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P R O C E E D I N G S

(Transcript follows in sequence from Volume 8.)

CHAIRMAN EDGAR: We will go back on the record. Good morning. Welcome back. Glad to see everybody. I'd like to start on a positive note, of course, as we do every day at the Public Service Commission, and thank everyone again for their cooperation yesterday. We made very good progress. I am pleased and I am optimistic.

Again, a reminder that we still do though have a lot of material to cover, and so the words for the day are once again concise and focused. And I believe where we left off was with cross. Mr. Anderson.

MR. ANDERSON: Thank you, Chairman Edgar.

DONNA DERONNE

continues her testimony under oath from Volume 8:

CROSS EXAMINATION

BY MR. ANDERSON:

Q Good morning, Ms. DeRonne.

A Good morning.

Q We began yesterday talking about the \$21.7 million of 2004 storm costs that OPC proposes should not be recovered because, in your opinion, the money has not been spent; right?

A Yeah. Based on the information I had received from the company, it did not demonstrate that that amount had been spent.

1 Q The answer to my question was yes. I'm just trying
2 to get us focused where we're starting today.

3 A Yes.

4 Q Isn't it true that only \$16.3 million of 2004 storm
5 costs are not yet spent? Do you know?

6 A If you could give me a reference to that
7 \$16.3 million.

8 Q We'll do that in a moment. I'm asking you right now
9 based upon what you've seen in this case, do you know that only
10 \$16.3 million of 2004 storm costs are not spent? If you don't
11 know, that's okay.

12 A I would have to confirm it with Geisha Williams'
13 exhibit, but there was an exhibit that tied to the
14 \$798.1 million with some remaining estimates on that. That
15 \$16.1 million remaining of the \$798.1 million sounds correct,
16 but I would need a reference to confirm that.

17 Q You don't know that only \$16.3 million has not been
18 spent? Are you agreeing? I'm sorry. I just want to be very
19 clear.

20 A I'd want a reference to confirm that.

21 MR. BECK: Excuse me. I'm objecting that counsel is
22 argumentative and it's asked and answered. I'm objecting to
23 the question.

24 MR. ANDERSON: I'll ask a different question.

25 CHAIRMAN EDGAR: Ask a different question,

1 Mr. Anderson, please.

2 BY MR. ANDERSON:

3 Q Do you know whether \$15.3 million of the
4 \$16.3 million left to be spent is for the uninsured amount of
5 nuclear plant work that FPL Witness Mark Warner told us about
6 yesterday?

7 A I did see reference to that \$15.3 million in his
8 rebuttal testimony. And, again, those amounts, I believe, tied
9 into the \$798.1 million we were discussing yesterday.

10 Q Is that a yes?

11 A Yes, that number sounds correct. But I would like to
12 leave that subject to check, if I can.

13 Q That's fine. Any figures, subject to check is okay.

14 The other million dollars is for an FPL obligation to
15 reimburse a foreign utility for claims that arose while working
16 to restore power in FPL's service territory. Do you know that
17 to be true?

18 A I know the company has provided that amount as an
19 additional amount that has not been expended in addition to the
20 \$15.3 million you just referenced. And, again, each of these
21 amounts I had also recommended not be recovered as part of the
22 '04 storm recovery costs.

23 Q Because only \$16.3 million remains unspent, it is not
24 possible, is it, that \$21.7 million of storm cost remains
25 unspent?

1 A I wouldn't agree with that because, again, I walked
2 through yesterday trying from the, the 798.1 specifically
3 identified as recovered through the surcharge in the last case
4 and added that \$21.7 million as incremental to that that was
5 approved for recovery but not recovered through the storm
6 charge but allowed to be credited to the storm reserve, which
7 brings the total that would need to be expended of noncapital
8 and noninsurance related costs to tie into the '04 order to
9 \$819.8 million. And I wouldn't agree that if you expend that
10 additional, I believe you said, 15.3 and around \$1 million to
11 \$1.1 million, that it would bring you up to that \$819.8 million
12 of noncapital and noninsurance related costs.

13 Q Let's go at this a little easier way maybe to see if
14 we can reach agreement that only \$16.3 million remains to be
15 spent. I've placed before the Commissioners, and everyone has,
16 I believe, in a blue envelope several exhibits that have been
17 predistributed.

18 The first exhibit -- and, Ms. DeRonne, I know you had
19 a chance to look at this. I want you to go ahead and take it
20 out. It's titled "2004 Storm Costs." It's labeled as Document
21 KMD-12, which is attached to Mr. Davis's rebuttal testimony.
22 Chairman Edgar, I believe this would be Number 156.

23 CHAIRMAN EDGAR: And, yes, 156 would be the next
24 exhibit. So we will label this 156.

25 MR. BECK: Commissioner, isn't this already labeled

1 as an exhibit and entered into evidence, I believe?

