

**BEFORE THE FLORIDA  
PUBLIC SERVICE COMMISSION**

**In re: Florida Power & Light Company's )  
Petition for Issuance of a Storm Recovery )  
Financing Order )**

DOCKET NO. 060038-EI  
Filed: March 31, 2006

**DIRECT TESTIMONY  
OF STEPHEN A. STEWART  
  
ON BEHALF OF AARP AND  
OFFICE OF THE PUBLIC COUNSEL**

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1                           BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2  
3   TESTIMONY

4   OF

5   STEPHEN A. STEWART

6  
7           **Q.    Please state your name, address and occupation?**

8           A.    My name is Stephen A. Stewart. My address is 2904 Tyron Circle,  
9           Tallahassee, Florida, 32309. I am testifying as a consultant to AARP and the  
10          Office of the Public Counsel in this docket.

11          **Q.    Please describe your educational background and business**  
12          **experience?**

13          A.    I graduated from Clemson University with a Bachelor of Science degree in  
14          Electrical Engineering in December 1984. I received a Master's degree in  
15          Political Science from Florida State University in August 1990.

16                I was employed by Martin Marietta Corporation and Harris Corporation as  
17          a Test Engineer from January 1985 until October 1988. In July 1989, I accepted  
18          an internship with the Science and Technology Committee in the Florida House of  
19          Representatives. Upon expiration of the internship I accepted employment with  
20          the Office of the Auditor General in August 1990, as a program auditor. In this  
21          position I was responsible for evaluating and analyzing public programs to  
22          determine their impact and cost-effectiveness.

23                In October 1991, I accepted a position with the Office of Public Counsel  
24          ("Public Counsel") with the responsibility for analyzing accounting, financial,

1 statistical, economic and engineering data of Florida Public Service Commission  
2 (“Commission”)-regulated companies and for identifying issues and positions in  
3 matters addressed by the Commission. I left the Public Counsel in 1994 and  
4 worked as a consultant for the Florida Telephone Association for one year.

5 Since 1995 I have been employed by two privately held companies,  
6 United States Medical Finance Company (“USMED”) and Real Estate Data  
7 Services Inc. I worked with USMED for approximately four years as Director of  
8 Operations. I founded Real Estate Data Services in 1999 and I am currently its  
9 President and CEO.

10 Over the last ten years I have also worked for the Public Counsel on a  
11 number of utility related issues. In the last several years I have also served as a  
12 consultant to, and provided testimony for, AARP.

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

14 A. I am appearing on behalf of AARP and the Office of Public Counsel in  
15 opposition to FPL’s request for \$650 million to fund a Storm Damage Reserve. I  
16 believe FPL has failed to take into account a number of important factors,  
17 including a significant change in public policy, when determining the appropriate  
18 level for the Storm Damage Reserve. My analysis indicates that a Storm Damage  
19 Reserve Level of \$150 million to \$200 million is large enough to withstand the  
20 storm damage from most but not all storm seasons over the last 16 years. Any  
21 Storm Damage Reserve deficiencies resulting from excessive losses could be  
22 dealt with by a separate surcharge. Keeping the Storm Damage Reserve Level as  
23 low as is reasonably possible will reduce interest and bond issuance costs and

1 minimize the financial impact on customers' rates, while still allowing FPL and  
2 the Commission the flexibility to address FPL's prudent storm recovery costs  
3 from year to year.

#### 4 5 **STORM DAMAGE RESERVE**

6 **Q. Please summarize FPL's recommendation for the appropriate level of**  
7 **the Storm Damage Reserve.**

8 A. Two witnesses, Mr. Harris and Mr. Dewhurst, address the Storm Damage  
9 Reserve issue on behalf of FPL. Mr. Harris provides a historic statistical analysis  
10 indicating an expected annual cost for windstorm losses of \$73.7 million. Mr.  
11 Dewhurst then translates Mr. Harris's analysis into a requirement for a \$650  
12 million Storm Damage Reserve by "weighing a number of factors," the weighing  
13 of which is not abundantly clear to me.

14 **Q. Did you testify on the Storm Damage Reserve issue in FPL's 2005 rate**  
15 **case and how does that case differ from what is being requested of the**  
16 **Commission in this case?**

17 A. Yes, I testified in Docket No. 050045-EI. In that case I recommended that  
18 the Commission approve an annual storm damage accrual in base rates of \$40  
19 million, as opposed to the \$120 million a year accrual requested by FPL. As  
20 noted by Mr. Dewhurst in his current testimony, that case was settled in a manner  
21 that did not provide for a base rate storm reserve accrual, but which allowed for  
22 other storm damage recovery means, as well as for recharging FPL Storm  
23 Damage Reserve in subsequent proceedings. The chief difference between that

1 case and FPL's current case is that in the former, FPL was seeking an annual  
2 accrual of \$120 million a year to recharge the Storm Reserve Fund to a requested  
3 ultimate level of \$500 million, while in this case FPL seeks to immediately  
4 recharge the reserve to a level of \$650 million through the issuance of the bonds it  
5 asks the Commission to approve. Other factors being equal, I believe a given  
6 Storm Damage Reserve level approved by the Commission in this docket will  
7 necessarily result in FPL having the full value of the Reserve amount approved  
8 shortly after issuance of the bonds, rather than having to build to the same reserve  
9 level through an annual accrual in base rates.

