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Deputy General Counsel – Florida

August 5, 2005

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Ms. Blanca Bayo, Director
Division of the Commission Clerk and
Administrative Services
Florida Public Service Commission
Betty Easley Conference Center
2540 Shumard Oak Blvd.
Room 110
Tallahassee, FL 32399-0850

Re: Petition for Rate Increase by Progress Energy Florida, Inc.
Docket No. 050078-EI

Dear Ms. Bayo:

Enclosed for filing in the above referenced docket are the original and twenty-five (25) copies of Rebuttal Testimonies and Exhibits of Progress Energy Florida's Witnesses: Robert H. Bazemore, Jr., Charles J. Cicchetti, John B. Crisp, Ray F. DeSouza, Steve Harris, Jeff Lyash, Robert Matthews, David McDonald, Dale Oliver, Javier Portuondo, Earl Robinson, William C. Slusser, Thomas R. Sullivan and James H. Vander Weide.

Please indicate receipt of this document by stamping the enclosed extra copy of this letter. Please contact me should your staff have any questions regarding this filing.

Sincerely,

R. Alexander Glenn

RAG/sc
Enclosures

cc: Service List

CMP	
COM	5
CTR	org
ECR	
GCL	1
OPC	
RCA	
SCR	
SGA	
SEC	1
OTH	

Bazemore	07600-05
Cicchetti	07601-05
Crisp	07602-05
DeSouza	07603-05
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Matthews	07606-05
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Robinson	07610-05
Slusser	07611-05
Slusser exhibit	07612-05
Sullivan	07613-05
Vander Wiede	07614-05

Progress Energy Service Company, LLC
P.O. Box 14042
St. Petersburg, FL 33733

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished electronically and via U.S. Mail this 5th day of August, 2005 to all counsel of record as indicated below.

R. Alexander Glenn

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Progress Energy Florida, Inc.

Docket No. 050078-EI

Submitted for filing: August 5, 2005

REBUTTAL TESTIMONY OF
ROBERT H. BAZEMORE, JR.

ON BEHALF OF PROGRESS ENERGY FLORIDA

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REBUTTAL TESTIMONY OF ROBERT H. BAZEMORE, JR.

ON BEHALF OF PROGRESS ENERGY FLORIDA, INC.

1 **I. Introduction.**

2 **Q. Please state your name.**

3 A. Robert H. Bazemore, Jr.

4

5 **Q. Did you submit Direct Testimony in this case on April 29, 2005?**

6 A. Yes, I did.

7

8 **Q. Can you summarize the purpose of your Direct Testimony in this case?**

9 A. Yes. The purpose of my direct testimony was to support the reasonableness of the
10 Administrative and General ("A&G") portion of the Company's Operation and
11 Maintenance ("O&M") expenses and asset retirement obligations in this
12 proceeding and to sponsor and support the Company's depreciation study.

13

14 **Q. Have you reviewed the intervenor testimony filed in this proceeding by**
15 **witnesses Donna Deronne, Jacob Pous, Helmuth Schultz, and Hugh Larkin,**
16 **Jr. on behalf of the Office of Public Counsel ("OPC"), and Michael Gorman**
17 **on behalf of White Springs Agricultural Chemicals, Inc. d/b/a PCS**
18 **Phosphate – White Springs ("White Springs")?**

19 A. Yes, I have.

20

1 **Q. What do these witnesses address in their intervenor testimony?**

2 A. Ms. Deronne and Mr. Schultz take issue with certain A&G O&M expenses. Mr.
3 Pous, Mr. Larkin, and Mr. Gorman challenge certain aspects of the Company's
4 depreciation study and proposed level of depreciation expense.

5

6 **Q. Do Ms. Deronne and Mr. Schultz challenge the reasonableness of all of the**
7 **Company's A&G O&M expenses?**

8 A. No they do not.

9

10 **Q. Do Mr. Pous, Mr. Larkin, and Mr. Gorman challenge the reasonableness of**
11 **all aspects of the Company's depreciation study in their testimony?**

12 A. No, they do not. They take issue with the calculation of net salvage for some but
13 not all of the transmission and distribution ("T&D") FERC accounts. They
14 contend that the calculation of the theoretical depreciation reserve demonstrates a
15 real surplus that should be returned to customers, but they disagree on what the
16 Florida Public Service Commission ("FPSC" or "Commission") should do. They
17 do not take issue with any of the calculations of net salvage for the generation
18 FERC accounts.

19

20 **Q. Do you agree with the testimony of Ms. Deronne and Mr. Schultz concerning**
21 **the A&G O&M issues they raise?**

22 A. No, not all of them. There are two items where we noted adjustments may be
23 necessary based on information available after or right around the time the

