

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 041272-EI

PETITION FOR APPROVAL OF STORM
COST RECOVERY CLAUSE FOR RECOVERY
OF EXTRAORDINARY EXPENDITURES
RELATED TO HURRICANES CHARLEY,
FRANCES, JEANNE, AND IVAN, BY
~~PROGRESS ENERGY FLORIDA, INC.~~

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VOLUME 3
Pages 200 through 347

PROCEEDINGS:

HEARING

BEFORE:

CHAIRMAN BRAULIO L. BAEZ
COMMISSIONER J. TERRY DEASON
COMMISSIONER RUDOLPH "RUDY" BRADLEY
COMMISSIONER CHARLES M. DAVIDSON
COMMISSIONER LISA POLAK EDGAR

DATE:

Wednesday, March 30, 2005

TIME:

Commenced at 9:30 a.m.
Concluded at 5:38 p.m.

PLACE:

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

REPORTED BY:

MARY ALLEN NEEL, RPR

DOCUMENT NUMBER-DATE

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APPEARANCES: (As heretofore noted.)

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 2.)

Thereupon,

SARAH S. ROGERS

continues her testimony under oath from Volume 1 as follows:

CONTINUED CROSS-EXAMINATION

BY MR. MCWHIRTER:

Q Now, I'm going to deal only with Charley, but this is repetitive of the others. The company used 23,000 bolts, 10,000 ground rods, 21,000 insulators, and so forth and so on, and then the company restored 2,684 miles of damaged transmission lines and restored 274 substations to service. Is that -- and that's just that one thing, that one storm. Where did that equipment -- the materials and equipment you used, where did it come from?

A Some of it was in our inventory, and some of it we ordered specially for the storm.

Q Do you have any knowledge what percentage came from inventory and what percentage was ordered specifically?

A I do not.

Q Did you have any problems getting supplies during the storm season?

1 A Yes, we did. Transmission poles typically have
2 a fairly long lead time, so we did have difficulty
3 getting the poles that were needed and some of the
4 splices that were needed.

5 Q And what did you do about that?

6 A We sought out our neighboring utilities in the
7 Southeast and asked if they could provide us with any
8 excess that they might have had.

9 Q Do you know how those are priced?

10 A I do not.

11 Q Did Carolina send any of that equipment to
12 Florida?

13 A I do not believe so.

14 Q You don't think so?

15 A No.

16 MR. MCWHIRTER: That's all the questions I have
17 of Ms. Rogers.

18 CHAIRMAN BAEZ: Mr. Wright?

19 MR. WRIGHT: No questions.

20 CHAIRMAN BAEZ: Mr. Twomey?

21 MR. TWOMEY: No, sir.

22 CHAIRMAN BAEZ: Staff?

23 MS. RODAN: No questions.

24 CHAIRMAN BAEZ: Commissioners, any questions?

25 Redirect.

1 MR. WALLS: Very briefly.

2 REDIRECT EXAMINATION

3 BY MR. WALLS:

4 Q Ms. Rogers, you were ask about the inclusion
5 of your salary and other management salary in the storm
6 costs. Could you explain to the Commission what you
7 were doing during the hurricanes?

8 A Yes. As System Storm Coordinator, I manned
9 the System Storm Center. We prioritized the lines to be
10 energized and repaired. We interfaced with the
11 Distribution Storm Center to ensure that they were
12 knowledgeable of what substations were coming on when so
13 that they could direct their workforces to energize
14 customers as soon as possible. We also interfaced with
15 the Energy Control Center to ensure that our restoration
16 plans did not adversely affect the grid overall.

17 Q And how many days and hours did you put in
18 during the storm on that work?

19 A I worked 12 hours a day for six weeks straight,
20 with one Sunday off.

21 Q And is that the type of work that you normally
22 do on your day-to-day job?

23 A No, it is not.

24 Q One other question. Mr. McWhirter had asked
25 you about the number, and I believe he used the number

1 60 million. The number for the storm costs is around
2 366 million; correct?

3 A I believe he was referring to the transmission
4 portion only.

5 MR. WALLS: Okay. No further questions.

6 CHAIRMAN BAEZ: Mr. Walls, I have Exhibits 17
7 through 23 for Ms. Rogers.

8 MR. WALLS: Yes. At this time we would move in
9 evidence Ms. Rogers' Exhibits No. 17 through 23 in the
10 staff exhibit list.

11 CHAIRMAN BAEZ: Without objection, show
12 Exhibits 17 through 23 admitted into the record.

13 (Exhibits 17 through 23 were admitted into
14 evidence.)

15 CHAIRMAN BAEZ: Thank you, Ms. Rogers.

16 THE WITNESS: Thank you.

17 CHAIRMAN BAEZ: Mr. Walls, before you call
18 your next witness, why don't we take a five-minute
19 break.

20 (Short recess.)

21 CHAIRMAN BAEZ: We'll go back on the record.
22 Mr. Walls, you were going to call your next witness.

23 MR. WALLS: Commissioner, if I could just
24 re-call Ms. Roger for one brief question, with your
25 permission, that I --

1 CHAIRMAN BAEZ: I thought she had left.

2 MR. WALLS: No, she's still here.

3 CHAIRMAN BAEZ: Of course she is. Otherwise,
4 you wouldn't be trying to call her. Go ahead.

5 And, Mr. Walls, it cuts both ways, so subject
6 to what your questions are --

7 MR. WALLS: I understand.

8 CHAIRMAN BAEZ: -- the other parties may have
9 questions as well.

10 MR. WALLS: And I will fully give them the
11 opportunity.

12 CHAIRMAN BAEZ: That should be my job, but,
13 yes. I've already told you there may be the
14 opportunity. If you want the job, you're welcome to it.
15 Go ahead.

16 BY MR. WALLS:

17 Q Ms. Rogers, Mr. McWhirter had asked you a
18 question regarding your testimony at page 2 of your
19 direct regarding your phases, moving from pre-season
20 activities to pre-storm activities, and he had asked you
21 if that relieved you of your normal costs, and I believe
22 your answer was yes at that point. And I wanted to give
23 you an opportunity to explain your answer more fully.
24 What did you mean when you said that?

25 A What I meant was our direct storm-related

1 costs. It didn't relieve us of all the costs associated
2 with the transmission department during that period. It
3 would relieve us only of those storm-related activities
4 and those costs associated.

5 MR. WALLS: I have no further questions.

6 CHAIRMAN BAEZ: Do any of the parties have to
7 recross on the information? No.

8 Once again, Ms. Roger, thank you.

9 THE WITNESS: Thank you.

10 CHAIRMAN BAEZ: You're excused.

11 All right. Now we can call the next witness.

12 MR. WALLS: We would call Mr. Portuondo to the
13 stand.

14 CHAIRMAN BAEZ: All right. I'll note now -- at
15 this point, I'll note that there are certain -- I don't
16 want to say objections, because they haven't been
17 registered, but there may be some issues with some
18 portions of Mr. Portuondo's rebuttal testimony, and
19 certainly some exhibits that were held out for those
20 reasons.

21 And I'm open to suggestions as to what the most
22 economical way of dealing with those issues, whether we
23 deal with them up front or kind of let it -- you know,
24 I'm open to suggestions, I guess, in short, if there's
25 an efficient way of dealing with whatever objections

1 that might arise in advance.

2 MR. MCWHIRTER: Mr. Chairman, I'm the one
3 that's fussing, so --

4 CHAIRMAN BAEZ: Are you the one that's
5 fussing?

6 MR. MCWHIRTER: Yes. When we had the
7 prehearing conference, Commissioner Davidson did what I
8 thought was a very bright idea that would expedite the
9 hearing. He said when the witness comes on, let's put
10 both the direct and the rebuttal on at the same time,
11 and I think that's great. It really does save a lot of
12 time, because overnight we can't think of other
13 questions to ask.

14 But in any event, in Mr. Portuondo's initial
15 testimony, he appears as a representative of the
16 company, and he's a fact witness, testifying to known
17 facts and bookkeeping entries and so forth. After the
18 intervenors filed their testimony, Mr. Portuondo
19 responded to that, and he begins to offer opinion
20 testimony, and he's actually giving expert testimony on
21 regulatory philosophy and policy and what you did, using
22 hearsay and so forth.

23 And it's that testimony that I object to, but I
24 may not object to, because he hasn't been qualified as
25 an expert. And he may well be an expert and may well be

1 able to deal with those issues after he's properly
2 qualified, but if he fails to qualify --

3 CHAIRMAN BAEZ: And that was the purpose of
4 your -- I understand the purpose now. I seem to recall
5 some of the other parties, to quote Mr. McWhirter,
6 fussing. Are there any other grounds or anything else

7 that needs to come to our attention so that we can kind
8 of figure out how to handle this, Mr. McGlothlin?

9 MR. MCGLOTHLIN: My objections are somewhat
10 different. I object to the exhibits identified as, I
11 think, 43 and 46. The nature of the objection is that
12 these are -- these consist of an exhibit that was from
13 an FPL docket and prefiled testimony from an FPL docket,
14 and I think it's inappropriate to try to import that in
15 this proceeding when we haven't had a chance to
16 cross-examine the witness, when the sponsoring witness
17 did not prepare the exhibit, and that type of thing.

18 And that's the type of objection that usually
19 in PSC proceedings is entertained when the counsel
20 offers them in evidence. And I think my objections, I
21 will have that appropriate and usual opportunity. If I
22 prevail on my objection, I would also want the prefiled
23 testimony that addresses those exhibits to be stricken
24 at that time.

25 CHAIRMAN BAEZ: And these are -- okay. These

1 are rebuttal exhibits. Okay. All right. It sounds
2 like we're pretty much clear to take his testimony in
3 order and see where that leads us.

4 All right, Mr. Portuondo, you were sworn;
5 right?

6 THE WITNESS: Yes.

7 CHAIRMAN BAEZ: Okay. Go ahead, Mr. Walls.
8 Thereupon,

9 JAVIER PORTUONDO
10 was called as a witness on behalf of Progress Energy
11 Florida, Inc. and, having been first duly sworn,
12 testified as follows:

13 DIRECT EXAMINATION

14 BY MR. WALLS:

15 Q Will you please introduce yourself to the
16 Commission and provide your address, Mr. Portuondo?

17 A My name is Javier Portuondo. My address is 100
18 Central Avenue, St. Petersburg, Florida.

19 Q And who do you work for, and what is your
20 position?

21 A I work for Progress Energy Florida, and my
22 position is Director of Regulatory Services for Florida.

23 Q And have you filed prefiled direct and rebuttal
24 testimony and exhibits in this proceeding?

25 A Yes, I have.

1 Q And do you have those in front of you?

2 A Yes, I do.

3 Q Do you have any changes to make to your
4 prefiled testimony, both direct and rebuttal, and
5 exhibits in this proceeding?

6 A No, I do not.

7 Q And if I asked you the same questions in your
8 prefiled testimony, both direct and rebuttal, today,
9 would you give the same answers that's indicated in your
10 prefiled testimony?

11 A Yes, I would.

12 MR. WALLS: We would request that the prefiled
13 testimony, both direct and rebuttal, be moved in
14 evidence as if we read it in today.

15 CHAIRMAN BAEZ: Without objection, show the
16 prefiled direct --

17 MR. MCWHIRTER: I'm going to object to the
18 rebuttal, not to the prefiled.

19 CHAIRMAN BAEZ: You got ahead of me. We're
20 going to go -- without objection, we'll show the direct
21 testimony admitted into the record as though read.

22

23

24

25

FPSC DOCKET NO. 041272-EI

IN RE: PROGRESS ENERGY FLORIDA, INC.'S PETITION
FOR APPROVAL OF STORM COST RECOVERY CLAUSE FOR
EXTRAORDINARY EXPENDITURES RELATED TO HURRICANES
CHARLEY, FRANCES, JEANNE, AND IVAN.

DIRECT TESTIMONY OF JAVIER PORTUONDO

I INTRODUCTION AND QUALIFICATIONS

1
2 **Q. Please state your name, your employer, and business address.**

3 **A.** My name is Javier Portuondo, and I am employed by Progress Energy Service
4 Company, LLC. My business address is 100 Central Avenue, St. Petersburg, Florida.

5

6 **Q. Please tell us your position and describe your duties and responsibilities in that**
7 **position.**

8 **A.** I am the Director, Regulatory Services – Florida. I am responsible for the regulatory
9 accounting and reporting activities of Progress Energy Florida, Inc. (“PEF” or the
10 “Company”).

11

12 **Q. Please summarize your educational background and employment experience.**

13 **A.** I graduated from the University of South Florida in 1992 with a Bachelor’s Degree in
14 Business Administration, majoring in Accounting. I began my employment with
15 Florida Power Corporation in 1985. During my 19 years with Florida Power
16 Corporation and PEF I have held various staff accounting positions within Financial
17 Services in such areas as: General Accounting, Tax Accounting, Property Plant &
18 Depreciation Accounting and Regulatory Accounting. In 1996 I became Manager,

1 Regulatory Services, and in 2003 I was named Director, Regulatory Services –
2 Florida, for PEF.

4 **Q. Have you previously testified before the Florida Public Service Commission?**

5 **A.** Yes, I have testified before the Florida Public Service Commission (the
6 “Commission”) on numerous occasions.

7

8 **II. PURPOSE AND SUMMARY OF TESTIMONY**

9 **Q. What is the purpose of your testimony in this proceeding?**

10 **A.** The purpose of my testimony in this proceeding is to provide the Commission with
11 background of PEF’s current Storm Damage Reserve and to explain how the Reserve
12 operates. I will also describe the Storm Cost Recovery Clause proposed by the
13 Company, explain how it will function, and provide the Commission with the
14 Company’s current estimate of the costs that would be recovered under that Clause as
15 a result of Hurricanes Charley, Frances, Ivan, and Jeanne. I will further describe how
16 the recovery of these storm-related costs would affect customer bills.

17

18 **Q. Are you sponsoring any exhibits to your testimony?**

19 **A.** Yes. I am sponsoring the following exhibits to my testimony:

20 **JP-1 Summary of Storm Damage Reserve.**

21 **JP-2 Storm Cost Recovery Clause Levelized Factors Schedules.**

22 Each of these exhibits was prepared under my direction, and each is true and accurate.

23

1 **Q. Please summarize your testimony?**

2 **A.** As a consequence of cost-prohibitive premiums demanded by insurance carriers in the
3 aftermath of Hurricane Andrew, PEF has been self-insured for storm damage to its
4 transmission and distribution facilities since 1993. At that time, the Commission
5 authorized PEF to establish a Storm Damage Reserve on its books and to accrue funds
annually to the Reserve from base rates to cover the Company's storm-related costs.

7 However, the Commission purposefully set the annual accrual at an amount that was
8 not intended to cover the costs of a catastrophic storm or series of such storms.

9 Instead, the Commission provided PEF the opportunity to file a petition for relief in
10 the event it experienced catastrophic storms, with the express understanding that the
11 Commission would expeditiously review any such petition.

12 The Company's self-insured Storm Damage Reserve currently accrues \$6
13 million annually and will have a balance of \$46.9 million as of December 31, 2004,
14 before any offset for storm-related costs in 2004. The storm-related costs experienced
15 by the Company as a result of Hurricanes Charley, Frances, Ivan, and Jeanne,
16 however, are currently estimated at approximately \$366 million on a total system
17 basis. Of this amount, approximately \$311.4 million are storm-related operation and
18 maintenance (O&M) expenses. After the Storm Damage Reserve is applied, the
19 remaining amount of storm-related O&M expense is \$264.5 million, or \$251.9 million
20 allocated to the Company's retail jurisdiction.

21 Under the proposed Storm Cost Recovery Clause, the Company seeks to
22 recover the remaining retail O&M expenses of \$251.9 million, plus interest, in equal
23 amounts over a two-year period. This would result in the recovery of \$132.2 million

1 in 2005 and \$128 million in 2006, assuming a January 1, 2005 commencement date.
The impact of this on a residential bill for 1,000 kiloWatt-hours would be \$3.81 in
2005 and \$3.59 in 2006.

4 The Storm Cost Recovery Clause proposed by the Company would incorporate
the same procedural and substantive mechanisms traditionally employed by the
6 Commission's other cost recovery clauses. For example, the Storm Cost Recovery
7 Clause would include the true-up of estimated costs and sales to actual costs and sales,
8 with interest at the commercial paper rate applied to any over- or under-recoveries
carried forward, subject to the Commission's determination that recoverable costs
10 were reasonable and prudently incurred.

11

12 III. BACKGROUND: THE STORM DAMAGE RESERVE

13 **Q. Please describe how the Company's Storm Damage Reserve was established.**

14 **A.** The Storm Damage Reserve was established in 1993 as a part of the Company's self-
15 insurance plan approved by the Commission. The Company was forced to resort to
16 self-insurance for its transmission and distribution ("T&D") systems after Hurricane
17 Andrew in 1992, when adequate commercial insurance coverage was no longer
18 available at reasonable prices. The Company's self-insurance plan includes (1) the
19 continued search for the availability of commercial T&D insurance in adequate
20 amounts at reasonable prices, (2) ongoing accruals to an unfunded Storm Damage
21 Reserve to address the costs incurred as a result of non-catastrophic storms; and (3)
22 the ability to request additional cost recovery in the event that storm costs exceed the
23 Storm Damage Reserve.

1 **Q. Why was the Storm Damage Reserve created in 1993?**

2 **A.** Prior to Hurricane Andrew in 1992, commercial property insurance was generally
3 available to utilities at reasonable prices with adequate coverage for storm damage to
4 T&D facilities. Following Hurricane Andrew, however, the investor owned utilities in
5 Florida experienced difficulty renewing their insurance programs for transmission and
6 distribution lines with adequate coverage at a reasonable cost. Simply put, the risk of

7 severe storm losses is a risk the insurance industry evidently is no longer willing to
8 assume. As a result of the reluctance of commercial insurance carriers to provide
9 reasonable and adequate T&D coverage, the investor owned utilities petitioned the
10 Commission to implement self-insurance plans for storm damage to their T&D
11 systems.

12
13 **Q. How does the Storm Damage Reserve operate?**

14 **A.** In 1993, the initial annual accrual to the Storm Damage Reserve was set at \$3 million,
15 based on the Company's statistical study of storm occurrence, intensity, and damage.
16 This annual Storm Reserve accrual was increased to \$6 million effective January 1,
17 1994, and remains at this level today.

18 The annual accrual to the Storm Damage Reserve is treated as an O&M
19 expense included in the Company's base rates. Once the amount has been determined
20 by the Company's study and approved by the Commission, the annual accrual
21 becomes a reasonable and prudent cost of providing service. This means that, when
22 storms occur, the Company recovers its prudently incurred storm-related O&M
23 expenses from the Storm Reserve on a dollar-for-dollar basis.

1 The Storm Damage Reserve, like most reserves established by the Commission
2 under the Uniform System of Accounts, is an unfunded Reserve. For reserves of this
3 type, base rates are set to provide sufficient revenues to cover the annual accrual
4 credited to the Reserve on the Company's books, but cash is not actually transferred
5 into a separate physical account. This provides a distinct benefit to customers, since
6 the cash equivalent of the Reserve balance is treated as a cost-free source of funds for
7 ratemaking purposes and thereby reduces the Company's overall cost of capital that
8 customers support through their rates. The Company must provide the funds to cover
9 storm-related costs up to the balance of the unfunded Reserve from cash on hand or
10 borrowed funds, depending on the circumstances at the time. The issue addressed by
11 PEF's Petition, however, concerns the need to fund the storm-related costs associated
12 with the four 2004 hurricanes that exceed the Storm Damage Reserve balance by a
13 substantial amount.

14
15 **Q. Why doesn't the Storm Damage Reserve provide coverage for all storm-related**
16 **costs the Company might experience?**

17 **A.** Because to do so would be neither practical nor cost-effective. The Storm Damage
18 Reserve is intended to address the likely level of storm costs that might result from
19 study findings that 53% of the storms simulated a total cost of less than \$5 million and
20 the probability of a storm occurrence is only 23.3% a year. The annual accruals to the
21 Reserve were not designed to cover costs of potentially catastrophic hurricane seasons
22 because the Company's studies that provided the basis for these accruals have shown a
23 low probability that the most severe storms or series of storms would severely impact

1 its service territory. A summary of the Company's historical storm experience and
2 costs since 1994 is attached as Exhibit ___ (JP-1) to my testimony. When considering
3 these studies in the early to mid-1990's, it was the Commission's considered judgment
4 to avoid collecting from customers the significant additional reserves that would be
5 needed to cover the costs of catastrophic storms that were unlikely to occur. Instead,
6 the Commission decided to provide utilities the opportunity to seek recovery of the
7 costs associated with catastrophic storms if and when the need might arise. As we are
8 all too aware, the hurricane season of 2004 has presented that need.