2 MR. ANDERSON: It is. And we can do it either way.
3 We can do a duplication or -- you're right. I forgot.

4 CHAIRMAN EDGAR: Okay. If it's, if it's already in,
5 then I would prefer that we leave it as it is rather than have
6 duplicative because I'm sure a few more pieces of paper --

7 MR. ANDERSON: That's right. I'll just ask --

8 CHAIRMAN EDGAR: Can we take a moment, Ms. Gervasi,
9 and perhaps somebody can help me get the number?

10 MS. GERVASI: Certainly. Could you tell me what the
11 prefiled exhibit number was for Mr. Brown -- Dr. Brown, rather?

12 CHAIRMAN EDGAR: Yeah. This is Mr. Davis.

13 MR. BECK: I think it's Exhibit 120. Madam Chairman,
14 I believe Exhibit 120 is KMD-12.

15 CHAIRMAN EDGAR: Mr. Beck, I'm sorry. I couldn't
16 hear you.

17 MR. BECK: Exhibit 120.

18 CHAIRMAN EDGAR: Mr. Beck says 120. Does that
19 sound -- all right. Thank you, Mr. Beck. Appreciate that.

20 Mr. Anderson.

21 MR. ANDERSON: Thank you, Mr. Beck.

22 BY MR. ANDERSON:

23 Q Showing you Exhibit 120 in evidence, this is an
24 exhibit submitted by K. Michael Davis with his rebuttal
25 testimony; correct?

1 A Yes, it is.

2 Q You've had an opportunity to review this in
3 connection with your work in this case; isn't that right?

4 A Not prior to filing my prefiled testimony, as his
5 rebuttal was filed after my testimony. But since that time I
6 have reviewed it, yes.

7 Q Exhibit 120 updates the 2004 storm costs with data on
8 expenditures and the remaining accrual balance as of March 31,
9 2006; correct?

10 A Yes, it does.

11 Q Directing your attention to Line 3 of Exhibit 120,
12 which is labeled "Accruals for Remaining Work to be Completed."
13 Do you see that line?

14 A Yes, I do.

15 Q Now please look at the intersection of Line 3 and the
16 column on the right-hand side titled "As of March 31, 2006."
17 Are you there?

18 A Yes, I am.

19 Q Do you see the figure \$16.3 million?

20 A Yes, I do.

21 Q Do you agree that this exhibit shows that as of
22 March 31, 2006, the accruals for 2004 storm work remaining to
23 be completed is \$16.3 million?

24 A Yes. That's, that's what's shown in this exhibit.

25 Q You agree, don't you, that variances between budgeted

1 and actual amounts can be caused by factors other than storm
2 costs?

3 A Yes, I do.

4 Q In fact, there are a lot of things that can cause
5 variances from what was budgeted?

6 A Yes, I would agree with that.

7 Q For example, employees might retire earlier than had
8 been anticipated, resulting in lower payroll costs?

9 A Yes, I believe that may have been one of the examples
10 of a driver variance I provided in my deposition.

11 Q That's right. Timing of hiring may differ from what
12 was planned and budgeted.

13 A Correct.

14 Q Actual costs from outside vendors may come in higher
15 or lower than budgeted?

16 A Yes.

17 Q Let's look at the particulars of one of your
18 incremental adjustments. Do you have your Exhibit DD-1 in
19 front of you?

20 A Yes, I do.

21 Q That's the -- I'll pause to let people catch up. You
22 propose a \$1.1 million reduction to treat costs; correct?

23 A Yes. And as cited in my testimony, that was based on
24 the number provided by the company when we asked them to
25 calculate what the adjustments would be under the incremental

1 approach determined in the Commission's last decision. And I
2 did confirm the calculations of that number through other
3 interrogatory responses.

4 Q So the answer was yes; right?

5 A Yes.

6 Q That's because, and you're recommending the
7 adjustment, because FPL spent \$1.1 million less than budgeted;
8 right? That's just what you said, if I understand it.

9 A Well, they spent 1.1 million less than budget for
10 tree trimming costs. Once you factor out the storm-related
11 amounts, the amounts charged to the storm reserve, then the
12 difference between the budgeted and actual that were not
13 charged to the storm reserve, they were under budget by
14 \$1.1 million.

15 Q So, again, that's yes; right?

16 A Yes.

17 Q You are not an expert in tree trimming?

18 A No.

19 Q You did not review whether FPL's scope of tree
20 trimming work changed in the course of the year?

21 A No, I did not. And I didn't find that relevant to my
22 recommendation.

23 Q You did not participate in any FPL budget meetings
24 concerning vegetation management where causes of that budget
25 variance might have been discussed?

1 A No, I did not.

2 Q And, in fact, although you've proposed removing
3 1.1 million using your incremental method, you do not know the
4 reasons for variances between budget and actual expense for
5 tree trimming?

6 A No, I don't. And, again, I don't find that the
7 specific reasons for those budget variances are relevant to the
8 adjustment.

9 Q The answer to my question was no; right?

10 A Correct.

11 Q At Pages 13 to 14 of your testimony, you recommend
12 that the Commission disallow \$26,253,351 in contingency
13 estimated amounts; isn't that correct?

14 A Yes, that's correct.

15 Q Have you been trained to perform cost estimating for
16 construction or repair work?

17 A No, I haven't been trained to do that. I do look at
18 estimates made by companies as part of regulatory proceedings,
19 but I don't have any specific training in that, no.

20 Q You don't have any experience in computing
21 contingency in relation to construction or repair projects that
22 you have responsibility for; right?

23 A I'm not responsible for any of those types of
24 projects.

25 Q Are you aware that including contingency in estimates

1 for construction or repair work is a widely recognized way of
2 quantifying uncertainties involved in cost estimating?

3 A It's done in a lot of projects. I wouldn't say all
4 because, again, we do look at cost forecasts as part of rate
5 case proceedings when companies are projecting significant
6 capital expenditures. The level of contingencies would vary
7 depending on the type of projects. Some may have no
8 contingencies because they have better cost estimating methods
9 so they wouldn't include estimating costs and additional
10 contingencies beyond that. Some areas they may. For example,
11 when you get to nuclear decommissioning projects there are
12 significant contingencies in there. So it really varies
13 depending on the type of project and the estimating methods
14 used.

