

I N D E X

WITNESSES

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NUMBER:		ID.	ADMTD.
38	FERC Order No. ER 96-2637-000	202	
39	(Late-filed) Total Amount of Deferred Taxes	225	238
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P R O C E E D I N G S

(Transcript follows in sequence from Volume 1.)

K. MICHAEL DAVIS

continues his testimony under oath from Volume 2:

CONTINUED CROSS EXAMINATION

BY MR. McGLOTHLIN:

Q But the plant you are talking about is the plant that is the subject of the depreciation and the accumulated reserve for depreciation, nothing to do with the storm costs, correct? When you reduce the depreciation reserve excess, that has the effect of increasing the net book value of the associated plant, but the plant we are talking there is still in service, it is not associated with the storm damage repairs.

A All I can do is go back to the way I premised the answer earlier, that if you instead of collecting storm damages in cash, as the company has proposed, you instead suggest charging that to expense, and as a way of mitigating the effect on earnings, you write off a theoretical excess. Which I would really want to emphasize the word theoretical excess. The effect is to move that into -- I guess the effect of that is to increase future depreciation expense. And, yes, those assets are there. But the effect is also as a practical matter, to cause people for the remaining life of that plant to be paying for those storm costs.

Q You said to be paying for the storm costs, but they

1 would be paying for the plant that is being depreciated,
2 correct? The storm costs will have been satisfied by the
3 transfer, and I will grant you that one aspect of that is to
4 increase the net book value of the plant, but there is nothing
5 about that transfer that has the effect of pouring storm costs
6 into the depreciation regime.

7 A I would agree that the entries would not result in
8 that, however, I would reemphasize that the practical result is
9 to have done precisely that.

10 Q Well, the practical result would be to have an
11 investment in plant that is higher than before because of the
12 manner in which the depreciation reserve excess has been
13 addressed, correct?

14 A Yes, that is correct.

15 CHAIRMAN BAEZ: Mr. McGlothlin, do you have a natural
16 breaking point?

17 MR. MCGLOTHLIN: This is good.

18 CHAIRMAN BAEZ: This is good. We are going to break
19 for lunch for an hour, so we will be back at 1:00 o'clock.

20 (Recess.)

21 CHAIRMAN BAEZ: We will go back on the record. Mr.
22 McGlothlin, you were about to start another line of questioning
23 as I recall.

24 BY MR. MCGLOTHLIN:

25 Q Mr. Davis, prior to the lunch break, in response to

1 one of my questions you described the accounting transactions
2 or the accounting measures that would occur in the event the
3 Commission decided to use Mr. Majoros' proposal or some
4 variation of it, and use the depreciation reserve excesses to
5 satisfy some or all of the deficiency in the storm damage
6 account. And as I recall you said in that event the costs
7 would be expensed and some portion of the depreciation reserve
8 excess would be transferred to satisfy the deficiency. Have I
9 stated that correctly?

10 A Yes. There are presumably two ways. I don't know
11 exactly the entries that would be made, but certainly one way
12 would be to debit depreciation expense -- I'm sorry, debit
13 accumulated depreciation and credit depreciation expense, and
14 then to -- am I doing that right? Yes. And then credit the
15 storm damage reserve deficit and debit presumably storm expense
16 you would have to either go to transmission and distribution
17 maintenance or to the A&G accounts, which would be the
18 insurance accounts. And I would point out that if it goes to
19 the insurance accounts it has a different allocation factor for
20 cost of service than would that depreciation adjustment we are
21 making about, but the net effect, just leaving that to the side
22 for the moment, the net effect would be you would have a credit
23 in depreciation expense, reducing depreciation expense and an
24 debit in an O&M expense category. You would, of course, have
25 to make up the reduction in accumulated depreciation over the

1 remaining life of those plants, which is what I allude to as
2 having a higher cost.

3 Q Yes. But taking that a step at a time and focussing
4 on the storm cost component of that, at the conclusion of those
5 entries those costs will have been addressed and satisfied,
6 correct, and there is no longer a deficiency in the storm
7 damage reserve?

8 A I can only answer from an accounting perspective. I
9 would have reduced the storm reserve deficit by whatever amount
10 the Commission decided. I would simultaneously have reduced
11 accumulated depreciation and then as a result have increased
12 net plant and rate base and return requirements as well as
13 necessitating higher depreciation expense for the remaining
14 life of those facilities. That's why I keep coming back to my
15 practical effect.

16 Q Yes, you do keep coming back to it, but I want to
17 take it a step at a time. My question is limited to the storm
18 cost aspect or component of this overall situation. At the
19 conclusion of the accounting entries, the storm costs will have
20 been expensed and the deficiency in the storm damage reserve
21 will have been eliminated, correct?

22 A Yes, depending on the amount that is decided upon for
23 what is effectively a transfer.

24 Q All right. And on the other side of the transaction,
25 if you want to call it that, the depreciation reserve excess

1 will have been reduced by whatever extent the Commission
2 decided, and in your opinion reduced more rapidly than you
3 believe would be appropriate because you think the preferable
4 route is to address that over the remaining life of the assets,
5 correct?

6 A Yes, I would agree with one qualification. It is a
7 theoretical excess. I'm not prepared to call it an excess.

8 Q But you would not dispute the fact would you, sir,
9 that over time customers have paid real dollars that were used
10 to defray the depreciation expense and build the accumulated --
11 provision for accumulated depreciation that is reflected in the
12 study?

13 A I would not agree with that as unequivocally as you
14 have stated it. It is true that we have assigned capital costs
15 to prior periods through a systematic and rational depreciation
16 methodology that is reviewed generally every four years.
17 Because of our rate agreement it wasn't reviewed in '91, and
18 that accounts for part of this, why we have that excess now.
19 But you are stating it in terms of the customers have paid for
20 it.

21 The customers have paid the rates, the rates are
22 predicated on an amount of depreciation expense that was
23 estimated and reviewed and approved by the Commission at the
24 time the rates were set. But I think it would also be
25 appropriate for me to add that the investors in the company,

1 the company itself and -- or let's put it this way, the
2 investors in the company through the company itself paid for
3 those assets when they were originally placed in service.

4 So, it is not the customers who are paying first, the
5 customers through the rates, so in a somewhat indirect
6 relationship the customers are paying for it as they receive
7 the benefits. The largest single piece of the excess that
8 exists now is the result of the extension of the lives in the
9 nuclear plants which just occurred in the last few years,
10 certainly since the last depreciation study was reviewed and
11 approved by this Commission.

12 Q My point is simply is this, it is fair for you to
13 call this a theoretical reserve, but it is also fair to make
14 the point that with respect to the recoupment of the company's
15 investment in plant the customers pay for that in real dollars
16 and cents, correct?

17 A Yes, they do through rates, yes.

18 Q Please turn to Page 10 of your supplemental. In
19 response to the first question on that page you say, "Because
20 Mr. Majoros' proposal would recover storm damage costs via an
21 increase in plant in service, and this recovery primarily
22 effects the nuclear function, the recovery of these costs will
23 be based on the jurisdictional factor applied to nuclear."

24 Now, this answer is predicated upon your proposition
25 that somehow the effect of Mr. Majoros' proposal would be to

1 pour storm damage costs into the depreciation regime, is that
2 correct?

3 A No, that is not correct. It is predicated on the
4 fact that his proposal is to take the theoretical excess and
5 reverse it, as I understand it, in a single entry. And let's
6 say that entry is \$200 million. That would have the effect of
7 reducing accumulated depreciation, increasing rate base, and it
8 means that you will have to then depreciate, redepiciate if
9 you will, those nuclear plants, because we have already
10 depreciated it once, that's why the theoretical excess exists.
11 Now we are going to depreciate it a second time, and the point
12 here is that -- well, I am reading beyond where you were
13 reading, so I will stop there.

14 Q How would the proposal result in a shift of
15 responsibility from wholesale to retail? I'm trying to
16 understand your testimony there.

17 A Okay. The point is that because nuclear
18 depreciation, accumulated depreciation would be reduced by the
19 elimination of the theoretical reserve excess, or some portion
20 of it, you will have higher depreciation expense on a
21 going-forward basis. If I had net book value before of 100,
22 and in that 100 was 20 of a theoretical reserve, I eliminate
23 that theoretical -- I'm sorry, theoretical reserve --
24 theoretical surplus. I eliminate that surplus then the net
25 book value that I have to depreciate is now 120, and so over a

1 ten-year life I will be depreciating 12 per year instead of 10.
2 That increases the cost that is associated with the nuclear
3 function, that effects the assignment of costs to the retail
4 versus the wholesale function differently.

5 Q Page 11, Lines 12 through 16. You say Mr. Majoros
6 proposes to contaminate this depreciation process by
7 introducing unrelated costs into the accumulated reserve. The
8 unrelated costs you refer to there are the storm damage costs,
9 is that correct?

10 A Yes, sir, it is.

11 Q But, in fact, as we have discussed, the accounting
12 transactions would have the effect of eliminating the
13 deficiency in the storm damage reserve at the time the
14 depreciation reserve excess is used to offset those costs, is
15 that correct?

16 A That is correct. But the means by which you do that
17 is to make an adjustment in accumulated depreciation, and that
18 adjustment is an adjustment that is normally dealt with through
19 the remaining life methodology. So that is the point that
20 whether you physically move it -- I mean, one alternative way
21 of dealing with it is to take -- and I would hope we don't get
22 there, because I don't agree with the accounting entry -- but
23 to reduce the accumulated deficit in the storm account on the
24 balance sheet and reduce accumulated depreciation on the
25 balance sheet.

1 I think you have to do those things through the
2 income statement, but I am dealing here primarily with the
3 practical effect and the fact that you would alter what is
4 properly done in accumulated depreciation under the remaining
5 life methodology and do something now out of sorts, if you
6 will.

7 Q All right. You characterize this as a practical
8 effect, but in your testimony you say explicitly that Mr.
9 Majoros would introduce unrelated costs. But you are speaking
10 there by analogy, are you not, as opposed to actual accounting
11 entries that would take storm costs and put them into
12 accumulated depreciation?

13 A I will agree with that, but the effect is the same.

14 Q You have attached to your additional rebuttal KMD-6,
15 the short title of that is a revenue requirement comparison.
16 It consists of four pages. And do I understand correctly that
17 this comparison, or this exhibit is an extension of what you
18 characterize as financing the storm costs for a long period of
19 time?

20 A Yes, by moving it. By reducing accumulated
21 depreciation then you have higher rate base and that would be
22 financed at the overall cost of capital, yes, sir.

23 Q But, again, that is your characterization of the
24 practical effect of this offset as opposed to the actual
25 accounting entries which would show not that storm costs are

1 being financed, but that the depreciation reserve excess and
2 the plant functions had been reduced?

3 A I guess the way I would answer that is it is the
4 effect on rates. It is not something I dreamed up. If you
5 have higher rate base as a consequence of reducing accumulated
6 depreciation, you have higher return requirements, and that is
7 how it translates. That is how the customer will see it.
8 Contrasting that to a three-year recovery at commercial paper
9 rates, there is a significant differential between the two cost
10 rates, and there is also the added effect of that higher cost
11 rate being applied over a longer period of time.

12 Q And the impact on rates would result from the
13 decision to reduce the depreciation reserve excess resulting in
14 a higher plant value for the nuclear and other plant categories
15 than was previously the case?

16 A Yes, sir, that is correct.

17 Q Just as the company apparently is in a situation
18 where it will have significant depreciation reserve excesses,
19 it is also possible for a utility to encounter situations in
20 which it has significant depreciation reserve deficiencies, is
21 that correct?

22 A Correct.

23 Q Do you know whether FPL has ever advocated correcting
24 a depreciation reserve deficiency in a period of time shorter
25 than over the remaining life of the assets?

1 A In the situation that is driving the depreciation
2 reserve surplus today, to the best of my knowledge the answer
3 is no. However, we have used special recovery schedules for
4 assets that were being retired. But as I'm saying that, there
5 was a depreciation reserve surplus, I think in the '97 study,
6 and we had -- I believe that we were in revenue-based
7 depreciation at that point, or we had discretionary
8 depreciation at that point. So, I suppose taking my practical
9 effects of things and using it in a different way, we would
10 have recovered those deficiencies over a shorter period of
11 time, but not as the result of, I think, a specific schedule,
12 but rather the consequence of an accelerated depreciation
13 program that was approved by the Commission.

14 Q So with respect to depreciation reserve deficiencies,
15 you acknowledge that in the past the company has on occasion
16 seen the wisdom of addressing those deficiencies over a period
17 of time other than the remaining life of the assets?

