BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

Docket No. 050078-EI

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REBUTTAL TESTIMONY OF DAVID MCDONALD

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REBUTTAL TESTIMONY OF
DAVID MCDONALD

I. Introduction and Purpose

Q. Please state your name.

A. My name is David McDonald.

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

A. Yes.

Q. Have you reviewed the intervenor testimony of Donna Deronne and Jacob Pous filed on behalf of the Office of Public Counsel ("OPC"), of Sheree Brown filed on behalf of the Florida Retail Federation ("FRF"), and of Carl Vinson, William "Tripp" Coston, and Sidney Matlock filed on behalf of the Florida Public Service Commission Staff (the "Staff")?

A. Yes.

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

A. The purpose of my rebuttal testimony is to respond to certain wholly unsupported arguments presented by Ms. Brown and Ms. Deronne asserting that O&M expenses associated with various distribution initiatives should be reduced. In addition, I address the inferences in Staff's testimony that PEF's vegetation management and pole inspection programs are somehow less than adequate and that our record of reliability performance is less than superior. I also generally address PEF's cost to install and remove distribution equipment and the salvage value, if any, that the Company receives for such equipment following the end of

its useful life. This issue is addressed in greater detail by Bob Matthews and Ray DeSouza in their rebuttal testimony,

II. Response to Ms. Deronne's Distribution Vegetation Management Recommendations

Q. Ms. Deronne indicates that Progress Energy Florida's ("PEF's" or the "Company's") incremental distribution vegetation management spending request of $11 million is not adequately supported in your testimony. Do you agree with her assessment?

A. No I do not. First, Ms. Deronne is a CPA. She is not an engineer. Nor does it appear from her testimony that she has ever held any positions overseeing the operation and maintenance of a distribution system. She also has not inspected PEF's electric distribution system in this case that would enable her even to opine on what level of vegetation management programs are appropriate. Even if she were to have undertaken such a review, she does not appear to have the relevant experience to give such an opinion in any event as a CPA. As I will discuss in greater detail below, Ms. Deronne's request to eliminate $11 million is arbitrary and has no basis in fact.

My direct testimony, on the other hand, is based on my extensive experience operating and maintaining electric distribution systems and a detailed understanding of PEF's distribution system, vegetation management practices and future needs.

Q. Please summarize the Company's vegetation management program over the past several years.

A. Since 2002, PEF has been operating under the terms of our Stipulation and Settlement Agreement (the "2002 Settlement"), which resolved the Company's last rate case. Under the 2002 Settlement, the Company committed to achieve a system average interruption duration index ("SAIDI") of 80 minutes or less by 2004 while simultaneously delivering an annual $125 million rate reduction to our customers. PEF met these commitments. Two factors were most critical to this success. The first was the Company's investment of more than $120 million, over and above normal expenditures, to upgrade the transmission and distribution systems through the Commitment to Excellence ("CTE") program. The second factor was the efficiency gained from work prioritization, which allowed the Company to concentrate its reliability efforts on activities with the potential to produce the greatest improvements in relation to our SAIDI commitment. The prime example of this prioritization was the emphasis placed on outage mitigation; that is, reducing the average duration of, and the number of customers impacted by, outages occurring on the system. One effect of this increased focus on outage mitigation was a more stringent and strategic application of fault prevention activities that would not significantly impact that facet of reliability as measured by SAIDI. These circumstances are important to understand since they affected the level and nature of our work on several underlying initiatives, including vegetation management.

Q. Have there been any other significant impacts on your vegetation management program?

A. Yes. The cost per mile for vegetation management has risen considerably, which has impacted the number of miles we're able to trim annually. Per-mile costs of

our vegetation management contracts have increased every year and a total of 57% since 2001. This increase in the cost per mile is due to several factors. First, underlying labor and employee benefit costs have been rising over time and represent the major cost input for our contracts. Second, the end of a multi-year drought has resulted in increased vegetation growth, which has similarly contributed to the rising cost per mile. Third, the Company has established a more comprehensive trimming program, with additional attention given to right-of-way floor maintenance and overhead removal relative to the past. While this also contributes to a rising cost per mile, it provides a better result for every mile trimmed and is very consistent with our transition to a prevention focus as I will describe in a moment. Simply put, we have more growth now to trim and when we trim, we are trimming back more of the vegetation.

