I don't think it's
25 within your power to eliminate it.

1 CHAIRMAN JABER: Okay. So let's take that a step at
2 a time. If this state had clauses that passed through costs
3 associated with purchased power arrangements, then that would
4 provide certainty to those investors. And I really want
5 yes-or-no answers because I've got a series of questions for
6 you. That would provide certainty to investors.

7 THE WITNESS: Yes. It would provide more certainty.
8 It does not provide certainty. It is not a rock solid
9 guarantee.

10 CHAIRMAN JABER: And that's true about everything in
11 life in general, I would imagine; right?

12 THE WITNESS: It's true about everything in life, but
13 I think it's particularly true in the regulatory arena.

14 CHAIRMAN JABER: If this agency had long-term
15 revenue-sharing agreements between stakeholders, consumer
16 advocates, and the companies that are regulated, that would
17 provide more certainty to investors.

18 THE WITNESS: Yes, it could. It depends on the exact
19 circumstances, you know, what the features -- I think investors
20 look into the details because that's often where the devil
21 resides on these kinds of arrangements.

22 CHAIRMAN JABER: Does your opinion change at all if
23 that purchased power arrangement was between FPL and another
24 regulated IOU?

25 THE WITNESS: My opinion as to the appropriateness of

1 the equity penalty would not change. I mean, it is a valid
2 consideration. The assumptions that might go into calculating
3 how big the equity penalty is would likely change as you change
4 the nature of the counterparty.

5 I would point out that FPL currently has significant
6 power purchase arrangements with public utilities, and those
7 are viewed as significant off-balance sheet obligations by the
8 rating agencies.

9 CHAIRMAN JABER: I need to understand why the penalty
10 would be different if it was -- one of the bidders in this case
11 I think the record indicates was Florida Power Corporation, and
12 TECO was another bidder. If Florida Power Corporation won the
13 bid and a purchased power agreement had to be executed between
14 the two companies, how would that equity adjustment differ
15 from, let's say, PG&E entering into a purchased power agreement
16 with FPL?

17 THE WITNESS: It may differ, and I think the place
18 where it would differ is in step two. Remember the four-step
19 process. Step one is looking and discounting the future
20 payments. Step two is where you apply a risk factor to the
21 present value of those payments to get a debt equivalent.

22 Now, for purposes this analysis, FPL has used a
23 40 percent adjustment factor, which I think, in my opinion, is
24 representative of the general risk of the kinds of arrangements
25 that would be elicited given the RFP terms.

1 Now, if -- a concrete example, in the 1999 standard
2 offer case, this Commission determined that a 10 percent factor
3 was appropriate for qualifying facility power because it was
4 not as firm, the commitment was not as strong, and there were
5 lots of outs in the Commission rules. So in that case for
6 qualifying facility power, the 10 percent factor was used. For
7 other situations, a higher factor -- you know, a 50 or 60 or
8 80 percent factor might be used. Standard & Poor's says that
9 for a lease purchase or a unit lease, you might have a factor
10 as high as 100 percent. So that factor in step two is where
11 you take into account the particular circumstances of the deal.

12 CHAIRMAN JABER: Thank you. That's very helpful.
13 And the final question is: To the best of your knowledge, does
14 the RFP indicate clearly what the different adjustments might
15 be under what circumstances?

16 THE WITNESS: I have read the RFP, and the RFP, you
17 know, has general parameters about what people can bid. I
18 think that you could conceive of -- and we would expect the
19 bids to generally follow those parameters, and there's been a
20 lot of discussion here about to the extent they did or didn't.
21 But I think that sets a general framework that suggests a
22 magnitude of factors. And that's why I believe for the RFP
23 40 percent is a representative number.

24 Now, I could conceive of a bidder coming in and
25 structuring an arrangement, and by the nature of the

1 arrangement and the nature of the bidder, some different factor
2 might be appropriate, lower or higher, depending on the
3 circumstances.

4 CHAIRMAN JABER: Thank you.

5 Mr. Moyle.

6 MR. MOYLE: Thank you.

7 BY MR. MOYLE:

8 Q Just following up briefly on a question. It would be
9 true, would it not -- you've read the supplemental RFP?

10 A Yes, sir.

11 Q Okay. And the bidders were never told in advance how
12 the equity penalty was going to be calculated or determined;
13 isn't that correct?

14 A I don't recall any discussion of the equity penalty.
15 I mean, I think that's part of the analytics in making a
16 comparison between self-build and purchase. And to the extent
17 it had been used in previous cases, I would assume bidders
18 would be aware that it's likely to have been used here.

19 Q Right. But my question relates to whether the
20 bidders were informed as to how the calculation might be done.
21 You talked about the 40 percent level. There was nothing that
22 said FPL was going to use a 40 percent factor in calculating
23 the equity penalty or anything like that in the supplemental
24 RFP, was there?

25 A No, sir.

1 Q Thank you. You answered my question earlier about, I
2 guess, your experience in Texas. You were with the regulatory
3 Commission out there; is that right?

4 A Yes, sir.

5 Q And you said that the bond rating agencies would come
6 and talk to you about things like this?

7 A Yes, sir.

8 Q Did they ever come and give testimony in front of
9 your Commission?

10 A No, sir. The -- most rating agencies have a practice
11 that they do not testify before the Commission.

12 Q All right. Do you know --

13 A They will from time to time make presentations,
14 informal presentations, to the Commissioners. They did that in
15 Texas, and I would be surprised if they haven't done it here at
16 some point.

17 Q But it's not your testimony that Moody's or Standard
18 & Poor's has never given testimony to Congress or anyone with
19 respect to issues that were deemed important, is it?

20 A I do believe the rating agencies testify to Congress.
21 I think they recently testified relating to the Enron debacle.
22 So rating agencies will testify, especially if they're
23 subpoenaed before Congress, but their policy is not to testify
24 before regulatory agencies.

25 Q Do you know if any of the rating agencies have come

1 down to Tallahassee to talk to the staff or the Commissioners
2 about this issue in this proceeding?

3 A No, sir, I don't know from my personal knowledge. I
4 know that Mr. Maurey speaks about this issue with some
5 sophistication in his testimony. So he's certainly well-versed
6 on the matter.

7 Q Following up on a question you were asked by the
8 Chair. You talk about these being off-balance sheet
9 obligations; is that correct?

10 A Yes, sir.

11 Q So I presume from that -- and I'm not a sophisticated
12 investor. I invest a little. But I presume that that would
13 mean that that information would not be available on the
14 balance sheet that the company would file with the SEC;
15 correct?

16 A That is not quite correct. It is not in the body of
17 the balance sheet, but it is required to be disclosed in the
18 footnotes. So to comply with reg X which controls the Form 10K
19 and the other forms that public companies must issue to the
20 investing public, they are required to make disclosures in
21 their footnotes which include the purchased power obligations
22 and a projection of the amount of fixed payments under those,
23 as FPL has done.

24 Q Do you know how much off-balance sheet debt related
25 to purchased power agreements that FPL is currently carrying?

1 A Standard & Poor's estimates it at 1.2 billion. Those
2 numbers appear in Mr. Maurey's testimony, and he has several
3 exhibits that outline the amount of off-balance sheet
4 obligations for FPL and a number of other utilities.

5 Q Now, is this specific to the utility, or is this FPL
6 Group?

7 A I believe that's specific to the utility.

8 Q Do you know what FPL's overall debt is?

9 A You mean the total dollars of debt?

10 Q Yes.

11 A I don't have it on the tip of my tongue. If you want
12 me to -- it's in Mr. Maurey's testimony.

13 Q Okay. I can ask him about it.

14 A I didn't hear you, Mr. Moyle. Do you want me to look
15 that up?

16 Q No. I can ask him about it.

17 You're familiar with the supplemental RFP. It
18 contains indication that there will be a regulatory out
19 provision. Are you familiar with regulatory out provisions?

