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 6
Pages 514 through 662

PROCEEDINGS: HEARING

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

DATE: Thursday, March 31, 2005

TIME: Recommenced at 9:30 a.m.
Recessed at 5:50 p.m.

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

REPORTED BY: MARY ALLEN NEEL, RPR

DOCUMENT NUMBER-DATE
03227 APR-1 05
FPSC-COMMISSION CLERK

APPEARANCES: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

P R O C E E D I N G S

(Transcript follows in sequence from Volume 5.)

CHAIRMAN BAEZ: We'll go back on the record.

Mr. Walls, you have another witness?

MR. WALLS: Yes. At this time we would call Mr. Mark Wimberly.

Thereupon,

MARK V. WIMBERLY

was called as a witness on behalf of Progress Energy Florida, Inc. and, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. WALLS:

Q Mr. Wimberly, would you please introduce yourself to the Commission and provide your address?

A My name is Mark Wimberly, 5103 Great Oak Lane, Sanford, Florida.

Q Have you already been sworn in as a witness?

A Yes.

Q Who do you work for, and what is your position?

A I work for Progress Energy Florida, and I'm the Manager of Business Operations for Energy Delivery.

Q Have you filed prefiled direct and rebuttal testimony and exhibits in this proceeding?

A Yes, I have.

Q Do you have any changes to make to your prefiled testimony at this time?

A Yes, I do. I have one change. On the rebuttal testimony, page 6, the last line, 23, starting with, "August. PEF improved its SAIDI from 100.6 minutes in," that should read 2001. And I apologize for the error.

Q Do you mean 2000 instead of 2001?

A Excuse me. 2000 instead of 2001. I apologize.

Q Do you have any further changes to your testimony?

A No, I do not.

Q If I asked you the same questions in your prefiled testimony today, would you give the same answers?

A Yes, I would.

MR. WALLS: We request that the prefiled direct and rebuttal testimony for Mr. Wimberly be moved in evidence as if it was read.

CHAIRMAN BAEZ: Without objection, show the prefiled direct and rebuttal testimony of Mark V. Wimberly moved into the record as though read.

**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 MARK V. WIMBERLY**

## I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is Mark V. Wimberly. I am employed by Progress Energy Florida, Inc. ("PEF" or the "Company"). My business address is 3300 Exchange Place, Lake Mary, Florida 32746.

**Q. Please tell us your position with Progress Energy Florida, Inc., and describe your duties and responsibilities in that position.**

A. I am the manager of PEF's Energy Delivery Business Operations. I direct and manage the financial and accounting controls for the Energy Delivery Florida business unit, which includes distribution and transmission for the Company. This includes development of the budget, and management of costs for the construction, operation, and maintenance of the Company's distribution and transmission systems.

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

A. I hold a Bachelor of Science in Business Administration degree from Auburn University. Prior to joining the Company as its Manager of Energy Delivery

Business Operations in April 2003, I was the Florida regional manager for Southern Company Generation, a Southern Company. I worked for the Southern Companies in various positions following my graduation from Auburn University, including a number of management positions with several Southern Companies.

## II. PURPOSE AND SUMMARY OF TESTIMONY

**Q. Please describe the purpose, and provide a summary, of your testimony.**

A. I am testifying on behalf of PEF in support of its petition for recovery of the Company's storm-related costs due to Hurricanes Charley, Frances, Ivan, and Jeanne. The total storm-related costs to the Company from this season total approximately $366 million.

To put the Company's extraordinary storm-related costs in context, I will first describe the unprecedented 2004 hurricane season. I will then generally define what storm-related costs are and describe how PEF tracks and records storm-related costs. I will also explain how storm-related costs were accounted for before, during, and after each storm, and I will explain the process that the Company uses to verify that costs assigned to the storms were in fact related to the storms.

Next, I will take each of the four hurricanes in the order that they struck PEF's service territory and describe the Company's storm-related costs for each hurricane. This will include the Company's total costs for storm damage to its generation, transmission, and distribution systems. I will also provide the breakdown of the costs related to each storm and will explain why certain costs sometimes differ among hurricanes. I will then summarize the total storm-related costs for all four hurricanes.

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

A. Yes, I am sponsoring the following exhibit to my testimony:

**MVW-1 Major Storm Cost Estimate Summary.**

Exhibit ___ (MVW-1) to my testimony is a summary of our estimate at this time of the major storm costs incurred by PEF, on a storm-by-storm basis, and it was prepared under my direction, and it is true and accurate.

## III. THE 2004 STORM SEASON

**Q. Will you please describe the 2004 storm season?**

A. Yes. The 2004 hurricane season was extraordinary. PEF saw four major hurricanes make landfall in Florida, and all four impacted PEF's service territory. This is the first time that four hurricanes have struck our territory in a single hurricane season. The Company incurred significant costs to respond to the impact of the hurricanes on PEF's generation, transmission, and distribution system.

**Q. Was there anything else unique about the 2004 hurricane season?**

A. Yes. The four hurricanes struck the state during August and September 2004 in a span of less than six weeks. All four hurricanes were severe storms that had a devastating impact not only on PEF's system but also on the electric systems of nearly every electric utility in Florida, as well as the electric utilities in states that border Florida. As a result, there was a great demand during a brief period of time for the resources needed to prepare for, respond to, and recover from each storm, pushing up the cost of our storm response.

## IV. TRACKING AND ACCOUNTING FOR STORM COSTS

**Q. How does PEF determine whether a cost qualifies as a storm-related cost?**

A. In his direct testimony in this proceeding, Javier Portuondo describes in detail the specific charges that are considered to be storm-related costs. Briefly, these include the costs of activities associated directly with our storm planning and response efforts.

**Q. How did you develop the storm-related costs shown in Exhibit ___ (MVW-1)?**

A. PEF utilizes a dynamic process that allows PEF to identify, monitor, estimate, and track storm-related expenses. Once a storm has cleared and restoration efforts begin, PEF performs damage assessments on its generation, transmission, and distribution systems. Initial damage assessments are performed in each impacted Region, which includes a detailed analysis of approximately 5% of the Distribution system and 100% of the Transmission system. These initial assessments are used to help management optimize resource allocation decisions. Once the initial damage assessment is completed, a final assessment of the remaining line miles is done for each impacted area to ensure that all needed repairs to impacted equipment and devices are identified.

The external and native contract labor crews data is input into a tracking file by the system storm center Crew Mobilization team. The template file data includes the name of each contractor, an assigned crew ID number, the crew home location, and the number of crew personnel, and their estimated arrival and release dates. An average blended hourly labor and equipment rate is determined for each storm for the contract crews and is multiplied by the hours worked each day times the number of contract personnel utilized during storm restoration and cleanup. Estimated travel costs to and from PEF are also included.

PEF also sends template files to key contacts who manage critical storm restoration support functions such as the Customer Service Center, Staging and Logistics, Corporate Communications, Security, Safety, Purchasing, IT&T/Telecom, Fleet and Facilities, for example. The key contacts input data in the template files, which include the number of internal and external labor support personnel, an average hourly pay rate, the number of days and hours per day performing restoration activities, and other storm-related costs such as food, fuel, vehicle rentals, and materials.

As to internal PEF resources, the Company retains all available PEF personnel able to perform storm restoration activity in the regional operations centers and generation facilities impacted by the hurricane. Based on information received from plant accounting and operations, PEF calculates the costs of internal resources deployed for storm restoration by using average labor and material unit costs applied to the number of hours and an average material unit cost applied to materials needed in the restoration process based on storm damage assessments. This process results in the identification of internal resource costs, which are then added to external resource costs and the support function costs to arrive at total estimated storm restoration cost. These are the costs shown on Exhibit ___ (MVW–1) to my testimony.

These estimates are based on the number of internal and external resources, materials and consumables committed to or contracted for the restoration process. At the time we develop these estimates, we do not yet have all invoices and receipts for services and materials used in the storm restoration and recovery effort, but we have a high degree of confidence that the estimates will closely track the costs we are incurring.

Because PEF actually incurred these storm costs during the third and fourth quarters of 2004, the Company had to book these expenses fully during those quarters under Generally Accepted Accounting Principles ("GAAP"). In conjunction with reviewing PEF's quarterly expense statements, the accounting firm of Deloitte & Touche analyzed PEF's methodology for estimating and tracking storm costs. Deloitte did not note any exceptions to PEF's quarterly accounting statements.

**Q. How does PEF account for actual storm-related costs?**

**A.** When a storm threatens landfall in PEF's service territory, a "storm project" is established to accumulate all of the costs of the storm in a deferred debit account (FERC 186). For Hurricanes Charley, Frances, Ivan, and Jeanne, storm-specific charge numbers were established to direct storm costs to the deferred debit account on the balance sheet. This was done to simplify the charging process and to accumulate all costs for each storm so that we could analyze all charges to determine the appropriate capital expense allocations of such costs. All company and contract personnel assigned to storm-related duties use storm-specific charge numbers on invoices, purchase orders, work orders, payroll entry, and other paperwork related to accounting for storm costs and expenses.

Documentation regarding storm-related work and expenses is then reviewed by departmental cost analysts, regional managers, supervisors and crew chiefs who ensure that storm-related work is being recorded and accounted for properly. Once that documentation is approved, the regional supervisors and crew chiefs forward that documentation to my Section, where we review storm-related charges and expenses to ensure that all such charges and expenses qualify as proper storm-related costs.

**Q. Once the Company has identified and estimated its storm restoration costs, does PEF take any measures to confirm those costs?**

A. Yes. Company and contract personnel assigned to storm-related duties use storm-specific charge numbers on purchase orders, work orders, payroll entry, and other paperwork related to storm work and expenses. That documentation is reviewed and confirmed against actual invoices, payroll reports, credit card statements, and receipts, and other storm costs records. Also, charges for internal materials and supplies are confirmed against PEF's "Passport Source" computer system, which shows actual internal material usage.

**Q. How have PEF's estimated storm restoration costs compared to actual costs received to date?**

A. Although the Company has not received to date invoices from all outside contractors or vendors involved in its storm restoration effort, as of the date of the Petition, the

Company has paid storm-related invoices, payroll, receipts, etc. totaling $200 million. This documentation has confirmed the Company's estimates for the corresponding work performed.

**Q. Were any of your estimated storm costs covered by insurance?**

A. No. We have insurance for storm-related damage to our generation and substation facilities, but the storm damage we incurred did not exceed our sizable deductible. We have not been able to obtain adequate and cost-effective insurance for storm-related damage to our transmission and distribution system or other storm-related costs.

## V. HURRICANE CHARLEY

**Q. What was the first hurricane to impact PEF's service territory in 2004?**

A. The first hurricane to strike PEF's service territory was Hurricane Charley. At that time, Hurricane Charley was a category 4 hurricane on the Saffir-Simpson Hurricane Scale. The counties in PEF's service territory affected by Hurricane Charley were Citrus, Franklin, Gilchrist, Orange, Polk, Osceola, Highlands, Seminole, Volusia, Lake, Pinellas, and Hardee.

**Q. What was the impact of Hurricane Charley on PEF's service territory?**

A. In their direct testimony in this proceeding, David McDonald and Sarah Rogers detail the damage caused by Hurricane Charley to PEF's distribution and transmission system. As an overview, however, Hurricane Charley left 502,000 of PEF's customers without electric service. This represents 32.7% of PEF's total number of customers. PEF also experienced widespread damage to its transmission and distribution system. PEF had to repair 630 damaged transmission structures, restore 83 de-energized substations, and repair or replace 700 miles of downed transmission lines. The Company used 667 miles of primary and secondary wire, replaced 3,820 poles, replaced 1,880 overhead and underground transformers, installed 31,140 insulators, and installed 27,710 splices during the work associated with the damage caused by Hurricane Charley.

**Q. Did Hurricane Charley cause any damage to PEF's generation facilities?**

A. Yes. As shown on page 4 of Exhibit ___ (MVW–1) to my testimony, PEF incurred $624,000 in damage to its generation facilities as a result of Hurricane Charley. This damage affected roofs at Avon Park, a cooling tower at Tiger Bay, electrical connections for circulating water pumps at the Hines Energy Complex, station batteries at Rio Pinar, an equipment shelter, fence, and electric supply lines for water supply at Debary, main lube oil pumps and a fence at Turner, and a fence line at Intercession City.

**Q. What were PEF's total storm-related costs for Hurricane Charley?**

A. As shown in page 4 of Exhibit ___ (MVW–1) to my testimony, PEF incurred $108 million of storm-related distribution costs, $28 million transmission costs, $.6 generation costs, and $9 million support functions costs (such as customer service, fleet, safety, security, communication, and IT). The total cost for the repairs or replacements to PEF's system caused by Hurricane Charley is approximately $146 million. Of this amount, approximately $37.5 million will be capitalized. The remaining $108.5 million consists of Operation and Maintenance (O&M) costs that are properly chargeable against the Company's self-insured Storm and Property Insurance Reserve and qualify for payment from the Reserve.

**Q. How did you determine the allocation between capital items and expenses?**

**A.** Where work was not engineered (typically the case for distribution repairs), we tracked issuances from our inventory, by part numbers and quantities, and compared these inventory items to our work management information to filter out units of property from other non-capital items. Based upon the number of units issued, the time to install and respective labor rates, we calculated the typical cost to install the units. We used actual material cost in our capital cost calculation, with the current inventory burden rate. We also developed prototype designs for major replacement units of property, which included estimated material and labor costs for minor units of property that would accompany a normal installation or replacement of the unit of property (such as the cross arm on a distribution structure). Based upon these percentages, we added the cost of minor units to the expected capital cost of the unit of property replaced.

Where work was engineered (more typically for transmission repairs), we used engineering estimates to determine capital costs for units of property called for by engineering designs and estimates.

Ultimately, we will make appropriate entries to retire assets damaged by the respective storm and to book removal labor costs at that time, assuming a one-for-one retirement for each unit installed.

**Q. What were the major cost drivers related to Hurricane Charley?**

A. My Exhibit ___ (MVW–1) details the major line item cost details for Hurricane Charley. As shown on page 3 of Exhibit ___ (MVW-1) to my testimony, the major cost driver was outside crews, including $68.2 million for distribution line crews and $8.2 million for transmission line crews.

## VI. HURRICANE FRANCES

**Q. What was the second hurricane to strike PEF's service territory?**

A. On September 4, 2004, just a couple of weeks after restoration following Hurricane Charley was complete, Hurricane Frances, a category 2 hurricane at the time it made landfall in Florida, reached the area between Fort Pierce and West Palm Beach with sustained winds of 105 miles per hour.

**Q. What effect did Hurricane Frances have in PEF's service territory?**

A. As mentioned previously, David McDonald and Sarah Rogers specifically explain the damage caused by all four hurricanes to PEF's distribution and transmission system in their direct testimony in this proceeding. In general terms, however, the impact of Hurricane Frances on PEF's service territory was widespread: 30 of the 35 counties that PEF serves were affected by the storm. 832,898 PEF customers lost power from Hurricane Frances during the course of the storm. This represents 54.4% of PEF's total number of customers. As a result of Hurricane Frances, PEF also experienced extensive damage to its transmission and distribution system. PEF had to repair 211 damaged transmission structures and re-energize 105 substations knocked out or shut down due to the storm. Approximately 1,131 miles of transmission lines were downed or damaged. The Company used nearly 500 miles of primary and secondary wire, replaced 33,088 insulators, replaced 2,800 distribution poles, replaced 1,560 overhead and underground transformers, and installed 69,693 splices in the course of its storm-related work due to Hurricane Frances.

**Q. Did the Company experience storm-related costs at any of its generation facilities as a result of Hurricane Frances?**

A. Yes. Crystal River Unit 3 had storm-related costs of $2.4 million. These costs include $1.1 million in damage to the facility, with the balance in mobilization and support costs. There were also storm-related costs for fossil generating facilities totaling $2.9 million, as shown on page 6 of Exhibit ___ (MVW–1) to my testimony. In this regard, the Company experienced excessive flooding at Debary and the Hines Energy Complex requiring the Company to rent pumps and generators. The Company also experienced damage to the well pump shed at Debary, along with tree and brush removal and fence repairs at Debary. At the Hines Energy Complex, the Company experienced erosion to the cooling pond divider dam. Finally, the Company also had to remove trees and had fence repairs at Turner.

**Q. What were PEF's total storm-related costs for Hurricane Frances?**

A. As shown at page 6 of Exhibit ___ (MVW-1) to my testimony, the total cost of the damages to PEF's system caused by Hurricane Frances is approximately $128.6 million, including $95.8 million distribution costs, $18 million transmission costs, $5.4 million generation costs, and $9.4 million mobilization and support costs. Of the total amount, approximately $9.4 million will be capitalized. The remaining $119.2 million consists of O&M costs that are properly chargeable against the Company's self-insured Storm and Insurance Property Reserve and qualify for payment from the Reserve.

**Q. What were the major costs for Hurricane Frances that you incurred?**

A. Again, the costs of contract crews accounted for a significant portion of the total. These costs amounted to $53.7 million for distribution and $9.5 million for transmission as show on page 5 of my Exhibit ___ (MVW-1) to my testimony. The cost of distribution staging, including meals, lodging, and rentals, increased significantly compared to Hurricane Charley because this storm affected all four of our regions, while Hurricane Charley affected only two of our regions, and because Hurricane Frances moved very slowly across our service territory delaying initial restoration work.