18 A Only as I just described to you in the answer, and I
19 can repeat it if you would like.

20 Q Well, I heard your answer, and I think you were
21 agreeing that the company has done that in the past, correct?

22 A The consequence, the practical consequence of the
23 accelerated depreciation methods that the Commission used to
24 address a very real concern about reserve deficiencies, or more
25 to the point stranded cost in nuclear facilities at a period in

1 the '90s when we were seeing a lot of that, the Commission
2 approved some accelerated depreciation methods which had the
3 practical effect of eliminating deficiencies that existed in
4 the nuclear plant categories. That is different in my mind
5 than taking and separately amortizing an excess, or writing it
6 off, which is what you are suggesting, or Mr. Majoros is
7 suggesting be done.

8 Q Well, the direction is different, but the principle
9 is that there can be circumstances which would warrant a
10 departure from the otherwise applicable principle of addressing
11 those matters over the remaining life of the assets. Would you
12 agree with that?

13 A I would agree that the accelerated depreciation
14 programs did that, yes.

15 MR. MCGLOTHLIN: I am going to distribute a document.
16 Chairman Baez, we are distributing copies of Order Number
17 PSC-98-0027-FOF-EI issued in Docket 970410 on January 5th,
18 1998. Because it is an order, I don't request that a number be
19 assigned to it.

20 CHAIRMAN BAEZ: We can take notice of it.

21 BY MR. MCGLOTHLIN:

22 Q Mr. Davis, we have provided you with a copy of an
23 order issued in a docket captioned proposal to extend plan for
24 reporting of certain expenses for years 1998 and 1999 for
25 Florida Power and Light Company. And I ask you to turn to Page

1 5 of the order. At Page 6, the order recites some testimony
2 that Witness Gower provided for Florida Power and Light
3 Company. Are you familiar with Mr. Gower?

4 A Yes, I know Mr. Gower.

5 Q Would you read the paragraph in the middle of the
6 page that begins, "Witness Gower further testified."

7 A "Witness Gower further testified that correction of
8 the nuclear decommissioning and fossil dismantlement reserve
9 deficiencies over a time period shorter than the remaining life
10 of the associated plants is consistent with this Commission's
11 prior actions. He stated that the reserve deficiencies can be
12 recovered over the remaining life of the associated plant or
13 over a much faster period of time. He referenced various
14 orders in which we corrected reserve deficiencies over
15 relatively short periods of time. Witness Gower asserted that
16 because the corrections reduced the amount of required investor
17 capital, it is in the customers' best interest to accomplish
18 the corrections as soon as possible."

19 Q And if you will continue with the first sentence of
20 the following paragraph.

21 A "Because the reserve deficiencies represent costs
22 that should have been recovered in prior years,
23 intergenerational equity suggests that these deficiencies be
24 recovered quickly so that future ratepayers are not burdened
25 with an unfair share."

1 Q With respect to the relevancy of the consideration of
2 intergenerational equity, would you agree with me that that may
3 come into play with respect to a depreciation reserve excess
4 just as it comes into play here with a depreciation reserve
5 deficiency?

6 A Yes, I think that would be the case. I mean, you are
7 talking about different groups of customers paying for costs in
8 different periods than the period. Perhaps a departure from
9 the payment of the costs versus the receipt of a benefit.

10 Q And if the Commission were ultimately to decide to
11 use a portion of the depreciation reserve excess that is shown
12 by the pending depreciation study to offset some or all of the
13 deficiency in the storm damage reserve, would that have the
14 practical effect of giving the customers who through the
15 depreciation rates they paid contributed to this excess in a
16 shorter period of time than would addressing the excess over
17 the remaining life of the investment?

18 A I believe by definition it would give this benefit
19 back to them over a shorter period of time than would
20 correcting it over the remaining life of the plant, but one
21 point I would like to make here, and it is just a matter of
22 distinction, what Mr. Gower is talking about here are nuclear
23 decommissioning and dismantlement. He is not talking about
24 accumulated depreciation.

25 Q Tell me what you think the distinction means?

1 A Well, the distinction is that with respect to
2 accumulated depreciation we are taking a primarily known cost,
3 that is the cost of the installed plant, and spreading that
4 over the expected period of benefit of that particular plant.
5 With respect to decommissioning and dismantlement, we are
6 talking about costs that will be incurred at the end of the
7 service life of the facility for removing it in particular with
8 respect to nuclear removing contaminated material, disposing of
9 that material in a manner that is prescribed by law. In the
10 case of both nuclear and fossil, it is basically removing all
11 of the plant and greenfielding the site. So, the key
12 difference is the costs that we are dealing with. Are we
13 dealing with a future cost or a past cost, but both share I
14 would admit the common characteristics of being a cost that you
15 would want to recognize over the period of benefit, meaning the
16 period that the facility is in service.

17 Q Now, if you would turn to Page 14 of the same order.
18 First of all, in your testimony you address the issue of
19 whether Commission policy would favor or allow the proposal
20 that Mr. Majoros described in his testimony, do you not?

21 A Yes, I do.

22 Q At Page 14, please read the next to the last
23 paragraph, the one that begins, "The second threshold is
24 whether."

25 A "The second threshold is whether the correction of

1 the reserve deficiencies over a shorter period of time than the
2 remaining life is in accordance with normal regulatory
3 accounting practice. The record evidence demonstrates that the
4 correction of reserve deficiencies over a shorter period of
5 time than the remaining life is in accordance with normal
6 regulatory accounting practice. Moreover, the record evidence
7 demonstrates that the correction of reserve deficiencies over a
8 shorter period of time than the remaining life is in accordance
9 with past Commission practice."

10 Q And I promise you there is only one more in this
11 order. Would you read the next short paragraph?

12 A Okay. "The remaining threshold is whether the record
13 demonstrates that correcting a reserve deficiency over a
14 shorter period of time is more reasonable or fair than
15 correcting the reserve deficiency over the remaining life. The
16 record evidence demonstrates that the tenet of
17 intergenerational equity dictates that in this docket
18 correcting reserve deficiencies over a shorter period of time
19 is more reasonable or fair than correcting the reserve
20 deficiency over the remaining life."

21 Q Would you agree with me, sir, that as indicated in
22 this order, the Commission has considerable discretion and
23 latitude to consider departures from the remaining life method
24 where other considerations warrant a departure?

25 A I would agree that the Commission has the discretion

1 to do that. I would also want to add that one of the things we
2 are talking about here is nuclear decommissioning, as I said
3 earlier, and the time period that we were talking about here is
4 a period where there was extensive concern about stranded costs
5 in nuclear facilities. But with that said, I would agree with
6 you; yes, sir.

7 Q In your testimony, you refer to SEC policy at one
8 point, and you refer to a case involving Microsoft. As I
9 recall, the SEC concluded that Microsoft had violated generally
10 accepted accounting principles by the manner in which it failed
11 to disclose the change in depreciation lives, is that correct?

12 A No, sir, it is not.

13 Q How is it incorrect?

14 A You said that the SEC took exception to the company's
15 failure to disclose the action that they took. The SEC's
16 exception, as I recall it, and I'm flipping pages trying to
17 find it, my recollection is that the SEC took exception to the
18 fact that they ran the change in the service life through
19 expense in a single period versus as would be required under
20 generally accepted accounting principles, which is over the
21 remaining life of the asset.

22 Q Okay. Here is an easy one. Will you agree with me
23 that Microsoft is not a regulated electric utility?

24 A They are not a rate regulated cost of service
25 utility. However, the same generally accepted accounting

1 principles apply to all enterprises. In other words, the
2 standards published by -- approved by and published by the
3 Financial Accounting Standards Board apply to all of us.
4 Statement Number 71, accounting for the effects of rate
5 regulation, provides a bridge that allows cost of service rate
6 regulated businesses to, if you will, bridge the income
7 statement to the regulatory objective, while at the same time
8 still complying with GAAP. So that is the origin, if you will,
9 of regulatory assets and regulatory liabilities.

10 Q So if the Commission provides an order approving the
11 practice, a regulated utility may on occasion adopt an
12 accounting practice that does not conform to GAAP?

13 A Yes, so long as the ultimate linkage, if you will,
14 that is found in FAS 71 is that there essentially is a rate
15 consequence. You know, you view it a long-term short-term rate
16 consequence.

17 Q Okay. At Page 13 of this testimony you assert that
18 Mr. Majoros' proposal is contrary to FERC policy, do you not?

19 A Yes, I do.

20 Q And on Page 14 you refer to an order issued by the
21 FERC with respect to a South Carolina Public Service Commission
22 decision. Would you agree with me that in that order the FERC
23 addressed only those matters that were jurisdictional to FERC?

24 A Yes, I would.

25 MR. MCGLOTHLIN: I would like to distribute a

1 ocument. Chairman Baez, I would like to have this marked as
2 n exhibit.

3 CHAIRMAN BAEZ: I am showing -- where is the order
4 umber?

5 MR. McGLOTHLIN: There is a citation at the very top,
6 ir.

7 CHAIRMAN BAEZ: I am showing an order in FERC Docket
8 uments ER96-2637-000 and FA96-49-000, and we will show that
9 arked as Exhibit 38.

10 (Exhibit 38 marked for identification.)

11 BY MR. McGLOTHLIN:

12 Q Mr. Davis, do you have Exhibit 38 in front of you?

13 A Yes, I do.

14 Q And is this the FERC order to which you referred in
15 your testimony?

16 A Yes, it is.

17 Q Please turn to Page 11, and would you read the
18 sentence in the last paragraph above the footnote that begins,
19 "This determination"?

20 A "This determination, however, is not intended to
21 limit the authority of the South Carolina Commission to
22 determine in the exercise of its jurisdiction the appropriate
23 depreciation rates."

24 Q In your testimony, at Page 14, Line 16, you state,
25 "not only is this clearly contrary to what FERC has already

1 decided is improper, but, again, you agree that the FERC
2 decision was only as to the portion of the South Carolina
3 utility that was jurisdiction to FERC and did not purport to
4 override the South Carolina agency's determination?

5 A Yes, I believe that is the essence of what you just
6 had me read.

7 Q Mr. Davis, I want to backtrack for just a moment. I
8 have a question about the capital cost component of the manner
9 in which the company is accounting for the restoration costs.
10 With respect to the differences between the manner in which the
11 company has proposed to proceed, which is to charge all capital
12 costs to the storm damage reserve on the one hand and the
13 approach described by Mr. Majoros, which is to quantify the
14 normal investment and place that in the plant accounts and then
15 charge only the increment of extraordinary O&M to the storm
16 damage costs, is it true that the company has the ability to
17 make those adjustments if the Commission decided that the
18 Majoros approach is to be used?

19 A Yes, I believe we have the ability to make them. I
20 think I cited the amounts in my rebuttal testimony, and, in
21 fact, we talked about those earlier, that is the 58 million of
22 capital costs and the 12.2 million of cost of removal.

23 Q As a matter of fact, not only does the company have
24 the ability, but in implementing its preferred method of
25 charging 100 percent of capital costs to the storm damage

1 reserve, the methodology for doing that entails quantifying the
2 normal account plant amount which is later the subject of an
3 additional entry called CIAC to accomplish the charge to the
4 storm damage reserve, is that correct?

5 A That is correct. We record the gross plant at the
6 new cost, the 58 million. We would use the equivalent. It is
7 really not contributions in aid of construction, but it is
8 literally the equivalent of it. It is a credit. An offset, if
9 you will, to the 58 million. That would reduce that back to, I
10 believe it is 36 million of property that was estimated would
11 be the cost of the property retired as a result of the
12 hurricane. And that is done so that we have the information
13 available to the tax assessors throughout the state because
14 they are going to tax us on the higher value.

15 Q So the implementation of what I will call the
16 incremental methodology as it relates to capital costs does not
17 involve any additional administrative steps that the company
18 would have to undertake that it hasn't already performed in
19 terms of quantifying those values?

20 A I'm going to give you a yes and a no answer, and I
21 don't mean to obscure. It depends on how it is implemented.
22 If it is implemented in the manner that we are doing the
23 accounting today, which is to go to our work management systems
24 and estimate what the costs of those would have been had we
25 done it on normal time and at a normal pace and so forth, yes.

1 There would not be any incremental effort. I am already doing
2 it. And, in fact, I am already recording it. I would have
3 fewer entries to make.

4 On the other hand, if as a consequence of being
5 required to do that, I were expected to account for the time of
6 the linemen in the field, so I have a lineman out there who is
7 working, his sole focus right now is on restoring power, he
8 could care less about what job he is charging his job to. He
9 is focused on restoring power quickly and safely.

10 If I require him to split his time so that he keeps
11 track of the time that he spent working on a retirement, the
12 time he spends putting in a new pole, then I would say it is
13 extremely burdensome and would slow down the restoration
14 process. So the answer really gets down to a degree of
15 precision.