20 A Yes, sir, I am.

21 Q To the extent that a purchased power agreement had a
22 regulatory out provision, wouldn't that mitigate against the
23 risk with respect to this equity penalty that you've been
24 talking about?

25 A Yes, it does. It's one of the factors that affects

1 the factor that goes between the present value of the
2 off-balance sheet obligations and what their debt equivalent
3 is. So the presence of a regulatory out is something that
4 serves to reduce that factor, and that's been taken into
5 account in the 40 percent factor that's been used here.

6 Q Now, don't rating agencies consider a whole wide
7 variety of factors when making judgments about companies?

8 A Yes, sir, they do.

9 Q How many would you guess? How many factors? Are
10 they in the dozens, in the hundreds?

11 A I think the general categories are in the dozens.
12 Now, the individual facts that they might look at about a
13 utility might be in the hundreds, but there are dozens of
14 factors that the rating agencies say are important to them,
15 service area, regulation, obviously, economy, fuel mix, on and
16 on.

17 Q Is this imputation of debt issue, would that be one
18 of the dozens of factors that agencies consider, or would it be
19 one of the hundreds of facts?

20 A I think it would be one of the dozens. I think the
21 presence of off-balance sheet obligations and purchased power
22 obligations are usually right there in the first list of
23 considerations.

24 Q And if I understand the rationale, this would
25 apply -- this concept would apply to any long-term obligation,

1 would it not, of the company, or any obligation to pay moneys,
2 fixed moneys, over a period of time?

3 A I think it depends on the firmness of the obligation
4 and the nature. For example, in addition to purchased power
5 obligation, FPL has off-balance sheet equivalents due to its
6 nuclear fuel trust. So any kind of firm obligation that
7 extends over time, investors and the rating agencies who advise
8 them regard part of those obligations as off-balance sheet
9 debt.

10 Q So if they had a contract to buy a commodity over a
11 number of years, coal, for instance, then that would also
12 similarly be viewed as imputed debt?

13 A I think it depends on the circumstances. Typically,
14 except for nuclear fuel, the rating agencies and investors
15 generally have not really focussed on long-term fuel contracts.
16 Now, there are some case where they might; in my experience,
17 where you might have commitment to pipeline capacity, for
18 example. But I think the circumstances of the arrangement
19 determine whether -- and to the extent it's viewed as an
20 off-balance sheet liability, there is no question that
21 investors view long-term purchase power agreements from
22 independent power producers as off-balance sheet liabilities.

23 Q But that wouldn't be the case necessarily with the
24 long-term purchase for fuel, necessarily, or for lease
25 payments? Let's say there were -- FPL I'm sure leases a lot of

1 property. If you aggregated all the leases that they were
2 obligated to, that wouldn't be something that would be an
3 off-balance sheet issue that would be imputed debt, would it?

4 A Not generally. There is a recognition of the
5 off-balance sheet obligation when the lease is for a generating
6 facility. I've seen that viewed as an off-balance sheet
7 obligation. So I think the rating agencies look at the
8 particular circumstances, and I think investors following the
9 rating agencies' advice look at the circumstances, but I don't
10 think it's ambiguous with respect to purchased power.

11 Q Have you seen any FPL documents that have
12 acknowledged that this is a controversial issue, whether you
13 impute this debt, or how it's considered in these proceedings?
14 Are you aware that this is a controversial issue?

15 A I don't know that I've seen any document. I know
16 it's a controversial issue because it is a fairly significant
17 issue. And sometimes it's kind of hard to -- people find it
18 hard to understand.

19 MR. MOYLE: I appreciate you helping me understand
20 this a little better. Thank you for your time.

21 COMMISSIONER PALECKI: I'd like to follow up on one
22 of the Chairman's questions.

23 CHAIRMAN JABER: Go ahead, Commissioner Palecki.

24 COMMISSIONER PALECKI: What if this Commission
25 guaranteed a pass-through dollar for dollar on purchased power

1 contracts? What would that do to your calculation?

2 THE WITNESS: Commissioner Palecki, I think we would
3 have to see how investors would react and how that would be
4 different from the current arrangements the Commission has.
5 But I do believe that even if this Commission were to make the
6 strongest possible statement that a particular set of purchased
7 power obligations would be recoverable, I think the investors
8 would still impute some amount of debt because of the inability
9 of this Commission to bind future Commissions or the
10 possibility that some unexpected circumstance, political,
11 economic, could intervene to render that commitment not
12 effective.

13 COMMISSIONER PALECKI: But that guarantee would have
14 some affect in minimizing the dollar amount that was imputed.

15 THE WITNESS: Yes, Commissioner Palecki, I think it
16 could. Again, there is already built in, I think, to
17 investors' perception an understanding of the regulatory policy
18 in Florida. That's built into the 1.2 billion, for example,
19 that Standard & Poor's calculates for the off-balance sheet
20 liability for FPL. So I think to reduce that, investors would
21 have to see regulatory changes that are more in the direction
22 of allowing assurance of collection.

23 COMMISSIONER PALECKI: And what about the assurance
24 of collection for a company-built power plant, a utility-built
25 plant? Is there any imputation of risk on cost recovery there

1 where you have long-term payments stream over -- or long-term
2 payment for the plant itself for the capital investment that
3 may or may not be recovered based upon any number of factors?

4 THE WITNESS: Yes, Commissioner, I think there is. I
5 think that is built into the cost of equity and the cost of
6 debt that the firm faces, the possibility that there might be a
7 disallowance or an imprudence finding. So in using the
8 11.7 percent cost of equity and the 7.4 percent cost of debt, I
9 believe the self-built option has built in investors'
10 expectations of that possibility.

11 COMMISSIONER PALECKI: And in the year 2002 when
12 we're seeing tremendous technological strides -- I mean, the
13 natural gas combined cycle plant is relatively new technology,
14 but the plants we're seeing today are much more efficient than
15 the plants we saw five or six years ago. I guess we could
16 envision that ten years from now we'll have even newer
17 technology that could antique this technology we're seeing
18 today. Wouldn't the fact that a third party is taking that
19 risk and not the investor-owned utility, wouldn't that be a
20 factor that is given some consideration by investors?

21 THE WITNESS: Well, I think that technological risk
22 is given consideration. I think it is reflected both in the
23 cost of equity of the utility when we discount the
24 utility-built option and calculate its revenue requirements,
25 and I think those kinds of considerations are built into the

1 risk factor. Some of the risk of unknown future unknowns kind
2 of affect both sides of the equation, so there's no need to
3 adjust for them. And --

4 COMMISSIONER PALECKI: Well, which utility faces the
5 most risk? The one that's all self-build, the one that is all
6 purchased power contract, or the one that doesn't have its eggs
7 all in one basket but splits it a reasonable amount between
8 self-build and purchased power?

9 THE WITNESS: Well, I always think diversification is
10 good, but I think you would have to look a little bit further,
11 Commissioner, to look at the nature of the fleet of plants that
12 stand behind the purchased power versus the utility. Purchased
13 power all from one technology and all affected by the same
14 natural disasters might be more risky than a utility fleet. So
15 I think diversification both in terms of sources and other
16 relevant risk factors, fuel, fuel availability, technologies,
17 would be important as well.

18 COMMISSIONER PALECKI: So some purchased power in the
19 mix would actually reduce risk.

20 THE WITNESS: I think it's possible that it could.
21 You know, I think to the -- how much it would and so forth
22 would depend on how the purchased power affected the overall
23 match the diversification of the utility fleet.

