BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

PETITION FOR RATE INCREASE BY FLORIDA POWER & LIGHT COMPANY.	DOCKET NO. 050045-EI
2005 COMPREHENSIVE DEPRECIATION STUDY BY FLORIDA POWER & LIGHT COMPANY.	DOCKET NO. 050188-EI

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Pages 1224 through 1440

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN BRAULIO L. BAEZ COMMISSIONER J. TERRY DEASON COMMISSIONER RUDOLPH "RUDY" BRADLEY COMMISSIONER LISA POLAK EDGAR
DATE:	Monday, August 22, 2005
TIME:	Commenced at 9:55 a.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	LINDA BOLES, RPR, CRR Official FPSC Hearings Reporter (850) 413-6734
APPEARANCES:	(As heretofore noted.)

I N D E X

WITNESSES

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

IN RE: PETITION FOR RATE INCREASE	)	DOCKET NO. 050045-EI
FLORIDA POWER & LIGHT COMPANY	)	

DIRECT TESTIMONY OF LANE KOLLEN

I. QUALIFICATIONS AND SUMMARY

Q. Please state your name and business address.

A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. What is your occupation and by whom are you employed?

A. I am a utility rate and planning consultant holding the position of Vice President and Principal with the firm of Kennedy and Associates.

Q. Please describe your education and professional experience.

A. I earned a Bachelor of Business Administration in Accounting degree from the University of Toledo. I also earned a Master of Business Administration degree from the University of Toledo. I am a Certified Public Accountant, with a practice license, and a Certified Management Accountant.

I have been an active participant in the utility industry for more than twenty-five years, both as an employee and as a consultant. Since 1986, I have been a consultant with Kennedy and Associates, Inc., providing services to state government agencies and large consumers of utility services in the ratemaking, financial, tax, accounting, and management areas. From 1983 to 1986, I was a consultant with Energy Management Associates, providing services to investor and consumer owned utility companies. From 1976 to 1983, I was employed by The Toledo Edison Company in a series of positions encompassing accounting, tax, financial, and planning functions.

I have appeared as an expert witness on accounting, finance, ratemaking, and planning issues before regulatory commissions and courts at the federal and state levels on more than one hundred occasions. I have developed and presented papers at various industry conferences on ratemaking, accounting, and tax issues. I have previously testified before the Florida Public Service

Commission ("Commission") in Docket Nos. 870220-EI (Florida Power Corporation), 8800355-EI (Florida Power & Light Company), 881602-EU and 890326-EU (Talquin Electric Cooperative), 890319-EI (Florida Power & Light Company), 910890-EI (Florida Power Corporation), and 001148-EI (Florida Power & Light Company). My qualifications and regulatory appearances are further detailed in my Exhibit LK-1.

Q. On whose behalf are you testifying?

A. I am offering testimony on behalf of the South Florida Hospital and Healthcare Association ("SFHHA") and individual healthcare institutions (collectively, the "Hospitals") taking electric service on the Florida Power & Light Company ("FPL" or "Company") system .

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address various components of the Company's revenue requirement for the 2006 test year, including operation and maintenance ("O&M") expense, storm damage expense, GridFlorida expense, incentive compensation expense, return on equity performance incentive, and capital structure, and to quantify the revenue requirement effects of the return on common equity ("ROE") recommendation by Hospitals' witness Mr. Baudino. Another purpose of my testimony is to address the additional rate increase sought by the Company for Turkey Point 5 based on a 2007 projection of costs.

Q. Please summarize your testimony.

A. The Company's proposed base revenue increase of $384.6 million for the 2006 test year, net of various clause adjustments, is excessive and should be reduced. Instead, the Company's base rates should be reduced by at least $224.7 million based on the Hospitals' recommendations. I recommend that the Commission adopt the following adjustments to the Company's proposed base revenue requirement:

1. Reduce O&M expense to set storm damage expense at reasonable level. ($45.7 million).

2. Reduce O&M expense to remove speculative GridFlorida costs. ($102.5 million).

3. Reduce O&M expense to reflect productivity improvements. ($60.3 million jurisdictional).

4. Reduce the requested return on equity to remove the proposed 50 basis points return on equity performance incentive reward. ($50.2 million jurisdictional).

5. Reduce the required return on common equity to reflect recommendation of Hospitals' witness Mr. Baudino. ($311.3 million jurisdictional).

6. Establish a reasonable capital structure for FPL as a standalone utility in the computation of the rate of return. ($39.3 million jurisdictional).

In addition, the Company's proposed additional rate increase for Turkey Point 5, based on projections of 2007-2008 costs, should be rejected. The Commission should not allow piggybacked rate increases using speculative projections that are some four years beyond the historic data relied on by the Company to develop these projections.

II. STORM DAMAGE EXPENSE IS EXCESSIVE AND SHOULD BE LIMITED TO REASONABLE LEVEL

Q. Please describe the Company's request for storm damage expense included in its revenue requirement.

A. The Company's filing includes $120.0 (total Company) million in storm damage expense for the test year, an increase of $99.7 million from the present $20.3 million recovered through base rates. The Company's request includes $73.7 million in expense for the current recovery of projected storm damages, quantified on a probabilistic basis by ABS Consulting, and an additional $46.3 million in expense to establish a storm damage reserve fund of $367 million within the next five years, also quantified on a probabilistic basis by ABS Consulting.

The Company's request reflects its expectation that the existing storm damage reserve deficiency will be recovered through a storm surcharge. The framework for recovery of actual storm damage expenditures previously established by the Commission provides for base rate recovery of estimated annual losses in conjunction with a funded storm reserve account and surcharge recovery of catastrophic losses if there is a significant reserve deficiency.

Q. Is the amount of storm damage expense included in the base revenue requirement a matter of significant judgment?

A. Yes. The Commission must balance the amount of storm damage expense recovery through base rates with the potential for catastrophic losses and the necessity to recover those losses through a storm surcharge. Thus, the amount of expense allowed for base rate recovery is a function of the expected annual storm damage losses and the appropriate amount that should be included in the storm damage reserve.

The amount that should be included in the storm damage reserve is a matter of judgment as to whether amounts should be accumulated in excess of the expected annual storm damage losses, and if so, how much should be accumulated. Another matter of judgment is whether the storm reserve should be funded or unfunded.

Q. What ratemaking objectives should guide the Commission in making these judgments?

A. There are two primary ratemaking objectives that should guide the Commission in its attempt to balance the interests of the Company and those of the ratepayers who actually pay for such costs. The first ratemaking objective is that the Company should be provided recovery of its prudently incurred and reasonable costs for storm damage. The second objective is that the process of recovering prudent and reasonable costs should be structured to minimize the costs to ratepayers on an economic, or net present value, basis consistent with other ratemaking objectives such as intergenerational equity and rate stability.

Q. Does the Company agree with these ratemaking objectives?

A. Yes. The Company has identified four regulatory objectives, based on the testimony of Mr. Dewhurst. In addition to full recovery, the Company believes that the regulatory objectives should be "(1) achieve the lowest long-term customer costs; balanced with (2) dampen volatility of the reserve (i.e., reduce reliance on special assessments/rate increases); and (3) cover the costs of most storms, but not those from the most catastrophic events." (Dewhurst Direct at 40).

Q. How can the Commission provide the Company recovery of its prudent and reasonable costs while minimizing the effect on ratepayers?

A. These dual ratemaking objectives can be achieved by adopting a recovery process that results in the least cost to ratepayers on a net present value basis, tempered judgmentally by other ratemaking objectives. Generally, the least cost to ratepayers can be accomplished by providing recovery at the expected annual amount of storm damage losses, with no intentional buildup or deficiency in a storm damage reserve. The storm damage reserve would continue to operate as a means of tracking the difference between recoveries and actual storm damage losses. If there is a significant buildup or deficiency in the storm damage reserve over time, then the Commission can determine an appropriate recovery or amortization period and amount, whether through base rates or surcredit/surcharge, that will eliminate the buildup or deficiency.

Q. Why should the Commission target an average $0 storm damage reserve amount in quantifying the annual expense accrual allowed?

A. First, the Commission should use the best estimate of annual storm damage losses to set the allowed level of expense, including the costs associated with unusual storm events such as those that occurred in 2004. The Company's estimate of $73.7 million, developed by ABS Consulting, includes the effects of the costs incurred by FPL in 2004. Such an estimate will provide the Company full recovery of its storm damage losses over time, including the damage from even the most unusual and severe storm activity, no more and no less, consistent with the ratemaking objective of full recovery of prudent and reasonable costs.

Second, there is no economic justification to set the allowed storm damage expense at a level designed to intentionally overrecover by $46.3 million annually the Company's best estimate of annual storm damage losses, particularly if the Commission continues to require that such overrecoveries be included in a storm damage reserve fund with its low earned returns. Overrecoverries included in the storm damage reserve fund earn even less than the Company's cost of short-term borrowings and less than ratepayers' cost of capital. Thus, there is a net present value harm to ratepayers from intentional overrecovery for the purpose of building up an excess in the storm damage reserve fund.

Third, intentionally setting the storm damage expense at an excessive level results in an intergenerational mismatch between those ratepayers that will be required to prepay storm damage costs and those that will benefit from the prepayment in the future. Setting the storm damage expense at the level of expected storm damage losses mitigates this problem.

Q. Should the Commission continue to require the use of a storm damage reserve fund?

A. No. This requirement does not result in the least cost to ratepayers. If the Commission intentionally provides for excessive recovery to build-up an excess in the storm damage reserve, then it should at least provide ratepayers with a rate of return equivalent to that provided on all other rate base components rather than a short term earned return on fund balances. This can be achieved by eliminating the funding requirement and requiring the Company to include a deferred carrying charge each month on the excess or deficiency in the reserve. The Company's requested grossed-up rate of return on rate base in this proceeding is 12.03%, more than 3 times the 3.9% short term interest return assumed for earnings on amounts recovered in excess of actual costs and accumulated in the storm damage reserve fund. In addition, a storm damage reserve fund is unnecessary given the Company's strong financial condition and its ability to draw on its credit facilities at favorable short-term interest rates.

Q. Please summarize your recommendation on the recovery of storm damage costs.

A. I recommend that the Company be allowed to recover the expected storm damage expense quantified at $73.7 million (total Company) by ABS Consulting, or $46.3 million less than the Company's request. To the extent the Commission allows some amount in addition to the $73.7 million, then the Commission should no longer require that such excess amounts be placed into a storm damage reserve fund. Instead, the Commission should require that the Company add a return to the monthly balance in the storm damage reserve account on the accumulated overrecovery amounts at the Company's cost of capital. This will provide ratepayers a return on such overrecovered amounts at the same rate as the Company earns on its rate base investment.

III. GRIDFLORIDA COSTS ARE UNCERTAIN AND NOT KNOWN AND MEASURABLE FOR TEST YEAR

Q. Please describe the Company's request for recovery of GridFlorida RTO costs.

A. The Company's filing includes $104 million for GridFlorida costs in the test year. This amount consists of $59.0 (total Company) million projected for 2006 and supported by FPL witness Mr. Mennes and another $45.0 million (total Company) imputed to the test year to reflect the average annual effect of projected increases from 2007 through 2010, which is supported by FPL witness Mr. Davis.

Q. Are the implementation and operational dates of GridFlorida RTO currently known?

A. No. These dates are not known at this time because they are dependent upon approvals from state and federal regulators, according to the Company's response to Staff 1-29.

Q. Are the costs that will be incurred by the Company for GridFlorida RTO and the timing of when those costs will be incurred currently known?

A. No. The total amount that will be incurred and the timing of those costs are presently unknown. The total amount of the GridFlorida start-up costs that will be incurred by FPL is dependent upon two major factors, the actual start-up costs and the actual GridFlorida membership, according to the Company's response to Staff 1-30. Neither of these factors is presently known. Nor does the Company know when it will incur this unknown level of costs. The total amount of the GridFlorida operating costs and their timing also is unknown for the same reasons. The Company's filing reflects start-up and operating costs quantified by Accenture Group in 2002, which it has adjusted to account for inflation and the delays in implementation, according to the testimony of Mr. Mennes and the Company's response to Staff 1-30. Since then, other estimates have been prepared by ICF Consulting for the GridFlorida cost-benefit analysis, according to the Company's response to Staff 1-32. I have replicated the Company's response to Staff 1-30 as my Exhibit___(LK-2) and its response to Staff 1-32 as my Exhibit___(LK-3).

Q. Do the GridFlorida costs included by the Company in its filing reflect all

costs and revenues associated with the implementation and operation of the GridFlorida RTO?

A. No. The Company has not included all potential costs, according to its response to Staff 1-37, nor has it included any Day 1 or Day 2 incremental revenues, investment efficiencies, or operational efficiencies from the operation and use of its transmission system pursuant to the GridFlorida RTO OATT or considered in the ICF Consulting cost-benefit analysis, which quantified nearly $1 billion in statewide benefits through 2016. I have replicated the Company's response to Staff 1-37 as my Exhibit___(LK-4).

Q. **Should the Commission include either the $59.0 million projected by the Company for 2006 or the additional $45.0 million estimated annual average projected post-test year through 2010 in the base revenue requirement?**

A. No. No portion of the $104.0 million is known and measurable. It is not certain if any amount actually will be incurred in the test year, according to the Company's discovery admission. Further, the Company's filing does not include all costs, incremental revenues, investment efficiencies, or operational efficiencies associated with the operation and use of its transmission system pursuant to the GridFlorida RTO OATT or those addressed in the ICF Consulting cost-benefit analysis.

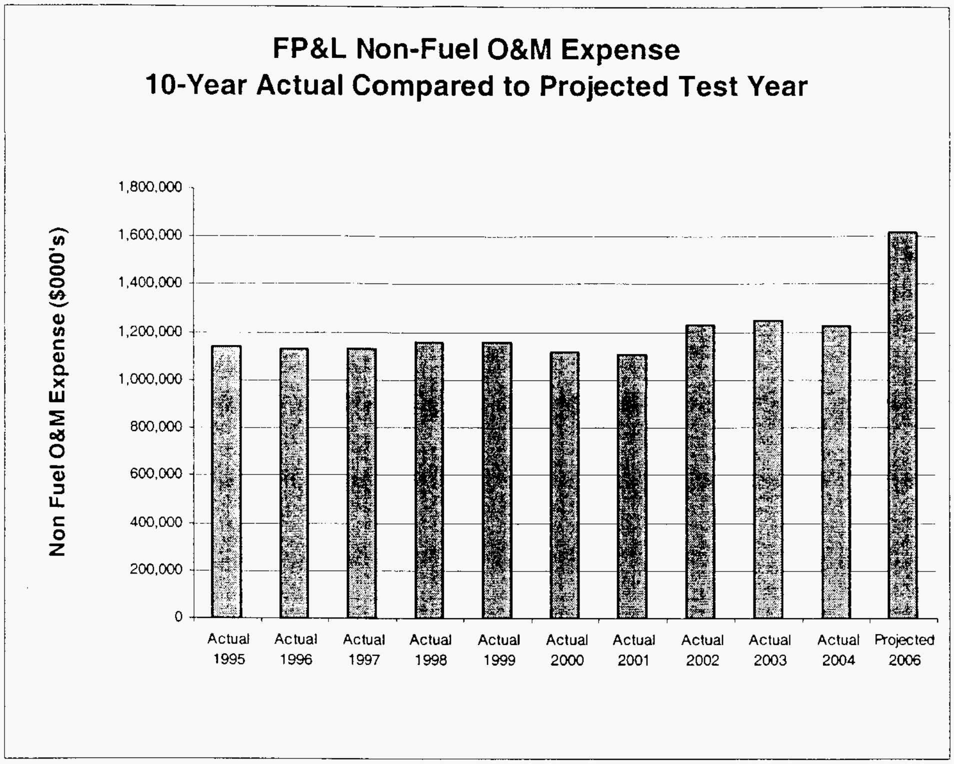
In addition to the preceding reasons, the Commission should reject the $45 million because it represents an average of costs that the Company projects will be incurred post-test year from 2007 through 2010. The $45.0 million component is even more unreasonable than the $59.0 million component of the Company's proposed GridFlorida costs. The Company's proposal violates the sanctity of the test year and creates a mismatch in the measurement of the revenue and cost components comprising the revenue requirement.

The Company's proposed post-test year adjustment is a classic example of a single-issue selective ratemaking adjustment that fails to consider other components of the revenue requirement in those years. If the Company's adjustment is acceptable, then it would be equally equitable to project the increase in revenues due to customer growth for the years 2007 through 2010 and to selectively impute the average annual incremental revenues into the 2006 test year. Similarly, if the Company's adjustment is acceptable, then it would be equally equitable to compute the projected reduction in rate base due to depreciation expense for the years 2007 through 2010 and to selectively impute the average effect on accumulated depreciation into the 2006 test year. These two additional post-test year adjustments alone would reduce the revenue requirement more than the $45 million post-test year adjustment proposed by the Company for the same four year post-test year period.

IV. O&M EXPENSE SHOULD BE REDUCED TO REFLECT PRODUCTIVITY IMPROVEMENTS

Q. Has the Company been successful at controlling its O&M expense over the last ten years?

A. Yes. The Company has addressed this issue at considerable length through various witnesses in their functional areas of responsibility. The following chart provides a ten-year history of the Company's actual O&M expense from 1995 through 2004 compared to its projected O&M expense for the test year. The chart demonstrates that the Company has been successful at controlling its O&M expense with virtually no growth, except in 2002.

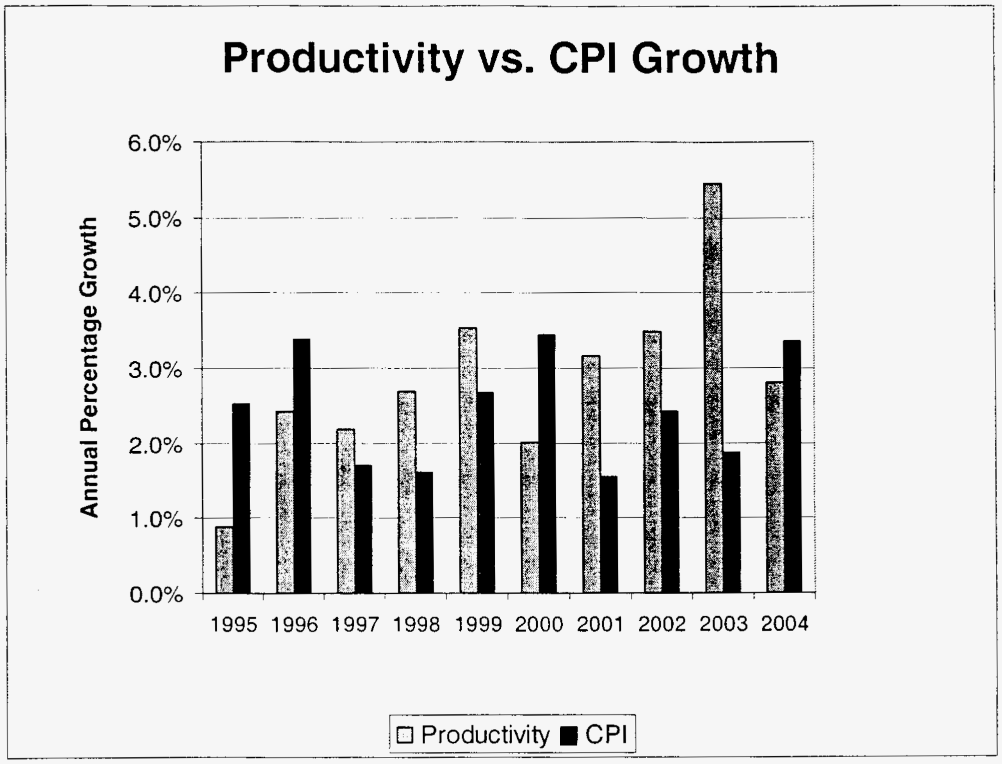


Q. What conclusions can be drawn from this chart?

A. First, the Company has been successful in controlling its actual O&M expense over the last ten years, except for the significant increase which occurred in 2002, and of which $35.0 million was a one-time expense to increase the storm damage reserve fund. Second, the Company allows its O&M expense to increase substantially coincident with rate filings and the use of projected test years in those filings. The 2002 increase coincided with the Company's filing in Docket No. 001148-EI, which was based on a 2002 test year. The huge increase projected for 2006 also coincides with a base rate filing. The increase projected for the 2006 test year compared to actual 2004 levels is nearly 33%, a huge increase by comparison even to the increase in 2002. Given this historic pattern and the inherent ratemaking incentive to project excessive cost levels, the Commission should view the requested increase in test year O&M expense with a high degree of skepticism in considering whether the Company's projections are prudent and reasonable.

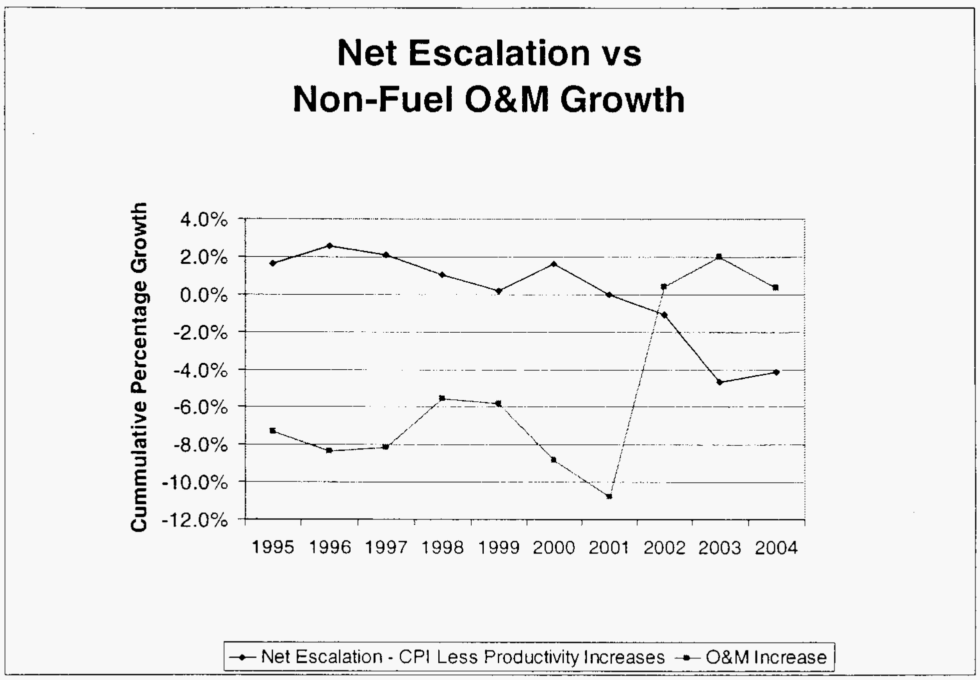
Q. During the ten-year historical period, what was the relationship between annual growth in inflation and offsetting growth in productivity?

A. In most years, productivity growth was greater than inflation growth, thus contributing to a net reduction in costs for businesses nationwide. The following chart portrays the annual changes in productivity and inflation for the last ten years.



Q. **Does the Company's historical growth in O&M expense, except for the increase in 2002, parallel the inflation rate less growth in productivity on a national basis?**

A. Yes. There was significant growth in productivity nationwide over the last ten years, which mitigated the growth in inflation. The Company's O&M expense followed a similar pattern whereby inflation was almost entirely offset by improvements in productivity. The Company was able to improve its productivity during the historical ten-year period through various means, including investment in technology. In general, the Company was able to limit the growth in its O&M expense to less than inflation adjusted downward for the growth in productivity (measured on a national basis), with the exception of the increase in 2002. The following chart portrays this correlation.



Q. Were the Company's improvements in productivity reflected in the number of employees?

A. Yes. Productivity is a measurement of output per employee. Despite significant customer and sales growth, the Company has reduced the number of employees over the ten-year historical period from 11,396 to 10,000, or an average of 140 positions per year, according to the Company's response to OPC 1-113.

Q. Does the Company's O&M expense projection for the test year explicitly recognize a continuation of its historic productivity improvements as measured by the number of employees?

A. No. The Company has reflected an increase in the number of employees to 10,558 in the test year compared to 10,000 actual in 2004, which reflected staffing levels necessary to meet the unusual storm requirements. It has reflected inflation growth in O&M expense, but no explicit offset to that growth for productivity improvement.

Q. Is the Company's O&M expense for the test year excessive given that there is no explicit recognition of continued productivity improvement?

A. Yes. The Company's O&M expense is excessive by $61.159 million (total Company), computed as the number of excess employees (838) times the all-in cost per employee ($91,228, according to Schedule C-35) times the O&M payroll expense ratio (80%). If the Company had properly reflected a continuation of the historic growth in productivity as measured by the number of employees, then it should have included 9,720 employees in the test year, a reduction of 140 employees per year on average compared to 2004 levels.

Q. Should the Commission disallow this amount included by the Company in projected test year O&M expense as unreasonable?

A. Yes. The Commission should view the requested increase with a high degree of skepticism given the Company's actual experience and the national experience in net cost escalation. The Commission should consider the Company's ten years of history in controlling O&M expenses by implementing productivity improvements and reducing the number of employees. There is no reason why the Company cannot continue this decade-long pattern of productivity improvement given the appropriate ratemaking incentives to do so, i.e., providing a target level for the Company to achieve consistent with its history of achievement. I should note that the Company has not expended the projected O&M expense amounts; they remain projections based on assumptions unless and until the expenses are actually incurred. If the Commission establishes the base revenue requirement based on an appropriate O&M expense level, then it will be incumbent upon the Company to achieve it.

V. COMPANY'S PROPOSED RETURN ON EQUITY PERFORMANCE INCENTIVE SHOULD BE REJECTED

Q. Please describe the Company's request for a return on equity performance incentive.

A. The Company's filing includes a 50 basis point increase in the requested return on common equity from 11.80% to 12.30%. The Company's request for this 50 basis point increase in the return on equity comprises $50.211 million (jurisdictional) of the requested base rate increase.

Q. Is Mr. Dewhurst correct that "traditional cost-of-service based regulation has a shortcoming in that it fails to provide incentives for utilities to achieve more efficient levels of service over a long period of time?"

A. No. This statement is incorrect and directly at odds with this Commission's and the Company's own experience, the very experience that is touted by many of its witnesses in this proceeding. In general, traditional cost-of-service based regulation provides incentives for utilities to achieve efficient levels of service over a long period of time by allowing the utility to retain excess earnings between rate cases. More specifically, the Commission has allowed FP&L to retain all of the earnings from the savings it achieved from 1988 through 1998 and then a portion of the savings through the operation of two successive revenue sharing plans from 1999 through 2004. The Company has earned higher returns as the result of the incentive to reduce and control O&M expense between base rate proceedings.

Q. **Does the Company's successful achievement of savings support the Company's argument that an incentive rate of return must be provided in order to achieve such savings?**

A. No. The Company's experience is directly contrary to this proposition. In the Company's experience, traditional cost-of-service regulation has been effective because the Company was allowed to retain excess earnings in the absence of a base rate case. According to Mr. Dewhurst's testimony in this proceeding, "FPL achieved unprecedented reductions in operating expenses during the decade of the 1990s." It achieved those savings with no ROE performance incentive. Also according to Mr. Dewhurst's testimony, "After a decade of steady reductions, costs have grown only modestly over the last few years despite the increased costs of nuclear maintenance, healthcare, and insurance." It also achieved those savings with no ROE performance incentive.

As I noted previously, the Company's actual costs demonstrate its historical success in achieving O&M expense savings with no ROE performance incentives provided through the ratemaking process. Between rate cases, the Company has demonstrated its ability to restrain cost growth because of the ability to retain the earnings benefit for its shareholder was a powerful and sufficient incentive to do so. Only in conjunction with the filing of rate cases has the Company allowed its O&M expense to increase by any significant amounts over the last ten years. This pattern of reductions or no increases between rate cases, and substantial increases in conjunction with the filing of rate cases, demonstrates that there already exists a dual incentive system that is the direct result of the ratemaking process. Thus, it is clearly unnecessary to overlay yet another incentive system in the form of an increased ROE, particularly one that is inherently gratuitous.

Q. Mr. Dewhurst states that one of the two purposes of the Company's proposed ROE performance incentive "is to recognize FPL's past superior performance." Is this an appropriate ratemaking objective?

A. No. The Company's request is the quintessence of improper retroactive ratemaking given this stated purpose. The Commission cannot and should not modify lawful rates that were in effect in prior years by including a surcharge on prospective rates through an incentive rate of return. The Company already has been handsomely rewarded by its retention of achieved savings in those prior years.

Q. Mr. Dewhurst states that the second of the two purposes of the Company's proposed ROE performance incentive is "to encourage continued strong operational performance over the long-term." Has the Company provided any logical or empirical support for this proposition, i.e., that an additional 50 basis points on the return on equity will motivate Company management to achieve strong operational performance?

A. No. There is no demonstrated nexus between the proposed ROE performance incentive and the future achievement of strong operational performance. To the contrary, such a reward is gratuitous if it is not contingent upon the prospective achievement of specific performance improvements that benefit ratepayers and that are based on quantifiable metrics rather than generalized claims.

Instead of a reward for achieved performance, an ROE performance reward will provide a reward for success in achieving a higher allowed rate of return, and thus, higher revenues, through the ratemaking process. This is not the type of incentive that benefits ratepayers and should not be adopted or encouraged by the Commission.

VI. RETURN ON COMMON EQUITY RECOMMENDED BY HOSPITALS WILL RESULT IN REDUCTION TO BASE REVENUE REQUIREMENT

Q. Have you quantified the effect on the Company's base revenue requirement of the Hospitals' witness Mr. Baudino's recommended return on common equity?

A. Yes. The return on equity recommended by Mr. Baudino will result in a reduction in the Company's requested base revenue requirement of $311.311 million (jurisdictional). This amount represents the difference between the Company's request for an 11.80% return, excluding the Company's proposed 50 basis points ROE performance incentive reward, and the 8.70% return recommended by Mr. Baudino. I have quantified the effect of the requested 50 basis point ROE performance incentive separately. My computations are detailed on my Exhibit___(LK-5).

VI. CAPITAL STRUCTURE SHOULD BE SET AT REASONABLE LEVEL TO REFLECT FPL AS STANDALONE UTILITY

Q. **Please describe the capital structure reflected in the Company's filing.**

A. The Company's capital structure, reflecting the projected short term debt, long term debt and common equity outstanding for the test year, but excluding other components incorporated in the cost of capital computation for ratemaking purposes, is as follows, according to Company witness Dr. Avera:

Component	Jurisdictional Company Adjusted Balances	Capital Ratios
Long Term Debt	3,751,548	37.47%
Common Equity	6,200,049	61.92%
Short Term Debt	61,631	0.61%
Total	10,013,228	100.00%

Q. **Mr. Dewhurst and Dr. Avera argue that the requested ratemaking common equity ratio of 61.92% is reasonable because it is equivalent to a common equity ratio of 55.83% on a Standard & Poor's bond rating basis, which reflects imputed debt due to purchased power agreements. Please**

respond.

