BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

DOCKET NOS. 050045-EI AND 050188-EI
FLORIDA POWER & LIGHT COMPANY

JULY 28, 2005

IN RE: PETITION FOR RATE INCREASE BY FLORIDA
POWER & LIGHT COMPANY
AND
IN RE: 2005 COMPREHENSIVE DEPRECIATION STUDY
BY FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY & EXHIBIT OF:

KATHLEEN SLATTERY

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF KATHLEEN SLATTERY

DOCKET NOS. 050045-EI, 050188-EI

JULY 28, 2005

INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Kathleen Slattery. My business address is 700 Universe Boulevard, Juno Beach, Florida 33408.

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

A. I am employed by Florida Power & Light Company (FPL or Company) as Human Resources (HR) Manager, Compensation and Benefits.

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

A. I have various duties in the areas of compensation and benefits plan design and administration, primarily the Company's incentive compensation plans.

Q. Please describe your educational background and professional experience.

A. I have a Bachelor of Science degree from Florida State University and am a graduate of the Florida State University College of Law. I have been a member of the Florida Bar since 1992. Before joining FPL, I worked in labor relations and served as a trustee of two outside electrical worker unions' pension and health and welfare funds. I began working at FPL in September 1996 as a benefit plan administrator and have held various positions of increasing responsibility in Human Resources since that time. My experience at FPL has included qualified and non-qualified benefit plan administration, non-qualified benefit plan design, salary and incentive compensation plan design and administration, and legal compliance of such plans and programs. I have extensive knowledge of FPL's compensation and benefits philosophy, plans, and practices, and of its payroll system.

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

A. No, but I have adopted the direct testimony and exhibits submitted by Robert Escoto.

Q. Are you sponsoring an exhibit to your rebuttal testimony?

A. Yes, I am sponsoring an exhibit consisting of one document, KS-1, which is attached to my rebuttal testimony.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of this testimony is to demonstrate the reasonableness of the company's payroll cost estimates in response to challenges by Mr. Helmuth W. Schultz, III of Florida Office of Public Counsel (OPC), Ms. Sheree L. Brown of Florida Retail Federation and by Mr. Lane Kollen of South Florida Hospital and Healthcare Association (SFHHA). In addition, I will defend the Company's total compensation cost including the use of variable and incentive pay programs and describe why it is important to allow the company flexibility to design the optimal components of pay in order to maximize economic efficiency and enable FPL to attract and retain needed talent. Lastly, I will demonstrate why the Company's incentive plans provide for improved performance and serve the needs of all constituents, including customers.

TOTAL COMPENSATION: PAYROLL AND STAFFING LEVELS

Q. The level of the Company's total compensation expense has been disputed by the intervening parties. Is FPL's projected total compensation expense for 2006 reasonable?

A. Yes. As previously demonstrated in direct testimony (RHE-1), FPL's projected total compensation and benefits expense is fair and reasonable. The reasonableness of the cost is clearly evident when the growth in the cost is compared to inflation indices, such as CPI and World at Work. The result shows that our actual cost is much lower than the projected values. The reasonableness of our cost is also demonstrated by comparing FPL's salaries to market, where pay levels are below market in six of the last seven years (RHE-5). Comparison of our compensation cost to those of other utilities provides another measure of reasonableness. Total compensation is lower than most comparable utilities on a per employee, per operating revenue, and per customer basis (RHE-4). Finally, the reasonableness of our benefits programs is demonstrated through the use of an analytical survey that benchmarks FPL's plans to those of its peers. The relative value of our benefits plans is consistently below average when compared to both utility and general industry (RHE-6, RHE-7, RHE-9).

Q. The intervenors have analyzed specific components of FPL's total compensation. In your view, is it appropriate to consider the individual components on a stand alone basis?

A. No, it is not appropriate to analyze the various components of total compensation separately. As stated in the Company's direct testimony (Robert H. Escoto, page 3), FPL employs a total compensation and benefits approach. One of the stated objectives of this approach is to control fixed costs by placing emphasis on variable pay rather than fixed pay and traditional benefits. The strategic emphasis on variable pay rather than fixed salary costs lowers the Company's exposure to steadily increasing salary and fringe benefit costs and adds flexibility in recognizing performance.

Q. OPC, FRF, and SFHHA have all formulated recommendations for FPL's required staffing and payroll for 2006. Have any of them evaluated the required staffing level in view of FPL's specific workload or operating measures?

A. No. They have relied on general productivity measures and on observed historical staffing levels, but have evidently made no attempt to analyze FPL's specific productivity measures or workload trends.

Q. Mr. Schultz and Ms. Brown cite an observed historical gap between budgeted and actual staffing to establish a recommended staffing level, and payroll deductions, for the test year. Should the Commission accept that analysis?