24 COMMISSIONER PALECKI: Thank you.

25 CROSS EXAMINATION

1 BY MR. MCGLOTHLIN:

2 Q Sir, I'm looking at Page 4 of your prefiled direct
3 testimony. At Line 5, you state, "The purpose of my testimony
4 is to examine the impact of power purchase contracts on FPL's
5 financial position and present to the Florida Public Service
6 Commission the method FPL used to account for these impacts in
7 its evaluation of capacity alternatives." When you say "the
8 impact of power purchase contracts on FPL's financial
9 position," do you refer to the manner in which rating agencies
10 appraise the riskiness of investments in FPL?

11 A Well, the way that investors generally and rating
12 agencies look at the purchased power as adding to the risk due
13 to off-balance sheet obligations, what we've talked about. So
14 I'm talking about that, and then I'm also talking about the
15 additional consideration that that off-balance sheet obligation
16 doesn't really take into account the financial viability risk
17 that may be attached to a particular vendor. So I think both
18 issues are encompassed in this statement.

19 Q But a rating agency's appraisal of financial position
20 is not purely a function of this imputed debt argument, is it?

21 A No, sir.

22 Q In fact, as was discussed by Mr. Moyle, isn't it true
23 that rating agencies look at a host of factors when rating a
24 utility?

25 A Yes, sir, they do. But the only factor that's kind

1 of subject to change in this proceeding is the amount of
2 purchased power obligation.

3 Q Well, you say you're going to examine the impact of
4 purchases on FPL's financial position. With respect to the
5 manner in which a rating agency rates a utility such as FPL, I
6 think we've established they look at a host of things.

7 A Yes, sir.

8 Q Would you expect some to be -- with respect to the
9 impact of power purchase contracts, would you expect some to be
10 favorable and others unfavorable?

11 A Do you mean that a power purchase agreement may have
12 favorable effects on the utility?

13 Q Right.

14 A Yes, I think that's possible. I think that was the
15 gist of my discussion with Commissioner Palecki, that you could
16 conceive of a circumstance where it would be favorable.

17 Q Well, check me on this. You say your purpose is to
18 examine the impact of power purchase contracts on FPL's
19 financial position. As I look through your testimony, it
20 appears to me that 100 percent of the references you make to
21 the impact of power purchase contracts on FPL are those that
22 are unfavorable; am I correct?

23 A Well, what I'm looking at --

24 Q I think that's a yes or no.

25 A Yes, sir. I'm looking at the unfavorable because

1 that's the particular circumstance of why you need to make the
2 equity penalty adjustment and why you need to consider
3 financial viability.

4 Q You also agreed that the rating agencies take into
5 account far more than just this imputation of debt when they
6 rate a company; is that correct?

7 A Yes, sir.

8 Q And would it be possible, for instance, that S&P
9 could go through this exercise of calculating imputed debt but
10 then take into account other things and decide not to change
11 the rating of the utility that entered that power purchase
12 contract?

13 A They could. I don't believe it's my testimony that
14 the rating agencies would change the rating just because of
15 imputed debt. I think my testimony is that imputed debt has
16 the effect of increasing the risk and cost of the utility from
17 a financial perspective. And you need to offset that with the
18 equity penalty calculation to make an equivalent comparison.
19 So I'm trying to help the Commission understand a necessary
20 adjustment, not all of the possible -- for this case, not all
21 of the possible factors that might increase risk. My rate case
22 testimony did that filed in January.

23 Q You say it's necessary to make this calculation of
24 imputed debt. Isn't it true that other rating agencies, only
25 S&P has this formula that has been applied in some form in this

1 case?

2 A S&P is the only one that has articulated a
3 particularly quantitative technique.

4 Q So there are other ways to look at the risk of a
5 power purchase contract and take that into context with the
6 other pros and cons and arrive at a view as to the impact of a
7 PPA on financial position other than this calculation?

8 A Yes. The other rating agencies have uniformly said
9 they consider off-balance sheet obligations, and they impute
10 debt, but none of the other rating agencies have given us a
11 format for a quantitative analysis. The Standard & Poor's
12 format has been used by this Commission a number of times
13 because it is the only one out there that the rating agencies
14 have given us.

15 Q At Page 10 of your testimony, beginning at Line 21,
16 you say, "Considering that the 1,700-megawatt increase in
17 purchased power contemplated under FPL's supplemental RFP would
18 constitute a greater than 60 percent increase in the company's
19 firm purchased power capacity, investors focus on the financial
20 ramifications and other uncertainties that purchased power
21 would undoubtedly intensify." To what percentage of purchased
22 power relative to the overall portfolio were you applying the
23 60 percent?

24 A I was applying the 1,700 to approximately a 3,200
25 portfolio of purchased power. I might want to check those

1 numbers. They are in my testimony, but it was an adjustment,
2 and that is assuming that the whole -- I believe it's
3 1,722-megawatt need was fulfilled with purchased power.

4 Q Yes, sir. And my question is this: If you were
5 starting at 3,200, what percentage of the total portfolio, FPL
6 portfolio, does the 3,200 comprise?

7 A Of their total generation, it's about 16 percent.

8 Q Okay. So what's 60 percent of 16?

9 A Do you have a calculator? I saw you had one a few
10 minutes ago. I can get mine out.

11 Q It's about 9 percent, isn't it?

12 A 9.6.

13 Q So you believe the investors' focus would undoubtedly
14 intensify if FPL had as much as 25 percent purchased power in
15 its portfolio?

16 A I think it would if they were under long-term fixed
17 contracts. With the current level of purchased power, there is
18 a lot of discussion about purchased power in analyses that I've
19 seen of FPL by rating agencies, by investment advisory
20 services. Again, the testimony I filed in the rate case in
21 January goes over a number of instances where investors have
22 shown that this is a particular consideration with this
23 company, its level of long-term purchased power commitments
24 right now at a 16 percent level. So if it were to increase
25 through firm contracts, I would expect investors would show

1 more concern.

2 Q You told Commissioner Palecki that you think
3 diversity is a good thing. At what point do you regard a
4 portion of power contracts to be towards diversifying?

5 A That's a hard thing to answer in the abstract. I
6 think I agree with Commissioner Palecki that diversification of
7 generating sources is a good thing. If you achieve
8 diversification through purchased power, that would be a good
9 thing, but that is not to say that all purchased power
10 contributes to diversification.

11 Q At Pages 16 and 17, beginning at 22, you state,
12 "Take-and-pay contracts that require capacity payments only if
13 power is available would come next on the scale, with risk
14 factors in the range of 10 to 50 percent." Do you see that
15 statement?

16 A That's correct.

17 Q And you're recommending in this case that a
18 40 percent risk factor be applied?

19 A That is correct, based in part because of the
20 requirements in the supplemental RFP that availability be
21 maintained at high levels. So I think a take-or-pay commitment
22 in an environment where you're obliged to maintain availability
23 increases the firmness of those obligations.

24 Q Is high availability a good thing or a bad thing?

25 A I think it's generally a good thing in terms of

1 reliability of the system. I'd much rather have capacity there
2 when I need it than it being not available when I need it.

3 Q So the stronger the requirements placed on an IPP,
4 the riskier the contract becomes in terms of the eyes of the
5 investors?

6 A Not necessarily the riskier, but the more firm, the
7 more likelihood that those payments in the future are actually
8 going to have to be made; therefore, from the imputation of
9 off-balance sheet debt, the imputation becomes a higher number.
10 I mean, we're looking at the financial effect in terms of this
11 imputation. That is not to say that there aren't favorable
12 effects on the other -- you know, operating effects and other
13 circumstances. But what I'm saying is that you need to
14 consider the financial effects in making the comparison between
15 self-build and purchase. And that's the narrow focus of my
16 testimony.