A. First, the Company's requested common equity ratio for establishing the revenue requirement is 61.92%, not 55.83%, according to Schedule D-1a, once the nonfinancing components are of the ratemaking capitalization are removed. I have replicated this Schedule and shown the computations for the financing components of capitalization as my Exhibit___(LK-6). These computations result in the financing capital structure shown on page 61 of Dr. Avera's testimony.

Second, a common equity ratio of 61.92% for ratemaking purposes is wildly excessive for a standalone utility with a single A utility bond rating and with a business profile of 4, which Standard & Poor's ("S&P") has assigned FP&L. Even a 55.83% common equity ratio, adjusted to reflect the Company's purchased power obligations is above the high end of the range for a single A utility bond rating by S&P and with a business profile of 4, assuming the utility is evaluated on a standalone basis, which FPL is not. The S&P equity range for a single A utility bond rating with a business profile of 4 is 48%-55%. Thus, a reasonable level for the common equity ratio of a single A utility could be as low as 48%, adjusted to include the effects of purchased power contracts as debt. I have replicated a copy of the S&P Corporate Ratings Criteria dated October 28, 2004, as my Exhibit___(LK-7).

Third, an excessive FPL common equity capital ratio will force ratepayers to subsidize FPL Group's unregulated affiliate activities, which are grouped into the FPL Group Capital affiliate. FPL Group could not maintain a single A bond rating on a corporate-wide basis without an excessive FPL common equity ratio because FPL Group Capital is extremely highly leveraged. In a recent report, S&P confirmed that its single A rating for FPL was based on the consolidated credit profile of FPL Group, which includes both FPL and FPL Group Capital. FPL Group Capital owns FPL Energy. In that report, S&P confirmed that the FPL Group credit profile reflected the financial strength of FPL against the financial weakness and increased risk of FPL Energy. In that April 1, 2005 Ratings Direct Report on FPL, S&P explained its rationale for the single A bond rating for FPL as follows:

> **The ratings on Florida Power & Light Co (FP&L) reflect the consolidated credit profile of its parent, diversified energy company FPL Group, Inc. The consolidated rating on FPL Group reflects the strength of FPL's stable cash flows. FP&L, which is an integrated electric utility in Florida, contributes about 80% of the consolidated cash flow and has a above average business profile relative to its integrated electric peers. Concerns include the higher-risk cash flows from FPL Energy's portfolio of merchant**

generation, the utility's increased exposure to natural gas, uncertainty regarding pending regulatory proceedings, and the consolidated company's slightly weak financial profile for the rating.

Q. **How do the capital structures of FPL, FPL Group Capital, and FPL Group on a consolidated basis compare to each other?**

A. To achieve an acceptable common equity ratio for FPL Group on a consolidated basis for financial statement and rating purposes, FPL Group has used the excessive FPL common equity ratio to balance the minimal FPL Group Capital common equity ratio. At December 31, 2004, FPL Group on a consolidated basis had a 43.6% common equity ratio, FPL had a 61.6% common equity ratio, and FPL Group Capital had a 20.4% common equity ratio. The FPL Group and the FPL Group Capital common equity ratios were both well below the level required for a single A rating for a standalone utility. I obtained this information from Schedule D-2 of the Company's MFR filing in this proceeding.

Q. **Should FPL ratepayers subsidize the FPL Group Capital unregulated activities through an excessive common equity ratio for ratemaking purposes?**

A. No. The Commission should consider FPL on a standalone regulated utility basis. On a standalone basis, the FPL common equity ratio should be set within the range for a single A utility pursuant to the S&P guidelines. It is inappropriate for Florida ratepayers to subsidize the unregulated operations of FPL Group Capital in other states through an excessive revenue requirement based on an excessive common equity ratio.

Q. What is your recommendation for a reasonable FPL standalone capital structure?

A. I recommend that the Commission use the midpoint of the S&P range for a single A utility, with the capital structure reflecting the imputed value of the purchased power agreements as an increase in debt. The capital structure for ratemaking purposes would then be computed by removing the imputed value of the purchased power agreements from debt and including the nonfinancing capital structure components. On an adjusted S&P basis, the common equity ratio would be limited to no more than 51.5%, with total short and long term debt comprising the residual 48.5%. On a ratemaking basis, the common equity ratio would be set at 46.08%, long-term debt at 34.05%, and short-term debt at 0.55%, after consideration of the nonfinancing components. The computations of these capital ratios is detailed on my Exhibit___(LK-6).

Q. **Have you quantified the revenue requirement effect of your recommendation for a reasonable FPL standalone capital structure?**

A. Yes. The use of a reasonable capital structure for the Company will reduce test year revenue requirements by $39.3 million, using the Hospitals' return on common equity. The computations are detailed on my Exhibit___(LK-5).

VII. ADDITIONAL RATE INCREASE FOR TURKEY POINT 5 SHOULD BE REJECTED

Q. **The Company has proposed an additional increase based upon a projected revenue requirement for Turkey Point 5 for the twelve months ending May 31, 2008 compared to a projected revenue requirement for 2007. Should the Commission grant this request?**

A. No. First, this is nothing less than a selective post-test year adjustment packaged within the context of additional test years. The Commission should reject this approach as a matter of principle. If the Company concludes it will have a revenue deficiency in either 2007 or the twelve months ending May 31, 2008 absent an additional rate increase, then it should be required to file for that increase in 2006 or 2007, not simply be awarded that additional increase on the basis of a an additional projected revenue requirement after the 2006 test year.

Second, the projected data for a 2007 test year or the twelve months ending May 31, 2008 test year are even more speculative than the projected data for the 2006 test year. The Company prepared its 2005 budget and the 2006 – 2008 forecasts based on actual information only through mid-year 2004. Thus, the projected amounts for the twelve months ending May 31, 2008 are nearly four years beyond the historic data relied on in the budgeting and forecasting process.

Third, the projected data for a 2007 test year or the twelve months ending May 31, 2008 fail to consider the effects of the Commission's decisions on the various issues related to the 2006 test year and the Company's real-world responses to those decisions. For example, if the Commission determines that the Company's requested O&M expense is excessive in the 2006 test year and the Company responds by reducing its O&M expense, then that benefit also would be achieved in 2007 and the twelve months ending May 31, 2008, thus reducing the revenue requirement in those two periods.

Fourth, if the Commission adopts this selective post-test year adjustment in this proceeding, as a matter of principle, there is nothing that will preclude the Company or another utility in the future from proposing not only two rate increases based on three different test years, but proposing four increases or five increases based on three or four different test years.

Q. Does this complete your testimony?

A. Yes.

DIRECT TESTIMONY OF KATHY L. WELCH

Q. Please state your name and business address.

A. My name is Kathy L. Welch and my business address is 3625 N.W. 82nd Ave., Suite 400, Miami, Florida, 33166.

Q. By whom are you presently employed and in what capacity?

A. I am employed by the Florida Public Service Commission as a Public Utilities Supervisor in the Division of Regulatory Compliance and Consumer Assistance.

Q. How long have you been employed by the Commission?

A. I have been employed by the Florida Public Service Commission since June, 1979.

Q. Briefly review your educational and professional background.

A. I have a Bachelor of Business Administration degree with a major in accounting from Florida Atlantic University and a Masters of Adult Education and Human Resource Development from Florida International University. I have a Certified Public Manager certificate from Florida State University. I am also a Certified Public Accountant licensed in the State of Florida, and I am a member of the American and Florida Institutes of Certified Public Accountants. I was hired as a Public Utilities Analyst I by the Florida Public Service Commission in June of 1979. I was promoted to Public Utilities Supervisor on June 1, 2001.

Q. Please describe your current responsibilities.

A. Currently, I am a Public Utilities Supervisor with the responsibilities of administering the Commission's Miami District Office and reviewing work load and allocating resources to complete field work and issue audit reports when due. I also supervise, plan, and conduct utility audits of manual and automated accounting systems for historical and forecasted financial statements and exhibits.

Q. Have you presented expert testimony before this Commission or any other regulatory agency?

A. Yes. I have testified in several cases before the Florida Public Service Commission. Exhibit KLW-1 lists these cases.

Q. What is the purpose of your testimony today?

A. The purpose of my testimony is to sponsor the staff audit report of Florida Power & Light Company (Company) which addresses the Company's petition for rate increase, Audit Control Number 05-094-4-1. This audit report is filed with my testimony and is identified as Exhibit KLW-2. I am also sponsoring the supplemental audit report which addresses the management fee and affiliate transactions. This audit report is filed with my testimony and is identified as Exhibit KLW-3.

Q. Did you prepare or cause to be prepared under your supervision, direction, and control these audit reports?

A. Yes, I was the supervisor in charge of these audits.

Q. Please describe the work performed in the initial audit (KLW-2).

A. For rate base, we selected major additions and construction projects and traced them to contracts, change orders, payments, and bidding procedures. We reviewed a sample of retirements and overhead calculations and examined entries for Allowance for Funds Used During Construction (AFUDC). We examined accumulated depreciation and traced selected accounts to the depreciation computation and to the rates previously ordered by the Commission. We also obtained a list of Property Held for Future Use projects and randomly sampled and traced each project to the closing settlement statements and other related documents. For working capital, we reconciled accounts to the general ledger and reviewed all adjustments, and we reviewed selected accounts for affiliate activity. We reconciled rate base adjustments to supporting documentation and traced each adjustment to the general ledger.

For operating income, we compiled revenues and verified the company calculation of unbilled revenues. We extracted a sample of expenses and agreed the expenses selected to source documentation. We also examined depreciation and selected random entries in the depreciation schedule to verify the calculation and traced the depreciation rates to the Commission's prior depreciation order. We also compiled taxes, selected payments, and traced some property tax amounts to invoices. We obtained a reconciliation schedule of total paid property and real estate taxes to amounts on the MFR filing and reconciled the Regulatory Assessment Fee and Gross Receipts tax amounts in the filing to the returns. We also compiled income taxes. We reconciled Net Operating Income Tax Adjustments to supporting documentation and traced each adjustment to the general ledger.

For cost of capital, we reconciled all components to the books and compared long-term debt issuances and preferred stock issuances to authorized documents. We recalculated cost rates, obtained a reconciliation of rate base to capital structure and determined that non-utility assets were removed, and traced all company adjustments to schedules and explanations.

Q. Please review the audit exceptions in the initial audit report.

A. Audit Exceptions disclose substantial non-compliance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA), a Commission rule or order, or formal company policy. Audit Exceptions also disclose company exhibits that do not represent company books and records and company failure to provide underlying records or documentation to support the general ledger or exhibits.

Audit Exception No. 1

Audit Exception No. 1 discusses rate base adjustments included in the environmental cost recovery clause. In reviewing the 2004 adjustments to rate base, we determined that FPL did not remove the construction work in progress (CWIP) that FPL is recovering through the environmental clause. There are two projects that are included in the environmental cost recovery clause. According to the environmental cost recovery clause filing, the 13-month average CWIP for the Manatee Reburn No. 24 project was $5,621,823.85 for 2004. The 13-month average CWIP for the Port Everglades ESP No. 25 is $6,605,703.23. The total CWIP included in the environmental clause is $12,227,527.08. This amount should be removed from CWIP in the 2004 rate base in the MFR filing for the historical year. If the environmental projects are still included in construction work in progress projected in 2006, they need to be removed.

In addition, the company removed all projects from CWIP that accrued an allowance for funds used during construction (AFUDC). FPL excluded $4,600,000 each month from AFUDC eligible CWIP projects it claimed were already in base rates. This adjustment leaves a 13-month average effect of $4,600,000 in rate base for CWIP projects that would normally be excluded because they qualify for AFUDC. The reason the company made the adjustment was because it included $4,648,000 of construction projects in its last rate filing in 2001 (Docket No. 001148-EI, Review of the retail rates of Florida Power & Light Company.) The settlement agreement approved in that docket allowed the company to keep construction work in progress in rate base, thus the construction projects are already in base rates. When the company calculates the allowance for funds used during construction, it removes this amount of CWIP before calculating the AFUDC. The adjustment for the $4,600,000 increases rate base for CWIP projects that would normally not be included because they are eligible for AFUDC. This adjustment was also made in FPL's MFRs filed in this docket for 2004 and 2005.

Audit Exception No. 2

Audit Exception No. 2 discusses the allocation of common costs. In reviewing the sample of expenses, we found expenses that relate to all affiliates that should have been charged to a budget activity code so that they could be allocated among all affected affiliates through the management fee (the management fee is recorded as a contra expense account to remove costs that relate to affiliated companies.) We identified $2,464,330.68 of costs charged to the human resource division that appear to be costs that benefit the affiliate companies. Therefore, we allocated these costs based on the headcount percent used in the revised management fee for 2004. This results in $416,471.88 that should be removed from the 2004 surveillance report and historical test year.

Q. Please review the audit disclosures in the initial audit report.

A. Audit disclosures disclose material facts that are outside the definition of an Audit Exception.

Audit Disclosure No. 1

Audit Disclosure No. 1 discusses adjustments to the working capital allowance. FPL has included two adjustments to remove working capital accounts that were not adjusted in its last rate case. First, the company has removed all assets and liabilities related to the asset retirement obligation related to Statement of Financial Accounting Standards (SFAS) 143. The net effect on rate base is zero. Rule 25-14.014 Florida Administrative Code (F.A.C.) requires the company to record the effects of SFAS as revenue neutral. Since the accounts have a zero balance, the company has complied with the rule. The second new adjustment removes $1,926,000 of Design Basis Threat deferred security costs from working capital.

Audit Disclosure No. 2

Audit Disclosure No. 2 discusses material and supply write offs. The MFR historical test year schedules included write-offs in 2004 of materials and supplies (M&S) for items no longer used. These write offs include:

- $115,397.52 in January, 2004 (Account 506.960 - Misc. Steam Power Expense) for a write off of a Bi-Metal Repair Kit that is no longer required at FPL's Martin generating plant.
- $78,370.16 and $69,427.88, totaling $147,798.04 in December, 2004 (Account 562.160 - Station Expenses-Transmission) for transmission bushings and switches.

Audit Disclosure No. 3

Audit Disclosure No. 3 discusses cancelled work orders. The company charges cancelled work orders to Account 584.650, Underground Line Expense Distribution-Cancelled Work Orders. A total of $369,395.07 was expensed in this account in 2004. In the sample we selected, there were several work orders that were cancelled but later re-opened. No credits were taken out of the account for the re-opened work orders. The company is planning to correct this error.

Audit Disclosure No. 4

Audit Disclosure No. 4 discusses storm related costs included in the historical test year 2004. Account 590, Maintenance Supervision and Engineering Distribution, includes four entries that were transferred from the storm accrual because the internal auditors considered them "image enhancing." These costs were included in the expenses in the 2004 MFR filing. The entries totaled $3,180,806.10. The invoices removed related to valet charges, flower purchases, storm appreciation parties, storm appreciation t-shirts and caps, storm tents for hurricane Ivan, and image enhancing ads after Hurricane Jeanne.

Also in Account 590, the company created a reserve for possible disallowances by the Public Service Commission in FPL's storm cost recovery docket (Docket No. 041291-EI, <u>In re: Petition for authority to recover prudently incurred storm restoration costs related to 2004 storm season that exceed storm reserve balance, by Florida Power & Light Company</u>.) The company originally estimated the disallowances at $22,000,000 and then reduced it by $6,600,000 to $15,400,000.

The company expensed an additional $189,968.26 in the same account in 2004 for Florida Power and Light-Energy (FPLE) storm loadings. The total amount billed by FPLE was at the regular inter-company billing rate for FPLE (payroll and payroll and loading). However, FPL loaded its own payroll for only pension, welfare, taxes, and insurance in determining the amount to charge to the storm reserve. To be consistent, FPL loaded the storm work orders for FPLE payroll only for pension, welfare, taxes, and insurance. This reduced the amount charged to the storm work orders. The difference between the pension, welfare, taxes and insurance, and the normal FPLE payroll loading rate was charged to the 590 expense account along with other costs FPL did not include in its request for storm cost recovery. By doing so, FPL charged a consistent loading rate to the storm work orders for the FPLE payroll and did not penalize FPLE for its participation in the storm restoration effort.

Audit Disclosure No. 5

Audit Disclosure No. 5 discusses affiliate transactions. We found several expenses that appeared to need to be allocated to affiliates. The company response was that these expenses are charged as part of its rent fee to affiliates. This issue is discussed in more detail in the supplemental audit.

Audit Disclosure No. 6

Audit Disclosure No. 6 discusses pension expense. The majority of Account 926, Employee Pension and Benefits, in 2004 relates to expenses from the actuarial studies for pension, Supplemental Executive Retirement Plan (SERP), SFAS 106, and medical and dental expenses. The company allocated the pension accrual, which was a negative (credit) balance, differently than the actuarial study by Towers Perrin. The actuarial study allocated the cost to the utility and the affiliates based on headcount. The company allocated the cost based on payroll dollars. If FPL charged the pension fee by headcount, Account 926 would be reduced by $3,489,424.28.

In Account 926.500, we found a charge of $105,428 in November that included affiliate charges of $11,000. Account 926.600 had a charge in February 2004 for $1,706,754 for a settlement with Ernst and Young for a non-recurring project (BVA 17) that related to all affiliate companies and was not allocated through the management fee.

Audit Disclosure No. 7

Audit Disclosure No. 7 discusses rate case expense. In Account 928, Regulatory Commission Expense, in 2004, the company has included rate case expenses. The company responded that it removes and adjusts these in 2005. When the rate case expense is approved, these expenses need to be removed from 2004 expenses and allocated to a deferred account.

Audit Disclosure No. 8

Audit Disclosure No. 8 discusses membership dues. In Account 930.260, Miscellaneous General Expense, in 2004, the company included both the 2003 and the 2004 dues paid to the EPRI for the Nuclear Energy Institute assessment. The dues were $240,000 each year.

Audit Disclosure No. 9

Audit Disclosure No. 9 discusses expenses related to Grid Florida. Account 930.200, Miscellaneous General Expense, for 2004 includes $650,000 for a reserve for the collectibility of notes receivable for Grid Florida.

Audit Disclosure No. 10

Audit Disclosure No. 10 discusses a reserve for mitigation costs. Included in Account 907, Supervision-Customer Service, in 2004, is a $1,000,000 charge to set up a reserve for inadequate installations by a contractor that is now out of business related to the conservation multi-family insulation program. This is the estimate of the cost of mitigation.

Audit Disclosure No. 11

Audit Disclosure No. 11 discusses Outside Services. Our audit found certain legal costs that are allocated between FPL and an affiliate. The company has requested confidential classification of this disclosure. More details regarding this disclosure can be found in the confidential version of Exhibit KLW-2.

Audit Disclosure No. 12

Audit Disclosure No. 12 discusses liaison expenses. FPL did not remove liaison expenses in its Net Operating Income adjustments in 2004. The liaison expenses have been removed from the Surveillance Reports in the Net Operating Income adjustments prior to 2002. After 2002, Staff Advisory Bulletin 35, which required FPL to remove these expenses, was discontinued along with all staff advisory bulletins. The work order that contained the charges for the Tallahassee office totals $503,819.59 for 2004. The company does not remove this amount in the rate case because it doesn't believe liaison expenses should be considered lobbying. According to a company response, "The instruction to Account 426.4 expenditures for certain civic, political and related activities, 18 CFR, Part 101 Uniform System of Accounts (SofA) states in part '... but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.' FPL's liaison expenses fall within this exception. FPL is not aware of any FPSC order or rule which supersedes the instruction for Account 426.5 in the SofA with respect to liaison expenses."

Audit Disclosure No. 13

Audit Disclosure No. 13 discusses charitable expenses. The company included cash vouchers for charitable expense in Work Order 9934 for the Manatee Combined Cycle Project. The total charitable expense charged to the work order was $27,650. These amounts were included in Construction Work in Progress for 2004.

Audit Disclosure No. 14

Audit Disclosure No. 14 discusses accounts receivable for retiree medical reimbursement. Included in the rate case filing as part of the working capital computation, the company shows a 13-month average for Account 143.126 of $8,641,542 for Retiree Medical Reimbursements. Cigna is FPL's insurance agent that pays for FPL's self insurance plan for medical reimbursement. FPL pays Cigna on a weekly basis. The company closes at the end of the year what was paid to expense and allocates approximately 10% to non-regulated affiliates. However, the affiliate amounts remain in the monthly balances until December and therefore, the 13-month average balance includes amounts for non-regulated affiliates. Nine percent is used in the 2004 management fee for allocation of retiree costs to non-regulated affiliates based on head count. If the 13-month average of $8,641,542 is multiplied by the 9%, then $777,738.78 would have to be removed as non-regulated. The company agrees with this exception, and is taking steps to correct the problem.

Q. Please describe the work performed in the supplemental audit (KLW-3).

A. For the management fee, we reviewed the calculation by the company and verified that costs found in the sample that provided a benefit to FPL's affiliates were included in the fee. For budget activity codes that were not included in the management fee calculation, we tested other costs in the budget activity code. We tested the methodology of the calculation and compared most items to actual costs. For other affiliate costs, we analyzed rent charges to affiliates by reviewing the cost and market rates provided and comparing the methodology to the Commission's affiliate transaction rule, Rule 25-6.1351, F.A.C. We also scanned all intercompany receivables and payables and selected various accounts for testing. We verified the sample items by tracing them to source documentation.

Q. Please review the audit exceptions in the supplemental audit report.

A. **<u>Audit Exception No. 1</u>**

Audit Exception No. 1 discusses the management fee calculation. FPL allocates some costs directly when invoices or accruals are recorded. In addition, FPL designates common budget activity codes for charges that affect its affiliated companies and allocates these with a credit to expense Account 922. To do this, FPL computes the Massachusetts formula (a methodology that uses three ratios to determine an allocation percentage.) The formula shows that 19.6% of the shared expenses should be allocated to affiliate companies. However, only certain budget activity codes are allocated using this percentage. Some activities only affect certain affiliates. When this is the case, FPL deletes the information used in the Massachusetts formula for that subsidiary and recalculates the percentages for its affiliates. All charges that go through the management fee are paid by FPL and the costs related to the affiliates are backed out. Three problems were found with the calculation. They are as follows:

1. FPL estimates the management fee at the beginning of the year and does a monthly accrual. In October, it annualizes the actual expense and does a true-up of the accrual. It does not true-up for December actual amounts. We were unable to obtain all actual information in the format used in the management fee to determine if the difference between actual and the annualized October amounts was material. The difference was not material for the accounts we were able to test, however, the company should true-up at December.
2. FPL allocated $13,004,046 of General Counsel expense at 12.59%. The supporting documentation showed that $13,773,113 should have been allocated. The difference of $769,067 at 12.59% is $96,825.53.
3. To arrive at the 12.59% that FPL used to allocate costs that do not benefit two affiliate companies, FPLE-OSI or Seabrook-OSI, FPL reduced the 19.6%

arrived at in the Massachusetts formula by 3.16% and 3.85%, respectively. If this is done, the 7.01% (3.16% + 3.85%) not attributed to OSI affiliates is not allocated between FPL and the other affiliates but charged in its entirety to FPL. The method that should have been used is to eliminate the affiliate information totally so that 100% of the costs are appropriately allocated among the divisions they relate to. The revised formula is included in the audit report and shows the proper allocation factor to be 13.27%. Using this method, 86.73% of the costs remain with the regulated utility instead of the 87.41% the company used. The difference amounts to $247,088.58.

Audit Exception No. 2

Audit Exception No. 2 discusses the rent charged to affiliates. FPL charges its affiliates for rent based on market rates. Rule 25-6.1351(3)(b), F.A.C., states that a utility must charge an affiliate the higher of fully allocated costs or market price for all non-tariffed services and products purchased by the affiliate from the utility. However, a utility may charge an affiliate less than fully allocated costs or market price if the charge is above incremental costs.

In response to an audit request, the company indicated the following unaudited market and cost rates for its General Office and its Juno Beach Office. Unless FPL can prove that the charge is above incremental costs, FPL should have charged its affiliates cost for the Juno Beach office.

General Office	Market: $17.50	Cost: $14.47
Juno Beach Office	Market: $20.00	Cost: $24.75

Regarding the General Office, we believe that the market analysis needs to be updated. The General Office is located near the PSC Miami District Office. Approximately four months ago, Department of Management Services (DMS) did a study of average rent prices and determined that the average market rate was $21.50 a square foot ($4 more than the rate used by FPL). Because FPL has security and food service it would probably be at the higher end of the market rates.

The difference in rent using the difference between cost and market rate for the Juno Beach Office and the difference between the DMS rate and the market rate for the General Office results in an increase in rent due from affiliates of $652,552.07.

Audit Exception No. 3

Audit Exception No. 3 discusses budget activity codes that should have been included in the management fee. We reviewed three budget activity groups for this issue.

Budget Activity Code 13397: Audit Exception 2 in the initial audit identified specific vouchers that related to all affiliates, and we made a specific adjustment to allocate these costs. In this supplemental audit, we reviewed these areas in more depth. This budget group includes payroll, cafeteria subsidies, actuarial studies for pension benefits, and other human resource related costs. Two items were identified by the company as being FPL-specific. We removed utility-related costs and the costs that were adjusted in the initial audit. The amount remaining in the budget activity group is $2,057,567.03. If this amount was allocated at 16.9%, using an employee head count, the affiliates would have been allocated $347,728.83.

Budget Activity Code 11737: This budget group contains costs related to recruiting and hiring. According to FPL's review of our sample, the vouchers tested should have been allocated to affiliates. (Seven of the ten employees tested should have been allocated.) The company did not believe accruals and pension and welfare adjustments should have been allocated. The audit report provides the detailed calculation, but based on the company's response, we believe that $116,716.08 should be allocated to the affiliates.

Budget Activity Code 13391: This budget group contains medical expenses that were FPL-specific. When the amounts adjusted in the initial audit and the items in the sample that the company identified as specific to the utility are removed, $899,112.47 remains in this group. Allocating this amount at the 16.9%, using an employee head count, the utility would charge $151,950 to the affiliates.

Q. Does this conclude your testimony?

A. Yes, it does.

Q. Please state your name and business address.

A. (MR. VINSON) My name is Carl S. Vinson, Jr. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida.

(MR. FISHER) My name is Robert "Lynn" Fisher. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida.

Q. By whom are you employed and in what capacity?

A. (MR. VINSON) I am employed by the Florida Public Service Commission as a Public Utilities Supervisor within the Bureau of Regulatory Review, Division of Competitive Markets and Enforcement.

(MR. FISHER) I am employed by the Florida Public Service Commission. I am a Government Analyst II in the Bureau of Regulatory Review, Division of Competitive Markets and Enforcement.

Q. What are your duties and responsibilities?

A. (MR. VINSON) As a Public Utilities Supervisor, I oversee four analysts. They conduct operations audits and complaint investigations of regulated Florida utilities and also participate in docketed proceedings. One of these analysts is Mr. Fisher, who is testifying jointly with me.

(MR. FISHER) As a Government Analyst II, I conduct operations audits and complaint investigations of regulated public utilities within Florida. I also assist in the analysis of issues in docketed proceedings.

Q. Please describe your educational background and professional experience.

A. (MR. VINSON) I received a Bachelors of Business Administration degree in Finance from Stetson University in 1980. I have worked for the Commission for 15 years conducting and supervising operations audits and investigations of regulated electric, telephone, gas, and water companies. Prior to my employment with the Commission, I worked for five years as a

Research Associate with the consulting firm of Ben Johnson and Associates, Inc. in Tallahassee, Florida. Dr. Johnson's firm participates in utility proceedings throughout the country.

(MR. FISHER) I received a Bachelor of Science Degree in Marketing from Florida State University in 1972. I have worked at the Commission since 1989 and have worked in the Bureau of Regulatory Review for the entire time. During my employment, I have been involved in operational audits and complaint investigations of telephone, electric, and gas utilities throughout Florida. Prior to my employment with the Commission, my utility-related experience includes more than ten years in telecommunications sales, sales management, marketing management, and public relations.

Q. Have you previously testified before this or any other utility commission?

A. (MR. VINSON) I have prefiled direct testimony before this Commission in two dockets regarding audits of a telecommunications company. In both cases, the dockets were settled prior to hearing.

(MR. FISHER) No, I have not.

Q. What is the purpose of your direct testimony?

A. The purpose of this joint testimony is to present the results of an audit we conducted regarding Florida Power & Light Company's (FPL's) efforts in the areas of vegetation management, lightning protection, and pole inspection for the period 1999 through 2004.

Q. Do you have any exhibits to your testimony?

A. Yes, Exhibit No. CSV/RLF-1 is the report on our operational audit of Florida Power & Light Company. It is entitled *Preliminary Review of Vegetation Management, Lightning Protection and Pole Inspection at Florida Power & Light Company.*

Q. Please discuss the results of your audit.

A. Based on the focused review of Florida Power & Light Company's functional areas of vegetation management, lightning protection, and pole inspection, we have made the following observations:

Staff's review of FPL's vegetation management reveals that vegetation-related outages increased during the period 2000 through 2003. Though a reduction occurred last year, the number of vegetation-related outages remained above the 1999 outage level in 2004. FPL's vegetation-related SAIDI, CAIDI, and SAIFI measurements all increased during the period. The total number of distribution line miles trimmed by FPL decreased in 2000-2001 and increased during 2002-2004.

Staff's review of FPL lightning protection activities and efforts revealed that lightning-related outages remained generally stable throughout the period, although FPL experienced abnormally high lightning strike activity during 2003 and 2004. Lightning-related SAIDI, CAIDI, and SAIFI measurements also decreased during the period. Staff did not identify any deficiencies in FPL's lightning protection activities and efforts during the review.

Staff's review of FPL's pole inspection activities reveals that FPL may not be completing sufficient numbers of its specific pole inspections throughout its territory to identify the condition of deteriorated poles in a timely manner. Further, staff found that FPL has not procedurally documented a cycle completion period for its specific pole inspections to ensure all distribution poles have been inspected.

Q. Does this conclude your testimony?

A. Yes.

DIRECT TESTIMONY OF SIDNEY W. MATLOCK

Q. Please state your name and business address.

A. My name is Sidney W. Matlock. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida, 32399-0850.

Q. By whom are you employed and in what capacity?

A. I am employed by the Florida Public Service Commission (Commission) as a Regulatory Analyst in the Division of Economic Regulation.

Q. What are your present responsibilities with the Commission?

A. My responsibilities include analysis of utility regulatory filings in the Fuel Cost Recovery docket and other dockets and activities relating to electric distribution reliability and electric meter accuracy.

Q. Please give a brief description of your educational background and professional experience.

A. I graduated from the Florida State University in August of 1975 with a B.S. degree in economics. I was employed by the Florida Department of Commerce (later the Department of Labor and Employment Security) from February of 1976 to February of 1985. I have been employed by the Florida Public Service Commission since February of 1985. In August of 1992, I obtained a B.S. degree in statistics from the Florida State University.