15 Q Just focusing on the question, including contingency
16 is a widely recognized way of quantifying uncertainties; right?

17 A I don't know if I'd say widely recognized. It is
18 used in a lot, in a lot of instances, but I wouldn't say always
19 or necessarily widely used.

20 Q Your proposal is to disallow all contingency amounts
21 as of February 2006; right?

22 A Yes. Because as of that date there are significant
23 amounts still remaining within the projected storm cost for
24 estimates. These estimates are not entirely known amounts,
25 they're estimated future amounts, and my position is you should

1 not have both the significant amount of remaining estimates and
2 additional contingencies above and beyond that.

3 Q Isn't it true that as work is actually performed,
4 contingency amounts are used up and resolved into actual costs?

5 A They may or may not. If the actual costs aren't
6 greater than what was estimated, then that would not occur.
7 For example, I believe it's in Ms. Williams' rebuttal
8 testimony. The amount of contingencies have declined, but also
9 the actual expenditures for projects have declined. So I would
10 not agree that those contingencies always turn into actual
11 dollars.

12 Q In this case, focusing first on the 26 and a quarter
13 million dollars you want to disallow, isn't it a fact that that
14 amount of contingency has come way, way down as of March 31,
15 2006?

16 A According to Ms. Williams' testimony it's come, I
17 believe, slightly over 7 million. But at the same time the
18 actual expenditures and actual remaining projected expenditures
19 have declined by a similar amount to that reduction to the
20 \$26 million contingency to get to that \$7 million.

21 Q But you are aware then that as of March 31, 2006, it
22 was not 26 and a quarter million, it was \$7.5 million remaining
23 in the 2005 storm estimate; right?

24 A Yes. And again partially because the remaining
25 actual and estimated costs have also declined. So apparently

1 some of those contingencies have since been removed to get to
2 the current contingency amount.

3 Q For clarity of the record, \$7.5 million is all that
4 remains in contingency for 2005 storm costs as of March 31,
5 2006; yes or no?

6 MR. BECK: Objection. Asked and answered. Counsel
7 is simply repeating the same thing.

8 CHAIRMAN EDGAR: I'm going to overrule the objection.
9 But as I have said before, Mr. Anderson, if a witness feels
10 that they need to give additional information in order to give
11 a complete response, I will allow it.

12 MR. ANDERSON: I respect that. Thank you.

13 CHAIRMAN EDGAR: And, again, I would give my same
14 response that I agree that is what's reflected as the estimated
15 remaining contingencies as, I believe, of March 31st presented
16 in Ms. Williams' rebuttal testimony. But, again, part of the
17 reason that has been reduced to this approximately 7, slightly
18 over \$7 million is because the remaining actual and projected
19 additional expenditures have been reduced, which would remove
20 part of those previous contingencies.

21 BY MR. ANDERSON:

22 Q Reduction in costs is not bad, is it?

23 A No. That's a good thing.

24 Q Okay. Are you aware that 6.9 million of the
25 7.5 million remaining contingency recorded by FPL is in

1 connection with follow-up restoration work being performed by
2 outside contractors?

3 A I would have to see a reference. That number does
4 not sound familiar to me.

5 Q Do you have Witness Williams' rebuttal testimony with
6 you there?

7 A Yes, if you can give me a moment.

8 Q Do you have a spare?

9 A I have it, if you have a page or you have a
10 reference.

11 Q Yes. Page 23, Lines 3 through 6. If you could just
12 take a look at that and verify that I've stated correctly.

13 A Yes. It indicates that 6.9 million of the
14 distribution follow-up work restoration being performed by
15 contractors that's included within that contingency. And again
16 that would be a contingency amount as opposed to the estimating
17 costs. It would be a contingency above and beyond what's
18 estimated to be expended.

19 Q You agreed earlier that sometimes contractor costs
20 come in higher than expected?

21 A They could come in higher or lower. It depends on
22 the facts and circumstances of the specific projects and what
23 happens.

24 Q The 7.5 million contingency as of March 31 represents
25 only 0.8 percent of FPL's total storm cost estimate; is that

1 right?

2 A Perhaps of the total storm cost estimate. But I
3 don't know what percentage that would be of the remaining
4 estimated costs. I haven't done that calculation.

5 Q Take a look at the same page in Ms. Williams'
6 testimony, Pages 6 and 7. Did I state that correctly?

7 A No, I'm sorry. Same page or --

8 Q Yeah. Same page.

9 A Okay.

10 Q Lines 6 and 7.

11 A Yeah. It says it's .8 percent of our total '05 storm
12 cost estimate. I just question how that 7.5 million compares
13 to the remaining projected expenditures.

14 Q OPC and you would agree, wouldn't you, that even if
15 your proposed disallowance of contingency were to be granted,
16 and we disagree with you about that very strongly, that it
17 should be no more than the outstanding contingency amount at
18 the time of the Commission's order in this case or as reflected
19 in the record, which would be \$7.5 million or less; right?

20 A As long as, and again, I had explained that the
21 reason, one of the reasons the contingency had declined is
22 because the actual expenditures and remaining estimated
23 projections had also declined. And as long as those declines
24 are also reflected so the net amount is approximately the same
25 amount as the amount presented in my testimony, I would agree

1 with that.