17 Q At Page 20, beginning at Line 2, you say, "As S&P
18 concluded in reporting the results of its review." Now, if I
19 recall correctly, that report from S&P took the form of an
20 e-mail, did it not?

21 A Yes, sir.

22 Q And the first statement in the quoted portion there
23 says, "We evaluated the RFP for purchased power and determined
24 that between 40 to 60 percent of the capacity payments would be
25 added to FPL's debt." So is it fair to say that the 40 to

1 60 percent recommendation, if you can call it that, stems from
2 their review of the supplemental RFP document?

3 A That is correct. That is the basis of this e-mail.
4 It's not the total basis of my judgment that the 40 percent
5 factor is a reasonable factor, but this is one of the things
6 that I considered.

7 Q Okay. But my question is what S&P looked at. And
8 based upon this report and your response, they looked at the
9 four corners of the supplemental RFP document.

10 A My understanding --

11 Q Yes or no, please.

12 A No. I think there were more materials supplied to
13 S&P than just the RFP documents.

14 Q Well, based upon what's quoted here, for instance, we
15 don't know to what extent S&P included or excluded such things
16 as Florida's capacity cost recovery clause when it came up with
17 this 40 percent number.

18 A No, we don't know that. But to the extent that S&P
19 and the people at S&P have followed FPL for a long period of
20 time, I think they're very much aware of the regulatory
21 framework here in Florida. Mr. Maurey in his testimony cites
22 comments that Standard & Poor's has made on the regulatory
23 environment here in Florida. So I think in the context of
24 evaluating the risk factor, I would certainly expect they would
25 comprehend the regulatory framework here. And certainly in my

1 evaluation of the 40 percent, I took into account the
2 regulatory framework here in Florida.

3 Q With respect to S&P -- and this is what my question
4 is: With respect to what S&P took into account, all we know is
5 that they evaluated the supplemental RFP. You're reading the
6 rest of it into it, aren't you, sir?

7 A I'm not reading into this. I'm telling you my
8 understanding of the way S&P operates. It follows utilities
9 very carefully. It has staff members like Ms. Heck (phonetic)
10 assigned to follow specific utilities, and they write up their
11 reports on these utilities and currently, you know,
12 continuously refresh their ratings and understanding of what
13 goes on relevant to the risk of these companies.

14 Q You say you think that S&P was supplied more than the
15 supplemental RFP document. Do you know whether, for instance,
16 the draft purchased power agreement that's been discussed in
17 this hearing today was ever provided to S&P as part of that
18 analysis?

19 A As I sit here today, I don't know. I've had
20 conversations with people on Mr. Dewhurst's staff about the
21 materials that were supplied, but I cannot remember -- I know
22 there were materials in addition to the four corners of the
23 RFP, as you put it. But as I sit here today, I can't tell the
24 Commission all the things that were included.

25 Q If a utility were to undertake a large construction

1 contract -- a construction project that has not yet been put
2 into rate base, would rating agencies and investors perceive
3 that to be a risky proposition?

4 A They could. It depends on the nature of the
5 construction project. Is it -- how large it is relative to the
6 other assets. Rating agencies sometimes worry about something
7 called asset concentration, when you have all of your eggs, as
8 Commissioner Palecki was talking about, in a few baskets. They
9 also are concerned when a construction project is troubled or
10 when the utility has a bad record of success in terms of
11 successfully getting construction projects underway.

12 I think as far as FPL is concerned, in my reading of
13 investor materials about FPL, it's regarded as having a
14 splendid record in terms of its ability to complete
15 construction projects in a timely manner, usually underbudget,
16 even nuclear power projects in the period of time that other
17 utilities were having terrible problems.

18 Q But in general, isn't it true that rating agencies
19 and investors perceive large construction projects as something
20 that affects and increases financial risk of the utility?

21 A Yes, they might. Again, it depends on the
22 circumstances, how large, who the utility is, what the record
23 of the utility is, the regulatory environment, all of those
24 factors. So they do consider it. I think rating agencies will
25 tell you they consider everything. Now, whether it affects

1 their judgement I think involves the factors that you and I
2 have been talking about.

3 Q A large solid IOU on day one has no construction
4 program in place. A day later the same large solid IOU has a
5 1,900-megawatt construction program that costs a billion
6 dollars. Is one more risky than another?

7 A I think it depends on the circumstances. An IOU that
8 is unable to meet its load is regarded as very risky. So I
9 think investors would regard an IOU taking action to anticipate
10 need to keep the lights on, to keep the Commission happy with
11 their performance, that might be something that investors would
12 view favorably.

13 Q Okay. So financial risk really depends on the
14 particular utility involved and the circumstance of that
15 utility; correct?

16 A I think the impact of a particular item, but I think
17 as to these off-balance sheet liabilities, I think it's pretty
18 clear that that is something that investors consider whenever
19 they're looking at a utility, so that in a circumstance like
20 this where we're talking about adding to the off-balance sheet
21 liabilities and comparing that to a scenario where there is a
22 neutral effect on the balance sheet, it is appropriate to make
23 an adjustment like the equity penalty.

24 Q But the investors and the rating agencies will take
25 into account such things as the regulatory policy towards

1 allowing collection of those imputed debt obligations?

2 A Yes, sir, they would take that into account. Of
3 course, how they are collected, that's a rate case issue, and
4 it depends on, you know, how the Commission treats the balance
5 sheet for rate purposes. The settlement that FPL entered into
6 in April of this year considered that off-balance sheet
7 obligation in adjusting the equity.

8 Q One of the functions that a regulatory agency such as
9 this Commission performs is to authorize returns on equity for
10 regulated utilities; is that correct?

11 A Yes, sir.

12 Q And when an agency examines or analyzes the return on
13 equity that should be authorized for a particular utility,
14 doesn't the agency take into account the financial and business
15 risk that should be reflected in the authorized return?

16 A Yes, sir, I think they should. And I believe in most
17 cases they do.

18 Q So doesn't that authorized rate of return already
19 have built into it a recognition of the financial risk to which
20 the utility is exposed?

21 A I think it should, but that is a different issue than
22 when we're comparing two options. One of which has no affect
23 on the financial risk and one of which has some affect on the
24 financial risk. I think you need to take account of that
25 difference in financial risk in comparing those options.

1 Q If a utility has a large investment in a large new
2 generating unit that is not yet operated, do rating agencies
3 and investors perceive an operating risk in that situation?

4 A An operating risk?

5 Q Yes, sir.

6 A I mean, I think again as we've discussed before, the
7 amount of concern that investors would have would depend on the
8 circumstances: The type of unit, is it a unique unit, or one
9 the utility has a great deal of experience with? What has been
10 the utility's track record with similar units? What has been
11 the regulatory environment in which the utility is operated?
12 Is there anything to suggest that the project is in trouble? I
13 mean, I think investors would look to the particular facts and
14 circumstances in making an assessment.

15 Q If I understand your answer, you say yes, but it's a
16 matter of degree. Is that a fair characterization?

17 A That's right, and it may be a very small degree or a
18 very large degree depending on the circumstances.

19 Q If a utility is facing a transition to a competitive
20 environment, would rating agencies and investors regard that as
21 increasing risk?

22 A Yes, they could. Again, I think one thing that
23 investors have become particularly sensitive to in the last
24 several years is that all competitive environments are not
25 equal. So I think that they again look to the rules and how

1 they're implemented and whether it is a well thought out
2 regulatory environment.