Q. Have you previously testified before the Commission?

A. Yes. I testified in Docket Number 030623-EI, Complaints by Ocean Properties, Ltd., J.C. Penney Corp., Target Stores, Inc., and Dillard's Department Stores, Inc. against Florida Power & Light Company concerning thermal demand meter error.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring Exhibit SWM-1 consisting of one table containing three columns of reliability index data and three line graphs, one for each column.

A. The purpose of my testimony is to present the values of three distribution reliability indexes - System Average Interruption Duration Index (SAIDI), Customer Average Interruption Duration Index (CAIDI), and System Average Interruption Frequency Index (SAIFI) - for the years 1992 through 2004 for Florida Power & Light Company.

Q. Please define each index.

A. SAIDI is the average number of customer minutes of interruption per customer, for the utility system. It is the total customer minutes of interruption divided by the total number of customers served.

CAIDI is the average number of customer minutes of interruption per customer interruption. It is the total customer minutes of interruption divided by the total number of customer interruptions.

SAIFI is the average number of customer interruptions per customer, for the utility system. It is the total customer interruptions divided by the total number of customers served.

Q. What is the importance of these data?

A. These indexes are used as indicators of utility performance in the area of distribution reliability. Changes in the indexes over time are interpreted as indicators that the utility is performing better or worse, depending on the direction of change, than in an earlier period. These data appear in direct testimony of Geisha J. Williams in Docket Number 050045-EI for the years 1998 through 2004. My testimony presents the three series along with the index values for the six years prior to 1998. Therefore, with the additional six years of data provided in my testimony, one may approximate changes in performance since 1992 along with the changes since 1998. These indexes are presented in Exhibit SWM-1.

Q. Do the additional six years of data (1992 through 1997) indicate anything contrary to what one might conclude by examining only the 1998 through 2004 data.

A. Yes. From 1998 through 2004, each of the three performance indicators showed improvements in distribution reliability. The changes over the six-year period are summarized below.

SAIDI – 100.2 minutes in 1998 to 69.7 minutes in 2004.

CAIDI – 64.9 minutes in 1998 to 57.3 minutes in 2004.

SAIFI – 1.54 interruptions in 1998 to 1.22 interruptions in 2004.

As indicated by changes in the three indexes, FPL has shown improvements in performance since 1998, achieving a reduction of 30.5 minutes per customer in its SAIDI, a reduction of 7.6 minutes per customer interruption in its CAIDI, and a reduction of .32 interruptions per customer in its SAIFI.

However, the 1992 through 1997 indexes show an entirely different picture. During the 1992 through 1997 period, FPL experienced a significant decline in reliability - so much so that the Commission found it necessary to call FPL's reliability into question. The changes since 1992 are summarized as follows.

SAIDI – 71.8 minutes in 1992 to 69.7 minutes in 2004.

CAIDI – 56.3 minutes in 1992 to 57.3 minutes in 2004.

SAIFI – 1.28 interruptions in 1992 to 1.22 interruptions in 2004.

Assessing changes in performance since 1992, improvements in SAIDI and SAIFI are much smaller, with decreases of only 2.1 minutes and .06 interruptions, respectively. In addition, CAIDI increased slightly during this period, by one minute.

Q. What are the sources of the reliability indicators you are using in your analysis?

A. The 1992 through 1999 data are taken from the Commission report titled "Review of Electric Service Quality and Reliability at Florida Power Corporation and Florida Power & Light Company", published in November 2000. The data were obtained by making document requests of the company in 1997 and 2000. The 1992 through 1996 data also appeared in a similar Commission report, "Review of Electric Service Quality and Reliability", published in

December 1997.

The 1998 through 2004 data are taken from the Annual Distribution Service Reliability Reports filed by FPL. The two sources overlap for 1998 and 1999.

Q. Did the two reviews that you cited as data sources include any other information pertinent to FPL's reliability performance?

A. Yes. The 1997 review noted that in the period 1992 to 1996, the Commission's Division of Consumer Affairs had experienced a sharp increase in service-related inquiries and complaints from FPL customers, after a period of declining or stable numbers of inquiries from 1985 to 1991. The 2000 review noted that in the previous three years, FPL had taken steps to reverse the previous downward reliability trend. This review noted a marked decrease in the number of service-related customer complaints since 1996 as well as improvements in the three indexes, and it concluded that FPL had begun a reversal of its previous downward trend in electric service quality and reliability.

Thus, when looking at the full period, 1992 through 2004, along with observations appearing in Commission publications, one can see that FPL has basically returned to its 1992 reliability level. This return was preceded by several years of decline during which regulatory pressure was brought to bear to encourage the utility to improve its performance.

Q. During the years 1992 through 2004, were any changes made to the method of calculating reliability indexes that could have affected the comparability of the data before and after the change was initiated?

A. Yes. An audit of the 2002 Annual Distribution Service Reliability Reports revealed that some electric utilities, including FPL, used monthly average numbers of customers served, or annual averages, to calculate the annual system indexes, SAIDI and SAIFI. Beginning in 2003, the utilities agreed to calculate the indexes using the year-end number of customers rather than the monthly average number of customers. For FPL, the number of customers served in December, in the years 1998 through 2004, was around one percent greater than the average of the monthly numbers of customers. Although the definition of "customers", as used in calculating the system indexes, changed beginning in 2003, the affect on the indexes was slight. Using a larger number of customers to calculate an index results in the index being lower, but the change is so small that the year-to-year comparability of the index data is not affected. A change as great as one percent to FPL's customer count would effect changes of less than one minute (SAIDI) and only about two one-hundredths of an interruption (SAIFI).

Q. Based on your analysis of FPL's 1992 through 2004 reliability data, should the Commission award FPL a 50 basis point incentive for exceptional performance?

A. No. Based on changes in FPL's reliability index data from 1992 through 2004, the Commission should not provide any basis point reward to FPL. The index values are practically the same as they were thirteen years ago. Improvements have been made since 1996 or 1997, depending on the indicator, but only after the data indicated marked deterioration from 1992 to 1996 or 1997, and after this deterioration received regulatory attention.

Q. Does this conclude your testimony?

A. Yes, it does.

BEFORE THE FLORIDA PUB LIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF LEONARDO E. GREEN

DOCKET NOS. 050045-EI, 050188-EI

JULY 28, 2005

Q. Please state your name and business address.

A. My name is Leonardo E. Green. My business address is Florida Power & Light Company, 9250 West Flagler Street, Miami, Florida 33174.

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

A. Yes.

Q. Are you sponsoring an exhibit?

A. Yes. I am sponsoring an exhibit consisting of four documents, LEG-8 through LEG-11, which is attached to my rebuttal testimony.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to refute claims made in the direct testimonies of Office of Public Counsel (OPC) witness, Dr. David Dismukes and Florida Retail Federation (FRF) witness, Ms. Sheree L. Brown relating to the FPL forecasts that I support in my direct testimony. Specifically, I will show that the bases for the calculations performed by Dr. Dismukes and Ms. Brown to obtain additional projected revenues of \$38,550,538 and \$33,972,000, respectively, are inappropriate and should not be considered by the Florida Public Service Commission (FPSC). In addition, I am providing testimony in support of Dr. Morley's rebuttal testimony, which addresses issues raised by Federal Executive Agency

(FEA) witness, Dr. Goins, and South Florida Hospital and Healthcare Association (SFHHA) witness, Mr. Baron. My testimony explains why Dr. Goins' support for an adjustment to the energy charge for certain interruptible customers is inappropriate and why Mr. Baron's suggestion that equal weighting should be given to the seasonal summer and winter peak demands is incorrect from a resource planning perspective.

Q. **Before addressing each of these points, do you have a general comment regarding making changes to FPL's revenue forecast based on piecemeal changes to forecast assumptions?**

A. Yes, I do. This Commission should reject recommendations to change revenue requirements based on piecemeal changes to forecast assumptions for two reasons: First, such recommendations fail to take into account changes to other assumptions that mitigate or offset the revenue impact of the assumption proposed to be changed. Second, allowing such piecemeal changes invites near constant revision of forecasts and revenue and cost items based on the forecasts, which is unreasonable, unsuitable, and impractical for a rate case proceeding.

It takes several months and numerous man hours to prepare forecasts for the MFRs and develop MFRs based on those forecasts. The value of the input assumptions that are used to produce forecasts of customers, peak demand, and energy sales change on an ongoing basis. As assumptions change, so do the forecasts. Thus, the number of potential forecasts is infinite unless a cut-off date is defined. A forecast that is the best outlook at a given moment in time should not be changed every time a variable changes, but should be examined on the basis of the validity of the assumptions and the quality of the model as of the time it was prepared. Otherwise, the constant changing nature of the forecast assumptions would not lend themselves to any usable forecast at any given time. Further, it is not reasonable to update one input in the forecast to the exclusion of other known changes that would likely mitigate or even more than fully offset other changes. Dr. Dismukes and Ms. Brown both propose to alter just one input that works in favor of reducing revenue requirements.

FPL's input assumptions are reasonable and appropriate, and the forecasting models suitable. Therefore, the forecasts utilized in FPL's filing are reasonable for use in this rate review.

REBUTTAL TO TESTIMONY OF DR. DAVID DISMUKES

Q. Please summarize the issues addressed in Dr. Dismukes' testimony.

A. In the forecast component of his direct testimony, Dr. Dismukes makes four recommendations:

1. Removal of FPL's proposed customer forecast adjustment associated with the hurricanes of 2004;
2. Updating of Florida's population forecasts to reflect more recently published information;
3. Removal of the proposed storm damage surcharge from the price of electricity used to estimate the Net Energy for Load (NEL) model; and
4. Utilization of a different specification of industrial customer model.

Dr. Dismukes testifies that the overall revenue impact of his recommendations increases FPL's projections of base revenues by $38,550,538.

Q. Turning to Dr. Dismukes' first point regarding adjustments to the customer forecast, why should the adjustment for the impact of the 2004 hurricane season remain a part of the forecast?

A. Preliminary data suggesting a slow down in customer growth and FPL's prior experience with major storms, determined that an adjustment was necessary. The University of Florida's Bureau of Economic and Business Research (BEBR) produces the official population forecast for the state of Florida in April of each year. BEBR's next population projection, which would incorporate the impact that the 2004 hurricane season would have on population growth would not be issued until April of 2005, months after FPL's forecast was completed. Because of this, at the time the forecast was prepared in the fall of 2004, FPL appropriately applied FPL's prior experience with major hurricanes and preliminary data depicting a slow down in customer growth to develop the best customer growth forecast in the wake of such an abnormal hurricane season.

This out-of-model adjustment is necessary and appropriate considering that at the time the forecast was prepared, customer growth dropped from an annual rate of 120,000 new customers in August 2004 over August 2003 to fewer than 94,000 by October 2004 over October 2003. In addition, the last time a major hurricane impacted FPL's service territory, Hurricane Andrew, customer growth dropped to under 60,000 in the year of the hurricane and then averaged around 65,000 for next 5 or 6 years. Furthermore, FPL has had years in which customer growth dropped by a considerable amount in two successive years. Exhibit LEG-8 shows a reduction of 46,334 in new customer growth in 1975 compared to customer growth in 1974. In 1982 the reduction in customer growth was 27,234 less than the growth in 1981. In 1991, customer growth was 26,743 less than the prior year's growth. Exhibit LEG-8 also shows other years with significant reductions in the growth of customers between successive years.

Q. Why are out-of-model adjustments an appropriate forecasting technique?

A. A statistical or econometric model quantifies a-priori expectation between a variable of interest and acknowledged explanatory variables. If the models are properly specified and estimated correctly then the results are deemed to be unbiased. Oftentimes impacts from unexpected events with a potential impact on the forecast such as hurricanes, September 11th, etc., cannot be captured by statistical models. Therefore, their impact needs to be accounted for outside the statistical framework. Considering the major events that occurred in 2004 when four major hurricanes impacted Florida, it would be incorrect to disregard the potential influence of these storms on population growth. A better approach is to recognize that the event has occurred and try to quantify its impact relying on an objective technique rather than the traditional model. FPL chose to rely in part on prior history in the aftermath of Hurricane Andrew which would be the closest in magnitude to the hurricane experience of 2004.

Q. Please explain why it is not necessary to update the population forecasts to reflect the BEBR's April 2005 data.

A. As discussed earlier, Dr. Dismukes proposes to update just one input, namely population, which will result in a higher number of customers and, all else being equal, energy sales. However, it is not practical or reasonable to measure the impact on the forecast from changes in an individual assumption without examining changes in all other assumptions and their total impact on the forecast. For example, due to price elasticity effects on consumption, increased fuel prices will negatively impact the forecast of energy sales.

Q. How would the rise in fuel prices affect the forecast?

A. The price of fuel is a key component of the total price of electricity; therefore, any changes in the price of fuel will have a direct impact on the total price of electricity. The fuel forecast that was used to develop the fuel clauses and the projected price of electricity is now one year old. This intervening year has seen record breaking increases in prices for fuels. If this component of the overall forecast were updated to reflect the significant change in the price of fuel, the resulting price of electricity will be significantly higher than what was assumed when preparing the forecast used in this rate case. The higher price of electricity would reduce the demand for electricity because it affects all customers, not only the new customers. Dr. Dismukes suggests by adjusting customer growth, the forecast of energy and peak demand would be higher than the current projections. However, in my opinion, even with the higher growth in new customers, the overall net effect of a higher price of electricity would be to lower the energy and peak demand forecasts.

Q. **What other assumptions have changed since the forecast was prepared that could also be examined?**

A. In addition to the price of fuels, there have been changes to other important factors that would need to be revised if the forecast assumptions were revisited. For example, the inflation assumption used in this forecast is below the actual inflation that has unfolded in 2005. Higher inflation values reduce the purchasing power of FPL customers by reducing their real personal income. With customers' income reduced, the demand for electricity would also be lower than it would otherwise be, thus reducing the overall energy forecast. Another consideration is that as customer growth increases, FPL incurs additional costs to serve these customers. More meters, transformers, wires and staff, among other things, are needed to serve these customers. These additional FPL costs would also have to be taken in consideration.

Q. **Please explain why the Commission should not entertain Dr. Dismukes' proposal to remove the Company's price adjustment for its proposed storm damage surcharge used to estimate the NEL model.**

A. Dr. Dismukes recommends the removal of the storm surcharge from the projected price of electricity in order to create a higher forecast of energy sales and peak demand. This implies that FPL revenues would be larger because of these increases in sales and demand. Removing the storm surcharge is incorrect because it is a part of the cost of electricity to the customer. Ignoring this component of the cost would only result in an arbitrarily biased forecast, and would not be appropriate for this proceeding. In addition, by making this change in isolation, Dr. Dismukes fails to take into account changes to other factors that might be affecting the forecasts in a negative manner (e.g., price of fuel, price of electricity, inflation, and reduced personal income) which result in lower sales and peak demand forecasts.

Q. What is the year to date variance of the current projections for energy sales?

A. As of June 2005, the current level of FPL sales for this year is 2.3% below the forecast. Use per customer for all FPL customers is 2.8% below the projected usage through June.

Q. Please comment on Dr. Dismukes' alternative model to project industrial revenue class customers.

A. Dr. Dismukes suggests that a different model be used to project the number of industrial revenue class customers. He claims that his model is superior to FPL's model based on his contention that the coefficient of determination (R^2) of the model he proposes is 0.9998 versus FPL's which is 0.55. Given that an R^2 of 1 indicates the model is a perfect fit to the historical data, he must assume that his model is a virtually perfect fit. Achieving a perfect fit is unrealistic, and in fact, Dr. Dismukes' contention is based on an incorrect application of the R^2 concept. It is commonly understood that when an economic model is estimated without an intercept using most standard statistical programs, such as the program used by Dr. Dismukes, the R^2 has no meaning (*Basic Econometrics*, by Damodar Gujarati, pages 134-138). The computer will compute an erroneous R^2, and to obtain the correct R^2, it needs to be calculated directly without the use of a standard statistical program. When the R^2 is estimated manually for the model that Dr. Dismukes developed, it yields an R^2 of only 0.45 which is inferior to FPL's model. Therefore, Dr. Dismukes' point is absolutely incorrect.

Q. Dr. Dismukes also claims that the industrial forecast could be improved because "the empirical results lead to an anomalous negative sign on the parameter estimates for the relationship between industrial customers and population." Do you agree?

A. No. The negative coefficient for the Florida Population, seen here as a trend variable, is intended to capture the negative trend in the purely Industrial Customer base, whereas the positive coefficient on housing starts is intended to capture the increase in Temporary Construction Meters.

FPL's Industrial Customer base is made up of two major classes:1) the typical Industrial Customers that manufacture products, and 2) Temporary Construction Meter accounts are customers only during the construction period for residential, commercial, industrial and general service structures. Florida, like the rest of the nation, has been experiencing a contracting trend in its typical Industrial Customer base for the last few years. On the other hand, construction of new homes is approaching record levels. The current status is that the two major components in the Industrial Customer base are moving in opposite directions. The a-priori expectation is that the typical Industrial Customer base will continue to contract and Temporary Construction Meters will continue to increase with new homes and other permanent structures being built.

Q. What do you conclude regarding the changes suggested by Dr. Dismukes?

A. For the reasons I have explained, the Commission should reject the changes to projected revenues suggested by Dr. Dismukes.

REBUTTAL TO TESTIMONY OF SHEREE L. BROWN

Q. Please summarize the issues addressed in Ms. Sheree L. Brown's testimony.

A. Ms. Brown alleges that the Company has understated its forecast of the number of customers for the Test Year, resulting in an understatement of $33.972 million in Test Year revenues at present rates. The bases for her change to the forecast and the resulting revenue calculation are inappropriate and therefore her claim that the revenues are understated is incorrect.

Q. Why is Ms. Brown's decision to ignore the impacts of the 2004 hurricanes inappropriate?

A. In arriving at her claim that revenue is understated by $33.972 million, Ms. Brown assumes that the growth in customers between 2005 and 2007 will be same as the growth over the last 6 years. Historical data demonstrates that a major hurricane can and does affect customer growth. Customer growth after Hurricane Andrew was depressed for the next six years. This impact must be recognized in the forecast. As I described earlier in my comments to Dr. Dismukes' testimony, FPL has appropriately done this. BEBR's recent population forecast reflects a slower rate of growth in 2005 and 2006 due to the 2004 hurricanes. This is consistent with FPL's view.

Q. How does Ms. Brown attempt to validate her forecast for 2005 and 2006?

A. Ms. Brown claims that she has relied on the customer growth observed so far in 2005 to support her projection of customer growth for the rest of 2005, as well as 2006 and 2007. However, her method is inappropriate because it fails to consider changes in the customer mix that have occurred in 2005.

Q. What information on customer mix is not considered in Ms. Brown's testimony?

A. Ms. Brown fails to consider that much of the growth in customers is attributed directly to temporary construction meter accounts (which are labeled industrial customers) related to the reconstruction of dwellings and commercial establishments due to damage done by the hurricanes in 2004 and a booming new construction activity in Florida. It is erroneous to assume that these construction meter accounts, though classified as "industrial customers" will consume electricity in quantities similar to the amount a regular industrial customer would demand. The revenue class that is seeing above normal growth is the residential class, which has a small usage per customer. The commercial revenue class and the true industrial customers, which consume much more electricity, are experiencing a much lower level of growth which is changing the customer mix in favor of low consumption residential customers.

Q. Why is the customer mix important in projecting the level of sales?

A. In arriving at a final energy sales forecast, FPL assumed an aggressive growth in use per customer for all customer classes. If the revenue classes that are growing the fastest are low consumption consumers, then the use per customer for the entire body of customers will be lower due to the disproportionate growth in these low consumption classes. Therefore, Ms. Brown's exercise, extrapolating the current customer growth data and multiplying it by the use per customer estimated originally based on a different customer mix, has the effect of inappropriately overestimating energy sales.

Q. What other important aspect of the rate of growth in FPL's customers is missing from Ms. Brown's analysis?

A. Ms. Brown ignores the historical cyclical behavior in the growth of FPL customers. In my direct testimony and in Exhibit LEG-8, I clearly demonstrate that customer growth in FPL's service territory is cyclical. There have been years in the past where annual growth decreased by over 46,000 customers between two successive years. It is not uncommon to see large decreases in customer growth between two years. If the cyclical pattern in customer growth is ignored, and a constant growth rate is utilized instead, this would result in a miscalculated customer growth.

Q. Why is it inappropriate to adopt the projections of revenues suggested by Ms. Brown?

A. There are several problems associated with adopting Ms. Brown's projections. First, it ignores the impact of the 2004 hurricane season; second, it negates the existence of a cyclical behavior in customer growth; and third, it does not consider the change in the customer mix due to abnormally high growth in only certain revenue classes. For these reasons stated above, Ms. Brown is incorrect in suggesting that FPL understated revenues from energy sales.

Q. **Dr. Green, do you have any other issues you would like to address?**

A. Yes. In support of Dr. Morley's rebuttal testimony I would like to address certain aspects of the issues raised by Dr. Goins and Mr. Baron.

Q. **What specifically will you be addressing?**

A. Regarding Dr. Goins' testimony, I will address how the load and energy requirements of interruptible service, particularly the Commercial/Industrial Load Control (CILC) program, are reflected in FPL's resource planning to serve forecasted system peak demands and NEL. Additionally, regarding Mr. Baron's testimony, I will address the impact of seasonal (i.e., summer and winter) peak demands on FPL's resource planning.

Q. **Please describe the CILC Program.**

A. This program reduces peak demand by controlling loads of 200 kW or greater during periods of extreme demand or capacity shortage, in exchange for monthly electric bill credits.

Q. **Does FPL include the effects of the CILC Program when forecasting system peaks?**

A. Yes.

Q. **Please describe the effects of the CILC Program on forecasted system peaks.**

A. This may best be illustrated by Schedules 3.1 and 3.2 in FPL's 2005 Ten Year Power Plant Site Plan, History and Forecast of Summer Demand: Base Case and History and Forecast of Winter Peak Demand: Base Case (Exhibit LEG-9 & LEG-10 respectively). In these schedules, FPL begins with a

Total Peak Demand in Column (2) and from that total excludes the effects of Demand Side Management (DSM) program capabilities, including CILC in Column (8), to arrive at a total Peak Demand that represents a hypothetical "Net Firm Demand" if the load control values had definitely been exercised on the peak" in Column (10). The resulting peaks, therefore, are inclusive of the MW effects of the total DSM program capabilities, i.e., system peaks are reduced.

Q. Please describe the effects of the CILC Program on forecasted NEL.

A. Again, these effects may best be illustrated by FPL's 2005 Ten Year Power Plant Site Plan, History and Forecast of Annual Net Energy for Load – GWH; Base Case, shown in Schedule 3.3 (Exhibit LEG-11). The NEL begins with a "Total Net Energy For Load w/o DSM" in Column (2) and excluded from that amount is the "forecasted values of the reduction on sales from incremental conservation" in Columns (3) and (4) from "Residential Conservation" and "C/I Conservation," respectively, but not "C/I Load Management" where the effects of the CILC Program are included. The resulting NEL, therefore, does not include the energy MWH effects of the CILC Program.

Q. Are there energy reductions associated with the CILC Program?

A. Yes.

Q. How are these energy reductions associated with the CILC Program considered?

A. The cost-effectiveness analyses for the CILC Program reflect peak period interruptions of six hour durations and, as I discussed previously, these interruptions are reflected in the forecasted peak demands. The cost-effectiveness analyses, however, also include an assumption that the customer will make up approximately 80% of the energy after the peak period interruption, i.e., during non-peak periods. To the extent that there are energy reductions associated with the CILC Program, therefore, they would be minimal (i.e., 20% times six hours or approximately 1.2 hours per peak period interruption) and would have negligible, if any, impact on NEL.

Q **What is your conclusion regarding any equivalence between the demand capability reductions and energy reductions of the CILC Program?**

A. The energy reductions associated with the CILC Program have a much smaller impact on FPL's resource planning for NEL as would the effects of the interruptions on forecasted system peaks.

Q. **Please address the issue raised by Mr. Baron concerning seasonal (i.e., summer and winter) peak demands in FPL's resource planning.**

A. Mr. Baron states that "[i]t is clear that the requirements to meet the summer ***and*** winter peak demand is driving the capacity resource addition on the system." (Direct Testimony, page 29, lines 2 – 4) (emphasis added) Mr. Baron, with this statement, places an equal weighting on the seasonal peak demands in FPL's resource planning.

Q. **Do you agree with Mr. Baron's conclusion?**

A. No. In general, such a conclusion does not reflect the manner in which FPL's generation resources are planned or operated. As Dr. Morley has explained in her rebuttal testimony, peak demands driving the decision to add additional capacity are not based on an average of the Summer Peak and Winter Peak. The need for additional resources has been driven by summer capacity requirements. Further, Mr. Baron's assertion ignores the influence of energy usage on the type of generation added, and the influence of the loss-of-load probability criterion which requires consideration of peak loads throughout the year.

Q. Is there another factor regarding generating capacity that impacts FPL's generation planning and operation differently in the summer and winter?

A. Yes. Total Installed Capability of the same generating units is different during the winter months versus the summer months. Ambient air temperature affects the output from generation resources in that the cooler the air temperature the greater the output from the generating unit. The Total Installed Capability during the cooler winter peak month, therefore, is higher than during the corresponding warmer summer peak month. This can be seen in Column (2) on pages 1 and 2 of Exhibit ___ SJB-2. FPL's Total Installed Capability projected for the 2006 summer peak, as shown on page 1, is 21,020 MW. The Total Installed Capability projected for the 2005/2006 winter peak, as shown on page 2 is 22,390 MW. This difference reflects the cooler ambient air temperature during the winter peak. As the winter peak is temperature driven, the cooler the temperature the greater the winter peak, but the increase in the winter peak is somewhat mitigated because there is also an increase in capacity output as a result of the cooler temperature. It does not seem very likely that FPL would have sufficient Total Installed Capability to satisfy the summer reserve margin criteria and that a winter peak of such magnitude would occur that FPL would have to consider capacity additions to meet a deficiency in the winter Reserve Margin criteria.

Q. What is your conclusion regarding the impact of summer and winter seasonal peaks on capacity additions?

A. Mr. Baron's conclusion regarding the equivalence of the summer and winter peak "driving capacity additions" is incorrect.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF JOHN H. LANDON, PH.D.

DOCKET NOS. 050045-EI, 050188-EI

JULY 28, 2005

Q. Please state your name and business address.

A. My name is John H. Landon, and my business address is Two Embarcadero Center, Suite 1750, San Francisco, California, 94111.

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

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. I will respond to portions of the testimony submitted by the following witnesses:

- Teresa Civic and Jess Galura on behalf of the Commercial Group;
- David E. Dismukes, Ph.D. and Hugh Larkin, Jr. on behalf of the Florida Office of Public Counsel (OPC);
- Matthew Kahal on behalf of the Federal Executive Agencies; and
- Sidney W. Matlock on behalf of Staff.

My testimony addresses four issues raised by the intervenors and staff witnesses mentioned above:

1. FPL's distribution reliability performance over the period 1992-2004.

2. FPL's cost performance.

3. Comparisons of FPL's future expected expenses to those of other utilities in the benchmark group.

4. Comparisons of FPL's retail rates to the rates of other utilities.

FPL'S DISTRIBUTION RELIABILITY

Q. Please describe Staff witness Mr. Matlock's testimony regarding FPL's distribution reliability.

A. Mr. Matlock examines FPL's distribution reliability over the period 1992-2004. In contrast, I have reviewed the Company's benchmarking of distribution reliability over the period 1998-2004. Mr. Matlock observes that although "FPL has shown improvements in [reliability] performance since 1998", reliability worsened between 1992 and 1997.[1] He concludes that reliability is "practically the same" as it was in 1992.[2]

Q. Does Mr. Matlock's testimony change the conclusions you drew in your direct testimony regarding FPL's distribution reliability?

A. It does not, for several reasons. First, because Mr. Matlock has not compared FPL's reliability to any benchmark group, he cannot draw any conclusions about FPL's reliability relative to peer utilities prior to 1998. Thus my conclusion that FPL's distribution reliability has improved relative to comparable utilities remains unrebutted. Second, although Mr. Matlock asserts that "FPL has basically returned to its 1992 reliability level", he does

[1] Direct Testimony of Sidney W. Matlock, at 3:6, 7; 3:10-11.

[2] Matlock Direct at 5:12-13.

not criticize the Company's reliability in the 1998-2004 period. In fact, he refers to the Commission's acknowledgement in 2000 that FPL's reliability had been improving since 1996.[3] Third, Mr. Matlock fails to acknowledge that over the period 1998-2004 FPL has delivered a high level of reliability at the same time that it has reduced total non-fuel O&M expenses per customer and held total distribution O&M expenses relatively constant[4] in the face of approximately 15 percent growth in the number of customers. Fourth, Mr. Matlock's conclusion is based entirely on a comparison of FPL's reliability in a single year, 1992, to the Company's performance over the most recent seven-year period. However, he has not examined reliability prior to 1992 and he presents no direct evidence that FPL's reliability performance in 1992 was representative of earlier performance. Mr. Matlock cannot draw reasonable conclusions regarding the Company's reliability performance over the past several years through a comparison with its performance in a single year, thirteen years earlier.

Q. Do you have any other comments regarding Mr. Matlock's testimony on distribution reliability?

A. Yes. Mr. Matlock concludes that "the [reliability] index values are practically the same as they were thirteen years ago."[5] My concerns, as discussed earlier, with respect to a comparison of performance in one year to performance over a multi-year period notwithstanding, the data do not support Mr. Matlock's conclusion. In fact, FPL's distribution SAIDI over the five-year period 2000-

[3] Matlock Direct at 4:9-13.
[4] See Direct Testimony of Geisha J. Williams, Document No. GJW-3.
[5] Matlock Direct at 5:12-13.

2004 has been consistently lower than the 1992 level, and 3.8 percent lower on average. Average distribution CAIDI and SAIFI values over the period 2000-2004 have been 2.1 percent lower and 1.6 percent lower, respectively, than the 1992 levels. Even Mr. Matlock's fatally flawed comparison approach suggests that FPL has improved distribution reliability performance.

Table 1: FPL Distribution Reliability

	SAIDI	CAIDI	SAIFI
1992	71.8	56.30	1.28
2000	70.3	58.30	1.21
2001	69.1	56.60	1.22
2002	68.2	52.80	1.29
2003	68.2	50.50	1.35
2004	69.7	57.30	1.22
Average 2000-2004	69.1	55.10	1.26
Relative Change 1992 to 2000-2004 Average	-3.8%	-2.1%	-1.6%

Source: Matlock Direct Exhibit SWM-1

FPL's Cost Performance Has Been Superior

Q. Please describe Mr. Larkin's testimony regarding FPL's declining cost per customer.

A. Mr. Larkin testifies that it is not "legitimate" for FPL to claim credit for the reductions in cost, on a per customer basis, over the past several years.[6] Mr.