Q. What has been the net impact of these issues on PEF's distribution vegetation management program?

A. The Company has dedicated significantly more funding to distribution vegetation management, increasing the annual average of $9.7 million over the 1999 to 2001 period by over 150% to an annual average of $14.4 million over the 2002 to 2004 period. In addition, the Company has worked to more precisely target expenditures on those activities that will achieve maximum improvement in reliability. Although we continue to believe that a three-year weighted average maintenance cycle is a reasonable goal on a system-wide basis, there are nonetheless benefits that can be captured from the fact that preventative maintenance on certain individual feeders may be deferred to longer cycles without significantly impacting reliability. System reliability and customer impact

are our ultimate drivers, and the very successful results of our focus can be seen in a steadily declining customer-weighted average duration of tree-caused outages from 2000 to 2004 as well as the Company's broad record of reliability improvement over this period.

Q. Please describe and support your need for $11 million in incremental distribution vegetation management funding as requested in this case.

A. Going forward, PEF believes that the most significant improvements in customer satisfaction can be realized by maintaining the Company's SAIDI reliability measure in its current range while broadening the current focus on the mitigation of outages to the improvement of power quality through fault prevention. In the area of vegetation management, this means that we will have to look beyond simply reducing the duration of, and the number of customers impacted by, tree-related outages, and shift our focus to the actual prevention of tree-related faults in the first place. Clearly, this will require a much greater vegetation maintenance effort and it is the main driver of our incremental vegetation funding proposal. As opposed to a more targeted approach to trimming, this implies a broader and more robust approach where less potential for vegetation contact with the conductor can be tolerated. The payoff will be greater power quality and less interruptions for our customers.

Q. Ms. Deronne proposes that the Commission grant PEF an increase in vegetation management spending equal to fifty percent of actual spending in 2004. Do you agree?

A. No. PEF's $11 million incremental funding request is scaled to maintain a three-year weighted average cycle time considering anticipated per-mile cost increases. This amount is based on a detailed review of our past vegetation management activities, the state of our system today, and a recognition of the unique needs of varying feeders within the system. It is not, and should not be, based on an arbitrary mathematical formula or percentage that is taken out of thin air. Our proposal represents an appropriate amount of funding and is designed to improve power quality consistent with the rising expectations of our customers. Ms. Deronne argues that the requested funding would enable trimming of 41% of overhead miles, rather than the 33% which would be consistent with a three-year cycle. While this may be true in a strict mathematical sense, it does not recognize PEF's need to operate above this level in the short term as we transition from a focus on mitigation to prevention.

Q. Ms. Deronne recommends that the PEF be required to report distribution vegetation management spending to the Commission quarterly and return any under-spent amounts to ratepayers. Do you agree?

A. No. The Company has a strong track record of balancing stakeholder interests and prioritizing spending for our customers' benefit. This is clear from the consistency and breadth of our operational improvements over the past several years. It is not in our customers' interest to blindly adhere to every underlying procedure, budget, estimate, and plan. Effective management calls for precisely the type of balancing and prioritization that PEF has demonstrated. The implementation of balancing funds for budget line items would reduce management's ability to make such tradeoffs and would not be in the best interests of our customers.

III. Response to Ms. Brown's Recommended Adjustments to Distribution Reliability Initiatives

Q. Ms. Brown recommends that the Commission reduce PEF's requested test year incremental reliability projects from $18.65 million to about $8.6 million. On what basis, does Ms. Brown make this recommendation?