9
10 **Q. How does the Company treat storm-related costs that exceed the balance in the**
11 **Storm Damage Reserve?**

12 **A. Pursuant to Rule 25-6.0143(4) (b), F.A.C., entitled "Use of Accumulated Provision**
13 **Accounts 228.1, 228.2, and 228.4," storm-related costs may be charged to the Reserve**
14 **account regardless of the balance in the Reserve. As a result, the Commission**
15 **recognizes there may be times when the Reserve can have a negative balance. What**
16 **the Commission has not yet addressed, however, is how a negative Storm Damage**
17 **Reserve balance will be recovered by a utility and over what period of time that**
18 **recovery will occur.**

19 Indeed, the Commission recently declined the Company's request for authority
20 to establish a regulatory asset in the amount of the expected excess storm-related costs
21 above the Storm Damage Reserve balance for Hurricanes Charley and Frances
22 because it found that the deferral of the negative Reserve balance from the costs of
23 these storms would yield the same result as the establishment of the requested

1 regulatory asset. In so ruling, the Commission deferred any determination of how and
2 how long the recovery should occur, directing PEF to charge storm costs to the Storm
3 Reserve pursuant to the rule, pending “a subsequent petition for recovery of storm-
4 related damages.” In re: Petition for approval to establish regulatory asset for costs in
5 excess of Storm Damage Reserve Fund, by Progress Energy Florida, Inc., Order No.
6 PSC-04-0977-PAA-EI, issued October 8, 2004 in Docket No. 041085-EI. The

7 Company will comply with the Commission’s Order and Rule and charge its storm-
8 related costs from Hurricanes Charley, Frances, Ivan, and Jeanne to the Storm Damage
9 Reserve.

10
11 **Q. Can PEF use the annual accrual to the Storm Damage Reserve to pay its storm-**
12 **related costs?**

13 **A. Conceptually, yes, but the result would be the deferral of the storm-related costs over**
14 **an impractically long period of time. At the rate of \$6 million a year, the Company’s**
15 **current annual accrual to the Storm Damage Reserve, customer rates will not retire the**
16 **storm-related costs from Hurricanes Charley, Frances, Ivan, and Jeanne for over 42**
17 **years, not including the return as a component of working capital. In addition to the**
18 **financing costs associated with this protracted recovery period, stretching out the**
19 **recovery of these storm-related costs over the next 40 plus years only increases the**
20 **chances that further storms will add to the ratepayers’ cost responsibility before the**
21 **current storm-related costs are paid off. In fact, as the Commission has previously**
22 **ruled, carrying a negative balance in the Storm Damage Reserve for over two years**
23 **was not desirable for Gulf Power Company because of its self-insurance position. In**

1 re: Petition for Approval of Special Accounting Treatment of Expenditures Related to
2 Hurricane Erin and Hurricane Opal by Gulf Power Company, Order No. PSC-96-
3 0023-FOF-EI, p. 7, issued January 9, 1996 in Docket No. 951433-EI, *7 (January 8,
4 1996). Moreover, if the negative Reserve balance were to be carried forward, the
5 recovery period would be further extended by the need to include a return on the
6 unamortized balance as a component of working capital. Allowing the current storm-
7 related costs to be strung out almost indefinitely as a negative Reserve balance in the
8 Storm Reserve is simply not sound regulatory policy.

9
10 **Q. What is the balance in PEF's Storm Damage Reserve?**

11 **A.** As I noted in my summary, the Company's self-insured Storm Damage Reserve will
12 have a balance of \$46.9 million as of December 31, 2004, before any offset for 2004
13 storm-related costs. The storm-related costs experienced by the Company in 2004 as a
14 result of Hurricanes Charley, Frances, Ivan, and Jeanne that have been identified to
15 date are approximately \$366 million on a total system basis. Of this total amount,
16 storm-related O&M costs are \$311.4 million. Applying the year-end storm damage
17 reserve, the negative balance in the Storm Reserve to date is \$264.5 million, or \$251.9
18 million on a retail jurisdictional basis.

19 These amounts are subject to further revision as the Company continues to
20 receive and process its storm-related costs and invoices. As of the date the Company's
21 petition was filed, approximately 48% of the total costs have been paid, 49% are based
22 on currently outstanding charges, and 3% are estimates of work remaining to be done.
23

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IV. THE STORM COST RECOVERY CLAUSE

4

Q. How does the Company propose to address the negative balance in the Storm Damage Reserve as a result of the storm-related costs from Hurricanes Charley, Frances, Ivan, and Jeanne?

5

6

7

A. The Company proposes the establishment of a Storm Cost Recovery Clause that will allow the Company to recover its reasonable and prudently incurred storm-related costs in excess of its Storm Damage Reserve balance from customers over two years beginning January 1, 2005.

8

9

10

11

12

Q. What costs would be recovered under the Company's proposed Storm Cost Recovery Clause?

13

14

A. The storm costs that would be recovered by the clause include the Company's storm-related O&M costs, net of the year-end balance in the Reserve, and its incremental costs above those typically incurred under normal operating conditions for capital expenditures. These storm-related costs are explained in more detail in the testimony of Mark V. Wimberly.

15

16

17

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20

Q. What are the types of O&M costs charged to the Storm Reserve and, therefore, recoverable from the Storm Cost Recovery Clause?

21

22

A. As approved by the Commission in Docket 930867-EI, the Company includes all actual repair activities and those activities directly associated with storm damage and

23

1 restoration activities. Indirect costs, such as service company allocations, are not
2 charged to the Reserve. Direct costs typically are payroll, transportation, materials
3 and supplies, and other services necessary to locate and repair or replace damaged
4 property. Payroll includes labor charges for those employees involved in actual repair
5 activities as well as those in support roles such as customer service, engineering,
6 storeroom, and transportation personnel.

7 The following is a list of examples of the type of costs the Company charges to
8 the Storm Damage Reserve: (1) Labor costs – including overtime or premium pay for
9 employees dedicated to repair activities such as line crews, storeroom, engineering,
10 and transportation personnel, payroll loading for associated taxes, administrative costs,
11 and employee benefits; (2) Materials and supplies – all materials and supplies (M&S)
12 used for the temporary or permanent repair or replacement of facilities, including a
13 standard loading factor to cover the administration of M&S inventories and the cost of
14 preparing, operating, and staffing temporary staging facilities for materials and
15 supplies distribution; (3) Outside Services – including reimbursement costs to other
16 utilities and payment to subcontractors dedicated to restoration activities; (4)
17 Transportation costs – including operating costs, fuel expense, and repair and
18 maintenance of Company fleet or rented vehicles; (5) Damage assessment costs –
19 including surveys, helicopter line patrols, and operation of assessment and control
20 facilities; (6) Costs associated with the rental or operation and maintenance of any
21 equipment used in direct support of restoration activities such as communication
22 equipment, office equipment, computer equipment, etc.; (7) Costs associated with
23 injuries and damages to personnel or their property as a direct result of restoration

1 activities; (8) Costs of temporary housing for restoration crews and support personnel
2 and their related subsistence costs; (9) Storm preparation costs – including information
3 costs and training for Company employees; (10) Fuel and related costs for back-up
4 generators; (11) Costs of customer service personnel, phone center personnel, and
5 other division personnel dedicated to customer service needs and locating and
6 prioritizing areas of damage; (12) Special advertising and media costs associated with
7 customer information, public education or safety; (13) Special employee assistance –
8 including cost of cash advances, housing or subsistence for employees and families to
9 expedite their return to work; (14) Identifiable bad debt write-offs due to storm
10 damage; and (15) any other appropriate cost directly related to storm damage and
11 restoration activities.

12
13 **Q. Does the Company propose to recover all of its capital expenditures as a result of**
14 **the four hurricanes under the Storm Cost Recovery Clause?**

15 **A.** No. Only those capital expenditures above the level of what would have been incurred
16 under normal operating conditions, whether related to labor or materials, will be
17 classified as O&M and charged to the Storm Damage Reserve. All other storm-related
18 capital expenditures will be included in ongoing surveillance reports to the
19 Commission and will be absorbed by the Company in current base rates until the next
20 base rate adjustment.

21 For example, if a pole costs the Company \$100 to install using standard
22 charges for labor, material, and equipment under normal operating conditions, the
23 same pole might cost the Company \$125 to install under the extraordinary

1 circumstances of around-the-clock storm restoration work. In that event, \$25 will be
2 charged to the Storm Damage Reserve as O&M and recovered through the Storm Cost
3 Recovery Clause. The remaining \$100 will be capitalized and included in the
4 Company's surveillance reports until the Company's next base rate adjustment.

5 To explain further the accounting treatment for capital expenditures that are
6 not charged to storm-related O&M costs, the book value of capital investments that
7

have been retired due to storm damage will be charged against the accumulated
8 depreciation reserve. New storm-related capital expenditures will be added to plant in
9 service in an amount equal to the capital expenditure that would have been incurred
10 using a standard cost approach under normal operating conditions. The net effect of
11 this accounting treatment is that capital expenditures will reflect that level of
12 investment necessary to provide adequate and reliable service under normal operating
13 conditions.

14 Those capital expenditures incurred to date as a result of the four hurricanes
15 that will be capitalized and carried by the Company until its next base rate adjustment
16 total \$54.9 million (system).

17
18 **Q. How will the Storm Cost Recovery Clause work?**

19 **A.** The excess storm-related costs above the Company's Storm Reserve balance
20 determined to be reasonable and prudently incurred and recoverable through the
21 Clause will be included as a component of the non-fuel energy charge on the
22 customers' bills. The retail jurisdictional amount of these costs, including interest, is

1 \$132.2 million for 2005, and \$128 million for 2006, based on a commencement date
2 of January 1, 2005.

3 The Company proposes that these costs be allocated among the various rate
4 classes in the same manner as the Company's last approved cost of service study, i.e.,
5 production demand-related costs would be allocated using the 12 Coincident Peak
6 ("CP") and 1/13th Average Demand ("AD") method, production energy-related costs

7 would be allocated based on energy usage, transmission costs would be allocated
8 using the 12 CP method, and distribution costs would be allocated using the Non-
9 Coincident Peak method. In this manner, the allocation and calculation of the charges
10 to customers under the Storm Cost Recovery Clause would mirror the allocation and
11 calculation of costs under PEF's Commission-approved cost of service study and other
12 cost recovery clauses established by the Commission.

13
14 **Q. Does the Company propose any safeguards to ensure that only appropriate**
15 **storm-related costs are recovered through the Storm Cost Recovery Clause?**

16 **A.** Yes, PEF proposes that the Storm Cost Recovery Clause should operate in the same
17 manner and include the same safeguards as the other cost recovery clauses that have
18 been established by the Commission. The Company's projected storm costs and
19 megawatt-hour sales would be submitted for initial Commission review and approval
20 and would then be subject to subsequent true-up based on actual results. Just as in
21 other cost recovery clauses, PEF's costs would be subject to a determination of
22 reasonableness and prudence, which the Company will have the burden to
23 demonstrate. In conjunction with the true-up process, the storm-related costs

1 recovered through the Clause would be subject to the same periodic Staff audits
2 performed in other clauses. In addition, interest at the Commission-prescribed
3 commercial paper rate will be applied to any over- or under-recovery balances carried
4 forward. These steps will ensure that the Company obtains nothing more than a
5 dollar-for-dollar recovery of its actual storm-related costs and that customers pay no
6 more than reasonable and prudently incurred storm-related costs. As a result, PEF's
7 customers will be afforded the same safeguards and protections under the Storm Cost
8 Recovery Clause that they have traditionally received under the other cost recovery
9 clauses established and administered by the Commission.

10
11 **Q. Why has the Company proposed a clause-based mechanism for the recovery of
12 its storm-related costs?**

13 **A.** First, the costs associated with severe storms are volatile. They depend on where and
14 how long a storm impacts the Company's service territory, the strength of the storm as
15 it moves across the service territory, and the compounding effect of other severe
16 weather systems that precede or follow the storm. Storm-related costs can vary
17 greatly with changes in any one of these factors.

18 Second, the costs associated with severe storms are irregular in their
19 occurrence. These kinds of extraordinary costs are not incurred every year, and often
20 a number of years may pass without a hurricane or similar severe storm striking the
21 Company's service territory. The Company's historical experience bears this out.
22 Never before has the Company's service territory experienced four hurricanes in a
23 single hurricane season, let alone four hurricanes in a span of less than six weeks. In

1 fact, only once in the last eighty years have four hurricanes struck a single state during
2 a hurricane season. A summary of the Company's historical storm experience and
3 costs since 1994 is attached as Exhibit ___ (JP-1) to my testimony.

4 Finally, because severe storm-related costs are volatile and incurred at irregular
5 intervals, they also defy attempts to predict their occurrence. Severe storm-related
6 costs simply cannot be budgeted accurately in advance.

7 Cost recovery clauses are designed to provide utilities recovery for volatile,
8 irregularly occurring costs that are beyond the ability of the utilities to accurately
9 predict or to control when costs are incurred. Indeed, for these same reasons, the costs
10 of severe storms have not been included in the utilities' rates. A Storm Cost Recovery
11 Clause is, therefore, the most suitable recovery mechanism for the extraordinary,
12 volatile, irregular and unpredictable storm-related costs incurred by PEF due to
13 Hurricanes Charley, Frances, Ivan, and Jeanne.

14
15 **Q. Please explain why implementation of a Storm Cost Recovery Clause is consistent**
16 **with the other cost recovery clauses implemented by the Commission.**

17 **A.** The Fuel and Purchased Power Cost Recovery Clause, for example, allows utilities to
18 pass through their reasonable and prudently incurred fuel costs directly to their
19 customers. Fuel costs are volatile and irregular in the sense that, similar to severe
20 storm costs, they vary in amount from year-to-year and even day-to-day with a variety
21 of different factors. Because fuel costs are volatile, irregular, and beyond the
22 Company's control, the Commission has implemented an adjustment clause to provide
23 for the recovery of fuel costs by investor-owned utilities.

1 In fact, the Commission has extended the Fuel and Purchased Power Cost
2 Recovery Clause to cover other non-fuel costs under extraordinary circumstances
3 when a utility cannot reasonably anticipate the costs. For example, the Commission
4 has allowed PEF, Florida Power & Light Company, and Tampa Electric Company to
5 recover security expenditures incurred in response to the terrorist attacks of September
6 11, 2001 through the Fuel Clause even though security costs were traditionally and
7 historically recoverable through base rates. Because “of the extraordinary nature of
8 the costs in question and the unique circumstances under which they arose,” the
9 Commission determined that the costs did not fall within the classification of items
10 recoverable through base rates. Rather, the Commission permitted the recovery of the
11 post-September 11 security costs under the cost recovery clause precisely because they
12 were the “type of cost [that] was a potentially volatile cost, making it appropriate for
13 recovery through a cost recovery clause.” Indeed, the Commission concluded that the
14 recovery of such costs through the fuel clause provided “a good match between the
15 timing of the incurrence and recovery of the cost.”

16 In addition to the applicability of the cost recovery clause to the extraordinary
17 post-September 11 security costs, the Commission made clear that providing for
18 immediate cost recovery under the clause was consistent with the incentives the
19 Commission wanted to create. The Commission pointed out that its decision on cost
20 recovery of the extraordinary security costs sent the “appropriate message” to the
21 investor-owned electric utilities that the Commission encouraged the utilities to
22 protect their generation assets in extraordinary, emergency conditions.

1 The storm-related costs the Company experienced from Hurricanes Charley,
2 Frances, Ivan, and Jeanne warrant similar treatment. Severe storm-related costs have
3 not been traditionally or historically a part of base rates. And, because of the unique
4 circumstances in which the storm costs arose here - four back-to-back major storms in
5 less than six weeks - they are the type of volatile, irregular, extraordinary costs that are
6 well-suited for a cost recovery clause. Moreover, the Company has just incurred these

7 extraordinary costs so the timing of their recovery under the Storm Cost Recovery
8 Clause will closely match when the costs were incurred.

9
10 **V. IMPACT TO CUSTOMER BILLS.**

11 **Q. If your proposal for a Storm Cost Recovery Clause is adopted, what would the**
12 **customer billing factors be?**

13 **A. The billing factors for each customer class based on the costs and allocation factors**
14 **discussed above are shown in Exhibit __ (JP-2) to my testimony.**

15
16 **Q. What would be the impact on an average residential customer bill?**

17 **A. The effect on a residential customer using 1,000 kiloWatt-hours would be \$3.81 for**
18 **2005 and \$3.59 for 2006, excluding gross receipts tax.**

19
20 **VI. CONCLUSION.**

21 **Q. Should the Commission adopt the Storm Cost Recovery Clause as the recovery**
22 **mechanism for storm-related costs that exceed the balance in the Company's**
23 **Storm Reserve?**

1 **A.** Yes. A Storm Cost Recovery Clause most effectively balances the equities between
2 the Company and its ratepayers. Implementation of the Storm Cost Recovery Clause
3 will allow the Company’s extraordinary storm-related costs to be allocated directly
4 and proportionately to PEF’s customer classes who benefited from the Company’s
5 efforts to restore and otherwise maintain electric service during and immediately after
6 the unprecedented hurricanes in 2004.

7

8 **Q.** **Does this conclude your direct testimony?**

9 **A.** Yes.

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1 I've got to tell you, from where I'm sitting, it would
2 be very difficult for me to find substantial grounds to
3 not qualify him as an expert. But I'm going to allow
4 you your chance to ask your questions as long as they're
5 not too many and too long. Is that fair?

6 MR. MCWHIRTER: That's fair.

7 CHAIRMAN BAEZ: Okay. You know what you're
8 walking into; right?

9 MR. MCWHIRTER: Right.

10 CHAIRMAN BAEZ: Okay. Go ahead.

11 MR. MCWHIRTER: You want me to go now?

12 CHAIRMAN BAEZ: Huh?

13 MR. MCWHIRTER: You want me to ask him voir
14 dire at this point?

15 CHAIRMAN BAEZ: I think now would be a good --

16 MR. WALLS: And if he wants to challenge
17 Mr. Portuondo on regulatory accounting, then --

18 CHAIRMAN BAEZ: I think Mr. McWhirter has heard
19 what I said. I don't know, unless he has --

20 MR. MCWHIRTER: I think I see where you --

21 CHAIRMAN BAEZ: -- you know, Oppenheimer's,
22 something or other. Go ahead, Mr. McWhirter.

23 VOIR DIRE EXAMINATION

24 BY MR. MCWHIRTER:

25 Q Well, the first question I would ask you,

1 Mr. Portuondo, is, are you here as a fact witness,
2 testifying as to material facts as to how you booked
3 things, or are you here testifying to regulatory policy
4 with respect to how things should be booked?

5 A Both.

6 Q All right. And you're going to give the

7 Commission your opinion on how they should be booked; is
8 that correct?

9 A That's correct.

10 Q Now, I notice on the cover of your prepared
11 testimony that your name is listed on the cover sheet
12 along with five attorneys, and I was wondering if you
13 would walk us through the procedure you and the five
14 attorneys used to prepare your testimony.

15 A Well, my efforts in preparing my testimony was
16 predominantly with Mr. Walls. He and I discussed the
17 issues that came about from the rebuttal witness -- from
18 the intervenor witnesses' testimonies, and I proceeded
19 to communicate to him where I felt that those arguments
20 were in error, based on my experience in dealing with
21 the Florida Public Service Commission.

22 Q Did you physically type up or have your
23 testimony typed up at your office and then send it over
24 to Mr. Walls to look at, or did he do the typing?

25 A I typed up a draft, certain Q and A's. He sent

1 it back with his edits and comments.

2 Q And at what point in your testimony did these
3 six orders that you refer to -- I mean in your
4 discussion with Mr. Walls, at what point did these six
5 orders come into the discussion?

6 A I mean, I've had the FP&L orders and the
7 Progress Energy orders since '94, because I've been
8 around in this arena since '94, so I was very familiar
9 with those orders.

10 Q And so you brought them up and you explained
11 them to Mr. Walls, or did he explain them to you?

12 A No. I believe we discussed them mutually.

13 Q All right. Now, are you a certified public
14 accountant?

15 A No, I am not.

16 Q And as I read your vitae, apparently right out
17 of high school you went to work for Florida Progress.

18 A I was in college.

19 Q You were in college?

20 A Yes.

21 Q And you finished college in 1992 with a -- what
22 was your degree?

23 A B.S. in accounting.

24 Q And during your working career, have you worked
25 for anyone other than Florida Progress?

1 A Prior to my employment with Progress, yes, I
2 worked with other firms.

3 Q Were you working in a financial or accounting
4 position?

5 A Just before my employment with Florida Power at
6 the time, I was working with Gold Dome Bank at the time

7 -- I think they've gone out of business or merged -- in
8 a financial capacity.

9 Q What were you doing with Gold Dome?

10 A I was responsible for managing their accounts
11 receivable.

12 Q And then you apparently went through several
13 iterations at Florida Power and then Florida Progress.
14 Tell me how you moved up the ladder.

15 A Well, over the 20 years I've been employed with
16 Progress Energy, I've held positions in almost every
17 financial department of the company. I've worked in
18 their customer accounting area. I've worked in their
19 tax accounting area, their plant accounting area, of
20 course, regulatory accounting, as well as regulatory
21 services and administrative proceedings such as these.
22 I've worked indirectly with the budgeting and
23 forecasting group. I've worked indirectly in support of
24 financial aspects of all the business units at Progress
25 Energy.

1 Q And have you ever written treatises, articles,
2 books on the subject of regulatory accounting?

3 A No, I have not.

4 Q And have you ever offered expert testimony for
5 any entity other than Florida Progress with respect to
6 regulatory matters?

7 A No, I have not.

8 Q And you're not the treasurer of Florida
9 Progress, are you?

10 A The treasurer? No, I am not.

11 Q And your function is the regulatory guy? You
12 come up to Tallahassee on regulatory matters
13 principally? Is that the deal?

14 A Yes. I'm the consultant to the various areas
15 of the company on regulatory matters.

16 Q And who is it that makes the bookkeeping and
17 financial determinations with respect to the company?

18 A I guess I'm not sure what you mean by that.

19 Q Well, you have -- the company has an outside
20 accounting firm that prepares your annual audited
21 reports. Do you work with that firm personally, or does
22 your treasurer work with that firm?

23 A A number of individuals throughout the company
24 works with that firm.

25 Q What do you do with respect to your outside

1 auditors?