2 Q You are aware that a cooling tower fan had to be
3 repaired at FPL's Martin Unit 8 generating station; right?

4 A Let me check my testimony just to make sure I can
5 confirm the generating station.

6 Q Pages 11 and 12.

7 A Okay. Did you reference Martin Unit 8?

8 Q Yes.

9 A Yes.

10 Q The repairs costs \$316,250?

11 A I don't know if that's the exact amount it cost.
12 That's the estimated amount that was included within the
13 filing. I have no way of confirming if the actual costs ended
14 up being what was estimated.

15 Q You have no doubt the fan was damaged, repairs are
16 needed?

17 A No, I don't have an issue with that.

18 Q You propose disallowing the approximately \$316,000
19 because FPL is pursuing a warranty claim; right?

20 A Yes. The company provided some documentation in
21 response to a production of document requests that showed that
22 they were pursuing warranty recovery. And from reading those
23 documents, FPL seemed to feel pretty strongly that it was
24 warranted to receive warranty recovery at that project.

25 Q You're not criticizing FPL for pursuing a warranty

1 claim, are you?

2 A Not at all. My contention is that they should not
3 include amounts in the storm reserve for which they may be
4 receiving warranty recovery, because that would result in the
5 double recovery of that project. And ratepayers should not pay
6 for projects that the company is pursuing warranty recovery on.

7 Q If FPL succeeded on the warranty claim, that would be
8 adjusted in the reserve in any event, wouldn't it?

9 A That's the company's contention in this case. So any
10 differences between the estimates and actual would affect that
11 storm reserve. But OPC has the concern that if those estimated
12 amounts are inflated, that that's more that the customers have
13 to pay now and will result in a higher reserve balance. And
14 instead the shift should be more in consumers' favor where, if
15 anything, perhaps a reduction to that reserve balance instead
16 of the increase for inflated estimates.

17 Q If FPL did not have a warranty claim, you would not
18 be recommending disallowance; right?

19 A For this project, no.

20 Q So the reason you are proposing a disallowance of
21 this cost is because FPL is taking a proactive step on behalf
22 of its customers to help reduce storm costs by pursuing a
23 warranty claim; right?

24 A What I'm recommending is that that not be included in
25 the estimated amounts to be recovered through the

1 securitization that's being requested. If that warranty does
2 not work out that FPL is pursuing, then you could credit it to
3 the reserve. But I don't see a reason to inflate the amount to
4 be recovered from the reserve for something that you are
5 pursuing warranty recovery of at this time. My contention is
6 not you should be totally disallowed that amount. If that
7 warranty claim does not pan out, then you could charge it to
8 the reserve.

9 Q So to be very clear and to understand you, if FPL
10 does not prevail under the warranty claim, your position would
11 be that the Commission should allow FPL to charge the full cost
12 of the cooling fan repair to the storm reserve; right?

13 A Yes. That it could be charged against that reserve.

14 Q That it -- I'm sorry?

15 A Yes. It would then be appropriate to charge that
16 cost.

17 Q Thanks. I was just having trouble hearing you.

18 Let's talk a little bit more about your incremental
19 cost methodology. We talked earlier about tree trimming a
20 little bit. There are many areas of FPL's budgets, aren't
21 there, where the actual amount spent at the end of the year is
22 higher than the budgeted amount; right?

23 A There may be. You're never going to be exact in your
24 budgeting process. So there will be areas where you're over
25 and areas where you're under, yes.

1 Q Did Larkin & Associates do a systematic assessment of
2 all of FPL's budgets and costs to determine whether FPL spent
3 more than budgeted in some cases?

4 A I did look through the budget variance reports that I
5 had available. There were areas where they, where they had
6 overspent in areas and other areas where they underspent. And
7 again in doing the incremental cost adjustment, we had looked
8 at the variances in areas where costs were being, where the
9 same types of costs were being charged to the storm reserve
10 such as the tree trimming costs and the telecommunications
11 costs.

12 Q Are you aware that Florida Power & Light Company
13 exceeded its 2005 fleet services operations in maintenance
14 budget by \$3.2 million?

15 A I did see that number referenced in one of the
16 witness's rebuttal testimony. But I apologize. I don't recall
17 which witness that was.

18 Q It was Witness Williams, Page 25, Lines 4 to 6. Do
19 you accept that, subject to check?

20 A If you could give me a moment because I recall when I
21 read that I had a concern with the way it was worded. I didn't
22 think it was real clear. Yes, I do note that she says on those
23 lines you cited, she said, I would note that FPL's actual 2005
24 fleet vehicle costs exceeded its '05 budget by 3.2 million.
25 But I'm not sure, there was amounts significantly in excess of

1 3.2 million charged to the storm reserve. So I wasn't clear
2 when I read this if that factored out the amounts charged to
3 the storm reserve or not.

4 Q Of the 3.2 million maintenance cost budget overrun
5 for fleet services, isn't it true that 1.2 million of that was
6 for additional maintenance due to extraordinarily high usage of
7 vehicles during storm restoration?

8 A That's what her testimony indicates. Again, I have
9 no way of confirming if that 1.2 million was included in the
10 charges, the amounts charged to the storm reserve or not.

11 Q Lets assume that that's not charged in the storm
12 reserve. Shouldn't OPC propose an increase of 1.2 million in
13 FPL's storm cost recovery for this incremental cost through the
14 storm under your theory?