A. Ms. Brown claims that, on average, from 2002 through 2004, PEF only spent 46.2% of what it said it would spend in Docket No. 000824-EI. As such, based on this simple mathematical calculation, PEF should only be able to recover 46.2% of its current request for incremental distribution initiatives.

Q. Do you agree with Ms. Brown's recommendation?

A. No. As Mr. Oliver states in his rebuttal testimony, the budget for specific distribution reliability programs identified by the Company (in Robert Sipes' testimony) in Docket No. 000824-EI were based on an annual $5 million rate reduction and not on the annual $125 million rate reduction that PEF and the interveners, including Ms. Brown's client at that time, ultimately agreed to under the 2002 Settlement. The 2002 Settlement did not mandate the programs identified in Mr. Sipes' testimony and, beyond this, it is not reasonable to think the Company could reduce revenue by almost $500 million over the term of the 2002 Settlement with no change in underlying spending. Based on the 2002 Settlement and the associated SAIDI commitment, PEF necessarily re-prioritized programs to focus on outage mitigation measures. Within that context, which Ms. Brown fails to mention in her testimony, PEF nonetheless spent $123 million from 2002 to 2004 on key distribution and transmission reliability initiatives over and above the

normal, budgeted amounts. These initiatives are shown in Exhibit No. ____(DO-1) to Mr. Oliver's direct testimony, and represent a very significant commitment to reliability and operational excellence. Ms. Brown's misstatement that the Company "overestimated" its distribution expenses in Docket No. 000824-EI is disingenuous and ignores the 2002 Settlement her client signed following the submittal of Mr. Sipes' initial testimony in that case.

Q. What other problems are there with Ms. Brown's recommended adjustments to PEF's proposed distribution initiatives?

A. Like Ms. Deronne, Ms. Brown is an accountant. Ms. Brown has no experience in operating and maintaining an electric distribution system, does not have the background to opine on what initiatives are appropriate, and appears to have undertaken no review of PEF's electric distribution system, were she even qualified to do so, to give any educated opinion as to the appropriateness of any distribution initiatives proposed by PEF. Instead, Ms. Brown simply makes up a number – based on no technical analysis. In essence, she calculates CTE spending as a percentage of the original, *as-filed*, reliability spending proposals in Docket No. 000824-EI and recommends that the Commission only approve the same proportion of this request. The 2002 Settlement renders the relationship between these two items absolutely meaningless. Since Ms. Brown's premise is flawed, it should not have any bearing on this proceeding.

IV. Response to Reliability Audit Findings by Messrs. Vinson and Coston

Q. Messrs. Vinson and Coston state that PEF has experienced an increase in vegetation-caused outages during the period 1999 through 2004, while

decreasing the number of miles trimmed and the number of feeders trimmed annually during the same period, which implies that reliability as a result of PEF's vegetation management programs has gone down. Do you agree?

A. No I do not. The criticism of Messrs. Vinson and Coston focuses on the number of miles and number of feeders trimmed. This is only one measure, and in this case not the best measure, of the effectiveness of PEF's distribution reliability activities. Over the period from 1999 to 2004, PEF has significantly improved overall distribution reliability. The Company reduced its 1999 SAIDI of 97 minutes by over 20% and has also reduced other system reliability metrics, including SAIFI, CAIDI, and CEMI5. The breadth and magnitude of this improvement is highlighted in the Commission's most recent "Review of Florida's Investor-Owned Electric Utilities' Distribution Reliability" report. This most recent review of reliability covers the four-year period from 2000 through 2003 and shows that PEF demonstrated improvement on seven of eight reliability metrics examined.