[6] Direct Testimony of Hugh Larkin, Jr., at 6:2-4.

Larkin argues that FPL's success in reducing cost per customer should be attributed to customer growth, rather than the Company's cost management programs.

Q. On what basis does Mr. Larkin argue that customer growth, not cost management, is responsible for declining cost per customer?

A. Mr. Larkin's argument is based on the assumption that a utility always can supply new customers at or below average cost. Mr. Larkin asserts that:

> The cost for providing electric service does not increase proportionately with the addition of more customers. Except for fuel, there is a tendency for the cost of providing utility service to be predominantly fixed.[7]

Q. Do you agree with Mr. Larkin's testimony regarding FPL's per customer cost of service?

A. I strongly disagree. Mr. Larkin presents no evidence to support his assertion that the Company's expense achievements have been due to customer growth, rather than management. For certain types of non-fuel expenses, generation, transmission, or distribution, the cost of providing service is fixed, only to the extent that a utility can add customers without adding additional capacity. To the extent a utility's customer base is growing rapidly, it will have to add additional capacity more frequently. Rapid growth also will tend to increase per customer costs, because it is generally more expensive to serve new customers through newly constructed infrastructure than to serve existing

[7] Larkin Direct at 6:8-11.

customers through infrastructure that is already in place. That is, the incremental cost of serving new customers with new facilities, constructed under current environmental, zoning, and safety rules tends to be greater than the average embedded cost.

FPL has experienced very rapid customer growth over the past decades. Between 1998 and 2004, FPL's customer base has grown 15 percent, as more than 500,000 customers have been added to the system. By way of comparison, in 2003 there were more than 230 utilities with less than 500,000 customers. FPL has been able to serve its rapidly growing customer base at the same time that it has reduced per customer costs, primarily by offsetting the higher cost of serving new customers through cost management efforts.[8]

In my experience, the ability that FPL has demonstrated to manage costs and deliver a high level of service in the face of rapid customer growth is unique. The Company's achievements represent superior management.

[8] See, for example, Williams Direct at 17:17-18; Direct Testimony of C. Martin Mennes at 12:10-15.

BENCHMARKING PROJECTED FUTURE O&M EXPENSES

Q. Please describe Dr. Dismukes' testimony regarding FPL's 1998-2003 O&M expenses.

A. Dr. Dismukes reviews the benchmarking of FPL's non-fuel O&M expenses that I presented in my direct testimony. He concludes that "the Company has performed relatively well" and that "FPL has ranked in the top ten in terms of the lowest overall non-fuel O&M costs relative to the peer group defined by Dr. Landon."[9]

Q. Does Dr. Dismukes comment on FPL's forecasted O&M expenses?

A. Yes. Dr. Dismukes states that it is important to evaluate "how well the Company is forecasted to perform relative to its peers..."[10] For the industry peer group presented in my benchmarking study, Dr. Dismukes presents projections of total non-fuel O&M expenses per kWh sold for the period 2004-2007. Dr. Dismukes projections for the companies in the peer group are based on 2003 expense levels escalated by the average annual change in total non-fuel O&M expenses per kWh sold over the five-year period 1999-2003. He also projects FPL's total non-fuel O&M expenses per kWh for 2004-2007, using the same approach. Dr. Dismukes then compares FPL's forecasted total non-fuel O&M expenses, based on the Company's budgeting and forecasting process, to his projections. In addition to total non-fuel O&M, Dr. Dismukes also presents comparisons of other, more detailed FPL expense forecasts to

[9] Direct Testimony of David E. Dismukes, Ph.D., at 18:6-12.
[10] Dismukes Direct at 19:4-5.

similarly derived projections for the benchmark group. He compares the following expense measures: administrative and general O&M per kWh, non-fuel nuclear production O&M per kWh, transmission O&M per kWh, and non-fuel steam and "other" production O&M per kWh.

Q. What are Dr. Dismukes' conclusions regarding FPL's forecasted O&M expenses.

A. He concludes that FPL's forecasted expenses are higher than his projections for the Company and compare less favorably to his projections for companies in the benchmark group.

Q. Are Dr. Dismukes' conclusions regarding FPL's forecasted expenses reasonable?

A. No. Dr. Dismukes' analysis is inappropriate and unreliable because he has violated a basic principle of benchmarking: performance of companies in the comparison group and the company of interest must be measured in the same way. The expense projections he presents for the benchmark companies are not comparable to FPL's expense forecasts. FPL's forecasted expenses are based on operational-level budgeting and management expectations about future expense patterns. Dr. Dismukes' simplistic projections for the companies in the benchmark group are based entirely on past expense levels and do not incorporate, in any fashion, the expectations of the companies' management regarding future expenses. Moreover, Dr. Dismukes makes no attempt to incorporate managerial expectations about future expenses in his projections for the benchmark companies.

In addition to violating a basic principle of benchmarking—that performance be measured comparably across all companies—Dr. Dismukes' comparison does not consider the impact of differing growth rates between FPL and the comparison companies. FPL is growing more rapidly than the benchmark group, on average. In fact, only 5 of the 34 companies in the industry peer group experienced higher customer growth than FPL over the study period. Consequently, the simplistic comparison Dr. Dismukes presents is badly biased. This is because higher growth rates, all else equal, tend to increase incremental current dollar investments relative to average embedded costs.

It is not appropriate to compare FPL's detailed, bottom-up forecast of future expenses to projections based on a simple average of past performance. Because his analysis is inappropriate and unreliable, the conclusions Dr. Dismukes draws are not reasonable. The Commission should disregard Dr. Dismukes' "benchmarking" of O&M forecasts and the conclusions he draws.

COMPARING FPL'S RATES

Q. Please summarize the testimony of Ms. Civic and Mr. Galura regarding FPL's rates.

A. Ms. Civic and Mr. Galura testify that "with respect to electric bills that we receive from FPL, the Company's rates are substantially higher than many similar electric utilities, particularly those in the Southeast."[11] They assert, as an example, that the "fuel rates that FPL charges us are nearly double those of Georgia Power Company..."[12]

Q. Does FEA witness Mr. Kahal also discuss FPL's retail rates?

A. Yes. Mr. Kahal presents some results from an EEI survey of residential customer bills, which he characterizes as "retail rates" or "residential rates."[13] Mr. Kahal concludes that "FPL's residential retail rates are well above average," compared to companies in my industry peer group and "other major electric utilities in the Southeast (SERC) region of the U.S."[14]

Q. How do you respond to the criticism of FPL's rates?

A. The testimony of Ms. Civic, Mr. Galura, and Mr. Kahal regarding FPL's rates is misleading and irrelevant to this proceeding. It is misleading because although they claim to be discussing FPL's rates, their testimony, in fact, is based, all or in part, on the results of an EEI survey of "typical" bills. Their testimony is irrelevant to this proceeding because the EEI survey of typical bills reports what customers pay as a result of utilities' base rate structure and fuel charges. Fuel costs should not be a consideration in the Commission's evaluation of FPL's base rates in this proceeding.

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[11] Direct Testimony of Teresa Civic and Jess Galura at 2:19-21. Ms. Civic and Mr. Galura testify on behalf of the Commercial Group, which is composed of BJ's, Lowe's Home Centers, JC Penney, and Wal-Mart.

[12] Civic and Galura Direct at 2:23-3:1.

[13] Direct Testimony of Matthew I. Kahal at 42:6-18 and Schedule MIK-7.

[14] Kahal Direct at 42:2-4.

Q. Are there legitimate reasons why the average or "typical" bill of an FPL customer may be higher than that of other utilities?

A. Yes. There are many reasons why customer bills may differ across utilities that should not affect the Commission's evaluation of FPL in this proceeding, including ratemaking and fuel costs. Rate schedules for a particular customer class may differ across utilities due to different regulatory treatment. Fuel costs, as I mentioned earlier, are not a valid performance measure in this proceeding. Fuel costs, while a component of the typical bill measure, reflect factors such as fuel mix, the structure of long term power purchase contracts, and demand profiles. Utilities tend to have differing fuel options and transmission costs. FPL is on a peninsula and is likely to have higher transmission and fuel transportation costs than many other utilities. Mr. Kahal, Ms. Civic, and Mr. Galura do not address these factors in their analyses.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. I have reached the following conclusions:

1. In his testimony regarding FPL's distribution reliability performance Mr. Matlock does not rebut my conclusion that FPL has provided customers with much higher reliability than companies in the benchmark group, on average.

2. Mr. Matlock does not criticize FPL's recent reliability performance.
3. Mr. Matlock's comparison of reliability in 1992 to reliability over the period 1998-2004 is not reasonable. Therefore, the conclusions he draws from this discussion also are not reasonable.
4. Mr. Larkin's assertion that FPL's cost reductions result from customer growth, rather than superior management, is based on unsupportable assumptions and is unreliable.
5. Dr. Dismukes' comparisons of FPL's forecasted expenses to his projections based on average past performance are inappropriate and unreliable.
6. Mr. Kahal, Ms. Civic, and Mr. Galura do not testify regarding FPL's rates, but rather "typical" bills, including fuel costs, of FPL customers.
7. Mr. Kahal's, Ms. Civic's, and Mr. Galura's testimony is misleading and irrelevant to this proceeding

Q. **Does this conclude your rebuttal testimony?**

A. Yes.

ERRATA SHEET

( ) DIRECT TESTIMONY, OR (X) REBUTTAL TESTIMONY (PLEASE MARK ONE WITH "X")
WITNESS: **John H. Landon**

PAGE #	LINE #	CHANGE
6	9	Change 230 to 100

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF C. DENNIS BRANDT

DOCKET NOS. 050045-EI, 050188-EI

JULY 28, 2005

Q. Please state your name and business address.

A. My name is C. Dennis Brandt. My business address is 9250 W. Flagler Street, Miami, FL 33174.

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

A. I am employed by Florida Power & Light Company (FPL) as Director of Products and Services.

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

A. I am responsible for managing products and services relating to demand side management, billing and payment options and value added products offered to FPL's residential and business customers.

Q. Please describe your educational background and professional experience.

A. I received a Bachelor of Science Degree in Industrial Engineering from the University of Miami in 1978. I received my Masters Degree in Industrial Engineering from the University of Miami in 1984. I am a certified Professional Engineer in the State of Florida. I was hired by FPL in 1979 in the Materials Management department and have worked in positions of increasing responsibility in the areas of Load Management, Commercial and Industrial

Marketing, Residential and General Business Marketing, and Product Management and Operations.

Q. What is the purpose of your rebuttal testimony?

A. I will respond to portions of testimony submitted by Ms. Kimberly H. Dismukes, on behalf of the Office of Public Counsel (OPC), which addresses allocations of natural gas margins between FPL and FPL Energy Services, Inc. (FPLES). In addition, in response to questions raised at the Ft. Myers customer service hearing and at the request of OPC, I will address FPLES' Connect Services.

Q. What is the amount of net revenues that Ms. Dismukes contends should be attributed to FPL in 2006 based on the sales of natural gas in FPL's territory?

A. The amount identified on page 27 of Ms. Dismukes' testimony is $2,746,000.

Q. Is this the correct amount of net revenues for the natural gas business for customers within FPL's service territory?

A. No, as stated in FPL's response to OPC's Interrogatory No. 331, part E, FPL reported the net revenues for the natural gas in-territory business for the 2006 test year as $1,734,000.

Q. What is the difference in this amount and the amount used by Ms. Dismukes?

A. As also stated in FPL's response to OPC's Interrogatory No. 331, part E, FPL reported net revenues of $1,012,000 attributed to the Bill Statement Advertising program. This value plus the $1,734,000 of natural gas net revenues corresponds to Ms. Dismukes' amount of $2,746,000.

Q. Is the Company proposing to change the allocation of the revenues and expenses of the natural gas business for the test year?

A. Yes. Prior to the test year, revenues and expenses for the natural gas business were allocated between FPL and FPLES based on whether the natural gas customer was within FPL's service territory or outside of its territory. All customers within the FPL service territory had their associated revenues and expenses recorded at FPL. For the test year, all natural gas revenues and expenses are recorded at FPLES.

Q. How was the natural gas business developed?

A. The natural gas business was established in the late 1990's as part of FPL Group's involvement in new deregulated energy markets. FPLES was active in several of the deregulated electric and natural gas markets, primarily in the Northeast. To support this effort, the required infrastructure, including a customer billing system, risk management system and resources with technical knowledge in gas operations, was established by FPLES.

Q. How were these efforts used to support the natural gas business within FPL's territory?

A. This infrastructure, developed by FPLES, was used to support the sale of natural gas to both in-territory FPL customers and other customers outside of FPL's territory. A key difference between the sales of natural gas in-territory as compared to the sales in other areas was the sales organization employed for this activity. Initially for in-territory customers, FPL account managers were used to market natural gas. In 2003, a dedicated sales force was deployed for natural gas sales both in and out of territory, thus eliminating the need to utilize the FPL account managers.

Q. Why has the Company proposed transferring the in-territory natural gas sales to FPLES?

A. As I have explained, the key infrastructure that supports in-territory gas sales resides within FPLES. In addition, with the creation of a dedicated sales force in 2003, there was no longer a need to utilize FPL account managers for this activity. Finally, this activity is clearly not related to the provision of electric service. For these reasons, FPL has concluded that both the in-territory and out of territory natural gas activities should reside at FPLES.

Q. Why has the Company proposed this change as part of this proceeding?

A. The Company would have made this change sooner, but determined it was not appropriate to make this type of change during the current rate agreement.

Q. Is the Company planning to make an adjustment to recognize the market value of the gas contracts being transferred to FPLES?

A. Yes. This adjustment is discussed in Mr. Davis' rebuttal testimony.

Q. Is the Company making an adjustment to the Bill Statement Advertising program?

A. Yes. The Company is adjusting the 2006 net revenues of $1,012,000 attributed to the Bill Statement Advertising program to reflect this as an FPL activity. This adjustment is reflected in Document No. KMD-10 to Mr. Davis' rebuttal testimony.

Q. Please describe FPLES Connect Services.

A. FPLES Connect Services was established in 1999. Customers call FPL's customer care centers to either establish or transfer their electric service. The customer is transferred to FPLES for confirmation of the request for electric service. As part of the confirmation process the customer receives a confirmation number and is also asked if he or she would be interested in hearing about other products and services. If the customer is not interested, the call is ended. If the customer is interested, then various products and services are offered to the customer.

Q. What value does FPLES' Connect Services offer?

A. Connect Services provides an opportunity for the customer to initiate, through one call, services such as local and long distance telephone service, newspaper subscriptions, satellite and cable services in a fast and effective manner – a "one stop shopping" approach. To that end, FPLES has formed partnerships with the providers of these services that are offered to customers.

Q. How have customers reacted to Connect Services?

A. Our research found that those customers who elect to hear about these services are more satisfied with the connect process than those who do not participate. These customers see the benefit of a "one stop shop" during a sometimes stressful move. FPL tracks customer reactions to major programs and processes. For the time period of 2004 through June 2005, the rate of dissatisfaction with the Connect Services was only .007%.

Q. Does FPLES use FPL provided customer information in connection with Connect Services?

A. Only after permission is obtained from the customer. Moreover, FPLES does not use any of this connect customer information for any other purposes, including telemarketing efforts. Nor does FPLES retain or resell customer information such as the customer's name, address or telephone number.

Q. Does FPL bear any costs for Connect Services?

A. No. FPL is fully reimbursed for the costs it incurs related to Connect Services. These costs include the costs associated with the time spent transferring the call to Connect Services, including overheads and adders and all associated telecommunications costs.

Q. What benefits does FPL and its customers receive from FPLES Connect Services?

A. The Connect Services business provides the customer's electric service order confirmation at no cost to FPL. In addition, for customers who complete their connect transaction with BellSouth as part of Connect Services, FPL receives updated customer telephone numbers at no cost. Having accurate customer telephone numbers substantially enhances FPL's provision of efficient and effective customer service. FPL utilizes a popular call center technology called Computer Telephony Integration (CTI). CTI integrates telephones with computers, which produces many benefits for FPL and our customers. Utilizing the telephone numbers assigned by the telephone company to each telephone company customer, the CTI software attempts to match the telephone number with an FPL account that has that same telephone number on record. A match allows customers to utilize the self-service features of FPL's Interactive Voice Response (IVR) system. A telephone number match also reduces the estimated average handle time of each call by 25 seconds for calls handled by an FPL representative. This reduces the customer's inconvenience of waiting while their account is located as well as reducing FPL's cost per call.

Q. **Should the revenues and expenses for FPLES Connect Services be included at FPL?**

A. No, Connect Services is not related to the provision of electric service, FPL is fully reimbursed for the costs it incurs related to Connect Services and this activity is performed by FPLES.

Q. **Does this conclude your rebuttal testimony?**

A. Yes.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF NANCY A. SWALWELL

DOCKET NOS. 050045-EI, 050188-EI

JULY 28, 2005

INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Nancy A. Swalwell. My business address is 700 Universe Boulevard, Juno Beach, Florida, 33408-0420.

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

A. I am employed by Florida Power & Light Company (FPL or the Company) as the Director of Corporate Real Estate.

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

A. I have overall responsibility for managing FPL's real estate acquisitions and divestitures, FPL's facilities management and operations, and FPL's cafeteria services functions.

Q. Please describe your educational background and business experience.

A. I received a Bachelors of Science degree in Systems Analysis from Miami University in Oxford, Ohio in 1977. I have since attended the Executive Development Program at Cornell, Financial Management for Non-Financial Managers at the Darden School of Business at the University of Virginia, and the Advanced HR Executive Program at the University of Michigan.

My experience began as a computer programmer working for Champion International (now International Paper), Johns Manville Corporation, and I then joined Florida Power & Light Company as a computer programmer in late 1980. Over a period of several years, I held various positions in FPL's Information Management organization eventually leading to leadership roles as Manager of Information Management Planning, Director of Information Management Operations, and Director of Applications Development. I was responsible for the Company's Y2K program and managed several large systems development projects in support of most major functions on the Company.

In 2002, I joined the Human Resources and Corporate Services business unit to lead a corporate-wide effort to establish a corporate business continuity plan and to lead select functions within the HR organization. In 2003, I became the Director of Corporate Real Estate and have been managing the Corporate Real Estate function since that time.

Q. **Are you sponsoring or co-sponsoring any MFRs in this case?**

A. Yes, I am co-sponsoring MFR B-15, Property Held for Future Use – 13-Month Average.

Q. **What is the purpose of your rebuttal testimony?**

A. I will respond to portions of the testimony submitted on behalf of the Florida Office of Public Counsel (OPC) by Hugh Larkin, Jr. which address the amount FPL has forecasted in the Property Held for Future Use (PHFFU) account and the age of the property in that account. I will also respond to a portion of the testimony submitted on behalf of the Florida Office of Public Counsel (OPC) by Donna DeRonne regarding FPL's forecast of gains on sales of property. Finally, I will also respond to portions of the testimony submitted on behalf of the Florida Public Service Commission Staff (Staff) by Kathy L. Welch which address allocation of costs to affiliates for office space in our Juno Beach and Miami General Office buildings.

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

A. Yes. I am sponsoring an exhibit consisting of the following:

1. Document NAS-1 – Sites Under Contract, 1998 through June, 2005
2. Document NAS-2 – Transmission Easements Acquired, 1998 through June, 2005
3. Document NAS-3 – PHFFU as of December, 2004 – Analysis of in-service dates
4. Document NAS-4 – PHFFU as of December, 2004 – Age of properties going into service within 5 years.
5. Document NAS-5 - Analysis which supports FPL's position that the market rate being charged to affiliates for occupancy of Juno Beach recovers incremental costs.

AMOUNT FORECASTED FOR PROPERTY HELD FOR FUTURE USE

Q. Mr. Larkin has challenged FPL's forecasted amount for Property Held for Future Use. What is the process used to forecast the amount for Property Held for Future Use?

A. As indicated in the testimony of other FPL witnesses, FPL must make significant investments in plant, transmission, and distribution infrastructure to serve Florida's growth and FPL's reliability objectives. As a result of the forecasted infrastructure plans, the need for land on which to build those facilities is identified. Future power plant sites, transmission substation sites, distribution substation sites, and transmission corridor needs are identified for the upcoming 10-year period. Our real estate representatives located around the state know the local markets and provide estimates for acquiring the land to meet the need. Acquisition of land must precede the construction of the facilities, so acquisitions are planned and timed to ensure the company acquires the sites in advance of the construction dates for these new facilities.

Q. Why is the forecasted amount for Property Held for Future Use so much higher than historical trend, and why were historical trend data not used to formulate the 2006 Test Year forecast?

A. There are three primary drivers for the increase in the value of PHFFU for the 2006 test year. First, the cost of acquiring real estate in Florida, and especially South Florida, is escalating rapidly and that escalation shows no sign of abating. The rising cost of real estate is exacerbated by the fact that much of the load growth is in urban areas of FPL's service territory where development and redevelopment have exhausted much of the available and/or suitable land. Second, in the past five years, FPL has seen an increase in the rate of acquisitions necessary to support growth and reliability. As indicated in Document Nos. NAS-1 and NAS-2, the number of sites we have placed under contract has been steadily increasing since 1998 and the number of easements acquired each year has more than doubled in the past five years with progress year-to-date indicating it is tripling this year. Third, the nature of our acquisitions is changing. FPL has identified the need to purchase a power plant site in western Palm Beach County and has included $40 million by 2006 for the site known as the Corbett site or the Western County Energy Center. This is the first time FPL has purchased land for a power plant site in over thirty years. Finally, as older, less expensive sites are put into service and the inventory is updated with newer, more expensive sites, the effect on the 13-month average naturally increases.

Q. In the 2002 Test Year filed in Docket 001148-EI, FPL forecasted PHFFU at $68.26 million while the Surveillance Report for the same period indicated the actual was only $62.77 million. Is this variance significant?

A. This is less than a 10% variance which is not significant or unreasonable given the variability in real estate dealings. Variations from plan can occur due to negotiation of a different price from plan, changes in schedule due to time required to find a suitable site, changes in schedule to allow the necessary time required to exercise appropriate due diligence before closing the deal, or even the cancellation or addition of sites from the original forecast.

Q. Mr. Larkin asserts that, as of March, 2005, FPL's forecast for PHFFU is 75% higher than actual and that FPL had not purchased approximately $48 million of property as planned between December, 2004 and March, 2005. What is your response to Mr. Larkin's contention?

A. Mr. Larkin's selective use of statistics is problematic. FPL had not purchased the full $48 million as of March, 2005, but is on track in acquiring the properties identified in the forecast. As of March, 2005, FPL had purchased $19.9 million (including property mistakenly put into Construction Work in Progress but since moved to PHFFU) and another $7.7 million was under contract. Several additional sites were in final negotiations at that point in time.

The window of time upon which Mr. Larkin bases his conclusions is relatively short and does not account for the timing variations that can occur in real estate dealings. In reviewing the progress against plan through June 30, 2005, the results indicate FPL is tracking on plan when considering sites committed and under contract as well as closed sales.

Forecasted Balance in PHFFU for June 30, 2005:	$100.9 million
Actual Balance in PHFFU as of June 30, 2005:	$ 73.9 million
Properties under contract as of June 30, 2005:	<u>$ 24.6 million</u>
Total Acquired and/or under contract	$ 98.5 million
Difference as of June 30, 2005:	$ 2.4 million

Q. **Does the age of the inventory in PHFFU indicate that this account does not experience dynamic growth?**

A. No. Given that our planning process identifies sites needed for the upcoming ten years, it is to be expected that we would have a number of sites which range in age.

Of the balance in PHFFU as of December, 2004, 23% is in two older properties. One was recently placed into service ($3.65M) and another is the DeSoto power plant site ($9.57M) which is being held in support of future power generation needs on the west coast of Florida. This site is identified in FPL's 10-Year Power Plant Site Plan. The cost of replacing this site in today's market would be costly for the customer.

Excluding the Desoto site, 72% of the sites which represent 80% of the December 2004 balance will be placed into service between now and 2010 as indicated in Document NAS-3. Some of the older properties are transmission corridors which will connect existing corridors at the point in time when growth has made that a requirement. It is more economical to establish transmission corridors prior to the advent of urbanization.

Finally, as indicated in Document NAS-4, of the remaining properties, 48 of the properties are planned to go into service within the next five years. Of these, 23 were purchased in 1995 or before, and the remaining 25 were purchased since 1995. This demonstrates that we are continuing to need both older properties as well as newer properties to satisfy the demand, which represents both a balanced and dynamic flow of properties through Property Held for Future Use.

Q. **Do you believe an adjustment to the forecast for Property Held for Future Use, as recommended by Mr. Larkin, is warranted?**

A. No. In fact, if an adjustment is made, it could be argued that it should be higher given the risk associated with the escalating real estate prices in Florida.

FORECASTED GAIN ON SALES

Q. Why has FPL not forecasted any gains on sales of property as suggested by Ms. DeRonne?

A. Due to the uncertainty regarding properties to be sold, the selling price of such properties, and the timing of such sales, no sales of properties were forecasted for 2005 or 2006.

RENTAL RATES CHARGED TO AFFILIATES FOR OFFICE SPACE IN THE MIAMI GENERAL OFFICE AND JUNO BEACH

Q. Is FPL charging affiliates for space occupied in the Miami General Office and, if so, at what rate?

A. Yes, FPL is charging affiliates for space at the Miami General Office. FPL is charging market rate, which is higher than cost.

Q. How was the market rate determined for the Miami General Office?

A. FPL did not simply estimate the market rate. In 2002, FPL evaluated and used a market rate analysis conducted by the Trammell Crow Company in 2001. That market rent analysis evaluated 5 properties and concluded that a market rental rate of $17.50 was appropriate for the Miami General Office given the nature, location, and condition of the space being rented. This rate is $3.00 higher than cost.

Q. Do you believe this rate is still valid?

A. Yes. In a commercial lease of this nature, a minimum of a 5-year term would be typical. Therefore, we will use this rate for 5 years and then reevaluate the market rate and cost at the end of the 5-year period which will be in 2006.

Q. Is FPL charging affiliates for space occupied in the Juno Beach Office and, if so, at what rate?

A. Yes, FPL is charging affiliates a market rate of $20 per square foot for space at the Juno Beach Office. As indicated in Document NAS-5, the market rate of $20 per square foot enables FPL to recover more than the incremental cost of having affiliates on the Juno Beach premises, lowering the cost for regulated operations, which benefits customers.

Q. How did FPL determine the market rate for the Juno Beach Office?

A. In late 2002 FPL hired Jenkins Appraisal Services to conduct a market rent analysis for Juno Beach. That market rent analysis evaluated 14 properties and concluded that a market rental rate of anywhere from $16 to $20 per square foot was appropriate given the nature, location, and condition of the space being rented. FPL adopted the high end of this range which is the $20 rate.

Q. Do you believe this rate is still valid?

A. Yes. In a commercial lease of this nature, a minimum of a 5-year term would be typical. We, therefore, will use this rate for 5 years and then reevaluate the market rates at the end of the 5-year period which will be in 2007.

Q. Are operating costs included in the rental rate charged to affiliates for office space?

A. Yes. In both Juno Beach and General Office, the market rate being charged is representative of Base Rent and Operating Costs. Operating Costs include all property management costs (maintenance and projects), utilities, insurance, and taxes necessary to keep the facility operating and in good repair. Specific project costs in any given year will vary by facility, but the operating cost portion of market rate includes the type of maintenance and project costs any landlord would need to incur to keep a facility in good condition.

Q. **Does this conclude your rebuttal testimony?**

A. Yes.

I. QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William M. Stout, and my business address is 207 Senate Avenue, Camp Hill, Pennsylvania.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am President of the Valuation and Rate Division of Gannett Fleming, Inc.

Q. PLEASE DESCRIBE THE VALUATION AND RATE DIVISION OF GANNETT FLEMIING, INC.

A. The Valuation and Rate Division of Gannett Fleming, Inc., provides consulting services to public utilities and railroads. The Gannett Fleming affiliated companies employ nearly 1,900 people in over 50 offices throughout the United States. The Valuation and Rate Division of Gannett Fleming, Inc., has a long history of client services encompassing valuations; depreciation studies; revenue requirement, cost allocation and rate design studies; analyses of accounting systems; and acquisition and feasibility studies.

Q. PLEASE STATE BRIEFLY YOUR EDUCATIONAL BACKGROUND AND EMPLOYMENT EXPERIENCE.

A. I have a Bachelor of Science degree in Management Engineering from Rensselaer Polytechnic Institute. While attending Rensselaer, I was employed by the Valuation Division of Gannett Fleming Corddry and Carpenter, Inc., during the summers of 1970, 1971 and 1972. My principal assignments related to valuation studies and computer programming.

After my graduation in June 1973, I was employed by the Valuation Division as a Valuation Engineer. The scope of my activities included assembly of basic data, statistical service life analyses utilizing the retirement rate and simulated plant record methods, field surveys, preparation of preliminary estimates of service life and salvage, calculation of annual and accrued depreciation, and preparation of reports presenting the results of the studies.

In January 1980, I was assigned to the position of Manager of Depreciation and Cost Allocation Studies conducted by the Valuation Division. In June 1982, subsequent to a corporate reorganization, I became a Vice President of Gannett Fleming Valuation and Rate Consultants, Inc. I became a Senior Vice President in 1991 and attained my current position of President in 1994.

Q. **ARE YOU A REGISTERED PROFESSIONAL ENGINEER?**

A. Yes. I am registered in the Commonwealth of Pennsylvania.

Q. **ARE YOU A MEMBER OF ANY PROFESSIONAL SOCIETIES?**

A. Yes, I am a member of the National and Pennsylvania Societies of Professional Engineers, the Institute of Industrial Engineers, and the Society of Depreciation Professionals (SDP). I am a former member of both the Rates & Charges Subcommittee of the American Water Works Association and the Accounting Services Committee of the American Gas Association (AGA) and a past president of SDP.

Q. DO YOUR PROFESSIONAL ACTIVITIES INCLUDE PARTICIPATION IN CONTINUING PROFESSIONAL EDUCATIONAL PROGRAMS?

A. Yes. I have completed the "Fundamentals of Life Estimation," "Forecasting Service Life," and "Making and Administering [Depreciation] Policy" programs conducted by the Center for Depreciation Studies at Western Michigan University. In 1985 I became a member of the faculty of Depreciation Programs, Inc., lecturing on "Forecasting Service Life," "Fundamentals of Salvage Analysis", and "Managing a Depreciation Study". I also have been an instructor at the annual Advanced Accounting Seminar sponsored by AGA and the training programs offered by SDP.