15 A No, I would not agree with that.

16 Q You make some recommendations in your testimony at
17 Page 38 concerning setting a cutoff date for amounts charged to
18 the storm reserve for the 2005 storm costs; right?

19 A Yes, I do.

20 Q You discuss some parameters that you believe the
21 Commission should look to in establishing sort of an end to
22 work and accounting and costs for the 2005 storms; right?

23 A Yes, I do recommend that consistent with the last
24 decision and because of concerns I've had with looking at
25 amounts now being proposed as additional charges to the

1 '04 storm costs.

2 Q And part of your concern was the idea that some
3 projects you felt weren't listed in various schedules and
4 things; right?

5 A For the '04 storm costs?

6 Q Yes.

7 A The items I specifically referenced were the nuclear
8 costs. That was one of the many concerns I had with that,
9 including additional concerns with the fact that the projects
10 probably should have been considered capital amounts, not
11 expense amounts to be charged to the reserve. So that was one
12 of many reasons I had with the concern with that additional
13 amount projected for '04 associated with the nuclear costs.

14 Q In your suggestions to the Commission about the
15 parameters that should be considered, you say that items
16 contained in any accruals should be identified as part of this
17 case and should actually be started by December 31, 2006;
18 right?

19 A Correct.

20 Q Would you please take out the third exhibit that you
21 were given this morning?

22 A The last -- I don't think we addressed the second
23 one.

24 Q That's right. The second one, just for the record,
25 was Exhibit 155 that the witness talked about yesterday. Just

1 for convenience I gave everybody an extra copy of it. But the
2 third exhibit here I'd like to label 157, I believe is we're up
3 to?

4 CHAIRMAN EDGAR: Actually it will be 156 since we did
5 not --

6 MR. ANDERSON: I'm sorry.

7 CHAIRMAN EDGAR: That's okay. We will label this one
8 156. And, Mr. Anderson, a title, please.

9 MR. ANDERSON: Remaining FPL Projects as of March 31,
10 2006.

11 (Exhibit 156 marked for identification.)

12 MR. BECK: Madam Chairman, this a document that had
13 never been provided to us prior to this morning. I wonder if
14 counsel could identify the origins of this document.

15 CHAIRMAN EDGAR: Mr. Anderson?

16 MR. ANDERSON: Yes. This is a document that was
17 prepared at the direction of Florida Power & Light Company's
18 Chief Accounting Officer, K. Michael Davis, by asking all the
19 business units to provide the most detailed information they
20 could, which supports the accruals on the company's books for
21 the remaining projects that have been identified as of
22 March 31, 2006. The purpose of this was to really get to
23 Ms. DeRonne's idea, which is a thoughtful one, which is that
24 for purposes of clarity it's good to know what projects are on
25 the books that haven't been done yet.

1 MR. BECK: I'm sorry, Counsel. Is this being
2 sponsored by Mr. Davis or has this been provided to the parties
3 previously?

4 MR. ANDERSON: No, it has not. It's been prepared,
5 but, as we know, upon cross-examination a witness can be asked
6 about anything which counsel has a good-faith basis to be true
7 and correct. And I'd also note that this exhibit is
8 specifically prepared, you know, in thinking about
9 Ms. DeRonne's recommendation, to try to provide assistance to
10 the parties, so a year from now we don't get into discussions,
11 if we can avoid it, about what projects were in or out. And
12 Mr. Davis will be available on rebuttal, he can tell you all
13 about it. And I'm very sorry that we couldn't have provided it
14 earlier. A lot of work was done to pull this together. It was
15 felt important to be able to provide this information to the
16 Commission. And I apologize that it wasn't available earlier,
17 but we do feel it's, it's valuable, and I'd like to ask
18 Ms. DeRonne some questions, especially about in relation to the
19 cutoff date, the expected completion date.

20 MR. BECK: I object to the document, Madam Chairman.
21 There's a lack of foundation for it. Counsel's statement is
22 not a foundation for introducing an exhibit.

23 MR. KISE: Madam Chair, the record, just want to
24 register an objection. Fortunately I am paying attention this
25 morning unlike yesterday. This is at least I think the second

1 instance where we've heard of new information. This docket has
2 been pending an awfully long time. It's completely
3 objectionable; this document should be disallowed.

4 MR. WRIGHT: I'd add to that Madam Chairman that this
5 appears to be what should have been introduced in Mr. Davis's
6 rebuttal testimony. It seems to be a pretty transparent
7 attempt to get in extra rebuttal testimony through
8 cross-examining the Public Counsel's witness. It's completely
9 inappropriate.

10 CHAIRMAN EDGAR: Mr. Twomey?

11 MR. TWOMEY: Madam Chair, for AARP. The same, the,
12 are we going to have Mr. Davis back to testify to the veracity
13 of these numbers?

14 MR. ANDERSON: Mr. Davis is here.

15 MR. TWOMEY: I'm speaking.

16 MR. ANDERSON: I'm sorry. Go ahead.

17 CHAIRMAN EDGAR: One at a time. Mr. Twomey, were you
18 finished?

19 MR. TWOMEY: I wasn't finished, Madam Chair. We're
20 going to have him back to testify to the veracity of these
21 numbers? That wouldn't be fair. And without him coming back,
22 she's left to take counsel's statements that they're accurate
23 and to be believed. It's inappropriate and we object as well.