16 Q Okay. But utilizing what I think you called work
17 orders and estimates would impose no additional steps in terms
18 of what the company is already doing?

19 A Using work orders would impose an extreme burden.
20 Using the work management system as a way of estimating would
21 not impose an additional burden.

22 Q Okay. Thanks for correcting me. I meant to say the
23 work management system that you referred to in your earlier
24 answer.

25 A Yes, sir.

1 Q With respect to the cost of removal value that we
2 discussed earlier, do I understand correctly that built into
3 the depreciation rates that the company has in effect is a
4 component designed to enable the company to collect on a
5 current basis the anticipated costs of removing plant at the
6 time it is retired?

7 A I am going to modify one word if I may, and you said
8 collect. Again, the collection comes about through the rates.
9 It does enable me to -- I do have a rate in the depreciation
10 rate that I apply to gross plant that is designed to recognize
11 and provide for the cost of removing the facility at the end of
12 its useful life.

13 Q That's fine. And, so the company has accumulated or
14 built up over time a substantial cost of removal reserve for
15 that purpose, has it not?

16 A Yes, it has built up a reserve. I think for T&D
17 property it is about \$1.1 billion worth of cost. That cost
18 relates to, for example, in excess of a million poles, but it
19 also covers all of the transformers, conductors, everything
20 else that is included in the distribution accounts.

21 Q And the company begins -- and I will use the term
22 collecting, I don't know what to substitute for it, but it
23 begins accumulating that cost of removal reserve at the time an
24 item of plant is placed into service, is that correct?

25 A Yes. At the time the item goes into service each

1 month we would apply the appropriate remaining life
2 depreciation rate, which would include a component for salvage.
3 We would multiply that times the gross plant and recognize that
4 as depreciation expense. As a result of that, that is how you
5 accumulate the reserve for salvage. We call it negative
6 salvage. Negative salvage is cost of removal plus any proceeds
7 you might get from, say, selling scrap wire and what have you.

8 Q So some portion of the existing reserve for cost of
9 removal would relate to those items of plants that were removed
10 as a consequence of the storm restoration activities?

11 A Right. Yes, it would. Our estimate, I have not
12 broken out cost of removal separately, but I believe in my
13 testimony it is 36 million worth of retirements. We estimate
14 that the accumulated depreciation, including cost of removal
15 for that 36 million, is about 24 million. So, if we were to
16 follow normal accounting for this, I would leave a deficit of
17 about 12 million hung up in accumulated depreciation, and that
18 is before considering the cost of salvage or cost of removal.

19 Q And do I understand correctly that the company
20 proposes to charge that cost removal expense, not to the
21 reserve, but to the storm damage reserve? When I say not to
22 reserve, I mean the cost of removal to the reserve?

23 A That is correct. It is included in the deficit
24 again. The same discussion that you and I had about burden and
25 so forth. I do not require the linemen in the field to keep

1 track of their time as to when they are putting in a new pole
2 versus removing an old pole or other property. I just use
3 poles as representative. So, you know, I would agree that the
4 12 million is included in the storm damage reserve deficit. We
5 have estimated what it would be, again, using the work
6 management system, the same as we estimated the normal cost of
7 poles.

8 Q So, the cost of removal was collected, if you will,
9 at the time the plant was placed in service and resides in the
10 cost removal reserve, and now the company proposes to charge
11 the storm damage reserve for the cost of removal experienced
12 during the storms?

13 A I think your description aside from collected is
14 accurate, but as I pointed out a few moments ago, the poles
15 that -- let me move away from poles -- the equipment that was
16 destroyed and had to be retired as a result of the storm
17 exceeded the amount of accumulated depreciation. So, as a
18 consequence of the storm, if I follow the accounting Mr.
19 Majoros is suggesting, I believe that -- I have to think of the
20 numbers -- I think it is somewhere in the neighborhood of \$70
21 million -- plant in service would increase by approximately \$70
22 million. Plant in service net of accumulated depreciation.
23 The net book value of plant in service would increase by about
24 70 million.

25 Q And would that correspond to the proposal to use the

1 normal average cost of removal and charge the balance, any
2 excess to the storm damage reserve?

3 A Yes, it would be at normal cost.

4 MR. MCGLOTHLIN: No further questions.

5 CHAIRMAN BAEZ: Mr. Perry.

6 CROSS EXAMINATION

7 BY MR. PERRY:

8 Q Good afternoon, Mr. Davis. My name is Tim Perry. I
9 represent the Florida Industrial Power Users Group, and I have
10 a few questions for you.

11 Let me have you refer to your rebuttal testimony. In
12 your rebuttal testimony you cite to a number of Commission
13 orders. Could you clarify for me whether or not you are a
14 lawyer?

15 A I have enough trouble being an accountant. No, I'm
16 not a lawyer.

17 Q And would you agree with me that the Commission's
18 orders speak for themselves?

19 A The words on the page say what they say. I think
20 that it is often useful to look at the staff recommendations
21 and things like that to try to understand it, because as an
22 accountant, one of the things I have to do is to understand the
23 direction that I am being given by the Commission and to ensure
24 that my accounting conforms with that direction.

25 Q And am I correct in saying that your testimony

1 characterizes that the Commission in its 1995 order approved
2 the actual restoration cost method that was in FPL's '93 storm
3 study?

4 A Yes, that is my testimony.

5 Q Could I have you turn to Page 5 of your rebuttal
6 testimony, please.

7 CHAIRMAN BAEZ: What page did you say, Mr. Perry?

8 MR. PERRY: Say that again, Chairman.

9 CHAIRMAN BAEZ: What page?

10 MR. PERRY: Page 5 of his rebuttal.

11 CHAIRMAN BAEZ: Thank you.

12 BY MR. PERRY:

13 Q And at the top of that page you are citing to the --
14 you are excerpting the Commission's '95 order. Can I have you
15 read the sentence on Page 5, Line 4, starting with, "FPL
16 stated"?

17 A I'm sorry, I don't -- oh, okay. It starts on Line 4.
18 "FPL stated that it would use the actual restoration cost
19 approach for determining the appropriate amounts to be charged
20 to the reserve. This methodology is consistent with the manner
21 in which replacement cost insurance works."

22 Q Would you agree with me that sentence doesn't say
23 that the Commission approved the actual restoration cost
24 approach?

25 A I would agree that that sentence does not say that,

1 However, the title of the order is a notice of proposed agency
2 ction order approving storm damage study and adjustments to
3 elf-insurance mechanisms. So I think those words speak for
4 hemselves.

5 Q Okay. And let's go down to Line 21 on that same
6 age, and at that line you are quoting the ordering paragraph,
7 or one of the ordering paragraphs in the '95 order. Can you
8 please read that quote that starts with, "Ordered that the."

9 A "Ordered that the storm damage study submitted by
10 'lorida Power and Light Company is hereby found to be
11 adequate."

12 Q And would you agree with me that that ordering
13 paragraph doesn't say that the Commission approves the actual
14 restoration cost approach?

15 A It does not say that they approved that approach.
16 What it does say is that the study is found to be adequate.
17 And if you look at the '93 order, they ask explicit questions
18 which we were to answer. We answered those questions. We
19 answered those questions, we made a recommendation as to the
20 approach to be used. Nothing in the order indicates that the
21 Commission disagreed with the recommended approach, which I
22 would think that if they had an alternative view of the
23 accounting that should be followed they would have given me
24 that direction.

25 Q Would you also agree that neither of those two

1 excerpts from the order that you read state that the Commission
2 disapproves of the incremental cost approach?

3 A I would agree that there is nothing in the order that
4 says that they disapprove that, merely that they approved the
5 study.

6 Q Let me ask you to turn to Page 19, please.

7 A Of the rebuttal testimony still?

8 Q Yes, sir.

9 A Page 19?

10 Q And at Lines 10 to 12, you state that the company
11 estimates that they lost base rate revenues of \$38.2 million,
12 is that correct?

13 A That is correct.

14 Q I am going to ask you to look at a document. It is
15 from staff's consolidated exhibit which was marked as Hearing
16 Exhibit Number 2. I'm not sure if you have that in front of
17 you, so I am just going to give you my copy.

18 A What is the -- do you know how is the document
19 identified? Go ahead and give it to me. If I have it then I
20 will give it back to you.

21 Q In the notebook that staff handed out it is marked as
22 Bates stamp 000260.

23 A That doesn't help me, but we are looking.

24 MR. BUTLER: I am going to ask that there be some
25 pretty specific reference and give him some time to find it, or

1 else hand him copies of it. It is a pretty thick notebook.

2 MR. PERRY: That's what I was intending to do.

3 THE WITNESS: I have the page here. Mr. Butler
4 supplied me his book, I think.

5 BY MR. PERRY:

6 Q And is this a response to OPC's fourth set of
7 interrogatories, Question Number 39C?

8 A It would appear to be, yes.

9 Q Do you remember providing that response?

10 A I do not, no.

11 Q You do not.

12 A It may have been provided out of my area. I wouldn't
13 dispute that the company provided it.

14 Q Do you agree with me, subject to check, that when the
15 discovery responses were provided to the Office of Public
16 Counsel that you supplied an affidavit that said that you gave
17 that answer?

18 A No, that wouldn't surprise me. I mean, it is
19 financial information, so I would assume it came out of my
20 area. With the volume of production I just don't remember each
21 one.

22 Q And if you could look at this, if you could look at
23 this chart, the chart shows FPL's total base retail revenues
24 for the years 2002, 2003, and 2004?

25 A Correct.

1 Q When you calculated the \$38.2 million of lost
2 revenues, which months of 2004 did you contemplate that that
3 covered?

4 A It would have included the months of August,
5 September, and October. There would have been short periods in
6 August and October, and a significant portion of the month of
7 September.

8 Q Let me ask you to compare the line for August for
9 those three years, 2002, 2003, and 2004. Would you agree with
10 me that the difference between the retail revenues received by
11 the company in August 2004 and August 2003 is roughly \$10
12 million, so that FPL earned \$10 million more in August 2004
13 than it did in August 2003?

14 A Yes, I would.

15 Q And would you agree with me that FPL earned roughly
16 the same amount of money in August of 2004 as it did in August
17 of 2002?

18 A Yes, I would.

19 Q And did FPL have hurricanes affected service
20 territory during either 2003 or 2002?

21 A Not that I recall.

22 Q Let's do the same exercise for September of 2004.
23 Would you agree that the difference between September 2004 and
24 September 2003 is in the amount of roughly \$6 million that FPL
25 made more in 2003?

1 A I would agree that the revenues in 2004 are less in
2 04 than they were in '03. They are less than they were also
3 .n '02.

4 Q About 6.1 million less than in '02?

5 A Correct.

6 Q And let's perform the same exercise one last time for
7 October 2004 and October 2003 where FPL earned roughly 9
8 million more in October of 2004 than it did in October of 2003?

9 A The retail base revenues were 9,000 more, yes. Or 9
10 million more, excuse me.

11 Q And about 3 million less in October 2004 than in
12 October 2002?

13 A That is correct. Now, one of the -- I mean, a key
14 thing as you compare across years, please don't forget that
15 customers, the number of customers taking power has grown
16 roughly 2 percent in each one of those years, carrying with it
17 all of the attendant costs associated with providing service to
18 new customers. You would also have weather effects unrelated
19 to hurricanes. So the estimate that we made of 38.2 million
20 attempts to identify on a weather adjusted basis the service
21 that would have been taken by those customers who were not able
22 to receive power during particular periods of time. It is
23 based on actual accounts of customers on a daily basis.

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

25 CHAIRMAN BAEZ: Mr. Wright.

1 MR. WRIGHT: No questions.

2 CHAIRMAN BAEZ: Mr. Twomey.

3 MR. TWOMEY: No, sir.

4 CHAIRMAN BAEZ: Staff.

5 MR. KEATING: Good afternoon, Mr. Davis. One more
6 over here.

7 CROSS EXAMINATION

8 BY MR. KEATING:

9 Q My name is Cochran Keating with the Commission staff.
10 I just have a few sets of questions for you this afternoon.
11 One of the issues in this case is at what point in time FPL
12 should stop charging costs related to the 2004 storm season to
13 the storm reserve, and if I am reading right, FPL's position as
14 stated in the prehearing order on this issue is that the
15 application of PSC Rule 25-6.0143 provides that all costs
16 determined to be the result of storm damages should be charged
17 to the storm damage reserve, and I would assume that is your
18 position.

19 A Yes, sir, it is. If the storm caused it, then it
20 should be charged to the storm damage reserve.

21 Q And to your knowledge there is not, though, a
22 pre-established list in any PSC rule or order of the specific
23 types of projects or followup projects following a hurricane
24 that are directly caused by storm damages?