2 A Well, I assist them in supporting the
3 accounting treatment for certain transactions that they
4 may not understand. Of course, some of the types of
5 transactions that they would seek my opinion on would be
6 like the fuel area, how we account for fuel, how we

7 account for deferred fuel, accounting for FAS 143 as it
8 relates to regulatory matters, accounting for FAS 88,
9 minimum pension liability issues, and how the regulated
10 environment affects the GAAP requirement under those
11 particular standards. So we exchange questions and
12 answers along those lines.

13 Q Are you familiar with the Sarbanes-Oxley
14 legislation that was passed after the Enron debacle?

15 A Yes, I am.

16 Q And have you counseled with your outside
17 auditors concerning the requirements under
18 Sarbanes-Oxley?

19 A As it relates to this matter before us?

20 Q Yes.

21 A Sarbanes really has no pertinent impact on the
22 matter before us.

23 Q And what areas have you discussed
24 Sarbanes-Oxley with?

25 A Areas of the company?

1 Q Yes.

2 A Sarbanes-Oxley impacts every nook and cranny of
3 our company. It requires us to document every control,
4 every procedure, process, every review mechanism. It
5 requires us to provide and keep workflow charts, as well
6 as line-by-line procedural documentation.

7 Q And do you maintain those?

8 A I do not personally for the entire company, but
9 I maintain those that are relevant to the area of
10 responsibility that I have.

11 Q And what are the ones that you maintain?

12 A The accounting and controls for all the
13 pass-through dockets, the fuel, ECCR, environmental, and
14 so on.

15 CHAIRMAN BAEZ: Mr. McWhirter, are you anywhere
16 near wrapping this up?

17 MR. MCWHIRTER: Yes, sir.

18 BY MR. MCWHIRTER:

19 Q Now, attached to your testimony, you have your
20 company's statement of how hurricane storm losses should
21 be treated. Were you a participant in the development
22 of that study that your company submitted?

23 A In an indirect manner at the time.

24 Q And what was that?

25 A In a support function. I was a lower level

1 accountant at the time, so I was in support of John
2 Scardino. I reported to John Scardino at the time. So
3 I assisted in whatever manner they saw fit for me to
4 contribute.

5 MR. MCWHIRTER: Mr. Chairman, that concludes my
6 voir dire of Mr. Portuondo. And in light of the fact
7 that he has -- most of his experience is internal with
8 Florida Progress or its predecessor, Florida Power, and
9 he's imbued with the philosophy of that company as it
10 has been presented in adversarial proceedings in an
11 ex parte -- not in an ex parte fashion, but as an
12 advocate for their position, I don't think he rises to
13 the level of what you might call an independent expert
14 that would be qualified to render an opinion based upon
15 interpreting the orders of this Commission or operative
16 law that controls this Commission, which would be legal
17 opinions.

18 I think it's okay for him to talk about how he
19 feels you ought to do it from the company's perspective,
20 but I would recommend that he not be considered an
21 expert in this proceeding for the purpose of rendering
22 opinions.

23 CHAIRMAN BAEZ: Mr. McWhirter, I'm going to
24 disagree. I haven't heard anything -- I didn't hear
25 anything as a result of your questions that would give

1 me any doubt but that he is an expert.

2 However, I do recognize by your statements, and
3 I think it's readily evident to this Commission at least
4 who Mr. Portuondo works for. And at the risk of pulling
5 out the classic cliché, we're going to give it the
6 weight that it deserves. But I'm certainly not going to

7 -- you knew it was coming; right? Well, it had to be.
8 But I'm going to allow him to be questioned on his
9 testimony. All right?

10 MR. MCWHIRTER: I accede to your ruling and
11 won't fuss anymore.

12 CHAIRMAN BAEZ: Thank you, Mr. McWhirter.

13 At this point, now, Mr. Walls, if you have
14 preliminary positions on Mr. McGlothlin's objections to
15 -- I don't know if you heard his objections or he was
16 able to state them completely for you to hear, but if
17 you do have the benefit of them already and you want to
18 respond to Mr. McGlothlin's problems --

19 MR. MCGLOTHLIN: Are we going to do that now,
20 Mr. Chairman?

21 CHAIRMAN BAEZ: Is this something that you need
22 to wait for the --

23 MR. MCGLOTHLIN: Well, that was very
24 shorthand.

25 CHAIRMAN BAEZ: You're right. You're

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absolutely right. We had jumped off at entering the rebuttal testimony into the record as though read. And as a result of Mr. McWhirter's efforts and the result of that, we're going to go ahead and accept the rebuttal testimony into the record as though read.

FPSC DOCKET NO. 041272

IN RE: PETITION FOR APPROVAL OF STORM COST RECOVERY CLAUSE
FOR EXTRAORDINARY EXPENDITURES RELATED TO HURRICANES
CHARLEY, FRANCES, JEANNE AND IVAN

REBUTTAL TESTIMONY OF JAVIER J. PORTUONDO

1 **I. Introduction**

2

3 **Q. Please state your name, position, and address.**

4 **A.** My name is Javier J. Portuondo. I am the Director of Regulatory Services,
5 Florida, for Progress Energy Florida. My business address is 100 Central
6 Avenue, St. Petersburg, FL 33701.

7

8 **Q. Did you file direct testimony in this case?**

9 **A.** Yes, I did.

10

11 **Q. Have you reviewed the testimony filed by the witnesses testifying for the**
12 **Office of Public Counsel (“OPC”), the Florida Industrial Power Users**
13 **Group (“FIPUG”), and Buddy L. Hansen and the Sugarmill Woods Civic**
14 **Association, Inc. (collectively, “Sugarmill Woods”)?**

15 **A.** Yes, I have.

16

17 **Q. Do you agree with it?**

18 **A.** No, I do not. The testimony by each of these witnesses is fundamentally flawed
19 for two reasons.

1 **Q. Please explain your areas of disagreement.**

2 **A.** These witnesses base their testimony on (1) a misunderstanding of the history of
3 the regulatory treatment of storm cost recovery in Florida and (2) a
4 misunderstanding of ratemaking principles and the rate stipulation among the
5 parties currently in place.
6

7 **II. Regulatory Treatment of Storm Cost Recovery in Florida**

8

9 **Q. Addressing these issues in turn, please explain why you believe the**
10 **Intervener witnesses have misinterpreted the history of regulatory treatment**
11 **of storm cost recovery in Florida.**

12 **A.** The Intervener witnesses rely on selected excerpts from prior Commission orders
13 without taking into account what the Commission actually did, the circumstances
14 before the Commission, and the context of the rulings. When you review prior
15 Commission orders in their entirety and in context, it becomes clear that they
16 support the relief we are requesting in this case.
17

18 **Q. Please explain why you believe you are proceeding in accordance with prior**
19 **Commission orders and policy in this area.**

20 **A.** The starting point for analysis is the utilities' request in 1993 to convert from
21 reliance on third-party insurance for storm damage to transmission and
22 distribution ("T&D") facilities to a self-insurance program.

1 Up until November 1993, Florida Power Corporation (“FPC”) maintained
2 third-party T&D insurance in the amount of \$85 million per occurrence, subject to
3 a deductible of \$10 million. Customers paid for insurance premiums and losses
4 not covered through insurance through base rates. Specifically, the Company
5 maintained a Commission-approved Storm and Property Insurance Reserve (“the
6 Reserve”) to cover the costs of storm-related losses not reimbursed through third-
7 party insurance. The Company collected \$1 million annually in base rates for
8 T&D property damage not covered by insurance, and made annual contributions
9 in this amount to the Reserve. This is documented in Commission Order No.
10 PSC-93-1522-FOF-EI, dated October 15, 1993 (“1993 FPC Order”).

11 After Hurricane Andrew, third-party T&D insurance became prohibitively
12 expensive. Insurance rates increased 500-1500% over then-current rates, and
13 deductibles increased 900%. Insurers demanded an up-front capital contribution,
14 plus a potential retroactive premium. Further, insurers no longer offered
15 insurance on a per occurrence basis. They agreed to insure only aggregate annual
16 losses, which left utilities and their customers exposed to catastrophic uninsured
17 losses in the event of multiple storm events. Other utilities faced the same
18 untenable circumstances.

19 As a result of this change in market conditions, public utilities in Florida
20 petitioned the Commission for approval of a self-insurance program. This is the
21 genesis of the Commission’s treatment of storm-cost recovery in Florida.

22
23 **Q. Please explain what the utilities proposed to the Commission.**

1 A. The utilities proposed that the Commission approve a self-insurance program that
2 replicated the operation of third-party insurance.

3

4 **Q. Were the utilities proposing to fund T&D losses out of its shareholders'**
5 **pockets?**

6 A. Absolutely not. FPC and other public utilities requesting this relief are cost-of-
7 service regulated utilities. Under the regime of third-party insurance, these
8 utilities recovered the cost of paying for insurance and uninsured T&D losses
9 from their customers. They proposed replacing third-party insurance with a
10 system of self-insurance not as a mechanism for shareholders to shoulder the costs
11 of operating the business but based on the reasonable belief that the utilities
12 otherwise would have to call upon ratepayers to pay exorbitant premiums for
13 third-party insurance and to pay catastrophic uninsured T&D losses that third-
14 party insurers were declining to cover.

15

16 **Q. Please explain what the utilities asked the Commission to approve, and how**
17 **the Commission responded.**

18 A. The utilities proposed to increase their annual accrual and contributions to the
19 Reserve to replace and replicate third-party insurance. For example, in 1993, the
20 year of the request, FPC was contributing \$1 million annually to the Reserve to
21 cover premiums and uninsured T&D losses. As part of its self-insurance
22 proposal, FPC proposed to increase its annual accrual and contribution to \$3
23 million. The utility proposed, and the Commission explicitly acknowledged, that

1 “The reserve would be used to cover storm damage experience for all losses not
2 covered by insurance, including T&D lines and deductibles associated with other
3 property insurance.” (1993 FPC Order) (emphasis ours). The Commission
4 approved this approach as a reasonable alternative to continuing reliance on third-
5 party insurance.
6

7 **Q. Did the utilities and the Commission contemplate the possibility that storm**
8 **costs might exceed the amount accrued in the reserve?**

9 **A.** Yes, they did. This subject was discussed in the course of the proceedings. The
10 Commission assured FPC that it would “expeditiously review any petition for
11 deferral, amortization or recovery of prudently incurred costs in excess of the
12 reserve.” (1993 FPC Order).
13

14 **Q. Sugarmills Woods’ witness Stephen A. Stewart points out that, prior to 1993,**
15 **balances in the Storm and Property Insurance Reserves of certain utilities,**
16 **including FPC, were occasionally depleted and subsequently replenished**
17 **through base rates. He argues on this basis that the Commission favors base**
18 **rate treatment of such losses rather than a surcharge on top of base rates.**
19 **Do you agree with his conclusion?**

20 **A.** No, I do not. What he overlooks is that, prior to 1993, electric utilities in Florida
21 did not operate on a self-insured basis. As I have explained, electric utilities
22 maintained third-party T&D insurance sufficient to defray losses amounting to
23 \$85 million per occurrence. Electric utilities maintained reserves to cover normal,

1 recurring insurance premiums and occasional uninsured losses of a readily
 2 manageable magnitude. Before 1993, the utilities had no occasion to request, and
 3 the Commission had no occasion to consider, whether cost-recovery clauses or
 4 other similar mechanisms might be employed to recover costs for non-recurring,
 5 extremely volatile expenses like those incurred during this past hurricane season.

6 Traditionally, the Commission has not employed base rates to cover such

7 expenses. In fact, other Intervener witnesses in this docket recognize that the use
 8 of a surcharge to recover costs over a two-year period as we request serves the
 9 best interests of all stakeholders in this proceeding.

10

11 **Q. As part of the utilities' proposal to replace third-party insurance with a self-**
 12 **insurance program, did the utilities and Commission consider how to**
 13 **account for storm-related expenses?**

14 **A.** Yes. In fact, the Commission held open FPC's docket until it received and
 15 evaluated FPC's study discussing the Company's basis for accruing funds to the
 16 Reserve. The Commission treated other utility petitions the same way. In FPL's
 17 case, the Commission pointed out:

We find that FPL shall submit a study indicating the appropriate amount that should be contributed to the fund annually. The study shall be filed three months from the date of the vote in this docket.

. . . .

From the record in this docket it is unclear what storm related expenses FPL intends [to] draw from the reserve fund. For example it is unclear whether normal salaries would be charged to the fund if employees worked on storm related tasks. In addition, employees repairing storm damage would be required to spend time away from their everyday work tasks which would result in "catch up" expense. It is unclear from the record whether FPL intends to draw "catch up" expense from the reserve fund. The record reflects that "catch up" expense is not

recoverable under FPL’s current insurance policy. In addition it is unclear whether the cost of damaged assets would be accounted for at replacement cost or net book value. For example, if there were \$100 million of net book value of assets that were destroyed and it took \$200 million to replace those, what accounting entries would be made?

FPL shall address these questions in the company study discussed above. . . . FPL shall submit a study detailing what it believes the appropriate amount that should be annually accrued to the reserve. The company shall include in the study the costs it intends to charge to the reserve. The study shall be filed with the Commission no later than three months after the vote in this docket. Order No. PSC-03-0918-FOF-EI, pp. 3-4 (“1993 FPL Order”).

1

2 **Q. Did the utilities submit the requested studies documenting the methodology**
3 **they proposed to use in accounting for storm costs?**

4 **A.** Yes. I am attaching by way of example the studies submitted by FPC and FPL, as
5 Exhibits ___ (JP-3) and ___ (JP-4).

6

7 **Q. Did these studies explain how the utilities proposed to account for storm-**
8 **related costs?**

9 **A.** Yes, they did. In its study, FPC explained:

The Company proposes to use a replacement cost approach for determining the appropriate amounts to be charged to the storm damage reserve. This approach is consistent with both the Company’s prior coverage under traditional insurance for T&D lines as well as its current insurance coverage for other facilities. The damage to facilities currently covered through a self insurance program should be treated comparably. The replacement cost method represents by far the simplest approach and will transition well with any changes made in the Company’s current insurance program for all facilities. The replacement cost approach assumes that the total cost of restoration and related activities will be charged against the storm damage reserve.

....

Actual repair activities and those activities directly associated with storm damage and restoration activities would be charged to the reserve.

Indirect costs would not be charged to the reserve. Direct costs would typically be payroll, transportation, materials and supplies, and other services necessary to locate and repair or replace damaged property. Payroll includes labor charges for those employees involved in actual repair activities as well as those in supporting roles such as customer service, engineering, storeroom and transportation personnel. See Exhibit Number 3 for a detailed list of the types of costs the Company believes would be directly associated with storm damage and restoration activities. (FPC Study, pp. 9-10) (emphasis in original).

The study continued to explain in great detail the accounting treatment the

- 2 Company proposed to use in administering the Reserve and, by the same token,
 3 the accounting assumptions that formed the predicate for the Company's
 4 calculation of the amount of annual accrual for the Reserve.

- 5 Likewise, in the FPL study, FPL stated:

The Company recommends that the actual restoration cost approach, without adjustment, be used. . . . Initially the incremental cost approach appears appropriate, however, after evaluating the result, and the numerous adjustments based on estimates and allocations that are required to arrive at incremental cost, we do not believe that the method provides a benefit when compared to use of the simple and more straightforward actual restoration cost approach. Under the actual restoration cost approach, without adjustment, the only review required would be for the necessity and reasonableness of the costs actually incurred and recorded on the Company's books. Further, since the actual restoration cost approach mirrors replacement cost insurance, this approach allows the company to switch easily from self-insurance to traditional insurance if and when it becomes available at reasonable rates. (FPL Study, p. 2)

FPL continued:

We would define actual restoration costs to be those direct and indirect costs which are incurred to safely restore customer service, or to return plant and equipment to its original operating condition. In general, these costs include FPL payroll costs, costs associated with the use of vehicles and equipment, inventory costs, payments for outside services provided by contractors and other utilities, security services and crew support such as food, lodging, transportation and miscellaneous temporary subsistence costs. Development of a complete, detailed listing of all costs that could possibly be incurred as the result of a storm is neither practical or possible.

On pages 2 and 3 of **Attachment 1** we have provided representative examples of the types of activities and related costs that would fit the definition of actual restoration costs that can reasonably be expected to be incurred as a result of a storm.

....

It is important to note that actual restoration costs charged to the storm work order(s) would not include all costs resulting from a storm. Specifically excluded would be costs which are an indirect result of the storm. In particular, overtime incurred by Company personnel in work areas not directly affected by the storm due to loss of some personnel to storm assignments (backfill work) and costs associated with work which must be postponed due to the urgency of the storm restoration and accomplished after the restoration is completed (catch-up work) would not be included. In addition, revenues lost by the Company due to the disruption of customer service or the disappearance of customers after the storm would not be included. . . . For Hurricane Andrew we believe these indirect costs to total approximately \$48 million; however this is a rough estimate. While the actual restoration cost approach does not consider these indirect costs, the indirect costs are partially covered since there is also no adjustment to remove costs which would normally be incurred during the restoration period. In this way the use of the actual restoration cost approach to charge the Reserve when self insured would work much like replacement cost insurance. (FPL Study, pp. 8-9)

FPL elaborated on its consideration and rejection of the incremental cost approach:

While it may seem reasonable in theory to charge only incremental costs resulting from a storm to the Reserve, we believe that there is not a clear benefit derived by attempting to quantify incremental cost. Both direct incremental and indirect incremental costs should be considered if an incremental cost approach is to be used. Recoverable incremental costs would exclude reasonably estimable and quantifiable costs that would be charged to expenses normally in the absence of a storm. We believe such charges to be straight time FPL employee payroll charged to the storm work order, appropriate loadings for pension, welfare, taxes and insurance applicable to the straight time payroll, and a representative level of normal Company vehicle use charges. If the incremental cost approach is to be used then all incremental costs should be considered, including backfill work, catch-up work and revenues lost by FPL as a result of the storm. While incremental cost can be calculated, it requires starting with actual restoration cost and making numerous adjustments which depend on estimates and allocations. The complexities are apparent when the

incremental costs column on page 1 of **Attachment 1** is reviewed. . . .
 [T]he field accounting must remain simple and it would be unworkable to attempt to record only incremental costs to the storm work order. Furthermore, each storm can be expected to impact the Company in a unique way and the assumptions and the estimation and allocation techniques needed to calculate indirect incremental costs and non-incremental costs might need modification. We can envision extensive debate before the Commission over these calculations which could result in unnecessary delays. As is the case with the net book value adjustment, the incremental costs approach would be inconsistent with replacement cost insurance recovery when some level of insurance is obtained. In contrast we view the actual restoration cost approach as relatively simple and fair. (FPL Study, pp. 10-11).

1 **Q. How did the Commission respond to these studies?**

2 **A.** The Commission received them, approved them, closed the respective dockets in
 3 those proceedings, and has permitted the utilities to follow them ever since. The
 4 Commission discussed the FPL study, in particular, at some length in subsequent
 5 orders. In Order No. PSC-95-0264-FOF-EI, dated Feb. 27, 1995 (“Feb. 1995 FPL
 6 Order”), the Commission described that it had “required FPL to submit a study
 7 detailing the appropriate amount that should be annually accrued to the reserve
 8 and the costs it intends to charge to the Storm Fund.” (Feb. 1995 Order, p. 2). In
 9 approving FPL’s study, the Commission stated:

FPL’s study provided sufficient analysis to indicate the appropriate annual amount that should be contributed to the storm damage reserve fund at this time.

In addition, the study addressed the issues raised in the [1993 FPL] order concerning the types of expenses that would be charged to the reserve. However, we have the authority to review any expenses charged to the reserve for reasonableness and prudence. FPL stated that it would use the actual restoration cost approach for determining the appropriate amounts to be charged to the reserve. This methodology is consistent with the manner in which replacement cost insurance works. (Feb. 1995 FPL Order, p. 4).

1 Later that same year, the Commission commented again that it had required FPL
2 to “submit a study detailing what it believed to be the appropriate amount that
3 should be accrued annually to the reserve and what costs it intended to charge to
4 the storm fund,” and that the Commission had “found the storm damage study
5 submitted by FPL to be adequate.” Order No. PSC-95-1588-FOF-EI, dated
6 December 27, 1995.

7 In 1998, the Commission had occasion to rule upon an FPL request to
8 increase the annual accrual to its Reserve. Order No. PSC-98-0953-FOF-EI,
9 dated July 14, 1998. Discussing the history of the utility’s self-insurance
10 program, the Commission noted again that it had previously approved FPL’s 1993
11 Study. In fact, the Commission pointed out that “[b]ased upon the study,” the
12 Commission had authorized a prior increase in FPL’s accrual amount. Order, p.
13 2. The Commission denied FPL’s request to increase the accrual further,
14 however, based upon its view that the then-current accrual amount should be
15 sufficient to cover most storms. In capping the accrual at then-current levels, the
16 Commission assured FPL that the Commission understood that “the costs of
17 storm damage incurred over and above the balance in the reserve and the costs of
18 the use of the lines of credit [to finance out-of-pocket storm costs] would still
19 have to be recovered from the ratepayers.” (Order, p. 5). In this regard, the
20 Commission stressed that, “In the event FPL experiences catastrophic losses, it is
21 not unreasonable or anticipated that the reserve could reach a negative balance. . .
22 . In cases of catastrophic loss, FPL continues to be able to petition the

1 Commission for emergency relief, as reflected in Order No. PSC-95-1588-FOF-
2 EI.” (Order, p. 5).

3 Finally, in discussing the state of FPL’s Reserve, the Commission
4 recognized the fact that the determination of the amount then in the Reserve, and
5 how long it should take for the Reserve to reach the targeted amount, was based
6 upon a “calculation [that] includes a reduction to the reserve of \$14.5 million in
7 charges associated with the 1998 ‘Groundhog Day’ storm.” (Order, p. 4). FPL,
8 of course, was then administering the Reserve in the manner described in its 1993
9 Commission-approved Study. Despite the fact that the Commission was
10 explicitly considering the adequacy of the Reserve and making decisions about
11 accrual to the Reserve based upon FPL’s implementation of its 1993 Study, the
12 Commission voiced absolutely no objection to FPL’s use of funds in the Reserve
13 in the manner prescribed in the 1993 FPL Study. To the contrary, as I have
14 described, the Commission specifically noted that it had previously found that the
15 Study was acceptable.