24 MR. ANDERSON: If I might add just one last thought.

25 CHAIRMAN EDGAR: Mr. Anderson.

1 MR. ANDERSON: I'm sorry. Just one last thought is
2 remembering that this is data that only was on the books as of
3 March 31, 2006. After the books are closed it takes some
4 considerable time to begin extracting data and preparing things
5 like this. So it was work that simply was not able to be done
6 to meet the April 10th deadline and that's all there is to say.
7 Mr. Davis is available, this is correct information, and I
8 would note that the rules applicable to this Commission is that
9 all evidence of a type commonly relied upon by a reasonably
10 prudent person shall be admissible. The witness, Mr. Davis, is
11 available if there are any questions about this. But that's
12 all we have to say.

13 CHAIRMAN EDGAR: Mr. Harris?

14 MR. HARRIS: I'm not sure I quite understand what's
15 going on so I'll try to verbalize what my understanding is
16 before answering. It seems to me that FPL is seeking to
17 introduce an exhibit that they've created through Ms. DeRonne.
18 It sounds like they're saying that it was prepared or they have
19 a witness who is not called for rebuttal who could testify as
20 to this document. I'm not sure that Ms. DeRonne, unless she
21 has personal knowledge of these numbers, is the person to be
22 saying that they're true and correct.

23 Now in my mind, if she's, if they can ask her these
24 numbers and she can say, yes, this number is correct here and
25 here and here, that might be appropriate. If she can't do

1 that, I'm not sure how they can introduce this exhibit through
2 Ms. DeRonne. That's my understanding of what the objection and
3 question is. If I've misunderstood I would appreciate it being
4 restated perhaps.

5 CHAIRMAN EDGAR: Mr. Beck, has Mr. Harris accurately
6 characterized the essence of your objection?

7 MR. BECK: I think so. The essence of my objection
8 is lack of foundation.

9 CHAIRMAN EDGAR: Mr. Harris?

10 MR. HARRIS: Right. I'm not, I mean, Mr. Anderson is
11 going to attempt to lay the foundation. If he's able to do
12 that, then I think it would be admissible. If he's not able to
13 do that because Ms. DeRonne doesn't have knowledge of those
14 facts, I don't think it could be admissible through here. I'm
15 talking at this point about admitting it into evidence. I'm
16 not sure he can't ask her questions about it right now. We're
17 not talking about admission, we're talking about asking
18 questions right now.

19 MR. ANDERSON: That's right where we're at.

20 CHAIRMAN EDGAR: We will take up whether or not the
21 document will be admitted into evidence at the conclusion of
22 the witness's testimony as we have done with every other
23 exhibit in this proceeding thus far and as is my intention for
24 the remaining of this proceeding. So with that, Mr. Anderson,
25 I will allow and see where it takes us.

1 BY MR. ANDERSON:

2 Q Looking at what has been marked for identification as
3 Exhibit 156, please look at the bottom of Page 2. This shows a
4 total accrual of 79,192,867, subject to check; right?

5 MR. BECK: Objection.

6 MR. ANDERSON: We can go on without even an answer to
7 that question. I'm just trying to move along and I don't want
8 to go through it line by line. I really want to focus on
9 expected completion date in relation to this cutoff issue.

10 MR. BECK: Madam Chairman, the proper question is
11 whether she is familiar with the number, not whether that's
12 what the number says. And he's trying -- and he's not asking
13 that in order to avoid the lack of foundation they have for
14 this exhibit.

15 MR. ANDERSON: I'll withdraw the question if it's
16 okay with the Commission.

17 BY MR. ANDERSON

18 Q Let's look at the right-hand column, Expected
19 Completion Date. And just please run your eyes down the
20 right-hand column and see if you agree with me that on the
21 first page of this exhibit, at least what it shows, is expected
22 completion dates with either 2006 dates or to be determined.
23 That's what the exhibit just says; right?

24 MR. KISE: Madam Chair, I need to, with all due
25 respect to the normal procedure that we have followed here with

1 respect to introduction of documents, the way with this
2 particular document is, I would submit is simply not going to
3 work. I mean, what this attorney has done is placed a document
4 front of this witness, a document that she has never seen,
5 didn't have any participation in creating, didn't have, has no
6 understanding of the origin of it other than as expressed by
7 counsel, it hasn't been introduced properly, and now he seeks
8 simply to have her essentially read from it and agree or to
9 testify about what is written on the page or what isn't written
10 on the page. It's just completely inappropriate. If he can
11 establish the foundation to introduce this document now, then
12 he can ask the witness about it. But to have her testifying
13 about something, it's as if I gave her this pad right here and
14 put it under her and said, now, what does that say there? I
15 mean, it's completely inappropriate. And with all due respect
16 to the procedure we've followed, it has worked with all the
17 other documents, but I would submit in this instance it's
18 simply not going to work.

19 MR. ANDERSON: I would indicate that the various
20 completion dates, which is all we're talking about, were
21 provided through various discovery in the case. But you know
22 what, I can greatly truncate this and just make this, make this
23 hypothetical for a moment.

24 BY MR. ANDERSON

25 Q Let's assume, Ms. DeRonne, that for the projects that

1 remain to be done by Florida Power & Light Company, that a
2 great number of them will be done sometime during 2006. Can
3 you follow that assumption for a moment?

4 A Yes. I note that attached to Ms. Williams' testimony
5 was a document, her rebuttal testimony, GJW-10, which provides
6 current estimates of projects outstanding as of March 31st,
7 2006, and that does indicate for the projects listed in the
8 attachment to her rebuttal testimony that several of the
9 projects had 2006 estimated completion dates.