**Q. Please discuss the total cost of Hurricane Charley versus the total cost of Hurricane Frances.**

**A.** As discussed above, Hurricane Charley, the first hurricane to hit PEF's service territory in August 2004, was a category 4 hurricane on the Saffir-Simpson Hurricane Scale. When a storm of that intensity makes landfall, most equipment that is susceptible of being damaged by hurricane force winds is damaged or destroyed, thereby making that storm more capital intensive when compared to subsequent storms in a season. Similarly, trees and non-electric fixtures that can cause damage to electrical equipment in a hurricane have their greatest impact in the first intense hurricane to make landfall in a season given the fact that those trees and fixtures are usually downed in the first hurricane and are not present to do damage in subsequent hurricanes. This is shown on page 1 of Exhibit ___ (MVW-1) to my testimony, where you can see that total capital distribution and transmission expenditures for Hurricane Charley were $37.5 million versus $9.4 million for Frances. Conversely, Frances was a wide impact, slow-moving storm, and that impact is reflected in the higher total O&M costs of $119.2 million versus $108.5 million for Charley.

## VII. HURRICANE IVAN

**Q. What effect did Hurricane Ivan have on PEF's service territory?**

**A.** On September 16, 2004, the eye of Hurricane Ivan made landfall near Gulf Shores, Alabama as a category 4 hurricane with maximum sustained winds of 130 miles per hour. It continued northward through Alabama, Tennessee, and Virginia, entering the Atlantic Ocean and then traveled South to re-enter Florida on September 20 as a tropical storm. PEF customers in Bay, Franklin, Gulf, Jefferson, and Wakulla counties in PEF's service territory lost power from Hurricane Ivan. At its peak, 8,891

PEF customers were without power as a result of Hurricane Ivan. This represents .6% of PEF's total customers. As a result of Hurricane Ivan, PEF also experienced further damage to its transmission and distribution system.

**Q. What were PEF's total storm-related costs for Hurricane Ivan?**

A. The total cost of damages caused by Hurricane Ivan is approximately $5.7 million. ~~$3.7 million of this was distribution costs, $.9 million transmission costs, and the~~ remaining $1.1 million storm-mobilization and support functions costs as shown on page 8 of Exhibit ___ (MVW-1) to my testimony. Of the total amount, approximately $145,000 will be capitalized. The remaining $5.6 million consists of O&M costs that are properly chargeable against the Company's self-insured Storm and Insurance Property Reserve and qualify for payment from the Reserve.

**Q. How were the costs related to Hurricane Ivan incurred?**

A. Some hurricanes, such as Hurricane Ivan, initially threaten an intense direct hit in a particular service territory thereby causing a utility to mobilize and hold resources and manpower to respond to that storm. This is why we incurred $2.4 million in costs for outside crews for Ivan, somewhat higher than what might be expected given the area of our service territory that the storm ultimately impacted. If such a hurricane changes course or intensity at the last minute and has less of an impact than expected, relative O&M costs for that storm will be greater than capital costs when compared to a storm that maintains its course and intensity causing a direct hit in a given service territory.

## VIII. HURRICANE JEANNE

**Q. What was the final storm to strike PEF's service territory so far during the 2004 hurricane season?**

A. On September 25, 2004, Hurricane Jeanne, the record fourth hurricane to hit Florida in one hurricane season, made landfall near Stuart, Florida. Hurricane Jeanne was a category 3 hurricane with 120 miles per hour winds. It moved northwest across Florida and through PEF's service territory and then proceeded north out of Florida.

**Q. What effect did Hurricane Jeanne have on PEF's service territory?**

A. Again, the impact on PEF's service territory was widespread as 722,012 customers in 33 out of the 35 counties that PEF serves lost power due to Hurricane Jeanne. This represents 47% of PEF's total number of customers. As a result of Hurricane Jeanne, PEF again experienced significant damage to its transmission and distribution system. The storm damaged 853 miles of PEF's transmission lines and 86 substations. During the course of its storm restoration work, PEF installed 222 miles of primary and secondary wire, replaced 100 poles, and installed 570 transformers, 7,860 insulators, and 19,970 splices.

**Q. Did Hurricane Jeanne cause any damage to PEF's generation facilities?**

A. Yes, PEF suffered damage at its generation facilities as a result of Hurricane Jeanne. This included excessive flooding at Debary and the Hines Energy Complex requiring the use of rental pumps. Also at Debary, the Company experienced damage to the P7 breaker cooling fan and tree removal and fence repairs. At the Hines Energy Complex, there was more erosion to the cooling pond divider dam. There was further damage to the Generator Step Up Transformer (GSU) and bus work at the Bartow combustion turbines, and the umbilical (stack tubing) was destroyed at Tiger Bay. As shown on page 10 of Exhibit ___ (MVW-1) to my testimony, the Company's total storm-related generation costs are $612,000, which are all storm-related O&M costs.

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**Q. What were PEF's total storm-related costs for Hurricane Jeanne?**

A. The total cost of the damages to PEF's system caused by Hurricane Jeanne is approximately $86.2 million. This includes $64.3 million for distribution costs, $13.3 million transmission costs, $.6 million generation costs, and $8 million storm-related mobilization and support functions costs. Of the total amount, approximately $7.4 million will be capitalized. The remaining $78.8 million consists of O&M costs that are properly chargeable against the Company's self-insured Storm and Insurance Property Reserve and qualify for payment from the Reserve.

**Q. What were the major cost drivers for Hurricane Jeanne?**

A. As shown at page 9 of my Exhibit, the major cost driver was contract crews, totaling $37.5 million for distribution and $6.7 million for transmission.

## IX. CUMULATIVE STORM COSTS

**Q. What were the cumulative effects of four hurricanes making landfall in PEF's service territory in August through September 2004?**

A. In total, the cost to restore PEF's system caused by Hurricanes Charley, Frances, Jeanne, and Ivan is approximately $366 million (system). Of this total amount, capital expenditures are $54.9 million (system) and storm-related O&M costs are $311.4 million (system). These amounts are subject to further revision as the Company continues to receive and process its storm-related costs and invoices. As of the date of our petition, approximately 48% of the total costs were charges incurred to date, 49% of the total charges were outstanding, and 3% were estimates of work remaining to be done.

Q. **Are there any additional storm-related costs from Hurricanes Charley, Frances, Ivan, and Jeanne?**

A. Yes. Following restoration, the Company conducted sweeps of its transmission and distribution systems to identify and correct any further damage from the storms to restore the system to its condition prior to the storm. The Company's sweeps of its transmission and distribution systems have identified an additional $11 million in storm-related work, including $8.3 million in additional storm-related repairs and $2.7 million in customer service expense, which includes bad-debt write offs due to storm damage. The details are shown at pages 11-15 of Exhibit ___ (MVW -1) to my testimony.

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

A. Yes.

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 MARK V. WIMBERLY

**I. Introduction**

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

A. My name is Mark V. Wimberly. I am the Manager of Energy Delivery Business Operations for Progress Energy Florida, Inc. ("PEF" or the "Company"). My business address is 3300 Exchange Place, Lake Mary, Florida 32746.

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

A. Yes, I did.

**Q. Can you please summarize the purpose of your direct testimony?**

A. Yes, I filed direct testimony to explain how PEF tracked and recorded its storm-related costs for the four hurricanes that struck PEF's service territory in 2004, generally described the Company's storm-related costs for each hurricane, and explained the process the Company uses to verify that the costs assigned to the hurricanes were in fact related to the storms.

**Q. Have you reviewed the testimony filed by the witnesses testifying for the Office of Public Counsel ("OPC"), the Florida Industrial Power Users**

**Group ("FIPUG"), and Buddy L. Hansen and the Sugarmill Woods Civic Association, Inc. (collectively, "Sugarmill Woods")?**

A. Yes, I have.

**Q. Did these witnesses comment on how the Company accounted for or verified its storm-related costs?**

A. Some did, some did not.

**Q. Do you agree with the testimony of those witnesses who did address the accounting for or verification of the Company's storm-related costs?**

A. No, I do not. To begin with, the witnesses do not challenge the fact that these hurricanes occurred, that they had a devastating impact on the Company's facilities and operations, and that the Company had to engage in an unprecedented effort to marshal and coordinate vast internal and external resources to prepare for, respond to, and recover from the impact of these hurricanes. Rather, the focus of their testimony regarding the accounting for PEF's storm-related costs is whether PEF's budgets for Energy Delivery operations under normal operating conditions somehow cover some of the costs incurred as a result of these extraordinary storm events. This testimony, I believe, reflects a fundamental misconception regarding the budgets for Energy Delivery operations that distorts the budgets into something they are not and cannot be, namely, a tool to predict and account for in advance the costs for such extraordinary events as hurricanes.

**Q. Are you referring to Ms. Brown's testimony that PEF engaged in "profitable cost shifting" by allegedly "shifting its regular costs from normal O&M to the storm damage accrual account" at page 6, lines 13 and 16-17 of her testimony?**

A. Yes, I am. To "shift" costs from one "account" to another assumes that those costs are in the first "account" in the first place. Her reference to "normal O&M," which I assume means the Company's budgeted O&M costs for Energy Delivery, does not and cannot include the catastrophic storm costs that the Company has charged to the storm accounts. The Company does not and cannot budget for catastrophic storms. There is no way to predict in advance whether a hurricane will strike PEF's territory, when and where it will strike, what its intensity will be, or how long it will impact PEF's service territory. As a result, such extraordinary events are not part of the Company's budget process and, therefore, our Energy Delivery budgets do not include costs to prepare for, respond to, and recover from hurricanes. Ms. Brown seems to acknowledge this fact when she agrees that such storm damage costs are non-recurring expenses. (Brown, p. 7). But she nevertheless says that we "shifted" our "regular" costs from "normal O&M" to the storm accounts and, even if that is not what she meant, that statement is simply not true.

**Q. You did charge the storm accounts for PEF employees who worked on the storms and included charges for the Company's vehicles, material, and equipment used in the storms, is that right?**

A. Yes, it is. These costs are part of our direct costs to prepare for, respond to, and recover from the hurricanes, and charging all of our direct costs related to the hurricanes to the storm damage reserve is consistent with long-standing Commission orders, policy, and utility practice, as explained in the rebuttal testimony of Mr. Portuondo.

**Q. But Mr. Majoros alleges that the Company is "double-dipping" if it does not reduce its storm-related costs by the "normal" costs already budgeted by the Company during the same time period. Do you agree?**

A. No, I do not. Mr. Majoros' testimony is based on a faulty premise. He assumes that the work that would have been performed but for the hurricanes goes away and that is simply not true. The work that the Company wanted to get done but for the hurricanes must still be done. The Company must have employees that are not devoted to the hurricane work put in more time than they would have to try to keep up with the work load and then, after the hurricanes are over and the restoration work is complete, employees and contractors must be devoted to catching up the work that was missed as a result of the hurricanes.

**Q. Mr. Majoros first speculates that there will be no "catch up" work because the changes brought about by the hurricanes eliminate the need to do the work. Do you agree?**

A. No, this is pure speculation by Mr. Majoros. It also reflects a fundamental misconception about the nature of the work brought about by the hurricanes and most of our normal workload in the transmission and distribution areas. First, the focus of the restoration efforts during and following the hurricanes is to get service restored as quickly and as safely as possible. The Company is in crisis mode; the only goal is to put the system back the same way it was before the storms so that power can start to flow to customers immediately. The Company does not have time to sit down and figure out whether there are projects planned that can be eliminated by the restoration work. The Company simply sets its mind to, and focuses its efforts on, restoring power.

Second, both Mr. Majoros and Ms. Brown assume, without any factual support whatsoever, that PEF's transmission and distribution systems were in disrepair such that the restoration work only repaired what would have been repaired anyway. (Majoros, p. 13; Brown, page 22). Ms. Brown supports her assumption with the further speculation that PEF must not have made the repairs and upgrades that were needed to provide PEF with the increased reliability of the transmission and distribution systems PEF promised in its last base rate proceeding in 2001. (Brown, p. 22).

PEF's Commitment to Excellence (CTE) program identified in 2001 investments in the transmission and distribution systems that would improve system reliability, measured by the System Average Interruption Duration Index (SAIDI), to a SAIDI of 80 minutes by the end of three years, or by the end of 2004. The Company started work on improving reliability immediately in 2001 and fulfilled its CTE program by 2004, <u>before</u> the hurricanes started in late August. PEF improved its SAIDI from 100.6 minutes in 2001 to 88 minutes in

2002, dropped the SAIDI further to 86 minutes in 2003, and was on track to achieve a SAIDI of 80 minutes by the time of the first hurricane. This improvement in SAIDI moved PEF to the top quartile of its peer utilities in reliability. Ms. Brown's speculation that PEF had not made the investments in its transmission and distribution systems to achieve the reliability it promised in 2001 before the storms hit is, therefore, baseless. PEF's transmission and distribution systems were functioning with a high degree of reliability at the time the hurricanes hit.

PEF's maintenance programs for its transmission and distribution systems are also designed to replace facilities and equipment only when they are no longer performing their intended function. Our pole inspection process, for example, reviews all of the wood poles on our system on a regular basis, and provides for treatment and bracing of poles in accordance with the National Electric Safety Code (NESC) standards as needed, to extend their useful life. Our customers benefit from this program, and other, similar maintenance programs, because their costs are lower than if we simply replaced all facilities and equipment on a regular basis without regard for whether they were still performing their function. With this background on our maintenance programs in mind, it is improper to assume, as these witnesses did, that our transmission and distribution systems were in a state of disrepair at the time of the hurricanes because they were functioning systems at that time.

Finally, substantially all of the work that the Company planned to do but had to postpone due to the hurricanes was unaffected by the hurricane restoration efforts. The postponed work included new construction involving new customer connections, new streetlights and related facilities, Department of Transportation road widening or road construction projects, and customer conversions. This work must be done regardless of the work accomplished in the restoration efforts following the storms. The Company has to accelerate its work schedule to complete the postponed work along with work of the same type that was already scheduled at the same time as the catch up work that must be done. Customers will simply not tolerate longer delays as a result of the postponed work. The Company, accordingly, has incurred and will continue to incur overtime and contract labor costs to do this work until the work is fully caught up. We have estimated the total cost to the Company as a result of the catch up work for the transmission and distribution systems to be well over $25 million.

Q. **Mr. Majoros also speculates that the "flexibility" of your budgeting process may accommodate the "catch up" work. Is this accurate?**

A. No, it is not, if Mr. Majoros means that the cost of the catch up work goes away, which is what he implies by this statement. All of our budgets are driven by our goals, such as the CTE program, and customer demands. Projects are identified to meet our goals and customer demands, they are estimated, and they are scheduled for the duration necessary to complete the project in order to meet our deadlines for our goals or our customer-driven deadlines. These schedules, then, determine our budgets, since our budgets are prepared annually. Once a project has been identified and scheduled it must be accomplished to meet our goals or our customers' deadlines. We might be able to defer work scheduled in one period of time to a later period, but the work still must be done to meet our goals or customer demands. This means the costs of scheduled projects might be deferred but they will still be incurred.

Q. **Mr. Majoros also claims that the Company should demonstrate it has incurred an "extraordinary expense" before it is allowed to recover for any remaining storm-related work. Do you agree?**

A. The remaining storm-related work is by definition "extraordinary." It is work caused by the hurricanes that simply could not be done during the restoration process because the goal was to restore power as quickly and safely as possible. This work is what we call our "sweeps" work because the objective is to "sweep" the transmission and distribution systems, determine the remaining storm damage, and restore the facilities and equipment on the transmission and distribution systems to their condition prior to the hurricanes. This is not work to upgrade the system; rather it is work that must be done to fix damage caused by the hurricanes that might present a safety or reliability problem. For example, in our "sweeps" work for the distribution system we are repairing hundreds of broken cross-arms, replacing over a thousand fractured poles, fixing thousands of broken insulators, street lights, or lightning arrestors, and correcting over a thousand leaning poles. For our transmission system, we are replacing damaged breakers, repairing damaged fans, bushings and/or sensors on substation transformers, replacing relays, replacing battery banks and chargers, replacing switches, repairing washed out access roads, making permanent fence repairs, and/or making repairs to control house roofs at over 40 substations, in addition to the work on damaged transmission lines which includes bonding and grounding, fixing damaged cross braces, and correcting leaning poles. The "sweeps" work was caused by the hurricanes and it, therefore, is not work that the Company otherwise would need to do in the regular course of its operations of the transmission and distribution systems.

**Q. Mr. Majoros lists a number of cost items that he claims should be deducted from the Company's storm cost recovery because of alleged budget "variances." Do you agree with this approach?**

A. No, I do not. First, as Mr. Portuondo explains in his rebuttal testimony, this approach is inconsistent with prior Commission orders, policy, and utility practice consistent with that policy. Second, his approach also ignores the fact that the Company must make up work deferred by the hurricanes, as I have explained above. I will not address again what Mr. Portuondo and I have already addressed in our rebuttal testimony but I do want to point out some other problems with Mr. Majoros' approach.

Mr. Majoros purports to deduct what was budgeted for certain items during the period of the storms but what he actually deducts is what was spent on the item during the course of our hurricane restoration efforts. For example, Mr. Majoros says the Company should receive only one-half of the fuel expense ($350,898.), based on his assumption regarding how long the Company's equipment was used during the storm compared to a normal 8-hour work day. (Majoros, pages 19-20). But this amount is one-half of what PEF spent on fuel solely for vehicles and equipment during the hurricane restoration process; it has nothing to do with the Energy Delivery budget, which reflects an annual budget for fuel for transmission and distribution vehicles and equipment. The amount of fuel costs incurred during the course of the hurricane restoration efforts that Mr. Majoros says PEF should not be allowed to recover is certainly not one-half of the budgeted amount of fuel for this period of time. Mr. Majoros overreaches here because he made no effort to determine the budgeted amount of fuel for the days of the hurricane restoration effort from the annual Energy Delivery budget for 2004.