10  
11 **Q. How do you understand that FPL arrived at its requested Storm**  
12 **Damage Reserve of \$650 million based upon the testimony of Messrs. Harris**  
13 **and Dewhurst?**

14 A. As I read their testimony, Mr. Harris's testimony in this case includes  
15 exactly the same Storm Loss Analysis that he filed in the 2005 rate case, aside  
16 from certain editorial revisions and corrections. That analysis is based on 103  
17 years of data, which included hurricanes affecting Florida during the period 1900  
18 through 2002. As noted by Mr. Harris, his analysis was not updated to reflect the  
19 2004 and 2005 storm seasons, which he said he would not expect to materially  
20 change his analysis given the long duration of the study. Consequently, he  
21 concluded, as he did in the 2005 rate case, "that the total expected annual  
22 uninsured cost to FPL's T&D system from all windstorms is estimated to be \$73.7  
23 million." Harris prefiled direct testimony, page 4, lines 8-9.

1           **Q.     How did Mr. Dewhurst turn Mr. Harris’s projected expected annual**  
2           **cost for windstorm loss of \$73.7 million into a request for a \$650 million**  
3           **Storm Damage Reserve?**

4           A.     Witness Dewhurst on page 15, at line 3 of his testimony states:

5                     “ Consistent with past Commission Orders, a reserve level should be large  
6                     enough to withstand the storm damage from most but not all storm seasons. The  
7                     Company’s proposed issuance of storm-recovery bonds would provide an initial  
8                     Reserve of approximately \$650 million to support restoration activities.”

9  
10           In addition, Witness Dewhurst, on page 15 at line 11 of his testimony, detailed  
11           five factors that he said supported a level of \$650 million. They are as follows:

12                   “(1) an expected average annual cost of for windstorm losses of approximately  
13                   \$73.7 million as determined by FPL’s outside expert Mr. Harris, (2) the  
14                   possibility that Florida is in the midst of a much more active hurricane period  
15                   relative to average levels of activity over the much longer term, (3) the potentially  
16                   diminished availability of non-T&D property insurance, (4) the impact of the  
17                   recent severe and unprecedented storm seasons on customer bills in the near term,  
18                   and (5) the opportunity to revisit this issue in future proceedings.”

19  
20  
21           **Q.     Do you object to Mr. Dewhurst’s five factors or deny that the selection**  
22           **of an appropriate Reserve may involve subjective considerations?**

23           A.     No, I agree that the analysis is inherently subjective, but believe that  
24           FPL’s request is substantially too high. Also, while I do not object to Mr.  
25           Dewhurst’s five factors, I think his list is both incomplete and that his analysis  
26           fails to give appropriate weight to other factors that are likely of greater concern  
27           to FPL’s customers. I also think the \$650 million Reserve request is inconsistent  
28           or contradicts several of the four key policy considerations Mr. Dewhurst  
29           discusses at pages 16-18 of his testimony.

30

1           **Q.     Would you please elaborate?**

2           A.     Yes. First, Mr. Dewhurst’s testimony and analysis does not fully address  
3           compliance with the first Commission criterion for a Reserve, namely, that  
4           “Consistent with past Commission Orders, a reserve level should be large enough  
5           to withstand the storm damage from most but not all storm seasons.” Dewhurst  
6           prefiled direct testimony, page 15, lines 3-4. While this statement is true for a  
7           \$650 million Reserve, it is almost equally true for as little as a \$100 million  
8           Reserve and more true for a \$150 million to \$200 million Reserve.