10 Q Right. And we would agree that projects that are
11 going to be done this year pose no problem under your suggested
12 cutoff date; right?

13 A No.

14 Q They do pose a problem or they do not pose a problem?

15 A The projects estimated to be completed during 2006 do
16 not pose a problem under my recommendation and my testimony for
17 the cutoff date, no.

18 Q Okay. And let's assume that of the remaining
19 projects that a number of them just are to be determined, for
20 example, nuclear plant work that will be done at some future
21 outage time. Would it be your position that Florida
22 Power & Light Company should start that work by taking those
23 units offline before December 31, 2006, solely to bring them
24 within the scope of recovery in this case, or should the
25 company make an economic decision to do that work whenever is

1 correct in the best interest of least costs?

2 A I think the company should do them under the most
3 economical means it can do so.

4 MR. ANDERSON: FPL has no further questions and
5 thanks the witness.

6 CHAIRMAN EDGAR: Thank you, Mr. Anderson.

7 Commissioners? Mr. Beck?

8 MR. BECK: Yes, thank you, Madam Chairman.

9 REDIRECT EXAMINATION

10 BY MR. BECK

11 Q Ms. DeRonne, are you aware that the cutoff date used
12 by the Commission for 2004 storm costs was July 31st, 2005?

13 A Yes. That is the date specifically set in the order
14 from that case.

15 Q For 2005 storm costs you're proposing December 31st,
16 2006?

17 A Yes, I am.

18 Q And why is that?

19 A In response to discovery, the company had indicated
20 that the majority of the projects should be completed as of
21 that date.

22 MR. BECK: Thank you. That's all I have.

23 CHAIRMAN EDGAR: Mr. Anderson?

24 MR. ANDERSON: We have no further questions. We
25 would offer Exhibits -- the first one I showed, which was --

1 I'm sorry. Let me start again.

2 CHAIRMAN EDGAR: Yes, you may.

3 MR. ANDERSON: That's right, because two of these are
4 already in evidence and I lost track of that. The one exhibit
5 we would be offering at this time, for the reasons we stated
6 before, recognizing this is an administrative proceeding, with
7 Mr. Davis available, we would offer into evidence Exhibit 156,
8 Remaining Projects as of March 31, 2006.

9 CHAIRMAN EDGAR: Okay. Before we take that up, I am
10 not showing that we admitted 155.

11 MR. ANDERSON: I don't see a need to offer it. I
12 didn't ask about it.

13 CHAIRMAN EDGAR: Okay. Okay.

14 MR. BECK: Madam Chairman, I'm going to offer 155.
15 Counsel did ask about it and Ms. DeRonne testified about it.
16 So I'm offering 155, and I object to 156 for lack of
17 foundation.

18 CHAIRMAN EDGAR: Okay. Well, let's take up 155 so
19 that we are all sure where we are.

20 Okay. Mr. Beck has offered the exhibit marked as
21 155 into evidence. Seeing no objection, Exhibit 155 will be
22 admitted into evidence.

23 (Exhibit 155 admitted into the record.)

24 Thank you. And we again are at the exhibit marked as
25 156. Mr. Beck?

1 MR. BECK: I object for lack of foundation.

2 MR. WRIGHT: We concur.

3 MR. KISE: Same objection, Madam Chair. If they want
4 to introduce it with Mr. Davis, they can attempt to do that
5 then. We'll register whatever appropriate objections we have,
6 if any, but at this stage there's been no foundation laid.

7 MR. TWOMEY: AARP as well.

8 CHAIRMAN EDGAR: Thank you, sir.

9 Mr. Harris?

10 MR. HARRIS: Yes, Chairman. I didn't hear the
11 witness testify that she has any knowledge about the creation
12 of this document or the numbers in it. I don't see how it can
13 be admissible through her.

14 CHAIRMAN EDGAR: Mr. Anderson, one more time.

15 MR. ANDERSON: You know, reflecting, that is right,
16 that Ms. DeRonne did not prepare this. This is a company
17 document. We vouch for it. But I agree, the foundation is not
18 laid through this witness. I'll withdraw the offer of it at
19 this time if that's okay.

20 CHAIRMAN EDGAR: We will withdraw the exhibit marked
21 as 156.

22 MR. HARRIS: Chairman, I'm sorry.

23 CHAIRMAN EDGAR: Mr. Harris?

24 MR. HARRIS: This is staff. I'm stepping over. When
25 you say withdraw, you're still going to leave it marked as 156;

1 correct?

2 CHAIRMAN EDGAR: My intention is that it will still
3 be labeled as 156, but it will not be offered into evidence, at
4 least not at this time.

5 MR. HARRIS: Thank you.

6 CHAIRMAN EDGAR: Thank you. The witness is excused.
7 Thank you very much.

8 THE WITNESS: Thank you.

9 CHAIRMAN EDGAR: And I see that our next witness has
10 been jointly offered. Mr. Twomey, are you going to take the
11 lead?

12 MR. TWOMEY: Yes, ma'am, I am.

13 AARP and the Office of Public Counsel call Steven A.
14 Stewart.

15 STEPHEN A. STEWART

16 was called as a witness on behalf of the Office of Public
17 Counsel jointly with AARP and, having been duly sworn,
18 testified as follows:

19 DIRECT EXAMINATION

20 BY MR. TWOMEY:

21 Q Mr. Stewart, have you been sworn?

22 A Yes, I have.

23 Q Okay. Mr. Stewart, did you cause to be filed
24 prefiled direct testimony consisting of 11 pages dated
25 March 31st, 2006?