This is true for nearly every single item that Mr. Majoros purports to deduct from PEF's storm costs, even base salaries because, for example, the level of employees change during the course of a year and may not always be reflective of what was budgeted for wages and salaries. With respect to almost every cost item that Mr. Majoros wants to deduct, he is using the actual costs spent by PEF during the course of the hurricane restoration effort, not the 2004 Energy Delivery budgets for the same cost items.

Mr. Majoros also proposes to offset our storm-related costs by what he calls the apparent "variance" of $3.9 million from the tree trimming budget. (Majoros, page 20). He claims the Company's "tree trimming" expenses in the storms should be limited to the amounts which exceed PEF's "normal" budget.

To arrive at the $3.9 million "variance' he relies on my deposition testimony. (Id.). Mr. Majoros is wrong for two reasons.

First, the "variance" Mr. Majoros refers to was "at that point in time" in October 2004. It was, therefore, a "snapshot" in time; it does not represent our variance from our tree trimming budget on an annual basis, which is how we budget, or reflect the fact that we are continuing to make up this work too through the end of 2004 and in 2005. For example, our base tree trimming expenses for our transmission and distribution systems was unfavorable to our budget for December 2004 by over $2.8 million, and only $1.4 million favorable for the year end. This increase in spending for our base tree trimming work after October 2004 shows that we had to and did make up base tree trimming work that was missed or postponed due to the hurricanes.

The fact that the budget "variance" that Mr. Majoros identifies for October 2004 is diminishing over time also demonstrates that base tree trimming expenses, which are budgeted, are very different from the type of tree trimming expenses incurred in hurricane restoration efforts. Our base tree trimming expenses for transmission and distribution operations are budgeted based on tree trimming cycles that account for all of our transmission lines and distribution feeders over a certain period of time, in our case, three or four years, depending on whether it is for our distribution or transmission systems and depending on the type of line involved. The base tree trimming on our cycles involves trimming of trees and limbs away from our lines sufficient to forestall growth in a three- or four-year period of time along the entire transmission line or feeder. We even compensate our base tree trimming crews based on a charge per mile of line or feeder.

In contrast, tree crews during the restoration process following a hurricane have a completely different objective. They are trimming trees or limbs away from poles and lines only to the extent necessary to get the poles and lines back up in the air and power restored. They are not proceeding down the line or feeder to trim back other trees or limbs as they would in a normal tree trimming cycle. In fact, to engage in cyclical tree trimming methods during the hurricane restoration process will only delay the restoration of power for our customers. Rather, the tree crews will only "spot" trim or cut back trees to the point necessary to ensure lines can be put back up and power restored as quickly and as safely as possible following a hurricane. As a result, this "spot" tree trimming during and following the hurricanes does not mitigate the need to continue with our cyclical tree trimming along the entire transmission line or feeder. This base tree trimming work must still be done and will be made up by the Company eventually.

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

A. Yes.

BY MR. WALLS:

Q Mr. Wimberly, do you have a summary of your testimony?

A Yes, I do.

Q Will you please summarize that at this time?

A I'll be happy to.

~~Good afternoon, Mr. Chairman and Commissioners.~~ My name is Mark Wimberly. I'm employed by Progress Energy Florida. I'm the Manager of Energy Delivery Business Operations. I direct and manage the budget and financial accounting controls for construction costs and operation and maintenance costs for the transmission and distribution systems. I was responsible for tracking and collecting the costs the company incurred to prepare for, respond to, and recover from the 2004 hurricanes. I'm also for responsible for verifying that the costs assigned to the storms were related to the hurricanes.

The company incurred significant costs to respond to the hurricanes' impacts on its generation, transmission, and distribution systems. As each hurricane threatened our service territory, we established storm-specific numbers, charge numbers to direct the costs incurred to a separate account set up to accumulate hurricane costs. All company and outside contractor employees, invoices, purchase orders, and other paperwork related to the hurricane costs used these numbers to simplify the accounting for the costs in the field during the massive restoration efforts.

At the same time that we set up the storm account, we began the process of estimating hurricane-related costs by sending templates to assigned personnel in each business area devoting resources to the restoration effort and obtaining material, equipment, and other costs from the resource needs identified in our initial and ongoing damage assessments. In this way, we were able to get a good idea what the costs were going to be, and further, had identified the sources to follow up with when we began to verify the costs that were charged to the storm.

Our verification process compared purchase orders, work orders, contracts, payroll entry, and other paperwork against actual invoices, payroll reports, credit card statements, receipts, and other storm records using our tracking numbers assigned to the storms. We believe we have accurately accounted for our hurricane costs and that our estimates are closely tracking the actual costs we incurred.

The total cost estimates for the four hurricanes are substantial. The impact of four back-to-back hurricanes and the severity of the damage to our generation, transmission, and distribution systems, however, explain the level of these costs. The hurricane restoration efforts involved massive numbers of personnel from outside the company, outside contractors and other utilities, massive amounts of equipment, material, and other supplies, the logistic support of fuel, food, lodging, and the communication personnel and media to stay in contact with our crews, our customers, and state and local officials regarding our restoration efforts. We did not budget for the restoration efforts for the 2004 hurricane season, nor could we budget for such extraordinary costs.

When hurricanes approach, our entire focus turns to preparing for and responding to them and to get the electric service back on as quickly and as safely as possible. We use our internal resources to the greatest extent possible because they are the most cost-effective. And when our employees return to work, they still have the work to do that they left behind when the hurricanes hit. We've incurred and continue to incur costs, including higher costs than expected through overtime and outside contractors to make up this work. The work does not go away. We will continue to maintain and improve our transmission and distribution systems after the hurricanes just as we did before the hurricanes.

Thank you.

MR. WALLS: At this time we tender Mr. Wimberly for cross.

CHAIRMAN BAEZ: Ms. Christensen?

CROSS-EXAMINATION

BY MS. CHRISTENSEN:

Q Good afternoon, Mr. Wimberly.

A Good afternoon.

Q Am I correct that during 2004, you were in charge of the accounting process for booking of the storm costs in the storm account, the storm accounts?

A I was responsible for collecting all storm costs, that's right.

Q Okay. And you also prepared the budgets for the transmission and distribution organization; is that correct?

A Yes, that is correct.

Q In your testimony and in your summary, you mentioned that you used templates to track hurricane expenses; am I correct?

A That is correct.

Q And are those template files merely forms, computer-generated forms that are used to track those costs?

A They are a combination of computer forms, Excel spreadsheets, and other methods to actually accumulate the costs.

Q And are these template files used -- do these template files use estimates?

A Yes, they do.

Q Okay. And did departments other than yours report their costs to you using those templates?

A Yes.

Q And were those templates used only for your estimates, or were they actually used to book costs to the storm reserve?

A They were only used for the estimates.

Let me clarify that. They were used to make the estimate, but the files were also used to verify when costs came in if they were accurate costs versus the storm. So I would say both. They were used for the estimate, and they were also used in terms of auditing the invoices as they came in.

Q But those were not used to actually book costs to the storm reserve?

A No. The actual costs as they come in through invoices is what is actually booked.

Q Okay. In your rebuttal testimony, you claim that energy delivery operations budgets can't be used as a tool to predict and account for in advance the cost of hurricanes; is that correct?

A Pardon me. Could you rephrase that?

Q In your rebuttal testimony, you claim that budgets in general, and particularly the energy delivery budget, cannot be used as a tool to predict and account for in advance the cost of hurricanes?

A That is correct.

Q Okay. And isn't it correct that the budget shows how much the company anticipates spending in any given month for operations and maintenance?

A I would say it is a predictor of how much. As you set the budgets, they're set a year in advance, so they are a predictor of what you may see in a given month. I don't think that you can say that that's exactly what you're going to spend, because situations change during the year.

Q But even though you can't predict extraordinary costs through the budgeting process, it is the purpose of the budget to predict and anticipate ordinary costs; am I correct?

A Yes, on an annual basis.

Q Okay. And isn't it correct those ordinary costs included in those monthly budgets are Progress employees' regular salaries?

A That is correct.

Q And is it also correct that the monthly budgets include vehicle expenses?

A That is correct.

Q And monthly budgets include monthly allocations for tree trimming; am I correct?

A That is correct

Q Okay. On page 6 of your testimony, you talk about a Commitment to Excellence program; am I correct?

A Are you on direct testimony or rebuttal?

Q On your direct testimony.

A Direct?

Q Uh-huh.

A What page?

Q Page 6.

A Page 6? Where on page 6 are you reading? I'm sorry.

I think in the direct testimony, I don't think there's any reference to CTE.

Q Let me see if that's the --

A I think it's rebuttal you may be referring to.

Q It may be rebuttal, and if it is, I stand corrected.

It is in rebuttal on page 6.

A Okay. I've got it.

Q And on page 6, you talk about the system average interruption duration index, and the program, the Commitment to Excellence program that was implemented.

A Yes.

Q Okay. And you agree that this program was implemented by 2003; correct?

A Yes.

Q Do you know exactly when the program was implemented?

A As I recall, it was implemented in 2002.

Q 2002?

A 2002, I think.

Q Am I incorrect in saying that Progress implemented this program because, of the four large electric utilities in Florida, in 2002, Progress had the worst service?

A I wouldn't say that's why we implemented the program, because we had the worst service. I think we wanted to improve our level of reliability, and we felt that it required a significant investment in our system to do that. And we petitioned the Commission to do that, and the Commission agreed with it.

Q And you state in your testimony that you were committed to reaching a -- is it SAIDI? I don't know.

How do you --

A SAIDI.

Q SAIDI performance index of 80 by 2004, and that's why you spent the money; correct?

A That is correct.

Q Okay. But wouldn't it also be correct that the commitment related back to Progress's agreement with Public Counsel to improve its service in the 2002 stipulation between Progress and the Office of Public Counsel, as well as other parties?

A I can't speak to that. I have not read that stipulation. I'm sorry.

Q Can you tell me, what does CSC stand for?

A Customer Service Center.

Q Okay. And attached to your testimony, and it may be your direct testimony, you refer to -- you have a portion that says CIC writeoffs; am I correct?

A Could you refer me to the page you're talking about? I'm sorry.

Q Certainly. In your Exhibit MVW-1, page 2.

A Two of 15?

Q Two of 15.

A Yes.

Q And in that, you have storm estimates and sweeps, and in parentheses under each of the storms, you have CSC writeoffs and an amount.

A Correct.

Q Okay. Am I correct in saying that the CSC writeoffs that are identified in that exhibit are actually bad debt writeoffs?

A That would be correct.

Q And as part of your storm request, Progress has included an amount of approximately $2.7 million in bad debt writeoffs?

A No, that is not correct.

Q What is the actual amount that is included in your request?

A I believe the total bad debt writeoff is 2.25 million. The other is direct costs.

Q Okay. So you're asking for 2.25 in bad debt writeoff?

A Those were the direct costs from the storm, that's correct.

Q And would I be correct in saying that you have no documentation to show that these bad debt writeoffs are attributable to the hurricane attached to your testimony?

A I would disagree with that. Well, when you say attached to the testimony --

Q Correct. Do you have any --

A Attached to the direct testimony? There's no supporting document that supports the 2.25.

Q And there's no supporting documents that were attached to the rebuttal that show how this 2.25 in bad debt writeoff is related to the hurricane; am I correct?

A To my recollection, there is no attachment to ~~the rebuttal testimony.~~

Q Okay. And you would agree that bad debt writeoffs occur everyone month and are charged against O&M?

A Yes. We do budget for bad debt writeoffs every year.

Q Okay. And during the months the hurricanes hit, you charged bad debt writeoffs against O&M expenses; is that correct?

A We charged the portion of the bad debt writeoff that we could directly attribute to the storm. During the period of time that we were performing restoration, the individuals who actually go out and cut service in the field redeployed to work the hurricane.

We have a system that basically looks at 30-day arrears, and a percentage of those arrears can be calculated as being bad debt in the future. That system has been validated. It performs within 1% of your actual experience during that time. So in looking at the growth of 30-day arrears from the period of time the first hurricane hit until we began to restore again, the percentage of that attributed -- was calculated using that methodology, which we can determine was attributed to the storm, the fact that we weren't able to cut during that period of time.

Q So essentially, you want the Commission to allow you to collect for people that you couldn't cut off that might have been cut off from service due to the hurricanes until you could get back out there and cut them off again? Is that the scenario we're talking about?

A Could you repeat that question? I'm sorry.

Q You're asking the Commission to allow you to collect for bad debts from customers you would have cut off but for the fact that the hurricanes came and they may have been cut off during the hurricanes, and you had to wait until you could restore power to them to cut them off again. I mean, is --

A We're asking --

Q -- that a scenario that would be essentially what you're describing?

A I don't necessarily agree with your scenario. We're asking to recover the bad debt expense which resulted from our inability to cut during that period of time. **The individuals who normally perform that** function were redeployed trying to get power on to people who were out. We had hundreds of thousands of customers out during each storm. Those people were working to get those customers back on, so they were not cutting customers during that period of time.

Q Did this calculation take into account at all what percentage of those customers who you were going to write off for bad debt may have been cut off or without power during that time?

A The fact that they're without power really has no effect on the calculation, because the calculation is an account receivable calculation. It's a 30 days in arrears calculation. That's the estimate you base the bad debt off of.

Q Okay. So that would have been 30 days in arrears for the electricity used prior to the storms?

A During a storm, electricity continues to be used. Not every customer is out.

Q But your assumption assumes that all these customers you're talking about had electricity; correct?

A No, it does not.

Q Well, let me ask you this. Well, let me go back to my previous question, because I'm not sure you actually answered it. During the months of the hurricane, did you not in fact write off bad debts from your O&M expenses?

A Yes, we did.

Q Okay. And for the months immediately after the hurricanes hit, you also charged bad debt against O&M expense; correct?

A Yes, we have.

Q Okay. So wouldn't it be correct that the $2.25 million in bad debt writeoff that you're requesting to be recovered through this proceeding has already been charged off against your monthly O&M expenses?

A No, I would not agree with that.

Q Any expenses that you are unable to collect, those get charged off against O&M; correct?

A No, I do not believe that's correct. If I understand your question, any expense gets charged to --

Q Well, let me be specific. Any bad debt expense gets charged off against O&M, correct, the actual expense, expense for bad debt?

A The actual expense either in base budget or that was directly attributable to the storm.

Q And would you agree that the 2.25 is really a speculative number? You have no way to demonstrate that that's actually a number that can be attributed to the hurricane?

A I would disagree with that I just gave u a very clear methodology that we used to calculate that and told you that the methodology that had been used, it is validated. It's the same way we use it during normal periods of time, and it's validated within 1% So I would say that that is a very accurate methodology to calculate that. I would agree that it is an estimate, though.

Q Let me ask you, would you agree that Progress charged a portion of its employees' regular salaries to the storm accounts?

A Yes.

Q And when Progress employees reported for the regular workday, if that day s spent working on the storm-related matters, the regular eight-hour workday s charged to storm accounts; am I correct?

A That is correct. That time spent directly working on restoration activities was charged to the storm.

Q And this is because of PEF's belief that the way to charge the storm accounts is based on the definition of what is extraordinary expenses; am I correct?

A I think it's based on the definition of the expenses that were part of the order, and those being direct costs.

Q Referring to page 9 of your rebuttal testimony, am I correct in understanding that on page 9 of your rebuttal testimony, you say that the work remaining after a hurricane is by definition extraordinary, specifically at line 9?

A Right. I'm reading it. Thanks. Yes.

Q Okay. So under your definition, if work is related to the hurricane, the costs related to that work is automatically extraordinary and chargeable to the storm accounts; am I correct?

A If it's related to hurricane restoration efforts, that is correct.

Q So that would be all costs of hurricanes are chargeable to the storm fund?

A If it's a direct cost of restoration, yes.

Q And under your definition, it would not take into account the level of cost already included in the budget for a particular category of costs collected through base rates, such as regular salaries?

A I disagree with that. No.

Q Again, under your definition, if an employee worked their normal eight-hour days on hurricane-related work, you charged that eight hours to the storm account;

correct?

A That is correct, if they worked directly on storm restoration.

Q And isn't it correct that you account for an average, normal eight-hour day of work for your full-time employees in your monthly budgets?

A Yes, that is correct. But what you are missing here is that that work does not go away. That work remains when that employee comes back after the hurricanes. Not only does he have that work, he has the work that exists that day too, so it does not go away.

Q Well, let me ask you this. Would you agree that the eight-hour work days for a 40-hour work week for a full-time employee position is covered by base rates regardless of what particular matter that full-time employee is working on?

A I would agree that there are salaries budgeted in our normal budget.

Q Right. And it's not dependent on what work they're doing at any particular time?

A That's right, but you're considering timing. If in fact during that month that budget existed and they did not spend that money because they were working on storms, the work does not go away, so the budget would follow the work. You just wouldn't sweep the budget away.

Q But the budget is based on that full-time employee doing eight hours' worth of work; correct?

A That is correct.

Q And isn't it correct that a normal eight-hour workday is not an extraordinary cost?

A That's correct.

Q On page 5 of your rebuttal, let me refer you to there. You speak about catch-up work; am I correct?

A Yes.

Q That's where you a start your discussion regarding catch-up work?

A Yes.

Q And then you discuss that for several pages, and on page 8 of your rebuttal testimony, you estimate catch-up work for transmission and distribution to be over $25 million; correct?

A That is correct.

Q However, you have no documentation to quantify this so-called catch-up work attached to your rebuttal testimony; am I correct?

A It is not attached. We did look at the work that remained to be done. When restoration efforts were complete, we actually used the same systems that we used to predict time and cost for that work. That work was quantified. The estimate was calculated to come up with that $25 million.

Q However, you provided no schedule attached to your testimony so that intervenors could look at that and try to determine whether or not those were valid catch-up costs?

A I would say this. We have provided every document that has been requested of us, so I'm not sure if it's, you know, covered in any other documents.