Q. HAVE YOU PREVIOUSLY TESTIFIED ON THE SUBJECT OF DEPRECIATION?

A. Yes. Since January 1978, I have testified in support of depreciation studies for over 30 companies including electric, gas, telephone, and water utilities. I have testified before the California Public Utilities Commission, the Texas Public Utility Commission, the Pennsylvania Public Utility Commission, the Georgia Public Service Commission, the Public Service Commission of Indiana, the New York Public Service Commission, the Alaska Public Utilities Commission, the Alberta Energy & Utilities Board, the Newfoundland Board of Commissioners of Public Utilities, the Federal Energy Regulatory Commission, the National Energy Board of Canada, the Canadian Radio-

Television and Telecommunications Commission and the United States Tax Court on the subject of depreciation.

II. INTRODUCTION AND PURPOSE

Q. WHAT IT THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to rebut the Direct Testimony of Michael J. Majoros, Jr., submitted on behalf of the Office of Public Counsel (OPC).

Q. WHAT IS THE SUBJECT OF YOUR REBUTTAL TESTIMONY?

A. The primary subject of my rebuttal testimony is net salvage. Within the overall topic of net salvage, I will discuss "excessive depreciation", depreciation concepts, the estimation of future net salvage, the alternatives to accrual accounting proposed by Mr. Majoros, and the treatment of net salvage used in other jurisdictions and recommended in authoritative texts. I also will discuss Mr. Majoros' proposal to modify a number of the survivor curve estimates proposed by Florida Power & Light Company (FPL).

Q. HAVE YOU REVIEWED THE DEPRECIATION STUDY OF FPL'S TRANSMISSION, DISTRIBUTION AND GENERAL PLANT THAT IS SPONSORED BY MR. DAVIS?

A. Yes, I have.

Q. ARE THE METHODS OF ANALYSIS AND CALCULATION OF DEPRECIATION RATES USED IN THE FPL STUDY APPROPRIATE?

A. Yes, they are.

Q. ARE THE ESTIMATES OF SERVICE LIFE AND NET SALVAGE REASONABLE?

A. Yes, they are.

III. OFFICE OF PUBLIC COUNSEL'S NET SALVAGE POSITION

Q. PLEASE SUMMARIZE THE POSITION OF OPC WITNESS MR. MAJOROS REGARDING THE RATEMAKING TREATMENT OF NET SALVAGE FOR FPL.

A. Mr. Majoros recommends the use of his "Net Present Value Approach" for the ratemaking treatment of net salvage for FPL. In his Net Present Value Approach, Mr. Majoros discounts the estimates of future net salvage used by FPL to the present using an annual rate of 5.5 percent, the same as the inflation rate that FPL used in its calculation of Asset Retirement Obligations for financial accounting purposes.

Q. WHAT ARE THE BASES FOR HIS PROPOSALS?

A. The bases for the proposals of Mr. Majoros as stated on page 14 of his direct testimony are his depreciation study, a review of net salvage data, FPL's responses to certain Staff and OPC data requests, prior Orders of the

Commission, and FPL's actions regarding depreciation collected from ratepayers.

Q. DO YOU AGREE WITH MR. MAJOROS' PROPOSAL AND THE CONSIDERATIONS ON WHICH IT IS BASED?

A. No, I do not. Mr. Majoros' Net Present Value Approach does not equitably allocate net salvage over the life of assets, and his estimates of service life are unreasonable because they do not properly consider the statistical analyses of FPL data and the typical range of service life estimates used in the industry. Mr. Majoros' proposal is designed to reduce rates for today's customers, but does so at the expense of tomorrow's customers. The Commission should reject this proposal and continue with more reasonable allocations of net salvage costs and typical estimates of service lives. Before addressing the Net Present Value Approach and the specific estimates, I will address the concepts and theories put forth by Mr. Majoros and also his criticisms of the traditional approach to accruing for net salvage.

IV. EXCESSIVE DEPRECIATION

Q. ON PAGE 14 AND 15 OF HIS DIRECT TESTIMONY AND IN EXHIBIT NO.___(MJM-4), MR. MAJOROS REFERS TO THE TERM "EXCESSIVE DEPRECIATION." PLEASE COMMENT.

A. Mr. Majoros expresses his concern over the possibility that the Company's depreciation rates will produce depreciation expense that is "more than necessary to return ...capital investment over the life of an asset." He cites the 1934 decision of the U.S. Supreme Court in Lindheimer v. Illinois Bell Telephone Company in support of his concern. In Lindheimer, the Court held that the company's depreciation was excessive and, therefore, represented a contribution of capital. The court determined that the annual depreciation allowances that resulted from the "studies of the 'behavior of large groups' of items" must "meet the controlling test of experience." Mr. Majoros failed to include in his quote the very next sentence in which the controlling test used by the court was described:

> " In this instance, the evidence of expert computations of the amounts required for annual allowances does not stand alone. In striking contrast is the proof of the actual condition of the plant as maintained..."

The concept of physical depreciation referred to in this sentence is no longer used in the determination of rate base in public utility regulation. Instead, largely as a result of the 1944 decision of the U. S. Supreme Court in Federal Power Commission et al v. Hope Natural Gas Co., net investment has become the primary, if not exclusive, means of determining rate base. In this approach, the Accumulated Provision for Depreciation as recorded on the company's books is deducted from original cost. The Accumulated Provision for Depreciation reflects the past allowances for depreciation, whether they have been excessive or inadequate. Thus, these past allowances are used to limit the amount on which the utility is permitted to earn a return and, in jurisdictions such as the Florida Public Service Commission (FPSC) that adjust the annual depreciation to reflect the level of the Accumulated Provision for Depreciation as compared to the calculated or theoretical reserve, they also are used to limit the amount that will be recovered through future depreciation expense allowances.

V. DEPRECIATION CONCEPTS

Q. IN EXHIBIT NO.___(MJM-5), MR. MAJOROS HAS PROVIDED A DISCUSSION OF DEPRECIATION CONCEPTS. DO YOU HAVE ANY DISAGREEMENTS WITH THE STATEMENTS MADE IN THIS DOCUMENT?

A. Yes, I do. Mr. Majoros' concept of public utility depreciation is at odds with the Uniform System of Accounts and authoritative texts on the subject. He states on page 1 of Exhibit No.___(MJM-5) that "public utility depreciation is straight line capital recovery" and "is accomplished by allocating the original cost of assets to expense..." He repeats this concept again at the bottom of page 2. Depreciation is not simply the allocation of original cost to expense. The Uniform System of Accounts defines depreciation as "the loss in service value not restored by current maintenance incurred in connection with the consumption or prospective retirement of property in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance." The operative words in this definition that differ markedly from Mr. Majoros' definition are *service value*. The Uniform System of Accounts goes on to define service value as "the difference between the original cost and the net salvage value of the utility plant", not as just the original cost. The service value rendered by an asset, i.e., depreciation, must reflect both its original cost and its net salvage.

Q. DOES THE UNIFORM SYSTEM OF ACCOUNTS ALSO ADDRESS THE MANNER IN WHICH DEPRECIATION IS TO BE RECOGNIZED?

A. Yes, it does. The Uniform System of Accounts requires that depreciation be recognized through accrual accounting. That is, the service value of an asset must be accrued during the life of the asset. Since net salvage is a part of the service value, it must be accrued during the life of the related asset in order to comply with the Uniform System of Accounts.

Q. DO YOU DISAGREE WITH ANY OTHER POINTS IN MR. MAJOROS' DISCUSSION OF DEPRECIATION CONCEPTS AS PRESENTED IN HIS EXHIBIT NO.___(MJM-5)?

A. Yes. Mr. Majoros makes several inaccurate or misleading statements throughout this exhibit. On page 1, he states that "in certain jurisdictions public utility depreciation rates incorporate net salvage factors". A more accurate statement would be "in *nearly all* jurisdictions public utility depreciation rates incorporate net salvage factors". I will discuss the policy of several state commissions on this subject later in my testimony. At the top of page 5, he states "Some utilities, such as FPL, include net salvage in the depreciation rate calculation." This statement more properly should state that "*Nearly all* utilities, including FPL, include net salvage in the depreciation rate calculation."

On page 3, Mr. Majoros states "...but no cash flows out of the company for depreciation expense." This is a true statement, but also may leave an incorrect impression. In order for the company to record depreciation expense, it must have first experienced a cash outflow which is represented by the original cost of the asset. Depreciation allows the recovery of that cash outflow by the company.

Mr. Majoros claims on page 5 that the net salvage adjustment in the numerator of the equation for the annual depreciation accrual rate is "equivalent to capitalizing or adding the estimated cost of removal to the original cost of the asset". This is only true mathematically with respect to the formula for the annual depreciation accrual. It is not true conceptually and such amounts are not capitalized for rate base purposes. He goes on to say in the concluding paragraph on page 5 that "when negative net salvage is included in the depreciation rate there will not be an equality of plant and reserve at the end of an asset's life because the Company will have charged more depreciation than it paid for the original cost of the asset." Of course they will have charged more than the original cost. The total depreciation expense must equal the sum of the original cost and the negative net salvage, not just the original cost. This is in accordance with the definition of depreciation as set forth in the Uniform System of Accounts and authoritative texts on the subject of public utility depreciation. Once the net salvage costs are incurred, the equality of plant and reserve at the end of an asset's life is restored.

Mr. Majoros continues his assault on net salvage at the top of page 6 by implying that the equality of depreciation expense with company expenditures, original cost and negative net salvage, "will only be achieved if the Company actually spends the additional money at the end of the asset's life. However, unless the Company has a legal liability to remove the asset, it is not required to spend the money." While FPL does not have a legal obligation to remove most of its plant, it does have an obligation to provide service. In order to provide service, FPL must continually renew its plant by adding new assets and retiring old assets. FPL has been spending significant sums to retire plant for many years. I see no reason to suspect that it will not continue to do so indefinitely into the future.

Mr. Majoros then suggests that the amounts recovered from ratepayers for negative net salvage could be used to pay "salaries, dividends, etc." While it is true that dollars paid by customers are not earmarked, it is disingenuous to suggest that dollars recovered for negative net salvage are not needed for plant expenditures. Each year FPL spends significantly more on plant, both its installation and removal, than it recovers in depreciation expense.

On page 9, Mr. Majoros concludes his discussion of Depreciation Concepts with an unsupported claim that "Many of FPL's proposed depreciation rates contain negative net salvage factors which charge too much for future cost of removal because they are too negative." On the strength of nothing but this unsupported supposition, he then concludes that "The combination of these two factors, i.e., understated lives and overstated cost of removal ratios, compounds the excessive depreciation rate problem." While that would be a true statement if the supposition were correct, in fact the supposition is belied by the overwhelming evidence in this proceeding. In my opinion, many of FPL's existing depreciation rates contain negative net salvage factors which charge too little for future cost of removal. If anything, FPL has a problem with *inadequate,* not excessive, depreciation rates.

VI. ESTIMATION OF NET SALVAGE

Q. BEGINNING ON PAGE 24 OF HIS TESTIMONY, MR. MAJOROS DESCRIBES WHAT HE REFERS TO AS THE TRADITIONAL INFLATED FUTURE COST APPROACH OR TIFCA. ARE YOU FAMILIAR WITH THE APPROACH BEING DESCRIBED BY MR. MAJOROS?

A. Yes, I am.

Q. HAVE YOU EVER HEARD OR READ OF IT REFERRED TO AS "TIFCA" BY PERSONS OTHER THAN MR. MAJOROS?

A. No, I have not. The name and related acronym were apparently made up by Mr. Majoros.

Q. ON PAGE 26 OF HIS DIRECT TESTIMONY, MR. MAJOROS

STATES THAT "TIFCA" NET SALVAGE STUDIES RELATE REMOVAL COSTS IN CURRENT DOLLARS TO RETIREMENTS IN VERY OLD HISTORICAL DOLLARS. IS THAT CORRECT?

A. Yes and no. While it is true that traditional studies of net salvage use as their statistical bases data that relate the cost of retiring an asset or group of assets to its original cost, such original costs are not usually of very old historical dollars. Instead, as I will discuss later, the average age of the retirements on a dollar weighted basis is relatively young, normally a fraction of the account's average life, and thus the original cost of the retired property reflects "young," not "old" historical dollars.

Q. IS THE EXAMPLE OF TIFCA PRESENTED BY MR. MAJOROS ON PAGES 26 THROUGH 30 OF HIS DIRECT TESTIMONY TYPICAL OF THE NET SALVAGE ANALYSIS AND APPLICATION FOR FPL?

A. No, it is not. First, the Hypothetical TIFCA Net Salvage Study on page 27 reflects retirements that occur at age 50. This is atypical. For most accounts, the average age of the retirements that are included in the analyses of net salvage is much less than 50 years. Consider the retirements for Account 365, Overhead Conductors and Devices, as shown on pages 7 and 8 in the section of the Depreciation Study titled "Average Age of Retirements." The average age of the retirements during the period 1941 through 2004 in this account was 16.79 years, less than half the estimated average life for the account of 35 years. Thus, the change in price level between installation and removal took place over a period of approximately 17 years, not 50 years as shown by Mr. Majoros. Although inflation has occurred since those assets were originally purchased, it is not nearly the amount implied by Mr. Majoros' use of 50-year old plant retirements. Plant that is 17 years old does not represent "very old historical dollars."

Second, Mr. Majoros uses a five-year period in the example and states "FPL's TIFCA studies show figures from two bands of historical net salvage data; a ten-year band and a five-year band as a basis for its future net salvage estimates." This is an incorrect statement. I'm not sure what depreciation study Mr. Majoros was reviewing when he wrote this portion of his testimony, but the band used by FPL, as shown in the Net Salvage section of the Depreciation Study, is for the period 1986-2004, a 19-year band.

Third, Mr. Majoros suggests that the experience with the $4,000 retirement in a single year in his example would be applied to a plant balance of $100,000,000, a ratio of 25,000 to 1. Nothing could be further from the truth. Continuing with the actual data for Account 365, the amount retired during the period 1986-2004 was $111,424,685. The net salvage estimate, based on the analysis of $111 million, was applied to a plant balance of $973 million, a ratio of 9 to 1, vastly lower than the ratio implied by Mr. Majoros's exhibit and a very reasonable approach, in my opinion.

Finally, Mr. Majoros mentions "negative [net salvage of] 350 to 400 percent as a result of TIFCA studies" to further support the "dollar mismatch" that he is trying to demonstrate. In response, I would simply note that the most negative estimate for FPL in the present study is negative 60 percent for Account 369, Services, Overhead. Mr. Majoros states on page 31 that amounts collected by FPL are a fiction. I disagree. Throughout his example and discussion of TIFCA, it is Mr. Majoros who engages in fiction.

Q. WHAT WERE THE STATISTICAL BASES FOR FPL'S NET SALVAGE ESTIMATES?

A. The statistical bases for FPL's estimates of net salvage were the historical net salvage costs as a percent of the original cost of the retired assets that produced the gross salvage or required the costs to remove during the period 1986-2004.

Q. DOES THE USE OF THIS STATISTICAL BASIS RESULT IN THE COLLECTION FROM CURRENT CUSTOMERS OF REMOVAL COSTS AT THE PRICE LEVEL THAT WILL BE IN EFFECT WHEN THE PLANT IN SERVICE IS RETIRED?

A. No, it does not. Although the reliance on historical indications of net salvage as a percent of the original cost retired results in the collection of net salvage costs at a future price level, it is a price level that is less than the price level that will be in effect when the plant in service is retired. Reliance on the historical indications will result in removal costs at the price level at the time of retirement only if there are substantial improvements in technology, comparable or lesser environmental regulations and a significant reduction in inflation.

Q. HOW DOES USE OF NET SALVAGE PERCENTS THAT ARE COMPARABLE TO THE HISTORICAL INDICATIONS ASSUME THESE EVENTS?

A. The net salvage percents, that is the net salvage costs divided by the original costs of the assets that have been retired and expressed as percents, are related to the retirement of plant that on average is significantly younger than the average service life of the plant in service, on an original cost dollar weighted basis. For example, the average age of retirements of Account 365, Overhead Conductor and Devices during the period 1986 through 2004 was 18.8 years. This amount is approximately half of the average life of 35 years estimated for this account.

The average cost of removal percent related to the retirements from this account during this same period of 1986-2004 was negative 50 percent. Thus, after 19 years in service, the plant was retired and the cost to remove the plant, as a result of inflation, technological changes and other factors, was 50 percent of the cost to install the same plant.

The future retirements of the total current overhead conductors in service will have an average age that actually exceeds the average life. Thus, future retirements will be of plant that has been in service nearly twice as long as the retired plant. For retirements at such ages to experience net salvage that is 50 percent of the cost to install, which is the estimate used in FPL's depreciation study, there will have to be a reduction in the rate of inflation adjusted for technological improvements over the time that passes before the property for which removal costs are currently being collected is retired. In fact, because those future retirements are going to have an average age approximately twice as long as the average age of the property presently being retired, the rate of inflation adjusted for technological improvements will need to be less than half of the rate that occurred during the life of the plant that was retired during the period 1986-2004 for FPL to avoid under-recovering the cost of removal.

Q. DO YOU HAVE ANY CONCERN THAT THE LEVEL OF NET SALVAGE COSTS INCURRED WILL BE LESS THAN THE AMOUNTS THAT FPL HAS ESTIMATED?

A. No, I do not. Net salvage costs will be incurred. For the reason just discussed, FPL's estimates will almost certainly result in the recovery of *less*, not more, net salvage than the actual costs incurred.

Q. IS IT APPROPRIATE TO ASK CURRENT CUSTOMERS TO PAY FOR FUTURE COSTS OF REMOVAL AT A PRICE LEVEL THAT IS GREATER THAN TODAY'S PRICE LEVEL?

A. Yes, it is. The future cost to remove an item of plant is part of the service value that it renders to current customers and a ratable portion of such costs should be recovered from these customers. That is the definition of depreciation, i.e., the loss in service value during a specific period. As these future costs are recovered from current customers, they are deducted from rate base. This deduction in the amount on which the utility is entitled to earn a fair return, in effect, represents a return to customers. That is, as customers provide for the future cost of removal, they receive a return on such amounts, in the form of a reduction in the return that they otherwise would have to pay the utility. This is fair compensation for making payment prior to the cost incurrence by the utility. Further, as already noted, by charging customers for these costs during the life of the plant; the customers that benefit from the plant, or consume its service value, are the ones that pay for such service. Customers paying today for future costs of removal and receiving a return on such payments is no different than the utility recovering today amounts that it invested many years ago, but on which it earned a return until the amount was recovered from customers.

Q. WHY ARE THE CURRENT NET SALVAGE ACCRUALS SO MUCH GREATER THAN THE CURRENT EXPERIENCE?

A. The difference in price level as described above is part of the difference. Another significant difference is that the current experience is related to plant retirements that largely come from an older, smaller plant base that was constructed to serve fewer customers, whereas the current net salvage accruals relate to the larger amount of plant presently in service that is required to serve a much larger customer base.

Q. IS IT APPROPRIATE FOR FPL TO COLLECT AMOUNTS FOR FUTURE NET SALVAGE COSTS THAT ARE GREATER THAN THE AMOUNTS CURRENTLY EXPENDED FOR SUCH COSTS?

A. Yes, it is. Although the amount that FPL proposes to collect from customers for future net salvage costs is greater than the amount currently expended for such costs, the amount that FPL spends for plant is far greater than the amount that it proposes for the recovery of original cost. If net salvage accruals should be limited to current net salvage expenditures, why shouldn't the portion of depreciation expense related to the recovery of original cost be increased to the current level of plant expenditures? For example, in the year 2004, FPL's total plant expenditures were $1,394 million. Adding the net salvage costs of $27 million for that year to this amount, results in total expenditures of $1,421 million in 2004. This total expenditure is nearly twice the level of 2004 depreciation expense that includes the recovery of past original costs and future net salvage costs. When both sides of the coin are considered, the amount for recovery of costs is far less than actual expenditures. Equity considerations require that customers pay for the service value, original cost less net salvage, of the plant from which they receive service. The fact that this results in accruals for net salvage that are greater than the current experience is not unfair.

Q. **WHAT IS THE IMPACT OF ACCRUALS FOR NET SALVAGE EXCEEDING THE CURRENT NET SALVAGE COSTS?**

A. The impact of accruals in excess of costs is a balance in Account 108, Accumulated Provision for Depreciation, which is deducted both from rate base and from determinations of future depreciation accruals.

Q. **WHAT DOES THIS BALANCE REPRESENT?**

A. The balance in the Accumulated Provision for Depreciation of past net salvage accruals in excess of past net salvage costs represents the amount accrued toward the future net salvage costs of the plant in service. It represents the portion of the service value that these assets have already rendered.

Q. **HOW IS THIS BALANCE RECORDED FOR FINANCIAL REPORTING PURPOSES?**

A. In accordance with Financial Accounting Standard No. 143, Accounting for Asset Retirement Obligations, and subsequent guidance from the Securities and Exchange Commission, the balance in the Accumulated Provision for Depreciation of past net salvage accruals in excess of past net salvage costs for assets for which FPL does not have a legal obligation to remove the asset is recorded as a regulatory liability for financial reporting purposes.

Q. **ON PAGE 25 OF HIS TESTIMONY, MR. MAJOROS STATES THAT THIS REGULATORY LIABILITY REPRESENTS "AN AMOUNT OWED TO RATEPAYERS UNTIL IT IS SPENT ON ITS INTENDED PURPOSE." DO YOU AGREE?**

A. No, I do not. The amounts paid by customers were for services rendered by FPL in accordance with the tariffs approved by the Florida Public Service Commission. Recording these amounts to the Accumulated Provision for Depreciation account affords the ratepayer the protection of not having to pay for such amounts a second time and provides the assurance that FPL will use such amounts for their intended purpose unless ordered to do otherwise by the Commission. These amounts will continue to be deducted from rate base and from determinations of future depreciation accruals until they are spent on cost of removal. Periodic depreciation studies and Commission oversight will not permit such amounts to mysteriously disappear into income as Mr. Majoros fears.

Q. DOES THE ABSENCE OF A LEGAL OBLIGATION TO REMOVE THESE ASSETS RAISE A CONCERN AS TO WHETHER FPL WILL ACTUAL REMOVE THEM?

A. No, it does not. The legal obligation standard of FAS No. 143 for recognizing a liability to retire plant does not recognize the reality of ongoing utility operations. Although the utility may not have a legal obligation to remove plant, it nevertheless does so on a regular basis and will continue to do so in the future.

VII. THE MAJOROS ALTERNATIVES

Q. ON PAGES 31 THROUGH 34 OF HIS DIRECT TESTIMONY, MR. MAJOROS PROVIDES THE COMMISSION WITH THREE ALTERNATIVES TO THE TRADITIONAL ESTIMATION AND ACCRUAL FOR NET SALVAGE. PLEASE COMMENT ON HIS FIRST APPROACH: "EXPENSING".

A. The first alternative offered by Mr. Majoros is the cash basis or expensing approach. Expensing does not charge the appropriate customers for the cost of retiring an asset and should be rejected. It defers the recovery of costs and imposes it on customers who are no longer, or never were, served by the asset. Mr. Majoros also suggests, both on pages 30 and 31, that a portion of the cost of retiring assets be charged to the cost of the replacement asset. This is worse, as it further defers the recovery of a cost properly attributable to the customers served by the asset. Mr. Majoros states that the allocation of costs between installation and removal is "somewhat arbitrary." This is not the case. The allocations are based on analyses of the effort required to do the several tasks related to the installation and removal of the asset. The resultant allocations are reasonable for both accounting and ratemaking purposes.

Q. PLEASE COMMENT ON HIS SECOND APPROACH: "NORMALIZED NET SALVAGE ALLOWANCE."

A. Mr. Majoros characterizes his normalized net salvage approach as representing an accrual basis. This is not true. The addition to depreciation expenses of an amount based on historical average net salvage amounts does not represent an accrual for the future cost of retiring assets. He states it is "similar" to the cash basis. This is disingenuous: this proposal *is* the cash basis. The only difference is that he has called it depreciation expense and charged it the Accumulated Provision for Depreciation rather than calling it an operating expense. For ratemaking purposes, this is the same approach and should be rejected for all the reasons that I discussed above for expensing.

Q. PLEASE COMMENT ON HIS THIRD APPROACH: "NET PRESENT VALUE."

A. The net present value accrual, the approach recommended by Mr. Majoros in this proceeding, is his attempt to remove inflation from the estimated future net salvage. The sum of the accruals based on the net present value of future net salvage will be significantly less than the amount required to retire assets at the end of their lives. Mr. Majoros makes no provision for this shortfall. Thus, there is an inherent flaw in this approach. Further, if the service value of the asset is to be adjusted to current price levels, then the future net salvage and the historical original cost should both be adjusted. I suspect Mr. Majoros would reject this modification to his net present value approach. I recommend that the Commission reject this alternative as well.

Q. **YOU STATED THAT THIS APPROACH IS MR. MAJOROS' ATTEMPT AT REMOVING INFLATION. DOES HE ACHIEVE HIS INTENDED PURPOSE?**

A. He more than achieves it, thus exposing the fundamental flaw of his "net present value" approach. Mr. Majoros removes far more inflation than is reflected in FPL's estimates of future net salvage. For example, continuing to use Account 365, Overhead Conductors and Devices, Mr. Majoros has reduced the estimated future net salvage percent by a factor of 3.43 from negative 50 percent to negative 14.59 percent by removing 23 years of inflation at 5.5 percent per year. The results of this calculation are presented in Exhibit No.___(MJM-9) and 23 years is used because it is the average remaining life of Account 365. However, the estimate of negative 50 percent does not reflect an inflation factor of 3.43. Instead, the inflation factor reflected in this estimate is the inflation during the past 19 years, the average age of retirements. According to the Handy Whitman Index of Public Utility Construction Costs, overhead conductors have experienced an inflation factor of 1.74 during the past 19 years in the South Atlantic Region. Thus, the level of inflation reflected in both the retirement data and the FPL estimate based on such data is only half the amount of inflation that Mr. Majoros has removed.

Q **WOULD THE REDUCTION OF FPL'S ESTIMATES OF NET SALVAGE BASED ON THE LEVEL OF INFLATION REFLECTED IN THE ESTIMATE BE APPROPRIATE?**

A. No, it would not. In fact, as I discussed earlier a more appropriate adjustment would be to *increase* the estimates of net salvage to reflect the additional inflation that will occur between installation and removal for the plant in service as compared to the plant that has been retired. The plant presently in service will be retired at its average probable life. The average probable life is equal to the average remaining life plus the average age of the plant and is always greater than the average life of the account. The average life of overhead conductors is 35 years. The average probable life of overhead conductors is greater than 35 years and is the period between installation and retirement for the plant in service. Thus, there will be at least 16 years of additional inflation reflected in the removal cost of the plant in service by the time it is retired as compared to the 19 years of inflation reflected in the removal cost for the plant already retired. Using a conservative rate of 3 percent inflation for this additional period of 16 years would suggest that we increase the negative 50 percent estimate by a factor of 1.6 to negative 80 percent. It is this correct analysis of the impacts of inflation on the analysis and the estimate that led me earlier to conclude that FPL's estimates likely understate future net salvage costs.

Q. ON PAGE 33, MR. MAJOROS STATES THAT HIS NET PRESENT VALUE APPROACH IS "<u>TOTALLY CONSISTENT WITH THE COMMISSION'S DEPRECIATION RULES.</u>" DO YOU AGREE?

A. No, I do not. The Commission rule that is cited by Mr. Majoros applies specifically to the dismantlement of fossil fuel power stations, not to the mass properties included in Transmission, Distribution and General Plant to which he has applied the rule. The only rules that the Commission has related to this issue for Transmission, Distribution and General Plant are those in the Uniform System of Accounts (USOA) that it has adopted and regulatory precedent. The USOA requires that the net salvage costs be accrued over the service life of the asset. Regulatory precedent for these assets has required that the accrual be on a straight line basis. Both the Commission's rules for fossil fuel power stations and its regulatory precedent for Transmission, Distribution and General Plant result in accruals that equal future net salvage. Mr. Majoros' proposal is not consistent with these rules as it will not result in accruals that equal the future net salvage costs.

VIII. DEPRECIATION TEXTS AND REGULATORY PRECEDENTS

Q. DO AUTHORITATIVE TEXTS ON DEPRECIATION SUPPORT MR. MAJOROS' PROPOSALS RELATED TO NET SALVAGE?

A. I am not aware of any authoritative texts on the subject of depreciation that support these alternative proposals related to net salvage costs. The two depreciation texts most often cited by depreciation experts as being authoritative support the traditional approach that I have proposed. Public Utility Depreciation Practices, published in 1996 by the National Association of Regulatory Utility Commissioners states:

> Closely associated with this reasoning are the accounting principle that revenues be matched with costs and the regulatory principle that utility customers who benefit from the consumption of plant pay for the cost of that plant, no more, no less. The application of the latter principle also requires that the estimated cost of removal of plant be recovered over its life.[1]

Depreciation Systems, another widely accepted text states the concept in this manner:

> The matching principle specifies that all costs incurred to produce a service should be matched against the revenue produced. Estimated future costs of retiring of an asset currently in service must be accrued and allocated as part of the current expenses.[2]

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1 Public Utility Depreciation Practices. Page 157. National Association of Regulatory Utility Commissioners. 1996.

2 Depreciation Systems, Wolf, Frank K. and W. Chester Fitch. Page 7. Iowa State University Press. 1994.

Q. WHAT OTHER STATE COMMISSIONS HAVE ALLOWED HIS 5-YEAR NET SALVAGE APPROACH?

A. I have testified extensively about depreciation around the country and have seen this approach approved in only four jurisdictions. The Pennsylvania Public Utility Commission uses the 5-year net salvage amortization pursuant to a 1962 court order interpreting and applying unique Pennsylvania law. The Kentucky Public Service Commission used it for two small electric cooperatives that did not maintain detailed records of cost of removal and gross salvage by account. In other Kentucky cases, where the utility maintains detailed records of net salvage as FPL does, the traditional methodology that I have used is adopted. The Board of Public Utilities of the State of New Jersey and the Georgia Public Service Commission have also used the expensing or five-year amortization approach.

Q. WHAT IS THE TREATMENT GIVEN TO NEGATIVE NET SALVAGE IN THE DETERMINATION OF THE ANNUAL DEPRECIATION RATES IN THE VAST MAJORITY OF STATE COMMISSIONS?

A. To the best of my knowledge, the 46 state utility commissions not mentioned above each use the traditional treatment of incorporating negative net salvage in the determination of an appropriate depreciation rate, which is consistent with FPL's approach in this case.

Q. HAVE ANY OF THESE COMMISSIONS RECENTLY DEALT WITH THIS ISSUE?

A. Yes, the Missouri Public Service Commission and the Indiana Utility Regulatory Commission both recently affirmed the use of the traditional straight line accrual of net salvage during the life of the related property.