3 In the case of Florida, the reviews that I've seen,
4 investors are very positive about the deliberative approach
5 that Florida seems to be taking in terms of allowing
6 competition into the state. And that is superior to states
7 that maybe have rushed in without as much thought. One of
8 which I can think of in California.

9 Q If a utility is investing heavily in a technology
10 which can or perhaps is being overtaken by a superior
11 technology, would that present financial risk?

12 A I think it could. Again, in talking to Commissioner
13 Palecki, the technological risk is something that investors are
14 mindful of, and the degree of that depends on the facts and
15 circumstances.

16 Q So it appears that if a utility enters a power
17 purchase contract, that's perceived as risky. If a utility
18 builds a power plant, quite possibly investors will perceive
19 that as risky. What's an agency to do?

20 A It's a hard job. Ladies and gentlemen, it's a hard
21 job. I think what the agency tries to do is to account for all
22 the risk that they can reasonably account for. And I think in
23 terms of this equity adjustment and the fact that there is
24 imputation, I think that is something that we know. It's
25 observable. This Commission has recognized it in the past. So

1 I think we ought to adjust for that.

2 If there are other differences out there that we know
3 about that, if we can quantify them, we ought to quantify them,
4 or I would suggest that the Commission ought to quantify them.
5 And if they can't be quantified, I think they ought to be
6 judgmental factors that are used in evaluating options. So I
7 don't think you can boil all of these risks down to numbers.

8 I think a lot of judgment is required. I've heard
9 some of the other witnesses talk about the judgment that's
10 required in this process. But I think in this small corner of
11 the world, which is the equity penalty part of the world, we do
12 have an area where there is a clear difference between the
13 utility-built option and its affect on the balance sheet and
14 the purchased power. And we know that occurs, and we can
15 quantify it, and I think it needs to be quantified to make a
16 rational choice about the cost-effective option.

17 Q If the Commissioners were to do those things
18 necessary to make the rating agencies fully happy, what would
19 electric service cost in Florida do you think?

20 MR. LITCHFIELD: I'm sorry. I did not hear the end
21 of that question.

22 Q If the Commissioners were to try to make the rating
23 agencies fully happy, what would electric service cost in
24 Florida?

25 A I don't know, but I don't believe it's the

1 Commission's job to make the rating agencies happy. I do
2 believe it's the Commission's job to be mindful of how
3 investors react to the decisions that they make because
4 investors are the source of the money that's necessary to buy
5 the plant and equipment that's necessary to provide the service
6 that the Commission is responsible for making available to the
7 people of Florida.

8 CHAIRMAN JABER: I thought the customers were the
9 source of the money that allowed the companies to buy the
10 equipment that makes the service available.

11 THE WITNESS: Well, the customers pay the bills, for
12 sure. But in terms of capital investment and access to capital
13 and financial integrity, I think the Commission has to be
14 mindful of the investor requirements.

15 Now, I don't think -- the Commission's constituency
16 is the customers, Chairman Jaber, and I don't disagree with
17 that. But I believe it is the Commission's obligation to be
18 mindful of investors' reactions. Now, I don't think that
19 this --

20 CHAIRMAN JABER: If you ain't got no customers, you
21 ain't got no investors.

22 THE WITNESS: Absolutely. But I believe this is not
23 an issue, and this is something that Mr. Maurey and I disagree
24 about. This is not an issue, this equity penalty between
25 customers and investors. You don't have to make a choice

1 between customers and investors in deciding on the equity
2 penalty. What you're trying to decide is, in comparing options
3 which are most cost-effective for the customers, you shouldn't
4 ignore a cost that you know is out there. And you know, I
5 think you can be reasonably sure that if this company enters
6 into long-term power purchase agreements, that is going to have
7 a financial effect on the utility.

8 BY MR. MCGLOTHLIN:

9 Q Sir, you just said that in your view the Commission
10 should not ignore this imputed debt subject. Should they focus
11 on that to the exclusion of other aspects of power purchase
12 contracts, many of which could inure to the benefit of the
13 utility when viewed in terms of its riskiness by the financial
14 community?

15 A No, sir. I don't think the Commission ought to
16 ignore any of those factors.

17 Q Earlier you and Mr. Moyle were discussing financial
18 viability of a bidder. Isn't it true that many and perhaps
19 most independent power projects are financed with financing
20 that is project specific?

21 A In my experience, many independent power projects are
22 project financed. The sponsor may have some equity position
23 and maybe some debt subordinated position in the project. In
24 my experience, many are funded as independent projects.

25 Q And in terms of the ability of an independent power

1 developer to obtain financing for that project, do you believe
2 a power purchase contract with a large utility on sound
3 financial footing would be an important consideration in
4 whether it's able to get money or not?

5 A I believe that investors do look at the contract and
6 the terms of the contract in assessing the financeability. I
7 think as we've talked there are many, many other
8 considerations, but I think that is a consideration.

9 Q It's a big one, isn't it?

10 A It may be a big one depending on the circumstances.
11 I think they do look to the contract and the protections in the
12 contract. They also look at the regulatory environment behind
13 the contract.

14 COMMISSIONER PALECKI: May I jump in here?
15 Dr. Avera, I think I heard you testify that the issue of
16 whether there would be an equity penalty is something that is
17 within the sound judgment of this Commission; is that correct?

18 THE WITNESS: I think it's in the judgment of this
19 Commission whether to do it and how big of an equity penalty
20 there should be. I believe that it is a logical and reasonable
21 adjustment to be made, and I think it's one that this
22 Commission has made in past cases properly. But -- and I think
23 it's consistent with the rules that I've read about having as
24 part of the need case to consider the financial impact of
25 purchased power.

1 COMMISSIONER PALECKI: Well, let me ask you this
2 question: This RFP process is already over, and we see a
3 situation where the state of Florida needs a power plant or
4 plants to be built. Wouldn't this have been a better issue for
5 us to decide prior to the RFP process so that we're not
6 haggling over this now when whatever we decide may be too late?

7 THE WITNESS: I don't know if I can help you very
8 much with that. It seems to me that the equity penalty is part
9 of the economic evaluation of alternatives. And presumably,
10 parties in responding to an RFP look at their cost and what
11 they're willing to do, and they put on offer on the table. And
12 that presumably is the best offer they can offer and still meet
13 their profit requirements and risk and whatever else they
14 consider in putting that bid on the table.

15 Now, that should be their best bid whether there's an
16 equity penalty or not. The equity penalty is part of the
17 process that the company uses, and then the Commission in their
18 oversight of the company make sure is being used correctly to
19 compare the various purchased power options that have been put
20 on the table and the self-build option. So I have a little
21 difficulty seeing how the equity penalty would have made a
22 difference as to, you know, the bids you got. It just makes a
23 difference as to how you evaluate the economics of the bids.

24 COMMISSIONER PALECKI: So let's say we agree with you
25 that there should be an equity penalty, but we believe that the

1 equity penalty in this case was set too high, that it should be
2 25 percent of where it was actually set at. What analysis
3 would you say this Commission should do at this juncture?

4 THE WITNESS: Well, if the Commission should believe
5 that, and I certainly believe that the equity penalty
6 assumptions that FPL made were reasonable, but I think as I
7 understand it, you have the equity penalty calculations for the
8 various projects presented to you that are part of the
9 evidence, and you know the magnitude of the equity penalty, and
10 in my testimony, I've laid out the logic and the steps in
11 evaluating it, so if you disagree with any of the assumptions
12 that I have in my testimony, I think it would be possible for
13 you or your staff to figure out what a revised equity penalty
14 would be.

15 And now, how that would be fed into the economic
16 analysis that Dr. Sim did and the other parts of this equation
17 is beyond my expertise, but certainly as to the equity penalty,
18 Commissioner Palecki, I think in this record you have what you
19 need if you disagree with the assumptions to come up with a
20 different result.