Two factors have been key to the distribution reliability improvements achieved by PEF over this period. The first is the Company's investment of more than $120 million, over and above normal expenditures, to upgrade its transmission and distribution systems despite the reduction in revenues associated with the current rate settlement, which provided the additional benefit to customers of over $500 million in savings. The second factor is the efficiency gained from work prioritization, which allowed the Company to readjust and concentrate its reliability efforts on activities with the potential to produce the greatest improvements. The prime example of this was the emphasis placed on outage

mitigation, which proved to be highly effective in reducing the average duration of outages and in reducing the number of customers affected by those outages that do occur. One effect of this increased focus on outage mitigation was a somewhat reduced emphasis on outage prevention activities and the resulting increase in vegetation-related outages, although this increase was more than offset by the overall reliability improvements achieved by PEF's outage mitigation efforts. The success of these efforts can be clearly seen in the Company's decreasing CAIDI related to tree-caused outages from 2000-2004, as well as in the broad record of overall reliability improvements described above. In addition, the apparent increase in the number of vegetation-related outages has been exaggerated by recent improvements in the accuracy of cause codes assigned to outages. It is likely that many outages now reported as caused by vegetation would have been assigned other codes in the past.

Despite the emphasis on outage mitigation throughout the period in question, the Company has endeavored to maintain an average trimming cycle of three years. Vegetation management spending has risen considerably over the 1999 - 2004 period. In fact, PEF's spending of $15.4 million in 2004 is an increase of over 150 percent compared to the $9.9 million spent in 1999, and the Company's average annual spending over the three-year period from 2002 to 2004 of $14.4 million is almost 150 percent greater than the 1999 - 2001 annual average of $9.7M. However, the cost per mile for vegetation management has risen considerably over this period, which has negatively impacted the annual mileage cited in the preliminary audit finding. This increase in the cost per mile is primarily due to higher labor costs and a more comprehensive trimming program,

with additional attention given to right-of-way floor maintenance and overhang removal relative to the past. Beyond this, the end of a multi-year drought has resulted in increased vegetation growth, which has contributed significantly to the rising cost per mile. In the face of these challenges, PEF has worked to more precisely target expenditures on those activities that will achieve the maximum improvement in customer reliability. Although the Company continues to believe that a three-year weighted average maintenance cycle is a reasonable goal on a system-wide basis, there are nonetheless benefits that can be captured from the fact that preventative maintenance on certain individual feeders may be deferred to longer cycles without significantly impacting reliability. System reliability and customer impact are the ultimate drivers, and the results of this focus can be seen in the steadily declining CAIDI related to tree caused outages from 2000-2004 and the Company's broad record of reliability improvement over this period.

Q. Messrs. Vinson and Coston also state that PEF does not have a fully-implemented central monitoring system to track distribution ground-line inspections and that this represents a situation that could compromise customer reliability. Do you agree?

A. No I do not. PEF enhanced its inspection program in 2003 with the implementation of a GPS tracking system, which has and will continue to significantly improve the Company's ability to monitor and administer the program. Since then, the GPS coordinates of all inspected poles have been entered into the system as they are inspected. When fully implemented, approximately an additional 8 to 10 years given our inspection cycle time, PEF will be able to

identify the precise location and specific inspection history for each of its approximately one million distribution poles. This data base, in turn, will enable the Company to better identify patterns and trends associated with inspection and maintenance practices and provide the basis for evaluating further improvements to its procedures, including the most cost-effective inspection cycle.

PEF believes that its current approach and timeline most appropriately balance costs and benefits for our customers since we essentially incur no incremental cost to build the database during our routine inspections. The alternative, obtaining the GPS coordinates of our poles outside the normal inspection process, would add roughly $5 million in cost and would not likely produce substantial benefits. Our experience and working knowledge of the system indicate that pole failures are very rare. The hurricanes of 2004 provide additional validation, given that only a miniscule number of wood poles failed due to a structural defect under even the most severe conditions.

V. Response to Mr. Matlock's Critique of Reliability Performance

Q. Mr. Matlock presents thirteen years of reliability history for PEF and, based on the trend of the data, concludes that the Company's recent improvements represent less than superior performance. First, do you agree with his approach?