1 Company filed its Minimum Filing Requirements ("MFRs") and direct testimony.
2 This information was provided by the Company to the intervenors. These
3 adjustments reflect the rate of increase in the Company's health care costs and the
4 expected Company distributions from the Nuclear Electric Insurance Limited
5 ("NEIL"). These adjustments are based on information available after or right
6 around the time the Company filed its Minimum Filing Requirements ("MFRs")
7 and direct testimony that the Company provided the intervenors. If the
8 Commission agrees that the Company should incorporate this updated
9 information in its request in this proceeding, then the Company agrees with these
10 two adjustments, as I explain below. I do not agree, however, that their other
11 proposed adjustments are reasonable.
12
13 **Q. Do you agree with the testimony of Mr. Pous, Mr. Larkin, and Mr. Gorman**
14 **concerning the depreciation issues they raise?**
15 A. No, I do not. I will generally address the issues they raise from the Company's
16 perspective. Mr. Portuondo and Mr. Robinson, the outside consultant retained by
17 the Company to prepare a depreciation study on the Company's behalf, will also
18 file testimony in rebuttal to the testimony of Mr. Pous, Mr. Larkin, and Mr.
19 Gorman. I also understand that other Company witnesses will file rebuttal
20 testimony to address some of the issues raised by these witnesses in their
21 testimony.
22
23 **Q. Are you sponsoring any exhibits to your rebuttal testimony?**

A. Yes, I am. I have supervised the preparation of the following exhibits to my rebuttal testimony:

- Exhibit No. ____ (RHB-8), the Company's revised response to OPC interrogatory number 26.
- Exhibit No. ___ (RHB-9), the Company's revised response to the Florida Retail Federation interrogatory number 17.
- Exhibit No. ___ (RHB-10), the Company's health care cost adjustment schedule.

All of these exhibits are true and accurate.

II. Depreciation Issues.

Q. Did you file a depreciation study as an exhibit to your pre-filed direct testimony in this case?

A. Yes. Both Mr. Portuondo and I sponsor the Company's depreciation study.

Q. Did you prepare that depreciation study?

A. No. The depreciation study filed with my direct testimony as Exhibit No. ___ (RHB-7) was prepared by Earl Robinson of AUS Consultants. Mr. Robinson prepared that depreciation study at PEF's direction, and my staff provided oversight and input as needed on the project. Specifically, Mr. Andrew Krebs of my staff was Mr. Robinson's contact with the Company and communications between Mr. Robinson and the Company went through Mr. Krebs. Mr. Krebs was the Manager of Property and Materials Accounting. The Manager of

1 Property and Materials Accounting is responsible for depreciation matters within
2 the Company.
3
4 **Q. Do you agree with Mr. Pous' suggestion that the Company was unaware of**
5 **the work being performed by Mr. Robinson in preparing the depreciation**
6 **study?**
7 A. No, I do not. As I said above, Mr. Krebs was the Company's point person on the
8 depreciation study and regularly met with and discussed the work with Mr.
9 Robinson. Mr. Krebs further kept me informed of the status of the work and the
10 study. I do want to be clear, however, that the Company retained Mr. Robinson
11 for his independent assessment of the Company's depreciable plant. At no time
12 did the Company direct Mr. Robinson on what recommendations to make in the
13 depreciation study. I understand that even Mr. Pous agrees that the depreciation
14 study should be the independent work of the consultant and that was true in the
15 case of the study that Mr. Robinson prepared on behalf of the Company.
16
17 **Q. Do you agree with Mr. Pous, Mr. Larkin, and Mr. Gorman that the**
18 **Company has a variance in its depreciation reserve that should be refunded**
19 **to customers?**
20 A. No. Mr. Robinson and Mr. Portuondo will also address this issue in their rebuttal
21 testimony, however, as a general matter, the variance is the difference between
22 the theoretical reserve, which uses proposed depreciation parameters, and the
23 book reserve, which reflects historical reserve transactions, including all previous

1 Commission approved depreciation parameters. This calculation is required by
2 Commission rule as one means for the Commission to evaluate the depreciation
3 study submitted by the Company. I understand the Commission rule does not
4 prescribe that any action be taken based on the calculation and comparison of the
5 theoretical and book reserves. In fact, it would be unusual for the theoretical
6 reserve to equal the book reserve so there will always be some variance when this
7 calculation is performed and the comparison of the theoretical to book reserve is
8 made.
9 Also, any variance that results between the theoretical and book reserve is
10 a non-cash item that should not be "refunded" to PEF's ratepayers. In other
11 words, PEF does not have an actual cash surplus in an account for its depreciation
12 reserve. The depreciation reserve is an accounting function that reduces rate base
13 to reflect the cumulative wear and tear experienced by this investment that has
14 been dedicated to providing customer electrical service. The money received
15 from customers, which includes the recognition of the consumption of
16 investments, is used by the Company to replace or repair consumed Electric Plant
17 in Service, build new power plants, build new substations and lines, pay
18 employees, and all other expenses that are necessary for the Company to provide
19 service. There is no bucket of money to be refunded to ratepayers.
20 Finally, there is a reason it is called the "theoretical" reserve. The
21 calculation of the theoretical reserve is a point in time calculation based upon the
22 Commission's requirement to perform a theoretical reserve calculation. In simple
23 terms, a theoretical depreciation calculation is a depreciation reserve calculation