Q But isn't it Progress's burden to support the $25 million number you concluded in your testimony?

A I would say I just gave you support.

Q Where you admitted that you have no documentation attached to your rebuttal testimony which demonstrates the basis for this $25 million; am I correct?

A I indicated that the estimate was based off the systems that we normally use. What we took was the work that was in the queue prior to the hurricanes, that was scheduled during that time. We used the same systems that we use on a daily basis to calculate the time and the cost to do those projects, and that's how the estimate was derived.

Q Let me make sure I have, though, the answer to my question, which is, you did not provide any schedules or documentation to your rebuttal testimony which supports or shows exactly what you're saying, anything that would provide that in a numerical quantification?

A There is nothing in the rebuttal testimony, but this is not the whole documented evidence in the case.

Q And there was nothing attached to your direct testimony to support that $25 million number?

A No.

Q Okay. If you know, will any of the catch-up work be completed in a normal eight-hour workday?

A Most of the work is going to be done on incremental overtime and with contractors. While a portion of that could be done during a normal day, if you had an employee that completed a scheduled project and he shifted over to this type of work, some of that could fall in an eight-hour day, but a very minor portion of it.

Q On page 5 of your rebuttal testimony, you indicate that Progress has not engaged in double-dipping, since it didn't reduce its storm request by the normal budgeted amounts because of catch-up work; am I correct?

A That is correct.

Q Would you agree with me that the definition of double-dipping is collecting twice for the same work?

A That would be one definition.
Q An example of double-dipping would be collecting from customers once through base rates and again through the storm fund for the same eight-hour day's worth of work; am I correct?
A What you said was for the same work. Yes, I would agree. If you're doing the same work and collecting twice on it, yes, I would agree with you. We're not doing the same work.
Q Would you agree that if I pay you to do eight hours' worth of work, regardless of whatever work it is that I'm asking to you do, if I ask you to pay for that eight-hour day twice, that that's double-dipping?
A No, I would not agree with that. I think where we're getting confused on double-dipping is exactly what you said in your first question, am I being paid eight hours for the same work. I would consider that double-dipping, and we have not done that.
Q Okay. So your definition varies that -- well, I think yours assumes that you could do eight hours' worth of work in the same -- two different types of work during eight hours, and I think we're getting confused on this.
A Well, you just got me confused. I'm sorry.
Q Well, you're being paid to come to work and do

-- to report to work and do eight hours' worth of work.

A Right.

Q Correct. That's what it is.

A Right.

Q And if during those eight hours that you're being paid for to do work, let's say, for the Office of Public Counsel, during that eight hours, let's say you also work on your home business, worth of work, and collect money for doing that work during that eight hours, aren't you in fact committing some sort of fraud by charging the original worker for work you're not doing?

MR. WALLS: I'm going to object to the form of the question as vague and ambiguous and confusing.

CHAIRMAN BAEZ: Ms. Christensen, you want to rephrase that?

THE WITNESS: I thought for a second she was calling me Mr. Ensell (phonetic).

BY MS. CHRISTENSEN:

Q No. I guess my point is, if you represent that you are going to do eight hours' worth of work for the Office of Public Counsel, you're going to report and do eight hours' worth of work, you should not be collecting for eight hours' worth of work even if you're doing something else during that time; am I correct?

A I've got a simple mind. If I'm told to chop wood and I'm going to be paid eight hours to chop that wood, and somebody comes to me and says, "Go mow the grass," when I get through mowing the grass, I've still got to chop the wood. It's still there. It doesn't go away.

Q Right. But in my example, you're paid for eight hours' worth of work regardless of whether you mow the grass or chop the wood.

A But I haven't done the work. I've got to go do the work.

Q Right, and you're still going to get paid for doing the wood chopping.

A For doing the work, for doing the work.

Q Yes, for doing the eight hours' worth of wood chopping later.

A Yes. I've got to do the work.

Q Okay. I think we have just a fundamental disagreement as to how do you define what eight hours' worth of work is.

Let me refer you back to page 2 of your direct testimony. You state that the total storm-related costs were 366 million; am I correct?

A That is correct.

Q And that number was based on estimates;

correct?

A That is correct, yes.

Q Do you have a current number for the total storm-related costs as of today based on the actual expenses?

A Yes. We're currently projecting the total costs will be in the 385 million range.

Q And what percentage of actual costs have you received to date?

A I think we've received approximately -- a little over 370 million in actual costs.

Q And do you have an updated number for the cost of removal to be charged to the storm reserve?

A No, I do not.

Q Okay. Let me ask you, if you know, do you know at what point in time after the hurricanes Progress workers reverted back to 10-hour days, six days per week?

A No, I do not.

MS. CHRISTENSEN: Okay. I have no further questions.

CHAIRMAN BAEZ: Mr. Perry?

CROSS-EXAMINATION

BY MR. PERRY:

Q Good afternoon, Mr. Wimberly. My name is Tim

Perry, and I represent the Florida Industrial Power Users Group. I have a few questions for you.

And I'll start with the $25 million worth of catch-up work that you discuss on page 8 of your rebuttal. If I understood your exchange with Ms. Christensen, did the company simply look at the work that would have taken place during the storm recovery period and push that work out, you know, a certain number of weeks when calculating what its catch-up work would be?

A We looked at two things. We looked at the level of work that was actually in the queue. During storms, work continues to come in. There are no workers there to do that. Because you don't have service out to all customers, you continue to have work come in. And we looked at that level of work again and calculated it using the systems that we had in place, which we would use on a normal, day-to-day basis, to estimate the hours to perform that work and the cost to perform that work.

We have worked as best we can with customers to try to schedule that work to minimize that cost as much as possible. However, customers do have expectations, and we strive to meet those expectations.

Q Did you just assume that all the work would remain the same, in other words, that the work you had budgeted for that time period, that you would also have to do that work after the storm restoration period?

A We actually went in -- if work was called in and canceled due to the storms, that work was taken out.

Q Did you perform any studies to ascertain whether or not any work that was performed during the storm restoration period would obviate the need to perform work at a later date?

A Again, if the work was called in and canceled, that work was taken out.

Q Okay. So if it was --

A But most of this is customer-driven work.

Q Okay. So it was only canceled work that you removed. You didn't remove any work that, you know, by working on the storm restoration that -- you didn't attempt to ascertain whether or not there would be future work that you didn't have to perform?

A No. There was no work that went away because of this. We did look at that.

Q Okay. Of the $25 million, what amount of that work is associated with tree trimming?

A I don't have a specific figure.

Q Can you just estimate?

A I do know that at the end of October, we were favorable in tree trimming by 3.5 million. That's in the testimony and exhibits. And that favorability went down by 1.4, so I do know that at least 2 point -- about 2 million of that was caught up in '04.

Q But relative to your budget, you remained favorable through the year?

A Yes, slightly, that is correct.

Q And how long is your tree trimming cycle?

A We're trimming today, I think, to between a three- and four-year cycle.

Q Wouldn't you agree that any catch-up work that needed to be done could be spread out over that three- to four-year cycle?

A I would disagree with that. Your tree trimming is a critical factor in your reliability, and to just push work out could have an impact in the next year in terms of reliability.

Q But you did identify that it's not a specific set period of time, it's a range, a one-year range of three to four years; isn't that correct?

A Yes, but you're continually trimming during that period of time.

MR. PERRY: I don't have anything further.

CHAIRMAN BAEZ: Mr. Twomey, no questions?

MR. TWOMEY: No, sir.

CHAIRMAN BAEZ: All right. And Mr. Wright, do we know where --

MR. TWOMEY: He told me he had no questions.

CHAIRMAN BAEZ: Okay. So he should see you about that then.

Staff?

CROSS-EXAMINATION

BY MS. RODAN

Q Good afternoon. Please look at your rebuttal testimony at page 5, line 12. You state, "The work that the company wanted to get done but for the hurricanes must still be done." Is it your testimony that all normal work was suspended and nothing that can be considered normal work occurred during the hurricane events of 2004?

A No, I don't think that is correct. Not all normal work was suspended. There were -- I believe there were two storms that did not impact our total -- pretty much our total service territory, and I do believe that not every Progress employee was deployed during those two storms, so they continued to do their regular assigned work.

Q So is it possible that normal work was inadvertently done as part of the storm restoration process, for example, pole replacements?

A No.

Q Please direct your attention to staff's consolidated exhibit which has been marked as Exhibit 6. On Bates stamp page number 95 is Progress's response to Staff's fourth set of interrogatories, number 38. Does the response indicate 329 poles were previously identified for replacement as part of a normal activity?

A Can you give me a second to read this?

Q Sure.

A I would really like to read the answer to the interrogatory that's referenced here so that I can get a reference of that, if that would be okay.

Q Please do so.

A I'll need someone to -- is it in this set of documents? It's Sugarmill Woods' first set of interrogatories, number 18.

MR. WALLS: Mark, it should be right below where it says "answers."

BY MS. RODAN:

Q The response is at the bottom of Bates stamp page number 95.

A Oh, okay. I'm sorry.

Q And it continues on to page 96.

A Okay. Thank you.

I think the answer to this leaves in question whether those specific poles were done away with, but I think it makes the point that it would be charged to capital anyway, unless I'm reading it incorrect.

Q Does Progress's response indicate that the 329 poles were replaced as part of the hurricane restoration activities?

A There were more than that, yes, but at least that.

Q Does the response indicate that the poles replaced were scheduled for 2005 and 2006?

A Yes.

Q Did the company replace lightning arresters as part of its hurricane restoration activities?

A Yes.

Q And this is no longer referring to the --

A Yes.

Q Is the replacement of lightning arresters a normal activity?

A Yes, it is.

MS. RODAN: Thank you. That's all the questions I have. I believe Ms. Brubaker has a few questions for you.

THE WITNESS: Sure.

CROSS-EXAMINATION

BY MS. BRUBAKER:

Q If I could, just kind of a quick kind of clarifying question. Isn't it true that there are certain classes of employees who just by the very nature of their function aren't really subject to catch-up work? And I guess kind of the example I have in mind is meter readers. You know, their normal eight-hour function -- for instance, during the storms, weren't there a number of estimated bills that had to go out to customers because of interruptions in the normal reading cycle and interruption of normal service, that sort of thing?

A I would agree with you to some extent, that if you skip a cycle, you normally -- you have to estimate it during a storm. You would normally read it during a regular cycle. However, for meter reading you have -- I believe it's a four-day window. So you're reading within a four-day window, and that window becomes compacted. So you would have some overtime, even in the meter reading classification, to catch up and get back on a normal schedule, because you don't want that four-day window to be compacted, because it could force customer bills to be estimated.

Q But there were some estimated bills?

A During the hurricane, that is correct, yes.

Q Okay. You certainly wouldn't have a meter reader, for instance, go back and reread a meter? You would --

A No. That is correct.

Q -- estimate, and then with the next billing cycle, you would read it for --

A You would read it at the next billing cycle.

Q Wouldn't there also be, kind of on the administrative side -- for instance, recording consumption data, wouldn't that also be kind of along those lines? You wouldn't do that twice. You would either estimate for those areas in which estimation was necessary and move on for the next billing cycle, or --

A I'm sorry. Could you repeat that? I apologize.

Q Well, I'm just trying to think from kind of the administrative function of things. When a meter reader comes back with the data and it gets recorded, there's kind of an administrative process that takes that information and distributes it for proper billing function.

A I don't think that would be correct for meter reading, because they just download the reads in the Itron device. It automatically loads and goes in. Whether you're estimating or using actual readings, the administrative function costs the same.

Q Okay. So there wouldn't be any employees or anything who would be required to do catch-up work associated with that particular function?

A Not with that function, I don't believe.

MS. BRUBAKER: Okay. Thank you. I think that's all I have.

THE WITNESS: Okay.

CHAIRMAN BAEZ: Commissioners, questions?

Commissioner Deason?

COMMISSIONER DEASON: Just a few.

Mr. Wimberly, you strike me as the type man who probably actually has mowed grass and chopped wood. Is that true?

THE WITNESS: Being from Port St. Joe, Florida, yes, sir.

COMMISSIONER DEASON: I thought I detected a little bit of an accent there.

You also attended Auburn University, did you not?

THE WITNESS: Yes, sir, I did. I did attend. I went to class.

COMMISSIONER DEASON: I've got a question about the 25 million of catch-up -- and that's catch-up, not ketchup -- you reference on page 8 of your rebuttal testimony.

Now, I get the impression -- I mean, it's my understanding that that 25 million is provided for informational purposes. It's not actually part of the direct costs you're seeking recovery; is that correct?

THE WITNESS: That is correct.

COMMISSIONER DEASON: Okay. So you're trying just to give a ballpark quantification of the amount of backlog work, catch-up work, or whatever you want to call it.

THE WITNESS: I think the context it was given, Commissioner, was that it was OPC and the intervenors' position that we should give up all base labor, and the point was, the work did not go away. And we were trying to give a quantification that we had actually looked at that.

COMMISSIONER DEASON: I also have a question about the bad debts.

THE WITNESS: Yes, sir.

COMMISSIONER DEASON: Does the company account for bad debts through a reserve, bad debt reserve, or do you actually try to expense bad debts as they actually are incurred?

THE WITNESS: I'm not sure I can answer that, Commissioner. I'm not sure if we budget money in a reserve on an annual basis and then expense it as it occurs or we just expense it as it occurs. My -- I better not speculate, because I do not know the answer.

COMMISSIONER DEASON: Well, let me ask you this then. Did you see an increase in the actual amount of bad debts incurred during the course of the hurricane season or soon thereafter?

THE WITNESS: Yes. As a matter of fact, I was in contact with the Customer Service Center rep as late as last week concerning this area, and those expenses have increased and are coming in as predicted.

COMMISSIONER DEASON: Do you know what the relationship is between that increase and what you're claiming for recovery through the storm cost recovery clause?

THE WITNESS: The question to her was, do the -- are the estimates continuing to hold true based on the actuals you're seeing, and the answer that I received was yes.

COMMISSIONER DEASON: Is there a way that we can confirm what the accounting treatment for bad debts is during the normal course, whether you use a reserve mechanism or whether --

MR. PORTUONDO: Yes.

COMMISSIONER DEASON: Is that part of the record, or can we get that back on --

CHAIRMAN BAEZ: Well, let's find out. I don't know if the question got asked in discovery or not.

MS. BRUBAKER: I don't think that is part of the record, what they've just experienced.

CHAIRMAN BAEZ: I'm sorry?

MS. BRUBAKER: I don't think that is part of the record at this point.

CHAIRMAN BAEZ: All right. Then let's -- Commissioner, if you can pose your question --

COMMISSIONER DEASON: Maybe we could just have a late-filed exhibit that just has a brief description of the normal accounting for bad debt and whether there is a reserve account that is used or not.

THE WITNESS: Okay.

COMMISSIONER DEASON: Can you provide that?

THE WITNESS: Yes, sir.

CHAIRMAN BAEZ: What kind of time do you need, Mr. Wimberly?

THE WITNESS: I will attempt to get it by -- I'm not as quick as Mr. Portuondo. Can I have until Monday and Tuesday of next week?

CHAIRMAN BAEZ: Monday or Tuesday. We will call that "Description of the Normal Accounting for Bad Debt," and we will mark it as Late-Filed Exhibit 52.

(Late-filed Exhibit 52 identified.)

CHAIRMAN BAEZ: Commissioner Deason, do you have any other questions?

COMMISSIONER DEASON: No further questions.

CHAIRMAN BAEZ: Commissioners, any other questions? Redirect?

REDIRECT EXAMINATION

BY MR. WALLS:

Q Mr. Wimberly, you were asked about your cost estimate and what your current cost estimate was. Based on what you've seen in actuals versus your cost estimate and the adjustment to that cost estimate, do you have a basis to conclude how accurate your original estimate was?

A I would say the original estimate was very accurate. Anytime you can predict something that is unpredictable to 5% of its total cost, that estimate -- the original estimate was given only a few weeks after the end of the storms. I would say that's a great effort.

Q You were also asked a number of questions about individual items, and I'll take some of those, and then we'll go to a more general question. The first was with respect to tree trimming, and I believe you were asked whether any of the tree trimming that you would normally do would be replaced, or I guess eliminated by the hurricane work. Is that what's going to occur?

A No, it is not.

Q And why not?

A The nature of tree trimming -- as I think one of the earlier witnesses testified, the nature of tree trimming is that you're doing spot trimming in hurricanes. You're actually trying to remove trees and limbs that are interacting with lines and preventing the restoration of service.

As I said in answer to the question earlier, our production trimming, our normal trimming is cycle trimming. That is where you go down a total feeder and clear the whole feeder, whereas in a storm, you may have -- you know, just for a hypothetical's sake, you may have 10,000 trees, and only 100 are impacting that line. During the storm, you remove those 100 trees. Well, you still have the remaining trees on that line to deal with, so when you come back, if that section is scheduled during your normal cycle, you clear that whole line. You trim the whole line.

And we trim on a dollar-per-mile basis, so the fact that you removed 100 trees has no effect to the cost that you'll see nor the work to be done.

Q I believe you were also asked a question about whether your budget for '04 still ended up being favorable even though you had caught up some of that tree trimming work from October of '04. Do you recall that?

A I do.

Q Are you going to continue to have hurricane -- I'm sorry. Are you going to continue to have tree trimming work to catch up in '05?

~~A Yes. That did flow up over into '05.~~

Q I believe you were also asked about an interrogatory regarding the pole replacements, and I think it was 329 poles were identified as being scheduled to be replaced and actually replaced during the hurricanes. Do you recall that?

A Yes, I do.

Q How is your budget established for pole replacement?