9           **Q.     Do you have any evidence that indicates a \$100 million Storm Reserve**  
10          **Fund would be large enough to withstand the storm damage from most but**  
11          **not all storm seasons?**

12          A.     Yes. In Exhibit SAS-1 I have constructed a table with 3 columns. Column  
13          1 provides the actual storm damage experienced by FPL from 1992 thru 2005.  
14          Column 2 and Column 3 indicate whether the actual storm expense would have  
15          been covered by the reserve levels of \$650 million and \$100 million, respectively.  
16          The table shows that for the 16 years studied, a reserve level of \$650 million  
17          would cover the expense levels of 14 years. However, the table also shows that a  
18          level of \$100 million would cover the expense level of 13 of the 16 years or  
19          approximately 81% of these years, a clear majority and clearly “most all storm  
20          seasons.” In fact a Reserve level of \$60 million would have covered 13 of the 16  
21          years. Consequently, the 16-year history indicates that a reserve level of \$100  
22          million would be consistent with FPL’s view and this Commission’s policy that

1           “a reserve level should be large enough to withstand the storm damage from most  
2           but not all storm seasons.”

3  
4           **Q.     What other reservations do you have regarding Mr. Dewhurst’s**  
5           **methodology and recommended Reserve?**

6           A.     As I suggested earlier, Mr. Dewhurst apparently considered Mr. Harris’s  
7           conclusions in light of at least five policy factors listed above and then just arrived  
8           at the utility’s request of \$650 million. While he testified that he weighed the five  
9           factors, he gave no explanation of what weight he gave to each. For example, a  
10          projected average annual cost for windstorm damages of \$73.7 million should not  
11          necessarily lead to a conclusion that a \$650 million Reserve is required,  
12          irrespective of the weight given it. Likewise, while increased storm activity may  
13          argue for a somewhat larger Reserve, it doesn’t follow that \$650 million is  
14          required. Further, the mere potential of a diminished availability of non-T&D  
15          property insurance doesn’t lead to the conclusion that customers should support a  
16          \$650 million Reserve. Additionally the impact of recent storms on customers’  
17          bills, which I will suggest has been burdensome, should not lead to a conclusion  
18          that the Commission should increase that burden by approving a \$650 million  
19          Reserve, where a smaller amount is warranted. Lastly, “the opportunity to revisit  
20          this issue in future proceedings” should argue for approving a smaller, not larger,  
21          Reserve.



1           **Q.     What do you mean by the last point?**

2           A.     In its effort to recover its alleged 2004 storm costs FPL received  
3           Commission approval to charge an interim surcharge prior to an evidentiary  
4           hearing on the matter.  Additionally, after hearing, FPL was awarded substantially  
5           all of its claimed storm damage expenses, as well as \$34 million for “lost  
6           revenues,” which it later claimed it had not requested.  I mention the 2004 storm  
7           case because it appears to me that FPL will retain the option of seeking an  
8           additional surcharge in the event the Reserve, whatever the amount approved,  
9           ever becomes deficient.  With this option, as well as the likelihood of getting  
10          rapid interim surcharge relief, it appears to me that there are clear advantages to,  
11          and reasons for, leaning toward the smaller end of a given Reserve range.

12          **Q.     What do you mean?**

13          A.     For one thing, I believe last year’s Securitization legislation should make  
14          the level of the Reserve less important to the utility.  Before the Securitization  
15          legislation, utilities collected a Commission-approved storm accrual each year to  
16          help pay for storm damage.  The accrual was not designed to guarantee recovery  
17          of every penny of storm damage costs.  In fact utilities might only recover storm  
18          damage expenses that caused them to earn less than a fair rate of return.  Under  
19          that policy, the utilities had a financial risk and were understandably interested in  
20          keeping the reserve level as high as possible.  However, the Securitization  
21          legislation guarantees the recovery of reasonable and prudent expenses for storm  
22          damage.  Therefore, no matter the amount of storm damage, FPL is statutorily

1 guaranteed recovery of its storm expenses as long as they are deemed prudent by  
2 the Commission.

3 **Q. Do you have any additional concerns with FPL's request?**

4 A. Yes. First, the history indicates that the review of storm damage expenses  
5 are less stringent when the expenses are paid from an existing reserve versus  
6 when the utility must document the expenses in an evidentiary hearing addressing  
7 an additional recovery mechanism. And second, the method supported by FPL is  
8 inconsistent with the method their customers have to use when recovering storm  
9 damage expenses to their own property.

10 **Q. What evidence supports your review that storm damage expenses are**  
11 **less stringent when the expenses are paid from a reserve versus when the**  
12 **utility must document the expenses in a hearing?**

13 A. It is my understanding that from 1996 to 2002 when FPL covered storm  
14 damage expenses with funds from existing Storm Reserve, there were no hearings  
15 and consequently little chance for a review of expenses by affected parties.  
16 Forcing a hearing for all but the minimal storm damage occurrences guarantees a  
17 more thorough review and the reduced likelihood that inappropriate expenditures  
18 will be charged to the Reserve.