1 that assumes the proposed depreciation parameters were in existence since day
2 one of the surviving investment in each account. For example and as outlined in
3 the Company's depreciation study, the Company is assuming a 20-year life
4 extension for its Crystal River 3 nuclear plant ("CR3"). The theoretical reserve
5 calculation assumes that the life extension assumption was known and factored
6 into the depreciation rates the day the CR3 plant became operational. This
7 assumption is, of course, simply not true but it is a necessary assumption to
8 perform the theoretical reserve calculation. There will always be changes to the
9 Company's depreciation rates over time as the Company incorporates the on-
10 going experience with, and knowledge of, its plant and how it is performing into
11 its depreciation analysis. That is the reason the Commission requires the investor
12 owned electric utilities to file new depreciation studies at least every four years.
13 One should not assume from the calculation of the theoretical reserve that the
14 Company's current rates unreasonably required current customers to pay more (or
15 less) than their fair share of the use of the Company's plant, as the intervenors do.
16 The Company's existing rates were approved by the Commission as fair and
17 reasonable rates. The Company's new depreciation study simply accounts for
18 changes in prospective life and net salvage values to reflect the Company's
19 current experience with its depreciable plant and the Company's best estimate of
20 what the future rates should be.
21
22 **Q. Do you agree with the intervenors that the Company's current variance**
23 **between the theoretical and book depreciation reserve is so significant that**

the Commission should take action to eliminate it by refunding the amount to customers?

A. No, again, the principles underlying the existence of the theoretical variance created by the theoretical reserve that I explained in my prior answer do not change because of the amount of the variance. They still hold true despite the amount of the theoretical variance between the theoretical and book depreciation reserves, which at about $504 million in the Company's depreciation study, is approximately 12% of the Company's total reserve. An understanding of the primary drivers behind the variance between the theoretical and book depreciation reserve in the Company's depreciation study helps put these principles into perspective.

Well over 80% of the $504 million variance between the theoretical and book depreciation reserves arises in the Company's production plant accounts (i.e., the Company's power plants) and the significant drivers there are the extension of production plant service lives. As noted above, the Company has requested a 20-year life extension on CR3 and the Company has determined, based on experience with its combined cycle plants since its last depreciation study, that the Hines Unit 1 life will turn out to be 30 rather than 20 years. This new information suggests different, *lower* depreciation rates for this production plant in the future because the Company will have a longer period of time to recover its investment in this plant. It does not mean that the Company's current rates, based on the information available at the time which, for example, did not include the decision to seek an extension of the service of life of CR3 from the

1 appropriate regulatory authority, were unreasonable. Indeed, if, for example, the
2 Company's request for a 20-year extension on the service life of CR3 was denied
3 or the Company subsequently learned that the additional investment necessary to
4 really obtain an additional 20 years of service from CR3 was not economical, the
5 theoretical variance between the theoretical and book depreciation reserves
6 resulting from that service life extension would disappear.
7
8 **Q. What is the appropriate regulatory treatment of the theoretical variance**
9 **between the theoretical and the book depreciation reserves in the Company's**
10 **current depreciation study?**
11 A. The appropriate and reasonable regulatory treatment is to adjust the Company's
12 depreciation rates prospectively over the remaining service lives of the
13 depreciable plant, just as the Company proposes in its depreciation study. This is
14 not "doing nothing" or simply "ignoring" the theoretical variance between the
15 theoretical and book depreciation reserves as Mr. Pous suggests. Indeed,
16 generally accepted accounting principles (GAAP) require prospective treatment
17 of the changes in plant estimates contained in the Company's proposed
18 depreciation parameters. The remaining life technique accomplishes this purpose
19 consistent with these accounting principles and those of the Florida Public Service
20 Commission memorialized in past orders as discussed in the rebuttal testimony of
21 Mr. Portuondo.
22 Mr. Pous and Mr. Gorman, in fact, agree that the prospective treatment of
23 these changes in estimates under the remaining life technique is appropriate. Mr.

Pous proposes to "return" the full $504 million imbalance between the theoretical and book depreciation reserves in the Company's study to customers using the remaining life technique – consistent with the Company's proposal – by lowering depreciation rates prospectively over the remaining service lives of the depreciable plant. Mr. Gorman similarly proposes to use the remaining life technique to "return" to customers half of the $504 million imbalance between the theoretical and book depreciation reserves. The intervenors themselves demonstrate the propriety and reasonableness of the Company's depreciation study in this regard.

The Company also believes this approach is in the best long-term interest of ratepayers in that it provides a gradual, levelized, and systematic approach to factoring into depreciation the proposed changes in estimates in the Company's Study. Perhaps the best way to demonstrate the wisdom of such an approach is to consider whether the intevenors would demand that customer rates be increased if the $504 million was a deficiency imbalance between the theoretical and the book depreciation reserves. In such an event I doubt that they would be before this Commission arguing that ratepayers should be required to pay an additional $125 million a year for four years back to PEF to address any theoretical reserve deficiency.

III. PEF Charging Practices.

Q. Are you familiar with arguments made by Mr. Schultz regarding certain of PEF's charging practices?

A. Yes. As I explained in my direct testimony, PEF reviewed its capitalization policies for its Energy Delivery business units, and that review indicated that in the areas of outage and emergency ("O&E") work not associated with major storms and the allocation of indirect costs, PEF should revise the way that it estimates the amount of capital costs associated with such work. The Company has implemented such changes effective January 1, 2005, that include more detailed classification of outage and emergency work. As a result of the changes in accounting estimates for the outage and emergency work and indirect costs, a lower proportion of PEF's costs will be capitalized on a prospective basis.

Mr. Schultz does not take issue with the substance of PEF's proposed accounting change. In fact, he agrees that the "Company's proposed accounting change for outage and emergency and indirect costs appears to have merit." (Schultz at page 25, lines 13-14). Rather, he contends that "quantitatively the Company has not supported the claimed impact on the test year; nor has it addressed possible carry-over impacts from years past." Based on his arguments, Mr. Schultz suggests that PEF should reduce its operating expense $10,356,000 on a jurisdictional basis and increase rate base $25,673,000 on a jurisdictional basis.