A The pole replacement program, it is a program. It considers that you inspect and replace poles on a continuous basis every year. So the fact that you may have some poles that now are no longer there to be repaired during that year which were scheduled, you just move to the next set and continue with the program.

Q And so will the money that would have been spent on these 329 poles be spent on other poles on the system that need to be replaced?

A Yes, they will.

Q You were asked generally about some areas of work, such as meter reading and -- I can't recall the other one, but meter reading certainly you were asked about. Going into the hurricane restoration process, was the company set up to track all those incremental effects?

A No, we were not.

Q And why not?

A The program that was established is a very simple program. When you're in the middle of a catastrophic event such as a hurricane, you don't need to be worried about what account number do I charge this to. You want your crews focused on restoration, getting customers back on as quickly as possible, and that's why the simple methodology was set up in the first place.

MR. WALLS: I have no further questions.

CHAIRMAN BAEZ: Thank you, Mr. Walls.

I have one exhibit, and that's 26.

MR. WALLS: Yes. We would move Mr. Wimberly's exhibit identified as MVW-1 and marked as, I guess, No. 26 into evidence.

CHAIRMAN BAEZ: If there are no objections, show it moved into the record.

(Exhibit 26 admitted into evidence.)

Mr. Wimberly, thank you.

Oh, I think we need to admit 52, the late-filed, as well, subject to objections.

MS. BRUBAKER: Mr. Chairman, 52 is identified as a late-filed. Typically those get moved into the record, I believe, at the final agenda.

CHAIRMAN BAEZ: Are they?

MS. BRUBAKER: Is that -- no?

CHAIRMAN BAEZ: I think we admit them subject to --

MS. BRUBAKER: Okay.

CHAIRMAN BAEZ: That's the way I've always seen it, but I can stand to be corrected. I'm not proud.

(Late-filed Exhibit 52 admitted into evidence.)

CHAIRMAN BAEZ: I'm showing the next witness as Rothschild.

MS. CHRISTENSEN: The Office of Public Counsel would like to call Mr. Rothschild.

Thereupon,

JAMES A. ROTHSCHILD

was called as a witness on behalf of the Citizens of the State of Florida and, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MS. CHRISTENSEN:

Q Good afternoon, Mr. Rothschild. Could you please state your name and your address for the record.

A My name is James A. Rothschild.

Q You might want to try -- is the green light on? Try that.

A My name -- I'll see if I can get my name right this time. My name is James A. Rothschild, and my business address is 115 Scarlet Oak Drive, Wilton, Connecticut.

Q Mr. Rothschild, did you cause to be filed in this case direct testimony with exhibits?

A Yes.

Q And do you have any corrections to your direct testimony or your exhibits?

A Yes, a couple of minor changes to the testimony.

The first would be on page 4. The paragraph on the top of that page should have been double-spaced. It was not part of the quote, which is single-spaced on the prior page. There's no change whatsoever in the actual text.

And on page 9, line 14, instead of referencing Atlantic City Electric, I would like to reference Rockland Electric.

Q Mr. Rothschild, with those corrections, if I were to ask you the same questions today as were asked in your direct testimony, would they be the same?

A Yes.

MS. CHRISTENSEN: Mr. Chairman, I would like to have Mr. Rothschild's direct testimony entered into the record as though read.

CHAIRMAN BAEZ: Without objection, show the direct testimony of Witness Rothschild moved into the record as though read.

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

**DOCKET NO. 041272-EI**

TESTIMONY

OF

JAMES A. ROTHSCHILD

**I. <u>STATEMENT OF QUALIFICATIONS OF JAMES A. ROTHSCHILD</u>**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is James A. Rothschild and my address is 115 Scarlet Oak Drive, Wilton, Connecticut 06897.

**Q. WHAT IS YOUR OCCUPATION?**

A. I am a financial consultant specializing in utility regulation. I have experience in the regulation of electric, gas, telephone, sewer, and gas utilities throughout the United States.

**Q. PLEASE SUMMARIZE YOUR UTILITY REGULATORY EXPERIENCE.**

A. I am President of Rothschild Financial Consulting and have been a consultant since 1972. From 1979 through January 1985, I was President of Georgetown Consulting Group, Inc. From 1976 to 1979, I was the President of J. Rothschild Associates. Both of these firms specialized in utility regulation. From 1972 through 1976, Touche Ross & Co., a major international accounting firm, employed me as a management consultant. (Touche Ross & Co. later merged to form Deloitte Touche.) Much of my consulting at Touche Ross was in the area of utility regulation. While associated with the above firms, I have worked for various state utility commissions, attorneys general, and public advocates on regulatory matters relating to regulatory and financial issues. These have included rate of return, financial issues, and accounting issues. (See Appendix A.

**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

A. I received an MBA in Banking and Finance from Case Western University (1971) ~~and a BS in Chemical Engineering from the University of Pittsburgh (1967).~~

## II. BACKGROUND AND PURPOSE

**Q. PLEASE EXPLAIN THE BACKGROUND FOR THIS TESTIMONY.**

A. Severe damage was inflicted on Florida by four hurricanes during 2004: Charlie, Frances, Ivan and Jeanne. Progress Energy Florida (PEF) claims that as a result of these hurricanes, it incurred $366 million in storm damage related costs. Of this amount, $55 million was capitalized and $311 million of restoration costs associated with these storms were charged to its storm damage reserve rather than being expensed. Since the Company had $45 million in its storm damage reserve fund before charging the extraordinary storm damage costs to the reserve, the result of the charges made by the company (prior to any adjustments the Commission may make in this case) is a $266 million negative balance in its storm damage reserve fund. The Company proposes to recover $252 million of this deficit from retail customers over a two-year period, with the remaining $14 million being attributable to wholesale customers. Since no amortization of this deficit in the storm damage reserve fund has begun, none of the storm damage costs that PEF charged to the storm damage reserve have yet impacted the earnings of PEF. (Source: PEF 3rd quarter 2004 10Q report to the U.S. Securities & Exchange Commission [SEC] obtained from the SEC website.)

Currently, PEF's rates are based upon a settlement agreement entered into in March 2002, with terms that are to remain in effect between May 1, 2002 and December 31, 2005. As explained in the Company's 3rd quarter 2004 10Q report:

> In March 2002, the parties in PEF's rate case entered into a Stipulation and Settlement Agreement (the Agreement) related to retail rate matters. The Agreement was approved by the FPSC and is generally effective May 1, 2002 through December 31, 2005; provided, however, that if PEF's base rate earnings fall below a 10% return on equity, PEF may petition the FPSC to amend its base rates.

The rate stipulation under which PEF is currently operating also specifically states that:

> FPC will not petition for an increase in its base rates and charges, including interim increases, that would take effect prior to December 31, 2005, except as provided in Section 7.

(Order No. PSC-02-0655-AS-EI, p. 15)

Section 7 of the stipulation says:

> If FPC's retail base rates earnings fall below a 10.0% ROE as reported on an FPSC adjusted pro-forma basis on an FPC monthly earnings surveillance report during the term of this Stipulation and Settlement, FPC may petition the Commission to amend its base rates notwithstanding the provisions of Section 4.

I am advised that the Office of Public Counsel's position is that the legal effect of the stipulation is such that prior to December 31, 2005, the source for amortization of the negative balance in the storm damage reserve must first come from earnings to the extent that earnings exceed 10.0% on equity. In other words, only after the company pays enough of the cost of the storm damage to bring the earned return on equity down to 10.0% is the company entitled to request authority to adjust its rates so as to recover the balance of storm damage costs. OPC has asked me to provide my opinion on the following subjects that are related to the decisions the Commission must make in this case:

---

(1) Is it appropriate to require a regulated electric utility such as PEF to bear some portion of the risk associated with storm damage losses?

(2) Given that the 10% return on equity is a matter of agreement, is it nonetheless reasonable under prevailing economic conditions?

(3) In the event the Commission decides that the threshold in the stipulation does not legally govern the situation, on what basis should the Commission apportion the burden of the storm damage costs between the utility and its ratepayers?

## III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

**Q. PLEASE SUMMARIZE YOUR FINDINGS.**

A. For reasons stated later in this testimony:

a) There is a requirement flowing from the stipulation that PEF first has to experience an earnings drop to no more than 10.0% on equity before it is entitled to request incremental recovery of any expenses. This requirement of the stipulation is applicable to all unanticipated expenses that may be incurred by the company, be they storm damage expenses or anything else. While it may be true that the company would have been able to earn more than the stipulated minimum 10.0% return on equity absent a storm, putting the portion of the 2004 storm damage losses that lower the return on equity down to 10.0% is fully consistent with the nature of risk and investment, as well as applicable principles of regulation. Investors are paid an allowance for risks, including the risk of storm casualty losses. The function of regulation is not to insulate the company from all risks that may cause earnings to decline below the levels they would have been without the realization of the risk. Because ratepayers pay rates that compensate investors for all risks, including storm damage, it would be entirely inappropriate to shift the full risk of such costs to ratepayers. In view of this, it would be proper to require PEF to absorb a portion of the storm damage losses even if there were no stipulation.

b) The 10% return on equity that PEF would be required to demonstrate under the terms of the stipulation before being allowed to request a rate increase is reasonable, if not conservatively high, under current economic conditions. More than half of the electric companies covered by Value Line in its Eastern edition are expected to earn 10% or less in 2004. Furthermore, as explained later in this testimony, the cost of equity determined by the Social Security Administration in its evaluation of what could be earned by allowing people to invest a portion of their Social Security funds in the stock market is 6.5% plus the inflation rate. Given investors' current expectations for inflation, this makes the current cost of equity based upon the Social Security Administration's approach equal to approximately 9.35%.

## IV. <u>RISK ALLOWANCE</u>

**Q. IS IT APPROPRIATE TO REQUIRE PEF TO BEAR A PORTION OF THE RISK ASSOCIATED WITH CATASTROPHIC STORM LOSSES?**

A. Yes, especially if the risk being borne is confined to the risk of reducing earnings to the extent that they are in excess of the stipulated return on equity floor of 10.0%. That PEF bears this portion of the risk associated with extraordinary storm casualty losses is fully consistent with the nature of business risks and investments. Investors understand that the companies in which they invest are exposed to a variety of risks. The possibility of having some reasonable exposure to storm casualty losses is but one example of the variety of risks that investors take—and for which they are compensated in the return on investment that the company is given an opportunity to achieve. Accordingly, to provide the appropriate opportunity to earn a fair return, given a company's overall risk profile, *and* to simultaneously require ratepayers to bear all of the risk of the storm losses that they are paying investors to accept, would be unfair to the company's customers.

**Q. CAN YOU DEMONSTRATE THAT PEF AND OTHER COMPANIES ARE COMPENSATED FOR TAKING BUSINESS RISKS?**

A. Yes. The return on long-term treasury bonds is indicative of a fully guaranteed (i.e., risk-free return). Because of the risk-free nature of the bonds, investors are willing to buy billions of dollars worth of long-term treasury bonds that are currently priced to yield 4.85%. The returns on equity that PEF and other companies are allowed to earn are significantly higher than this "risk-free" return. This means that ratepayers are paying investors a risk allowance in the range of 5% or more because the return on equity is not guaranteed. In other words, PEF ratepayers are paying investors millions of dollars every year to take risk.

**Q. TO WHAT BENEFITS ARE RATEPAYERS ENTITLED AS A RESULT OF PAYING THIS LARGE RISK ALLOWANCE?**

A. Ratepayers are supposed to be at least partially shielded from risks because, through the risk premium, they have already paid for that privilege. Investors understand they are paid to take a risk. Because of this understanding, they will still provide equity capital on reasonable terms to electric companies. This availability of capital on reasonable terms will happen so long as investors are confident that prospective rates continue to be set at a level that provides them with a reasonable opportunity to earn the cost of equity. Because ratepayers are making such payments, it is they, and not the company, who should be protected from having to bear the entire risk of storm damage losses.

**Q. HAS THE FLORIDA PSC ADDRESSED WHETHER IT IS REASONABLE FOR ELECTRIC COMPANIES TO ABSORB SOME OF THE RISK OF STORM DAMAGE?**

A. Yes. On pages 4-5 of its Order No. PSC-93-0918-FOF-EI issued in Docket No. 930405-EI, the Commission stated:

> FPL seeks approval for a Storm Loss Recovery Mechanism that would guarantee 100% recovery of expenses from ratepayers, over and above base rates in effect at the time of implementation. **This would effectively transfer all risk associated with storm damage directly to ratepayers, and would completely insulate the utility from risk.** We decline to approve such a mechanism at this time.
>
> FPL's cost recovery proposal goes beyond the substitution of self-insurance for its existing policy. The utility wants a guarantee that storm losses will have no effect on its earnings. We believe it would be inappropriate to transfer all risk of storm loss directly to ratepayers. **The Commission has never required ratepayers to indemnify utilities from storm damage.** Even with traditional insurance, utilities are not free from this risk. This type of damage is a normal business risk in Florida.

(Bold emphasis added.)

The principle that the Commission articulated in its 1993 order is not only fully applicable here, it is further reinforced by the Stipulation. The company is compensated for its entire risk profile, including the risk of storm damage. Even if there were no stipulation, or even if the Commission were to decide that the stipulation does not dictate the amount of storm losses that PEF must absorb, there would be a need to apportion the responsibility for the storm casualty losses between the company and ratepayers in a way that recognizes the risk that the company bears. The following section of my testimony shows that the 10% ROE criterion that OPC advocates as a consequence of the stipulation would be a reasonable basis for this decision even if there were no stipulation.

## V. UPDATED EXAMIMATION OF STIPULATED 10.0% MAXIMUM RETURN ON EQUITY PRIOR TO SEEKING AN ADJUSTMENT IN RATES

**Q. IS THE STIPULATED 10.0% MAXIMUM RETURN THAT PEF MUST DEMONSTRATE TO BE ELIGIBLE TO REQUEST A RATE INCREASE ADEQUATE TO PROVIDE A FAIR RETURN TO INVESTORS AND ENABLE PEF TO RAISE CAPITAL ON REASONABLE TERMS?**

A. Yes. If anything, it is more than adequate. Since the date of the stipulation, there have been some electric companies that have been awarded a cost of equity of less than 10.0%. These companies include Public Service Electric and Gas Company, Jersey Central Power & Light Company, Atlantic City Electric Company, and Connecticut Light and Power Company.

Schedule 1 of my testimony shows the actual earned returns on equity Value Line estimates the electric companies in the edition that covers Eastern electric companies will actually earn on equity in 2004. A review of the Value Line Eastern edition results reveals that in 2004 more than half of the 23 electric companies covered by Value Line are estimated to actually earn 10.0% or less with some companies, including Allegheny Energy, Central Vermont, Northeast Utilities, and TECO expected to earn 8.0% or less on equity. In other words, Progress Energy Florida's stipulated settlement that provides for actual earnings of 10.0% or higher produces results that place the Company at or above the median earned return on equity.

**Q. HOW DOES THE FINANCIAL RISK OF THE 23 ELECTRIC COMPANIES IN THE VALUE LINE EASTERN EDITION COMPARE TO THE CURRENT CAPITAL STRUCTURE OF FPC?**

A. The financial risk of a company is dependent upon the level of common equity in its capital structure. The higher the common equity ratio, the lower the financial risk. According to PEF's July 2004 report to the Commission, its capital structure contains 47.65% common equity. However, to be consistent with the way that Value Line reports common equity ratios, the impact of short-term debt, customer deposits, the investment tax credit, the FAS 109 asset and deferred income taxes must all be excluded. Excluding these amounts makes the common equity ratio of PEF'S 56.9%. At 56.9%, PEF has a lower financial risk than all but two of the 23 companies in Value Line's Eastern Edition of electric companies and is a considerably higher ratio than the 44% median common equity ratio for the group. The reduced financial risk associated with a 56.9% common equity ratio causes a reduction in the cost of equity of about 0.50% compared to an electric company with a common equity ratio equal to the 44% group median.

**Q. HAVE THERE BEEN CHANGES IN THE CAPITAL MARKETS SINCE THE 10.0% WAS ESTABLISHED?**

A. Yes. PEF'S stipulated 10.0% was the result of proceedings based upon direct evidence filed no later than very early in 2002. A revisiting of the 10.0%

maximum earnings standard before rate relief could be requested was not specified as a condition of the settlement. Furthermore, since the time of the evidence on which the 10.0% standard was based, long-term interest rates have declined. Therefore, even if one wanted to go beyond the settlement and update the 10% threshold, an updating would cause a revisiting of the threshold to be lowered. As of early January 2005, the interest rate on long-term U.S. treasury bonds is approximately 4.85% compared to the 5.64% as of the March 2002 date that the settlement agreement was made. Therefore, if the 10.0% maximum earnings threshold requirement were updated to reflect current conditions, the minimum required before rate relief should be approximately 9.2%.

**Q. YOU SAID THAT THE SOCIAL SECURITY ADMINISTRATION HAS DETERMINED THE COST OF EQUITY. PLEASE EXPLAIN.**

A. President Bush has proposed to allow people to choose to invest a portion of their Social Security funds in the stock market. As part of his argument in favor of this approach, it is anticipated that those who choose to invest in the stock market will be able to earn higher returns than if the funds are merely sent to the Social Security Administration in the old way. The cover article that appeared in the January 24, 2005 issue of Business Week addresses this topic. The article, entitled "Special Report. SOCIAL SECURITY. Are Private Accounts A Good Idea?" notes on page 69 that Stephen C. Goss, the SSA's chief actuary has determined that the total return on the stock market will be 6.5% over the inflation rate during the next 75 years. Currently, the future expectation for inflation is about 2.85%, a number I obtained by comparing the difference in yield between normal long-term U.S. treasury bonds and the yield on inflation-indexed U.S. treasury bonds. Adding the 6.50% and the 2.85% produces a cost of equity expectation of 9.35%. This 9.35% is before any risk reduction adjustment that would be applicable.