25 A I'm not aware of any Commission rule, order, or what

1 have you. I think it would be up to us to establish the
2 relationship between the two and provide that information.

3 Q And FPL would do that on sort of a case-by-case or
4 storm-by-storm basis?

5 A I may be incorrect, but I thought that it had already
6 been provided. But the answer is yes to your question.

7 Q So your position is that the appropriate criteria for
8 determining the direct costs of storm damages is the need of
9 the followup projects to restore the system to its
10 pre-hurricane status, not the timing of the work?

11 A That is correct. I mean, I think that goes back to a
12 couple of orders. It is not exactly the same thing, but in
13 Andrew there were instances where you had underground cable,
14 for example, with salt damage from water intruding into it, and
15 the decision was made, the Commission accepted it, that we
16 could charge those costs to the reserve several years, in fact,
17 afterwards because the charging was going to be done not by
18 pulling the cables today, but when they failed. So I think,
19 yes, it is the nexus between the storm and the needed repair.

20 Q If a cutoff date is set for expenses to be charged to
21 the storm reserve, would that provide an incentive for the
22 company to restore the system sooner? And what I mean is
23 restoring the system to its pre-hurricane status.

24 A As an accountant, I would say clearly yes, if that
25 what is I had. But I think as a practical matter one of the

1 issues that the distribution folks are having right now is
2 having a difficult time getting qualified people to do some of
3 that work because you have got TECO, Progress Energy, and Gulf
4 doing some of those same things, so the resources are a bit
5 scarce right now. So it would concern me if we did that, but
6 it is more an operational concern.

7 Q Do you believe that setting a cutoff date for
8 expenses to be charged to the reserve, while possibly providing
9 an incentive to restore the system faster, could result in
10 higher costs?

11 A Yes, I believe that is the case, because assuming the
12 premise that I just gave you that there is a shortage of
13 resources, if you can't get any more resources then the only
14 response is to work them longer, assuming they are willing to
15 do so. To work them longer and that involves premium pay, much
16 as it would during the actual initial restoration process.

17 Q I believe in your rebuttal testimony you have
18 indicated that as of December 31st, 2004, the cost for followup
19 projects were estimated at \$43.4 million, and I believe those
20 were projects that were incomplete as of December 31st, 2004,
21 is that correct?

22 A That is correct. I can give you an updated number.
23 It is about 26 million as of March 31st, so they have
24 accomplished some of that work.

25 Q And because those followup projects were not

1 completed as of December 31st, 2004, is it is your
2 understanding those costs were not fully examined by the
3 staff's audit that was conducted in this docket?

4 A I would agree with that. I mean, the invoices and
5 the bills, the M&S issues, the payroll charges, all of those
6 things would have been available to staff to audit, they would
7 have been available to the intervenors to review and challenge
8 if they saw fit. But respect to those future projects, there
9 is a clear difference because all we can give you there is a
10 description of the project, the reason that it is, in fact,
11 related to the storm, and an estimate of the costs. So, yes,
12 sir.

13 Q Would you agree, then, that it would be fair for the
14 Commission to review those costs after project completion to
15 assure that the costs incurred are within the scope of the
16 projects and are accounted for based on whatever methodology is
17 approved in this docket?

18 A Yes. Unlike the costs that have already been paid or
19 invoiced and the work performed, I would think that the
20 Commission would be well within its rights to want to look at
21 those later on.

22 Q I want to ask you a few questions about deferred
23 taxes. Is it correct that deferred taxes were created as a
24 result of the storm damage expenses recognized for tax purposes
25 in 2004?

1 A Yes. There would have been a -- we would have
2 received a tax deduction for the storm damage. **The book tax**
3 accounting would have resulted in the recognition of a deferred
4 tax credit or liability, if you will, that would be in capital
5 structure as a zero cost of capital.

6 Q And if you know, and if you just have an
7 approximation to give me that would be fine, but do you know
8 what the amount of interest that FPL proposes that it be
9 allowed to earn on the unamortized balance of storm-related
10 costs over the life of the storm damage surcharge would be?

11 A I don't know the number. There was one that was
12 attached to my direct testimony that was over two years. I may
13 have it, but it is blank right now. I don't know what the
14 number is. We can supply it to you if you would like it.

15 Q Do you know if the calculation of that number
16 whatever it may be took into account any of the accumulated
17 deferred taxes that resulted from the recognition of storm
18 damage restoration expenses for tax purposes in 2004?

19 A No, it did not. It would have been based upon the
20 entire \$533 million deficit in the storm damage reserve.
21 However, there would have been the offsetting benefit, if you
22 will, in that the overall cost of capital would have been lower
23 on the base rate side, because remember we are treating this as
24 a separate surcharge outside of base rates.

25 Q So it is FPL's intention to recognize the accumulated

1 deferred taxes related to storm damage expenses in the pending
2 rate case?

3 A I believe that that would be in there. They will
4 start turning around as we collect them. The deferred tax
5 credit will begin to reverse because I will have taxable income
6 as a result of receiving those revenues. So that deferred tax
7 credit will actually turn around in a shorter period, and to
8 that extent the deferred taxes that form a zero cost of capital
9 and the capital structure actually will get embedded in base
10 rates, which I think is beneficial to the customer.

11 Q Do you know what month and year the storm-related
12 deferred taxes were first recorded on the company's books?

13 A It would have been 2004. I don't know exactly what
14 month. Unfortunately, I found myself in the position of
15 increasing the storm damage accrual in the month of December,
16 so you would have had an adjustment certainly made in December.
17 We would have recorded probably adjusted current taxes on a
18 month-by-month basis based upon the estimates of the damages.

19 So really I think that would have been in September
20 would be the first month that you had a deferred tax effect.
21 That would have been based on the 710 million. Actually a
22 lesser number, because future projects would not be currently
23 deductible. And then in December we would have increased it to
24 the 890, to a deferred tax credit based upon the 890 adjusted
25 for future projects.

1 Q Over what period does FPL expect the storm-related
2 deferred taxes to turn around?

3 A Over the three-year period of the -- estimated
4 three-year period of the collection.

5 Q Is there anywhere in your testimony or exhibits where
6 you show the expected turn around of those deferred taxes by
7 month?

8 A No, there is not. You can look at the schedule,
9 which is the 710. Again, if you would like that precision, we
10 can certainly supply that information.

11 MR. KEATING: Staff would like to ask if the witness
12 can provide a late-filed hearing exhibit that would provide the
13 expected monthly turn around of storm-related deferred taxes,
14 and that is assuming the Commission approves the request to
15 collect the proposed surcharge over a 36-month period.

16 THE WITNESS: Okay. One question I have is right now
17 the schedule that is attached to my direct testimony assumes
18 ratable, in other words, equal monthly amounts. The actual
19 collection will not be ratable because you have higher
20 consumption during the summer months. Would it be acceptable
21 to do it on just a one 36, one 36 as a way of illustrating it?

22 MR. KEATING: That would be fine. Thank you.

23 CHAIRMAN BAEZ: Can you describe again the late-filed
24 for me, Mr. Keating?

25 MR. KEATING: I can give it a title. It would be

1 expected monthly turn around of storm-related deferred taxes.

2 BY MR. KEATING:

3 Q Mr. Davis, you are also a witness in FPL's pending
4 rate case, is that correct?

5 A Yes, I am.

6 Q And in the MFR filing for its rate case FPL has used
7 a projected 2006 test year, is that correct?

8 A That is correct.

9 Q And FPL has filed its 2006 projected test year
10 information on a 13-month average basis, is that also correct?

11 A That is correct.

12 Q Would you agree, then, that because FPL is using a
13 projected 2006 test year based on 13 month average balances,
14 that roughly half of the storm-related deferred taxes will have
15 already turned around and, therefore, only half of those
16 storm-related deferred taxes will actually be reflected in the
17 company's 2006 capital structure?

18 A It would be somewhere in that neighborhood. I mean,
19 with the 13 month moving average you would be at the midpoint,
20 so I wouldn't agree it is two-thirds. Maybe 18 months out of
21 36. And one thing I do need to clarify, I have to reverify
22 whether the timing of the MFR preparation, whether that would
23 have included in '06 the specific storm, because I'm sitting
24 here thinking that we had started on those MFRs beforehand. So
25 I would want to modify my answer to be subject to check, just

1 o make sure. It should be. It should be reflected in there
2 is zero cost of capital.

3 Q Do you know what the total amount of storm-related
4 deferred taxes is?

5 A No, I don't. I would assume that as of 12/31 it
6 would be the 890 million minus the future projects, and
7 probably minus the capital expenditures, so that would reduce
8 that down to probably about 790. Somewhere in that range as a
9 base number and then multiply that by 38.575. 38.575 percent.

10 Q I have to admit the math is flying over my head.

11 A I apologize. All I am saying is the only thing we
12 can deduct, we would not be able to deduct the future projects
13 and we would not be able to deduct the cost of the new capital
14 assets. And so you reduce those two from the 890, and then you
15 multiply by the combined federal and state tax rate, and that
16 is just a simplistic way of getting at it. There may be other
17 differences.

18 Q I am going ask if that number is something that could
19 be provided in the late-filed exhibit that is already
20 identified.

21 A I think so. And my brain sitting next to me here
22 just reminded me that to the extent that we had the storm fund
23 available to us, that would have -- we would have paid taxes,
24 so you would effectively had the reverse to the extent of the
25 354 million in the storm fund. We would have already paid

1 taxes on it. That would have reversed, so my starting point
2 should not be the 890, it should be the 536 deficit. But, yes,
3 we will add -- you want to see the amount of deferred taxes?

4 Q Yes, the total amount of the storm-related deferred
5 taxes.

6 A Okay.

7 CHAIRMAN BAEZ: And while we are on it, just for the
8 record that is Hearing Exhibit 39. And, Mr. Davis, I guess I
9 have to ask you what kind of time frame do you need to prepare
10 that?

11 THE WITNESS: Am I going to be measured against the
12 Progress standard, which is one day turn around? Seriously, I
13 will have it back -- I will try to have it to you tomorrow, and
14 if not, by Friday morning.

15 CHAIRMAN BAEZ: Okay. Thank you.

16 (Late-filed Exhibit 39 marked for identification.)

17 BY MR. KEATING:

18 Q And finally, I have one question. I do have a few
19 more questions, but on this line one other question that you
20 may not have the answer off the top of your head, and I
21 apologize, I don't usually like to ask for late-filed exhibits
22 at the hearing. This is something, an issue that has kind of
23 arisen very recently, but do you know what the amount of
24 storm-related deferred taxes is that is reflected in FPL's 2006
25 test year capital structure?

1 A No. That was what I was alluding to a few moments
2 ago. I have to see whether it was there, but I do not know off
3 the top of my head.

4 Q And, again, as I suggested, staff would ask that that
5 be provided in the late-filed exhibit.

6 A Okay. We will include it in the same exhibit.

7 Q Thank you. Since FPL only included a portion of the
8 storm-related deferred taxes in the projected 2006 test year,
9 would the company object to the Commission recognizing the
10 remaining portion of storm-related deferred taxes in the
11 calculation of interest on the unamortized balance of storm
12 damage recovery?

13 A I guess I would look at it and say that you are
14 differentiating because of a rate proceeding, and if you are
15 going to measure the capital, why would you treat it
16 differently. That would be my philosophical objection that why
17 is it different only because we are going to rates. It either
18 is in the permanent capital structure or it is treated in the
19 storm cost recovery. I would think it would be either or, but
20 it is up to the Commission.

21 Q I just have a few more questions for you, Mr. Davis.
22 This follows up on some of the questions that Mr. Perry asked
23 you earlier, and I think we have established that you are not
24 an attorney and that I'm not an accountant.

25 A We are in trouble.

1 Q Mr. Perry asked you about the conclusions in your
2 testimony that the Commission through its 1995 order approved
3 the methodology for charging items to the storm reserve that
4 was set forth in FPL's 1993 study, and it is your position that
5 that order did approve the methodology?

6 A Yes, it is. The order, or the study as I said
7 before, was filed to answer questions that -- specific
8 questions raised by the Commission. The Commission concluded,
9 I think if you look at the staff recommendation it indicates
10 all of the questions were answered, and then the order is
11 entitled an order approving the study. So as an accountant,
12 I'm not sure I know how would I answer, you know, how I would
13 conclude otherwise, or would account for things in a manner
14 inconsistent with that study.

15 Q If you could look at your Exhibit KMD-3, which I
16 believe is the study itself, and if you could turn to Page 1 of
17 that exhibit. That is using the number at the bottom of the
18 pages.