Q. Do you agree with Mr. Schultz's suggestions?

A. Absolutely not. As can be seen from Mr. Schultz's testimony, he summarily assumes that there are "carry-over" impacts in past years based on PEF's prior accounting treatment for O&E work and he arbitrarily recommends a

1 50% adjustment to operating income and rate base. However, Mr. Schultz's
2 proposed adjustments are incorrect and improper. First, Mr. Schultz implies there
3 are unresolved issues around the accounting treatment of the change in estimate,
4 when there are not. The change in estimate was independently verified by an
5 outside consultant retained to review the issue and make its own
6 recommendations. PEF's outside, independent accounting firm also reviewed the
7 issues and concurred with the treatment as a change in estimate and, further, the
8 Florida Public Service Commission and the Securities and Exchange Commission
9 (SEC) have been notified of the change. While Mr. Schultz has all of this
10 information, including the report of the Company's outside consultant, all he
11 refers to is an SEC notification filing (Form 8K dated December 16, 2004) in his
12 testimony. In that filing, the SEC requires the Company to outline scenarios
13 related to the accounting treatment. Mr. Schultz, therefore, relies on nothing more
14 than a reference to a hypothetical scenario and, accordingly, his suggestions are
15 mere speculation at this point. There is no open question or issue concerning the
16 prospective treatment of the change made effective January 1, 2005.
17 I also take issue with Mr. Schultz's implication that the Company has been
18 "vague and/or evasive" in its discovery responses. The Company has provided
19 background and detail on the charging practices change through several
20 interrogatories and production of document requests. Upon review of these
21 documents, Mr. Schultz himself states that the change "appears to have merit," as
22 noted above. As Mr. Schultz knows from the Company's discovery responses,
23 the Company identified an area for further study; engaged a qualified independent

1 firm to review the issue; implemented that firm's recommendations; notified the
2 regulators of the issue; and reviewed the accounting treatment with its
3 independent accounting firm. At this point, the accounting treatment is clear and
4 Mr. Schultz's concerns with a potential "prior year impact" are unwarranted.
5
6 **Q. Did Mr. Schultz raise any other arguments regarding this issue?**
7 A. Yes. First, Mr. Schultz appears to take issue with how PEF described the outside
8 consulting firm that PEF hired to evaluate its proposed change in its accounting
9 practices and make best practices recommendations to PEF. Next, Mr. Schultz
10 appears to take issue with how PEF has notified various regulatory bodies of its
11 change in accounting policy. Neither of these arguments have any merit.
12
13 **Q. What issue does Mr. Schultz raise regarding how the Company described the**
14 **outside consulting firm that evaluated PEF's proposed change in accounting**
15 **practices?**
16 A. The consulting firm hired to evaluate PEF's proposed change in accounting
17 practices was erroneously identified as an independent accounting firm in Javier
18 Portuondo's testimony. It should have been referred to as an independent
19 consulting firm. As Mr. Schultz can see from the documents provided in
20 discovery, the Company went through a rigorous proposal process to select the
21 consulting firm in question. The consulting firm that was retained was selected
22 based on their experience in both utility operational and financial areas. The
23 engagement team consisted of individuals with T&D experience, as well as the
24 appropriate utility accounting background. In addition, the firm's price was

competitive with others in the bid process. The Company implemented the consultant's recommendations (which Mr. Schultz agrees with) and our independent accounting firm reviewed the recommendations, results, and related accounting treatment.

IV. Incentive Programs.

Q. Are you familiar with the proposed adjustments that Mr. Schultz and Ms. Deronne recommend regarding PEF's incentive compensation programs?

A. Yes. Mr. Schultz contends that PEF's incentive compensation plans are not "customer oriented." He also contends that goals under PEF's incentive plans are not challenging enough. Based on his opinions, Mr. Schultz recommends that the Commission exclude all expenses for PEF's Management Incentive Compensation Plan and its Long Term Incentive Plan, and he further recommends a 50% reduction of PEF's Employee Cash Incentive Plan.

In addition to the adjustments recommended by Mr. Schultz, Ms. Deronne adopts Mr. Schultz's arguments regarding PEF's incentive compensation plans and suggests that the Commission also exclude the incentive compensation expense projected to be allocated from Progress Energy Service Company to PEF in the projected test year. Ms. Deronne's only justification for her proposed adjustment, other than the arguments made by Mr. Schultz in his testimony, is her incorrect claim that Service Company incentives should be disallowed in this proceeding because, according to her, they were not included in PEF's 2002 rate case.

1

2 **Q. Do you agree with the proposed adjustments that Mr. Schultz and Ms.**

3 **Deronne recommend?**

4 A. No, I do not. As an initial matter, Mr. Schultz, and Ms. Deronne through her

5 adoption of Mr. Schultz's arguments, are simply incorrect in their assertion that

6 PEF's incentive compensation plans are not "customer oriented." Logically,

7 PEF's ability to attract, retain, and motivate a quality workforce has a direct

8 correlation to PEF's ability to effectively and efficiently serve its customers.