Q. **ARE YOU RECOMMENDING THAT THE STIPULATION UPON WHICH CURRENT RATES ARE BASED SHOULD BE LOWERED FROM 10.0%?**

A. No. The stipulation does not provide for a revision of the 10.0% prior to 12/31/05. However, I have provided the 9.2% (based upon an update to the 10.0% finding based upon interest rate changes) or the 9.35% (based upon the method chosen by the Social Security Administration) to show the Commission that if the 10.0% return on equity was appropriate when the stipulation was entered into in March 2002, it is more than reasonable in today's financial climate.

Q. **SHOULD THE COMMISSION BE CONCERNED THAT ENFORCING THE 10% ROE CRITERION COULD CAUSE RATING AGENCIES TO DOWNGRADE PEF, RESULTING IN AN INCREASE IN ITS COST OF CAPITAL?**

A. No. The terms of the stipulation are not new news to the bond rating agencies. If the Commission allows PEF to earn a return on equity that is commensurate with its risk profile and prevailing economic circumstances, rating agencies would have no reason to be concerned about PEF's ability to meet its debt service requirements. Additionally, for the reasons stated, providing PEF the opportunity to earn 10% on its equity capital while affording it the ability to recover the balance of storm-related costs would be fully adequate to enable PEF to access capital markets on reasonable terms in the current environment.

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## VIII. CONCLUSION

**Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.**

A Requiring PEF to bear some of the costs associated with repairs to 2004 storm damage that exceeded the positive balance in its storm damage reserve is consistent with the nature of business risk inherent in investments. To induce them to take on risk, investors have been paid millions of dollars to provide a return greater than a risk-free rate. Because they are paid such a large amount to do so, occasionally requiring them to actually bear some of this risk is well within the parameters to which ratepayers are entitled and investors expect. Indeed, because ratepayers have been paying rates that compensate PEF's investors for such risks, it is they, and not shareholders, who are entitled to a degree of insulation from storm damage costs.

Applying the 10% ROE criterion in PEF"s stipulation will not result in the inability of PEF to earn its cost of capital. **The 10.0% earned return on equity** is still as high or higher a return on equity than the return on equity Value Line expects more than half of the electric companies in its Eastern edition to actually earn, and was established at a time when long-term interest rates on U.S. treasury bonds were higher than they are today.

I recommend that the Commission use the 10% ROE criterion to quantify the portion of PEF's negative storm damage reserve balance for which PEF's shareholders should be responsible. While this position flows from OPC's position regarding the effect of the ratemaking stipulation to which PEF is a party, in my opinion it would be an appropriate basis for assigning the company's responsibility even in the absence of a stipulation.

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes.

BY MS. CHRISTENSEN:

Q Mr. Rothschild, have you prepared a brief summary of your testimony?

A Yes.

Q Can you please provide us with that brief summary?

A Yes, I will. The testimony that I prepared starts with the interpretation given to me by counsel, and that interpretation is that the stipulation which currently is in effect for Providence Energy Florida prohibits the company from requesting a rate increase prior to December 31st, at least one that would come into effect prior to December 31, 2005, unless its actual earned return on equity should drop below 10%.

I'm understanding that OPC proposes to honor that stipulation and agreement by allowing the company to recover its hurricane damage costs to the extent that it would bring the return on equity up to 10%, but not more than that.

I was specifically asked to and did in my testimony address three basic questions. The first one is, is the 10% return on equity in the stipulation still reasonable in today's market, today's financial climate, and my answer is yes, it is. And among the reasons that I give for that are, number one, there are numerous electric companies that have recently been allowed earned returns on equity of less than 10%; number two, long-term interest rates are lower now, considerably lower now, in fact, than when the 10% number was initially established in the stipulation; and number three, if you look at the earned returns on equity, not ~~cost of equity, now, but the earned returns on equity~~ actually achieved by all 23 of the electric companies covered in the Value Line Eastern Edition, approximately half of them earned in 2004 less than 10%. So if Providence Energy Florida has its earnings brought up to 10%, it's going to be in the middle of the pack, even under what is by all accounts very trying times with the hurricanes that did bombard them.

The second question I was asked to address was, if for whatever reason the Commission should decide that the stipulation does not legally apply in this proceeding, how should the hurricane costs be shared in that instance? And there I would say that if we were to be conservatively high, we could still use the 10% number. If I were testifying on cost of equity today, my number would be -- for Providence Energy Florida would in all probability be less than 10%. **And I say** that for much the same reasons that I gave in my prior answer, and that is that interest rates are down from what they were before.

And in addition, I point out in my testimony that the chief actuary for the Social Security Administration determined that in the current environment, the average -- the cost of equity for a company of average risk would be 6-1/2% plus an allowance for inflation. And as I explain in my testimony, it's easy to see what investors expect for inflation by looking at the difference between long-term Treasury bonds that include inflation and long-term Treasury bonds that do not include inflation. And when you go through that arithmetic, you still end up with a cost of equity in the low 9% range.

And I also lean on my other testimonies that I've filed in other cases where I have done complete DCF analyses and so forth. I didn't feel it was something that -- people usually aren't too thrilled to see big piles of DCF analyses, so I decided it was more appropriate to save the client's money and spare the Commission the chore of going through that when I didn't think it was necessary in this instance.

And the final question that I would address is, are investors paid to take a risk, and the answer is clearly they are. The allowed return on equity of 10% is considerably higher than what long-term Treasury bonds are paying. When I prepared my testimony, it was in the 4.8-something percent range. And I just got a quote a couple of hours ago. It's a little bit less than that now, 4.77 at midday today. I'm not sure where it closed. So that difference is significant, and that difference is a number that investors are paid in exchange for taking on risk, and it's substantial dollars.

So for all of those reasons, I think what we have here is, from the areas that I'm looking at in the testimony, we have a very, very reasonable approach proposed by OPC and very much supported by the current financial climate.

Q Mr. Rothschild, does that conclude your testimony, or your summary?

A Yes, it does.

MS. CHRISTENSEN: I would tender the witness for cross.

MR. PERRY: I don't have any questions.

CHAIRMAN BAEZ: Mr. Wright?

MR. WRIGHT: I have a few.

CHAIRMAN BAEZ: Okay.

CROSS-EXAMINATION

BY MR. WRIGHT:

Q Good afternoon, Mr. Rothschild. Thank you for being here.

A Good afternoon.

Q You talk a lot about risks and the compensation for risks that ratepayers pay utility shareholders in your testimony, and I have a number of questions for you along those lines.

My first question is rather a general one. Does the availability of surcharge recovery for various costs, fuel, conservation, environmental costs, et cetera, reduce the risks to utility shareholders?

A Yes. Certainly the opportunity to recover those items which can result in variability of cash flow and variability of earnings from period to period does mitigate risk and, among other things, would give the company an opportunity to use a greater percentage of debt in its capital structure and lower the cost of capital by doing that.

Q Even without the storm recovery surcharges which Progress has not yet been authorized to recover, do you happen to know or do you have an idea of the percentage of Progress Energy Florida's revenues, say, in 2004 that were recovered via surcharges?

A I have not made that computation, no.

Q Okay. On page 6 of your testimony, you make the statement that investors understand that the companies in which they invest are exposed to a variety of risks. Does that statement hold true for utility investors, that is, investors in utility stocks?

A I'm sorry. Which --

Q Page 6, lines 10 and 11. You make what I interpreted to be a general statement that --

A Oh, yes. The general statement does apply to utility investors as well. I just want to make sure I'm reading on the same wave length, but, yes.

Q Thank you. And do you believe that that also applies specifically to storm cost risks?

A Yes.

Q Do you believe -- in your what I understand to be fairly extensive experience in consulting in the utility business, is it your experience that public utility commissions generically also understand that they're compensating investor-owned utilities for storm cost risks and when they set their allowed ROEs and approve their capital structures?

A Yes. Storms are a phenomenon. They certainly -- hurricanes in particular are a phenomenon that most, if not all, of the Eastern electric utilities are exposed to. And as you work your way north, you run a higher risk of ice storms, which can be expensive also.

Q Thank you. Are you familiar to either a general or specific degree with the history of hurricanes in Florida?

A Well, I have a general knowledge. I know there was Hurricane Andrew in the early 1990s that was very big, and then I'm well aware, obviously, of the four hurricanes in 2004, and certainly was aware of that even before these proceedings. It's front-page news when that happens.

Q And as I understand from your testimony, you're familiar with a number of Florida Public Service Commission orders addressing storm cost recovery or the recovery of storm restoration costs?

A Yes.

Q Do you believe, based on what you know, that the Florida Public Service Commission itself has considered all risks, including those associated with storms, in setting rates and in determining allowable ROEs for the utilities that it regulates?

A I'm not sure anybody is good enough to include all risks, but I think certainly in the case of storms, the Commission has specifically spoken. And I also believe it has tried to include all reasonably knowable risks in coming up with its allowed returns, yes.

Q Thank you. At page 7 of your testimony, lines 7 and 8, you make the statement that PEF ratepayers are paying investors millions of dollars every year to take risk. I would like to -- I've got a few questions about that. Are Progress Energy's shareholders paying their customers to take any risks?

A Are the shareholders paying the customers?

Q That's my question.

A No.

Q Okay. Are you familiar with earnings surveillance reports submitted by Florida utilities?

A Yes, I have seen some of them.

Q Okay. Did you happen to see the 2004 earnings surveillance report for Progress Energy Florida?

A Yes.

Q Using information in that report, can you estimate the total amount that the ratepayers paid in 2004 to Progress Energy Florida's shareholders to take risks?

A Well, I don't have a calculator in front of me, but I can go through the computation. I'm looking at Schedule 1 of the report you're discussing, which has a date on it of March 3, 2005, and I see on Schedule 1 in the surveillance report that the earned after-tax return on equity achieved by Progress Energy was 13.48%. I also see that the net operating income was $366 million.

If we take the long-term risk-free rate of approximately 4.8% and subtract that from the 13.48, we end up with a little under 9. We take that as a percentage of the 13.48, and we arrive at the percentage, which is an allowance for risk, multiply that by the 366 million, which is going to -- somebody can go through the computations, but let's say that's 200 million. And then gross that up for taxes, and you're going to end up somewhere in the range of $300 million.

Q Thank you.

COMMISSIONER DEASON: I'm sorry. Let me ask this. You said the 366 million was net operating income?

THE WITNESS: Yes.

COMMISSIONER DEASON: Isn't that before debt service?

THE WITNESS: I'm looking at this quickly. If that is before -- if that is before debt service, then certainly I should be corrected and we should be taking the number that's available for common equity in the computation.

COMMISSIONER DEASON: Thank you.

BY MR. WRIGHT:

Q At a rate of return on equity of 10%, can you give us a ballpark estimate of how much Progress's ratepayers would be paying Progress's shareholders to take risk?

A Well, that would reduce the percentage, but it would still be roughly 50% of net income grossed up for taxes, a little bit more than 50%, because the long-term interest rate on Treasuries is a little bit less than 5%. And that would be -- Commissioner Deason is certainly correct. You would be taking the net income available to common equity in making that computation.

Q Thank you, Mr. Rothschild. I have just one or two more questions.

At page 6, lines 14 through 18, of your testimony, you make the following statement: "Accordingly, to provide the appropriate opportunity to earn a fair return, given a company's overall risk profile, and to simultaneously require ratepayers to bear all of the risk of the storm losses that they are paying investors to accept, would be unfair to the company's customers." I read that accurately, did I not?

A Yes.

Q My question for you is, would ratemaking treatment that allowed the result that you describe in your testimony result in rates that are unfair and unreasonable?

A In my opinion, it would be, yes.

MR. WRIGHT: Thank you. That's all the questions I have.

CHAIRMAN BAEZ: Excuse me. Mr. Twomey?

MR. TWOMEY: No, sir.

CHAIRMAN BAEZ: Staff?

MS. RODAN: No questions.

CHAIRMAN BAEZ: Commissioners?

COMMISSIONER DEASON: What about --

CHAIRMAN BAEZ: I'm sorry. You know, you get into a -- it's like stepping off of the elevator on the wrong floor. The door opens, and you go.

I'm sorry, Mr. Walls. Go ahead and cross, please. It was too good to be true.

CROSS-EXAMINATION

BY MR. WALLS:

Q Mr. Rothschild, let me start with what you've not been asked by OPC to do in this docket. As I understand, you've not been asked by OPC to challenge the reasonableness or prudence of the work done by the company to prepare for and respond to the 2004 hurricanes; is that right?

A Yes.

Q And you've also not been asked by OPC to challenge the reasonableness or prudence of the costs the company incurred to prepare for and respond to the 2004 hurricanes; is that right?

A Yes. That's not within the scope of my testimony.

Q And as I understand what you were asked to do, and I believe you briefly summarized that, by OPC is that you were first to testify as to whether the reference in the company's 2002 rate case settlement to a 10% ROE before the company can request a change in base rates is reasonable today; is that right?

A It's still reasonable, yes.

Q Well, that's what you were asked to determine; right?

A Whether it's still reasonable today.

Q And as I understand, the second thing that you were asked by OPC to do was address whether investors bear a certain portion of the risk of the company's normal business through ROE; is that right?

A Yes.

Q Well, let's start with the second thing you were asked to do first, and I have some questions for you where I think we have some agreement. You would agree with me that hurricanes are natural phenomena that reoccur periodically in unpredictable ways and not necessarily every year; right?

A They are certainly natural phenomena, and they reoccur in unpredictable ways. Yes, they don't necessarily occur at any one place in any given year.

Q And you understand that four hurricanes in Florida in one year was an unprecedented event; correct?

A Yes.

Q And you would also agree with me that hurricane or storm-related costs are unpredictable; right?

A Well, the shorter the time interval, certainly the more unpredictable it is. If you ask me whether or not there's going to be a hurricane on September 1st this year, I certainly don't know, nor does anybody else, whether or not there's going to be one. We're going to have to wait and see. Hopefully there won't be. If you say, "Is there going to be a hurricane sometime over the next five years in Florida?" I would say there's a darn good chance there will be some, but I don't know how many, and I don't know when.

Q You recall giving a deposition in this case, don't you, Mr. Rothschild?

A Yes, I do.

Q Okay. And I took that deposition; right?

A Yes.

Q Okay. At page 11 of your deposition, lines 14 to 16, you were asked the following question and gave

the following answer: "Would you also agree with me" --
A Excuse me. May I please turn to the page?
Q Sure. Page 11, lines 14 to 16.
You were asked the question and gave the following answer: "Would you also agree with me that hurricane or storm-related costs are unpredictable?"
Answer, "Yes."
Is that correct?
A That's what that says, yes.
Q Now, would you also agree with me that hurricane or storm-related costs are volatile?
A As I said in my deposition in the next question, in any given year, certainly they are volatile. And I can elaborate and say that as you -- the longer you go out to make a projection, the more likely you are to hit a longer term average. But there's certainly no guarantees, even over a five-year period, what they're going to be.
Q And that certainly is an elaboration on the answer in your deposition, isn't it?
A Is it an elaboration?
Q Yes.
A It's an elaboration of that one question. I don't know whether I said that somewhere else in the deposition or not.

Q And you agree with me that the purpose of a base rate proceeding is to set rates prospectively; correct?

A Yes.

Q Okay. And you would not take the position in an electric utility base rate proceeding that the Commission should set an annual accrual in base rates for storm reserves at a rate sufficient to pay for a 2004 hurricane season every year; isn't that right?

A Well, recognizing that you're outside of the scope of my testimony and I don't claim to be an expert weather person, I would not expect to take an extraordinary or the most extreme case we know about and use that as the normal allowance, no. But that doesn't mean you wouldn't take a look at the variations and use that, ups and downs, when coming to the allowed amount.

Q Well, Mr. Rothschild, you wouldn't want this Commission to set rates, base rates on an annual basis for a storm reserve to pay for a 2004 hurricane season every year, would you?

MS. CHRISTENSEN: Objection. Beyond the scope of Mr. Rothschild's direct testimony. And I believe he indicated that in the first answer, and I think now we're starting to really get --

CHAIRMAN BAEZ: Mr. Walls, can you point to me where you're off his testimony?

MR. WALLS: Well, I believe he was asked by Mr. Wright whether he understood about hurricanes and the way they were accounted for in Florida in his questioning without objection.

And also, these are just fundamental issues that are apparent in the case. If Mr. Rothschild wants to talk about risks of investors in the State of Florida, then one of the things that has to be understood is whether the base rates cover this kind of risk, of a 2004 hurricane season, and that's why I'm asking him these questions. He has testified in his direct quite a bit about what level of investors' risk they should expect.

CHAIRMAN BAEZ: If you're trying to gauge his understanding of how we set rates and what's included and what's not, I'll give you a little leeway, but I don't think you're going to get very far with it.

So ask your question again, but I think you're getting a little wide of even what Mr. Wright asked.

BY MR. WALLS:

Q Mr. Rothschild, the question was, you would not want this Commission to set base rates on an annual basis to include costs to pay for a 2004 hurricane season every year, would you?

MS. CHRISTENSEN: Objection. Same objection. This is beyond the scope, and it's beyond his understanding of --

CHAIRMAN BAEZ: Hold on, because I allowed him to ask the question. But can you ask it in a way that's -- if you're asking objective questions, that's fine. He hasn't professed an opinion of what he wants us to set reserves at, and I'm not sure that it's fair to ask him now.

BY MR. WALLS:

Q Mr. Rothschild, would you agree with me that the company's current base rates were not designed with the specific expectation for the hurricanes hitting in 2004, the 2004 hurricane season?