16
17 **Q. How have you interpreted these orders in administering the Reserve and in**
18 **accounting for storm costs arising out of the catastrophic hurricanes in 2004?**

19 **A.** I believe the Commission’s orders and the context in which they were rendered
20 are quite clear. For the last ten years, the electric utilities and the Commission
21 have shared a common understanding that the Reserve would be administered to
22 replicate and mirror replacement cost insurance and that the electric utilities
23 would account for storm-related costs to achieve that objective in the manner

1 detailed in the studies we submitted in 1993. Over the last ten years, the utilities
2 in this state have consistently booked storm costs and administered the Reserve in
3 the manner described, in full view of the public and the Commission. In fact,
4 FPC applied the Reserve in the same manner we now propose for storm costs
5 directly associated with Hurricanes Erin, Floyd, and Gabrielle. The Commission,
6 its staff, and various parties in various rate proceedings have had countless

7 opportunities to review these actions. Until now, no one has questioned the
8 propriety or integrity of this approach. Progress Energy Florida faithfully
9 implemented this consistent understanding going into the hurricane season last
10 year and in its filing in this docket, and the Company's submissions should be
11 recognized as consistent with long-standing Commission policy.

12 I believe that the Intervener witnesses are completely disregarding the
13 context, purpose, and meaning of the prior actions of the Commission and the
14 utilities to recommend an approach that turns the Commission's prior actions on
15 their head.

16
17 **Q. Does the long-standing approach to these issues in Florida make sense in the**
18 **context of a catastrophic season like 2004?**

19 **A.** Absolutely. It is important to keep in mind that this policy was forged in a
20 catastrophic season, as a direct result of the horrendous impact that Hurricane
21 Andrew had on this State. Andrew not only wreaked a tremendous amount of
22 damage in Florida, but it induced insurance companies to adjust rates and
23 coverage in unprecedented ways, forcing utilities to replicate third-party insurance

1 through a self-insurance program. Accordingly, when the Commission conducted
2 proceedings on these issues and requested and received studies and analyses
3 addressing the very issues the Interveners seek to raise in these proceedings, it
4 was not an academic exercise. The Commission and the electric utilities had seen
5 and experienced firsthand how catastrophic storms might impact this State.
6

7 **Q. The Intervener witnesses argue that the Commission has made reference**
8 **from time to time to the relationship between storm-cost recovery and the**
9 **utility's earnings. On the basis of these statements, the Intervener witnesses**
10 **argue that PEF should absorb all storm costs that would not push PEF's**
11 **earnings below a 10% ROE. Do you agree with this contention?**

12 **A.** No. This leads me to a discussion of the Intervener's misunderstanding of
13 ratemaking and the current stipulation among the parties to PEF's last rate
14 proceeding.
15

16 **III. The Interveners Base their Case on a Misunderstanding of Ratemaking**
17 **Principles and the Parties' Stipulation in PEF's 2001 Rate Proceeding**
18

19 **Q. Please explain how the Intervener witnesses are missing the mark in**
20 **suggesting that PEF must absorb any expenses that will not force the**
21 **Company to experience an ROE below 10%.**

22 **A.** As an initial matter, it is important to understand how base rates are set.
23 Traditionally, base rate proceedings have not been designed to capture non-

1 recurring, volatile expenses like catastrophic storm losses. Indeed, FIPUG
2 witness Sheree Brown concedes this much. She acknowledges that “if PEF had
3 just booked the [storm-related] expenses to O&M and filed for a rate increase, it
4 would have had to absorb the total costs.” (Brown, p. 7) (emphasis ours). She
5 explains that this would have occurred because “rates are implemented on a
6 prospective basis” and “any non-recurring expenses, such as the storm damage
7 losses, would typically be removed through pro-forma adjustments. This would
8 have eliminated PEF’s recovery of the costs in a future rate period.” (*Id.*)
9 (emphasis ours).

10 This is a significant concession, but Ms. Brown does not appear to
11 recognize the importance of what she has acknowledged. It is an important
12 concession because it recognizes that base rates do not contemplate extraordinary
13 expenses like the catastrophic storm costs at issue in this case. Base rates are not
14 set with such costs in mind. Base rates are set to defray other normal, recurring
15 costs of running the utility. After those rates are set, the utility may do better or
16 worse in managing those other functions than anticipated. And the utility’s
17 earnings will benefit or suffer depending upon how well the utility does in
18 managing those costs. But it is untenable and unfair for Interveners to suggest
19 that PEF must use its base rate revenues to absorb all or part of the costs of
20 volatile, non-recurring expenses that base rates were never intended to recover in
21 the first place.

22 Typically, the Commission has employed different mechanisms to ensure
23 that electric utilities are able to recover non-recurring, volatile costs. In this

1 regard, as we discussed in our direct testimony, the Commission recently
2 authorized the use of a cost-recovery clause to permit utilities to recover
3 extraordinary security costs resulting from the 9/11 terrorist attack.

4 This only makes sense. PEF is a regulated cost-of-service utility. It is
5 entitled to recover reasonable and prudent expenses as a statutory and
6 constitutional entitlement. It follows that, if the Company cannot recover

7 reasonable and prudent storm-related costs through a base-rate proceeding, then it
8 must be able to recover those costs through a cost-recovery mechanism,
9 surcharge, or some other means. This is why the Commission has repeatedly
10 invited the electric utilities to petition the Commission to recover reasonable and
11 prudent storm costs in excess of amounts accrued in the Reserve.

12 Indeed, Ms. Brown and OPC witness Michael J. Majoros, Jr. both concede
13 that a two-year recovery by means of a surcharge makes sense for part of PEF's
14 storm-related costs. It is neither fair nor sensible, however, to force PEF to
15 employ base rates to absorb the substantial balance of those costs when everybody
16 appears to agree that base rates were not set in the first place with those costs in
17 mind.

18 The circumstances of this very case make clear that the Commission's
19 long-standing policy makes perfect sense when applied to catastrophic events like
20 these. By all accounts, the hurricanes of last season were unanticipated and
21 unprecedented. Never in recorded history has Florida experienced hurricane
22 activity of that magnitude. Had the hurricanes never occurred, PEF had plenty to
23 do to run the Company. When the hurricanes struck, the Company had to divert

1 employees and other resources to the monumental task of coping with back-to-
2 back highly destructive storms and restoring power to customers, no questions
3 asked. By no means did these events excuse the Company from other work that it
4 had to perform to operate the utility. The Company still had to hook up new
5 customers and terminate old ones, it had to continue its work on capital projects, it
6 had to compute customer bills, it had to operate and maintain plant and
7 equipment.

8 As FPL explained in its 1993 Study, dislocation like this forces a utility to
9 incur significant backlogged work that must often be performed at higher than
10 “normal” costs. PEF experienced this problem after the last hurricane season
11 because the Company had to commit virtually all of its resources for a substantial
12 period of time to storm restoration. Also, the Company lost substantial revenues
13 and numerous customers as a result of the storms.

14 PEF is not seeking to transfer these indirect storm-related risks to its
15 customers. But PEF is seeking to enforce the understanding reached and followed
16 since 1993 concerning how it must account and recover for direct storm-related
17 expenses. The Commission may rest assured that the Company will use the base
18 rates previously approved to perform the activities and services contemplated by
19 the Company in its Minimum Filing Requirements in the last rate case. But it
20 cannot be expected to use those rates to absorb costs that were most definitely not
21 contemplated during the last rate case.
22

1 **Q. But Ms. Brown contends that PEF is “gaming” the system by “shifting” what**
2 **should be seen as normal labor costs covered by base rates to storm costs**
3 **reimbursable through a special cost-recovery clause, and that this will result**
4 **in “double dipping.” Do you agree with her characterizations?**

5 **A. No. I believe that her argument and pejorative characterizations are unfair. PEF**
6 **is not “gaming” anything. As I have explained, the Company is complying with**
7 the accounting methodology that the utilities proposed and discussed extensively
8 in their 1993 Studies. The extraordinary costs in excess of the Reserve that the
9 Company has booked to the storm accounts were not “normal” in any sense and,
10 by definition, were not contemplated at the time base rates were established.

11 Ms. Brown reaches her conclusion that we have engaged in “cost shifting”
12 by looking at only part of the picture. The premise of her argument is that we
13 recovered base rates to pay for O&M and other activities during this period and
14 that we used our resources to deal with storm-related activities instead of
15 performing these “normal” demands. What this completely ignores is the fact that
16 the Company’s “normal” demands did not go away during the storms. The
17 Company was forced to deploy its resources to cope with the devastating
18 hurricanes in addition to meeting its commitment to perform other “normal”
19 projects and responsibilities. After the storms, the Company faced the significant
20 backlog of “normal” activities that I just discussed.

21

1 **Q. The Intervener witnesses argue that the 10% ROE trigger in the parties'**
2 **Stipulation must be used as the operative measure of the amount of losses the**
3 **Company must absorb with base rates. Do you agree?**

4 **A.** No, I do not agree. This argument reflects a misunderstanding of the background,
5 structure, and meaning of the Stipulation. First, the Intervener witnesses ignore
6 important considerations that went into the Stipulation. At the time of the last rate
7 case, the Company had just completed a merger. As a direct result of that merger,
8 the Company had been able to achieve tremendous savings in O&M expenses,
9 through a reduction in headcount and other measures. The parties arrived at a
10 Stipulation, in part, as a means to share the benefits of those savings. For its part,
11 the Company agreed to provide rate relief in the staggering amount of \$125
12 million. What the Company received in return included in part the elimination of
13 the use of an ROE limitation on earnings.

14 Traditionally, the Commission has set rates tied to an authorized ROE.
15 The Commission establishes a "midpoint," say 12%, and then creates a band
16 around that midpoint of 100 basis points on either side. The Commission has
17 used this band to determine whether it is appropriate to initiate a rate proceeding
18 either to increase or decrease rates.

19 In the case of the parties' Stipulation in the last rate case, the Commission
20 and the parties did not establish a midpoint ROE, representing a target rate of
21 return. Nor did the Commission establish an upper limit on a band around the
22 midpoint, which might be used to determine whether the Company was "over
23 earning." Instead, the Commission approved a revenue sharing mechanism to

1 allow both the Company's shareholders and its customers to benefit from greater-
2 than-anticipated revenues.

3 It is true that the Commission approved a 10% ROE as a trigger for
4 determining whether PEF could initiate a request to increase rates. But this must
5 be understood in context also. The parties essentially agreed to a base rate freeze
6 for five years. To ensure that PEF would not return to the Commission before
7 that time to argue that its base rates were too low in view of the substantial base
8 rate "give up," the parties agreed that PEF would be bound to adhere to the base
9 rates it accepted unless the parties seriously miscalculated the amount of base rate
10 revenues that the Company would require to meet its anticipated costs. The ROE
11 of 10% serves as that trip point, and it was purposely set at a low number to
12 prevent PEF from seeking an adjustment in base rates absent a serious
13 miscalculation.

14 It would be a complete misreading of the Stipulation to contend that the
15 Stipulation requires PEF to absorb expenses that, by Ms. Brown's own admission,
16 are not typically addressed through base rates so long as PEF would not earn less
17 than a 10% ROE.

18
19 **Q. The Intervener witnesses insist that the Commission's prior orders on storm**
20 **costs mean that the Company must be driven down to the 10% trigger point.**
21 **Are they correct?**

22 **A.** No, they are not. To the contrary, the Commission's orders unmistakably
23 foreclose that reading. Time and time again, the Commission has invited utilities

1 to petition the Commission for recovery of storm costs in excess of the Reserve.

2 If the Interveners were correct, the Commission would have instructed the utilities
3 to petition only for relief from costs that would cause the utilities' earnings to
4 reach 100 basis points below its authorized midpoint ROE.

5 Further, it makes no sense to focus on the bottom end of any approved
6 ROE range, as the Interveners do. The Commission has not sought to drive

7 utilities to the bottom end of an approved range to cover storm costs, even in
8 circumstances where the utility has operated under such a range. In a case
9 involving Gulf Power, for example, the Commission permitted Gulf Power to
10 apply excess earnings, exceeding 12.75%, to augment its Reserve. The
11 Commission concluded: “[W]e find it appropriate to allow the Company the
12 flexibility to increase its annual accrual to the accumulated provision account
13 when the Company believes it is in a position, from an earnings standpoint, to do
14 so.” Order No. PSC-96-0023-FOF-EI, dated Jan. 8, 1996 (“1996 Gulf Order”), p.
15 4. Although the Commission had approved a Reserve balance that Gulf had not
16 then achieved, the Commission did not order Gulf to fund that balance out of base
17 rate revenues forthwith up until the point where funding would depress the
18 utility's earnings below the bottom end of its authorized ROE range.

19 In the same vein, the Commission approved a request by FPC to cap its
20 1994 earnings at a 12.5% ROE, at a time when it had a 12% midpoint and a range
21 extending from 11% to 13%, by applying any earnings above the utility's
22 proposed cap to increase its storm damage accrual to \$6,000,000. Again, despite
23 the Commission's finding that “an increase above the current \$3,000,000 annual

1 accrual is needed,” the Commission did not direct the Company to augment its
2 Reserve so long as this did not depress earnings below 11%.

3 Indeed, during the 1993 proceedings, when FPL had just encountered
4 catastrophic losses as a result of Hurricane Andrew, nowhere did the Commission
5 direct that FPL must absorb those losses up until the point where FPL’s earnings
6 reached the bottom end of its authorized range. To the contrary, the Commission
7 anticipated that those losses would be covered by replacement insurance and the
8 previously-approved Reserve and approved a mechanism for future accruals using
9 the very means of accounting employed by PEF in this case.

10

11 **Q. The Interveners argue, nonetheless, that PEF will be over earning unless the**
12 **Company is made to absorb a substantial share of the storm costs. Do you**
13 **agree?**

14 **A.** No. This argument makes less sense in this case than it might have in prior cases
15 because PEF has no cap on earnings under the current Stipulation. The
16 Interveners are, in essence, seeking to re-write the Stipulation to include some
17 kind of cap on ROE. The parties agreed to a revenue sharing arrangement in lieu
18 of a cap. The 10% figure that Interveners use has no relationship to that revenue
19 sharing mechanism, and it certainly does not constitute an upper limit on earnings.
20 But that is exactly how the Intervener witnesses are using it.

21 The fact is, before the storms, PEF was targeting earnings in excess of
22 13%. It had every right to do this under the Stipulation. In addition, the
23 Company was enjoying revenues in an amount sufficient to trigger the

1 Stipulation's revenue sharing mechanism. So the Company's customers were
2 benefiting, too.

3 There can be no question that the Company's revenues were impaired
4 below what they would have been but for the storms. What the Company seeks to
5 achieve by this proceeding is not to obtain any windfall, but to recover no more or
6 less than the direct costs that it incurred as a result of these catastrophic storms,
7 based on the accounting the Commission has long accepted.

8

9 **Q. Would it be either fair or appropriate to change the rules for accounting for**
10 **storm costs after the fact?**

11 **A.** No. A regulated utility depends upon predictable and reasonable regulation in
12 running its business. Investors and analysts require and expect this, too.
13 Changing rules after the fact is neither predictable nor reasonable. In fact, in the
14 context of the regulation of cost recovery, it amounts to impermissible retroactive
15 ratemaking.

16 This is not an academic issue. Knowing the rules in advance allows a
17 regulated utility to make reasonable and prudent decisions about how to run the
18 business. This is especially important in the context of emergency response,
19 when the utility simply does not have the time or opportunity to consult with
20 regulators first to determine whether change may be in the air.

21 Every business has choices about how to handle any situation confronting
22 the company. Regulated utilities are no different. As the Commission has
23 recognized time and time again, utilities may exercise prudent judgment to

1 balance the needs and interests of their customers and their shareholders. The
2 Commission has never required electric utilities to subvert the interests of their
3 shareholders to favor the short-term financial interests of customers because
4 experienced regulators know that this will only hurt ratepayers in the long run by
5 raising the utility's cost of capital.

6 In the case of these hurricanes, relying on the rules in place, the Company
7 deployed all of its resources to get power back in service, knowing that this would
8 create a substantial backlog of normal work assignments that might have to be
9 completed under difficult circumstances at a higher cost, at the Company's
10 expense. If the Company had known that its shareholders would have to bear a
11 substantial portion of direct labor costs and other direct expenses associated with
12 the storm response effort, the Company may well have opted prudently to keep its
13 employees on task, tending to their normal, recurring responsibilities, while
14 relying more heavily on contract labor to manage storm response and restoration.
15 But this likely would have resulted in higher costs to the customer than the relief
16 PEF is now seeking.

17 Having faith that the Commission would "do the right thing" by adhering
18 to long-standing policy if the Company "did the right thing" by applying all of its
19 resources to storm response and repair, the Company plunged ahead to return
20 customers to service at the earliest practicable time and the lowest practicable
21 cost. In this proceeding, PEF is not asking for any favorable change in
22 Commission policy. Rather, PEF is simply asking the Commission to apply the

1 tools that have been used for the last 10 years to account for and recognize the
2 Company's storm-related efforts.

3 As for the assertion by Intervener witness James Rothschild that our
4 shareholders should be satisfied so long as the Company receives a 10% ROE,
5 this is completely unrealistic and divorces the 10% figure from the context in
6 which it was used in the Stipulation. As I have explained, the 10% ROE figure in
7 the parties' Stipulation is not a cap on the Company's earnings; nor is it a target
8 earnings rate. The Company can and does target earnings above that level, and its
9 investors know that. The rate agreement set forth in the parties' Stipulation
10 represents the level of base rates that the parties have agreed should be sufficient
11 to enable the Company to meet its normal, recurring expenses. As I have
12 explained, the parties' Stipulation does not contemplate the recovery of non-
13 recurring, volatile costs. Nor was the 10% trigger point set with such costs in
14 mind. Thus, Mr. Rothschild is mixing apples and oranges by trying to apply the
15 trigger point in the Stipulation to cost recovery that should occur outside the
16 contours of that Stipulation.

17 To be sure, our investors may be expected to be familiar with the
18 Stipulation in place at this time. But it is unrealistic to assert that our investors
19 must treat as a normal part of PEF's "risk profile" the occurrence of a string of
20 four catastrophic hurricanes, never before seen in the State of Florida. Further,
21 there is no basis to assert that our investors should expect that the current
22 Stipulation contemplated this extraordinary event when the assumptions going
23 into that Stipulation were radically different. Finally, our investors must be

1 deemed to be familiar with the Commission's long-standing policy relating to the
2 accounting for storm costs, and the Commission's repeated assurances that the
3 electric utilities in Florida should be able to seek recovery of reasonable and
4 prudently incurred storm costs in excess of the Reserve, notwithstanding the fact
5 that these costs are not the kind of costs typically covered in base rates.
6

7 **Q. The Intervener witnesses contend that, in view of the fact that PEF has**
8 **initiated a full requirements rate case that will take place later this year, the**
9 **Commission should act upon PEF's request for recovery of storm-related**
10 **expenses as part of its examination of the Company's overall finances and**
11 **operations. Do you agree?**

12 **A.** No, I do not. This argument amounts to reliance on coincidence rather than sound
13 regulatory policy. In addition, it reflects a misunderstanding of ratemaking
14 principles and the ratemaking process.

15 Catastrophic storms can occur at any time. It is mere happenstance that
16 Hurricanes Charley, Frances, Ivan, and Jeanne struck last year, the second-to-last
17 year before expiration of the current rate Stipulation. The Commission's response
18 to events like these should not depend upon proximity to the utility's next full
19 requirements rate proceeding. Rather, the Commission should respond by taking
20 action best suited to the nature of PEF's request.

21 In this connection, the Commission has never treated the utilities' actions
22 in drawing upon funds in the Reserve, or petitioning the Commission for recovery
23 of excess storm costs, as an exercise in the setting of base rates. It is important to

1 remember that the current approach to storm response was conceived as a
2 replacement for third-party T&D insurance. Insurance benefits are payable upon
3 occurrence of the loss, not upon completion of a utility rate case. Certainly, if the
4 current Reserve were sufficient to cover the amount of the recently incurred
5 storm-related losses, nobody would argue that the utility would have to undergo a
6 rate case before drawing upon the Reserve to satisfy those losses. By the same
7 token, the Commission has repeatedly invited utilities to petition for relief from
8 excess storm costs, and has repeatedly assured utilities that any such petition
9 would be processed expeditiously. Either folding this proceeding into a rate case,
10 or – even worse – converting this proceeding into a rate case by putting on the
11 table all aspects of the utility’s finances and operations would be completely at
12 odds with the way the Commission and the utilities have treated this issue over
13 the years.