21 COMMISSIONER PALECKI: Thank you.

22 BY MR. McGLOTHLIN:

23 Q Sir, let me get you to clarify one thing for me. On
24 Page 20, we were looking at the quoted portion of the S&P
25 e-mail which says, "The RFP states that a minimal level of

1 performance would be required." And one of your answers to me,
2 you said that the source of the concern was the fact that the
3 contracts require high availability. I'm trying to square this
4 comment with yours.

5 A Well, I think availability considerations were part
6 of the RFP, and I believe -- my interpretation of when they say
7 "a minimal level" is that there was a level below which you
8 could not go. That's my understanding of what S&P is saying,
9 and I think it's a little clearer if you look at the entire
10 e-mail.

11 Q So perhaps it should say "a minimal level of
12 performance"?

13 A Right. There's a statement that says -- and I don't
14 remember if this is in the quote or not. It says, "This
15 provision increases the likelihood that the payments will be
16 made, making the capacity payment more firm or debt-like." I
17 mean, this is different from, say, a QF contract, where QFs are
18 not held to minimal levels of performance. So to the extent to
19 which FPL is obliged to make future payments to a QF is much
20 less certain than the kinds of contracts that are contemplated
21 by the RFP.

22 MR. McGLOTHLIN: I think I understand. I have no
23 further questions.

24 MR. PERRY: I have no questions.

25 MR. TWOMEY: Thank you, Madam Chairman.

CROSS EXAMINATION

1

2 BY MR. TWOMEY:

3 Q Good afternoon, sir.

4 A Good afternoon, Mr. Twomey.

5 Q I just have a couple of questions, Dr. Avera. Given
6 your discussion with Commissioner Palecki about the benefits of
7 a purchased power agreement to the IOU, should there be an
8 equity credit in the calculation of these bids, the analysis of
9 these bids?

10 A No, sir, I don't think so. I think to the extent
11 they're benefits, they're not equity benefits. They don't go
12 to the financial risk. They go to the operating risk. So I
13 think if FPL or the Commission thinks a project has a
14 particular advantage in terms of its diversification or some
15 other characteristic, I think that advantage could be taken
16 account of on its own terms. But it's not about the balance
17 sheet the same way this off-balance sheet obligation is about.

18 So, you know, the equity penalty addresses one
19 particular but very concrete phenomenon, which is when a
20 utility signs a long-term purchased power agreement, it has
21 debt-like characteristics which investors factor into their
22 evaluations of a utility.

23 Q Okay. Because of the -- I'm sorry.

24 A Because of the fixed obligations. Now, the contract
25 can have all sorts of other beneficial characteristics which

1 are either quantifiable or not, and they can be taken into
2 account on their own terms, but they still -- this effect on
3 this balance sheet is still there. So you take account of it,
4 have it equilibrated, and then you can look at operating
5 advantages, technology advantages or whatever in comparing the
6 self-build option to the purchased power opportunity.

7 Q Because the fact that the long-term contract is
8 equivalent. It's not off-balance sheet debt; right? Your
9 testimony is that it's in the eyes of the investor, the
10 equivalent of off-balance sheet debt?

11 A Well, yes. It's the equivalent of off-balance sheet
12 liability. It is an affixed obligation that the utility has to
13 meet every year or every month or at some future date, and
14 investors regard those as an off-balance sheet liability which
15 are equivalent to debt. Now, they don't count them dollar for
16 dollar. That's what you have this risk factor for, but it's
17 still -- investors say, that firm has more debt than what you
18 see on the balance sheet.

19 Q Right. And isn't it true or didn't you say earlier
20 to someone that investors view the purchased power contracts as
21 risky in one part because there's the possibility that a
22 Commission could disallow a portion of those payments that are
23 required for the revenue stream to pay off the contract?

24 A Yes, sir, that's one thing the investors have to
25 worry about.

1 Q Okay. And they would do that as risky?

2 A Yes, sir. The utility would be in the position of
3 having to make the payments but not being able to get the
4 revenue.

5 Q To recoup all the revenue?

6 A Yes, sir.

7 Q Now, isn't it true that the supplemental RFP that's
8 before this Commission had a regulatory out provision that
9 provided that if FPL had accepted any of the bids, that FPL's
10 payments on the energy contract would be limited to whatever
11 the Commission allowed through the purchased power clause?

12 A I remember a couple of sentences on regulatory out.
13 I don't remember if it said exactly what you represented, but
14 there was certainly a regulatory out comment, provision in the
15 supplemental RFP.

16 Q Okay. Well, let's just stay then hypothetically, if
17 you had a situation where the purchased power agreement with
18 the bidder had a contract that said that the IOU, that it
19 entered into the long-term contract, would only be responsible
20 for whatever amount that the regulatory agency approved; then
21 that would be more advantageous to the investor or be seen as
22 being better than a situation where the utility was subject to
23 having to pay the full amount of the purchased power contract
24 but perhaps having lesser payments from the agency?

25 A Yes, sir. That is a favorable factor, and that's one

1 of the factors that is incorporated into using a 40 percent
2 adjustment from the present value of the obligation to what the
3 debt equivalent is.

4 Q Okay. And I think you conceded with Commissioner
5 Palecki, did you not, that a utility could benefit in the eyes
6 of the investment community by having purchased power contracts
7 because it would supply -- it would give you supply diversity?

8 A Yes, sir. I could certainly conceive, and I think in
9 my experiences, circumstances where purchased power
10 arrangements do increase the diversity for a company.

11 Q Okay. And I think you've testified as well that the
12 purchased power agreements have benefits that have to be taken
13 into the mix which include the elimination of the risk of
14 having an ongoing large construction project; right?

15 A Yes, sir, that may be a consideration.

16 Q Okay. And as well, the appearance of new technology
17 where if there was a five- or ten-year contract, the utility
18 could conclude its contract and then go on to a newer, better,
19 more efficient technology, perhaps. Whereas, at the self-build
20 option, it might be stuck with that technology for 25, 30 more
21 years?

22 MR. LITCHFIELD: Madam Chairman, may I interject here
23 for a moment? I mean, Mr. Twomey may be going somewhere with
24 this, but at this point, it sounds like he's simply trying to
25 have Dr. Avera summarize questions and answers that have

1 already been asked, and I'm not sure that's terribly
2 productive.

3 CHAIRMAN JABER: So is your objection that some of
4 these are asked and answered?

5 MR. LITCHFIELD: Asked and answered, yes, ma'am.

6 CHAIRMAN JABER: Mr. Twomey.

7 MR. TWOMEY: Well, the -- I was ready to sum up.

8 BY MR. TWOMEY:

9 Q Given those admissions, if you will, isn't it
10 possible that -- isn't it possible that a utility could gain a
11 greater advantage in the eyes of the investment community by
12 entering into a long-term purchased power agreement than
13 self-building?

14 A It certainly could be possible. I have not examined
15 that in these terms, but I think it is also true even in that
16 circumstance utilities or investors would regard those fixed
17 payments as an off-balance sheet obligation, and equity would
18 have to be added to the portfolio to bring it into balance. So
19 all of that is true and -- or may be true, could be true in a
20 circumstance, but the financial impact would still be there.

21 MR. TWOMEY: Okay. Thank you.

22 CHAIRMAN JABER: Thank you, Mr. Twomey.

23 Staff.

24 MR. HARRIS: Yes, thank you.

25 CROSS EXAMINATION

1 BY MR. HARRIS:

2 Q Dr. Avera, would it be fair to say that Standard &
3 Poor's did not create the equity penalty adjustment as Florida
4 Power & Light is proposing be recognized in this proceeding?