9 Simply stated, a highly motivated, quality workforce provides better service to

10 PEF's customers. In order to attract, retain, and motivate quality employees,

11 managers, and executives, PEF's compensation must be competitive. To be

12 competitive in attracting and retaining high quality, highly motivated Company

13 personnel, the Company must provide them with incentive compensation. Indeed,

14 that was one factor that allowed PEF to provide superior performance, to the

15 benefit of its customers, since the merger.

16 In addition, PEF's incentive compensation goals are customer focused. In

17 an attempt to justify disallowing 50% of PEF's employee incentives and 100% of

18 management incentives, Mr. Schultz refers to PEF's incentive compensation legal

19 plan documents and states that these documents make no mention of PEF's

20 customers in the purpose of the plans. However, the Company's incentive goal

21 structure demonstrates a clear focus on PEF's customers. For example, PEF's

22 incentive goals are created in four broad categories (customer, operations,

23 financial, and employee). PEF's customers indirectly benefit from all of these

goals and directly benefit from success in the "customer" and "operations" categories. Examples of customer and operational goals include: customer centered gauge results, customer transaction study results, customer call metrics, transmission and power quality measures, environmental and safety goals, capacity factor, commercial availability, INPO performance index, and other similar initiatives. Success in these areas enable PEF to provide safe, responsive, and reliable service to the customers and locations it serves. Thus, PEF's goal structure itself demonstrates PEF's focus on its customers, and Mr. Schultz's arguments to the contrary are simply wrong.

Additionally, this Commission, in PEF's last litigated rate case in 1992, recognized that PEF's Management Incentive Compensation Plan provides a benefit to PEF's customers. Specifically, the Commission stated:

> The company has placed a portion of the total compensation of specific key employees at risk by requiring the achievement of goals and objectives. Placing part of executives' pay at risk has proven to be a substantial performance motivator....FPC's incentive plans are similar to plans adopted by other electric utilities in Florida....Incentive plans that are tied to the achievement of corporate goals are appropriate and provide an incentive to control costs.

In Re: Petition for a Rate Increase by Florida Power Corporation, Docket No. 910890-EI, Order No. PSC-92-1197-FOF-EI at *117-18.

Q. Do you have any other points that you would like to make with respect to this issue?

A. Yes. With respect to Mr. Schultz's and Ms. Deronne's contention that PEF's incentive compensation goals are not challenging enough, Mr. Schultz cites to

1 PEF's earnings per share ("EPS") goal; its environmental index goal; and its
2 energy supply customer care goal. I address each of these goals below:

- EPS - The Company evaluates the EPS goal each year during the budget process, considering the many variables in place that impact this goal. This goal will naturally vary between years and can, in some situations, decrease between years. Just because this goal is less, however, does not make it less challenging. If the number of shares outstanding increases from one year to the next, such a change will lower the EPS goal. Changes in the underlying business operations, such as divestitures of business lines, can also impact EPS. Based on the many variables that impact an annual EPS goal, it is not reasonable to compare it between years unless the underlying businesses and the number of shares outstanding are static -- which is clearly not the case.

- Environmental Index – As the name implies, this is an index that is established and approved annually by the Company's Environmental Health and Safety Performance Council. While the index remains static, the underlying metrics do change.

- Energy Supply Customer Care – While Supply may use the same goal each year, that does not mean that the goal is de minimus or becomes so over time. The Supply goal is set based on the expected superior performance. Meeting this goal each year means Supply is providing superior service to the Company.

3 My overall point is that PEF's incentive goals are evaluated and updated annually to
4 ensure that they are current and that they reflect the Company's objectives with
5 respect to customer service, operations, financial goals, and employee performance.
6 The examples cited by Mr. Schultz in his testimony do not reflect diminishing goals,
7 but instead reflect goals that are updated from year to year based on PEF's most
8 updated sets of data and objectives.
9 I would also note that Mr. Schultz seems to imply in his testimony that there is no
10 oversight in the incentive compensation area. This is not accurate. For the
11 Management Incentive Plan ("MICP"), the Compensation Committee of the Board
12 ("Committee") has been assigned responsibility to (a) approve the applicable
13 threshold, target, and outstanding levels of performance for a Performance Measure

1 for the year; (b) approve the performance criteria and awards for all participants who
2 are members of the Senior Management Committee; and (c) determine the total
3 payout under the Plan up to a maximum of four percent (4%) of the Sponsor's after-
4 tax income for a relevant year. Additionally, the Committee is authorized to change
5 Target Award Opportunity for the Chief Executive Officer of the Sponsor from year
6 to year, or to award an amount of compensation based on other considerations. The
7 Committee also reviews the employee incentive goal structure before each year and
8 approves adjustments to the EPS goal for unusual items (i.e. the impact of storms and
9 the like). Therefore, Mr. Schultz is incorrect in his assertion that there is no oversight
10 of the incentive compensation program.
11
12 **Q. Did Mr. Schultz and Ms. Deronne express any other concerns regarding**
13 **PEF's incentive compensation programs?**
14 A. Yes. Apparently they contend that the expense amounts for incentive
15 compensation programs have increased too rapidly since 2002. They also contend
16 that incentive compensation necessarily cannot be warranted when a utility has a
17 need to increase its rates.
18
19 **Q. Are Mr. Schultz's and Ms. Deronne's concerns in this regard warranted?**
20 A. No, they are not. Mr. Schultz makes the point that PEF's incentive compensation
21 has increased since 2002 and is normally over budget. However, 2002 was a year
22 which proves PEF's point that its incentive compensation plans are not easy to
23 meet. Incentives were paid at the lowest of three levels in that year. For budget

purposes, the Company uses a target level assumption for incentives (the middle achievement level). Actual payouts in 2003 and 2004 averaged between the target and outstanding levels. The years 2003 and 2004 were a time of increasingly improved performance due largely to PEF's Commitment to Excellence program, so an increase in incentives is not unusual for those years.