A My understanding of prospective ratemaking is that rates are set in a way to provide a company a reasonable opportunity to recover its reasonably expected expenses and its cost of capital. And then reality hits, and reality can produce better or worse than what is prospectively anticipated. There can be a year of no hurricanes, even though there's a hurricane allowance, and there can be a year of multiple hurricanes which could result in the allowance being inadequate.

And that's the nature of prospective

ratemaking. In stors are paid for risk, because prospective ratemaking is imperfect, but it has the advantage of providing incentives for management to do the best they can, and indeed then have an opportunity, if they can beat the prospective expectations, to earn more than anticipated. And it goes both ways. You migh arn ss

Q Well, Mr. Rothschild, my question was that the current -- you would agree with me that the current base rates the company is operating under were not designed with the specific expectation of the 2004 hurricane season; correct?

A If you're asking me does the existence of the 2004 hurricane change what might be factored into future prospective ratemaking, I can see where an expert in the field might look at that And I'm certainly not an expert in hurricane .

But the concept is that if we were here -- look at it the other way around Suppose -- and I know that the company has had an allowance for hurricane damage that has been put into a reserve. If it turned out we went through a decade where there were no hurricanes, or whatever would be a statistically reasonable period where it might happen -- d I d 't claim to know what that is -- I think we would all find it strange if ratepayers said, "Well, we went through 10 years or eight years or six years of wind that never went over 20 knots, and now we want our money back." And I don't think that that would happen. So that's the whole nature of prospective ratemaking.

Q Mr. Rothschild, do you recall that I asked you the following question and you gave the following answer on page 12 of your deposition, lines 11 through 22?

Question: "Now, would you agree with me that the base rates are not set to cover the costs of such storms as the 2004 hurricanes?"

Answer: "Well, I think there's a lot implied in that question, and I think it's probably better if I elaborate. There was a prospective allowance for hurricane storm damage, and as the utility ratemaking process works, a good faith estimate is made for prospective events. Was a specific expectation of four hurricanes hitting in 2004 specifically built in? I find that hard to believe, so I would expect the answer is no, but I didn't specifically prepare that analysis."

Did I read that correctly?

A Yes.

Q Now, you would also agree with me that the company lost some revenues as a result of the hurricanes that it would have otherwise received had there been no hurricanes; right?

A I believe, going by memory to my deposition, my answer is that, yes, I'm sure that during the outage there were people who couldn't get service, and so there were there were some lost revenues. But also, there were some additional revenues that the company earned once the power was turned back on again, as people used power tools or other devices in the process of rebuilding.

Q And you would also agree with me that it's inappropriate for the company to bear the full risk of the 2004 storm damage costs; correct?

A Well, OPC is certainly not proposing that, and to bear the full cost is probably too extreme in this case. It would probably go beyond where the -- certainly what has been communicated by this Commission as to what they're likely to do. So I would say that to bear the full cost is going too far.

Q Now, I want to turn to the first thing that you were asked by OPC to do, which is look at the 10% ROE referred to in the rate case stipulation and talk about what is reasonable during the same time period of the rate case stipulation. And as I understand, you start with the premise that was given to you by OPC that prior to December 31, 2005, the negative balance in the storm damage reserve must first come from the company's earnings until the company reaches a 10% ROE. Is that right?

A Yes.

Q And that's not a position you developed independently; right? That's what you were told to use by OPC?

A That was the legal interpretation of the stipulation.

Q And they provided you the stipulation; right?

A Yes.

Q And you referred to that in your testimony; right?

A I believe so, yes.

Q They didn't provide you Rule 25-6.0143(4), did they?

A I don't know.

Q You don't refer to it in your testimony, do you?

A The number doesn't mean anything to me, so I don't know whether or not I've seen that rule. I certainly wouldn't remember the number.

(Documents distributed.)

BY MR. WALLS:

Q Mr. Rothschild, do you see what's in front of you and recognize that as Rule 25-6.0143 of the Florida Administrative Code?

A I see -- it says Florida Administrative Code Annotated, Title 25, Public Service Commission, Chapter 25-6.

Q Do you see right below that where it says 25-6.0143, Use of Accumulated Provision Accounts 228.1, 228.2, and 228.4?

A Yes.

Q This is not something that you were provided by OPC in connection with your testimony; right?

A I don't know that I specifically saw this document, but at least scanning it here, I don't see any concepts I'm not aware of.

Q Okay. I don't particularly remember any reference to this rule, and particularly subsection (4)(b), in your testimony. Is there any?

A I don't believe so, and I don't know why there would need to be.

Q Okay. Well, let's read subsection (4)(b). "If a utility elects to use any of the above listed accumulated provision accounts, each and every loss or cost which is covered" --

A Excuse me. I'm trying to find where you are. (4)(b). Okay. I see it.

Q Front page, last paragraph.

A I've got it. Okay.

Q Reading again, Rule 25-6.1043, subsection (b), "If a utility elects to use any of the above listed accumulated provision accounts, each and every loss or cost which is covered by the account shall be charged to that account and shall not be charged directly to expenses. Charges shall be made to the accumulated provision accounts regardless of the balance in those accounts." Did I read that correctly?

A Yes.

Q Now, with respect to your opinion, Mr. Rothschild, it's fair to say that what you do is conclude that even without the stipulation in place, a 10% ROE is reasonable during the same time period as this stipulation; is that correct?

A Well, I think it's very important to -- there's two different concepts here, and a lot of people get them mixed up. There's the ROE, which can have a dual meaning. ROE can be the earned return on equity, or sometimes it can mean the cost of equity. And so in order to make sure we're talking on the same wave length, I need to be sure which you mean in that question, because it will change the answer.

Q Well, Mr. Rothschild, I asked you the same question in your deposition. If you would turn to page 29, lines 15 through 21, I asked the same question, and you gave this answer.

Question: "And it's fair to say then" --

A Excuse me. I need to get there.

Q Okay.

A All right. Page 29, lines --

Q Fifteen to 21. The question was, "And it's fair to say then that what you do is, you conclude that even without the stipulation, a 10% ROE is reasonable during the same time period; is that correct?"

Answer: "Even without the stipulation?"

Question: "Yes."

Answer: "Yes."

Did I read that correctly?

A Well, yes, but you have to put it in the context we're talking about. And I think in the context that we were discussing it and got there, it was at least at the time clear to me what you meant, and now you're taking this out of left field, and it's not clear to me what you mean. And so I think in fairness to everybody, so we make sure you get the correct answer out of me rather than a random answer, it would be better if you define the term.

Q Mr. Rothschild, you would agree with me that the company is permitted to earn more than 10% ROE under the rate case stipulation; correct?

A It is -- under the stipulation, which was agreed upon, the company is given a reasonable opportunity to earn more than 10%. It was also provided a safety net. In the event the return fell below 10%, the company was then given the opportunity, but not the guarantee, the opportunity to request, but not the guarantee it would get, an increase. In exchange for that, the company had no ceiling on what it could earn. It could earn 30% on equity.

And ratepayers had the benefit also that to the extent revenues exceed a forecast level, that the ratepayers share in that revenue growth.

Q Mr. Rothschild, you would agree with me, and using your words from the deposition, that if the company's earnings were higher than 10%, the Commission can't reduce it, period; correct?

A Yes.

Q Now, you would also agree with me that a discounted cash flow is the most commonly used method of determining the cost of equity; correct?

A Yes.

Q But you did not do a specific discounted cash flow analysis to prepare your testimony that a 10% ROE is reasonable in this case; isn't that right?

A What I said in the deposition, which is the same as I'll say here, is that I regularly do DCF analyses, and my conclusion is based upon looking at those DCF analyses, whereas for the context of this proceeding, as I said in my opening statement, no, I did not prepare a specific DCF analysis.

Q And in fact, you told me in your deposition that if you had done a DCF analysis, you would have generated work papers and included them as schedules to your testimony; correct?

A And I have such work papers associated with the other testimonies that were filed there that I'm thinking of. But, no, I did not prepare a specific DCF analysis in this proceeding, because it was not only based upon what counsel told me, but it was clear to me that the 10% was already established. And why should I spend my client's money and spend the time of everybody else to go through what most people find an extremely boring part of the ratemaking process when I don't think it was needed?

Q Mr. Rothschild, let's look at what you did rely on. First you attached as an exhibit to your testimony a document where you picked all the electric companies covered in Value Line's Eastern Edition. And what you did was include their actual earned returns for 2004, not their allowed returns for that year; isn't that right?

A Well, it's correct I prepared such a schedule, but there was something in your question which is not correct. I did not prepare that schedule for the purpose of determining the cost of equity. That schedule was prepared to show the reasonableness, the very reasonableness of what is the low end threshold for Progress Energy Florida to request an increase. And it has this opportunity to see that its return doesn't fall below 10%, even though approximately half of the companies in the -- of all of the 23 companies covered in the Eastern Edition of Value Line earned less than 10%. It was not -- it was definitely not to say that just because companies earn a particular number, it's a cost of equity. Here we're looking at an end result of, in effect, what's a safety net, and is the safety net adequate. And I conclude, in part based upon the schedule you're referring to, that it's very adequate.

Q Mr. Rothschild, my question is very simple. Yes or no, does your exhibit include the actual earned returns for those companies that you identified and not what they were allowed to return by whatever regulatory body that governed them, yes or no?

A Yes, it shows the actual earned returns. It does not show what they were allowed.

Q Okay. Now, the second thing I recall that you relied on is at page 5, carrying over to page 6 of your testimony. And as I understand it, you relied on a cost of equity number that you pulled from a Business Week article that you obtained, and that was regarding an analysis by the Social Security Administration of the stock market; is that correct?

A That is one of the analyses I used and presented in my testimony, yes.

(Documents distributed.)

BY MR. WALLS:

Q Mr. Rothschild, do you have in front of you the Business Week article from which you obtained your 6.5% figure in your testimony on page 5?

A Yes.

Q And if we turn to page 69 in the lower right-hand corner of this Business Week article, the last paragraph on that page, and carrying over to the next page, or I guess in the last paragraph on that page, where it reads, "Goss assumed, as most privatization proponents do, that the stock market would average 6.5% a year after inflation for the full 75 years." Did I read that accurately?

A That sentence, yes.

Q And this is where you obtained your 6.5% number from, correct?

A Yes. I think it might be somewhere else in the article also, but that's certainly one place I could have gotten it.

Q And as I understand it, you did not talk to Mr. Goss; correct?

A I did not specifically talk to Mr. Goss, no.

Q And you didn't help Mr. Goss write his analysis; correct?

A That's right. His analysis is independent of mine.

Q And you didn't ask Mr. Goss for his work papers, and he didn't give them to you, did he?

A That's correct, although I have seen other places where the same number is discussed, and so therefore, I do have an understanding of where it was obtained and certainly have seen other sources with more elaboration around them that have come up with a very, very similar number.

Q And as I understand, as you said in your deposition, President Bush didn't call you and ask you what you thought the right number was; is that right?

A That's correct.

Q And let's look at what the author of the Business Week article had to say about Mr. Goss's analysis. If you would turn to page 70, the last paragraph, it reads, "Goss's reliance on conservative assumptions is perfectly reasonable, especially since no one can really project anything over 75 years. But his more optimistic scenario, based largely on historic growth rates, shows no shortfall at all. Since the U.S. economy has produced pleasant surprises for nearly a decade, little might be lost by waiting to see if these trends continue." Did I read that correctly?

A That's what that portion, says, yes.

Q And is that the author's conclusion with respect to Mr. Goss's analysis in this article?

A I'm not sure.

Q Okay. But this is the article you relied on to get that 6.5% number; correct?

A Yes.

Q The next thing I want to turn to that you relied on to support your opinion as to a reasonable ROE is your reference on page 9 of your testimony at the bottom of the page to electric companies that have been awarded a cost of equity of less than 10%. Do you see that?

A Yes.

Q And as I understand, you didn't do a survey of electric utilities' ROE awards to come up with this list. You just used a sample of cases you were involved in and knew off the top of your head; is that correct?

A The ones that I had been involved in and I knew, yes. But also, it needs to be explained that what I'm doing here is testing the reasonableness of 10% as a safety net. And if there are companies out there that have earned less than 10% and that's the safety net, the safety net is at a comfortably high level. I'm used to seeing safety nets that, when you're talking about kind of a stopgap thing, are oftentimes considerably lower than this. So I think you need to look at the analysis as it was presented, in the context in which it was used.

Q Well, the answer to my question is correct; right? You did not do a complete survey of electric utilities. You relied on what you could recall off the top of your head; is that correct?

MS. CHRISTENSEN: Object to the mischaracterization, off the top of his head. I mean, it's --

MR. WALLS: It's his words.

CHAIRMAN BAEZ: Are you reading it off of his --

MR. WALLS: Yes. If you would like --

CHAIRMAN BAEZ: I don't know that you can object. Overruled.

A I think I just answered it to you, that the purpose for which this was done was to test the reasonableness of the safety net, and for that purpose, I went to the companies with which I was familiar. And "off the top of my head" in the formal proceeding sounds like it means something different than I meant it in the more informal deposition. It was that which I could do without having to go through a research analysis. "I just knew from memory" is the more formal way of saying "off the top of my head."

Q If we could turn to page 52, lines 7 through 11.

A Page 52 of --

Q Your deposition, lines 7 through 11.

A Yes.

Q I asked the following question, and you gave the following answer. Question --

A Excuse me. It takes me a little while, because the pages printed a different way. Page 52, lines --

Q Seven to 11.

A Yes.

Q Okay. I asked the following question, and you gave the following answer.

Question: "Can you give me a complete list?"

Answer: "No. I have not done a complete survey. I was writing my testimony just based upon -- with my only sample being cases in which I was involved and knew off the top of my head. That was all."

Did I read that accurately?

A Well, you read it accurately, but I think in seeing how this might be used out of context rather than in context, "out of the top of my head" should be changed, or "off the top of my head" should be changed to "from memory," because that's what I meant when I said that. And I see how in a brief that might look like something different, like I've got it written on my hat or something, on my baseball cap.

Q Mr. Rothschild, why don't we take a look at some of these orders that you referred to, if we could.

Oh, I'm sorry. Let me ask one question before I get there. All of the companies that you identify by name on page 9 of your testimony are transmission and distribution or distribution-only companies; isn't that right?

A Yes.

Q All right. Now let's look at a couple of these orders.

(Documents distributed.)

BY MR. WALLS:

Q The first one, Mr. Rothschild, if you have in front of you the State of New Jersey, Board of Public Utilities order regarding the petition of Public Service Electric and Gas Company for approval of changes in electric rates, Docket No. ER02050303, agenda date 7/9/03, agenda item 2A. Do you see that?

A Yes.

Q And this is one of those orders that you relied on in your testimony on page 9; correct?

A Yes.

Q And the ROE for the utility in this particular order was set as a result of a settlement; correct?

A It was set as a result of a settlement, but the settlement was based upon Commission decisions, and everybody knew where the Commission was going to come out. So it was a settlement based upon knowledge, not based upon some separate event.

Q Mr. Rothschild, let's look at another order. This one is State of New Jersey, Board of Public Utilities, Two Gateway Center, involving the matter of the verified petition of Jersey Central Power & Light Company for review of approval of an increase in and adjustment to its unbundled rates and charges for electric service, and for approval of other proposed tariff revisions in connection therewith, Final Order, Docket No. ER02080506, agenda date 7/25/03, agenda item 2B. Do you have that one in front of you?

A Yes.

Q And is this also another one of the orders that you relied on in your testimony?

A Yes.

Q What I would like you to do is to turn to page 38 of the order.

A My copy, what you handed me stops at page 17. Am I looking at --

Q We haven't handed it out yet.

(Documents distributed.)

A Okay. I don't know if your question referenced the Summary Order or the Final Order, but what you handed me before --

Q The Final Order. My question references the Final Order.

A Okay.

Q Page 38 of the Final Order.

A There is a page 38 to this copy.

Q I'm happy to hear that.

Looking at the last paragraph on page 38 of this order, and referring to the second sentence, "Most notably, the Board believes that the overall risks facing the electric utility distribution companies in New Jersey have decreased as a result of the various provisions of EDECA." And reading --

A I think it would certainly help me if you started from the beginning of the paragraph rather than just jumping to that, because there's some other important things you just glossed over, not least of which is appropriate capital structure.

Q Okay. Well, let's read this part first. Did I read that accurately?

A I was reading the context of it, so I don't know. I would like it if we started just one sentence, two sentences sooner, one sentence sooner.

Q Did I read the sentence I read accurately, Mr. Rothschild?

A I don't know.

Q Okay. How about reading the second sentence and telling me if I read it accurately?

A The second sentence, which does not yet talk about, which was glossed over, appropriate capital structure, says, "Most notably, the Board believes that the overall risks facing the electric utility distribution companies in New Jersey have decreased as a result of various provisions of EDECA."

Q Okay. Now, let's move to the fourth sentence. "The BGS process eliminates the risks associated with the companies' planning, construction and operation of generation facilities. The resulting 'wires only' distribution companies should therefore require a lower cost of capital that ratepayers are required to support in their retail rates." Did I read that accurately?

A Yes, but if you try and make conclusions without putting it in the context of what else is in that paragraph, you will probably get to the wrong place.

Q Mr. Rothschild, you would agree with me that was the Board's conclusion in this case; correct?

A I would agree with you that the entire paragraph is the Board's conclusion. I think what you end up with running the risk of misusing is if you take just snippets of it.

Q Let's turn to another order you relied on. This one is the State of Connecticut, Department of Public Utility Control, Docket No. 0307-02, Application of the Connecticut Light and Power Company to amend its rate schedules, December 17, 2003. Do you have that?

A Yes, I do.

Q And this is another order you relied on in your testimony; correct?

A Yes.

Q Let's turn to page 143 of this order.