19 A At the bottom? There is a number is in upper right,
20 too.

21 Q This would be Page 2 of 51, referring to the numbers
22 in the upper right.

23 A Okay.

24 Q Would you agree looking at the last sentence on that
25 page, that the primary purpose of the study was to address what

1 costs should be charged to the reserve during the period of
2 self-insurance and what the appropriate annual accrual should
3 be?

4 A Yes, sir, that is what it says.

5 Q And turning to Page 3, or referring to the page
6 numbering in the upper right corner of your exhibit, Page 451
7 under the subheading conclusion. Would you agree the study
8 recommends, or FPL's recommendation of the study was that the
9 use of the actual restoration cost approach was the proper
10 method to use for charging items to the reserve, and that a
11 \$7.1 million accrual was the appropriate amount to accrue to
12 the reserve on an annual basis?

13 A Yes, I would agree that it is our position that the
14 actual restoration cost should be accrued. I think the docket
15 wound up using an accrual of 10.1, though, not the 7.1 that was
16 mentioned in here.

17 Q Okay. And that does lead me to my next question. If
18 you would look at Exhibit KMD-4 to your rebuttal testimony,
19 which is the order addressing the study, the 1993 study.

20 A Okay.

21 Q And you would agree that although the study --
22 turning to Page 4 of that order, if I didn't indicate already.
23 Would you agree that the first full paragraph on that page
24 indicates that while the study recommended a \$7.1 million
25 annual accrual, the Commission ultimately approved a

1 ;10.1 million annual accrual?

2 A Yes, sir.

3 Q So while the order is titled an order approving the
4 study, and while the order found that the study was adequate,
5 the Commission did not approve the study's recommended annual
6 accrual, is that correct?

7 A That is correct.

8 Q And I think we established earlier under Mr. Perry's
9 questions that the order does not expressly state anywhere that
10 it found the methodology for charging items to the reserve to
11 be appropriate or reasonable, is that correct? It didn't use
12 those exact words?

13 A It did not use those exact words, but one point I
14 would make is that the decision as to the amount of the
15 self-insurance accrual is a matter of looking at the policies
16 that were set forth in the study and then repeated in the
17 order, and each of those policies is built around a separation,
18 if you will, of the costs, with one portion being charged to
19 base rates through the annual accrual for storm cost, and the
20 remainder being left outside base rates to be recovered through
21 a cost-recovery mechanism. And so while the Commission staff
22 -- I believe the intervenors met over an extended period of
23 time and ultimately reached a compromise to change the 7.1 to
24 the 10.1. I would agree that I think some of the motivation
25 for moving from the 7.1 to the 10.1 was at the behest of staff.

1 Q Nonetheless, though, the order while stating that it
2 approved the study and found it adequate, did not actually
3 approve -- explicitly approve either of the recommendations
4 made in the study, is that correct?

5 A All I can tell you is what the order says, and the
6 order says that it approves the study, and that the study
7 itself was adequate to presumably answer the questions and for
8 regulatory purposes. The only other point that as an
9 accountant I could make is that the area that you are talking
10 about where there was a change in the description of the order,
11 and I don't know whether it is a distinction without a
12 difference or not, but it, one, deals with the increase in the
13 storm damage accrual, and the other deals with the storm damage
14 study. So it tended to carve the pieces out, but I can't sit
15 here and dissect and say what that means.

16 Q Is it possible, then, that a fair interpretation of
17 this order, a fair interpretation of the Commission's finding
18 that the study was adequate would be that the Commission simply
19 wanted to indicate that the study was sufficient for purposes
20 of beginning its analysis rather than blessing every aspect of
21 the study as a final statement on the issues that were
22 addressed in the study?

23 A As the chief accounting officer of Florida Power and
24 Light, I would say no, I could not agree to that. I certainly
25 did not read it that way, and if I had I would have been back

1 here asking for the guidance so that I would not find myself in
2 the position now of having issued financial statements for the
3 calendar year 2004 and debating the issue now as to whether or
4 not something I reported in there as an asset was, in fact, an
5 asset. That is very troublesome to me as an accountant.

6 MR. KEATING: Thank you. That is all the questions I
7 have.

8 CHAIRMAN BAEZ: Commissioners, questions?

9 COMMISSIONER DEASON: I have a question.

10 CHAIRMAN BAEZ: Go ahead, Commissioner.

11 COMMISSIONER DEASON: Mr. Davis, I want to explore
12 with you for just a moment the potential pricing concerns with
13 a utilization of a depreciation, theoretical depreciation
14 reserve excess, use that to offset part of the storm damage
15 reserve deficiency. Assume with me for a moment that there is
16 a theoretical depreciation reserve excess in generation assets
17 And assume with me that the generation assets are allocated to
18 customer classes generally on a demand basis as opposed to an
19 energy basis. And assume with me that costs associated with
20 storm cost recovery are allocated to customer classes based
21 upon an energy basis. Do you follow all of that so far?

22 THE WITNESS: Yes, sir, I do.

23 COMMISSIONER DEASON: So if we take a theoretical
24 depreciation reserve excess from generation and allocate that
25 to offset a deficiency in the storm cost reserve, that would

1 have the tendency, would it not, of increasing costs for
2 generation above what they otherwise would be, is that true?

3 THE WITNESS: That is correct.

4 COMMISSIONER DEASON: And those costs could be
5 allocated on a demand basis as opposed to an energy basis,
6 correct?

7 THE WITNESS: Correct. You would have a higher cost
8 pool to be allocated on an energy basis and a lower cost --

9 COMMISSIONER DEASON: There would be a higher cost
10 for a demand basis, would it not?

11 THE WITNESS: I'm sorry. Thank you. I'm glad you
12 were -- the generation assets would have a higher cost. They
13 are allocated on a demand basis, so you would have more costs
14 going out on a demand basis.

15 COMMISSIONER DEASON: What effect would that have on
16 customer classes, primarily residential versus, for example,
17 industrial?

18 THE WITNESS: Primarily industrial, commercial that
19 have that kind of a rate. I think most customers would be
20 primarily energy, but I would want to defer to Rosemary Morley,
21 who I think is a witness scheduled here to go into the rate
22 design.

23 COMMISSIONER DEASON: Okay. So she should testify to
24 that question then.

25 THE WITNESS: If you don't mind, I would prefer that.

1 I can get myself in a lot of trouble with rates pretty quickly.

2 COMMISSIONER DEASON: I will do that. Thank you.

3 CHAIRMAN BAEZ: Any other questions, Commissioners?

4 Redirect.

5 MR. BUTLER: Just a few redirect, please.

6 REDIRECT EXAMINATION

7 BY MR. BUTLER:

8 Q Mr. Davis, returning to a subject you were just
9 discussing with Mr. Keating a moment ago, is there anything in
10 the -- well, first of all, Mr. Keating pointed out to you that
11 the order adjusted actually upward the annual accrual to FPL's
12 storm fund from what had been proposed in FPL's 1993 storm
13 study, correct?

14 A That was the result of the negotiations between the
15 parties, they did increase it from 7.1 to 10.1.

16 Q Is there anything in the order that reflects a
17 similar change, adjustment, reservation, whatever to what FPL
18 had proposed with respect to the storm damage accounting in the
19 '93 study?

20 A No, there is not. In fact, if you look at the staff
21 recommendation on it, the issue was did FPL's study on
22 transmission and distribution insurance replacement adequately
23 address the storm damage accrual, the types of costs to be
24 charged to the storm fund, and the treatment of all Hurricane
25 Andrew T&D damages as required by PSC Order PSC-93-0918-FOF-EI,

1 and the recommendation was yes. And then the discussion tends
2 to support the fact that all of the issues were addressed.

3 Q Thank you. Would you turn in the storm study itself
4 to Page 9 of 51, the page that has Number 8 at the bottom of
5 it?

6 A At the top or the bottom, I'm sorry?

7 Q Nine at the top, 8 at the bottom.

8 A Nine at the top, 8 at the bottom. I'm there.

9 Q Mr. McGlothlin, I think, had asked you some questions
10 about the next to last paragraph on that page, and the
11 significance of the comments about the cumbersome and
12 potentially arbitrary accounting for storm restoration
13 utilizing two different methodologies. Do you recall those
14 questions?

15 A Yes, I do.

16 Q And his questions, some of them at least, were
17 premised around the assumption that FPL does not now have
18 property insurance for the T&D assets that might be exposed to
19 storm damage, correct?

20 A Right. I believe I answered him strictly on the
21 basis of what I call poles and wires.

22 Q Right. Does FPL still have property damage insurance
23 on a replacement cost basis for some of its other types of
24 property?

25 A Yes, it does for substation facilities, power plants,

1 nuclear facilities and so forth.

2 Q As the chief accounting officer for FPL, would you
3 want to have two different storm damage cost accounting
4 approaches for T&D property on the one hand and other types of
5 property on the other?

6 A I would not, and I would think that the field would
7 find it somewhat difficult to administer.

8 Q Do you have still with you a copy of the order that
9 to Mr. McGlothlin distributed, the Order Number PSC-98-0027,
10 dated January 5, 1998?

11 A Yes, sir, I do.

12 Q Would you turn to Page 16 of that order, please?

13 A I'm there.

14 Q I would ask you to read the paragraph that begins
15 about the middle of the page after the indented quote, "This
16 order clearly shows."

17 A Okay. "This order clearly shows that our approach to
18 reserve transfers is to make them between accounts within the
19 same function and not between accounts across functions. This
20 approach is in agreement with the approach put forward by FPL
21 Witness Gower."

22 Q Mr. Davis, would you consider the proposal of Mr.
23 Majoros concerning the use of a theoretical depreciation
24 reserve surplus to offset storm damage costs to be consistent
25 with the policy set forth in that paragraph?

1 A No, I would not. You have a couple of ways of
2 looking at it. One is the storm accrual itself is accounted
3 for as an A&G cost and, therefore, is allocated on a general
4 plant basis. T&D maintenance, if you treat it as transmission
5 and distribution maintenance, it would be allocated on another
6 basis, and nuclear has an altogether separate allocation factor
7 for cost of service.

8 Q Do you know whether FPL had any increase in base
9 rates in the 1997/1998 time frame that was designed to recover
10 the accelerated depreciation that Mr. McGlothlin was discussing
11 with you concerning this Order PSC-98-0027?

12 A There was not. In fact, in I think it was '99 there
13 was a 350 million rate decrease.

14 Q You were asked about the cost of removal that is in
15 FPL's depreciation reserve, and I would ask you whether FPL
16 still will be subject to the requirement and obligated to incur
17 the expense of removing the poles and other equipment that were
18 installed in replacement of facilities damaged by the
19 hurricanes during 2004?

20 A Yes, they will.

21 Q And assuming that that occurs in the normal course of
22 removal, will the cost of removal come from the accumulated
23 reserve that has been established for that purpose?

24 A It will be charged to that accumulated reserve, yes.

25 Q Almost done. Mr. Davis, there is an interrogatory

1 response included in the Office of Public Counsel composite
2 exhibit. It is response to Mr. Twomey's Interrogatory Number
3 44, and it deals with management bonuses. Just one simple
4 question for you there. Are management bonuses at this point
5 charged to the storm reserve?

6 A No, they are not. They were initially charged to the
7 storm damage reserve because they were in lieu of overtime for
8 management employees. A decision was subsequently made to
9 remove them.

10 MR. BUTLER: Thank you, Mr. Davis.

11 That's all the redirect that I have.

12 CHAIRMAN BAEZ: Thank you, Mr. Davis. We will take
13 exhibits.

14 MR. BUTLER: I would move the admission of Exhibits
15 7, 8, 24, 25, 26, and 31.

16 CHAIRMAN BAEZ: Without objection show 7, 8, 24, 25,
17 26, and 31 admitted into the record. And, OPC, you have got
18 35, 36, 37, and 38.

19 MR. MCGLOTHLIN: I move those.

20 CHAIRMAN BAEZ: If there are no objections, show
21 those moved into the record, as well.

22 (Exhibits 7, 8, 24, 25, 26, 31, 35, 36, 37, and 38
23 admitted.)

24 CHAIRMAN BAEZ: And we have a late-filed exhibit
25 which we can go ahead and move in subject to.

1 MR. KEATING: I believe that would be appropriate.

2 CHAIRMAN BAEZ: If there are no objections, we will
3 move it into the record subject to inspection and circulation
4 to the parties.

5 (Late-filed Exhibit 39 admitted.)

6 CHAIRMAN BAEZ: And, Mr. Davis, just to confirm, you
7 had said that you might have that late-filed by Friday?

8 THE WITNESS: No later than Friday, yes, sir.

9 CHAIRMAN BAEZ: No later than Friday. Thank you,
10 sir. The witness is excused, and we are going to break for
11 five minutes before we set up the next witness.