As an additional argument, Mr. Schultz implies that the corporate success driving incentive payouts is contradictory to PEF's need to increase rates. In other words, Mr. Schultz contends that if a utility seeks a rate increase, there cannot, by definition, be any circumstances that would warrant incentive compensation payments. Such an argument, however, is illogical on its face. Excellent corporate performance and the need to increase rates are not directly related. PEF's need for a rate increase based on continued customer growth and new generation units has nothing to do with how PEF and its employees have performed or will perform. It is apparent that a utility can provide excellent performance that warrants incentive compensation to its employees, but nonetheless need a rate increase to account for factors (such as customer growth) that are beyond the utility's control.

Q. Is Ms. Deronne correct in her assertion that Service Company Incentives were not included in PEF's 2002 rate case?

A. No. Ms. DeRonne's belief that Service Company incentives should be disallowed in this proceeding because they were not in the 2002 rate case is incorrect. Service Company incentives were included in PEF's 2002 rate case. PEF's

product code structure was changed between 2002 and 2006 to add a separate product code for incentives. In 2002, incentives were charged to PEF by each Service Company department separately. This may be why Ms. Deronne believes that Service Company incentives were not included. The incentives charged and budgeted to PEF are as follows:

Year	Amount
2002 Actual	$3,207,000
2003 Actual	$4,762,000
2004 Actual	$5,850,000
2005 Budget	$5,549,939
2006 Budget	$5,671,471

V. Payroll Issues.

Q. Are you familiar with the proposed adjustments that Mr. Schultz recommends regarding PEF's payroll and payroll tax expenses?

A. Yes. While Mr. Schultz makes clear that he does not question PEF's payroll dollars in total, he nonetheless contends that PEF's projected expense for base pay and overtime is excessive. Specifically, Mr. Schultz states that the company has improperly increased the expense factor for its payroll from 54% to 57% without providing any justification for the increase. Additionally, Mr. Schultz opines that PEF may not have captured the full impact of PEF's recent employee reduction programs in its payroll expenses. With respect to payroll tax expenses, Mr. Schultz states that those expenses should be reduced commensurately with payroll expenses because payroll taxes are based on payroll.

1 **Q. Do you agree with the proposed adjustments that Mr. Schultz recommends**
2 **regarding PEF's payroll and payroll tax expenses?**
3 A. No. Upon reviewing the intervenor testimony, we discovered an error made in
4 the interrogatory responses related to this area. One component of base payroll is
5 labor charged to clearing accounts. In the data supporting the initial responses to
6 OPC interrogatory number 26 and FRF interrogatory number 17, the total labor in
7 clearing accounts was treated as capital in calculating the percentages Mr. Schultz
8 cites. However, a significant amount of these dollars are correctly cleared out to
9 expense accounts. Examples of the types of costs include stores, fleet, and
10 exceptional hours (loading of vacation, holidays, etc. on productive labor).
11 Therefore, we revised both interrogatories to correctly reflect where the clearing
12 labor is ultimately charged. You can see the results in Exhibit No. ___ (RHB-8)
13 and Exhibit No. ___ (RHB-9). A summary of the expense percentages from the
14 revised answers to these interrogatories is outlined below:
15

	Base Payroll	Payroll Taxes
2006 budget	68%	67%
2005 budget	67%	67%
2004 actual	66%	65%
2003 actual	65%	63%
2002 actual	66%	64%

16
17 I believe the results are reasonable. The percentage expensed will vary between
18 years based on the nature and type of projects (O&M vs. capital mix) in any given
19 year.

1 I would also point out that the payroll expense percentage is much more in
2 line with the payroll tax expense percentage in the revised interrogatory responses
3 and is consistent with our actual experience. Based on the new information
4 outlined above, I do not believe any adjustment to either payroll or payroll tax is
5 warranted.
6
7 **VI. <u>D&O Insurance.</u>**
8 **Q. Do any of the intervenor witnesses take issue with PEF's expense for D&O**
9 **Liability Insurance?**
10 A. Yes. Ms. Deronne agrees with me that premiums for D&O Liability Insurance
11 have steadily increased in the past few years largely due to corporate scandals
12 such as Enron. However, Ms. Deronne, without challenging the validity of the
13 actual expense numbers that PEF has offered, makes the argument that all
14 expenses for D&O Liability Insurance should be removed because, in her opinion,
15 D&O insurance only benefits PEF's shareholders and not PEF's ratepayers.
16
17 **Q. Do you find Ms. Deronne's proposed adjustments to be logically persuasive?**
18 A. No, I do not. D&O insurance is a legitimate, reasonable cost of doing business.
19 All companies, investor owned regulated electric utilities included, must have
20 officers and directors to manage their operations. D&O insurance is a required
21 component of the compensation for officers and directors because no officer or
22 director can reasonably be expected to be retained without D&O insurance
23 coverage. To compete for quality management, the Company must provide such

coverage and, accordingly, it is a reasonable and prudent business expense of the Company.