Q. PLEASE DESCRIBE THE MANNER IN WHICH THE MISSOURI COMMISSION DEALT WITH THE ISSUE OF NET SALVAGE?

A. The Missouri Public Service Commission has been dealing with the issue of net salvage for a number of years. It had originally adopted the expensing approach in a few cases while continuing to adopt the traditional straight line accrual method in another case. Laclede Gas Company appealed its case in which the Commission effectively adopted the expensing approach. The order was remanded to the Commission by the courts. During the remand proceeding the Commission accepted additional evidence on the subject of net salvage. In its final order, the Commission concluded:

> "The Commission finds that the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption. The Commission further finds that the method utilized by Laclede is consistent with that fundamental goal."

Q. WHAT CONCLUSIONS DID THE INDIANA COMMISSION REACH IN ITS RECENT RULINGS ON THIS SUBJECT?

A. The Indiana Utility Regulatory Commission considered the net salvage issue in its 2004 order involving PSI Energy. It dealt with net salvage related both to production plant and to delivery assets, i.e., transmission and distribution plant. The Commission's conclusions regarding the appropriate recognition of net salvage for both types of facilities are as follows:

> "The next issue is the timing of the collection of such costs. The parties did not disagree that dismantling costs are a part of the cost of current facilities providing current service. They disagreed as to the timing of the collection of such costs and their amount. This Commission can either find that current customers should pay a share of dismantling costs, which will not be incurred for a number of years, or, in the alternative, conclude that these costs should be passed on to a future generation of customers. This Commission does not believe that the latter alternative constitutes sound regulatory policy, or is based on sound ratemaking principles. Current customers are receiving service from PSI's generation facilities. A part of the costs of those facilities is dismantlement upon retirement. Therefore, we do not believe it would be appropriate for the Company to backload the dismantlement costs for future ratepayers to pay when the facilities associated with these costs are providing service to current customers. Rather, we find it is appropriate that these costs be shared by all customers that received service from PSI's generation facilities. Accordingly, this Commission finds that dismantlement costs are properly included in determining the depreciation rates approved in this cause.
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> . . .
>
> We believe that there is a sound basis for the traditional approach on this issue that is utilized by a majority of states. Utilizing historical averages as an item to be expensed to current customers means that these customers will be paying for salvage costs at levels that may not be sufficient. That means that the next generation of customers will be paying for salvage costs related to facilities from which they may never have received service. The use of best estimates of future salvage costs addresses this

> inequity. Moreover, use of historical averages for dismantling costs does not take into account the current configuration of PSI's system with regard to its production, transmission, distribution and general facilities. Facilities in service 40-50 years ago did not take into account the significantly enhanced customer base that PSI now serves, nor the current configuration of PSI's facilities that serve these customers. It seems appropriate to utilize best cost estimates for net salvage values taking into account specific facilities now serving PSI's customers in developing depreciation rates that today's customers should pay. Accordingly, we find that the use of historical averages for net salvage values with regard to transmission, distribution and general plant for the purpose of expensing them outside the context of the depreciation determination should be, and hereby is, rejected.

IX. SPECIFIC SERVICE LIFE ESTIMATES

Q. WHAT ARE THE SPECIFIC ACCOUNTS FOR WHICH MR. MAJOROS HAS ESTIMATED A SERVICE LIFE THAT IS DIFFERENT FROM THE ESTIMATE OF FPL?

A. Mr. Majoros has revised FPL's estimates of service life for Accounts 350.2, Easements; 352, Structures and Improvements; 357, Underground Conduit; 358, Underground Conductors and Devices; 359, Roads and Trails; 361, Structures and Improvements; 366.6, Underground Conduit – Ducts; 366.7, Underground Conduit – Direct Buried; 369.7, Underground Services; and 397.8, Communication Equipment – Fiber Optics.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 350.2, EASEMENTS.

A. The rights of way in this account relate to easements for certain transmission lines. The statistical analysis for this account is indeterminate with insignificant information available beyond age 50. FPL retained the 50-S4 and Mr. Majoros has increased the life to an average life of 99 years, also with the S4 type curve. This suggests the use of certain rights for a period of 170 years. Although the industry limits for this account may be 25 to 100 years, the estimates at the outer limits should not be considered for this purpose. Instead, I have selected the values that comprise 80 percent of the estimates. This typical range of lives for this account is from 50 to 80 years. Mr. Majoros' estimate is well beyond this typical range and his maximum life is beyond credulity.

Mr. Majoros' estimate of 99 years is beyond the upper end of the typical range for this account and produces a maximum life that is not consistent with the maximum life of the related transmission lines and should be rejected.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 352, STRUCTURES AND IMPROVEMENTS.

A. The current and FPL proposed estimate for this account is the 47-S4. It is a good fit of the significant portion of the original survivor curve as shown on page 13 of the Transmission Plant section of the Depreciation Study. The portion of the original survivor curve beyond approximately age 45 is not significant because the amount of plant exposed to retirement is small and the retirements are sporadic. Mr. Majoros has increased the estimate of service life and modified the type curve by proposing the 63-L2. His primary justification is that it is the best fit of all the data points, regardless of whether the plant exposed at older ages is sufficient for purposes of forecasting future rates of retirement. This reminds me of his concern regarding the use of a net salvage percent derived from a $4,000 retirement and its application to $100,000,000. Relying on a statistical fit of all data points for life estimation is no different. Although his estimate of 63 years is within the outer limits of service lives estimated for this account, it is outside the typical range of 40 to 60 years that 80 percent of the estimates are within. In contrast, FPL's estimate of 47 years is near the midpoint of this typical range. Finally, Mr. Majoros' estimate of the 63-L2 forecasts that structures could live as long as 177 years, the maximum age of the 63-L2. This is not reasonable and should be rejected.

Q. **PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 357, UNDERGROUND CONDUIT.**

A. Mr. Majoros has once again relied entirely on statistics rather than use them with common sense. His 74-S2 projects an average life that is nearly twice the oldest significant survivor for this account and a maximum life of 144 years. These are both unreasonably long. The 46-S3 that FPL estimated for underground conduit projects a more reasonable maximum life. This is confirmed by a review of other estimates used in the industry. Although the outer limits are 6 to 80 years, the more typical range is 40 to 60 years. Mr. Majoros' estimate of 74-S2 is outside this range, relies on insignificant statistics at older ages, and should be rejected.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 358, UNDERGROUND CONDUCTORS AND DEVICES.

A. For this account, Mr. Majoros modifies his best fit curve, 65-R2.5, to the 60-R3. The basis for the modification is the upper limit of the industry range of estimates and the type curve that, in conjunction with a 60-year life, provides the best fit of the entire original survivor curve. Neither curve is reasonable for underground conductor. Although the outer limits of life estimates in the industry are 4 to 60 years, a life of 60 for this account is no more reasonable than the life of 4 years. 80 percent of the industry estimates are within the range of 35 to 45 years. FPL's estimate of 35-S3 is far more reasonable for this account.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 359, ROADS AND TRAILS.

A. The roads and trails in this account relate to certain transmission lines. The statistical analysis for this account is indeterminate with insignificant information available beyond age 45. FPL retained the 50-SQ and Mr. Majoros has increased the life to an average life of 99 years with the S4 type curve. This suggests the use of certain roads for a period of 170 years. Mr. Majoros apparently ignored the outer limits of industry estimates for this account as they range from 4 to 90 years. The values that comprise 80 percent of the estimates range from 40 to 75 years. Mr. Majoros' estimate of 99 years is beyond the upper end of the typical range for this account and produces a maximum life that is not believable and should be rejected.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 361, STRUCTURES AND IMPROVEMENTS.

A. Mr. Majoros has estimated the 61-R2.5 based on a statistical fit of the entire original survivor curve and the industry range of 4 to 75 years. The typical range in which contains 80 percent of the values is 35 to 60 years. The 45-L3 used by FPL is more reasonable for these assets and within the typical range used in the industry.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 366.6, UNDERGROUND CONDUIT – DUCT SYSTEM.

A. Mr. Majoros has estimated the 68-L2 based on a statistical fit of the entire original survivor curve. The maximum life of the 68-L2 is 191 years, rather long even by the most optimistic standards. Although well within the outer limits of the industry range, his estimate is toward the upper end of the more typical range of 44 to 70 years. The estimate of FPL is the 48-S3, toward the lower end of the typical range, but with a much more reasonable maximum life of 92 years. The current estimate of 48-S3 should be retained.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 366.7, UNDERGROUND CONDUIT – DIRECT BURIED.

A. Conduit that is direct buried has been used on the FPL system in significant amounts for about 30 years. It is at this age that the estimates of Mr. Majoros, the 66-S1, and FPL, the 41-S3, diverge. After age 30, Mr. Majoros relies on rates of retirement from the original survivor curve that were developed from an insufficient amount of conduit. The life estimate for this account should be somewhat, but not significantly greater, than the life of Account 367, Underground Conductors and Devices – Direct Buried. Both FPL and Mr. Majoros used the 34-R2.5 for underground conductors that are direct buried. The 66-S1 is not at all close to the 34-R2.5. Mr. Majoros' proposal should be rejected and the 41-S3 proposed by FPL should be adopted.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 369.7, UNDERGROUND SERVICES.

A. Mr. Majoros does not include a discussion of this account in his direct testimony. The following observations are based on a review of his exhibits. Mr. Majoros recommends an increase in the life for this account from 34 to 65 years through a slavish fitting of the entire original survivor curve using the outer limit life from his review of industry estimates. Although the outer limits for underground services are 20 to 65 years, the typical range for this group is 30 to 40 years.

It also is logical that the life of this account would be similar to both Account 367, Underground Conductors and Devices, and Account 369, Services – Overhead. Many of the forces of retirement that act on underground conductors are the same in account 367 and 369. Many of the forces of retirement that act on overhead services, e.g., changes in demand or loss of customer, are the same for underground services. The lives used by both Mr. Majoros and FPL for these similar accounts are within the narrow range of 34 to 38 years.

The 34-R2 survivor curve, which is used for FPL's current and proposed estimates, should be retained. It is within the typical range of estimates for this account and comparable to the estimates for similar FPL accounts.

Q. PLEASE DISCUSS THE SERVICE LIFE ESTIMATE FOR ACCOUNT 397.8, COMMUNICATION EQUIPMENT – FIBER OPTICS.

A. Mr. Majoros relies on data related to plant that has since been transferred to a separate company. The current equipment is of more recent vintage and has had little retirement experience. The average age of the plant in this account is 4.83 years. If it were all retired in 2005, the account would experience a life greater than the 4 years that was estimated by Mr. Majoros. The 10-L0 proposed by FPL is more reasonable and should be adopted.

X. SUMMARY AND CONCLUSION

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. The service life and net salvage proposals of Mr. Majoros should be rejected. Depreciation, including both the original cost and net salvage, should be recognized ratably during the life of the related asset. Assets render service relatively uniformly during their service lives. The net present value approach back-end loads the recovery of such costs and is not fair to future ratepayers. The other two alternatives proposed by Mr. Majoros also should be rejected. None of the alternatives provides for both complete capital recovery and intergenerational equity.

The traditional approach to estimating future net salvage used by FPL is appropriate and results in estimates of net salvage that actually may understate future net salvage costs. The discounting by Mr. Majoros drastically overstates the inflation that is reflected in the estimates of FPL. More importantly, FPL's net salvage estimates should not be discounted at all; it would be more appropriate to actually increase the estimates of future net salvage costs.

The estimates of service life of Mr. Majoros are the result of a slavish and unrealistic adherence to statistics in some cases, an inappropriate reliance on the outer limits of estimates used by other utilities, and an unwillingness to consider the circumstances that produced the data in other cases. The estimation of service life requires judgment that considers appropriate factors as I have described above. Mr. Majoros' estimates do not properly incorporate such factors and should be rejected.

Mr. Majoros' conclusions regarding the magnitude of the variance between the Accumulated Provision for Depreciation and the theoretical reserve are based on his net salvage proposal and his estimates of service lives. Inasmuch as his net salvage proposal and his service life estimates are without merit, his conclusions regarding the status of the Accumulated

Provision for Depreciation are also without merit and should be rejected. The depreciation rates proposed by FPL should be adopted.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF K. MICHAEL DAVIS

DOCKET NO. 050045-EI & DOCKET NO. 050188-EI

JULY 28, 2005

Q. Please state your name and business address.

A. My name is K. Michael Davis, my business address is 9250 West Flagler Street, Miami, Florida 33174.

Q. Are you the same K. Michael Davis who submitted direct testimony and supplemental direct testimony in this proceeding?

A. Yes.

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

A. Yes. I am sponsoring an exhibit consisting of 11 Documents, KMD-10 through KMD-20, which are attached to my rebuttal testimony.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to rebut positions taken in this case by the following witnesses for the intervenors and the FPSC Staff:

- Office of Public Counsel (OPC) witnesses Donna DeRonne, Kimberly H. Dismukes, Hugh Larkin, and Michael Majoros
- South Florida Hospital and Healthcare Association (SFHHA) witness Lane Kollen
- Florida Retail Federation (FRF) witness Sheree L. Brown
- Commercial Group witness James T. Selecky

- FPSC Staff witness Kathy Welch

My rebuttal testimony covers the following areas where issues have been raised:

- Capital Structure
- Rate Case Expenses
- Automated Meter Reading Project
- CWIP in Rate Base
- Working Capital
- GridFlorida
- Nuclear Fuel Last Core and End-of-Life Materials and Supplies Accruals
- Nuclear Maintenance Reserve
- 2007 Turkey Point Unit 5 Adjustment
- Depreciation
- Dismantlement Costs on New Plants
- FPSC Staff Audit Reports
- Affiliate Transactions

Additionally, my rebuttal testimony sponsors Document KMD-10, Identified Adjustments, which summarizes the adjustments FPL has identified as appropriate during the course of this proceeding. Further, my testimony sponsors Document KMD-13 which shows the effects of FPL's updated Depreciation Study, and Document KMD-15 which shows the adjustments necessary to reflect the Commission's decision on our storm damage cost recovery petition in Docket No. 041291-EI.

Capital Structure

Q. Mr. Larkin asserts it is inappropriate to offset deferred income tax assets against deferred income tax liabilities because the customers are paying the tax represented by the deferred income tax assets in most instances. Do you agree?

A. No. The Commission's policy on capital structure has been to include the net amount of deferred income taxes in the capital structure as a cost free source of capital. To the extent that taxes are not immediately paid to the state or Federal government, deferred income tax liabilities are created. To the extent taxes are paid earlier, deferred income tax assets are created. There is no fundamental difference between the two. Rates paid represent the ultimate source of funds in both cases. As such, the Commission should continue to follow its long standing policy of treating the net amount of deferred income taxes (i.e., deferred income tax liabilities less deferred income tax assets) as a cost free source of capital.

Commission orders support this position. For example, Order No. 13537, Docket No. 830465-EI, page 26, states: "Because, as a general rule, sources of capital cannot be clearly associated with specific utility property, the Commission has traditionally considered all sources of capital (with appropriate adjustments) in establishing a fair rate of return." Whenever FPL makes a cash payment for any type of expenditure — whether it is for income taxes, payroll, construction or whatever — it does so from a pool of funds generated from operations and all sources of capital. When FPL records an accrual to reflect the excess of the tax depreciation over book depreciation on a particular asset, it has additional funds available in that period due to reduced current income tax payments. The additional funds aren't put into a restricted bank account to be used only when the tax-over-book differences turn around and the tax payments increase. Instead, the increased operating cash flow in that period becomes a source of funds that is used to pay current costs and expenses.

In contrast to the situation described above for deferred income tax liabilities, where the deferral of income tax payments makes cash available to FPL, deferred income tax assets arise where FPL has paid income taxes to the government. As a result, FPL no longer has the cash available to use for other purposes. This reduces the cost-free capital provided by deferred income tax liabilities and, accordingly, it is natural and appropriate to offset the deferred income tax assets against the deferred income tax liabilities when determining the funds FPL actually has available to it as a cost-free source of capital.

Examples of situations that result in recognition of deferred income tax assets include reserves (liabilities) for injuries and damages and for environmental cleanup. Because FPL does not get a tax deduction for the accruals that build up the reserve, a deferred income tax asset (prepaid tax asset) is created which will reverse when actual payments associated with the injuries and damages are made. Because the Commission requires deferred income taxes to be included in the capital structure at zero cost, the inclusion of the prepaid tax asset is necessary to offset the reduction to rate base. As an alternative, the Commission could allow the deferred income tax asset in rate base which would accomplish the same objective of getting the reserve (reduction to rate base) to a level representative of the actual funds the Company has available. However, that is not the Commission's policy.

Q. **Do you agree with Ms. Brown's assertion that FPL has improperly allocated the removal of the accumulated deferred income taxes associated with the storm damage fund on a prorata basis across all capital structure components and that FPL should instead specifically eliminate the deferred taxes from the deferred income tax capital structure component?**

A. No. The principles described in the immediately preceding answer apply equally for the deferred income taxes associated with accruals to the Storm Damage Reserve. Trying to track book accounting accruals that occur in different time periods to actual cash payments and then attempting to track those cash payments to a specific capital structure source is a futile exercise. Although it may be possible to track the income tax effects of an item, doing so would result in inconsistent treatment of like items. I believe this is why the Commission has traditionally allocated rate base adjustments over all capital structure components.

Rate Case Expenses

Q. Ms. Brown observes that FPL included rate case expenses of $10.8 million in Docket No. 001148-EI, which were amortized over a two year period resulting in an annual rate case expense of $5.4 million. She goes on to state that actual rate case expenses in that docket were only $4.5 million resulting in an overrecovery and therefore asserts the currently requested rate case expenses should be denied. Also, Ms. Brown states that: "While the Commission has allowed utilities to defer rate case expenses in the past, FPL is already recovering its rate case expense and its request for deferral and amortization of rate case expenses should be denied." She alleges that, since FPL included $5.4 million of rate case expenses in Docket No. 001148-EI and since FPL was earning a return on equity in excess of its requested midpoint, in effect the rate case expenses included in the 2006 test year have already been recovered. Ms. DeRonne makes similar assertions. Do you agree with these witnesses that the recovery of rate case expenses for this case could or should be measured by the extent to which FPL recovered its 2002 rate case expense?

A. No. FPL's last rate case was in 2002 and was settled through a negotiated agreement, obviating the need to incur the additional costs. That negotiated settlement resulted in a $250 million base rate reduction and did not address either the amount or disposition of rate case expenses. It would be inappropriate and infeasible to trace recovery of the 2002 rate case expenses into the subsequent years and reach conclusions about whether the precise amount of the test year rate case expenses were or were not fully reimbursed to FPL, or were part of the $250 million reduction. Moreover, such an exercise would run directly counter to the concept of prospective, test year ratemaking.

Rate case expenses are a legitimate cost of doing business and should be fully recognized. If these costs are not reflected in base rates to be set in January 2006, FPL will be unfairly denied an opportunity to recover them.

Q. Ms. DeRonne asserts that FPL is requesting rate case expenses in the 2006 test year that are out of period costs. Do you agree that recovery of rate case expenses should be restricted to those incurred in the test year?

A. No. As to the rate case expenses being out of period, this is a natural fallout of the use of a projected test year. FPL must prepare in advance to file a projected test year to set rates in a future period. In FPL's current case, we started the preparation of MFRs and witness testimony in the last half of 2004, filed them in the first quarter of 2005, and will be spending the rest of 2005 responding to discovery requests, participating in the hearings and implementing the Commission's final order. Inevitably, only a small portion of the rate case expenses will be spent in the 2006 test year, because that's when the rates are supposed to be approved and in effect. Adopting Ms. Brown's proposal to deny recovery of rate case expenses incurred outside the test year would effectively result in forbidding a utility recovery of such rate case expenses in cases based on a projected test year. This would be unfair and inconsistent with the Commission's well-established practice of allowing recovery of reasonable rate case expenses.

Q. Ms. DeRonne asserts that a two-year amortization period for rate case expenses is unreasonable since it has been 20 years since FPL's last fully litigated base rate case. Ms. Brown asserts that it is inappropriate to include the unamortized portion of rate case expenses in working capital. Do you agree with these assertions?

A. No. The Commission used a two-year amortization in FPL's last rate case, with no more certainty than there is today as to when the next rate case would occur. A general rate proceeding could be initiated at any time. Rate case expenses represent actual costs incurred by FPL and have a definite relationship to the provision of electric service to FPL's customers. As such they are no different than any other regulatory asset or prepaid expense.

Contrary to Ms. Brown's assertion, it is entirely appropriate to include the 2006 unamortized rate case expense in working capital and earn a return on these unrecovered expenses until they are fully recovered. This approach is consistently applied for other prepaid expenses and there is no reason to deviate from that practice.

Q. Finally, Ms. DeRonne asserts that the $550,000 of rate case expenses projected to be incurred in 2006 is unreasonable since rates will be implemented on January 1, 2006. Do you agree?

A. No. What matters is whether the rate case expenses in total are reasonable and are expected to be incurred. Whether they are incurred in 2004, 2005 or 2006 is not relevant.

Automated Meter Reading Project

Q. Ms. DeRonne asserts that $4.6 million of project costs related to the Automated Meter Reading project (AMR) should be removed from rate base in the test year. Do you agree?

A. No. As explained in Ms. Santos' rebuttal testimony, the $4.6 million underrun referred to by Ms. DeRonne will be incurred in 2005 in conjunction with the first phase scheduled deployment of 50,000 meters. Therefore, the projected test year amounts of $15.4 million in plant in service and $1.6 million in accumulated depreciation are appropriate components of rate base.

Q. Ms. DeRonne further proposes that the amount projected in plant in service for the AMR project should be transferred to CWIP and accrue AFUDC until system-wide deployment is implemented. Also, she recommends removal of the related depreciation expense of $768,000, and O&M expense of $1.6 million, from 2006 operating expenses. Do you agree?

A. No. Ms. DeRonne is apparently unfamiliar with this Commission's policy regarding the pre-capitalization of meters. The Commission has a long-standing policy of recognizing meters as "reserve items" and as such has allowed utilities to pre-capitalize them (i.e., place the meters directly into plant in service at the time of purchase). In Docket No. 990529-EI, Petition for 1999 Depreciation Study by Tampa Electric Company, Order No. PSC-00-0603-PAA-EI, the Commission stated: "The accounting treatment utilized for meters, Account 370, is cradle-to-grave in which a meter is capitalized upon purchase and not retired until the meter can no longer be refurbished and is finally junked." Ms. DeRonne's suggestion to place these costs in CWIP and accrue AFUDC goes against Commission policy. The Commission's policy recognizes that meters are immediately used and useful in direct contrast to the concept of AFUDC for large projects that are typically placed in service at the end of construction when they become used and useful. To wait until system-wide deployment is completed would ignore this fact.

Because the AMR meters will be used and useful as soon as they are acquired, the associated depreciation expense of $768,000, and O&M expenses of $1.6 million, should be allowed.

CWIP in Rate Base

Q. Mr. Larkin proposes to remove CWIP from FPL's test year rate base. Would such an adjustment be consistent with the Commission's policy on CWIP?

A. No. The amount of CWIP included in rate base was determined in accordance with Commission Rule 25-6.0141. CWIP should be allowed to accrue AFUDC or be included in rate base. To do otherwise would result in confiscatory treatment.

The Commission historically has recognized that utilities are entitled to a return on CWIP either through AFUDC or via inclusion in rate base. For example, in Order No. 11437, Docket No. 820097-EU, the Commission states that:

> "The Company's investment in plant under construction can be accounted for by either of two methods. An Allowance for Funds Used During Construction (AFUDC) may be applied to the balance to be capitalized and later

recovered through depreciation charges once the plant is placed in service. When this method is chosen, the financial statements of the Company reflect paper income "credits" associated with AFUDC, but the utility realizes no current cash earnings from the investment in CWIP. Alternatively, CWIP may be included as a portion of rate base. Where this treatment is allowed, CWIP generates cash earnings, which provide cash flow and increase coverage ratios. Of course, no AFUDC is taken on that portion of CWIP which is included in rate base."

Based on this excerpt, it is clear that the Commission's policy is to allow AFUDC or rate base treatment of CWIP. Therefore, the only question should be whether the CWIP included in rate base has been determined in accordance with the Commission's rules and Mr. Larkin does not dispute this fact.

Q. Did the modification of Rule 25-6.0141 for AFUDC change the Commission's historic practice of allowing a return on CWIP either through the accrual of AFUDC or inclusion in rate base?

A. No. The modification of Rule 25-6.0141 (AFUDC Rule) in 1997, only changed the basis for determining whether CWIP will accrue AFUDC or will be included in rate base. Under the Rule, the CWIP associated with projects that will cost greater than 0.5% of the total balance of Accounts 101 and 106 are eligible to accrue AFUDC. Smaller projects do not accrue AFUDC and, accordingly, are to be included in rate base. The transcript of the Agenda Conference at which the

Rule modifications were approved contain several discussions between the Commissioners and Staff that clearly indicate the Commission was focused on determining whether CWIP would accrue AFUDC or instead earn a current return as rate base. There is no suggestion in the transcript that prudently incurred CWIP would be denied a return as alleged by Mr. Larkin. My Document KMD-11 contains excerpts from the relevant portion of that transcript.

Q. How has FPL treated CWIP in its 2006 test year MFRs?

A. FPL has accounted for CWIP consistent with the Commission's rule. That is, FPL has excluded from rate base that portion of CWIP that is eligible for AFUDC under Rule 25-6.0141 and has included in rate base the remaining CWIP that, under the Rule, is not earning an AFUDC return. This is clearly the treatment that is envisioned by the Commission and is consistent with how FPL has accounted for CWIP in all of its monthly Earnings Surveillance Reports since the AFUDC Rule was changed in 1997 and in the reports and schedules used to support the 1999 and 2002 Settlement Agreements.

Working Capital

Q. Mr. Larkin recommends exclusion of items from working capital, apparently because the assets do not involve current cash receipts and the liabilities do not result from current cash payments. Do you agree with his approach?

A. No. Mr. Larkin acknowledges on page 52, lines 11 through 13 of his testimony that the basis for his proposed adjustments hinges on the outflow, or lack of outflow, of dollars (cash). What Mr. Larkin proposes is a transparent attempt to use the discredited lead-lag study or "formula" approach in determining working capital. FPL's books and records are kept using accrual accounting, which results in both assets and liabilities being recognized when economic events take place, not at the time of cash receipt or disbursement. For example, as meters are read, revenues are recorded; as goods and services are received, expenses are recorded. The offsets to the recording of these profit and loss items before cash is received or paid are corresponding balance sheet items, i.e., accounts receivable and accounts payable. These assets and liabilities, recorded on the balance sheet, recognize that no cash flow has occurred.

For the 2006 test year, FPL calculated its working capital using the balance sheet method, which has been consistently applied by this Commission since the early 1980s. Order No. 13537, Docket No. 830465-EI, page 15 states: "In recent cases we have applied the balance sheet approach to determine the working capital allowance." Order No. 11437 in Docket No. 820097-EU, states: "A traditional component of rate base is the value of the working capital committed to utility operations. In recent cases we have applied the balance sheet approach to determine the working capital allowance, as opposed to the 'formula' approach previously utilized." This same Order goes on to define working capital: "…as current assets and deferred debits that are utility related and do not already earn a return, less current liabilities, and deferred credits and operating reserves that are utility related and upon which the Company does not already pay a return." In summary, whether a working capital item generates a cash transaction immediately or there is a timing difference associated with the working capital item are not the criteria used by this Commission for inclusion in working capital. Focusing on the cash transactions would be clearly inconsistent with the Commission-approved balance sheet approach. A logical extension of Mr. Larkin's philosophy would be that FPL should not reduce rate base for any of its accounts payable. Were FPL to take this approach, it would result in a substantial increase in working capital thereby increasing rate base and resulting in increased revenue requirements. In fact, this increase in working capital would significantly exceed the sum of all Mr. Larkin's recommended working capital adjustments.

Q. Mr. Larkin's testimony is that: "Mr. Davis is wrong when he states FPL is paying a return on these amounts to customers twice, once as a return on the reduction of working capital included in rate base through base rates and, a second time through interest expense paid to customers on the overrecovery at the commercial paper rate through the cost recovery clause." He then asserts that underrecoveries should be excluded from rate base because if they were included the Company would receive a double return on the underrecovery. Do you agree with his statements?

A. No. His statements are incorrect and inconsistent. As I discussed in my direct testimony, a return is paid on overrecoveries and received on underrecoveries through the appropriate cost recovery clause. Overrecoveries should be removed from rate base in the same manner that underrecoveries are removed from rate base since both pay or earn a return through the appropriate cost recovery clause. To include the overrecovery in rate base is to provide customers a double return

because it reduces rate base and the associated return. These are similar items that should be treated the same.

Q. Do you agree with Mr. Larkin's proposals to (1) record the Other Deferred Credit associated with SJRPP accelerated recovery as a reduction to working capital unless FPL can show that the liability to SJRPP is not a source of funds to the Company and (2) to restore the $1 million regulatory liability the Company has removed from working capital for the gain on the sale of emission allowances because the Company has the use of the funds during the period they have not been flowed back to ratepayers?

A. No. Both items are properly included in a cost recovery clause.

Mr. Larkin acknowledges that the credit associated with this SJRPP liability is collected through the capacity clause, yet he still wants to leave it in working capital (reversing the adjustment in MFR B-2). This would result in customers' receiving a double return on this liability—once through a current return on the balance of the SJRPP liability paid to customers through the capacity clause and again through the reduction in rate base by leaving the liability as a reduction to rate base. Also, such treatment is inconsistent with the definition of working capital provided in Order No. 11437 in Docket No. 820097-EI, that I quoted earlier in my testimony. Specifically, because FPL pays a return on the SJRPP liability through a clause, it does not meet the Commission's definition of a liability includable in working capital.

Mr. Larkin raises this same argument with respect to the $1 million regulatory liability for the gain on the sale of emission allowances which is wrong for the same reasons as above since a return on this credit is paid to customers through the environmental clause.

Q. Do you agree with Mr. Larkin's proposed adjustment to remove from working capital items related to derivative assets and liabilities?

A. No. All balance sheet entries related to derivatives zero out except for the cost of option premiums.

What Mr. Larkin did not recognize is that, except for option premiums, an offsetting regulatory asset or liability is recorded at the same time and in the same amount as the derivative liability or asset is recorded. This has the effect of directly and completely offsetting the derivative transactions such that they have no impact on rate base.

The options relate directly to the hedging program approved by the Commission in Docket No. 011605-EI, Order No. PSC-02-1484-FOF-EI, issued October 30, 2002. In that Order, the Commission stated: "Further, the Proposed Resolution of Issues appears to remove disincentives that may currently exist for IOUs to engage in hedging transactions that may create customer benefits by providing a cost recovery mechanism for prudently incurred hedging transaction costs, gains and losses, and incremental operating and maintenance expenses associated with new and expanded hedging programs." The option premiums are legitimate and necessary cash outlays made as part of the hedging program. Option premiums are included in rate base exactly as is the cost of fuel inventory. When the fuel is burned, the cost of the options and the related fuel are expensed in tandem through the fuel clause. If the options are removed from working capital, FPL would not have an opportunity to recover the time value of money associated with the option premiums over the period between FPL's purchase of the options and their recovery through the clause. This would provide a disincentive to FPL which is contrary to the provision contained in The Proposed Resolution of Issues, attached to the Order in Docket No. 011605-EI as Attachment A and incorporated in the Order by reference. Also, removal of the cost of the options from working capital would result in their being treated differently than the fuel to which they relate.