A. No. I find it interesting that Staff's reliability audit, entered into evidence in this case for its alleged relevance in assessing the Company's reliability performance, utilized an evaluation period from 1999 to 2004. However, Mr. Matlock rejects such an evaluation period and substitutes data from more than a decade ago to judge the very same reliability performance in the very same case. I think this

leads to a wholly inappropriate evaluation. For several reasons, comparisons in reported reliability data become less meaningful the farther back in time one compares the results, and by the time one gets back to 1992, the analysis has little relevance.

Q. Could you please provide some examples as to why such a comparison is flawed?

A. Yes. The systems used to collect and process the data, and the procedures used to calculate and report the metrics, have improved steadily over the years. For example, the introduction and refinement of automated outage management systems have increased the amount of outage information we're able to capture and record. This would have a tendency to make our results actually look worse over time, all else equal, and makes the improvements we've shown even more impressive than would be apparent from the data. As another example, the types of outages that are excluded from the calculation have changed over time and the methods of excluding minutes have changed. Prior to 1998, a different set of criteria was in place to determine which events would be excluded from the calculations. In addition, the methodology was different and less sophisticated, removing customer minutes of interruption for the entire system for the entire day. Today, we're utilizing different exclusion criteria and our methodology is more sophisticated such that the data is not skewed as easily by unusual events.

Q. Could you please address 1993 specifically?

A. Yes. You'll notice on Mr. Matlock's Exhibit No. ___ (SWM-1), that the year 1993 is clearly an anomaly and makes no sense. The reason for this was a storm,

commonly referred to as the "Storm of the Century" that caused power interruptions to 33% of our customers and resulted in over 400 million minutes of customer interruption being excluded from the annual SAIDI calculation. Only about 94 million minutes of customer interruption (or less than one quarter of the amount excluded) were included in the calculation that year, resulting in a SAIDI of 79. Clearly, this result was based on a very different methodology than would be employed today and Mr. Matlock's assertion that we have not improved performance beyond this 1993 level is plainly wrong. Exclusions taken in association with the hurricanes of 2004 were more meticulously calculated, based on a more modern set of procedures, in order that our reported performance is roughly equal to what would have resulted had the storms never occurred. Here again, given the tendency of older data to contain a downward bias, PEF's actual results are more impressive than an uninformed review of Exhibit No. ____ (SWM-1) would suggest.

Q. Is there anything else you'd like to add?

A. Yes. I would like to make the point that customer expectations have been rising over this time period, largely due to increased use of sensitive electronics. My direct testimony discusses this in more detail. Within this context, a direct comparison of absolute performance levels over the past 13 years does not make sense. Over the long term, one would expect reliability to trend in the direction demanded by customers, which over this period suggests a downward-sloping curve.

Q. Given these clarifications, what conclusions do you draw from Exhibit No. ___ (SWM-1)?

A. The right-hand side of the exhibit, focusing on a more recent timeframe, clearly demonstrates that PEF has made consistent and substantial improvements over the full range of reliability metrics presented. Even if one were to put the negative biases and inconsistencies in the data that I described above aside, the exhibit shows significant, steady, and balanced improvement over approximately the past decade. And if we throw out 1993, which is clearly an anomaly due to exclusions associated with the "Storm of the Century", we have also shown very significant improvement on each metric since 1992.

Q. Mr. Matlock indicates that much of the Company's performance improvement for the 2001 to 2004 period occurred in 2004. Can you please explain?

A. Yes. As described in the direct testimony of Dale Oliver, the Company made significant investments in its distribution and transmission systems as part of its overall $123 million Commitment to Excellence program. As one would expect, reliability performance improved as these initiatives were rolled out over the 2002 to 2004 period. This performance effect is not necessarily linear, however, due to the substantial up-front planning, engineering, and installation time required prior to implementation of each initiative. What we noted in this case, and what is very typical, is that there is a lag in realizing the true benefits of the initiatives. Toward the later stages of the program, the cumulative effect of the implemented performance improvements begins to magnify and emphasize the observed results.

Q. Mr. Matlock states on page 4 of his testimony, that "without the changes from 2003 to 2004, little overall improvement has taken place over the entire period." Would you like to comment on this?