VII. <u>Healthcare Costs.</u>

Q. Are you familiar with the proposed adjustments that Mr. Schultz recommends regarding PEF's healthcare expenses?

A. Yes. Mr. Schultz contends that PEF has overestimated its healthcare costs based on inflation trends that are too high; by failing to assume proper levels of refunds/rebates; and by using an expense factor that is too high.

Q. Do you agree with any of Mr. Schultz's adjustments?

A. Yes. Mr. Shultz does note that the actual trend of increase in health care costs has not been as significant as we estimated in the initial MFR filing. Based on more recent information and analysis, available following the filing of the Company's MFRs and my Direct Testimony, we agree the trend warrants adjustment to the amount as noted in my Exhibit No. ___ (RHB-10). I also agree that the rebate/refund amount should be forecasted into the Test Year. However, I disagree with the amount Mr. Shultz recommends. In my Exhibit No.____ (RHB-10), you can see the results of a four-year average of experience in this area. Based on that analysis, I concur with a $448,500 decrease in health care costs, not $757,000 as Mr. Shultz contends (2004 actual).

I do not agree with one component of his adjustments in the health insurance area. As discussed above, the percentage of payroll that is expensed in

1 the case is appropriate. Therefore, Mr. Shultz's adjustment to health care costs
2 based related to that issue is not valid.
3
4 **VIII. <u>NEIL Issues.</u>**
5 **Q. Are you familiar with the proposed adjustments that Ms. Deronne**
6 **recommends regarding PEF's insurance through the Nuclear Electric**
7 **Insurance Limited ("NEIL")?**
8 A. Yes, Ms. Deronne states that PEF's projections for NEIL nuclear distributions in
9 the test year is too low based on 2005 data schedules.
10
11 **Q. Do you agree with Ms. Deronne on this point?**
12 A. Yes. Based on new information available to the Company around the time of its
13 initial filings in this proceeding and produced to the intervenors, the Test Year
14 distribution estimate should be $2,834,700, which results in a $639,000 reduction
15 to insurance expenses. If the Commission agrees that the Company should rely
16 upon this updated information, the adjustment should be made.
17
18 **IX. <u>Conclusion.</u>**
19 **Q. Does this conclude your rebuttal testimony?**
20 A. Yes, it does.
21

Revised Response to Question #26

	2006 Budget	2005 Budget	2004 Actual	2003 Actual	2002 Actual
Total Gross Payroll & Fringe Benefits Expensed	252,133,149	242,428,970	260,876,751	240,850,785	200,383,597
Total Gross Payroll & Fringe Benefits Capitalized	123,137,552	121,405,972	132,065,043	125,898,129	107,393,049
Percentage of Payroll Charged to Expense	68%	67%	67%	65%	67%
Percentage of Fringe Benefits Charged to Expense	65%	65%	65%	69%	54%
Fringe Benefits (excluding Pension) *	68%	67%	70%	68%	69%

* Progress Energy Florida's Pension cost is charged entirely to expense, and this dollar amount fluctuates a great deal from year to year. When Pension cost is excluded from Fringe Benefits, the remaining Fringe Benefits are charged approximately 65% to

Revised Response to Question #17

Total Gross Payroll & Fringe Benefits expensed and capitalized

Percentage of Payroll charged to expense

Percentage of Fringe Benefits charged to expense

		2006				
Line #		C-35	% Capital	% Expense	$ Capital	$ Expense
2	Base Payroll - Regular FT Employees	272,926,655	32%	68%	87,862,059	185,064,596
3	Incentive Compensation Plan	18,761,714	34%	66%	6,461,742	12,299,972
4	Long Term Incentive Plan	684,000		100%	-	684,000
6	**Total Payroll**	292,372,369	**32%**	**68%**	94,323,801	198,048,568
10 & 11	FICA and Unemployment	23,363,155	33%	67%	7,642,351	15,720,804
12	Workers' Compensation	5,010,000		100%	-	5,010,000
13	Pension Plan Expense	(7,450,000)		100%	-	(7,450,000)
14 - 18 & 21	OBB Benefit Plans	60,354,789	35%	65%	20,983,500	39,371,289
19	Employee Educational Assistance	658,312	7%	93%	48,660	609,652
20	Performance Awards & Relocation	962,076	14%	86%	139,240	822,836
22	**Total Fringe Benefits**	82,898,332	**35%**	**65%**	28,813,751	54,084,581
24	**Total Payroll & Fringe Benefits**	375,270,701	33%	67%	**123,137,552**	**252,133,149**

		2005				
Line #		C-35	% Capital	% Expense	$ Capital	$ Expense
2	Base Payroll - Regular FT Employees	265,864,980	33%	67%	87,029,629	178,835,351
3	Incentive Compensation Plan	18,702,959	34%	66%	6,451,319	12,251,640
4	Long Term Incentive Plan	552,000		100%	-	552,000
6	**Total Payroll**	285,119,939	**33%**	**67%**	93,480,948	191,638,991
10 & 11	FICA and Unemployment	22,896,478	33%	67%	7,576,404	15,320,074
12	Workers' Compensation	4,392,000		100%	-	4,392,000
13	Pension Plan Expense	(6,990,000)		100%	-	(6,990,000)
14 - 18 & 21	OBB Benefit Plans	56,827,278	35%	65%	20,163,395	36,663,883
19	Employee Educational Assistance	642,040	6%	94%	38,665	603,375
20	Performance Awards & Relocation	947,207	15%	85%	146,560	800,647
22	**Total Fringe Benefits**	78,715,003	**35%**	**65%**	27,925,024	50,789,979
24	**Total Payroll & Fringe Benefits**	363,834,942	33%	67%	**121,405,972**	**242,428,970**