12 (Recess.)

13 CHAIRMAN BAEZ: We'll go back on the record. Mr.
14 Huntoon, welcome. You can go ahead and call your witness.

15 MR. HUNTOON: Thank you, Mr. Chairman.

16 Mr. Chairman, Commissioners, I'm Steve Huntoon
17 appearing for FPL. FPL calls Rosemary Morley.

18 Mr. Chairman, she has not been sworn.

19 CHAIRMAN BAEZ: Good afternoon, Ms. Morley. Could
20 you please stand and raise your right hand.

21 (Witness sworn.)

22 ROSEMARY MORLEY

23 was called as a witness on behalf of Florida Power and Light,
24 and testified as follows:

25 DIRECT EXAMINATION

1 BY MR. HUNTOON:

2 Q Ms. Morley, would you state your name and position
3 with FPL, please?

4 A Rosemary Morley, Rate Development Manager, Florida
5 Power and Light.

6 Q Do you have with you the direct testimony of Rosemary
7 Morley and attached Exhibit RM-1, which is Hearing Exhibit 9,
8 as well as the supplemental direct testimony of Rosemary Morley
9 and attached Revised Exhibit RM-2, which is Hearing Exhibit 10?

10 A Yes, I do.

11 Q If I were to ask you the questions in your
12 testimonies today, would your answers be the same?

13 A Yes, they would.

14 MR. HUNTOON: Mr. Chairman, we would ask to insert
15 these testimonies into the record as though read at this time.

16 CHAIRMAN BAEZ: Without objection show the direct and
17 supplemental direct prefiled testimony of Witness Rosemary
18 Morley entered into the record as though read, and for the
19 record also show that those exhibits attached to her testimony
20 labeled RM-1 and RM-2 revised are numbered, already numbered as
21 Exhibits 9 and 10 respectively.

22 MR. HUNTOON: Thank you, Mr. Chairman.

23

24

25

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **DIRECT TESTIMONY OF ROSEMARY MORLEY**

4 **DOCKET NO. 041291-EI**

5

6

7 **I. INTRODUCTION AND CREDENTIALS**

8

9 **Q. Please state your name and business address.**

10 **A.**My name is Rosemary Morley. My business address is Florida Power &
11 Light Company, 9250 West Flagler Street, Miami, Florida, 33174.

12

13 **Q. By whom are you employed and what is your position?**

14 **A.**I am employed by Florida Power & Light Company (“FPL” or the
15 “Company”) as the Rate Development Manager in the Rates & Tariffs
16 Department.

17

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

19 **A.**I am responsible for developing electric rates at both the retail and wholesale
20 levels. At the retail level, I am responsible for developing the appropriate rate
21 design for all electric rates and charges. I am also responsible for proposing
22 and administering the tariff language needed to implement those rates and
23 charges.

1 **Q. Please describe your educational background and the business experience**
2 **that qualifies you to be a Rate Development Manager.**

3 **A.** I hold a bachelor's degree in economics from the University of Maryland and
4 a master's degree in economics from Northwestern University. I am currently
5 pursuing a doctorate in business administration from Nova Southeastern
6 University. Since joining FPL in 1983 I have held a variety of positions in the
7 forecasting, planning, and regulatory areas. I joined the Rates and Tariff
8 Department in 1987 as a Senior Cost of Service Analyst and was subsequently
9 promoted to Supervisor of Cost of Service. I have held the position of Rate
10 Development Manager since 1996.

11

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

13 **A.** Yes. I am sponsoring Exhibit RM-1 which shows the calculation of the storm
14 restoration surcharge factors by rate class and Exhibit RM-2 which is the
15 proposed tariff sheet for the Storm Restoration Surcharge.

16

17 **II. PURPOSE**

18

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

20 **A.** The purpose of my testimony is to outline FPL's proposed Storm Restoration
21 Surcharge tariff for recovering the storm-related revenue requirements
22 described in K. Michael Davis' testimony. I describe how the storm
23 restoration surcharge factors by rate class are developed. I also discuss the

1 true-up process for preventing any over- or under-recovery of the storm
2 related costs.

3

4 **Q. Please describe the process for computing the storm restoration**
5 **surcharge factors.**

6 **A.** The primary input into the process is the annual storm revenue requirements.
7 For the purpose of computing a rate effective January 1, 2005, I will begin
8 with the estimated 2005 annual revenue requirements of \$183,179,800
9 provided by Witness K. Michael Davis. This amount is allocated between the
10 retail and wholesale jurisdictions consistent with its treatment in FPL's
11 surveillance report. The resulting figure is \$182,308,988. An expansion
12 factor is then applied to account for the gross receipts and regulatory
13 assessment fees. This is the same expansion factor used in FPL's clause
14 filings. The estimated adjusted retail revenue requirements figure,
15 \$185,220,657, is then allocated by retail rate class.

16

17 **Q. How is this allocation by retail rate class determined?**

18 **A.** The allocation by rate class reflects their treatment in base rates. The revenue
19 requirements are allocated based on each rate class's share of gross plant.
20 This methodology is consistent with the treatment of these costs in Docket
21 001148-EI. The next step in the process is to divide each rate class's costs by
22 its kWh sales. The resulting figure is each rate class's kWh Storm Restoration

1 Surcharge. For consistency, both the gross plant allocation factors and the
2 kWh sales are based on the most recent actuals available.

3

4 **Q. How long will the Storm Restoration Surcharge be effective?**

5 **A.** The Storm Restoration Surcharge will be effective for a period of twenty-four
6 (24) months from the effective date of this tariff or for such shorter period as
7 may be sufficient to fully recover the applicable revenue requirements. FPL is
8 proposing an effective date of January 1, 2005 for the Storm Restoration
9 Surcharge.

10

11 **Q. Have you calculated separate storm restoration surcharge factors for the
12 second twelve months of the tariff's application?**

13 **A.** No I have not. We do not believe that such an exercise is necessary. The
14 Storm Restoration Surcharge will be subject to true-up and, if necessary,
15 customers will be refunded any amounts in excess of the applicable revenue
16 requirements. This true-up process is described later in my testimony.
17 Moreover, as the tariff outlines, the Storm Restoration Surcharge will only be
18 in effect for such period of time as is needed to recover the applicable revenue
19 requirements.

20

21

22

1 **Q. Could the sales by rate class experienced between 2005 and 2006 be**
2 **different than the actual sales by rate class used to develop these rates?**

3 **A.** Yes. The sales by rate class experienced during the 2005 and 2006 recovery
4 period could differ from the figures presented in Exhibit RM-1. However,
5 with the true-up mechanism FPL is proposing this difference should have no
6 effect on what customers are ultimately charged for the Storm Restoration
7 Surcharge.

8
9 **Q. How will FPL's proposed true-up mechanism work?**

10 **A.** At the conclusion of the recovery period, FPL will compare the amount
11 actually collected with the revenue requirements recovery methodology
12 described in K. Michael Davis' testimony. A storm recovery true-up factor
13 will then be developed based on each rate class's kWh sales during the
14 recovery period. Based on these factors, refunds with interest will be
15 distributed to each customer based on their actual kWh sales during the
16 recovery period.

17
18 **Q. Is FPL proposing to include the Storm Restoration Surcharge as part of**
19 **its retail tariff?**

20 **A.** Yes. As shown in Exhibit RM-2, the Storm Restoration Surcharge is
21 proposed as sheet 8.033.

22

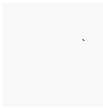
23

1 **III. CONCLUSION**

2

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

4 **A. Yes.**



1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **FLORIDA POWER & LIGHT COMPANY**

3 **SUPPLEMENTAL DIRECT**

4 **TESTIMONY OF ROSEMARY MORLEY**

5 **DOCKET NO. 041291-EI**

6

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

8 A. My name is Rosemary Morley. My business address is 9250 West Flagler Street,
9 Miami, Florida 33174.

10

11 **Q. Did you previously submit direct testimony in this proceeding?**

12 A. Yes.

13

14 **Q. What is the purpose of this supplemental direct testimony?**

15 A. The purpose of my testimony is to submit a revised proposed Storm Restoration
16 Surcharge Tariff to reflect the continuation of the Storm Restoration Surcharge, at the
17 current level, for an additional twelve months beyond the twenty-four months
18 originally proposed, or for such shorter period as is necessary to recover the Storm
19 Reserve Deficit.

20

21 **Q. Why are you proposing an additional twelve months?**

22 A. As described in the Supplemental Direct Testimony of Witness K. Michael Davis, the
23 estimate for total storm damages has increased by \$180 million, and the jurisdictional

1 portion of the Storm Reserve Deficit is now estimated to be \$533 million. As a result,
2 FPL projects that a longer recovery period is required.

3

4 **Q. Are you sponsoring any exhibits?**

5 A. Yes. I am sponsoring Revised Exhibit RM-2 which is the proposed tariff sheet for the
6 Storm Restoration Surcharge.

7

8 **Q. Does FPL believe that 36 months will be sufficient to recover the revenue
9 requirements associated with the updated Storm Reserve Deficit?**

10 A. Yes. The total Storm Reserve Deficit of \$533 million (jurisdictional) results in total
11 retail revenue requirements (including interest) of approximately \$557 million. As I
12 outlined in my direct testimony, the Storm Restoration Surcharge is derived from an
13 annual retail revenue requirement of \$185 million and the most recent actual retail
14 kWh sales available at the time of the filing. Multiplying this annual revenue
15 requirement figure by a 36 month recovery period results in a total revenue figure of
16 \$555 million which is within \$2 million of the total retail revenue requirements
17 needed. Assuming load growth occurs during the recovery period, it is possible that
18 the \$557 million revenue requirements could be reached before the conclusion of the
19 36 months in which case the surcharge would be terminated earlier.

20

21 **Q. What does Revised Exhibit RM-2 show?**

22 A. Revised Exhibit RM-2 is the proposed revised Storm Restoration Surcharge, First
23 Revised Sheet No. 8.033, in legislative format, which shows a revised recovery

1 period of 36 months or such shorter period as may be sufficient to fully recover the
2 applicable revenue requirements.

3

4 **Q. Does FPL propose that the revised tariff sheet take effect immediately?**

5 A. No. FPL proposes that First Revised Sheet No. 8.033, shown in Revised Exhibit RM-
6 2, take effect upon the Commission's vote subsequent to the hearing that is scheduled
7 in Docket No. 041291-EI. If the Commission votes to accept First Revised Sheet No.
8 8.033, then FPL will submit a clean version of the tariff sheet for implementation at
9 that time.

10

11 **Q. Does this conclude your supplemental direct testimony?**

12 A. Yes, it does.

1 BY MR. HUNTOON:

2 Q Ms. Morley, would you summarize your testimony,
3 please?

4 A Yes, I will. The purpose of my testimony is to
5 address FPL's proposed storm restoration surcharge by rate
6 class.

7 My testimony encompasses three areas. First, my
8 testimony addresses the allocation of the storm restoration
9 surcharge by rate class. FPL allocates the storm restoration
10 surcharge on the basis of gross plant in service, which is
11 consistent with the method approved in FPL's base rates. As
12 approved by the Commission, the cost of the storm accrual is
13 allocated in base rates on the basis of gross plant in service.
14 The recovery of the deficiency should be consistent with this
15 allocation and is under FPL's proposal.

16 Second, my testimony discusses the recovery period
17 for the storm restoration surcharge. FPL proposes a recovery
18 period of 36 months or less as may be needed to recover the
19 storm deficiency. The tariff language proposed by FPL makes it
20 clear that the surcharge will be terminated in less than 36
21 months if the approved cost associated with the storm
22 deficiency is fully recovered before that time.

23 Third, my testimony discusses the true-up process to
24 be applied to the surcharge. As I discuss in my direct
25 testimony, FPL proposes a single cumulative true-up at the

1 onclusion of the recovery period based on the actual sales and
2 evenues recorded during the recovery period. At the
3 onclusion of the recovery period, any overrecovery will be
4 efunded to customers with interest as soon as feasible.

5 In this manner, FPL's proposal for a single
6 umulative true-up works hand-in-hand with its plan to
7 erminate the surcharge in less than 36 months if the approved
8 osts are recovered before that time. Intermediate or annual
9 rue-ups before the end of the recovery period are not
10 ecessary and would not represent the best use of the
11 ommission's time and resources.