Q. **Do you agree with Mr. Larkin's proposal to include the payable to the Nuclear Decommissioning Fund in the calculation of working capital and thus decrease working capital by $5.7 million because it represents a source of funds between the time the revenues are collected and when the funds are deposited in the nuclear decommissioning trust fund?**

A. No. The Commission has previously determined that the nuclear decommissioning reserve should be excluded from rate base because it earns a return, and that related accounts should also be excluded from rate base including the nuclear decommissioning accounts payable. Also, it is important to note, that the amount due to the nuclear decommissioning trust fund is paid in the next month so the liability only exists for a few days.

GridFlorida

Q. Various witnesses have criticized the inclusion of the $45 million Company adjustment and other costs budgeted for GridFlorida RTO costs in the 2006 test year. Would you like to comment?

A. As discussed by Mr. Mennes in his direct testimony, GridFlorida is a real activity looming on the horizon. FPL needs to recover the costs associated with this RTO and my adjustment brings the level of GridFlorida costs to an annual average of what FPL expects to incur for these types of costs over a five year period. Additionally, as Mr. Mennes stated in his direct testimony, the costs included in our test year compare favorably to actual costs incurred by similar RTOs currently in operation. Without this adjustment, the level of GridFlorida costs included in the test year would not be representative of the costs FPL can expect to incur for this type of RTO and our base rates would not provide for recovery of those costs. The Commission should not ignore a cost which is outside of FPL's control, unless an alternative means of recovery is provided.

Nuclear Fuel Last Core and End-of-Life Materials and Supplies Accruals

Q. Ms. Brown states that the Commission should suspend Last Core Nuclear Fuel and End-of-Life Materials and Supplies Accruals until FPL files its decommissioning studies and justifies continued accruals to the reserves. Do you agree with this proposal?

A. No. Both items have already been approved for recovery by the Commission. FPL's test year expense is based on the amounts approved by the Commission in Order No. PSC-02-0055-PAA-EI. As I stated in my direct testimony, FPL will file updated studies later this year. Until a determination is made by the Commission to change those accruals, the amount included is appropriate.

Nuclear Maintenance Reserve

Q. Ms. Brown has proposed an adjustment to the Nuclear Maintenance Reserve of $61.6 million for 2006. Her basis for this adjustment is that the Company has debited the Nuclear Maintenance Reserve with anticipated costs of the next outage at the time the accruals began instead of when the actual expenditures are made. Do you agree with her proposed adjustment and conclusion?

A. Not entirely. Ms. Brown's adjustment to FPL's regulatory liability associated with the Nuclear Maintenance Reserve is partially correct, but she has neglected to consider corresponding adjustments to correct pre-test year balances that actually reduce the regulatory liabilities and increase rate base. The comment that the Company has debited the Nuclear Maintenance Reserve with anticipated costs of the next outage at the time the accruals begin instead of when the actual expenditures are made is true. However, Ms. Brown's recalculation neglected to include the 2004 and 2005 outage reversals which impact the 2006 beginning balance of the reserve. My Document KMD-12 recalculates the balance of the regulatory liability based on Ms. Brown's recommended adjustment for the timing of expenditures, and corrects her omission of the 2004 and 2005 outage reversals. This Document shows that the resulting jurisdictional 13-month average regulatory liability should be $53.1 million instead of the $58.9 million currently included in rate base. Because regulatory liabilities reduce rate base, this means that the test year rate base is actually understated by $5.8 million.

2007 Turkey Point Unit 5 Adjustment

Q. Mr. Larkin and Mr. Selecky recommend the removal of the Turkey Point Unit 5 Adjustment as it is outside the test period and would be better addressed within a base rate proceeding closer to the actual in service date. Do you agree with their recommendations?

A. No. The in-service date of Turkey Point Unit 5 and the revenue requirements associated with placing the unit in service are determinable with a high degree of certainty. As such, it is entirely appropriate to consider them in this proceeding. The Commission has approved similar limited scope requests in previous proceedings such as FPL's St. Lucie Unit 2 Plant in Order Nos. 11437 and 12348, Docket No. 820097-EU and for Progress Energy Florida's Crystal River Unit 5 Plant in Order No. 13771, Docket No. 830470-EI. In Docket No. 820097-EU, FPL presented costs associated with St. Lucie Unit 2 in its rate case. In Order No. 11437, the Commission stated:

> "With some modification, we are in favor of the general concept proposed by FPL. Failure to recognize in rates the investment in a plant as expensive as this could have disastrous financial consequences for FPL in a short period of time. On the other hand, requiring the utility to initiate another full revenue requirements case merely to place this plant in rate base would involve significant regulatory lag

> detrimental to the utility and substantial amounts of unnecessary rate case expense to be borne by the customers. Notwithstanding our approval of the concept, we believe we would be premature in approving the costs and expenses associated with the plant at this juncture. FPL's latest projection is that it will place St. Lucie Unit No. 2 in commercial service in mid-June, 1983, while the cost data available on the plant was prepared and filed with testimony in April, 1982. We believe that more current cost data will be required to make an informed decision as to the revenue requirements of this plant. Additionally, we believe that the methodology for allocating the increased revenues associated with this plant deserves closer examination."

While in the case of St. Lucie Unit 2, the Commission subsequently conducted a limited scope hearing because of uncertainty about the cost data, no such follow-up hearing is warranted in this case. The Commission has previously reviewed the cost information for Turkey Point Unit 5 in FPL's need docket and the operating costs of this type of plant are highly estimable because we already have similar plants in operation. Mr. Yeager discusses the reliability of the Turkey Point Unit 5 costs in more detail in his rebuttal testimony. Therefore, there is no corresponding need for a subsequent update of the Turkey Point Unit 5 cost data.

Depreciation

General

Q. After having reviewed the issues raised by Mr. Majoros and others, would you please provide some background on this Commission's practices for recovery of plant in service and cost of removal?

A. Yes. The Commission provides the following three separate mechanisms which FPL uses to recover the costs associated with its ownership, use and disposition of property, plant and equipment:

- Depreciation addresses recovery of FPL's investment in plant in service. Also, depreciation addresses the cost of removing specific units of property that have reached the end of their useful life before the facility, of which it is a part, reaches the end of its useful life (cost of removal).
- Nuclear Decommissioning addresses the cost of removing both contaminated and non-contaminated property when an entire nuclear unit reaches the end of its useful life.
- Fossil Dismantlement addresses the cost of removing complete fossil-fueled generating units when they reach the end of their useful life, or when a unit or units at a site are repowered, (i.e., the original steam turbine is retained and a new combined cycle steam supply is constructed).

Each of these mechanisms is governed by numerous Commission rules and precedents, which FPL follows in keeping its books and records and in preparing the very detailed studies required to support recovery under each of the mechanisms. The studies are subject to Commission review and approval. As part of this process, the Commission Staff and interested parties are given an opportunity to review and comment on the studies. Ultimately, the Commission determines any adjustments to these studies arising out of this review. These studies are filed every four or five years depending on the Commission's rules.

Q. Have FPL's current and previous depreciation studies been prepared and filed in compliance with Commission requirements?

A. Yes. FPL's current depreciation study and its predecessors were prepared and filed in compliance with all of the Commission's requirements. Thus, the issues raised by Mr. Majoros and others represent an attempt to convince the Commission to rework its rules and practices on depreciation in order to achieve the particular base rate results sought by the intervenors. Specifically, Mr. Majoros is recommending that the Commission change a limited number of depreciable lives and implement his ideas regarding the measurement and recognition of removal costs. Also, the intervenors are proposing alternative ways to deal with the calculated theoretical reserve surplus.

I will address the issues raised by Mr. Majoros and others in the following subsections:

- Depreciable Lives,
- Theoretical Reserve Surplus, and
- Cost of Removal.

Q. Mr. Majoros has recast the depreciation study filed by FPL on March 17, 2005, and has included it as his Exhibit MJM-7. Do you agree with the changes he is recommending in his study?

A. No. The principal differences reflected in his study are changes to the depreciable lives for certain transmission, distribution and general property, the use of a net present value (NPV) approach to providing for cost removal, and accelerated amortization of the theoretical reserve surplus.

FPL rebuttal witness, Mr. Stout, addresses the changes in depreciable lives and the approach to cost of removal in his testimony. Based on the conclusions expressed by Mr. Stout and my own conclusions regarding the theoretical reserve surplus, which I discuss later in my testimony, Mr. Majoros' study should be rejected by this Commission.

Q. Has FPL updated the Depreciation Study it filed on March 17, 2005?

A. Yes. Consistent with normal practice, FPL filed an updated depreciation study on July 1, 2005.

Q. What were the changes between the studies filed on March 17, 2005 and July 1, 2005?

A. The July 1, 2005 study updated the earlier study to include all actual results for 2004. The updated study also reflects the effects of FPL completing the unitization of the Sanford and Fort Myers combined cycle units (placed in service in prior years). In addition, the updated study includes the effects of revised retirement units for nuclear and fossil plants (as I discussed in my cross examination in Docket No. 041291-EI), and a separate capital recovery schedule for the replacement of approximately 2.6 million meters related to the AMR project. Finally, the updated study reflects allocation of all of the bottom line reserve deficit to the nuclear function, instead of the nuclear, transmission and distribution functions.

Q. **Would you please summarize the impact of these changes on the depreciation expense that FPL is requesting in its test year?**

A. My Document KMD-13 summarizes all of the updates I mention above. The total effect on depreciation expense in 2006 is $64.7 million.

Q. **At the time FPL filed its initial depreciation study in this docket did it advise the Commission and other parties that it would be updating this study?**

A. Yes. In the transmittal letter attached to the March 17, 2005 filing, FPL advised all the parties that it would be updating this initial filing for actuals for 2004 and other known changes.

Depreciable Lives

Q. **Do you agree with Mr. Majoros' comments that the 2005 depreciation study filed in this docket results in "excessive depreciation" expense?**

A. Absolutely not. First of all Mr. Majoros' characterization of "excessive depreciation" is telling in itself. He says that: "An ***excessive depreciation rate*** is one that produces more depreciation expense than necessary to recover the cost of a company's capital asset over the life of the asset." (Emphasis in original). Thus, he acknowledges that the measure of the adequacy of a depreciation rate is its effect over the life of an asset, not just the rate's effect during a portion of the life of an asset. Despite acknowledging the appropriateness of this long-term view, he proposes to adjust depreciation expense over a period much shorter than the life of the assets primarily by amortizing the theoretical reserve surplus over 10 years.

Because FPL's proposed depreciation rates are designed to produce only the amount of depreciation necessary to recover the remaining net book value of the assets over the remaining useful life plus the cost of removal, they are not excessive.

Q. **Mr. Majoros alleges that FPL's depreciable lives are too short. He cites the existence of FPL's fossil units that are almost fully depreciated as an example. Specifically, on page 7, lines 6 through 8 he makes the following statement: "The impact of past excessive depreciation rates can be demonstrated by looking at the current status of several of the company's fossil plants. Several of these plants are almost totally depreciated today and they are still producing power. That means that the rates paid by past customers were higher than needed." Do you agree with Mr. Majoros' conclusion?**

A. No, I do not. Mr. Majoros' conclusion is simplistic and misses the point. The mere fact that a generating unit is mostly depreciated but still capable of producing power should not cause a reasonable person to conclude that past depreciation rates have been excessive. One should look instead to the remaining net book value of the plant and consider that in relation to the ongoing utility of the plant.

The fossil units cited by Mr. Majoros are presumably the steam units which are older and are dispatched less often because they are less efficient. The weighted average 2004 capacity factor for these units was about 40% with several in the teens. Nevertheless, customers benefit from these units because they are available to meet load when necessary. The lower net book value and the lower resulting depreciation expense are entirely appropriate given the manner in which the plants are utilized.

Q. **Mr. Majoros contends that FPL's theoretical reserve surplus was caused primarily by the use of nuclear and steam production depreciation rates based on life assumptions that were too short. Do you agree with his statements?**

A. No. When a depreciation study is done, FPL uses known or expected lives believed to be accurate at the time the study is prepared. Prior to the NRC license extensions, FPL reasonably and appropriately calculated the depreciation expense for its nuclear plants over their original operating license periods. This approach yielded a deficiency in the reserve for the nuclear function that was reflected in FPL's 1997 depreciation study. FPL's 2005 depreciation study, filed in this proceeding, used the known or expected lives for those units, which includes the newly approved license extensions for the nuclear generating facilities. Thus, in both instances, FPL properly used the plant lives that were known or expected at the time. The change between 1997 and 2005 in what was "known or expected" about the lives of these units is the primary cause of the theoretical reserve surplus in depreciation. The possibility of such changes is one of the reasons the Commission requires electric utilities to file new depreciation studies every 4 years.

Q. What is the proper accounting for changes in the useful lives of depreciable assets?

A. Changes in the estimated useful lives of depreciable assets should be reflected as prospective changes to depreciation rates over the remaining lives of the related assets. This accounting policy has been recognized by the FPSC and FERC. Also, Generally Accepted Accounting Principles (GAAP) require that changes in estimates (specifically service lives of depreciable assets) be accounted for in the current period if the change affects that period only or the period of change and future periods if the change affects both. FERC states that utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of depreciable property over the service life of the property. FPL's use of the "remaining life method" which reflects the recovery of the net book value of the assets over their remaining life is consistent with all of this guidance. This Commission has consistently approved the application of the remaining life method for FPL in Docket Nos. 910081-EI, 931231-EI, and 971660-EI, the last three times new depreciation rates were established based on comprehensive depreciation studies as well as for individual plant studies filed by FPL.

I think it is interesting to note that SFHHA witness Lane Kollen's filed Surrebuttal testimony in a 2001 Entergy Gulf States case (Louisiana Public Service Commission Docket No. U-24993) supports FPL's position by recognizing that:

"...once the twenty-year life extension is considered, the existing accumulated depreciation reserve is higher than it would have been if the unit had originally been depreciated over a 60-year life rather than a 40-year life. This difference is termed a "reserve surplus". If the useful life of an asset is shortened from its original estimate, then the accumulated depreciation reserve is lower than it would have been if the asset had been depreciated over a shorter life. This latter difference is termed a "reserve deficiency". ***Such reserve surpluses and reserve deficiencies inherently are recovered (amortized) over the remaining estimated life of an asset every time a new depreciation study is developed.*** Such adjustments are considered to be changes in estimates and do not constitute retroactive ratemaking. This methodology historically has been utilized by the [Louisiana] Commission, and just three years ago in the Docket No. U-22092 depreciation proceeding, was proposed again by the Company ... and again approved by the Commission." (Emphasis added).

<u>Theoretical Reserve Surplus</u>

Q. What is a theoretical depreciation reserve?

A. A theoretical depreciation reserve is a calculated rather than an actual depreciation reserve which is used as a guide in analyzing the actual reserve condition. It is not an exact measurement for determining the condition of the actual reserve. It is a reference point calculated at a point in time based on current or proposed depreciation parameters. Also, it gives no consideration to the manner in which the asset is being utilized.

Q. How is a theoretical reserve surplus determined?

A. The theoretical depreciation reserve is a snapshot look at where the accumulated provision for depreciation should be at a specific point in time based on specific assumptions about the future. This is compared with the accumulated provision actually reflected in the books and records. The difference between these amounts is the theoretical reserve surplus or deficit.

If you lived in a world of perfect information and knew precisely the exact lives, retirements, cost of removal, salvage and other recoveries of all plant in service the accumulated provision for depreciation would be identical to the theoretical reserve. However, because this is not a perfect world, you may have more or less accumulated depreciation resulting in either a theoretical reserve deficit or surplus. However, as future events change, the theoretical reserve deficit or surplus will change.

Q. Did the depreciation study filed on March 17, 2005 and the July 1, 2005 update reflect a theoretical reserve surplus?

A. Yes, both the original study and the update reflect a theoretical reserve surplus. The theoretical reserve surplus in the March study was $1.5 billion. The theoretical reserve surplus in the July update was $1.3 billion.

Q. Please explain why the theoretical reserve surplus changed.

A. The items causing the change in the theoretical reserve surplus are shown on my Document KMD-13.

Q. Mr. Majoros says that the theoretical reserve surplus is $2.4 billion. Do you agree?

A. No. His theoretical reserve surplus is based on his depreciation study which I recommend be rejected by the Commission.

Q. Mr. Majoros says that FPL is not paying a return to customers on the surplus. Does this mean that customers receive no benefit from the existence of the theoretical reserve surplus?

A. Absolutely not. Revenue requirements for the 2006 test year in this proceeding are $265.4 million lower than they would have been without the theoretical reserve surplus. This reduction has two components: lower return requirements due to lower rate base, and lower depreciation expense due to lower unrecovered balances of plant in service.

Mr. Majoros' statement is misleading and more than a little disingenuous. The theoretical reserve surplus relates to the recovery of funds (capital investments) paid by FPL when the plant in service items were acquired or constructed. The only time it would be appropriate for FPL to actually pay a return would be when it collects funds from customers ***before*** it expends them. Nevertheless, as I stated above, FPL's customers are receiving a very real and tangible benefit from the existence of the theoretical reserve surplus.

The benefit is a direct result of accumulated depreciation reducing rate base. Because rate base has been reduced, the return requirements associated with rate base are lower. Based on the theoretical reserve surplus shown in the depreciation study filed July 1, 2005, the lower rate base reduced revenue requirements by $169.3 million.

In addition, because the theoretical reserve surplus reduces the net book value of the associated plant in service, depreciation expense in the test year and future years will be lower. This is because there is less investment in plant remaining to be recovered. The reduction in test year depreciation expense reduced revenue requirements by $96.1 million.

Q. Mr. Majoros states that: "...based solely on the Company's depreciation study as filed...the FPSC should amortize FPL's calculated reserve excess back to rate payers." Do you agree?

A. No. In the first place, I disagree with the implication that amounts have inappropriately been collected from our customers. Second, the proper way to address the theoretical reserve surplus is through lower depreciation expense over the remaining lives of the assets, reflecting the lower net book value remaining to be recovered. Under Commission rules, FPL can only recover its investment in plant plus the cost of removing that plant at the end of its useful life. As such, there is an absolute ceiling on FPL's recovery. To the extent a dollar has been recovered in the past, future recoveries are reduced. That is precisely why depreciation expense is lower than it would have been if the theoretical reserve surplus did not exist.

FPL has properly included the effects of the theoretical reserve surplus in the development of prospective depreciation rates in its 2005 depreciation study. As a result, those rates, and the resulting depreciation expense that is included in our 2006 test year, are lower than they would have been without the surplus. This has the dual effect of reducing the depreciation expense that customers will pay through base rates and of eliminating the theoretical reserve surplus over the remaining life of the affected assets. Additionally, the accumulated provision for depreciation which is the cumulative effect of the recovery of plant in service reduces plant in service included in rate base.

Q. Do you agree with Mr. Majoros' proposal for dealing with the theoretical reserve surplus?

A. No. Mr. Majoros is proposing to flow the surplus back to customers over a 10 year period. He also said a 4 year period could be justified. Using his amortization periods has the effect of providing current customers a windfall at the expense of future customers. My Document KMD-14 shows the rate shock impact on FPL customers in the fifth year under Mr. Majoros' proposed four-year flowback or in the eleventh year under his proposed ten-year flowback. When coupled with the approximately $858 million in planned capital expenditures for the nuclear plants and the additional depreciation of these nuclear additions, the flowback would result in an increase in revenue requirements of $616 million in the case of the four-year flowback or of $415 million in the case of the ten-year flowback. These large rate shocks illustrate why Mr. Majoros' "borrow against the future" approach to depreciation should be rejected.

Q. Messrs. Majoros and Larkin assert that, since the Commission has previously permitted accelerated recovery of a deficiency in the reserve for depreciation it would only be appropriate that the Commission follow that same policy regarding reserve surpluses (or what Mr. Larkin refers to as reserve sufficiencies). Do you agree?

A. No. The Commission has allowed reserve deficiencies to be recovered over periods that are shorter than the remaining useful lives of the affected assets where specific events supported the recovery. Neither OPC witness cites any instance where any public service commission has flowed back what they refer to as a depreciation reserve surplus over a period shorter than the remaining life of the affected assets. Also, neither of them has cited any specific event or circumstance, other than the mere existence of the theoretical reserve surplus to support their recommendation of a period shorter than the remaining useful life of the related asset.

Q. Mr. Larkin states that FPL has advocated the elimination of reserve deficiencies as soon as possible when a reserve deficiency existed in the past. Would you like to comment on this?

A. Yes. FPL has done this: (1) to recover potentially stranded assets at a time when deregulation seemed imminent; and (2) to establish, pursuant to the Commission's Depreciation Rule 25-6.0436: "capital recovery schedules to correct associated calculated [reserve] deficiencies" prior to retirement of major installations where: "(1) replacement of an installation or group of installations is prudent and (2) the associated investment will not be recovered by the time of retirement through the normal depreciation process." Both of these exceptions relate to very specific circumstances and do not apply generally to theoretical depreciation reserve deficiencies as Mr. Larkin implies.

Q. Mr. Larkin cites FPL witness Mr. Gower's statements in Docket No. 970410-EI regarding amortization of reserve deficiencies. Mr. Larkin states: "Mr. Gower, as stated above, thought it important to return underrecoveries to investors over a short period of time and that the return of these funds will result in lower future costs...By amortizing overrecoveries back to ratepayers' rates will also be reduced. Lower rates will stimulate sales and thus increase returns to stockholders." Do you agree with Mr. Larkin's conclusion?

A. No. Mr. Larkin ignores two obvious facts in his analysis. The first is that as the theoretical reserve surplus is flowed back, rate base will increase, causing an increase in revenue requirements. The second is that any reduction in base rates will have an adverse effect on cash flow requiring FPL to seek replacement funds through increases in capitalization. The combination of the two will result in an increase, not a decrease, in requirements and rates. As such, Mr. Larkin's assertions regarding sales and stockholder returns will be short lived if they occur at all.

<u>Cost of Removal</u>

Q. What approach has the Commission taken regarding the cost of removing plant in service at the end of its useful life?

A. The Commission requires that the depreciation rates used by companies it regulates include a provision for cost of removal. That provision is reflected as an addition to the depreciation rate associated with the recovery of the cost of the item of plant in service or through the separate mechanisms described earlier in my rebuttal testimony.

Q. **Does FPL have a legal obligation to remove these items?**

A. Not in every case. As a general rule, a legal liability only exists where transmission and distribution assets are located on leased property or where there are environmental issues. In addition, a legal liability exists for removal of significant portions of our nuclear facilities; however, that is addressed through a separate mechanism outside of depreciation rates. In any case, whether a legal liability exists is irrelevant. The relevant question is whether FPL intends to remove those assets at the end of their useful lives and the Commission's policies and practices regarding removal of such property.

Q. **Mr. Majoros suggests that the Company is collecting funds through cost of removal that will never be spent. His implication is that the Company will keep those funds. Do you agree?**

A. No. I strongly disagree with Mr. Majoros' allegation that the Company could collect money for cost of removal and be able to take it into income simply because there is no legal obligation for FPL to remove the assets. I cannot understand how anyone with integrity who understands rate regulation could believe that a regulated entity could act unilaterally to seize and dispose of funds collected from customers for a specific purpose.

Even the premise for Mr. Majoros' statement is faulty. If an entity was not rate regulated, they would not be able to accrue cost of removal unless a legal liability existed. If a rate regulated entity was being deregulated, it would be highly unlikely that a commission could fail to ensure that cost of removal dollars were not restricted.

Q. What are the Commission's policies and practices regarding the cost of removal of assets at the end of their useful lives?

A. In accordance with Commission Rule 25-6.0436, Depreciation, FPL accrues the original cost of the assets and the estimated net salvage cost for each asset over its useful life. This method of accounting for cost of removal matches the costs with the revenues and charges paid by the customers benefiting from the consumption of the asset. The National Association of Regulatory Commissioners endorses the accrual method as described in their Public Utility Depreciation Practices, page 18:

> "Net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired. The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative, that will be obtained when the asset is retired. This concept carries with it the premise that property ownership includes the responsibility for the property's ultimate abandonment or removal. Hence, if current users benefit from its use, they should pay their pro rata share of the costs involved in the abandonment or removal of the property and also receive their pro rata share of the benefits of the proceeds realized."

Q. Does FPL remove assets when it retires them even though they do not have a legal obligation to do so?

A. Yes. FPL continually replaces poles, conductors, and other equipment and removes old poles, conductors and equipment when it does. In fact, there have been instances where FPL did not immediately remove the existing facilities and has been cited by the Commission and instructed to remove the facilities.

Q. Mr. Majoros asserts that FPL's cost of removal included in depreciation rates is overstated. Do you agree?

A. No. This assertion is based on Mr. Majoros' alternative ways to determine cost of removal which are refuted by Mr. Stout in his testimony and by me later in my rebuttal testimony.

Q. Mr. Majoros discusses three alternative ways to determine the annual provision for cost of removal: the Expensing Method, the Normalized Net Salvage Allowance Method and the Net Present Value Method. Do you agree with any of these methods?

A. No. Mr. Stout discusses a number of concerns he has with these approaches and recommends that all of them be rejected. I agree with Mr. Stout and have a few additional observations I would like to make.

Both the Expensing Method and the Normalized Net Salvage Allowance Method look to actual retirements and ignore any cost of removal associated with plant that is still in service. As such, they leave the cost of removal on remaining plant in service to be paid by future customers who derived no benefit from them.

Mr. Majoros' description of the Net Present Value Method fails to point out that whenever a cost is discounted, the resulting discount must then be accreted, increasing future accruals. The accretion together with future increases in the actual cost of removal would result either in significant increases in the accrual in future years, or the accumulated amounts of the accrual will turn out to be inadequate to cover the actual cost of removal.

Q. Is Mr. Majoros' assertion that the cost of removal should match what actually occurs on a yearly basis correct?

A. No. Mr. Majoros' assertion that the Company is accruing more removal cost than is being incurred each year ***is a thinly veiled attempt by OPC to steer the Company and the Commission once again to cash basis accounting.*** The cost of removal percentage included in the depreciation rates is designed to recover the removal costs associated with the surviving plant investment over a ratable period of time (i.e., the average remaining life), not just to recover what removal costs actually occurred on an annual basis. Mr. Majoros would have today's customer pay for only what retires today, leaving future customers to pay the removal costs of equipment from which current customers are receiving a benefit.

Q. Mr. Majoros asserts that where old items of property are removed and new items of property are installed, FPL could allocate 100% of the costs it incurs in removing old items of plant in service to the new items of plant in service. Do you agree?

A. No. Either Mr. Majoros is not familiar with the FERC rules or he has little regard for them. Mr. Stout addresses these rules in his testimony. In addition, the purposeful misallocation of costs as advocated by Mr. Majoros would result in a clear misstatement of gross plant with potentially significant ramifications under the Sarbanes-Oxley Act of 2002.

Dismantlement Costs on New Plants

Q. **Mr. Larkin is recommending that the Commission exclude the Company adjustment for the accumulated provision and dismantling costs for Ft. Myers Unit No. 3 which went into service after 2001 and Martin Unit No. 8 and Manatee Unit 3 which went into service in June 2005. He contends that since each of these plants have or will be placed in service after the period used in FPL's last dismantlement study and that an adjustment downward in total depreciation expense and dismantlement cost is justified, these should be removed. Do you agree?**

A. No. The plants Mr. Larkin mentions above are producing power and providing service to customers. Since they are generating revenues which are included in our base rate request, it is only appropriate to include the expenses related to running the plants in base rates as well. The dismantlement accruals requested for these units by FPL are based on accruals for similar units that are supported by detailed dismantlement studies which have been approved by the Commission. FPSC Order No. PSC-04-0086-PAA-EI approved the current dismantlement accrual for FPL's fossil and other production plants, including the units (Sanford Unit 4 and Martin Units 8A and 8B) whose accruals serve as proxies for the estimated accrual of $880,000 for the new units at Fort Myers, Manatee and Martin. They are reasonable estimates. The Commission should not deny FPL recovery of a valid cost. Additionally, failure to begin accruing dismantlement costs will create a deficiency in the dismantlement reserve that will have to be recovered at a later time.

FPSC Staff Audit Reports

Q. Have you read the testimony of Staff witness Ms. Welch, dated July 8, 2005?

A. Yes. For the purposes of my comments I will refer to two exhibits in Ms. Welch's testimony: Exhibit KLW-2, the Audit Report and Exhibit KLW-3, the Supplemental Audit Report.

Q. What time period was covered by the audit that is discussed in the two audit reports?

A. The audit applied only to historic 2004 results. Attached as my Document KMD-16 is FPL's response to the Audit Report and Supplemental Audit Report as filed in this docket.

Q. Did the auditors suggest that FPL's 2006 test year be reviewed to determine whether any of the adjustments recommended in the audit for 2004 would also apply to 2006?

A. Yes.

Q. Has FPL reviewed the 2006 test year results to determine if any such adjustments need to be made?

A. Yes. FPL has confirmed that only Supplemental Audit Exception No. 1, Item 3 and Supplemental Audit Exception No. 3 (includes Audit Exception No. 2) applies to 2006. FPL identifies the effect of these exceptions on my Document KMD-17.

Q. Please explain the effect of these exceptions.

A. The Affiliate Management Fee (AMF) charged to affiliates by FPL was increased by $2,261,927 which corrected the treatment of FPLE-OSI and Seabrook-OSI (Supplemental Audit Exception No. 1, Item 3). The AMF was also increased by $981,721 to correct for the budget activities that should have been included in the AMF (Supplemental Audit Exception No. 3).

In addition, my Document KMD-17 describes two other necessary corrections to the AMF found during our subsequent review. The total effect of these items is $3,454,534.

<u>**Affiliate Transactions**</u>

Q. Ms. Dismukes raises several points criticizing some of FPL's cost allocations and transactions with respect to its affiliates. Do you have any general comments about Ms. Dismukes' criticisms?

A. Yes. FPL is committed to ensuring that its affiliate transactions and related cost allocations are correct, reasonable and comply fully with Commission policy including all applicable laws and regulations. My testimony explains why the Commission and our customers should have confidence that costs are properly allocated among FPL and its affiliates, consistent with the Commission's regulations and sound accounting practices.

Ms. Dismukes' criticisms begin by imputing improper motivations to FPL concerning its incentives to comply with regulations. She goes on to make recommendations which are factually incorrect, contrary to sound principles of affiliate cost allocation, and seek to arbitrarily shift and disallow properly allocated costs. Ms. Dismukes' testimony also overlooks the benefits to FPL customers of FPL's affiliate relationships.