14 Equally fundamental, the Interveners’ arguments do not recognize the
15 limitations on the upcoming rate case. As Ms. Brown herself points out, rate case
16 proceedings are designed to set base rates prospectively. They are not used, and
17 may not properly be used, to provide cost recovery for non-recurring past events
18 or to change the rules of cost recovery retroactively. Although PEF has charged
19 storm expenses to the Reserve and has thus not expensed these costs to date, PEF
20 incurred the costs last year, and all the issues that Interveners want to examine –
21 namely, the impact of storm response on “normal” workload during 2004 or
22 budgeted O&M and capital items for 2004 and 2005 – occurred last year or will
23 occur this year. The Commission will set PEF’s base rates in the upcoming

1 proceeding based upon its examination of a future test year – 2006 – not based on
2 one-time events in the past.

3 It is true that PEF will propose an increase in accrual to the Reserve for
4 predictably higher, future storm costs. But this is a function of estimating costs
5 that are likely to recur in the future, not a process of obtaining recovery for costs
6 already incurred. Therefore, it would be wrong to use the upcoming rate

7 proceeding to review the storm costs incurred in 2004 and to provide a cost
8 recovery mechanism for those costs.

9
10 **Q. Mr. Rothschild contends that, in acting upon PEF's petition, the Commission**
11 **may wish to examine whether 10% would constitute a reasonable ROE**
12 **under current market conditions. Is this a proper inquiry?**

13 **A.** No, it is not. We disagree with Mr. Rothschild's views about what would be a
14 reasonable ROE in today's circumstances. But more importantly, we suggest that
15 this discussion is totally out of place in this proceeding, and therefore we do not
16 agree that it is appropriate to engage in this debate in the current docket. Again,
17 Mr. Rothschild confuses a program that was conceived to replicate third-party
18 insurance with a base rate proceeding. While it is appropriate to examine the
19 ranges of reasonable returns on equity in a base rate proceeding, PEF has not
20 petitioned in this case to re-set base rates. That matter is resolved definitively for
21 the time being by the parties' rate Stipulation. In seeking to reopen this matter
22 before January 2006, it is Mr. Rothschild, not PEF, who is arguing for a departure
23 from a binding Stipulation.

1 Further, under that Stipulation, the parties and the Commission have not
2 established a framework revolving around an authorized ROE. Rather, the
3 Commission has approved a revenue sharing mechanism as the device to control
4 over-earning by the utility. Accordingly, Mr. Rothschild's suggestion not only
5 fails to come to terms with the fact that PEF is calling upon the Commission to
6 take action on what is fundamentally a self-insurance, not base rate, issue. But his
7 suggestion is out of alignment with the parties' current base rate Stipulation.

8
9 **IV. Miscellaneous Issues**

10
11 **Q. FIPUG's witness, Sheree Brown, contends that PEF is proposing to use**
12 **the wrong rate design for storm cost recovery. Should PEF be required**
13 **to modify its rate design in its GSD, CS, and IS rates in order to recover**
14 **the storm damage costs through a demand charge rather than an energy**
15 **charge?**

16 **A.** No. The Company has used an energy charge rate design consistently for
17 these rates in all of its recovery clauses including (i) Fuel Cost (ii) Energy
18 Conservation, (iii) Capacity Cost, and (iv) Environmental Cost. Much like
19 storm damage costs, the majority of the costs recovered by these clauses, with
20 the exception of the Fuel Cost, are demand-related. The rate design
21 recognizes the demand-related classification of these costs in determining
22 each rate class's cost responsibility. Within a rate class, it has been the
23 practice to recover the rate class's cost on the energy usage of that class.

1

2

Q. If the Company were required to modify its rate design in its GSD, CS, and IS rates for the storm damage costs to be recovered through a demand charge, do you agree with the calculations presented by FIPUG in their testimony?

3

4

5

6

A. No, I do not. FIPUG has not determined its charges as it pertains to voltage

7

level customers in the same manner as voltage level differences are

8

recognized in the Company's ratemaking practices. The Company's base rate

9

charges reflect service to the lowest delivery voltage (distribution secondary).

10

Where customers take service at higher delivery voltages, the customer's

11

billing is adjusted by two factors. First, metering quantities or rate charges

12

need to be adjusted to recognize lesser losses responsibility of 1% for

13

distribution primary delivery and 2% for transmission delivery. Second, the

14

higher delivery voltage customer is credited an amount for the avoidance of

15

transformation facilities that have been incorporated in the secondary delivery

16

charges.

17

The calculations performed by FIPUG do not appear to have been

18

performed in the manner described. Nor do the results appear to be

19

reasonable. FIPUG's calculations show greater charges should be assessed

20

for the higher delivery voltage customers than that for the distribution

21

secondary delivery customers. This is contrary to the nature of higher voltage

22

service costs. Since the transformation credits have been fixed in base rates,

23

the additional charges by voltage level, whether recovered on an energy basis

1 or a demand basis, should result in primary delivery charges of 1% less and
2 transmission delivery of 2% less than that for secondary delivery charges.

3

4 **Q. OPC witness Michael Majoros contends that PEF retains enough**
5 **flexibility in its budgeting process to absorb backup work pushed into**
6 **2005. Do you agree?**

7 **A.** I do not agree that this is a valid argument. It is built on a mistaken premise.
8 The Company has made a commitment to the Commission and its customers
9 to improve customer satisfaction and system reliability as part of its
10 Commitment to Excellence. In order to fulfill this commitment, the Company
11 was on track to perform a number of activities that got interrupted by the
12 hurricanes. The Company will not lessen its efforts or commitment to
13 improve customer satisfaction and system reliability now that the hurricanes
14 have passed. The fact is that PEF faces a substantial backlog of work that it
15 must perform to run its system. That work was not made easier or cheaper by
16 the advent of the hurricanes. To the contrary, the Company will in many
17 instances face greater costs in performing this backlog of projects. The
18 Company will incur greater than normal costs for performing “normal” utility
19 functions. Whether or not the Company meets or exceeds budget in doing so
20 is completely irrelevant. The Company’s budgets are projections. If the
21 Company manages to meet budget in 2005 despite its backlog of work from
22 the hurricane season, it will nonetheless incur greater costs for this period than
23 it otherwise would have. There is no way around that.

1

2 **Q. Ms. Brown argues that the storm repairs will likely reduce future O&M**
3 **requirements. Do you agree?**

4

A. No. We have no way to predict that this will occur or to quantify it if it does
5 **occur. Based on what we now know, we do not expect this to be the case.**

6

Given the urgency of the storm-related repairs, and the haste with which they

7

had to be made, we may as readily speculate that we will encounter greater,

8

not lesser O&M expenses in the future.

9

10

Q. Ms. Brown also argues that the Company should have credited to the
11 **Reserve all revenues that it received from other utilities when employees**
12 **were lent to assist those utilities with their storm-repair work. Do you**
13 **agree?**

14

A. No, I do not. Again, Ms. Brown ignores the fact that PEF employees who
15 **were diverted from their “normal” activities had to return to those demands**
16 **after they completed their service for other utilities. The services they**
17 **performed outside our service territory did not benefit our customers; nor did**
18 **our customers pay for those services. We used the base rates we collected**
19 **from our customers to pay for the “normal” work that these employees were**
20 **expected to perform before and after their out-of-state assignment. At the**
21 **same time, we used the revenues collected from other utilities to defray the**
22 **cost of the services these employees provided outside our system. This is all**
23 **symmetrical. By contrast, it would make no sense to credit our customers**

1 with revenues collected outside our system for work that benefited other
2 customers, as Ms. Brown suggests.

3

4 **Q. Ms. Brown and Mr. Majoros suggest that PEF has been accruing as part**
5 **of depreciation expense the cost of removal of T&D equipment and that**
6 **none of the accrued cost removal was applied to the storm damage. Is**

7 **this a fair criticism?**

8 A. No, it is not, for two reasons. First, PEF has always maintained that any
9 removal cost incurred, as a direct result of the storms, will be charged to the
10 accumulated reserve for depreciation and not to the storm reserve. Second, if
11 we end up over-collecting or under-collecting in depreciation expense, we will
12 correct for that by adjusting depreciation rates in our next depreciation study
13 to collect less (or more) on a yearly basis. So any discrepancy that may be
14 created in depreciation expense as a result of the storms will be corrected in
15 our next depreciation study by adjusting what we collect.

16

17 **Q. Mr. Majoros claims that PEF did not provide documentation that OPC**
18 **requested to back up the Company's representations about its accounting**
19 **procedures. Is this true?**

20 A. No. We provided everything OPC requested.

21

1 **Q. Sugarmill Woods witness Stewart argues that the Commission should**
2 **treat storm-cost recovery in the same manner that it treated the 1986**
3 **Federal Income Tax rate change. Do you agree?**

4 **A.** No. That tax rate change affected an item of cost of service that was included
5 in the rate making process as a normal, recurring cost. Therefore, when the
6 Federal Government changed the rate, it was logical and appropriate that the

7 Commission would adjust base rates on a going forward basis to allow FPC to
8 achieve its midpoint in light of this reduction in income tax expense.

9
10 **Q. Do you agree with Ms. Brown's suggestion that PEF should provide an**
11 **offset for the income tax benefits that PEF receives by expensing the**
12 **storm damage costs for tax purposes?**

13 **A.** No. This argument misapprehends the income tax effect of the 2004
14 hurricane season on PEF. I am submitting as Exhibit ___ (JP-5), a schedule
15 that demonstrates that PEF should not be required to offset the storm recovery
16 by the "temporary" tax benefit that it recognized in 2004. You can see from
17 the schedule that, although for tax purposes PEF is allowed to take a casualty
18 loss as well as a current period deduction for the storm damage cost, it is all a
19 temporary timing difference.

20 Line 5 of the schedule shows that, over the life of the assets installed,
21 PEF will recognize the tax depreciation, offset by Line 8, which represents the
22 book revenue requirement collected for depreciation expense on those assets.
23 The difference represents the above normal cost of installation that is

1 capitalized for tax purposes but expensed to the Reserve for book purposes.
 2 We will also recognize this amount of extraordinary costs over the life of the
 3 tax capital investment, but this will be offset by the taxable income created by
 4 the cost recovery clause.

5 This leads to consideration of the casualty loss, which witness Brown
 6 may believe is a permanent difference and thus a benefit for PEF. In fact, it is
 7 not a permanent difference but rather a timing difference. The casualty loss
 8 reduces the tax basis of current year additions. PEF will recognize the amount
 9 as taxable income over the tax life of the investment placed into service due to
 10 the storms. It is evident from the attached exhibit that, over time, PEF will not
 11 be advantaged by the tax impact of the storms.

PROGRESS ENERGY FLORIDA											
Federal and State Income Tax											
Retail Analysis of Storm Impact											
(Tax Deduction) / Taxable Income		(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)
Line No.	Description	Impact	PY's	Carry-back 2003	2004	2005	2006	2007	2008	2009 - End of Life	total
1	Tax Casualty Loss	\$ (107.8)		(94.7)	(13.1)						\$(107.80)
2	Tax O&M and Cost of Removal	\$ (298.0)			(298.0)						\$(297.97)
3	Recovery through Storm Reserve at 12/04	\$ 46.9	34.9	6.0	6.0						\$ 46.90
4	Recovery of COR through Bk Depr in PY	\$ 1.87	\$ 1.87								\$ 1.87
5	Capital portion for Tax	\$ (66.7)			(3.3)	(3.3)	(3.34)	(3.34)	(3.34)	(50.03)	\$(66.70)
6	Reversal of Tax Casualty Loss	\$ 107.8			5.39	5.39	5.39	5.39	5.39	80.85	\$ 107.80
7	Recovery through Clause	\$ 256.8				64.20	128.40	64.20			\$ 256.80
8	Book Depreciation on Storm Capital	\$ 47.0			1.6	1.6	1.6	1.6	1.6	39.17	\$ 47.00
9	Remove wholesale	\$ 12.1			12.1						\$ 12.10
10			\$ 36.77	\$ (88.66)	\$ (289.39)	\$ 67.82	\$ 132.02	\$ 67.82	\$ 3.62	\$ 69.99	\$ (0.00)
11											
12											
13	O&M Recovery per tax Calc										
14	Total Storm Cost Estimate	\$ 385.8									
15	Less Capital	48.8	337.0					337.00			
16	Less Storm Reserve	46.9						46.9			
17	Less Amount credited to capital per tax	21.2									
18	Less Wholesale	12.1						12.1			
19		\$ 256.8									
20								278.0			
21								385.8			
22								278.0			
								107.80			

12

1 **Q. You have addressed a number of issues in your rebuttal testimony but**
2 **may not have touched on each specific point the Interveners raise. Just to**
3 **be clear, do you accept any of the Intervener witnesses' criticisms?**

4 **A.** No. I believe that I have addressed all of their concerns directly or indirectly
5 in this rebuttal testimony. Lest there be any doubt, I do not accept any of their
6 adjustments or criticisms of our submission. They are based on the faulty
7 premise that the Commission should conduct a rate-case type inquiry of the
8 Company's cost-recovery proposal when, in fact, we are talking about
9 volatile, non-recurring costs that are not suitable for rate-case treatment.

10 PEF has accounted for the storm costs it incurred exactly in the manner
11 described in the utilities' Commission-approved studies following Hurricane
12 Andrew, and this has the virtue of treating extraordinary events in a
13 straightforward and fundamentally just manner. The Intervener witnesses
14 want to "back out" of those numbers any expense that they can conceivably
15 attribute to "normal" demands without allowing full credit for all of the direct
16 and indirect impacts on the utility caused by these unprecedented storms,
17 including the fact that the utilities are not excused from performing their
18 backlog of "normal" activities, in less-than-normal circumstances.

19 The Interveners want to do this by forcing the Commission and the
20 utility to undergo a full-blown rate-case type inquiry, lasting for many months
21 or more, conceivably every time we experience an extraordinary weather
22 event. At the same time, of course, the Interveners, assume, and undoubtedly
23 would insist, that the utilities in this state must continue to proceed at their

1 peril, no questions asked, to expend every resource, as we did this past
2 hurricane season, to get the Interveners' constituencies back in service
3 immediately after catastrophe strikes, and take their chances that they will
4 eventually receive fair treatment by the Commission after the fact and
5 following protracted regulatory hearings.

6 Finally, the Interveners want to define what is "fair" based on the

7 minimum return that the Interveners can argue the utilities may receive
8 without creating economic hardship. Sound regulatory policy, however,
9 should recognize that utilities should be rewarded, not penalized, for rising to
10 an occasion such as this, working tirelessly to restore power to millions of
11 customers struck by devastating storms. In circumstances such as these,
12 electric utilities should not be forced to earn a lower return than "normal." If
13 anything, their extraordinary efforts should be rewarded with an extraordinary
14 return. In fact, it is quite astonishing that the Interveners should argue that
15 PEF should be forced to earn the most minimal ROE defensible under the
16 parties' current rate Stipulation just because the utility dropped everything to
17 work day and night, week after week, often at great personal sacrifice and
18 even peril to the employees involved, to deal with an unprecedented natural
19 disaster so that the Company's customers would suffer the least loss and
20 inconvenience possible under the circumstances.

21 In sum, the Interveners' position is neither consistent with past
22 Commission treatment of storm costs, nor does it make sound regulatory
23 policy. Rather, sound regulatory policy, consistent with the Commission's

1 prior orders dealing with storm costs, requires the adoption of the Storm Cost
2 Recovery Clause proposed by the Company to recover from its customers all
3 of its extraordinary, direct storm costs from Hurricanes Charley, Frances,
4 Ivan, and Jeanne over a two-year period. This two-year recovery mechanism
5 benefits both the Company and its customers by ensuring a timely recovery of
6 all reasonably incurred direct costs to prepare for, respond to, and recover

7 from the 2004 hurricanes in a reasonable amount of time that also more
8 closely matches the recovery to the incurrence of the costs to ensure that
9 customers paying the storm costs are more likely the same ones who benefited
10 from the restoration efforts. Moreover, a recovery clause over two years
11 reduces the financial impact to customers from additional financing costs,
12 returns on working capital on negative storm reserve balances, and possibly
13 additional severe storm costs if the recovery period is extended over a longer
14 period of time.

15
16 **V. Staff's Testimony and Audit Contain the Same Fundamental Flaws that**
17 **are Found in the Interveners' Testimony and Further Fail to Appreciate**
18 **the Import of Auditing our Estimate of Storm Costs**
19

20 **Q. Have you reviewed the Direct Testimony of Jocelyn Y. Stephens on behalf**
21 **of Staff and the Audit Report identified as Exhibit ___ (JYS-1)?**

22 **A. Yes, I have. Ms. Stephens' direct testimony simply reiterates the findings in**
23 **the audit report that she has filed as an exhibit to her testimony.**

24
25 **Q. Did the Company respond to the Staff audit report?**

1 A. Yes, it did. I responded to the audit on behalf of the Company on February
2 11, 2005. A copy of the Company's response to the Staff audit is attached to
3 my rebuttal testimony as Exhibit ___ (JP-6).

4
5 **Q. Do you agree with all of the findings in the Staff audit?**

6 A. No, I do not. As I explained in greater detail in the response to the Staff audit
7 in Exhibit ___ (JP-6), some of the findings in the audit report, in particular
8 audit disclosures number 1 and number 3, reflect the fact that the Company is
9 still working with estimates because not all invoices for the Company's storm
10 costs have come in and been audited by the Company to ensure that they are
11 properly charged to the storm damage reserve. Until that process is completed
12 there will not be a final accounting of the storm-related capital and O&M
13 costs and an allocation of those costs to capital to be deferred to the next base
14 rate proceeding and to O&M to be included in the storm damage reserve and
15 our request for cost recovery under a clause.

16 Other findings in the audit report are simply wrong. For example, Ms.
17 Stephens states in the second point of audit disclosure number 2 that exempt
18 employees, who are not eligible for overtime pay, received overtime pay.
19 This statement is inaccurate. Certain, eligible exempt employees receive
20 extended pay, not overtime pay, under the Company's Extended Policy
21 provision that has been in place since the early 1990's. The Extended Policy
22 provision is used for special projects, including storms and outages, where
23 employees are required to work long hours for extended periods of time. The

1 Policy provides for extended pay only for time worked in excess of 40 hours
2 per week with a maximum of 72 hours of extended pay. Extended pay is paid
3 at a straight hourly rate under the Policy and, thus, is not overtime.

4 Finally, the findings in audit disclosures numbers 2 and 4 reflect the fact
5 that the Company has properly charged all of its direct costs to prepare for,
6 respond to, and recover from the four hurricanes to the storm damage reserve,
7 subject only to the allocation of the total installation costs under normal
8 operating conditions of the replacement facilities in the storms to capital to be
9 carried by the Company until the next base rate proceeding. This
10 replacement-cost insurance approach is consistent with the regulatory
11 treatment of storm cost recovery in Florida and sound regulatory policy, as I
12 explain in detail above in response to the interveners' testimony in this
13 proceeding, and is, therefore, fully supported by the Commission's policy and
14 prior decisions.

15
16 **Q. Are the findings in audit disclosures numbers 2 and 4 in the Staff audit
17 consistent with Staff audits of other utilities' 2004 storm-related costs?**

18 **A.** No, they are not. Staff's "opinion" in the Staff audit report of the 2004 storm
19 costs incurred by Florida Power and Light Company ("FPL") was that FPL
20 had recorded items included in base rates, such as regular, overtime, and
21 overhead costs for payroll employees who were assigned to the hurricane
22 restoration, consistent with FPL's 1993 Study and the Commission's 1995
23 Order. This "opinion" is found on page 18 of the Staff audit in audit

1 disclosure number 6 addressing items included in base rates. Audit disclosure
2 number 6 is similar to audit disclosures numbers 2 and 4 in the Staff audit of
3 PEF's storm costs. I have attached as Exhibit ___ (JP-7) to my testimony the
4 Direct Testimony of Iliana H. Piedra on behalf of Commission Staff in Docket
5 No. 041291-EI, together with page 18 of the audit report she prepared with
6 respect FPL's petition for authority to recover prudently incurred storm
7 restoration costs related to the 2004 hurricane season.

8 Ms. Piedra reviewed the FPL study filed in 1993 in Docket No. 930405-EI
9 and Commission Order No. PSC-95-0264-FOF-EI dated February 27, 1995 as
10 part of her audit of FPL's storm costs. She correctly notes that FPL was
11 required to file this Study by the Commission to describe for the Commission
12 how FPL would record hurricane related costs to the storm reserve. She
13 concedes that the FPL said that it would use the actual restoration cost
14 approach to determine the appropriate amounts to be charged to the reserve in
15 its Study, that the Commission understood this was the approach FPL selected
16 as the most reasonable and prudent methodology, and that the Commission
17 concluded that the actual restoration cost approach was consistent with the
18 manner in which replacement cost insurance works in Commission Order No.
19 PSC-95-0264-FOF-EI.

20 Staff's findings that FPL's storm-related costs have been recorded in
21 accordance with its Commission-approved Study should be similarly and
22 consistently applied to the Staff audit of PEF's 2004 storm-related costs. As I
23 explained in detail above, PEF filed its own Study adopting the same, actual

1 restoration cost approach consistent with replacement cost insurance that FPL
2 adopted, that Study was approved by the Commission, and PEF has followed
3 the approach approved in that Study on a regular basis consistent with the
4 sound regulatory policy that it represents.