Line #		2004				
		C-35	% Capital	% Expense	$ Capital	$ Expense
2	Base Payroll - Regular FT Employees	292,064,099	34%	66%	99,548,570	192,515,529
3	Incentive Compensation Plan	26,017,095	26%	74%	6,634,816	19,382,279
4	Long Term Incentive Plan	599,428		100%	-	599,428
6	**Total Payroll**	318,680,622	**33%**	**67%**	106,183,386	212,497,236
10 & 11	FICA and Unemployment	24,562,873	35%	65%	8,574,597	15,988,276
12	Workers' Compensation	4,515,064		100%	-	4,515,064
13	Pension Plan Expense	(11,302,220)		100%	-	(11,302,220)
14 - 18 & 21	OBB Benefit Plans	54,296,096	32%	68%	17,257,783	37,038,313
19	Employee Educational Assistance	370,676	2%	98%	8,923	361,753
20	Performance Awards & Relocation	1,818,683	2%	98%	40,354	1,778,329
22	**Total Fringe Benefits**	74,261,172	**35%**	**65%**	25,881,657	48,379,515
24	**Total Payroll & Fringe Benefits**	392,941,794	34%	66%	**132,065,043**	**260,876,751**

Line #		2003				
		C-35	% Capital	% Expense	$ Capital	$ Expense
2	Base Payroll - Regular FT Employees	260,992,358	35%	65%	91,219,067	169,773,291
3	Incentive Compensation Plan	21,901,319	41%	59%	8,968,642	12,932,677
4	Long Term Incentive Plan	295,777		100%	-	295,777
6	**Total Payroll**	283,189,454	**35%**	**65%**	100,187,709	183,001,745
10 & 11	FICA and Unemployment	22,289,553	37%	63%	8,204,631	14,084,922
12	Workers' Compensation	4,108,489		100%	-	4,108,489
13	Pension Plan Expense	2,355,570		100%	-	2,355,570
14 - 18 & 21	OBB Benefit Plans	52,495,302	33%	67%	17,423,914	35,071,388
19	Employee Educational Assistance	445,076	4%	96%	16,004	429,072
20	Performance Awards & Relocation	1,865,470	4%	96%	65,871	1,799,599
22	**Total Fringe Benefits**	83,559,460	**31%**	**69%**	25,710,420	57,849,040
24	**Total Payroll & Fringe Benefits**	366,748,914	34%	66%	**125,898,129**	**240,850,785**

Line #		2002				
		C-35	**% Capital**	**% Expense**	**$ Capital**	**$ Expense**
2	Base Payroll - Regular FT Employees	245,246,334	34%	66%	83,622,397	161,623,937
3	Incentive Compensation Plan	11,966,686	6%	94%	680,142	11,286,544
4	Long Term Incentive Plan	58,444		100%	-	58,444
6	**Total Payroll**	257,271,464	**33%**	**67%**	84,302,539	172,968,925
10 & 11	FICA and Unemployment	21,468,196	36%	64%	7,629,509	13,838,687
12	Workers' Compensation	4,200,137		100%	-	4,200,137
13	Pension Plan Expense	(24,191,457)		100%	-	(24,191,457)
14 - 18 & 21	OBB Benefit Plans	45,341,282	33%	67%	15,023,745	30,317,537
19	Employee Educational Assistance	384,284	13%	87%	49,440	334,844
20	Performance Awards & Relocation	3,302,740	12%	88%	387,816	2,914,924
22	**Total Fringe Benefits**	50,505,182	**46%**	**54%**	23,090,510	27,414,672
24	**Total Payroll & Fringe Benefits**	307,776,646	35%	65%	**107,393,049**	**200,383,597**

Docket No. 050078
Progress Energy Florida
Exhibit No. ___ (RHB-10)

Adjustments to Medical Insurance

	2002 Actual	2003 Actual	2004 Actual	2005 Projection	**PGN Proposed Adj**	**Intervenor Proposed Adj.**		**Difference**	**Comment**
Rebates/refunds	$567,000	$160,000	$757,000	$310,000	**$448,500**	**$757,000**		($308,500)	Reduce intervener H. W. Schultz adjustment by $309K based on four year average of Florida refund/rebates.
Impact of proposed change in payroll expense percentage	n/a	n/a	n/a	n/a	**0**	**$659,444**		($659,444)	Reduce intervener H. W. Schultz adjustment by $659K; 54.26 % used is related to impact of Mr. Schultz's proposed adjustment to payroll expense; we do not agree with this adjustment.
Medical trend rate adjustment	n/a	n/a	n/a	n/a	**$2,386,907**	**$2,386,907**		$0	Agree analysis of recent trends warrants adjustment to the amount
Total					**$2,835,407**	**$3,803,351**		($967,944)	