Ms. Dismukes' testimony falsely accuses FPL of failing to comply with a regulatory rule, recommending a punitive $25 million ratebase disallowance relating to the purchase of a turbine. This accusation, which is based on a misreading of the Commission's regulations, lacks factual basis and should be rejected. It also demonstrates a disturbingly cavalier approach for someone making such a serious accusation.

Q. **Please describe FPL's overall approach to ensuring that affiliate transactions and related cost allocations are correct, reasonable and comply fully with Commission policy.**

A. FPL uses three primary accounting concepts, each of which is carefully aligned with the Commission's requirements for correct affiliate cost allocations:

- Costs of resources used exclusively to provide service for the benefit of one company are directly charged to that company. For example, FPL had $27,221,684 of direct charges in 2004 (projected 2006 - $26,397,520);
- Where distinct cost "drivers" exist, the cost of resources used jointly to support utility and affiliate operations are allocated using specific factors. The drivers are carefully selected in order to best and most fairly allocate costs. Examples of commonly used drivers include megawatts (MW) of capacity, headcount and number of personal computers. In 2004, FPL

allocated to FPLE or its affiliates $1,682,810 through its Nuclear Management Fee (projected 2006 - $2,425,669); $3,299,654 through its Energy, Marketing and Trading Management Fee (projected 2006 - $3,631,050); $3,742,722 through its Power Generation Management Fee (projected 2006 - $3,004,020, which reflects a 2005 transfer of 10 employees to FPLE, previously included in the management fee); and $668,939 through its Integrated Supply Chain Management Fees (projected 2006 - $717,848).

- Corporate staff infrastructure and governance costs that benefit affiliates and which do not have specific drivers are allocated using the Massachusetts Formula, a methodology widely accepted as a fair and reasonable way to allocate common costs among affiliates. The results of application of the Massachusetts Formula, the Human Resource drivers and the Information Management drivers are included in the Affiliate Management Fee. During 2004, $17,346,303 was allocated to affiliates through the Affiliate Management Fee (projected 2006 - $22,254,534).

Q. Please explain how FPL implements these accounting concepts, through its business practices, to ensure correct affiliate cost allocations.

A. Each of the accounting concepts is implemented in a systematic way using the most reliable and accurate business information reasonably available to the Company. Our commitment to proper cost allocation is embodied in written corporate policies, as well as practices and procedures, which are a daily part of our business lives and are built into our information management and cost accounting systems. These policies, practices and procedures are rigorously carried out with attentive management supervision in order to ensure appropriate affiliate cost allocations, and that all of the affiliated transaction regulations and policies of the Commission are consistently carried out.

Q. **Ms. Dismukes starts her discussion of affiliate matters by saying that "whether or not FPL explicitly establishes a methodology for the allocation and distribution of affiliate costs, there is an incentive to misallocate or shift costs to regulated companies so that the unregulated companies can reap the benefits." Do you agree?**

A. No. Ms. Dismukes is engaging in abstract economic theorizing and ignores the realities of the incentives guiding FPL's affiliate relations. FPL is a regulated company providing public utility service to millions of customers. We are subject to the close oversight and scrutiny of the Commission and numerous other governmental and regulatory bodies at the federal, state and local levels. Our incentive is to ensure that at all times we are in full compliance with applicable laws, regulations and Commission policies, including those dealing with affiliate transactions and cost allocation. This is not only the right thing to do, and the legally proper thing to do, it is good business practice.

FPL works hard to earn the trust of its customers and regulators. Good affiliate cost allocation practices are part of earning and keeping that trust. In order to achieve those good practices, FPL commits a large amount of time and other resources to ensuring that costs are appropriately allocated among affiliates.

Q. Please describe the Company's policies concerning integrity, compliance with laws and regulations, record keeping, and information provided to regulators.

A. All employees of FPL and its affiliates are subject to the Company's Code of Business Conduct and Ethics (the "FPL Code"). The FPL Code in relevant part requires all representatives of the Company and its affiliates to: (i) act in accordance with the highest standards of personal and professional integrity and to comply with all applicable laws, regulations and Company policies; (ii) maintain all records accurately and completely; and (iii) ensure that the information provided to regulators is accurate and not misleading. All employees of FPL and its affiliates are required to review and commit to abide by the FPL Code.

Q. Is FPL subject to reporting requirements with respect to its affiliate transactions?

A. Yes. FPL's affiliate reporting provides a high degree of transparency concerning all of its dealings with its affiliates. FPL complies with strict affiliate accounting and reporting requirements mandated by the Commission.

Q. Will you describe some of the Commission's affiliate reporting requirements?

A. Yes. These reports include, but are not limited to, the Commission's requirement that FPL file a detailed and comprehensive Diversification Report each year providing extensive information concerning FPL and its affiliate relationships.

Matters reported to the Commission in the Diversification Report include: (i) a statement of any changes in corporate structure, including partnerships, minority interests and joint ventures, including an updated organizational chart; (ii) a detailed analysis of diversification activity which reports each new or amended contract or other business arrangement with affiliate companies for the purchase, lease or sale of land, goods or services (excluding tariffed items) (report includes terms, price, quantity, amount and duration of the contracts); (iii) a schedule of transaction-specific data concerning all affiliate transactions in excess of $500,000; (iv) a summary of affiliate transfers, and cost allocations, for each transaction with affiliates exceeding the very low threshold of $300; (v) a summary of all affiliated transactions involving asset transfers or the right to use assets; and (vi) a position-by-position listing of every employee earning more than $30,000 annually who is transferred between FPL and an affiliate company.

Q. **Do you have personal knowledge of FPL's preparation of the annual Diversification Report?**

A. Yes. The Diversification Report is prepared under my direction, and I personally certify to the Commission in each such report that the information contained in the report is true to the best of my knowledge, information and belief.

Q. **Ms. Dismukes, referring to Schedule 1 attached to her testimony, states that several affiliates owned by FPL Group, Inc. are not allocated any costs from FPL or FPL Group, and asserts that this is a "problem." Do you agree?**

A. No. FPL's affiliate cost allocations reflect correct application of the three basic cost allocation principles discussed above. No "problem," as Ms. Dismukes puts it, exists. FPL and its major affiliates -- which are operating companies with many employees, substantial revenues and/or property, plant and equipment -- bear most of the costs. This flows logically from application of the three affiliate accounting principles. Just as logically, some of FPL's affiliates which are non-operating and have few or no employees, little or no revenues and little or no property, plant and equipment, are allocated few and sometimes no costs.

Q. Please provide some examples of "no cost" affiliates from those listed on Schedule 1 to Ms. Dismukes' testimony.

A. FPL Group Trust I and II, FPL Group Capital Trust II and III, and FPL Group Holdings 1, Inc. and 2 Inc. shown on Ms. Dismukes' Schedule 1 were created with the intention of holding assets or conducting business, but were never used. Several of the companies shown on Ms. Dismukes' Schedule 1 do no more than hold certain financial instruments. FPL's Delaware investment companies are examples. The basic cost allocation principles I have discussed in my testimony have been applied to these and all other FPL affiliates. Where, as with the Delaware investment companies, affiliates do not incur or cause costs to be incurred, no costs are allocated to those entities. Document KMD-18 attached to my rebuttal testimony shows all companies including those not receiving costs, and the reasons why this is proper.

Several of the companies shown on Ms. Dismukes' Schedule 1 were established to explore opportunities in liquefied natural gas. FPL Group Resources, LLC is one of those companies and Ms. Dismukes specifically takes exception to its exclusion from the allocation process. However, she acknowledges that FPL Group Resources "...does not have any revenues or property, plant and equipment…and currently it has six employees.” Clearly, FPL Group Resources would have no impact if included in the allocation process under the Massachusetts Formula or any other method. However, any support provided by FPL to FPL Group Resources is directly charged together with associated administrative and general expenses (as well as pension, welfare, insurance and payroll taxes), which are included in the intercompany billings.

Q. Please comment on FPL’s cost allocation treatment for the FPLE subsidiaries shown on Ms. Dismukes’ Schedule 1.

A. The cost allocations and affiliate management fee for all of the FPLE subsidiaries shown on Ms. Dismukes’ Schedule 1 are included in the allocation to their parent company (FPLE). Accordingly, her assertion that FPLE subsidiaries are not allocated costs properly is incorrect.

Q. Ms. Dismukes criticizes FPL’s determination of cost allocation factors, claiming that (i) using the Massachusetts Formula means that the allocation factors are “largely size based”; (ii) some allocation factors are allegedly “stale”; and (iii) FPL was “unable to provide the amount of costs charged to FPL from FPL Group for the projected test year”. First, please respond to Ms. Dismukes’ criticism that FPL’s allocation factors are “largely size based.” Do you agree with her criticism?

A. No. First, Ms. Dismukes fails to mention that companies across the industry use sized-based allocations such as assets, employees and/or number of customers. Therefore, Ms. Dismukes’ complaint amounts to an indirect attack on FPL’s use of the Massachusetts Formula. Her attack is unwarranted and unfounded. The Massachusetts Formula is a widely-accepted methodology for allocating common costs, which is generally recognized as resulting in fair allocations. The Commission's Staff has reviewed FPL's Massachusetts Formula calculations during recent regulatory audit activities and has never objected to its use. FPL's Cost Allocation Manual, which describes the Affiliate Management Fee and the Massachusetts Formula, is on file with the Commission.

The Massachusetts Formula is accepted by the FERC, and has been used for many years for electric and other utility affiliate cost allocation matters. In fact, the factors used in this methodology are commonly accepted as a fair way to allocate costs. Therefore, they are also used in a number of non-utility applications, including apportionment of federal income taxes by states for multi-state business operations.

As a further example of this methodology, the Cost Accounting Standards contained in the Federal Acquisition Regulation, Section 9904.403-50 (attached as Document KMD-19 to my rebuttal testimony) provides that residual expenses, which are of the type FPL allocates through the Massachusetts Formula, are required to be allocated using the three-factor approach contained in the Massachusetts Formula.

The Massachusetts Formula is widely accepted and regarded for good reason. Its use of a weighted average of assets, revenues and payroll appropriately considers the various factors affecting the use of common services. This is demonstrated by the fact that if a company has only a minimal amount of one factor but more of others, it still receives a significant allocation. In this way, the Massachusetts Formula factors appropriately measure the likely benefit, or lack of benefit, to each affiliate.

In the face of this broad support and acceptance of the Massachusetts Formula and its clear logical appeal, Ms. Dismukes offers nothing but blanket criticism, suggesting that the methodology should be rejected merely because it is "size based." Her suggestion runs contrary to long-established regulatory and accounting practice, and should be rejected.

Q. Ms. Dismukes compares the allocations resulting from the Massachusetts Formula with a single-factor "costs per employee" factor. Is this a useful comparison?

A. No. Ms. Dismukes suggests this alternative but makes no recommendations based on it. Her reticence is easy to understand: Ms. Dismukes' "costs per employee" factor disregards (i) the property, plant and equipment of the affiliate; and (ii) the revenues of the affiliate, which are two of the three key factors relied upon by utilities, regulators and others in properly allocating costs for affiliates. It is interesting to note that Ms. Dismukes does not point to a single utility, regulatory commission or other governmental agency that uses a "costs per employee" factor for allocating costs to affiliates.

Q. Please address Ms. Dismukes assertion that for several of the Management Fees the allocation factors used during the test year are "stale." Is she correct?

A. No. A simple comparison of 2004 factors versus 2006 factors for FPLE indicates significant growth in (1) revenues (30%), (2) property, plant and equipment (24%) and (3) payroll (8%). Using stale factors would not have produced these results. This information was included in data used by Ms. Dismukes.

FPL's proposed rates are based upon projected 2006 revenues and expenses prepared with the best information available at the time all of the projections were made. The data FPL used for its allocation factors is reasonably representative data. By the very nature of the ratemaking process, as time passes from the time the projection was made, positive and negative variances occur in actual results compared with the projections. Moreover, the actual charges that will be made to affiliates in any year will reflect the actual affiliate transactions that occur in that year.

The megawatts (MW), revenues, payroll, and property, plant and equipment amounts used by FPL in its computations reflected all of FPL's reasonably expected changes, and for FPLE and its subsidiaries all their confirmed contracted projects at the time the forecasts were prepared. Projected growth for certain recent additions to the portfolio at FPLE during 2004, 2005 and 2006 is not reflected in the factors because at the time of the development of the 2005 and 2006 forecasts, some new projects were unknown.

For example, the GEXA Corp. and Solar Energy Generating System ("SEGS") acquisitions and the construction of the Horse Hollow Wind Energy Center, referred to by Ms. Dismukes, were certainly unknown. It would have been literally impossible to include the investment, revenues and payroll associated with such facilities and companies in the planned 2006 activity. In fact, it will likely take months before this type of information is developed due to the numerous business decisions that have to be made based on various analyses. However, project additions are included in the factors to the extent that the additions are identified and certain, such as construction of the Weatherford Energy Center. In addition, although unidentified as to specific projects, growth in FPLE's MWs was included in the forecast data.

It would be inappropriate and impractical to include speculative revenues, payroll and MWs from projects which may never come to fruition. Unlike FPL's projects which are primarily need-based and approved by the Commission, FPLE projects are transaction-based and may or may not occur. The same would hold true if FPLE announced that it was selling a project. The factors would not be adjusted until a transaction was completed.

Q. **Ms. Dismukes claims that FPL "failed to provide adequate workpapers to support some of the allocation factors that it used." Is this correct?**

A. No. She is simply wrong. FPL complied fully with the Commission's MFR requirements, and provided information responsive to OPC's and others' data requests concerning affiliate matters and many other issues. FPL's documentation is proper, and her claim should be rejected.

Q. Ms. Dismukes claims that "the inability to separately identify and examine the amount of FPL Group costs that are charged to FPL makes it difficult, if not impossible, to evaluate the reasonableness of these charges." Do you agree?

A. No. FPL's overall approach is to budget 100% of shared costs to FPL in order to provide for control over the budgeting process. From this budget, amounts are allocated to each affiliate based upon the accounting principles, rules and procedures described in my testimony.

FPL provided a detailed breakdown of the governance cost components (which include FPL and FPL Group costs) with allocation factors for each type of cost in its response to OPC's 10th Request for Production, request number 273. FPL believes that this provides sufficient information for the Commission to determine whether the governance costs are reasonable.

Moreover, through numerous detailed discovery responses, FPL has thoroughly explained how affiliate transactions are priced. Together, the combination of the data in the referenced MFR and in response to discovery requests provides the Commission with all of the information needed in order to consider and assess the correctness of charges.

Q. Ms. Dismukes asserts that FPL's methodology for allocating the costs associated with its executives is incorrect because "more senior executives ... are shared than non-senior executives" and that the "presumably higher costs" of the senior executives "tends to under-allocate costs to the affiliates

and over-allocate costs to FPL. Please comment.

A. Cost allocation is the process of assigning a single cost to more than one cost object. The basic goals of cost allocation methods should be to ensure proper distribution of costs and to minimize the time and expense necessary to record and audit transactions. FPL's methodology is a fair, reasonable and administratively workable method of providing for cost allocation. Ms. Dismukes' approach is not reasonably administrable because it would require cost allocation at an individual or near-individual level of detail rather than in a cost pool. It should also be pointed out that, even if FPL had no affiliates, the same corporate governance positions would need to be staffed for FPL, meaning that the substantial allocation of governance costs to affiliates is a clear benefit to customers using any reasonable method of allocation.

Q. Ms. Dismukes claims that due to what she calls "the problems associated with the size-based nature of the allocation factor, the fact that several affiliates are not allocated any of the management fees, and the problems associated with the added projects and acquisitions of FPLE that may not be included in the allocation factors," that the Commission should "assign an additional 5% allocation factor to this group of non-regulated affiliates." Do you agree?

A. No. Ms. Dismukes' claim is contrary to the sound cost accounting principles and data relied upon in FPL's careful and reasonable assignment of costs, and would arbitrarily and unfairly shift costs that have been properly allocated among FPL's affiliates. I have previously responded to her "stale data," "size based formula" and "no-fee subsidiary" claims, and will not repeat those detailed responses here.

Her 5% allocation factor is plucked from the air, with no analytical basis provided whatsoever. Moreover, she fails to point to a single utility, Commission or any other entity that has ever adopted such a speculative and arbitrary factor. This arbitrary 5% penalty ($6 million) represents 41.2% of the $14 million AMF adjustment Ms. Dismukes proposes in her Schedule 5 and should be rejected.

Q. Ms. Dismukes claims that the allocation of the affiliate management fee should be changed because (i) administrative and general services provided by FPL and FPL Group are "extremely valuable to the affiliates"; (ii) "within the AMF there are several accounts which FPL claims do not benefit certain segments of FPLE"; and (iii) the "allocation factors used to distribute costs for the Human Resource department and Information Management are outdated and not supported by source documentation." Based upon these assertions she claims that changes should be made to FPL's proposed cost allocations. Do you agree that administrative and general services are valuable to the affiliates and therefore the allocations to affiliates should be changed?

A. No. Ms. Dismukes claims that FPL's affiliates should pay more than their allocation of the cost of administrative and general services because the services are "valuable to the affiliates." Her point is an illogical non-sequitur. All agree that administrative and general services have value to affiliates. However, the correct question is whether the affiliates have been allocated the proper amount of costs of the services that they use, under applicable regulations and cost allocation principles. FPL has provided for and charged such proper costs. Accordingly, there is no basis under cost allocation principles or regulations for allocating extra costs to affiliates above and beyond their properly allocated costs. The services affiliates use are already charged to them and no additional charges should be allocated due to the fact that the services they obtain are useful.

Ms. Dismukes assumes that the level of administrative and general expenses would be the same for affiliates as it is for the utility. This is not so. Because of FPL's size and other factors, its infrastructure is much greater than what would be needed by the affiliates. Contrary to Ms. Dismukes claims, FPL's customers are benefited, not burdened, by the affiliates. Even Ms. Dismukes' Schedule 4, after correcting for her error of using \$18,000,000 instead of \$18,800,000 for the amount "Allocated to Affiliates," shows that 12.8% of the administrative and general services are borne by affiliates in 2006. Her schedule would actually indicate that the percentage allocated to affiliates is growing (i.e., 2004 – 11.8% and 2005 – 12.3%). My Document KMD-17 would indicate that the composite percentage allocated to affiliates for 2006 is 14.3%. Interestingly, included in that composite rate are costs allocated to affiliates at 20.7% (results of the Massachusetts Formula).

Q. Should the AMF be changed because FPL does not allocate certain activities to one or more affiliates?

A. No. There are sound reasons for FPL's treatment of certain activities. FPLE, for example, has its own accounts payable department. They do not use FPL's department in this area and therefore do not cause any costs to FPL in this respect. Nor does FPLE benefit in any way from FPL's expenditures in this area.

Accordingly, FPL's exclusion of such costs from fees due from FPLE is based upon solid business facts.

Likewise, only FPL and FPLE use and benefit from FPL's environmental services and natural resources business functions. Other affiliates do not use or rely upon these functions. Another example is FPL's community relations programs focused on educating communities in FPL's service territory (i.e. school energy and electrical safety awareness programs). Such costs only benefit FPL and not FPLE, and such costs are not allocated to FPLE.

It is this kind of detailed understanding and assessment of the functions and activities of FPL and its affiliates, applied using a careful and systematic method, which is the basis for FPL's decisions to include or exclude from cost allocation specific charges of the kind complained of by Ms. Dismukes. Her suggestion that FPL arbitrarily includes or excludes costs between affiliates, or that FPL's allocations are illogical, is incorrect and should be rejected as well as the $139,727 adjustment in her Schedule 5.

Q. Should the AMF be changed due to the allocation factors FPL used to allocate its Human Resources and Information Management costs?

A. No. Information used by FPL in its allocation factors relating to Human Resources and Information Management represented the latest and most reliable information available at the time of its preparation of the filing. There were and are no compelling reasons to believe that the percentages would materially change since the time the forecasts were prepared. It would be incorrect to base allocations and percentages based on speculation as to future affiliate growth, or affiliate divestiture for that matter, rather than the best available actual data of the Company.

Accordingly, Ms. Dismukes' suggestion that the allocation factors used to distribute costs for Human Resources and Information Management are "outdated and not supported by source documentation," that an alternative "composite allocation factor" mixing the Massachusetts Formula with other weightings, and that the AMF charges to the affiliates in the projected year 2006 should be increased by $5,666,219 are unfounded and should be rejected.

Ms. Dismukes spends a substantial amount of time in her testimony arguing that the Massachusetts Formula is inappropriate. Then, in order to recommend an increase in the allocations to affiliates, she factors in the results of the Massachusetts Formula, which yields the single largest allocation percentage to affiliates. Her recommendation fails to reflect the fact that affiliates have proportionally fewer employees than FPL. This notion alone represents approximately 40% of the $14 million adjustment recommended by Ms. Dismukes. This recommendation is unfounded and should be rejected.

Q. Do you have any additional comments regarding Ms. Dismuke's proposed changes to the AMF?

A. Yes. Ms. Dismukes carelessly proposes adjustments to FPL's property, plant and equipment and payroll used in the Massachusetts Formula based on other OPC witnesses' testimony. Adjustments proposed by those witnesses have absolutely nothing to do with proper allocation of costs. For example, OPC witness Larkin recommends that the Commission disallow approximately $523 million of CWIP in rate base because he claims it is not needed to maintain FPL's financial integrity. Mr. Larkin is not challenging the prudence of the CWIP. This is $523 million FPL will expend on capital additions and it is appropriately reflected in FPL's property, plant and equipment in the Massachusetts Formula regardless of how FPL earns a return on the CWIP. However, Ms. Dismukes totally disregards the principles of proper allocation and proposes a regulatory adjustment in her allocation methodology that would remove $523 million from the numerator of FPL. It is this type of illogical reasoning, together with the concerns I have addressed above, that should convince the Commission to reject Ms. Dismukes' proposed $14 million adjustment to the AMF. My Document KMD-17 reflects all appropriate adjustments to the AMF and therefore Ms. Dismukes' Schedule 5 should be rejected in total.

Q. **You stated that Ms. Dismukes' testimony overlooks real and tangible financial benefits to customers arising from FPL's affiliate relationships. Please describe some of these benefits.**

A. Ms. Dismukes fails to point out that the Commission's affiliate rules are intended to protect utility customers and therefore, by design, FPL's non-regulated affiliates are often charged more than the incremental cost FPL would pay for certain services. This can be seen by considering the benefits to customers of affiliate billings for certain specific services. One such service is for Operations and Mainframe Software maintenance. It costs FPL approximately $10 million for this support. Through FPL's Affiliate Management Fee, FPL charges affiliates approximately $1 million of the Operations and Mainframe Software expenses, effectively reducing the cost to FPL to $9 million. If the affiliates did not exist, FPL would still incur $9.7 million in costs, thereby increasing costs to FPL customers by $700,000. This is only one example of how FPL customers benefit from its affiliates.

Another example is that if FPL Group's only subsidiary was FPL, the full cost of the investor relations program (including the cost of the annual report) would be borne by FPL customers. Instead, FPL Group's other subsidiaries are allocated approximately 20% of the costs. I strongly urge the Commission to consider fully the benefits of FPL's affiliates and not to be misguided by isolated unsubstantiated representations.

Q. Ms. Dismukes claims that FiberNet charges to FPL should be reduced by $1,343,816. Do you agree?

A. No. Ms. Dismukes is incorrect in suggesting a reduction to the charges for the 2006 test year of $1,343,816 related to fiber services provided by FiberNet. First, her cost of capital is based on her reliance on Dr. Woolridge's recommended pre-tax overall cost of capital of 8.56% which is based on costs and a capital structure for a regulated electric utility and applying that to a telecommunications company which has a completely different risk profile. Dr. Avera addresses the appropriate cost of capital in his rebuttal testimony filed in this docket.

Ms. Dismukes ignores the benefit the relationship with FiberNet provides to FPL and its customers. FPL relies on FiberNet's dedicated fiber service to run its systems such as Supervisory Control and Data Acquisition (SCADA), internal voice and data networks, and nightly back ups of all the servers to the redundant computer centers in Juno Beach and the General Offices. Additionally, FiberNet allows outflow (interflow) calling between the two call centers via tielines, allows care center personnel access to outbound toll access (ITN) at a lower cost and FiberNet provides dedicated personnel services. Furthermore, if FPL were to transfer these services to another provider it would be very expensive and the current dedicated service to FPL might suffer. This would not be in the best interest of our customers and therefore Ms. Dismukes adjustment should be rejected in its entirety.

Q. **Ms. Dismukes claims that $2,746,000 in revenue should be attributed to FPL with respect to unregulated gas margin revenues. Do you agree?**

A. No. As discussed in Mr. Brandt's testimony, the correct net revenues for natural gas are $1,734,000. As Mr. Brandt addresses, this is a business that originated in FPLES. FPLES has been transferring net revenues to FPL and will continue to do so through the end of 2005 under the stipulation and settlement agreement. The contracts that were entered into by FPL and are being transferred to FPLES effective January 1, 2006 have been valued and FPL is proposing to amortize this amount of $835,318 over a five year period as is shown in my Document KMD-10 as an Identified Adjustment.

Q. **Ms. Dismukes claims that FPL should be credited with revenue of $78,000 representing "an administrative fee of 10%" representing what she says is the value of FPL's Energy Marketing and Trading (EMT) department setting up over-the-counter swaps on behalf of FPLES. Do you agree with**

her claim?

A. No. I do not. There is no logic in Ms. Dismukes' conclusion. The settlement results of financial instruments are driven by markets and have no correlation with costs at EMT. However, EMT direct charges fully loaded payroll and other costs to FPLES when any EMT employee from the front office, risk management or accounting works on a FPLES transaction. The direct charges to FPLES are reflected as credits to FPL's expense accounts. In addition, the volume of transactions is small (FPL executed 55 trades for FPLES in 2003, 27 trades in 2004, and 11 trades for the first six months of 2005).

Q. Ms. Dismukes asserts that FPL did not properly allocate expenses to FPL's New England Division (FPL-NED), and recommends a $2,571,061 reduction in test year expenses. Do you agree?

A. No. Ms. Dismukes adjustment is incorrect. FPL-NED was budgeted as a separate entity and was not included as an allocated portion of the FPL budget. All applicable costs of FPL-NED were considered in the 2006 budget forecast but were not presented by FERC account for budget purposes. These expenses were treated as a one-line item of $6.905 million charged to FERC account 562, Station Expense. Because FPL-NED receives a zero jurisdictional separation factor, FPL-NED is not included in the revenue requirements for this proceeding in any way. The detailed O&M expenses applicable to FPL-NED in my Document KMD-20 shows a breakdown of all costs which were accounted for separately for both budget and MFR purposes. Thus, the allocation process on Ms. Dismukes Schedule 15 resulting in an adjustment of $2,571,061 is both arbitrary and unnecessary and should be rejected.

Q. Ms. Dismukes claims that FPL violated the Commission's affiliate transaction rules concerning its purchase of a turbine and that FPL's plant in service should therefore be reduced by $25,088,783. Do you agree?

A. No. FPL complied with all applicable regulations, procured the subject turbine for utility purposes using reasonable business practices, and the subject turbine is vitally necessary for FPL to have readily available in order to permit FPL to swiftly repair any one of the other six sibling turbines that FPL needs and relies upon in providing service to customers. FPL witness, William L. Yeager, provides detailed information on the turbine in his rebuttal testimony.

Ms. Dismukes relies on an inapplicable section of the Commission's regulations as the basis for her regulatory violation claim. Citing Commission Rule 25-6.1351, she claims that "an independent appraiser must verify the market value of assets transferred with a net book value greater than $1,000,000." She claims that, because FPL did not have such an appraisal performed, it is in violation of the Commission's rule.

However, Ms. Dismukes has misread the Commission's regulations. There is no requirement for an independent appraisal in the circumstances of FPL's purchase of the turbine. Because the turbine was purchased by FPL from GE, and not transferred by FPL to a non-regulated affiliate, no appraisal requirement applies. It is only where "an asset used in regulated operations is transferred from a utility to a non-regulated affiliate" that an appraisal requirement applies. Rule 25-

6.1351(d). Accordingly, Ms. Dismukes' claim for a disallowance should be rejected.

Identified Adjustments

Q. Please describe your Document KMD-10 summarizing adjustments to net operating income and rate base.

A. My Document KMD-10 summarizes the adjustments FPL has identified as appropriate during the course of this proceeding. As you can see, the net effect on revenue requirements of these adjustments is only about $7 million, demonstrating the continued integrity of FPL's test year results for rate-setting purposes.

Q. Have you determined the effects of the Commission's decision in FPL's petition for storm damage recovery in Docket No. 041291?

A. Yes. My Document KMD-15 shows the effects of the Commission's decision in the above referenced docket.

Q. Does this conclude your testimony?

A. Yes it does.

ERRATA SHEET

( ) DIRECT TESTIMONY, OR (x) REBUTTAL TESTIMONY (PLEASE MARK ONE WITH "X")
WITNESS: **K. Michael Davis**

PAGE #	**LINE #**	**CHANGE**
___7_	__18__	___"Brown" s/b DeRonne"__________________________
__19_	__6__	____eliminate "of $61.6 million"______________________
__31_	_8-10_	___after "Majoros" eliminate through line 10_____________
__31_	__8___	___after "Majoros" insert "downplays the significance of FPL's theoretical reserve surplus reducing rate base. Please comment."
__31_	__11__	____eliminate "Absolutely not."________________________
__31_	_19-22_	___remove "The only time it would be appropriate for FPL to actually pay a return would be when it collects funds from customers ***before*** it expends them. Nevertheless, as I stated above,"
__53_	__7-8__	____eliminate " , such as construction of the Weatherford Energy Center"
__62_	__19__	____"$835,318" s/b "$866,741"________________________
__64_	_22-23_	____eliminate " " 's and insert "to or" before "from"________
__65_	__9__	___insert ".5" after "$7"______________________________
KMD-10	Item No. 11	Under column "RB or NOI", add "RB &" Under column "Description", after "reduces" insert "working capital by $780,000 and increases" and "by $167,000" s/b "$173,000" Under column "Impact on 2006 Retail Revenue Requirements", "$166" s/b "($266)"
KMD-10	Item No. 12	Under column "Description", "reduces" s/b "increases" _________________
KMD-10	Total Line	Insert "(Decrease)" after Increase and "($7,089)" s/b "($7,521)"

KMD-13	18__	Add "Production " before "Transmission, Distribution and General Plant."
____	____	____
____	____	____
____	____	____
____	____	____
____	____	____
____	____	____

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, CRR, Official Commission Reporter, do hereby certify that the foregoing prefiled testimony was assembled under my direct supervision.

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

DATED THIS 24TH DAY OF AUGUST, 2005.

Linda Boles

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