5

6 **Q. What about audit disclosure number 5 where Ms. Stephens singles out**

7 **one claim out of a number of damages claims arising from the storms and**
8 **recommends that this item be removed from the Company's storm cost**
9 **estimate. Do you agree with that finding?**

10 A. No, I do not. This is not an audit finding. Ms. Stephens is improperly
11 drawing conclusions on issues of negligence that will be determined as part of
12 a legal, not an auditing, process. There is no basis for Ms. Stephens to
13 assume, in her position as a Staff auditor, that this damage claim should not be
14 included as a regular cost of doing business. Any damage claim by one of our
15 customers is undesirable and unfortunate, but to suggest that the Company is
16 somehow negligent to a degree that would remove this particular claim from
17 treatment as a cost of doing business like any other damage claim, when it
18 arose during the crisis situation of responding to literally hundreds of
19 thousands of calls and attempting to promptly restore power during and
20 following a hurricane, is both baseless and inappropriate. Ms. Stephens is
21 judging the conduct of an individual employee using the standard of care
22 under ordinary circumstances. Under normal conditions notice of a downed
23 power line, once or even twice, would be a significant event and the

1 appropriate standard of care would require prompt attention. The same notice
2 of a downed power line, once or even twice, when there are hundreds of other
3 power lines down, each one having the potential of causing serious bodily
4 injury or property damage is an entirely different matter. While the failure to
5 timely address the downed power line that Ms. Stephens is referring to is
6 regrettable, it is a function of the extreme conditions that were present and is
7 not the product of gross negligence. PEF could allocate its resources to make
8 it less likely that this event would occur but it would do so at the increased
9 cost of slowing restoration and increasing manpower costs.

10
11 **VI. Conclusion**

12
13 **Q. Does this conclude your rebuttal testimony?**

14 **A.** Yes, it does.

1 CHAIRMAN BAEZ: Go ahead.

2 MR. WALLS: Yes. The two exhibits that
3 Mr. McGlothlin is referring to --

4 MR. SASSO: I think he said he's going to raise
5 it later.

6 MR. WALLS: Let me ask that it be made clear.

7 Are you raising this now, Mr. McGlothlin, or are you
8 going to raise it later?

9 CHAIRMAN BAEZ: Here's the situation. As
10 Mr. McGlothlin correctly pointed out, he is ready to
11 object once they want to be entered into evidence.

12 MR. MCGLOTHLIN: Correct.

13 CHAIRMAN BAEZ: And I suppose we'll have that
14 discussion in due course.

15 You mentioned there's two exhibits, and I'm
16 wondering. I had more of them marked off. Am I missing
17 objectors to the rebuttal exhibits, because I had
18 basically all of Mr. Portuondo's rebuttal exhibits.

19 MR. MCGLOTHLIN: I believe that was as a
20 consequence of Mr. McWhirter's overall objection.

21 CHAIRMAN BAEZ: I'm sorry?

22 MR. MCGLOTHLIN: I think FIPUG had objected to
23 several. I had only indicated two.

24 CHAIRMAN BAEZ: All right. So we have those
25 pending as well. At this point I think we can go ahead

1 and take Mr. Portuondo's summary and get to the cross.

2 MR. WALLS: Okay.

3 FURTHER DIRECT EXAMINATION

4 BY MR. WALLS:

5 Q Mr. Portuondo, do you have a summary of your
6 testimony?

7 A Yes, I do.

8 Q Will you please provide that to the
9 Commission?

10 A Commissioners, I think the story all begins
11 after Hurricane Andrew in 1992. The company approached
12 the Commission with a self-insurance proposal for
13 transmission and distribution storm damage because
14 available T&D insurance was no longer cost-effective for
15 our customers.

16 The Commission approved this self-insurance
17 program and included three aspects: Accruals in base
18 rates to an unfunded storm damage reserve; the ability
19 to request additional and expeditious cost recovery in
20 the event of extraordinary costs exceeding that
21 reserve. The Commission also required the company to
22 continue to monitor the insurance industry in order to
23 ascertain whether it was now available in a
24 cost-effective manner to secure third-party transmission
25 and distribution insurance.

1 The Commission further required the company to
2 file a study that explained what storm-related costs the
3 company would charge to this self-insurance mechanism.
4 The Commission's reserve under the self-insurance plan
5 established that an annual accrual should be charged to
6 the reserve. The Commission kept open the
7 self-insurance docket until the study was filed by the
8 company. The company filed the study in February 1994,
9 and in July of '94, the Commission approved an increase
10 in the company's annual accrual, after having reviewed
11 the company's study, and took no exception to our
12 accounting that we proposed as part of that study. And
13 following that, the Commission closed the self-insurance
14 docket.

15 We have continuously followed our study in
16 administrating the storm damage reserve over 10 years.
17 We have charged the storm damage reserve with costs
18 related to Hurricanes Erin, Floyd, and Gabrielle, and
19 other named hurricanes and tropical storms in exactly
20 the same manner that we charged the costs for the
21 hurricanes in 2004. Our accounting for storm costs for
22 the catastrophic 2004 hurricane season represents the
23 same accounting method that we have followed for the
24 last decade, consistent with the study accepted by the
25 Commission, and they represent sound policy in dealing

1 with such costs.

2 The accrual to the storm damage reserve has
3 never been said to cover catastrophic storm seasons like
4 the one we just experienced, because it would be neither
5 practical nor cost-effective to do so based on the
6 probabilities developed by our prior storm experience.

7 No one wants to set the accrual in base rates to cover a
8 2004 hurricane season each year, and it's simply wrong
9 to suggest that such catastrophic costs are covered in
10 base rates.

11 The cost of such severe storms are too
12 volatile, irregular in their occurrence, and
13 unpredictable to be addressed in base rates, and
14 traditionally and historically, severe catastrophic
15 events and their costs have not been addressed in base
16 rates. The Commission has always recognized this
17 before, providing for expeditious recovery in some form
18 for such costs upon the petition by the utility for cost
19 recovery. No one here seems to dispute that, since all
20 appear to agree that recovery of extraordinary 2004
21 hurricane costs directly from ratepayers over a maximum
22 of two years.

23 Because catastrophic hurricane costs have not
24 been traditionally or historically included in base
25 rates, it follows that the company's rate case

1 stipulation which settled a base rate proceeding is
2 inapplicable to the company's petition for recovery of
3 its 2004 hurricane costs. This hurricane season could
4 just as easily have occurred in the first year of our
5 stipulation or the first year following the conclusion
6 of our next base rate proceeding rather than at the near
7 end of the current stipulation.

8 And because a base rate proceeding is
9 prospective, a base rate proceeding will not be based on
10 this one-time event resulting from the 2004 hurricane
11 season. It is simply unreasonable and unfair to suggest
12 that extraordinary costs should be addressed in our next
13 base rate proceeding when such costs are not designed to
14 cover past events and has never covered extraordinary
15 costs. Base rate proceedings are intended to cover
16 normal recurring costs. This is an extraordinary,
17 unprecedented, and unpredictable event.

18 Having a mini rate case every time we have a
19 hurricane is also not sound regulatory policy. The
20 massive disruption caused by the hurricane and the
21 intense focus on quick restoration of service requires a
22 policy that is simple to administer, like the one in our
23 study that we have followed for 10 years. It is
24 inconsistent with this policy and unfair to the utility
25 to back out any expenses that can be attributed to

1 budgets during normal conditions without considering all
2 the indirect impacts on utilities of the abnormal and
3 extraordinary conditions of the hurricane. There's no
4 need for a rate case type inquiry, and it was never
5 contemplated before as part of the self-insurance
6 program. Rather, we had a substantial backlog of work

7 that was not made easier, cheaper, or eliminated by the
8 hurricanes that the company has been performing and will
9 continue to perform.

10 Finally, it is unfair to suggest that the
11 company should be required to earn the minimum return
12 that the company is entitled to recover in any
13 extraordinary -- I'm sorry. I lost my place. Finally,
14 it's unfair to suggest that the company should be
15 required to earn a minimum return before the company is
16 entitled to recover its extraordinary hurricane costs.
17 This penalizes the company at a time when the company
18 rose to face the challenge of the hurricane and restore
19 power to millions of customers struck by these
20 devastating storms. We dropped everything to focus on
21 preparing and responding to the hurricanes, at great
22 personal sacrifice to our employees, so that other
23 customers would suffer the least loss and inconvenience
24 possible.

25 We ask only recovery of our costs for providing

1 prompt restoration of service from customers who
2 benefited from it. Those costs represent over 75% of
3 our 2004 net income for the year, and the impact on our
4 investors now and in the future would be substantial if
5 we were not allowed to recover these costs from
6 customers who benefited from them.

7 Thank you.

8 MR. WALLS: At this time we tender
9 Mr. Portuondo for cross.

10 CHAIRMAN BAEZ: Mr. McGlothlin?

11 CROSS-EXAMINATION

12 BY MR. MCGLOTHLIN:

13 Q Mr. Portuondo, an initial clarification. Are
14 you an attorney?

15 A No, I am not.

16 Q Do I understand correctly then that you are not
17 purporting to offer a legal opinion with respect to the
18 applicability of the stipulation to this request?

19 A I am not offering a legal opinion.

20 Q I want to begin with a couple of questions
21 about the statement you made in your summary and the
22 related testimony and rebuttal, and I want to direct
23 your attention to page 20 of your rebuttal testimony.

24 A Yes, sir.

25 Q The paragraph beginning at line 3, where you

1 state, "It is true that the Commission approved a 10%
2 ROE as a trigger for determining whether PEF could
3 initiate a request to increase rates. But this must be
4 understood in context also. The parties essentially
5 agreed to a base rate freeze for five years. To ensure
6 that PEF would not return to the Commission before that

7 time to argue that its base rates were too low in view
8 of the substantial base rate 'give up,' the parties
9 agreed that PEF would be bound to adhere to the base
10 rates it accepted unless the parties seriously
11 miscalculated the amount of base rate revenues that the
12 company would require to meet its anticipated costs."

13 Do you see that statement?

14 A Yes, I do.

15 Q Now, would you agree with me that earnings are
16 a function of both revenues and costs?

17 A That is correct.

18 Q And a reduction of earnings can be caused by an
19 increase in costs?

20 A That is correct.

21 Q And a reduction in earnings can also be caused
22 by a decrease in revenues?

23 A That's correct.

24 MR. MCGLOTHLIN: I'm going to hand out a
25 document.

1 (Documents distributed.)

2 MR. MCGLOTHLIN: Commissioners, this the
3 Stipulation and Settlement in 000824-EI that was
4 attached to Order No. PSC-020655 in that docket.
5 Because it is part of an order, I don't think we need to
6 mark it as an exhibit, but I would just like to have the
7 witness refer to it for purposes of a question.

8 BY MR. MCGLOTHLIN:

9 Q Do you have that before you, Mr. Portuondo?

10 A Yes, I do.

11 Q I direct you to page 16 of the order, numbered
12 paragraph 7 of the stipulation. "If FPC's retail base
13 rate earnings fall below a 10% ROE as reported on an
14 FPSC adjusted or pro-forma basis on an FPC monthly
15 earnings surveillance report during the term of this
16 Stipulation and Settlement, FPC may petition the
17 Commission to amend its base rates notwithstanding the
18 provisions of Section 4." Do you see that statement?

19 A Yes, I do.

20 Q Where does it say in this stipulation that this
21 applies only to reductions that occur as a result of
22 discrepancy in revenues as opposed to an increase in
23 costs?

24 A It does not. It addresses base rates.

25 Q I'm going to refer you now to page 4 of your

1 direct testimony. At line 14 you make this statement:
2 "The storm damage reserve established in 1993 as a part
3 of the company's self-insurance plan approved by the
4 Commission," and then you continue by saying that you
5 were then forced to resort to self-insurance. Do you
6 see that statement?

7 A Yes, sir.

8 Q Now, as I understand it, prior to 1993,
9 Progress Energy had in effect commercial insurance on
10 its transmission and distribution; is that correct?

11 A That's correct.

12 Q I'm going to refer you now to your rebuttal
13 testimony, page 3. At the top of the page you refer to
14 the insurance coverage that was in effect prior to 1993,
15 and at line 3 you say, "Customers paid for insurance
16 premiums and losses not covered through insurance
17 through base rates." Do you see that statement?

18 A Yes, I do.

19 Q Would agree with me, Mr. Portuondo, that prior
20 to the self-insurance program being approved and during
21 the period of time when the company had affordable
22 commercial insurance in effect, under the commercial
23 insurance regime, the utility was subject to risks of
24 unusual hurricane costs?

25 A No, sir. The insurance coverage would protect

1 the utility up to \$85 million. The customers were
2 responsible for the deductible associated with that
3 coverage. So I don't see how we were at risk of
4 catastrophic losses.

5 MR. MCGLOTHLIN: Well, I have another document
6 to hand out.

7 (Documents distributed.)

8 BY MR. MCGLOTHLIN:

9 Q Again, I don't need to make this an exhibit,
10 but, Mr. Portuondo, I provided you with a copy of Order
11 No. PSC-93-1522-FOF-EI issued in Docket No. 930867 on
12 October 15, 1993. Do you have that before you?

13 A Yes, I do.

14 Q Please turn to the page that is captioned 93
15 FPSC 10:256. And would you read the first paragraph at
16 the top of the page out loud?

17 A "Exhibit JS-1," there?

18 Q Yes.

19 A "Part C, attached to the testimony of John
20 Scardino, presents a summary of the storm damage
21 experience for the period 1973 to 1999 (sic). The
22 reserve balance remained at 1.6 million from 1981 to
23 1985, when it was completely wiped out by 4 million in
24 storm damage from Hurricanes Elena and Kate. The
25 reserve was rebuilt to 4 million by 1992, and was then

1 depleted by the October 1992 tornados followed by the
2 March 1993 'storm of the century.'

3 Q I want to focus on the portion of the
4 paragraph dealing with Hurricanes Elena and Kate now.
5 Again, this was in the period of time in which the
6 company had in effect a policy of 85 million per

7 occurrence and the customers were paying through base
8 rates the cost of the premiums and deductibles; is that
9 correct?

10 A That is correct.

11 Q Do I understand correctly from this paragraph
12 that with respect to Hurricanes Elena and Kate, the
13 company experienced losses greater than the amount of
14 the reserve that was in effect at the time?

15 A In excess of the reserve on the books. I don't
16 know if that was because of the fact that the deductible
17 was not met or whether it was the fact that we exceeded
18 the limits of the policy, the 85 million. So it would
19 require further research to see which event caused the
20 depletion of the reserve.

21 Q But in any event, as a function of the
22 limitations on insurance coverage and the amounts being
23 collected in base rates, would you agree that the
24 company absorbed some costs that were not covered by
25 either insurance or base rates?

1 A The 4 million, yes, sir. I just would not
2 characterize the 4 million as extraordinary.

3 Q Okay. Well, you said earlier that the company
4 had in effect insurance policies of 85 million per
5 occurrence, and I believe this order establishes, or
6 perhaps your testimony establishes that in addition to
7 that, customers were paying about a million dollars per
8 year in base rates towards the deductibles and the
9 accrual to the storm reserve.

10 Assume that these hurricanes had amounted to
11 \$120 million. In that scenario, under the insurance
12 regime, wouldn't Progress Energy have been required to
13 absorb some storm-related costs?

14 A To the extent that the reserve did not pay for
15 the balance, yes.

16 Q Okay. So the company was at risk for possible
17 storm costs that would not have been covered by the
18 insurance regime?

19 A Very minimal.

20 Q Okay. Let's say the hurricane was \$250 million
21 instead of 120. Is it still very minimal?

22 A Well, I would say that I don't believe that --
23 I would have to research the context in which this
24 reserve that was being maintained was established in
25 order to see if it contemplated an extraordinary type of

1 an event. It seemed like this arrangement, like the 6
2 million that we have on our books, was for the more -- I
3 would say the non-catastrophic type of storm that our
4 original '94 study contemplated. And if there were an
5 extraordinary event that exceeded both the policy, the
6 third-party insurer, as well as the reserve that was

7 built to cover the deductibles associated with those
8 policies, I would imagine that the company would have
9 come to the Commission with a similar petition seeking
10 recovery for the extraordinary events that could not and
11 would not have been contemplated in base rates.

12 Q And would you agree with me that the Commission
13 would have had the discretion to grant some, all, or
14 none of your request in that situation?

15 A That would be up to the judgment of the
16 Commission.

17 Q Your answer is yes?

18 A Yes.

19 Q So because of the uncertainty attached to any
20 petition you would have filed under those circumstances,
21 Progress Energy under the commercial insurance regime
22 was faced with potential risks of having to absorb
23 hurricane-related damages?

24 A Theoretically, yes.

25 Q Please refer to page 7 of your direct

1 testimony. I direct you to the answer that begins at
2 line 12, where you refer to Rule 25-6.0143(4)(b).

3 A Yes, sir.

4 Q There you say, under that rule, storm-related
5 costs may be charged to the reserve account regardless
6 of the balance in the reserve. "As a result, the

7 Commission recognizes there may be times when the
8 reserve can have a negative balance. What the
9 Commission has not addressed, however, is how a negative
10 storm damage reserve balance will be recovered by a
11 utility and over what period of time that recovery will
12 occur."

13 Do you intend to imply with this statement that
14 under the rule, of necessity, the utility will recover
15 any negative balance through a mechanism other than base
16 rates?

17 A No. I was simply quoting the rule, quoting the
18 fact that we were, under the rule, not allowed to
19 expense these costs, and acknowledging that this rule,
20 incorporated with the Commission's order in the
21 self-insurance proceeding, required the company to come
22 back to this Commission in the event that we exceeded
23 the reserve such that we could discuss the recovery of
24 those costs.

25 And in the initial petition that Progress

1 Energy, Florida Power at the time, presented to this
2 Commission in that self-insurance docket, we
3 acknowledged that it was our preference and our desire
4 that if we were in this situation, that we would be
5 coming back to the Commission seeking cost recovery
6 through a clause. So this is not new information to
7 this Commission. We have simply done what we said we
8 would do.

9 MR. MCGLOTHLIN: I want to distribute another
10 document for purposes of a question.

11 COMMISSIONER DEASON: Mr. Portuondo, while
12 they're distributing that, let me ask a question. You
13 just indicated in your last answer that it was your
14 understanding that a cost recovery clause mechanism was
15 envisioned. Envisioned by whom, and at what time frame
16 was that first proposed?

17 THE WITNESS: The company in its petition in
18 1993, in the direct testimony of John Scardino, outlined
19 exactly what the company would be proposing in the event
20 that a deficiency were to occur in the reserve. We
21 understood that the Commission was not going to approve
22 such a clause prior to an event taking place, but we
23 wanted to make sure that the record reflected that
24 that's what we envisioned would happen, given the fact
25 that base rates were never intended to recover a

1 catastrophic event.

2 COMMISSIONER DEASON: Was it envisioned that
3 there would be a recovery clause or that the excess
4 costs would be deferred, perhaps in a negative balance
5 in the reserve, and that at some future time the
6 Commission would determine how to eliminate that

7 negative balance on a going-forward basis?

8 THE WITNESS: No, sir. It was explicit. It
9 was a recovery clause.

10 COMMISSIONER DEASON: And where is that? That
11 is within the study that was filed?

12 THE WITNESS: That is, I believe, within the
13 study, as well as in the direct testimony of Mr. John
14 Scardino.

15 BY MR. MCGLOTHLIN:

16 Q Again, Mr. Portuondo, I've given you a
17 document. I don't need it marked as an exhibit. This
18 is Order No. PSC-93-0918-FOF-EI issued in Docket 930405
19 on June 17, 1993. And I think you'll recognize it as
20 one of the orders that the parties have cited frequently
21 in this proceeding.

22 Referring again to page 7 of your direct
23 testimony, in describing Rule 25-6.0143(4)(b), you say
24 that what the Commission has not yet addressed is how a
25 negative storm damage reserve will be recovered by a

1 utility and over what period of time that recovery will
2 occur.

3 Please turn to page 3 of the order I provided
4 to you. You see there that in this order, the
5 Commission referred to and quoted from the same rule.
6 Do you see that, sir?

7 A Yes, I do.

8 Q And you recognize this as the order which was
9 issued by the Commission in response to FPL's request
10 for its counterpart self-insurance program, do you not?

11 A Yes.

12 Q So this was issued in the context of a request
13 for a self-insurance program and in the context of the
14 application of the same rule.

15 Now, please look at page 5 of the order. And
16 would you read the first -- I'm sorry, the third full
17 paragraph on that page?

18 A "If FP&L experiences significant storm-related
19 damage, it can petition the Commission for appropriate
20 regulatory action. In the past, the Commission has
21 acted appropriately to allow recovery of prudent
22 expenses and has allowed amortization of storm damage
23 expense. Extraordinary events such as hurricanes have
24 not caused the utility to earn less than a fair return,
25 and FP&L has shown no reason to believe that the

1 Commission will require a utility to book exorbitant
2 storm losses without recourse."

3 Q And one more passage for purposes of the next
4 question, if you would begin with the last paragraph and
5 continue on to the next page.

6 A "If FP&L suffers storm damage and finds it
7 necessary to draw on its line of credit, it will be able
8 to request that some or all of the storm-related costs
9 be passed on to customers. **In such an emergency**
10 situation, this Commission will act quickly to protect
11 the company and its customers. FP&L shall be allowed to
12 defer the storm damage losses until the Commission acts
13 on any petition filed by the company."

14 Q And continue on, one more paragraph. I promise
15 that's the last one.

16 A "The Commission will expeditiously review any
17 petition for deferral, amortization, or recovery of
18 prudently incurred costs in excess of the reserve. Our
19 vote today does not foreclose or prevent further
20 consideration at a future date of some type of cost
21 recovery mechanism, either identical or similar to what
22 has been proposed in this petition. The Commission
23 could implement a cost recovery mechanism, or defer the
24 costs, or such other treatment as is appropriate,
25 depending on what the circumstances are at the time."