12 MR. HUNTOON: We tender the witness for cross
13 xamination.

14 CHAIRMAN BAEZ: Ms. Christensen.

15 MS. CHRISTENSEN: We have no questions of this
16 witness.

17 CHAIRMAN BAEZ: Mr. Wright.

18 MR. WRIGHT: We have no questions, and Mr. Perry did
19 ell me that he had no questions.

20 CHAIRMAN BAEZ: Okay. Mr. Twomey.

21 MR. TWOMEY: No questions.

22 CHAIRMAN BAEZ: Staff.

23 MR. KEATING: I didn't know we would be the only one
24 asking questions of this witness.

25 CHAIRMAN BAEZ: A missed opportunity.

1 MR. KEATING: We just have a few. We won't keep her
2 long.

3 CHAIRMAN BAEZ: Go ahead.

4 CROSS EXAMINATION

5 BY MR. KEATING:

6 Q Ms. Morley, I'm Cochran Keating with the Commission
7 staff. In your direct testimony, I believe it is in Exhibit
8 RM-1, you derived storm cost-recovery charges by rate class, is
9 that correct?

10 A That is correct.

11 Q And these are the factors that went into effect on an
12 interim basis in February?

13 A On February 17th, correct.

14 Q And these were the factors that were developed to
15 recover FPL's storm damage costs over a two-year period
16 initially?

17 A Initially based on the estimated storm deficiency at
18 that time, yes.

19 Q Now that FPL has requested a three-year recovery
20 period for storm costs, is it FPL's position that these same
21 factors should remain in effect for a total of three years or
22 until the storm costs are fully covered?

23 A Yes, for 36 months or less.

24 Q If the Commission determines as a result of this
25 hearing that FPL should recover less than the total storm costs

1 for which it has requested recovery, is it FPL's position that
2 the factors in effect today should not be changed to reflect
3 the modified recovery amount?

4 A I think that that could be the approach. We could
5 simply terminate the factor according to when the approved
6 amount is recovered, whatever that approved amount ends up
7 being.

8 Q But the Commission could modify that amount if they
9 approved something less than the total amount requested by FPL?

10 A Could the Commission approve a recovery amount
11 different than what FPL is requesting?

12 Q I'm sorry, let me rephrase that. The Commission
13 could establish factors different than those that FPL is
14 proposing if it ultimately does not allow all of the amount for
15 recovery that FPL has requested?

16 A Yes, they could do that.

17 Q Okay. Is it correct that the currently effective
18 factors were derived using actual historic 2003 kilowatt hour
19 sales?

20 A The factors were derived based on an allocation
21 factor, gross plant in service, from the most recent actual
22 period available at the time, which was 2003, and then dividing
23 those allocated costs by 2003 sales, yes.

24 Q In developing the allocation percentages by rate
25 class, you did not attempt to take into account the actual

1 amount of storm costs that were incurred by functional area, is
2 that correct?

3 A No, we did not perform a study of the storm damage by
4 function. We chose to allocate the cost of the storm
5 deficiency consistent with the way customers have been paying
6 for the storm deficiency in our base rate, which is based on
7 gross plant in service.

8 Q Would it be unreasonable to develop allocation
9 percentages taking into account actual storm costs incurred by
10 functional area?

11 A I don't know if I would use the word unreasonable. I
12 would say it is inconsistent with the way those costs are
13 currently recovered in base rates and that it would be
14 unnecessary.

15 Q Would it, however, be consistent with the manner in
16 which those costs were incurred?

17 A I would have to take exception to that. The way the
18 costs are paid for is through the storm fund, and the way
19 customers have paid through the storm fund is through the
20 accrual, and the way those costs are allocated is based on
21 gross plant in service.

22 Q If you could turn to Page 5 of your testimony at
23 Lines 9 through 16. You describe the method that FPL has
24 proposed to true-up the storm cost recovery surcharge at the
25 end of the recovery period. Is that still the true-up method

1 that FPL is supporting?

2 A Yes, this would be one method. As I describe in my
3 testimony, we could at the end of the recovery period is
4 perform a one time true-up in the alternative depending on the
5 amount, the Commission might elect to put that overrecovery
6 amount into one of the clauses.

7 MR. KEATING: Thank you. That's all the questions I
8 have.

9 CHAIRMAN BAEZ: Commissioners, questions?

10 COMMISSIONER DEASON: Yes, I have a question. It is
11 your recommendation that we allocate the storm cost deficiency
12 based upon gross plant as the allocator between rate classes
13 and then once it is allocated, it gets charged on a per
14 kilowatt hour basis, is that correct?

15 THE WITNESS: That is correct.

16 COMMISSIONER DEASON: Okay. Now, are you familiar
17 with the proposal to use depreciation excess to offset all or
18 part of the reserve deficiency?

19 THE WITNESS: I'm familiar with it. Not being an
20 accountant, I would not say that I am versed on all the
21 mechanics that would be involved. But, yes, I have heard of
22 it.

23 COMMISSIONER DEASON: Okay. I want to concentrate on
24 potential impacts when it comes to pricing, and that is mainly
25 what I want to focus on, and I think that is your area of

1 xpertise. Generation assets, for an example, they go into the
2 ate base, we calculate a revenue requirement, it goes into the
3 verall calculation, but when it comes time to allocate costs
4 o customers, it is allocated -- and correct me if I'm wrong --
5 t is allocated primarily on a demand basis using a cost of
6 ervice study and then gets charged to some customers based
7 upon both an energy charge and a demand charge. For
8 esidential, though, obviously there is just an energy charge.
9 re there any pricing problems associated with making this
10 epreciation adjustment, or do you think it all just kind of
11 omes out in the wash, so to speak?

12 THE WITNESS: Well, I think the first thing in terms
13 of the rates, before you get to the retail classes is to ask
14 ow it effects the separation of cost between wholesale and
15 etail. And my understanding of the proposal is that it would
16 amount to increasing our nuclear net plant in service. That is
17 ny understanding.

18 COMMISSIONER DEASON: It would increase retail as
19 opposed to wholesale?

20 THE WITNESS: Right. Because what happens is when we
21 separate costs between wholesale and retail and we look at
22 nuclear plant, although we have wholesale power sales, the
23 majority of this load is a partial requirements contract where
24 the load is not served off of our nuclear system. They are
25 dedicated. The rates are designed to be non-nuclear in nature.

1 Even the fuel is non-nuclear. So if you push costs to nuclear,
2 the share of costs going to retail will increase. So that is
3 the first element.

4 Then in terms of the impact on rate classes, if you
5 allocate things more on a demand basis as opposed to energy,
6 and I am speaking very broadly here, but if you tend to do that
7 you tend to push costs onto residential and smaller commercial
8 and industrial customers as opposed to the larger customers.
9 Does that address your question?

10 COMMISSIONER DEASON: Yes, it does. Thank you.

11 CHAIRMAN BAEZ: Commissioners, any other questions?
12 Redirect.

13 MR. HUNTOON: No redirect, Mr. Chairman.

14 CHAIRMAN BAEZ: Exhibits.

15 MR. HUNTOON: We would like to move Hearing Exhibits
16 9 and 10.

17 CHAIRMAN BAEZ: Without objection show 9 and 10 moved
18 into the record.

19 (Exhibits 9 and 10 admitted.)

20 CHAIRMAN BAEZ: Thank you, Ms. Morley. You are
21 excused.

22 THE WITNESS: Thank you, Commissioner.

23 CHAIRMAN BAEZ: Ms. Christensen, your witness.

24 MS. CHRISTENSEN: Commissioner, we would like to call
25 James Rothschild to the stand.

1 CHAIRMAN BAEZ: Good afternoon, Mr. Rothschild. Were
2 you sworn, sir?

3 THE WITNESS: No, I was not.

4 CHAIRMAN BAEZ: Raise your right hand, please.

5 (Witness sworn.)

6 JAMES A. ROTHSCHILD

7 was called as a witness on behalf of the Citizens of the State
8 of Florida and testified as follows:

9 DIRECT EXAMINATION

10 BY MS. CHRISTENSEN:

11 Q Good afternoon, Mr. Rothschild. Can you please state
12 your name and your address for the record, please?

13 A Yes. James A. Rothschild, address 115 Scarlet Oak
14 Drive, Wilton, Connecticut.

15 Q And, Mr. Rothschild, did you cause to be filed in
16 this case direct testimony and exhibits?

17 A Yes.

18 Q And do you have any corrections to your direct
19 testimony and exhibits?

20 A One small correction, which was -- I don't see it
21 right this second, but the place where I reference Atlantic
22 City Electric should be Rockmon Electric.

23 Q And would that correction occur on Page 9, Line 2 of
24 your direct testimony?

25 A Yes.

1 Q And, Mr. Rothschild, with that correction, if I were
2 to ask you the same questions today as were asked in your
3 direct testimony, would they be the same?

4 A Yes.

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

8 CHAIRMAN BAEZ: Without objection, show Witness
9 Rothschild's direct testimony entered into the record as though
10 read.

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **DOCKET NO. 041291--EI**

3 **TESTIMONY**

4 **OF**

5 **JAMES A. ROTHSCHILD**

6

7 **I. STATEMENT OF QUALIFICATIONS OF JAMES A. ROTHSCHILD**

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

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

11

12 **Q. WHAT IS YOUR OCCUPATION?**

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

16

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

18 A. I am President of Rothschild Financial Consulting and have been a
19 consultant since 1972. From 1979 through January 1985, I was President of
20 Georgetown Consulting Group, Inc. From 1976 to 1979, I was the President of J.
21 Rothschild Associates. Both of these firms specialized in utility regulation. From
22 1972 through 1976, Touche Ross & Co., a major international accounting firm,
23 employed me as a management consultant. (Touche Ross & Co. later merged to
24 form Deloitte Touche.) Much of my consulting at Touche Ross was in the area of

1 utility regulation. While associated with the above firms, I have worked for
2 various state utility commissions, attorneys general, and public advocates on
3 regulatory matters relating to regulatory and financial issues. These have
4 included rate of return, financial issues, and accounting issues. (See Appendix
5 A.)

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

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

9
10 **II. BACKGROUND AND PURPOSE**

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

12 A. Severe damage was inflicted on Florida Power & Light's (FPL) service
13 territory by three hurricanes during 2004: Charlie, Frances, and Jeanne. FP&L
14 states in its 3rd quarter report to the U.S. Securities and Exchange Commission
15 that as a result of these hurricanes, it incurred \$710 million of expenses, which it
16 has charged to its storm damage reserve. This \$710 million is net of \$108 million
17 the Company states that it expects to recover from insurance companies. The
18 Company's charges to the storm damage reserve have resulted in a deficit or
19 negative balance of \$354 million which it proposes to recover from retail
20 customers. Since no amortization of this deficit in the storm damage reserve fund
21 has begun, none of the storm damage costs that FPL charged to the storm damage
22 reserve have yet impacted the earnings of FPL. (Source: FPL's 3rd quarter 2004

1 10Q report to the U.S. Securities & Exchange Commission [SEC] obtained from
2 the SEC website.)

3 Currently, FPL's rates are based upon a settlement agreement entered into
4 in March 2002, with terms that are to remain in effect between April 15, 2002 and
5 December 31, 2005. As explained in the "Stipulation and Settlement" agreement,
6 FPL was to lower its rates by \$250 million. The agreement implements a
7 "revenue sharing" arrangement in lieu of an authorized range for return on equity
8 capital during the term of the stipulation. The stipulation limits FPL's ability to
9 adjust its rates during the term of the agreement. While the agreement refers to
10 FPL's ability to petition the Commission for recovery of losses due to storm
11 damages, the agreement also provides:

12 If FPL's retail base rate earnings fall below a 10% ROE as reported
13 on an FPSC adjusted or pro-forma basis on an FPL monthly earnings
14 surveillance report during the term of this Stipulation and Settlement,
15 FPL may petition the FPSC to amend its base rates notwithstanding
16 the provisions of Section 5. (Settlement and Stipulation, p. 4.)
17
18

19 I am advised that the Office of Public Counsel's position is that the 10%
20 criterion of the stipulation is applicable to storm damage expenses, and that the
21 legal effect of the stipulation is such that the source for amortization of the
22 negative balance in the storm damage reserve must first come from earnings to
23 the extent that 2004 earnings exceed 10.0% on equity. In other words, only after
24 the company pays enough of the cost of the storm damage to bring the earned
25 return on equity down to 10.0% is the company entitled to request authority to
26 adjust its rates so as to recover the balance of storm damage costs. OPC has asked

1 me to provide my opinion on the following subjects that are related to the
2 decisions the Commission must make in this case:

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

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

7 (3) In the event the Commission decides that the threshold in the stipulation does
8 not govern the situation as a matter of law, on what basis should the Commission
9 apportion the burden of the storm damage costs between the utility and its
10 ratepayers?