A. No. There is no perfect correlation between headcount and the payroll budget or between headcount and revenue requirements. FPL has historically estimated employee headcount based on ideal staffing levels, but historically somewhat under-estimates salaries and wages. The Company primarily focuses on total compensation when formulating its operating budget. Headcount is a tool used in that process, but ultimately the Company is more focused on the total dollars spent. Therefore, the recommendations made by Mr. Schultz and Ms. Brown only consider one part of the equation and should be rejected.

Q. If the headcount budget gap analysis performed by Mr. Schultz and Ms. Brown were valid, wouldn't there be a similar gap in the Company's actual to budget payroll?

A. Yes, if headcount and payroll cost are well correlated, one could expect such a shortfall.

Q. Has history shown this to be the case?

A. No, that has not been the case. Historically, the Company's actual gross payroll has exceeded the estimates.

Q. How would you explain the gap between forecast and actual staffing that Mr. Schultz and Ms. Brown have identified?

A. The headcount forecasts are management's reasonable estimates of what is required to do the work based on ideal staffing levels. Every effort is made to fill the forecast positions, but a number of factors have made it increasingly difficult for the Company to fill all open positions. Among these are the cost prohibitive nature of the South Florida housing market, limited availability of a local technical and engineering related labor force, and the fiscal constraints the Company has placed on the competitiveness of its pay and benefits package. All of these factors have historically resulted in the hiring process lagging behind expectations.

Q. Why is it that the Company has historically exceeded its payroll budget?

A. Despite falling short of ideal staffing, the Company has obtained resources to perform the necessary work. Human resource demands are met through means other than forecasted increase in full time employees, such as contractors, outsourcing, overtime, etc. Although total costs have been reasonable, the hiring constraints and supplemental labor approaches result in higher costs overall, driven by higher than budgeted contractor and overtime expense, retention payments, relocation costs, among others.

Q. **Despite the Company's record of having reduced staff by over 30% while customer base increased by over 60%, SFHHA and Mr. Kollen suggest that FPL should be able to continue realizing similar staff reductions on a perpetual basis. Do you consider this a logical approach and one the Commission should accept?**

A. No, I do not. Mr. Kollen's analysis of productivity is purely theoretical with no tie to any specific FPL operating measures or work drivers. FPL has managed costs and pursued productivity gains aggressively over the last twenty years. The Company has demonstrated in direct testimony (RHE-1, RHE-3, and RHE-4) that total compensation and benefits costs are reasonable and that FPL's costs benchmark most favorably to those of other utilities. Furthermore, in the face of the steady customer growth projected for Florida, it is unrealistic to assume that the Company can achieve continued staff reductions as Mr. Kollen proposes and continue to effectively and reliably meet the energy needs of current and future customers. Mr. Kollen seems to suggest that there is no end to productivity gains. His logic, played out, would lead to "zero staffing" in the year 2075.

Q. **Mr. Schultz concluded that the vacant positions referenced in OPC's 1st Set of Interrogatories, No. 44, will not be filled. Could you please provide the status of the Company's current staffing level?**

A. The actual to budget staffing gap that existed at year end 2004 has largely been closed.

Q. So, would you say that the projected 2006 staffing level presented on MFR C-35 is realistic?

A. Yes. In response to OPC's Interrogatory No. 111, we identified about 300 positions that the business units plan to fill in 2005 and 2006. Those new positions added to the current staffing will result in the projected staffing identified on MFR C-35. More importantly, the Company's forecast of payroll costs is reasonable.

Q. On page 8 of his direct testimony, Mr. Schultz concludes that FPL's test year overtime expense is excessive. Do you agree?

No, I do not. The overtime projection for 2006 is realistic and reasonable. Mr. Schultz' analysis compares the 2006 expense to historical totals. And yet, the Company's projected overtime expense for 2006 is less than Mr. Schultz' inflation-adjusted overtime totals in three out of four years from 2001 to 2004. Even using Mr. Schultz' logic, there would seem to be no basis for concluding it is excessive.

Q. Do you have any concerns with Mr. Schultz' methodology in analyzing overtime expense?

A. Yes. Mr. Schultz selectively omits 2004 (which was unusually high) in his calculation of average overtime, but includes 2002 which was unusually low. Overtime by its nature is governed by unusual events; future years will also have unusual events. Ignoring 2004, but including 2002, discredits his analysis. For an electric utility, overtime caused by unusual or periodic events will occur at varying levels in every year.

Q. Is it logical to reduce overtime simply based on the historical amount paid?

A. No it is not. Payroll costs are budgeted on a comprehensive basis. The use of overtime may be necessary or cost effective depending on the operational need. Rather than over staff, FPL uses overtime efficiently to cover peak work loads, projects and unforeseen events, thus saving the cost of benefits and other loaders permanent employees would receive.