1 Q In your testimony, Mr. Portuondo, you said that
2 the Commission has not answered how a utility would
3 collect a negative balance, but isn't it true in this
4 order the Commission made it clear that in such a
5 situation, it wanted to keep all its options open and
6 would prescribe a treatment that would be specific to
7 the circumstances of that case?

8 A Yes. And I think what I was getting at is that
9 I don't think that the Commission has been faced with
10 such an event and has yet to apply the statements in
11 that order.

12 Q Looking at the last sentence again, the
13 Commission could implement a cost recovery mechanism, or
14 defer the costs, or begin amortization, or such other
15 treatment as is appropriate. Would you agree with me
16 that those approaches identified in this order are an
17 array of separate and different, distinct mechanisms
18 that the Commission was referring to?

19 A Yes. The Commission through those statements
20 has given itself many options from which to choose. Our
21 petition here today is consistent with the position that
22 the company took back in 1993. And we have stood behind
23 what we said when we established this mechanism, that we
24 believe that extraordinary events were not part of base
25 rates, and therefore more appropriately dealt with in a

1 cost recovery mechanism, similar to other volatile
2 costs.

3 Q Isn't it true that in the same order we're
4 talking about here, the Commission was critical of FPL's
5 approach because FPL did not take into account the
6 utility's earnings or achieved rate of return?

7 A That is a fact. Again, I don't know exactly
8 what staff was interpreting with regards to base rates
9 versus non-base rate expenditures.

10 Q Don't base rate and non-base rate expenditures
11 contribute to the calculation of earned rate of return?

12 A No, sir. This Commission has a longstanding
13 policy of two types of costs. You have the normal
14 recurring costs which are built into base rates. The
15 other type of costs are the costs that are considered in
16 a pass-through mechanism, which are volatile and hard to
17 predict, and for which the company, as long as it
18 prudently expends those costs, is entitled to dollar for
19 dollar recovery of those costs.

20 Q I understand your statement now.

21 You referred earlier to the petition that
22 Progress Energy filed in 1993. And in that submission,
23 is it true that Progress Energy proposed to identify the
24 costs associated with storms as regulatory assets
25 subject to a recovery mechanism outside of base rates?

1 A I don't understand the question. As a
2 regulatory asset? I don't understand.

3 Q You don't recall that? All right. I'll come
4 back to that in a moment.

5 CHAIRMAN BAEZ: Mr. McGlothlin, I think the
6 witness didn't understand the question. Maybe if you
7 rephrase it, he'll have an answer for you.

8 MR. MCGLOTHLIN: What I would like to do is
9 provide the order to which I'm referring. And I've
10 misplaced it for the time being, but I think I'll come
11 back to it, if I may.

12 BY MR. MCGLOTHLIN:

13 Q Please turn to page 4, line 18, of your direct
14 testimony. There you describe Progress Energy's
15 self-insurance plan as containing three components, the
16 continued search for the availability of commercial T&D
17 insurance in adequate amounts at reasonable prices,
18 ongoing accruals to an unfunded storm damage reserve to
19 address the costs incurred as a result of
20 non-catastrophic storms, and thirdly, the ability to
21 request additional cost recovery in the event that storm
22 costs exceed the storm damage reserve.

23 I want to ask you a couple of questions to see
24 if I understand the manner in which you envision this
25 three-component plan working. First of all, when you

1 say the third component is the ability to request, would
2 you agree with me that the ability to request does not
3 necessarily translate into a response that grants your
4 request in the form presented?

5 A I don't pretend to prejudge the Commission's
6 decision.

7 Q Let me pose to you a simple hypothetical. And
8 for purposes of the question, let's assume -- although
9 we disagree strongly, let's assume that the stipulation
10 is not a consideration and has no effect one way or the
11 other. This is a utility that has no such stipulation
12 in effect, and it has an approved range on equity of 10
13 to 12%. Let's assume that it has a hurricane experience
14 and places the associated costs in its storm reserve.
15 And in this hypothetical, the utility would have made an
16 11% return on equity, but if its request for recovery of
17 these costs in the reserve is denied and it's required
18 to absorb those costs, it will instead earn 10.6%.

19 As you understand it, with respect to this
20 three-component plan, in that situation, what would
21 happen?

22 A Well, first of all, I would have to ask myself
23 whether the storm experience in that hypothetical was of
24 the nature contemplated by the reserve that had been
25 created.

1 Q Okay. Assume that's the case.

2 A If that's the case, then the deficiency in the
3 reserve would remain and be funded by the normal annual
4 accrual, and it still would not be an impact to the
5 earnings of that company. The Commission has already
6 outlined in its rule that Account 228 can appropriately

7 remain as a negative balance. The accrual, of course,
8 is intended to address non-catastrophic storms, and the
9 accrual is set on a levelized basis, because you don't
10 necessarily plan to have that non-catastrophic storm
11 every single year. It's on a probabilistic approach.
12 So in a non-catastrophic event, the normal accrual will,
13 in essence, pay down that deficiency.

14 If it were an extraordinary catastrophic event
15 that the base rates never contemplated, then I believe
16 that is the recovery that I am discussing here in my
17 testimony, is that we in our petition in '93 made it
18 clear that our study represented non-catastrophic, and
19 that if there were a catastrophic event and the funds
20 were depleted, we would be seeking recovery of those
21 costs outside of base rates.

22 Q Okay. Let's modify the scenario slightly. The
23 approved range, authorized range is still 10 to 12%.
24 The utility would achieve 13.5% but for the hurricane
25 costs, but if its request for recovery is denied and

1 it's required to absorb those costs, it will instead
2 earn 13.1%. Does your answer change at all?

3 A No, as long as the circumstances I laid out for
4 you were the same as far as the type of storm.

5 Q Okay. Assume the same situation, the same
6 authorized return of 10 to 12%. **Assume that the utility**

7 would achieve 18% but for the hurricane, but if it's
8 required to absorb costs, it will achieve 17.5%. In
9 that situation, under the three-component plan that
10 you've described, should the utility seek recovery of
11 those costs?

12 A Yes, sir. If it's a catastrophic event, yes,
13 sir.

14 Q Okay. Even though by absorbing all those
15 costs, it would still continue to earn 5% above its
16 authorized range?

17 A Yes, sir. As I've stated, these type of
18 expenditures are not contemplated in base rates. **The**
19 shareholders' equity return does not contemplate taking
20 on the risk of catastrophic events. If it were to
21 include that type of risk profile, you would see much
22 greater returns on equity.

23 Q In that hypothetical, do you think it would be
24 appropriate for the Commission to take into account the
25 fact that this hypothetical utility would earn 17%

1 notwithstanding the storm costs in determining whether
2 to grant that petition or not?

3 A I think the Commission within its base rate
4 authority would have probably already called in that
5 utility and adjusted base rates accordingly.

6 Q No, don't change the hypothetical. In that
7 situation.

8 A I would assume that they would adjust base
9 rates. I mean, that's my answer.

10 Q Is there any point in the spectrum in terms of
11 the earnings of the utility and the achieved rate of
12 return at which you believe either the utility should
13 not request recovery outside base rates or the
14 Commission would be within its regulatory discretion to
15 take that into account in responding to such a petition?

16 A I think it's always within the Commission's
17 discretion to take all facts into consideration. I
18 don't believe that it's appropriate, given the
19 regulatory compact and rules and regulations that have
20 evolved in the State of Florida. Like I mentioned
21 earlier, there's a separate and distinct treatment for
22 the two types of costs that I mentioned before, and the
23 Commission has always seemed to adhere to those two
24 types of treatment.

25 A perfect example was the post-9/11 security

1 expenditures. No one could have envisioned the
2 utilities having to incur the magnitude of costs that
3 they had to incur. The Commission in its wisdom saw fit
4 that those types of extraordinary and volatile costs
5 should be recovered through a pass-through mechanism.

6 Q In that same answer, you indicated that the
7 third component is the ability to request additional
8 cost recovery in the event that storm costs exceeded the
9 storm damage reserve. Would you agree with me that
10 additional cost recovery does not necessarily mean a
11 cost recovery clause?

12 A No, sir. I would agree that it doesn't
13 necessarily mean that, but in the case of our petition,
14 as I have explained, we made it perfectly clear in '93
15 that that was the policy that we thought was most
16 applicable to these types of costs, and we've never
17 deviated from that.

18 Q In his opening statement, your counsel referred
19 to a mechanism of a two-year surcharge. Would a
20 two-year surcharge on base rates designed to recover the
21 same amount of dollars put the company in the same
22 position as would this cost recovery clause that you've
23 described in your testimony?

24 A I believe would be one and the same. It's
25 separate and independent from base rates.

1 Q Well, if it's a surcharge to base rates, does
2 that not become part of base rate revenues?

3 A I personally believe it should be a clause
4 mechanism separate from base rates, because it's not
5 something that I would be permitted to include in a base
6 rate proceeding. As even your witnesses have

7 articulated, it would not be a component of base rates
8 in a rate case type proceeding. So I would think that
9 the Commission would not want to, in essence,
10 contaminate the process by calling it a base rate
11 surcharge.

12 Q Please turn to page 3 of your prefiled
13 testimony, direct testimony. At the bottom of page 3,
14 you make this statement. "Under the proposed storm cost
15 recovery clause, the company seeks to recover the
16 remaining retail O&M expenses of 251.9 million, plus
17 interest, in equal amounts over a two-year period." Do
18 you see that statement?

19 A Yes, I do.

20 Q So this mechanism would be designed to last for
21 the two-year period proposed for the recovery of this
22 specific amount of dollars?

23 A Yes. Our proposal before the Commission is a
24 mechanism that will begin and end as it relates to the
25 recovery of the 2004 hurricane costs only.

1 Q Okay. Now, you're familiar with the fuel cost
2 recovery clause that the Commission allows electric
3 utilities under its jurisdiction to implement, are you
4 not?

5 A Yes, I am.

6 Q And the conservation cost recovery clause?

7 A Yes, I am.

8 Q And the environmental cost recovery clause?

9 A Yes.

10 Q Do any of those -- are any of those limited to
11 a specific time frame?

12 A No, they're not.

13 Q Please turn to page 16 of your prefiled
14 testimony. Beginning at line 10, you state, "A storm
15 cost recovery clause is, therefore, the most suitable
16 recovery mechanism for the extraordinary, volatile,
17 irregular, and unpredictable storm-related costs
18 incurred by PEF due to Hurricanes Charley, Frances,
19 Ivan, and Jeanne." Do you see that?

20 A Yes, I do.

21 Q Do you still have the FPL order that I gave you
22 a moment ago?

23 A Yes.

24 Q Please turn to page 5. Would you read the
25 second full paragraph on page 5 beginning with "storm

1 repair expense"?

2 A Yes. "FP&L's proposal does not take into
3 account the utility's earnings" --

4 Q Sir, I believe you're in the wrong place.

5 A Okay.

6 Q It's the second full paragraph.

7 A Second full. Okay. Storm repair?

8 Q Yes.

9 A "Storm repair expense is not the type of
10 expenditure that the Commission has traditionally
11 earmarked for recovery through an ongoing cost recovery
12 clause. Conservation, oil backout, fuel, and
13 environmental costs are currently recoverable under
14 Commission created cost recovery clauses. **These**
15 expenditures are different from storm repair expense in
16 that they are ongoing rather than sporadic
17 expenditures."

18 Q I want to focus for a moment on your testimony
19 at page 10. Beginning at line 14, you describe Progress
20 Energy's proposed treatment of capital costs, do you
21 not?

22 A I'm sorry. What line did you say?

23 Q Line 14.

24 A Yes.

25 Q And as I understand it, the proposal in this

1 case with respect to capital costs is to charge to the
2 storm reserve only the incremental costs above those
3 typically incurred under normal operating conditions for
4 capital expenditures; is that correct?

5 A Yes, it is.

6 Q And to implement that concept, as I understand
7 it, for accounting purposes, with respect to the plant
8 items that replaced damaged plant, it's necessary to
9 estimate, or rather quantify what it would have cost the
10 company under non-storm conditions, apply that to the
11 plant-in-service accounts, and charge the increment or
12 premium caused by the storm conditions as extraordinary
13 O&M to the storm reserve; is that correct?

14 A That's correct.

15 Q And at one point recently, the estimate of
16 those capital costs that would be recorded in rate base
17 was \$48 million. Is there any update on that?

18 A No.

19 Q That's the current number?

20 A That is the current number.

21 Q And do I understand correctly that you
22 personally and Progress Energy Florida as a corporation
23 regards this as the appropriate way to handle capital
24 costs for purposes of the storm reserve?

25 A Yes, sir. This is consistent with the

1 methodology that we put forth in 1993, 1994.

2 Q Okay. And I think at one point, either in your
3 testimony or in response to discovery, you made the
4 observation that charging the extraordinary portion to
5 the storm reserve would prevent customers from being
6 affected by an inflated rate base, unduly inflated; is
7 that correct?

8 A That's correct.

9 Q And by the same token, would you agree with me
10 that by placing the appropriate portion of capital costs
11 in rate base, this prevents the customers from dealing
12 with an understated rate base and an onerous storm
13 charge situation?

14 A Yes. I think our methodology is the correct
15 methodology. It places the investment on the books at a
16 normal value on which the shareholders would be entitled
17 to earn a return, similar to the assets that were on the
18 books prior to the storm.

19 Q Okay. Please turn to page 12 of your
20 testimony. At line 17, you state with respect to the
21 capital items that would be placed in rate base, "All
22 other storm-related capital expenditures will be
23 included in ongoing surveillance reports to the
24 Commission and will be absorbed by the company in
25 current base rates until the next base rate

1 adjustment." Do you see that statement?

2 A Yes, I do.

3 Q And when you say those capital expenditures
4 will be absorbed by the company in current base rates,
5 do I understand that correctly to mean that those costs
6 are recovered through base rates, with the effect that

7 earnings are impacted until the base rate proceeding
8 occurs?

9 A Yes, sir. To the extent that current revenues
10 support that level of investment, yes.

11 Q So with respect to those items charged to the
12 storm reserve, if the Commission in its discretion saw
13 fit to require Progress Energy to bear responsibility
14 for a portion of them and to require customers to bear
15 the other portion, with respect to the portion for which
16 the company is responsible, and expenses as it sees
17 lower earnings, it has in fact recovered those
18 storm-related costs, has it not?

19 A No, sir, it has not, because there are other
20 costs that the company has to expend. As other
21 witnesses have articulated, there are costs associated
22 with the backlog work. There are revenues that were
23 forgone because customers weren't using power during
24 their outages. Again, it's the concept of the base
25 rates were not intended to cover extraordinary costs of

1 catastrophic hurricanes. That was not the purpose of
2 base rates.

3 And the shareholders when the last rate case
4 was settled or litigated had an understanding. The ROE
5 that was accepted by the company, as your witnesses have
6 tried to indicate, does not include having to bear the

7 risk of, in essence, losses attributable to catastrophic
8 hurricanes. Their expectations of a return from a
9 utility that's required to assume the risk of a
10 potential \$200 million loss in any one year would be
11 significant.

12 Q I want to make sure I understand the answer.
13 Let's assume that in this proceeding, the Commission
14 determines that the balance in the storm reserve is a
15 negative \$100 million, for purposes of a hypothetical.
16 And let's assume that after reviewing the contentions,
17 it decides to permit Progress Energy to collect 50
18 million from customers and to expense the other \$50
19 million and absorb it through earnings. What part of
20 that \$100 million has the company not recovered?

21 A I would say the \$50 million that it has to
22 absorb in earnings that it would have otherwise been
23 entitled to retain for the risks its shareholders have
24 agreed to assume.

25 Q Now, a moment ago you said with respect to the

1 capital items that are not being put in the storm
2 reserve, but in fact are instead being placed in rate
3 base, you agreed with me that as the company, in your
4 words, absorbs those costs, those costs are recovered,
5 even though earnings fall as a result. **Do you remember**
6 that statement?

7 A Capital costs, in essence, are replacing the
8 capital assets that were already on the company's
9 books. It's kind of a one-for-one swap. The valuation,
10 yes, could be slightly different, because these are
11 newer assets versus the net book value of the older
12 assets, but it's a replacement of an existing investment
13 on which the shareholders are earning. The O&M cost is
14 not. It's an immediate impact to the profitability and
15 the earnings potential of the shareholders for which
16 there was no risk offset in the rates that the company
17 was awarded in the last base rate proceeding.

18 Q Okay. A moment ago you said in your answer
19 that the capital items are -- I believe you said a swap;
20 is that correct? Did you use that term?

21 A Yes. You retire the old and put on the new.

22 Q Are you suggesting a one-for-one relationship
23 there dollarwise?

24 A No. I made clear that the value of the new
25 assets might be greater than the value of the old

1 assets. And the shareholders are -- since they're
2 entitled to a return, are willing to front the cash
3 necessary to make that replacement happen. And that is
4 part -- since it is a replacement of an investment that
5 was in base rates, that is an appropriate base rate
6 item. These expenditures were not.

7 The reserve, inherently, if you go back to the
8 Commission's approval of the reserve, it was an O&M
9 reserve. It was not an O&M and capital reserve. It was
10 simply an O&M. The Commission knew that the utilities,
11 in the event of a storm, would be replacing capital, and
12 the shareholders would be earning a return on the
13 appropriate value of that. But as it relates to the
14 expenses that the Commission approves dollar for dollar
15 recovery of prudent ongoing expenditures, that was only
16 set at \$6 million.

17 Q So even if -- after expensing the allocated
18 portion of the negative balance, and assuming that the
19 company continues to, let's say hypothetically, achieve
20 a 10% return on equity, are you saying as a professional
21 accountant that the company has not recovered those
22 costs?

23 A Yes. I'm saying that the company has not
24 recovered what it would have otherwise have been
25 entitled to, the expectations of its shareholders, so

1 therefore they have earned a lower return than they
2 would have otherwise had, and they've incurred a loss.

3 Q Okay. Well, I think you said something very
4 different just now. You said in your answer just now
5 that the company will have earned a lower return, and I
6 agree with you.

7 A Well, that's what I said before, than they
8 would otherwise have earned.

9 Q Yes, but isn't that different than saying that
10 the company has not recovered its costs?

11 A In my opinion, if I was expecting to earn 12%
12 and I only earned 10, I would say I have not recovered
13 my costs.

14 Q Are you now saying you haven't recovered your
15 cost of equity or that you haven't recovered your costs,
16 the storm costs?

17 A Well, in essence, we use return on equity as a
18 measure of recovery. If I achieve my return on equity,
19 then that means I've recovered the recovery of my costs,
20 my periodic costs, as well as an appropriate return on
21 my investment. If I target that number to earn
22 something less, I would say I've not recovered those
23 costs.

24 Q Let's assume that there are two utilities, and
25 they're identical in every respect, except one has

1 higher costs than the other. And after -- the revenues
2 are the same, and the costs are different. And Utility
3 A, after paying all of its bills and calculating its net
4 income and relating that to rate base, has a return on
5 equity of 12%. The other has the same revenues, same
6 rate base, slightly different costs, so it does the same

7 calculation and has a 9% return on equity. With respect
8 to the costs incurred and paid, has either utility
9 failed to recover any of its costs?

10 A Yes. I mean, if the Commission has established
11 revenues to achieve a certain return, if that return is
12 not achieved and you earn a 9% return, that means that
13 earnings that would have otherwise have been meant for
14 the shareholders of the company are having to be used to
15 fund the expenses because there were insufficient
16 revenues to cover those expenses.

17 Q But my assumption is that the revenues cover
18 the expenses and there's something left over to provide
19 a positive return. Do you understand? That's part of
20 the hypothetical.

21 A Well, you said the return went down.

22 Q Yes, but it's still a positive return.

23 A But that doesn't matter. If the Commission
24 says that we are allowing the company to recover its
25 costs and a reasonable return, if I have to apply

1 earnings that the shareholder would have otherwise have
2 earned to cover the expenses, then I'm not really
3 getting the revenues to cover those current period
4 expenses.

5 Q Another item that you described in testimony is
6 the cost of removal associated with removing the damaged
7 plant. Do I understand correctly that the company
8 intends to identify the cost of removing the damaged
9 plant and booking that to its cost-of-removal reserve
10 rather than charging it to the storm reserve?

11 A Absolutely.

12 Q The most recent estimate I've seen with respect
13 to the cost of removal that you intend to charge to the
14 cost-of-removal reserve is about \$900,000. Is there an
15 update on that?

16 A Mr. Wimberly may have that. I do not.

17 Q If you know, is that approximately what has
18 been estimated recently?

19 A Pardon?

20 Q If you know, is this amount approximately what
21 has been estimated by the company recently?

22 A I believe so. For some reason I had like a
23 million 2, but subject to check.

24 Q Okay. For purposes of our conversation, then
25 roughly a million dollars? Can we work with that?

1 A Yes.

2 Q And do I understand correctly also that the
3 company intends to retire approximately 19 to \$20
4 million of plant associated with the plant that has been
5 removed?

6 A That's probably correct.

7 Q And that would be a ratio of about -- relating
8 the cost of removal to the amount of retirement, it's
9 approximately 5%; is that correct?

10 A Yes.

11 Q Isn't it true, Mr. Portuondo, that with respect
12 to the most recent depreciation study, the ratio between
13 cost of removal and the amount of reasonable cost
14 recorded in rate base with respect to transmission and
15 distribution assets is 50% or greater typically?

16 A That was the allocation that was necessitated
17 as a result of FAS 143. That's what I believe you're
18 referring to, that we provided in discovery. That was
19 again to be taken with a grain of salt, I believe,
20 because it was a mathematical calculation that -- we
21 attempted to quantify something that had never been
22 quantified before, and that was the separation of the
23 three components that are built into the depreciation
24 rate, which is the life depreciation, of course, and the
25 cost of removal and salvage. I say that because it

1 appears that in the new depreciation study that we're
2 producing, the amount assigned to cost of removal is
3 much lower through the consultant's theoretical
4 calculation.

