

Q. Is Mr. Majoros correct that FPL is following an inappropriate accounting methodology for the replacement of plant in service destroyed by the hurricanes?

A. No. In determining the amounts to be charged to the Storm Damage Reserve, FPL is following the accounting standards approved in the 95 Order. As with the various cost categories already discussed, the time to establish standards is before not after the event occurs.

The existing standards are designed to maintain the plant in service and depreciation accounts at the same levels after the hurricanes as existed before the hurricanes. This recognizes that the reason for replacing the assets was not to improve the system, but to restore it to the condition that existed before the hurricanes.

If the Commission adopts Mr. Majoros' recommendations, plant in service would increase, accumulated depreciation would decrease and annual depreciation expense would immediately increase due solely to the impact of hurricanes. This would place upward pressure for a long-term increase in electric rates because of an increase in return requirements as well as an increase in cost of service.

Q. Why would plant in service increase under the OPC approach endorsed by Mr. Majoros?

A. Plant in service would increase because the poles, wires and other equipment and related installation costs are generally higher even at normal costs than the costs associated with the property destroyed by the hurricanes and retired. This increase is due to inflation and other factors occurring between the time the destroyed assets were installed and when they were replaced.

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In addition, as described in the 93 Study, the normal costs of the replacement assets would have to be estimated because the assets are being replaced under extraordinary conditions. It is impossible to track the normal cost associated with the replacement assets under the conditions that exist when the Company is restoring service after a hurricane.

Q. Why would accumulated depreciation decrease under the OPC approach endorsed by Mr. Majoros?

A. Accumulated depreciation would decrease for the following reasons:

- The assets being replaced have not reached the end of their normal lives; therefore they have not been fully depreciated.
- Likewise, because the cost of removal associated with the destroyed assets is calculated in the same manner as depreciation, the full normal cost of removing the destroyed assets has not been accumulated.

The combined effect of these circumstances is to leave a deficit or shortfall in accumulated depreciation for the destroyed assets. This shortfall increases rate base resulting in an immediate increase in revenue requirements. Also, the shortfall will have to be factored into future depreciation rates resulting in higher costs to customers in the future. This is in addition to the fact that those customers face their own risk of future catastrophic hurricane events.

Q. Why would depreciation expense immediately increase under the OPC approach endorsed by Mr. Majoros?

A. Depreciation expense would immediately increase because of the higher plant in service balances. Annual depreciation expense is determined by applying an approved depreciation rate to plant in service balances. As plant in service increases, so does depreciation expense, without any change in rates. The change

in rates discussed in my previous answer could compound the effects of this increase.

Q. Wouldn't the fact that the equipment is newer offset these increases in depreciation expense?

A. The fact that the equipment is newer would certainly mitigate the effects because of the longer remaining life. Whether it would offset the full effect would depend on the amount of the cost differential for the assets, the remaining lives of those assets, and the extent to which the original cost and removal cost of the destroyed asset had been accumulated.

Q. Does the Company consider the effects of hurricanes in determining depreciation rates?

A. No. Because hurricanes occur at irregular intervals and the physical effects vary from storm to storm, the Company excludes the effects of hurricanes from the depreciation studies used to obtain Commission approval for depreciation rates. Inclusion of the hurricane related effects would potentially understate the life characteristics of plant and overstate the cost of removal, thereby overstating the depreciation expense associated with normal operations.

Q. Is Mr. Majoros correct in his assertion on Page 23 of his direct testimony that the existing standards inappropriately treat the removal reserve?

A. No. As I previously discussed, only a portion of the normal removal cost related to the destroyed assets would have been accrued since those assets generally would have remaining life left. The removal cost component included in the depreciation rate takes into account a future cost to remove an asset assuming normal retirements. This removal cost component is determined based on the historical relationship of removal cost to the plant investment and excludes extraordinary retirements such as those caused by hurricanes. As such, the

removal costs embedded in accumulated depreciation are designed to cover normal end of service life retirements, not catastrophic events like hurricanes.

Q. Is Mr. Majoros correct in his assumptions on removal cost related to the assets retired resulting from the hurricane?

A. No. Mr. Majoros would lead you to believe that the removal cost collected is related solely to the assets that would be retired for extraordinary events. The \$1.1 billion that Mr. Majoros referenced relates to the estimated removal cost associated with all of the Transmission and Distribution system assets. In order to identify the removal cost associated with the assets retired due to the hurricanes, the specific assets to be retired must be identified along with the vintage year. Then, the component of removal cost included in depreciation expense would need to be multiplied times the cost of the asset retired to determine the annual amount for each year that the depreciation rate was used and changed to reflect any represetion of depreciation rates. The total of all these annual amounts would be accumulated to determine the amount of removal cost included in the accumulated depreciation reserve related to the retirements associated with the hurricane.

Q. Has FPL estimated the capital additions, removal costs, and retirements that it expects to record as a result of storm restoration under the recommended approach, "Actual Restoration Cost" approved in the 93 Study?

A. Yes. FPL estimates that approximately \$58 million of capital additions, \$12.2 million in removal costs, \$36.4 million in retirements, \$21.7 million in Contributions in Aid of Construction, and \$48.5 million in other recoveries will be recorded in March 2005. The effect of recording these amounts is to restore

the plant and reserve accounts to their pre-storm balance. This approach is consistent with the 93 Study and 95 Order.

These estimates do not include the effects of approximately \$18 million of the approximately \$43.4 million of incomplete projects identified in Exhibit KMD-2 as "Remaining Work."