19 **Q. How is the method supported by FPL inconsistent with the method**  
20 **their customers have to use when recovering storm damage expenses to their**  
21 **own property?**

22 A. First, for FPL customers, the method of recovering expenses for storm  
23 damage starts after a storm causes damage to their property, not before. Second, a

1 claim must be filed with their insurance company. And third, in most cases an  
2 examination of the damage must be conducted before monies are paid out. In this  
3 case, FPL is asking for \$650 million before a storm has hit, before a claim has  
4 been filed, and before a review of expenses that have not yet been incurred.

5 **Q. Do you have other reservations about the size of the Reserve or the**  
6 **methodology used to support it?**

7 A. Yes. Given that FPL always has the option of seeking surcharges for  
8 storm costs that exceed its Reserve balance, it strikes me that a larger Reserve will  
9 necessarily incur significantly more interest expense over the proposed 12-year  
10 life of the bonds than a smaller Reserve. Additionally, reducing the level of the  
11 Reserve will necessarily reduce the already substantial costs and fees of the bond  
12 issuance. According to Mr. Dewhurst, the estimated up-front costs of the bond  
13 issuance are \$11.4 million, including \$5.25 million for underwriting fees, which  
14 are based on .50% of the principal. Additionally, there are in excess of another  
15 \$4.5 million of legal and other fees that may be reduced if the Reserve amount is  
16 smaller.

17 **Q. Based on your reasoning, why does FPL need a Reserve at all?**

18 A. Given the passage of the Securitization legislation subsequent to this  
19 Commission's orders addressing the level of Reserve required or desired, it is not  
20 entirely clear that a Reserve is essential. However, I believe it is prudent for the  
21 Commission to approve a Reserve that meets the historically-stated threshold of  
22 covering the costs of most, if not all, storms. Additionally, given the general  
23 acceptance that hurricane activity is more likely the next decade or so than in the

1 past, the Commission may wish to include a small margin above the amount that  
2 would cover most storm years.

3 **Q. What do you think is the proper level of the Storm Damage Reserve?**

4 A. Based on my analysis I think an adequate and appropriate Storm Damage  
5 Reserve should be \$150 million. However, based on the projected increase in  
6 hurricane activity, the Commission could reasonably include a “safety margin”  
7 raising the approved Reserve to \$200 million.

8 **Q. What is this recommendation based on?**

9 A. I calculated the average storm damage incurred by FPL over the last  
10 sixteen years to be approximately \$148 million. As shown in Exhibit SAS-1 a  
11 Storm Damage Reserve of \$150 million would be large enough to withstand the  
12 storm damage for 13 of the 16 storm seasons. This calculates to approximately  
13 81% of the storm seasons being covered by a \$150 million Reserve level, clearly  
14 a majority and consistent with the Commission doctrine of “most but not all storm  
15 seasons.” A Reserve of \$200 million would give a 33 percent increase for  
16 addressing increased hurricane activity and in the event the Reserve were depleted  
17 by damages exceeding the Reserve balance, FPL could immediately file for  
18 interim and permanent surcharge relief and, given recent Commission precedent,  
19 expect to get it.

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

21 A. Yes.

22

23

## STORM DAMAGE RESERVE LEVEL SCENARIOS

YEAR	ACTUAL STORM COSTS	STORM COSTS COVERED BY \$650M RESERVE	STORM COSTS COVERED BY \$100M RESERVE
1990	\$0.0	YES	YES
1991	\$1.3	YES	YES
1992	\$445.0	YES	NO
1993	\$0.0	YES	YES
1994	\$0.0	YES	YES
1995	\$0.0	YES	YES
1996	\$4.0	YES	YES
1997	\$1.1	YES	YES
1998	\$27.6	YES	YES
1999	\$57.8	YES	YES
2000	\$17.6	YES	YES
2001	\$27.2	YES	YES
2002	\$3.4	YES	YES
2003	\$0.0	YES	YES
2004	\$890.0	NO	NO
2005	\$879.0	NO	NO
<b>TOTAL STORM SEASONS COVERED</b>		14	13

## AVERAGE ANNUAL STORM DAMAGE CALCULATION

$$\text{Average} = \$2,354,000,000 / 16 = \$147,120,000$$

**CERTIFICATE OF SERVICE**

**I HEREBY CERTIFY** that a true and correct copy of the foregoing has been furnished by electronic mail and United States Mail on the 31th day of March, 2006, to the following:

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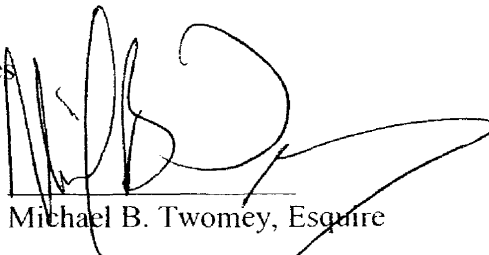
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