5 A I missed the first part of your question, Mr. Harris.

6 Q Would it be fair to say that Standard & Poor's did
7 not create the equity penalty adjustment as Florida Power &
8 Light is proposing it be used in this proceeding?

9 A The staff report? I still missed that.

10 Q Standard & Poor's.

11 A Standard & Poor's, yes. Okay. I got it.

12 Q Would it be fair to say --

13 A Yes, sir, it is fair to say. Standard & Poor's
14 stopped at the level of what is the off-balance sheet
15 obligation. The equity penalty is something that has been
16 developed in the regulatory arena.

17 Q Did Florida Power & Light develop this concept as
18 it's being applied today?

19 A I saw -- the earliest mention of this concept I have
20 seen is in the FPL testimony that's attached to Mr. Maurey's
21 testimony in this case. Although, I have seen references to
22 equity penalty in several Florida Power Corporation cases and
23 the equity adjustment in the FPL standard offer case. So I
24 have seen references to equity penalty in other Commission
25 orders and the equity adjustment, as I cite in my testimony.

1 Q So would that be a "yes or no" for Florida Power &
2 Light?

3 A The earliest that I have seen is the Florida Power --
4 FPL testimony. I don't know if they invented it. That's the
5 earliest that I have seen.

6 Q Thank you. Have you -- as Florida Power & Light is
7 requesting it be applied in this proceeding, have you seen any
8 other states with the same concept or adjustment, any orders
9 from any other state?

10 A No, I have not. I have not been -- seen a regulatory
11 decision framework exactly like this where the purpose is to
12 compare a self-build option to various purchased power options.
13 As we discussed in my deposition, my experience has generally
14 been where you have a number of purchased power options that
15 you're comparing among each other, not against a self-build
16 alternative.

17 Q Is it your testimony today that the Commission has
18 explicitly approved the use of the equity penalty adjustment as
19 proposed by Florida Power & Light in this proceeding in prior
20 cases?

21 A I will say yes. I believe that this Commission has
22 approved the framework of the equity penalty. The assumptions
23 that went into the calculation were different. For example, in
24 the standard offer case, a 10 percent risk factor was used
25 instead of the 40 percent. In the Florida Power Corp case, the

1 Hines 2 case, a 40 percent factor was used but different
2 assumptions were used about the cost of debt, the cost of
3 equity, and the capital structure. But I believe that the
4 framework that FPL used in this case is the same as the
5 framework used in those cases.

6 Q Am I correct in understanding that your testimony is
7 that there are other ways the company or the Florida Public
8 Service Commission could make investors comfortable with
9 purchased power agreements or contracts other than by using an
10 equity penalty?

11 A Yes and no. Yes, there are ways that the Commission
12 can make investors more comfortable with purchased power. I
13 don't think they can eliminate the off-balance sheet
14 calculations. They can certainly make them smaller and the
15 risk factor smaller. But I don't think -- and I want to
16 clarify in your question, I don't think the purpose of the
17 equity penalty adjustment is to make investors comfortable.
18 The purpose of the equity penalty adjustment is to make
19 alternatives comparable, recognizing how investors are going to
20 react.

21 The Commission should look and see how investors
22 regard these off-balance sheet obligations, and the fact that
23 they do regard them as off-balance sheet debt says that a
24 purchased power agreement has a balance sheet effect. So when
25 the Commission is evaluating alternatives, it should consider

1 that effect in evaluating alternatives.

2 Q Would it be fair to say that without use of the
3 equity penalty adjustment in the comparison of alternatives,
4 other means exist to restore investors' confidence or comfort
5 such that the bond rating or financial position of Florida
6 Power & Light would not be affected by the increase in
7 purchased power agreements?

8 A No. I don't think that it's possible to completely
9 eliminate the affect of a long-term purchased power agreement
10 on investors viewing it at least in some maybe small part as an
11 off-balance sheet liability that would be different from when
12 you are doing a self-build option where your economics are
13 based on a neutral effect on the capital structure. So I don't
14 think you could get to the point where the equity penalty
15 vanishes.

16 I think certainly this Commission could take actions
17 to make the equity penalty -- well, to make the investors'
18 reaction less, and I think the equity penalty should be based
19 on what the Commission thinks the investors' reaction will be
20 as it goes through the four steps to calculate it.

21 Q I think you testified a little while ago that you
22 disagree with Mr. Maurey, and your understanding is Mr. Maurey
23 is saying that you would have make a -- the Commission would
24 have to make a choice between investors and ratepayers; is that
25 correct?

1 A That's correct. I don't believe -- I think in many
2 occasions the Commission may be in a position of deciding a
3 balance between customers' interest and shareholders' interest,
4 but this is not one of those. I think the Commission is, I
5 believe, in this circumstance trying to identify the most
6 cost-effective option or to make sure that FPL has identified
7 the most cost-effective option. And I believe in doing that
8 exercise, you need to take account of a real cost that is
9 present because of the off-balance sheet obligations that
10 investors will impute to purchased power agreements.

11 The Commission has caused this a real cost in past
12 decisions, and I think if you are trying to find the least-cost
13 alternative, you can't ignore a real cost.

14 Q Does Mr. Maurey state this in his testimony anywhere?

15 A I believe Mr. Maurey has a discussion about
16 investors' versus customers' interest. If you want me to find
17 the section, I can look for it.

18 Q No. So you're testifying that Mr. Maurey does make
19 this statement clear in his testimony; is that correct?

20 A My memory is that he talks about there being a
21 division of interest on this issue, and I don't believe there
22 is.

23 Q So your answer would be, you believe yes?

24 A Yes, I believe he did. And I'll be up here for my
25 rebuttal, and by then I'll certainly know where he said it.

1 Q That's fair. I believe in response to a question by
2 Mr. McGlothlin you made some comments about different risks
3 other than purchased power agreements; is that correct?

4 A Yes.

5 Q Would the different risks apply equally to -- and my
6 recollection is, there was a discussion of multiple risks and
7 even greater multiples of -- okay. I'd like to withdraw that.
8 I don't think we have any further questions.

9 CHAIRMAN JABER: Commissioners?

10 COMMISSIONER BRADLEY: What is the depreciable life
11 of a power plant in terms of years?

12 THE WITNESS: I believe 25 or 30 years. I don't know
13 what FPL uses, but in my experience, it's something of that
14 nature.

15 COMMISSIONER BRADLEY: In terms of a purchased power
16 contract, what is the average length of a short-term purchased
17 power contract, and what is the average term in terms of years
18 for a long-term purchased power contract?

19 THE WITNESS: Well, I think the contracts
20 contemplated by the RFP need to be at least three years long,
21 and I think that's -- most people regard a three-year contract
22 as in the kind of the short-term range and could extend up, I
23 believe, to 25 years. And most people, I think, would consider
24 a purchased power contract to 15 to 25 years a long-term
25 contract, Commissioner.

1 COMMISSIONER BRADLEY: Okay. So the independent
2 power producers were offering you -- well, a part of their
3 terms-- I mean, they were only offering three years?

4 THE WITNESS: No, sir. I believe, Commissioner,
5 under the RFP that I reviewed, my memory is that the offer of
6 power in response to the RFP should be at least 3 years and
7 could continue out as many as 25 years.

8 COMMISSIONER BRADLEY: Could continue out for at
9 least --

10 THE WITNESS: Yes, sir. I think that's up to the
11 bidder to say how long they're making the power available.

12 COMMISSIONER BRADLEY: So what ordinarily happens if
13 you all don't agree to extend the contract after the short-term
14 period has expired and the plant has not been depreciated out
15 for 25 years?