5 Q How much lower?

6 A I don't have that number with me, but we can
7 provide it.

8 Q Well, a moment ago we agreed that with respect
9 to the values assigned to cost of removal and retirement
10 so far, the ratio is only about 5%.

11 A That's the actual. That's the actual cost that
12 we would have envisioned expending to accomplish the
13 removal task of those assets.

14 Q Is it the cost of removal that is built into
15 the depreciation rate?

16 A No, it would not be, because the
17 cost-of-removal rate that's built into the depreciation
18 factor is a mathematical calculation of the historical
19 trends that one sees in removal. It's an estimate in
20 order to build a reserve. And the Commission's policy
21 and rules are that you calculate this reserve, and you
22 apply to it the actual costs incurred, and then,
23 therefore, the next time you do the depreciation study,
24 if the experience, if the actual experience turns out to
25 be different than what you have, in essence, been

1 forecasting, then your depreciation factor would be
2 correspondingly adjusted.

3 Q I need to ask you a question to see if I
4 understood your last answer.

5 A Sure.

6 Q Let's assume the company installs a brand new
7 pole, and the investment recorded in the
8 plant-in-service account is \$200. Obviously, I don't
9 know what things cost. I'm making things up. Let's
10 also assume that built into the depreciation rate is an
11 anticipated cost of removal of \$75. The next day a
12 truck runs into the pole and knocks it over, and the
13 company removes it. What cost of removal do you charge
14 to the reserve in that situation?

15 A Whatever it truly cost me to move that physical
16 facility. If it cost me \$100, I would charge \$100. If
17 it cost me \$25 because the facility is already on the
18 ground and all I have to do is kind of haul it away, it
19 would be \$25. It's what actual cost I occur is what's
20 charged to the reserve. And that's Commission policy.

21 Q And does the company keep records of the cost
22 of removing each item of plant for that purpose?

23 A It depends on the category of plant. As you're
24 aware, there are some groups of property that are kept
25 on mass accounting or vintage accounting. So it

1 wouldn't be every specific pole, but everything done in
2 that particular month or quarter would be accumulated
3 and then booked on an annual basis. But it would always
4 be the actual cost experienced to take away that
5 facility.

6 Q With the 5% ratio that we established a few
7 minutes ago, does that low ratio suggest to you that the
8 cost of removal has been understated by those who
9 estimated it?

10 A I don't necessarily know if I can go that far.
11 But as is becoming apparent from our consultant's
12 report, it does appear that cost of removal is
13 declining.

14 Q Would it follow that the existing
15 cost-of-removal reserve is currently overfunded?

16 A In fact, in certain accounts, that is precisely
17 what we're seeing, and therefore it is driving down the
18 new -- the depreciation rates as we currently know them
19 to be, they are coming down.

20 Q You've referred a couple of times to a
21 consultant's report. What is the status of Progress
22 Energy's next depreciation study?

23 A We're this close (indicating). It's still in
24 draft form. There are a few things that still need to
25 be worked out. And hopefully in the next month, month

1 and a half, we will have things worked out.

2 Q When do you contemplate filing the study?

3 A As soon as it's complete and passes my
4 approval.

5 Q If you're this close, are you in a position to
6 say whether the company and its consultants have

7 identified the extent of any depreciation reserve
8 excesses?

9 A Depreciation reserve excesses? We're switching
10 now from the cost of removal or total --

11 Q Yes. Now we've jumped to the overall
12 depreciation study.

13 A Overall depreciation study. I would say there
14 are still some things that need to be validated, but I
15 believe that the rates will prove themselves to be lower
16 than what they are today.

17 Q On an overall basis, is the company overfunded
18 with respect to the depreciation reserves?

19 A I guess I wouldn't -- you continue to use the
20 characterization of overfunded, and I would say it's not
21 really over- or underfunded. It's a function of the
22 expected life span of the facilities that you're
23 analyzing. And over time, you could find yourself, as
24 you say, overfunded because the life spans have been
25 longer than you previously had perceived them to be, or

1 you could be underfunded if the life spans are shorter.
2 So again, it's an analytical calculation that is a
3 function of a number of variables which don't
4 necessarily lend themselves to be categorized as over-
5 or underfunded. It's just a new target that is
6 established by the remaining lives that you calculate
7 for each of your investments.

8 Q Well, a new remaining life is one means with
9 which to address an excess situation, but there are
10 other possible avenues; isn't that correct?

11 A Well, I don't view them as an avenue to achieve
12 a means. I see the remaining lives as the key variable
13 in determining what's the right depreciation rate. I
14 mean, the remaining life is a function of the economic
15 and technical aspects of the asset, can it be run, will
16 it be economical to run, can it withstand the elements
17 as the manufacturer had asserted them to be able to
18 achieve a certain life. I mean, you do that, and then
19 that will lend itself to how much of a depreciation rate
20 you would calculate.

21 Q Well, if the company has an excess or surplus
22 in one reserve and a deficiency in another, isn't one
23 way to address that situation simply to move the excess
24 to the deficiency?

25 A No, I think that's inappropriate. I think

1 they're separate and distinct. And I think the
2 mechanism that the Commission has to address it is
3 prudent and has served us well since the depreciation
4 studies have been developed, and that is simply to
5 modify the rates going forward, and it is
6 self-correcting at that point.

7 Q Are you familiar with the concept of a capital
8 recovery schedule?

9 A Yes.

10 Q And would you agree then that by prescribing
11 such schedules, it's possible to deal with a deficiency,
12 for example, in a period that is not necessarily the
13 remaining life of the asset?

14 A Yes, but that's different than moving dollars
15 from one reserve to another reserve to address a
16 particular issue.

17 Q Please turn to page 11. On page 11 you list
18 examples of the types of cost the company charges to the
19 storm damage reserve. And here we've changed subjects
20 again. I'm now talking about O&M. And there you
21 describe it as follows: All actual repair activities
22 and those activities directly associated with storm
23 damage and restoration activities. And examples of
24 direct costs you provide in your testimony are payroll,
25 transportation, materials and supplies, and other

1 services necessary to locate and repair or replace
2 damaged property. Do you recall that statement?

3 A Yes, sir.

4 Q Later in your testimony you say that the
5 company intends to charge to the storm reserve what you
6 describe as identifiable bad debt writeoffs. Are you

7 familiar with that?

8 A Yes, sir.

9 Q Now, a bad debt writeoff, do I understand
10 correctly that that's a situation in which a customer
11 owes the company money, has not paid, and the decision
12 is made to write it off?

13 A Yes, sir.

14 Q Would you agree with me that as defined, that
15 is something other than services necessary to locate and
16 repair or replace damaged property?

17 A I would say yes and no. I would say yes, that
18 is not an activity associated with uncollectible, and I
19 would say no because it's an unfortunate outcome of
20 redeploying one's workforce to address the immediate
21 needs associated with the hurricanes that hit Florida.
22 There were customers, of course, that still had power
23 that would have otherwise have been disconnected for
24 nonpay, that went on receiving service because we were
25 having to address the immediate needs of our citizens in

1 need. So that is the reason that that type of cost was
2 included in our petition for self-insurance.

3 Q But if I understand your answer, you do not
4 contend that that's an example of a service necessary to
5 locate and repair or replace damaged property; is that
6 correct?

7 A No, it is not. It's a consequence of having to
8 perform those functions and not being able to perform
9 the functions that those individual employees were
10 normally assigned to do.

11 Q Please look at page 5 of your rebuttal. I
12 refer to the question and answer that begin at line 7.
13 In response to the question, "Did the utilities and the
14 Commission contemplate the possibility that storm costs
15 might exceed the amount accrued in the reserve," you
16 answer, "Yes, they did. The subject was discussed in
17 the course of the proceedings. The Commission assured
18 FPC that it would, quote, expeditiously review any
19 petition for deferral, amortization or recovery of
20 prudently incurred costs in excess of the reserve." Do
21 you see that statement?

22 A Yes, I do.

23 Q Would you agree with me that the only assurance
24 provided was that review would occur expeditiously?

25 A Well, no. I disagree with that. I believe

1 that some form of recovery for those costs was
2 contemplated when the Commission made those statements.

3 Q And with respect to the statement, the specific
4 forms of recovery contemplated were deferral,
5 amortization, or recovery; correct?

6 A Yes, sir, exactly.

7 Q So recovery means, as I understand the use
8 here, recovery through a mechanism in addition to base
9 rates; correct?

10 A Yes. They articulated the various options they
11 had available to them in the FP&L proceeding. **We made**
12 it clear what we would petition in such an event when we
13 sought the self-insurance policy, and we have done just
14 that.

15 Q And based on this language, one option the
16 Commission reserved to itself was to provide
17 amortization instead; is that correct?

18 A Yes. I don't necessarily agree that that
19 should be applied in this particular situation. I
20 believe that these costs are exactly the type of costs
21 that the Commission has dealt with in mechanisms outside
22 of base rates.

23 Q I understand you disagree that that's an
24 appropriate choice, but it's a choice the Commission
25 reserved in its discretion?

1 A Yes, and I've said that, yes.

2 Q And if, for instance, in this case, for
3 whatever reason, it determined that the negative balance
4 in the storm clause is \$50 million, and it also decides
5 that given the company's earnings situation, it would be
6 appropriate to tell the company to amortize that \$50

7 million over five years without any additional measures,
8 that would be an example of the application of the
9 amortization approach as opposed to the others
10 mentioned, would it not?

11 A That is an application of that approach. I
12 would think that such an action would send a very
13 negative message to the investors of the utility as to
14 the level of risk that they're truly being asked to
15 take.

16 Q At page 7 of your rebuttal testimony, you quote
17 from the study that Progress Energy submitted to the
18 Commission, and you state, "The replacement cost
19 approach assumes that the total cost of restoration and
20 related activities will be charged against the storm
21 damage reserve." Do you see that statement?

22 A Yes.

23 Q I want to refer you to the study itself, which
24 is attached to your testimony. Are you there?

25 A Which page of the study?

1 Q Please turn to page 9.

2 A Yes.

3 Q Would you read the second paragraph on page 9,
4 which contains some language that was not quoted in your
5 testimony?

6 A The company anticipates charges (sic) in its
7 insurance program in the near future as the insurance
8 industry begins to recover from the crisis situation of
9 recent storm damage experience. However, the company
10 believes its insurance program will continue to be a
11 combination of total (sic) insurance coverage along with
12 some level of self-insurance. Any requirement to use an
13 approach other than replacement cost would place undue
14 administrative burden on the company, which would
15 presumably occur at a time when the company's efforts
16 would need to be dedicated to the restoration of service
17 and related activities."

18 Q Now, by administrative burden, if you know, did
19 the author of this study mean the requirement that
20 separate records be kept for insurance purposes and for
21 our regulatory accounting purposes?

22 A Well, I believe what was meant from
23 administrative burden is the simple fact that you would
24 be requiring your personnel in the field to be keeping
25 time records in such a fashion that would hinder their

1 ability to restore quickly and effectively in order to
2 maintain those two sets of books, one for ratemaking and
3 one for insurance purposes.

4 Q Now, beginning at page 9, the caption is
5 "Section IV, Accounting Issues," and that continues
6 through page 11. Does that constitute the entire

7 portion of the study that addresses the accounting
8 methodology?

9 A No, sir. There's, I believe, an Exhibit No. 3
10 that also details the types of costs. There's also, I
11 believe, an exhibit that simulates the accounting
12 journal entries, which is Exhibit No. 4. These were all
13 at the request of the Commission.

14 Q All right. I see those exhibits. Does the
15 study at any point identify rationale in support of the
16 replacement costs that is in addition to or that is
17 different from what we've just addressed here?

18 A I believe there are other maybe limited
19 passages in the other sections that may address the
20 operation of third-party insurance and how the
21 replacement costs worked and how this self-insurance
22 mechanism was intended to simulate that. I'm not 100%
23 sure. I would have to read the entire document again
24 to be certain.

25 Q Okay. From what you just said, I gather that

1 any additional references would be basically related to
2 the same rationale, which is the advantage of using an
3 approach that mirrors replacement insurance and how it
4 works; is that correct?

5 A Yes. And I would say that it's a very -- it's
6 a fair methodology, given that --

7 Q The question is what's in the study,
8 Mr. Portuondo.

9 A Yes. This is it right here.

10 Q Is it true that Progress Energy currently does
11 not have commercial insurance in place on transmission
12 and distribution assets?

13 A Transmission and distribution pole and lines,
14 that is correct. We do have that coverage on
15 substations, though.

16 Q Earlier we discussed the fact that with respect
17 to capital items, the company is pursuing an approach
18 which requires the quantification of the normal amount
19 of capital costs that would have incurred in a non-storm
20 situation and the actual cost of removal, both of which
21 are being charged to accounts other than the storm
22 reserve; is that correct?

23 A That is correct. The storm reserve was an O&M
24 reserve.

25 Q And in testimony, you described your approach

1 to capital items as quantifying only the increment above
2 the normal amount and classifying that as extraordinary
3 O&M and charging it to the storm reserve; is that
4 correct?

5 A Yes.

6 Q Would you agree with me that that is a form of
7 an incremental approach with respect to capital items?

8 A Yes, I would agree that is a form of
9 incremental accounting.

10 Q Please turn to page 16 of your rebuttal.

11 Oh, before we leave the study, in opening
12 remarks your counsel alluded to utilities, plural,
13 taking on the incremental approach in studies, plural.
14 But in fact, in Progress Energy's study, there's no
15 mention of an incremental approach, is there?

16 A I didn't get the gist of that question. Would
17 you repeat it, please?

18 Q In the Progress Energy storm damage methodology
19 study, do you agree with me that nowhere in the study
20 does Progress Energy address the merits or demerits of
21 the incremental approach?

22 MR. WALLS: I'm going to object to the form of
23 the question. I believe the prior question on his
24 testimony didn't relate to an incremental approach, so I
25 think it mischaracterizes his testimony.

1 MR. MCGLOTHLIN: I'm not referring to his
2 testimony. I'm simply asking the witness to confirm my
3 understanding that the Progress Energy study addresses
4 only the replacement cost approach and does not attempt
5 to analyze the advantages or disadvantages of other
6 approaches such as incremental.

7 CHAIRMAN BAEZ: I'll allow the question. Go
8 ahead.

9 A I would agree that it -- I don't believe it did
10 compare and contrast alternative methodologies. It was
11 put forth at the request of the Commission, and the
12 Commission did not take exception to the approach
13 proffered in the report.

14 Q Please turn to page 16 of your rebuttal.

15 CHAIRMAN BAEZ: Mr. McGlothlin, do you have an
16 estimate on how much you have left for the witness?

17 MR. MCGLOTHLIN: Probably 15 minutes or so.

18 CHAIRMAN BAEZ: Okay. Just for everyone's
19 information, this will be the last questioning done of
20 the witness for today. We'll break and start at 9:30
21 tomorrow, so you guys can do whatever. Go ahead.

22 MR. MCGLOTHLIN: Do you want me to try to
23 finish?

24 CHAIRMAN BAEZ: Yes, yes. We'll finish your
25 cross. I guess that's what I was trying to say.

1 BY MR. MCGLOTHLIN:

2 Q At page 16, lines 4 and following, you say,
3 "PEF is a regulated cost-of-service utility. It is
4 entitled to recover reasonable and prudent expenses as a
5 statutory and constitutional entitlement. It follows
6 that, if the company cannot recover reasonable and

7 prudent storm-related costs through a base-rate
8 proceeding, then it must be able to recover those costs
9 through a cost-recovery mechanism, surcharge, or some
10 other means." Do you see that statement?

11 A I apologize. What line were you on?

12 Q Beginning at line 4 through 9.

13 A Okay. Yes.

14 Q Do you believe the function of regulation is to
15 guarantee that Progress Energy will achieve a particular
16 return on equity?

17 A No, sir. Regulation allows the utility the
18 opportunity to achieve the regulated return that the
19 Commission sets for it.

20 Q And would you accept that there are maybe
21 circumstances in which, despite being given the
22 opportunity, a utility may not achieve its targeted rate
23 of return?

24 A As it relates to base rates, yes, I would agree
25 that there are activities, and that is the reason the

1 Commission sets a range of reasonableness around the
2 authorized target, because it knows that there will be
3 operational as well as customer usage and customer
4 growth deviations that the company will experience from
5 year to year, and therefore it sets a boundary around
6 the utility's authorized return on equity.

7 Q In the normal course of business, are a
8 majority of your transmission and distribution plant
9 retirements replaced with new plant?

10 A I would assume if it's being retired it's being
11 replaced with new plant. I'm not sure if I answered
12 your question correctly.

13 Q Your answer is yes; correct?

14 A Could you ask the question again? I want to
15 make sure I understand what you mean by new plant.

16 Q Just that. Where transmission and distribution
17 assets are retired, are they replaced with new items?

18 A By new do you mean new or used? I guess I'm
19 not -- brand new, spanking new out of the manufacturer,
20 or maybe refurbished or reconditioned assets? I mean,
21 it could be any of the above or all of the above.

22 Q I see. Well, as posed, the question refers to
23 a majority of your transmission and distribution. And
24 I'll define new to mean either out of inventory or out
25 of the wrapper, never been used.

1 A I can't -- I'm not an expert on whether it's
2 new, used, or refurbished. I would say that any
3 replacement is either coming out of inventory or
4 drop-shipped to the site.

5 Q Does your company have annual programs to
6 maintain your transmission and distribution plant?

7 A That's not a question for me. I'm familiar
8 that there are plans, but I'm not intimately familiar
9 with them.

10 MR. MCGLOTHLIN: Mr. Chairman, I'm about
11 through, but there was a short hiatus a few minutes ago
12 when I couldn't put my hands on the right document.
13 Could I have a moment in place to see if I can come up
14 with that?

15 (Pause.)

16 MR. MCGLOTHLIN: I'm ready, Mr. Chairman. I
17 couldn't find it in the accordion folder because we had
18 handed it out a pretty good while ago.

19 BY MR. MCGLOTHLIN:

20 Q It is Order No. PSC-93-1522, which should be
21 available to you there, Mr. Portuondo, dated October 15,
22 1993.

23 A All right.

24 Q In responses to some of my earlier questions,
25 you referred to the point in time when Progress Energy,

1 or rather its predecessor, filed a request for approval
2 of a self-insurance program. And I believe you said
3 that at that point in time, the company made clear to
4 the Commission that it intended to seek a cost recovery
5 mechanism. Do I recall your answer correctly?

6 A Yes, sir.

7 Q Please turn to the page captioned FPSC 10:256.
8 Do you see in the middle of the page the paragraph that
9 begins with, "Mr. Scardino proposes that"?

10 A Yes.

11 Q Would you read that, please?

12 A "Mr. Scardino proposes that, in the event that
13 actual expenses (sic) from storm damage exceeds the
14 reserve at any given point in time, the excess costs
15 should be deferred through the recovery of a regulatory
16 asset to be recovered from customers over five years
17 (sic) through a mechanism to be determined by this
18 Commission."

19 Q And that's the reference to the regulatory
20 asset to which I referred in an earlier question, and I
21 just couldn't put my hands on the right piece of paper
22 at the time. But does that paragraph summarize the
23 request of the company to which you were alluding in
24 your answer?

25 A Yes. In the direct testimony of Mr. Scardino,

1 he is explicit in the company's position that it would
2 be seeking a cost recovery mechanism for that regulatory
3 asset.

4 Q And now if you would read the short paragraph
5 below that which begins with, "No prior approval."

6 A "No prior approval will be given for the
7 recovery of costs to repair and restore T&D facilities
8 in excess of the reserve balance. However, we will
9 expeditiously review any petition for deferral,
10 amortization or recovery of prudently incurred costs in
11 excess of the reserve." Yes, that's consistent with the
12 language we've discussed already.

13 Q And would you agree with me then that
14 notwithstanding Mr. Scardino's presentation, in
15 responding to the request for self-insurance, the
16 Commission made it clear that it was not approving at
17 that time either a regulatory asset or the creation of a
18 particular cost recovery mechanism?

19 A Oh, absolutely. But they did not preclude one
20 either.

21 Q Mr. Portuondo, are you familiar with the fact
22 that between the months of June 2004 and December 31,
23 2004, the reported return on equity for Progress Energy
24 increased from 12.74% to 13.48%?

25 A Yes, I am.

1 Q Would you accept, subject to check, that the
2 corresponding reports for June 2003 and December 31,
3 2003, were as follows, 13.81%, and for December 31st,
4 13.3%?

5 A Subject to check, yes.

6 MR. MCGLOTHLIN: Those are all of my questions.

7 CHAIRMAN BAEZ: Thank you, Mr. McGlothlin.

8 Commissioners, I think this is a good stopping
9 point, and we'll pick up -- we'll reconvene at 9:30
10 tomorrow, and we'll continue cross for Mr. Portuondo.

11 Thank you and good night. We're in recess.

12 (Proceedings recessed at 5:38 p.m.)

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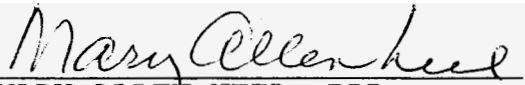
CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, MARY ALLEN NEEL, do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter transcribed under my supervision; and that the foregoing pages numbered 200 through 346 are a true and correct transcription of my stenographic notes.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, or relative or employee of such attorney or counsel, or financially interested in the action.

DATED THIS 31st day of March, 2005.


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