11
12 **III. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

13 **Q. PLEASE SUMMARIZE YOUR FINDINGS.**

14 **A.** For reasons stated later in this testimony:

15 a) My starting point is OPC's position that there is a requirement flowing from the
16 stipulation that FPL first has to experience an earnings drop to no more than
17 10.0% on equity before it is entitled to request incremental recovery of any
18 expenses. While it may be true that the company would have been able to earn
19 more than the stipulated minimum 10.0% return on equity absent a storm, in my
20 opinion applying the portion of the 2004 earnings that lowers the return on equity
21 down to 10.0% to reduce the negative storm reserve balance is fully consistent
22 with the nature of risk and investment, as well as applicable principles of
23 regulation. Investors are paid an allowance for risks, including the risk of storm

1 casualty losses. The function of regulation is not to insulate the company from all
2 risks that may cause earnings to decline below the levels they would have been
3 without the realization of the risk. Because ratepayers pay rates that compensate
4 investors for all risks, including storm damage, it would be entirely inappropriate
5 to shift the full risk of such costs to ratepayers. In view of this, it would be proper
6 to require FPL to absorb a portion of the storm damage losses even if there were
7 no stipulation.

8
9 b) The 10% return on equity that FPL would be required to demonstrate under the
10 terms of the stipulation before being allowed to request a rate increase is
11 reasonable, if not conservatively high, under current economic conditions. More
12 than half of the electric companies covered by Value Line in its Eastern edition
13 are expected to earn 10% or less in 2004. Furthermore, as explained later in this
14 testimony, the cost of equity determined by the Social Security Administration in
15 its evaluation of what could be earned by allowing people to invest a portion of
16 their Social Security funds in the stock market is 6.5% plus the inflation rate.
17 Given investors' current expectations for inflation, this makes the current cost of
18 equity based upon the Social Security Administration's approach equal to
19 approximately 9.35%.

20 **IV. RISK ALLOWANCE**

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

1 A. Yes, especially if the risk being borne is confined to the risk of reducing earnings
2 to the extent that they are in excess of the stipulated return on equity floor of
3 10.0%. That FPL bears this portion of the risk associated with extraordinary
4 storm casualty losses is fully consistent with the nature of business risks and
5 investments. Investors understand that the companies in which they invest are
6 exposed to a variety of risks. The possibility of having some reasonable exposure
7 to storm casualty losses is but one example of the variety of risks that investors
8 take—and for which they are compensated in the return on investment that the
9 company is given an opportunity to achieve. Accordingly, to provide the
10 appropriate opportunity to earn a fair return, given a company's overall risk
11 profile, *and* to simultaneously require ratepayers to bear all of the risk of the
12 storm losses that they are paying investors to accept, would be unfair to the
13 company's customers.

14
15 **Q. CAN YOU DEMONSTRATE THAT FPL AND OTHER COMPANIES ARE**
16 **COMPENSATED FOR TAKING BUSINESS RISKS?**

17 A. Yes. The return on long-term treasury bonds is indicative of a fully guaranteed
18 (i.e., risk-free return). Because of the risk-free nature of the bonds, investors are
19 willing to buy billions of dollars worth of long-term treasury bonds that are
20 currently priced to yield 4.85%. The returns on equity that FPL and other
21 ~~companies are allowed to earn are significantly higher than this "risk-free" return~~
22 This means that ratepayers are paying investors a risk allowance in the range of

1 5% or more because the return on equity is not guaranteed. In other words, FPL
2 ratepayers are paying investors millions of dollars every year to take risk.

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

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

14
15 **Q. HAS THE FLORIDA PSC ADDRESSED WHETHER IT IS REASONABLE**
16 **FOR ELECTRIC COMPANIES TO ABSORB SOME OF THE RISK OF**
17 **STORM DAMAGE?**

18 A. Yes. On pages 4-5 of its Order No. PSC-93-0918-FOF-EI issued in Docket No.
19 930405-EI, the Commission stated:

20
21 FPL seeks approval for a Storm Loss Recovery Mechanism that
22 would guarantee 100% recovery of expenses from ratepayers, over
23 and above base rates in effect at the time of implementation. **This**
24 **would effectively transfer all risk associated with storm damage**
25 **directly to ratepayers, and would completely insulate the utility**
26 **from risk.** We decline to approve such a mechanism at this time.

1 FPL's cost recovery proposal goes beyond the substitution of self-
 2 insurance for its existing policy. The utility wants a guarantee that
 3 storm losses will have no effect on its earnings. We believe it would
 4 be inappropriate to transfer all risk of storm loss directly to ratepayers.
 5 **The Commission has never required ratepayers to indemnify**
 6 **utilities from storm damage.** Even with traditional insurance,
 7 utilities are not free from this risk. This type of damage is a normal
 8 business risk in Florida.
 9 (Bold emphasis added.)

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

21 **V. UPDATED EXAMINATION OF STIPULATED 10.0% MAXIMUM RETURN ON**
 22 **EQUITY PRIOR TO SEEKING AN ADJUSTMENT IN RATES**

23
 24 **Q. IS THE STIPULATED 10.0% MAXIMUM RETURN THAT FPL MUST**
 25 **DEMONSTRATE TO BE ELIGIBLE TO REQUEST A RATE INCREASE**
 26 **ADEQUATE TO PROVIDE A FAIR RETURN TO INVESTORS AND**
 27 **ENABLE FPL TO RAISE CAPITAL ON REASONABLE TERMS?**

28 **A.** Yes. If anything, it is more than adequate. Since the date of the stipulation, there
 29 have been some electric companies that have been awarded a cost of equity of less

1 than 10.0%. These companies include Public Service Electric and Gas Company,
2 Jersey Central Power & Light Company, ~~Atlantic City Electric~~ Company, and
3 Connecticut Light and Power Company.

4 Schedule 1 of my testimony shows the actual earned returns on equity
5 Value Line estimates the electric companies in the edition that covers Eastern
6 electric companies will actually earn on equity in 2004. A review of the Value
7 Line Eastern edition results reveals that in 2004 more than half of the 23 electric
8 companies covered by Value Line are estimated to actually earn 10.0% or less
9 with some companies, including Allegheny Energy, Central Vermont, Northeast
10 Utilities, and TECO expected to earn 8.0% or less on equity. In other words,
11 Florida Power & Light's stipulated settlement that provides for actual earnings of
12 10.0% or higher produces results that place the Company at or above the median
13 earned return on equity.

14
15 **Q. HOW DOES THE FINANCIAL RISK OF THE 23 ELECTRIC**
16 **COMPANIES IN THE VALUE LINE EASTERN EDITION COMPARE TO**
17 **THE CURRENT CAPITAL STRUCTURE OF FPL?**

18 **A.** The financial risk of a company is dependent upon the level of common equity in
19 its capital structure. The higher the common equity ratio, the lower the financial
20 risk. According to FPL's July 2004 report to the Commission, its capital structure
21 contains 52.59% common equity. However, to be consistent with the way that
22 Value Line reports common equity ratios, the impact of short-term debt, customer
23 deposits, the investment tax credit, and deferred income taxes must all be

1 excluded. Excluding these amounts makes the common equity ratio of FPL'S
2 65.1% At 65.1%, FPL's reported regulatory capital structure has a lower
3 financial risk than all 23 of the companies in Value Line's Eastern Edition of
4 electric companies and is a considerably higher ratio than the 44% median
5 common equity ratio for the group. The reduced financial risk associated with a
6 65.1% common equity ratio causes a reduction in the cost of equity of about
7 0.75% compared to an electric company with a common equity ratio equal to the
8 44% group median.

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

11 A. Yes. FPL'S stipulated 10.0% was the result of proceedings based upon direct
12 evidence filed no later than very early in 2002. A revisiting of the 10.0%
13 maximum earnings standard before rate relief could be requested was not
14 specified as a condition of the settlement. Furthermore, since the time of the
15 evidence on which the 10.0% standard was based, long-term interest rates have
16 declined. Therefore, even if one wanted to go beyond the settlement and update
17 the 10% threshold, an updating would cause a revisiting of the threshold to be
18 lowered. As of early February 2005, the interest rate on long-term U.S. treasury
19 bonds is approximately 4.58% compared to the 5.64% as of the March 2002 date
20 that the settlement agreement was made. Therefore, if the 10.0% maximum
21 earnings threshold requirement were updated to reflect current conditions, the
22 minimum required before rate relief should be approximately 9.0%.

23

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

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

18

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

22 A. No. The stipulation does not provide for a revision of the 10.0% prior to
23 12/31/05. However, I have provided the 9.2% (based upon an update to the

1 10.0% finding based upon interest rate changes) or the 9.35% (based upon the
2 method chosen by the Social Security Administration) to show the Commission
3 that if the 10.0% return on equity was appropriate when the stipulation was
4 entered into in March 2002, it is more than reasonable in today's financial
5 climate.

6
7 **Q. SHOULD THE COMMISSION BE CONCERNED THAT ENFORCING**
8 **THE 10% ROE CRITERION COULD CAUSE RATING AGENCIES TO**
9 **DOWNGRADE PEF, RESULTING IN AN INCREASE IN ITS COST OF**
10 **CAPITAL?**

11
12 **A.** No. The terms of the stipulation are not new news to the bond rating agencies. If
13 the Commission allows FPL to earn a return on equity that is commensurate with
14 its risk profile and prevailing economic circumstances, rating agencies would
15 have no reason to be concerned about FPL's ability to meet its debt service
16 requirements. Additionally, for the reasons stated, providing FPL the opportunity
17 to earn 10% on its equity capital while affording it the ability to recover the
18 balance of storm-related costs would be fully adequate to enable FPL to access
19 capital markets on reasonable terms in the current environment.

20 **VIII. CONCLUSION**

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

22 **A.** Requiring FPL to bear some of the costs associated with repairs to 2004 storm
23 damage that exceeded the positive balance in its storm damage reserve is

1 consistent with the nature of business risk inherent in investments. To induce
2 them to take on risk, investors have been paid millions of dollars to provide a
3 return greater than a risk-free rate. Because they are paid such a large amount to
4 do so, occasionally requiring them to actually bear some of this risk is well within
5 the parameters to which ratepayers are entitled and investors expect. Indeed,
6 because ratepayers have been paying rates that compensate FPL's investors for
7 such risks, it is they, and not shareholders, who are entitled to a degree of
8 insulation from storm damage costs.

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

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

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

22 A. Yes.

1 BY MS. CHRISTENSEN:

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

4 A Yes.

5 Q And can you provide us with that brief summary?

6 A Yes. It will be very brief as I am aware that the
7 Commission has recently heard from me very, very similar
8 testimony in the Progress case, and so, therefore, is aware of
9 what I am going to say.

10 The guidelines that I started with to prepare this
11 testimony were on advice of counsel that the stipulation which
12 is currently in effect for Florida Power and Light provides the
13 company an opportunity to possibly recover additional revenues
14 if its earned return on equity falls below 10 percent.

15 I recognize that absent storms, the way the
16 stipulation was functioning, Florida Power and Light was
17 earning, or was allowed to earn an unlimited return on equity
18 and, in fact, was earning more than 10 percent based upon its
19 surveillance reports. In evaluating what to do with the storm,
20 I recognized that regulation pays investors to take risks, it
21 does not protect investors from risks. The testimony discusses
22 that even without the stipulation, the 10 percent return on
23 equity floor in the stipulation is a very adequate return in
24 the current financial environment, and that 10 percent is high
25 enough to allow FPL to fully earn its cost of capital in the

1 current marketplace. And that completes my summary.

2 MS. CHRISTENSEN: Based upon Mr. Rothschild's
3 conclusion of his summary, I would tender the witness for cross
4 examination.

5 CHAIRMAN BAEZ: Mr. Litchfield.

6 MR. WRIGHT: Mr. Chairman, sorry.

7 CHAIRMAN BAEZ: Oh, I'm sorry. Forgive me. Mr.
8 sorry, do you have -- Mr. Wright.

9 MR. PERRY: I do not.

10 MR. WRIGHT: I have a very few questions to clarify
11 and expand on his direct testimony.

12 CHAIRMAN BAEZ: And I apologize.

13 MR. WRIGHT: Not necessary. Thank you, Mr. Chairman.

14 (Transcript continues in sequence with Volume 3.)
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STATE OF FLORIDA)

COUNTY OF LEON)

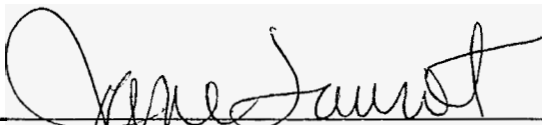
CERTIFICATE OF REPORTER

I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

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

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

DATED THIS 21st day of April, 2005.



JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
FPSC Division of Commission Clerk and
Administrative Services
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