INCENTIVE COMPENSATION

Q. Did Mr. Schultz recommend an adjustment to the Company's estimated variable pay?

A. Yes. Mr. Schultz's adjustment for "variable pay" is based on a four-year average of the amounts ***paid*** for exempt employees' annual incentive pay in the years 2001 through 2004, which he then compares to the Company's estimated accrued cost for 2005 which would be paid in 2006. In effect, he has skipped the year of accrual in 2004 which has been paid in 2005, making the increase for the test year appear much larger than it actually is.

Q. After maintaining total annual incentive payouts relatively flat for each of the years from 2001 to 2004, the Company's annual incentive compensation paid in 2005 increased to $40 million and is forecast to be $41.7 million in 2006. Why?

A. By the end of 2004, increasing employee headcount and planned staffing levels caused the Company to increase its 2004 annual incentive accrual, which was originally budgeted at $38.6 million, and to eventually pay out a total of $40 million in 2005. These annual incentive payouts are one component of a total compensation and benefits package that was carefully designed to attract, retain and competitively reward employees; link rewards to the attainment of results; control fixed costs, and maintain total costs at a reasonable level. Indeed, external market pressures, particularly the skyrocketing housing market in South Florida, have significantly increased the need to use variable pay as a means of attracting and maintaining employees.

Q. **In what other way might the reasonableness of the estimated 2006 cash incentive payouts be demonstrated?**

A. The Commission has traditionally used comparisons to indices as a measure of reasonableness for compensation. While FPL does not believe that components of total compensation should be individually evaluated, if this approach is used to escalate the 2002 annual incentive payout forward, the 2006 benchmark for annual incentive payments to exempt employees would be consistent with the level one would expect using the World at Work wage growth index.

Q. **Mr. Schultz, on pages 11 and 12 of his testimony, implies that FPL's annual incentive plan is not designed to reward improved performance. Is that an accurate assessment?**

A. No. He has apparently drawn conclusions without considering the total design of the plan. First, the net income goal that Mr. Schultz references is simply an initial "threshold" goal which is used in part to comply with certain tax rules. If the minimum net income goal is not achieved, then no payouts are made. The net income goals for the Company, with corresponding incentive payout levels, are determined at the beginning of the year. At year-end, the payout level earned on the basis of net income becomes the maximum payout; actual plan payout must be below such level and is based on the degree of achievement of other pre-established financial and operating performance measures, most of which are specifically customer-focused. Contrary to Mr. Schultz' contention that FPL's performance goals are not challenging enough to create better performance; they in fact are structured to reinforce FPL's culture of continuous improvement.

Q. **Can you elaborate on how the goals and performance measures are customer-focused?**

A. Yes. Many of the corporate performance goals are oriented specifically towards driving performance that directly benefits the customer. Specific examples from the 2004 plan are as follows: operations and maintenance costs; capital expenditure levels; service reliability as measured by the frequency and duration of service interruptions and service unavailability; system reliability as measured by availability factors for the fossil power plants and an industry reliability index for the nuclear power plants; employee safety; number of significant environmental violations; customer satisfaction survey results; load management installed capability; and conservation programs' annual installed capacity. In addition, business unit performance is an important factor in the reward determination, and the business unit indicators used are overwhelmingly operating and milestone measures that benefit customers.

Q. **Have you obtained any professional advice on the effectiveness of the plan design?**

A. Yes. Two outside compensation consulting firms have characterized FPL's selection of performance goals and overall plan design as more customer-focused than those of the majority of other clients they advise, based on the weighting of operating performance in our plan.

Q. Mr. Schultz states on pages 14 and 15 of his direct testimony that there is no evidence that the long-term incentive plan benefits or even intends to benefit customers. Is that statement correct?

A. No. Mr. Schultz' testimony states that his basis for making that statement is his assertion that the plan documents do not use the word "customer." Mr. Schultz ignores the fact that, as I previously described, the plan's objectives are defined by its goals, which are inextricably tied to customer benefits.

Q. Mr. Schultz proposes a 50/50 sharing of the cost of incentive compensation between customers and shareholders. Do you agree with this proposal?

A. No. Mr. Schultz has offered no Commission precedent for such an adjustment. If this adjustment is made, the Commission would be penalizing the Company by not allowing it an opportunity to recover its fair and reasonable compensation cost. Mr. Schultz' recommendation would give the Company stimulus to reduce incentive compensation in favor of base salary, but in doing so it would lose the productivity gains and flexibility gained from incentive compensation. This is an example of the folly of breaking out one specific element of FPL's total compensation and benefits package.