A. Yes. The statement is incorrect, as is obvious from a simple review of Exhibit No. ____ (SWM-1). Beyond this, a proposal to evaluate PEF's performance by excluding recent performance and substituting data from more than a decade ago makes no sense. As I just explained, our results in 2004 reflect a significant portion of the benefit derived through our Commitment to Excellence program. To exclude this year would be to exclude the core of the Company's efforts over the past several years. Again, this makes no sense. To our customers, these improvements are much more relevant than anything from thirteen years ago.

Q. Mr. Matlock also states on page 4 of his testimony, that the commitments of PEF's 2002 Settlement have not been met, specifically as they relate to 2005. Further, he states that even if they were met, this would still not indicate superior performance. Do you agree?

A. No. It is not clear on what basis Mr. Matlock is making this claim. All commitments to date, including achievement of SAIDI 80 by 2004, have been met. It is of no use to this rate case to suggest a measure of performance that cannot and will not be observable until after its conclusion. PEF's claim of superior performance is based on its historical and observable record.

Q. What is Mr. Matlock's definition of superior performance as it pertains to reliability and has PEF achieved this?

A. Mr. Matlock has not indicated how he would define superior performance. He has only indicated that he does not see superior performance in the trends on Exhibit No. ____ (SWM-1). I note that, in our prior 2002 rate case, Staff witness James Breman characterized our distribution service as "good". Putting this together with Mr. Matlock's comments and our observable improvements since 2002, I am left to assume that our performance is currently somewhere better than "good" but worse than "superior" in the eyes of the Staff. My position, on the other hand, is that PEF has demonstrated superior reliability performance. As I've already described above, a true picture of the Company's performance emerges when one disregards the anomalies, takes account of the inconsistencies in the data, and better yet uses an appropriate evaluation period. Compared against its own historical record, PEF has achieved steady, significant, and balanced improvement over time. This balance even extends down to the four regions which comprise PEF's service territory and where we've demonstrated the same steady, consistent and balanced progress over the past several years. Compared to its peer utilities, PEF has achieved top-quartile performance based on most recent benchmarks. This is a significant achievement given the frequent lightning, expansive rural areas, and high proportion of overhead miles that characterize our service area. I am extremely proud of PEF's reliability record. I urge the Commission to recognize this superior record of performance for what it truly is.

VI. PEF's Cost to Remove Distribution Equipment and Salvage Values

Q. Are you generally familiar with PEF's installation and removal of distribution equipment and the relative costs associated with each?

A. Yes. I have more than twenty years of experience in operating, designing, maintaining, and managing the operation of electric distribution systems in Florida. While I am not currently "on the ground" installing and removing equipment as is Mr. Matthews of our Company, I am generally familiar with what it takes to install and remove the various types of electric distribution equipment and the relative costs associated with installation and removal.

Q. What has been your experience relative to the installation and removal costs of distribution equipment?

A. As a general matter, it has been my experience that the cost of removing distribution equipment comes close, in many instances, to the costs to install the equipment. One key reason for this is that our access to equipment becomes more problematic as neighborhoods build up over time. For example, it's not uncommon for our crews to find poles surrounded by concrete or equipment inaccessible due to pools, sheds, and other residential structures upon removal.

Q. Are you generally familiar with the salvage value of equipment that PEF removes from service at the end of the equipment's useful life?

A. Again, throughout my career both at PEF and Florida Power & Light, I have had experience in removing distribution equipment and in disposing of such equipment.

Q. What has been your experience in the salvage values a utility typically receives for distribution equipment removed from service at the end of its useful life?

A. While I am not currently "on the ground" like Mr. Matthews, it has nonetheless been my experience that a utility typically receives very little, if any money, for distribution equipment removed from service at the end of its useful life. As one might expect, there is little to no salvage value, for example, for a 30-year old wood pole, conductor, transformer or similar equipment.

Q. Does this conclude your testimony?

A. Yes.