16 THE WITNESS: Well, I think an independent power
17 producer then has to go find another home for their power. In
18 some circumstances, they can find a better home for it. In
19 some circumstances, they can't. I think that's part of the
20 decision that the bidder has to make in terms of what duration
21 of contract they want to put on the table and the circumstance.

22 COMMISSIONER BRADLEY: Okay. Another question then
23 in terms of terms of agreement. At the -- say, for example, if
24 you all decided to go for three years, that means that you all
25 would renegotiate the terms after three years of the cost of

1 doing business; is that correct?

2 THE WITNESS: Well, Commissioner --

3 COMMISSIONER BRADLEY: I mean, would the price to the
4 consumer go up or would it go down?

5 THE WITNESS: I'm an outside financial consultant to
6 FPL, so I will answer the questions based on my understanding.

7 COMMISSIONER BRADLEY: Theoretically.

8 THE WITNESS: Theoretically, I think if a bidder said
9 three years and then at the end of the three years wanted to
10 renegotiate either with FPL or another utility, I think whether
11 the price would go up or down would depend on the market
12 conditions at that time. I think one thing that we've learned,
13 if anything, over the last 15 or 20 years is that market
14 conditions, the cost of power can change dramatically in a
15 particular region over the course of a few years.

16 So whether the prices will be higher or lower three
17 years hence or certainly -- really, we're talking three years
18 from 2005. So after 2008, I think it could be dramatically
19 higher, lower, or about the same.

20 COMMISSIONER BRADLEY: So who basically would have
21 the ability to determine what the cost of power is going to be
22 to the consumer when you all renegotiate?

23 THE WITNESS: Well, I think that would depend on
24 market conditions. I think if at the time the contract is up
25 for being renegotiated, I think the prices will be determined

1 by market conditions then prevailing. I think the Commission
2 at that time would obviously have regulatory oversight to make
3 sure whatever prices were paid were not out of line with what
4 was required in the marketplace.

5 COMMISSIONER BRADLEY: So if the independent power
6 producer did not agree with the decision that was made by the
7 Commission, then they could terminate their agreement and sell
8 that power elsewhere.

9 THE WITNESS: If they elected to go with a shorter
10 term contract, then they have the ability at a future time to
11 take their chances in the market. And they could be big
12 winners, big losers, or come out about the same.

13 COMMISSIONER BRADLEY: If they went elsewhere, what
14 type of condition would that create for the consumers in
15 your --

16 THE WITNESS: Well, I think it depends on the
17 circumstances, Commissioner.

18 COMMISSIONER BRADLEY: I guess what I'm trying to get
19 at is, would you then be confronted with a self-build option,
20 another RFP situation, or would you -- I mean, how would you
21 deal with the fact that you no longer have access to this
22 particular source of power?

23 THE WITNESS: I think the company would build in the
24 fact a contract is disappearing in three years or 2008 or
25 whatever the date is into its capacity planning, and it would

1 look for the most cost-effective alternative. And it might
2 turn out the most cost-effective alternative is to renegotiate
3 a contract with the new bidder.

4 My understanding of the process is there would be --
5 before the company could plan a new unit to meet that need, we
6 would have a determination, something like this. The company
7 would go out for proposals to see if there are other power
8 generators, other independent power producers, or utilities or
9 somebody that would make a better deal. So I think in some
10 ways the customers could get the benefit of new technology.
11 They could get the benefit of a more favorable market
12 condition.

13 I mean, I think the customers have the protection of
14 FPL looking after their interest and trying to figure out the
15 most cost-effective way to meet the power, and then they have
16 the defense of the oversight of the Commission over FPL to make
17 sure that FPL is doing what is best for the customer.

18 COMMISSIONER BRADLEY: One other question and I'll be
19 finished.

20 CHAIRMAN JABER: Go ahead, Commissioner Bradley.

21 COMMISSIONER BRADLEY: Who determines the terms and
22 the duration of a power purchase contract?

23 THE WITNESS: My understanding of the process that's
24 contemplated by this RFP is, the bidder initially proposes a
25 term, and then there would be negotiations between -- or could

1 be negotiations between FPL and the bidder that might change
2 that term, but I think the bidder is initially in the driver's
3 seat of putting on the table what they think a term that makes
4 sense from a business aspect for them.

5 So I think the seller is in the position to put the
6 term on the table, and then FPL is in the position of saying
7 this is attractive or not. And then the Commission is in the
8 position of saying, was FPL's decision consistent with the
9 least-cost alternative?

10 COMMISSIONER BRADLEY: So it sounds like you're
11 saying that there would two parties involved in -- well, the
12 Commission would have some regulatory oversight, but Florida
13 Power & Light ultimately would be -- I wouldn't say ultimately,
14 but would also be a partner in the decision as to what the
15 duration of the purchased power contract is going to be.

16 THE WITNESS: That's right, Commissioner. What would
17 happen is, Florida Power & Light and the bidder would negotiate
18 an agreement, and then that agreement would be subject to
19 regulatory oversight. So I think the customers have kind of
20 two lines of protection. I mean, first Florida Power & Light
21 has the customers' interest in mind in trying to get the
22 least-cost alternative, and then you have regulatory oversight
23 to kind of check the decisions that were made.

24 COMMISSIONER BRADLEY: Okay.

25 CHAIRMAN JABER: Commissioners?

1 COMMISSIONER DEASON: I have a few questions about
2 Page 21 of your testimony at the bottom of that page. And
3 there you talk about the return on equity utilized by Florida
4 Power & Light in its cost-effectiveness calculation. And you
5 indicate that they use 11.7 percent. I assume they use the
6 11.7 percent for their own self-build calculations as well as
7 calculating the equity penalty?

8 THE WITNESS: Yes, Commissioner Deason. They use the
9 same assumptions for the self-build that were used in the
10 equity penalty as to cost of equity, cost of debt, and capital
11 structure.

12 COMMISSIONER DEASON: Do you believe that
13 11.7 percent is an adequate return on equity to adequately
14 compensate investors in Florida Power & Light for the risk and
15 costs associated with building the self-build options?

16 THE WITNESS: No, sir, personally, I don't. I did an
17 assessment of the -- what I thought the cost of equity was to
18 Florida Power & Light in the rate case, and I came up with a
19 higher number. But I do think the 11.7 is in the range of the
20 kinds of returns that Commissions have allowed. It's
21 consistent with the recent practice of this Commission. And in
22 fact, in my rate case testimony, I did an analysis of the
23 average Commission order adjusted for interest rates in the
24 United States over the last 20 years, and the answer was 11.7.
25 So I think it is representative of the kinds of returns that

1 Commissions allow. Personally, I think it is inadequate for
2 FPL.

3 COMMISSIONER DEASON: What was your recommendation in
4 the docket you referenced on Page 21?

5 THE WITNESS: My recommendation was a 12.6 pure cost
6 of equity plus 25 basis points for flotation costs which
7 brought it up to 12.85, and then I also believe the company
8 asked for a management performance incentive of another 30
9 basis points, so the number that was requested was 13.15.

10 (Transcript continues in sequence with Volume 6.)

11 - - - - -

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

4
 5 I, TRICIA DeMARTE, Official Commission Reporter, do hereby
 6 certify that the foregoing proceeding was heard at the time and
 7 place herein stated.

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

13 I FURTHER CERTIFY that I am not a relative, employee,
 14 attorney or counsel of any of the parties, nor am I a relative
 15 or employee of any of the parties' attorneys or counsel
 16 connected with the action, nor am I financially interested in
 17 the action.

18 DATED THIS 4th DAY OF OCTOBER, 2002.

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Tricia DeMarte

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