Q. Did Mr. Schultz recommend an alternative adjustment to the Company's estimated long-term incentive compensation expense?

A. Yes. Mr. Schultz's alternative adjustment for long-term incentive compensation is based on a three-year average of the amounts ***paid*** to employees through FPL's payroll system for long-term incentive pay in the years 2002 through 2004, which he erroneously describes as the "cost." Mr. Schultz then compares this average to the Company's forecasted long-term incentive expense for 2006. As with his analysis of annual incentive pay, Mr. Schultz is comparing payroll dollars in past years to estimated accruals that are included in the amount expensed in a future year. This is a particularly invalid methodology when analyzing long term incentive compensation, because the expense for a long-term equity-based award is accrued over a multi-year vesting period, during which the employee realizes no actual compensation. In the case of stock option expense, for example, the potential gap in timing between the Company's accrual and the employee's receiving compensation through payroll may be as much as ten years.

Q. Have the Company's required accruals for long term incentive compensation exceeded the amount paid to employees through payroll during 2002 through 2004?

A. Yes. FPL is required to accrue an expense for outstanding awards that are granted during these years, for which compensation will be realized by employees in future years. In essence, this is merely a timing issue.

Q. How have the Company's required accruals for long term incentive compensation during this period compared to amounts forecasted and budgeted for the period?

A. They have been close to the budgeted amounts, as demonstrated in Exhibit KS-1.

Q. Why did the budget for long term incentive compensation increase significantly from 2003 to 2004?

A. Effective January 1, 2004, the Company adopted the fair value recognition provisions of FAS 123, "Accounting for Stock-Based Compensation." Accordingly, it began expensing stock options for the first time in 2004; the Company did not have to expense stock options under the pre-2004 method it used for valuing stock-based compensation plans.

Q. Has FPL accurately forecasted its costs related to the long term incentive plan for 2006?

A. Yes. FPL has accurately forecasted the long-term incentive 2006 expense required under accounting rules, based on the existing grants and future grants consistent with current practice.

Q. Both Mr. Schultz and Ms. Brown suggest that some or all of the long-term incentive plan cost should be disallowed because it does not represent a cash outlay. Is this a logical position?

A. No. Many components of revenue requirements are non-cash as rates are set on the basis of financial or GAAP accounting which is accrual, and not cash based. This same argument, if extended, would disallow recovery of all of the Company's depreciation expense among other such "non-cash" costs.

The Commission has already expressly recognized the appropriateness of the use of GAAP accounting in rates for purposes of deferred compensation expenses such as pension cost. (Order No. PSC-92-1197-FOF-EI in Docket No. 910890-EI, Petition for a rate increase by Florida Power Corp.). This is no different. The accrual amount is included in revenue requirements, not the cash benefits paid.

Finally, the Company utilizes a stock repurchase program under which it purchases on the open market many of the shares used to satisfy awards under the long term incentive plan; only a portion of equity compensation is currently provided through the new issuance of shares.

FRINGE BENEFITS: PENSION

Q. Do you feel there is a logical basis for Mr. Schultz' suggestion to substitute the 2005 pension actuarial report for the 2006 actuarial projection?

A. No. The argument made by Mr. Schultz is that 2005 is a known and measurable amount. This is a true statement for every dollar of 2005 cost; however, this rate case is based on a projected (2006) test year, not an historical test year. He has not found fault with the 2006 estimate; he simply chooses to use another number. The basis for this adjustment is unfounded and is no more appropriate for pension credit than for any other cost or balance sheet item that Mr. Schultz may decide to substitute with a 2005 amount.

Q. Has Mr. Schultz provided logical analysis and a factual basis for making this substitution?

A. No, he has not. FPL used the same actuary for the forecast for 2006 as it did to calculate the 2005 credit. These forecasts were not "back of the envelop" estimates, but were based on actuarial calculations and principles. Mr. Schultz did not perform an actuarial calculation, nor did he find fault with the actuarial estimate performed. He simply chose to propose an adjustment with no basis in fact or evidence.

Q. Does this conclude your rebuttal testimony?

A. Yes.

Long Term Incentive Plan Expense - Budget vs. Expense

	Budgeted Expense Stock Options + Other LTI	Expense (Accrual)	
2006	$29,717,000	NA	
2005	$27,545,300	NA	
2004	$29,044,100	$28,123,416	1
After Adoption of FAS 123 Stock Option Expensing			
Before Adoption of FAS 123 Stock Option Expensing			
2003	$17,761,000	$17,229,053	1
2002	$18,916,000	$21,590,063	

1 Excludes one-time reversals for non-recurring events, specifically reversal of expense due to a termination/forfeiture and awards not paid out, a change in accounting method, and a 2004 plan payback under a litigation settlement agreement.