A Yes, I have it.

Q Going to the bottom paragraph on page 143 that begins with the word "third," and reading, "Third, CL&P's risk has also declined significantly since electric restructuring. In 1998, CL&P was a fully integrated electric utility having a significant portfolio of generation facilities that included nuclear plants. Subsequent to deregulation, CL&P became a transmission and distribution company only, and only recently sold its interests in Seabrook Nuclear and Millstone. Generation is more risky than distribution business and nuclear adds to that risk." Did I read that correctly?

A Yes. And as I explained in the deposition, the risk that is relevant here and in the other proceedings is that generation -- the key, the priority part of risk is what's regulated and what's not regulated and how a particular jurisdiction deals with items that -- in particular, in generation, items of disallowance. When you're talking about the history of Connecticut Light and Power, there were significant disallowances associated with the Millstone nuclear plants, and that made particularly nuclear more risky for CL&P.

Q Mr. Rothschild, in terms of hourly billings, 100% of your work is spent providing testimony in utility rate proceedings; correct?

A Boy, you like to take everything and make it so it will come out of context. I explained in my deposition that, yes, in terms of what I charge hourly rates for as a consultant is involved in utility ratemaking. But I also obtain a significant amount of income, in fact, the majority of my income, directly from the stock market.

Q Mr. Rothschild, it's also true that you've testified hundreds of times to reasonable ROE involved in a regulated public utility; correct?

A Yes.

Q But you've never testified on behalf of a Florida regulated public utility; correct?

A Well, we're narrowing it to the point of -- what I told you was in the deposition that I had testified on behalf of one telephone company which is headquartered in Florida. They're not, to my knowledge, regulated in Florida. I'm not even sure of that. But the proceeding in which I was involved was a BellSouth proceeding in Georgia, and that proceeding was last year.

MR. WALLS: I have no further questions for

Mr. Rothschild.

CHAIRMAN BAEZ: Redirect? Staff? I thought we had gone around. I mean, I know I mucked up the order, but I'm assuming you-all's answers were accurate.

REDIRECT EXAMINATION

BY MS. CHRISTENSEN:

Q Mr. Rothschild, you were asked about lost revenues. Let me ask you this. Lost revenues, is that an example of the risk you describe in your direct testimony?

A Yes. Certainly it's part of the concept of setting rates prospectively, and stuff happens. Good stuff happens and bad stuff happens, and that's why rates are set prospectively rather than just strictly as a cost-plus reimbursement.

Q You were also asked about why you did not conduct a DCF study by Mr. Walls, and you said that you believed that it was not necessary for your purposes here. Can you explain that a little bit further?

A Yes. The purpose here is to determine -- given that the stipulation says that the company has a reasonable opportunity to ask the Commission for recovery to get it back to 10% should its earned return fall back from 10%, I needed to look at whether or not that 10% was still reasonable. And there, number one, if interest rates are down since it was set, that's a pretty strong indication it was reasonable. Number two, if the industry -- if a 10% return puts the company in the median level of what others are earning, that's a pretty high safety net. Others are falling a lot further, and they don't have that safety net. So I see that.

And when you put it all together, I don't think I have to go through a DCF cost number. I don't think the concept is to set the cost of equity in this proceeding. And as I even said, even though more likely than not the cost of equity is less than 10%, the stipulation doesn't let us go there. We can't come and say we should be truing up to 9 or 9.2 or 9.4 instead of 10. We shouldn't be revisiting the capital structure. And let me tell you that 55% common equity capital structure, put it on -- this makes this company very low risk compared to these others we're talking about. Financial risk makes a big difference. And we're not going there either. We're staying within the confines of the stipulation.

Q Okay. And you also spoke to the Value Line list, and you were asked questions about that. Why are the actual returns of those 23 companies relevant to the points in this case?

A It shows what happens in the real world with companies that have their rates set prospectively. It doesn't tell you per se what their cost of equity is. Their cost might be higher or lower than they're actually earning. But if we're talking about a safety net and that safety net mirrors the industry, it's a good sign of protection. If somebody came back and said the whole industry was in disarray, that would be different, but that's not the case.

Q You were also asked some questions regarding the Business Week article and the productions characterized in there. Is the 6.5%, is that for a company of average risk?

A Yes, that would be a company for average risk. It's not for the lower risk regulated public utility company. So again, that's a conservatively high look at things.

Q Okay. So is it your opinion that PEF is a company of average risk or low risk?

A Certainly lower than average risk. The typical number that witnesses on both sides, all sides typically use is the company's beta, and the beta shows the volatility of the particular company's stock price compared to a broad-based average. And a typical beta for electric utilities is in the range of 75%, which means it's 75% of the risk of average, 25% lower risk.

Q And as you just stated, PEF's risk is certainly less than the 6.5 average risk for most companies. What does that tell you about the reasonableness of using 6.5 in your analysis?

A It tells me it's a conservative number to use, conservatively high. And just for clarity, so people know, the 6.5, that's a number that forms the base to use before adding inflation. **Nobody is saying the cost** of equity is 6.5. **The cost of equity is 6.5% plus an** allowance for inflation.

Q Okay. And you were asked a number of questions regarding the issue of the 10% threshold in the stipulation; am I correct?

A Yes.

Q And in your review of the stipulation signed by Progress, would it be your opinion that by signing the stipulation, Progress was prepared to accept the risk of its earnings falling to, say, 12% in any given year?

MR. WALLS: I'm going to object to this line of questioning, because the witness testified he accepted OPC's construction and didn't give an opinion on the stipulation.

CHAIRMAN BAEZ: Didn't you ask him questions about the stipulation? I'm sorry.

MR. WALLS: I asked him questions based on what the range of -- what we were allowed to earn, yes, but he testified he was relying on what OPC told him.

MS. CHRISTENSEN: Commissioner, I believe he said he was relying on the fact that we put forth the position that the 10% threshold was the threshold to be ~~used, but I believe that Mr. Walls opened up the door on~~ questions regarding the risk that the company was willing to accept.

CHAIRMAN BAEZ: I'll allow the question.

BY MS. CHRISTENSEN:

Q Let me go ahead and repeat the question.

A Thank you.

Q In your review of the stipulation signed by Progress, would it be your opinion that Progress by signing that stipulation was prepared to accept the risk of its earnings falling to 12%?

A Falling to 12%?

Q From what they currently are today.

A Oh, yes. I think they were prepared to accept the risk of it falling to 10% in the stipulation, and in exchange for an opportunity to earn considerably more than 10% if it could achieve revenue growth or expense savings goals.

Q Okay. And you were also asked regarding the orders that you referenced in your testimony to demonstrate that there are certain companies whose ROE was set lower than 10%; is that correct?

A    Yes.

Q    And one of the points that Mr. Walls made was that these were distribution companies only; am I correct in that?

A    Transmission and distribution companies.

Q    Transmission, excuse me, and distribution.

A    Right, uh-huh.

Q    Regarding the settlement in the Public Service Electric Company case, what ROE was set in that case?

A    The company was allowed a cost of equity of 9.75%.

Q    I believe -- let me refer you to the full order regarding the New Jersey Central Power & Light company. You referred specifically to a page where there was a paragraph, page 38 of that order. It was the Final Order in Docket ER02080506. Do you have a copy of that order?

A    Probably if I looked in the right company I would get it.

Q    Just let me know when you have the right company.

A    Jersey Central, page 38.

Q Correct, the Final Order. And you were read several sentences out of there that, as you indicated, were read out of context. First, can you read the full paragraph on page 38, beginning with, "The board believes"?

A Yes. "The Board believes that the regulatory ~~principles developed by the Staff and adopted by the~~ Board in the RECO and PSE&G orders" -- and if I can just digress for a minute, RECO is Rockland Electric Company. "RECO and PSE&G orders should also be adhered to in this order as the basis for reaching a decision on the appropriate capital structure and cost of capital to be used by JCP&L in setting its permanent rates. Most notably, the Board believes that the overall risks facing the electric utility distribution companies in New Jersey have decreased as a result of the various provisions of EDECA." That's capital E-D-E-C-A. "Foremost is the basic generation service auction process that the Board has adopted for the procurement of power for the electric companies in New Jersey. The BGS process eliminates the risks associated with the companies' planning, construction and operation of generating facilities. The resulting 'wires only' distribution companies should therefore require a lower cost of capital that ratepayers are required to support in their retail rates. Additionally, the companies have the ability to request the recovery of stranded costs and deferred balances either through traditional amortization in rates or where approved by the Board through securitization. These major ratemaking benefits materially contribute to the reduced risk faced by the electric utilities in New Jersey."

Q And when you were asked to confirm the correctness of reading some of those statements, you had indicated that the cost of capital -- excuse me if I'm getting it wrong, the capital structure was important in the determination of the lowering of the overall risk. Can you explain why that is?

A Yes. The more debt a company has as a percentage of its total capital, the more interest expense it will tend to have to pay before there's any money left over for stockholders. And as a result, variability in earnings is more and more and more concentrated as an impact on stockholders as the amount of debt rises.

So when Progress Energy comes along and has -- if we put it on the comparable basis to the way it's looked at by Value Line and by a lot of other regulatory agencies where we don't include deferred taxes in capital structure, when you look at it that way, we see over 55% common equity in the capital structure. That is a significant cushion which provides a significantly lower financial risk. And so when you start trying to look at pluses and minuses in any one order, you have to consider that.

And the other thing is that what we're talking about, in New Jersey we had a situation where the companies had went through a transition where they were going through deregulation, and generating companies that are generating in a deregulated environment are notably more risky than regulated companies. So -- and you also have to consider other policies that are used and the existence of adjustment clauses and all of these other things that contribute to the overall risk consideration. So while -- you can take any company that you want, and if you look at the end result for it, you can find things why one company would appear more risky than another, and you can find reasons why it would be less risky. So if you concentrate on just one set of differences without putting the overall picture together, you're not going to get a true view.

And again, we're looking here not at a cost of equity determination. We're looking at a safety net. And while I believe that when you put everything together, you would conclude that Progress Energy

Florida with its capital structure has a lower risk than the companies that I've used as an example, you ought to, if you want to do it fairly, look at the overall pieces, not just one.

Q Are there other policy decisions that would also affect the risk factor, such as a protected test year?

A It could, yes.

Q As well as whether or not a company was able to receive interim increases?

A And the policy that's used to determine those interim increases, yes.

Q As well as --

A New Jersey specifically for interim has an emergency standard that would have a safety net far lower than the 10% we're talking about today. You would be talking more like coverage ratio, is it going to fall below invest grade, and bond downgrading below BBB, or something like that are typically the kinds of things that are looked at in New Jersey for interim relief.

Q And you were talking about coverage ratio. Is that a specific problem regarding PEF in this case?

A No. If they earn 10% with a 55% common equity ratio, they will have a very high coverage ratio. The coverage ratio will be -- the regulated entity will be supporting the rest of the company. If you look at the rest of the Progress Energy, Progress Energy's consolidated capital structure, which Standard & Poor's focuses on, does have lower coverage ratios because of that lower common equity ratio. And so what you have here is, to the extent there are problems, these ~~problems are being caused by the unregulated operations~~, or not the regulated operations in Florida.

Q And would a protected fuel clause and true-up also affect that?

A Sure. It makes the cash flow stream that much more reliable.

Q The company seems to take issue with your use of the 10%, regardless of stipulation, or with the stipulation. What has happened to the cost of capital since PEF agreed to the 10% provision in the 2002 stipulation?

A Well, it's lower because the -- and I think everybody should agree that its lower, if for no other reason than long-term interest rates are lower. And while it's no guarantee that the cost of equity has changed in lock-step with the change in interest rates, it's going to change in the same direction.

In fact, an external fact to the change in interest rates which has caused the cost of equity to drop more rapidly than the cost of debt is the more recent change in the way that the income on common equity is taxed. The long-term capital gains rate has been reduced from 20% to 15%, and dividends are now taxed at 15% instead of the regular income rates, whereas there were no policy changes in the way that the tax on interest income which is paid to bondholders is paid. To the extent that overall tax brackets were lowered a little bit, that would lower the tax on bonds, but that change is far less dramatic than the income tax component of common equity. That drives people, other things being equal, to want to buy common equity and tends to drive down the cost of equity vis-a-vis the cost of debt.

MS. CHRISTENSEN: Thank you, Mr. Rothschild. We have no further questions. However, we would ask that the orders that were passed out by PEF be made an exhibit, in all fairness, since only portions of the orders were read into the record, and marked for identification and moved into the record.

MR. WALLS: We have no objection as long as all the exhibits that I used in his cross are introduced.

CHAIRMAN BAEZ: Well, let me make sure, because there were quite a few. I think there's some middle ground there, Ms. Christensen. That would be the --

MR. WALLS: Yes. I believe it's the Business Week article.

CHAIRMAN BAEZ: The article, and then we have the two --

MR. WALLS: I believe there are three orders.

CHAIRMAN BAEZ: Yes. They do things different in New Jersey.

MR. WALLS: Yes, they do.

CHAIRMAN BAEZ: I meant no disrespect to the great state or to any way they do things. I'm just -- I'm wondering how many orders are we holding here. I saw three in one stack, and then this one.

MR. WALLS: There should be three.

CHAIRMAN BAEZ: Three orders total in this?

MR. WALLS: Yes.

CHAIRMAN BAEZ: Okay. So you're going to have to single them out for me, because I keep seeing -- and again, I apologize. I don't know how to read these. There's like, you know, nine different docket references. Do you see what I'm saying?

MR. WALLS: Yes, I understand what you're saying. We could make them a composite exhibit.

CHAIRMAN BAEZ: Yes, we'll make them a composite exhibit, and that would include the article from Business Week and the several orders from the

States of New Jersey and Connecticut; correct? And is that everything?

MR. WALLS: Yes, that's --

CHAIRMAN BAEZ: Yes, that's everything. And we will call them Composite Exhibit 53, titled Cross-Examination Exhibits for Witness Rothschild. And if there's no objection, we'll admit Exhibit 53 into the record.

(Exhibit 53 marked for identification and admitted into evidence.)

CHAIRMAN BAEZ: And I'm also showing one other exhibit for the witness.

MR. WALLS: Yes. That one we did have an objection to.

CHAIRMAN BAEZ: Yes. Well, and I know I didn't hear it, so --

MR. WALLS: I'll be brief.

CHAIRMAN BAEZ: Go ahead.

MR. WALLS: Our objection is simple. I'm going to revert to what Mr. Wimberly said. I've got a simple mind about this too. Our objection is on relevance grounds, because what Mr. Rothschild has testified to, the exhibit shows actual earned rate of returns, yet he's here to testify what a reasonable rate of return would have been in 2004 and 2005. And my simple mind can't get around how actual earned returns have anything to do with what the investors would have expected to earn and what the commissions would have wanted the investors to expect to earn in 2004 for those utilities, and that's my objection.

MS. CHRISTENSEN: Commissioner, I believe it is relevant, particularly since I think Mr. Walls may be mischaracterizing the purpose that Mr. Rothschild offered the exhibit for. As he testified to, he was offering that exhibit to provide a snapshot of what is reasonable regarding the 10% safety net and to give the Commission the ability to look and see what the actual earnings are for those companies on the Eastern Seaboard so that if the Commission were, of course, to adopt OPC's position, the Commission would have information to know where -- if they were required to earn that rate, where they would fall with other electric companies.

CHAIRMAN BAEZ: Mr. Walls, I'm going to allow the exhibit. Issue 15 is still in question. Certainly OPC's position is still viable for purposes of our consideration. And I can almost guarantee that if our staff were being required to try and find a -- set a reasonable rate of return for an investor-owned utility, I think Value Line would be one of the things that they would try and guide themselves by in making us a recommendation. Now, perhaps not the exclusive source, I would imagine, but it would be as part of an entire universe for consideration.

On that basis, I think it is relevant, and I'm going to let it come in. So show Exhibit 26 admitted into the record.

MS. CHRISTENSEN Commissioner, just for point of clarification, I'm not sure if we formally sought to move in all of Mr. Rothschild's exhibits. I know there's the Value Line exhibit as well as, I believe, his curriculum vitae and appendices as well. So I would just ask to move all of his --

MR. WALLS: And we have no objection to anything else.

CHAIRMAN BAEZ: Yes. I didn't see it listed here, but there's the testifying experience. I thought that was just an appendix to his testimony, and if it's in --

MS. CHRISTENSEN: I believe we made it an exhibit as part of the Prehearing Order, so I think it became part of -- we unfortunately didn't identify it as part of that on the testimony, but I think we did as part of the Prehearing Order.

CHAIRMAN BAEZ: Do we need to give it a number?

MS. CHRISTENSEN: I think it already has a number.

CHAIRMAN BAEZ: Does it have a number?

MS. BRUBAKER: Twenty-seven and 28 actually are the exhibits.

CHAIRMAN BAEZ: Oh, my. Yes, of course. Show 27 and 28 moved into the record. I'm sorry.

~~(Exhibits 27 and 28 admitted into evidence.)~~

MS. CHRISTENSEN: Thank you.

CHAIRMAN BAEZ: The Tylenol is wearing off, folks.

And on that note, we have run a little over from what I had expected and have gone a little slower than I had anticipated. We've got four witnesses, I think, left by my count. We're going to end it today and start up again -- Commissioners -- well, we'll start up again at 9:30 tomorrow. Nobody wants to stay overnight on a Friday.

MR. WALLS: I believe we have three witnesses.

CHAIRMAN BAEZ: Do we have three witnesses? Yes, because -- you're right. So even better news.

Nevertheless, we will start at 9:30 tomorrow. We're in recess.

(Proceedings recessed at 5:50 p.m.)

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 514 through 661 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 1st day of April, 2005.

Mary Allen Neel

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