1 A Yes, I did.

2 Q Okay. Do you have any changes or corrections to that
3 testimony?

4 A No, I do not.

5 Q Excuse me. If I were to ask you the questions
6 contained in that prefiled direct testimony, would your answers
7 be the same today?

8 A Yes, they would.

9 Q Okay.

10 MR. TWOMEY: Madam Chair, we'd ask that Mr. Stewart's
11 prefiled direct testimony be copied into the record as though
12 read.

13 CHAIRMAN EDGAR: The prefiled testimony from this
14 witness will be entered into the record as though read.

15 MR. TWOMEY: Thank you.

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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, Tallahassee, Florida, 32309. I am testifying as a consultant to AARP and the Office of the Public Counsel in this docket.

9

10

11

Q. Please describe your educational background and business experience?

12

13

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

14

15

16

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

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

24

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.

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

1 BY MR. TWOMEY:

2 Q Mr. Stewart, have you also prepared an attached
3 one-page exhibit, SAS-1, which I believe has been preidentified
4 as Exhibit 87 titled Storm Damage Reserve Level Scenarios?

5 A That's correct.

6 Q Do you have any changes or corrections to that
7 exhibit?

8 A Not at this time.

9 Q Okay. And thank you.

10 MR. TWOMEY: And Madam Chair, as indicated, it's been
11 identified already as Exhibit 87.

12 BY MR. TWOMEY

13 Q Mr. Stewart, do you have a brief summary for the, the
14 Commissioners?

15 A Yes, I do.

16 Q Okay. Would you please make that?

17 A Thank you. Good morning, Commissioners. I'm here
18 today appearing on behalf of the AARP and the Office of Public
19 Counsel. The purpose of my testimony is to ask this Commission
20 to object to FPL's request with regards to their proposed level
21 of the storm damage reserve.

22 In this case, FPL is asking for a \$650 million cash
23 infusion from its ratepayers. The problem with this request is
24 that a storm has not yet hit, a claim has not yet been filed
25 and a review of expenses that have not yet been incurred has

1 not yet been completed. There are a number of good reasons why
2 the Commission should reject FP&L's request.

3 However, in an attempt to be brief, I'll focus on the
4 most powerful and most important and that is as follows. The
5 Commission's denial of FPL's request and the acceptance of my
6 recommendation will keep \$450 million in consumers' pockets
7 without any adverse effect to FP&L's bottom line. I urge this
8 Commission to recognize this fact and to choose the consumers'
9 pockets over FPL's request. This concludes my summary.

10 MR. TWOMEY: Mr. Stewart is available for
11 cross-examination.

12 CHAIRMAN EDGAR: Thank you. Is there cross from any
13 of the other intervenors?

14 MS. CHRISTENSEN: No.

15 CHAIRMAN EDGAR: I'm seeing no. No. Mr. Shreve? Is
16 there cross from the Attorney General? Thank you. The answer
17 is no. Other questions from staff?

18 MS. GERVASI: Staff has no questions.

19 CHAIRMAN EDGAR: Ms. Smith?

20 MS. SMITH: Thank you.

21 CROSS EXAMINATION

22 BY MS. SMITH

23 Q Good morning, Mr. Stewart.

24 A Good morning, Ms. Smith.

25 Q You've never worked as a risk manager for a regulated

1 utility, have you?

2 A No, I have not.

3 Q And you've never advised regulated utilities with
4 respect to their risk management practices; correct?

5 A No. I've only -- when I have worked in this
6 environment it's been with consumer groups.

7 Q And you manage your own business out of your house
8 with six employees; correct?

9 A That's not correct. I manage my business out of a
10 office with six employees.

11 Q Okay. Perhaps you said in your deposition that you
12 started it out of your house and then moved to an office.

13 A That could be. About six years ago. Sure.

14 Q Okay. Thank you. Could you please turn to Exhibit
15 SAS-1 to your direct testimony? It's titled, Storm Damage
16 Reserve Level Scenarios.

17 A Okay. I'm there.

18 Q This is a compilation of historical data consisting
19 of the storm costs that FPL has experienced over the past 16
20 storm seasons; correct?

21 A Correct.

22 Q And do you arrive at an average annual storm damage
23 calculation of 147.1 million over that 16-year historical
24 period; correct?

25 A That's correct.

1 Q And you would agree that \$445 million worth of storm
2 damage in 1992 would not equate to \$445 million worth of damage
3 in 2006 or 2007; correct?

4 A In terms of dollar for dollar, no. But I would also
5 point out that that same hurricane may not do the same amount
6 of damage if it was to hit today.

7 Q The dollar value would be higher today due to
8 inflationary factors, increases in the value of FPL's system
9 due to customer growth and other factors; correct?

10 A I will agree with you that a dollar in 1992 is worth
11 more today but I would not agree that a hurricane that hit and
12 caused \$450 million, \$445 million in 1992, if the same
13 hurricane hit today that just because of the factors you state
14 that the damage would be, is assumed would be higher. I would
15 remind the Commission that there has been a lot of improvements
16 of the system over the last two years and so that number may be
17 actually lower with the same hurricane.

18 Q You haven't done any sort of analysis to support that
19 conclusion, have you?

20 A No. That's sort of a common sense approach I would
21 think. If you look at the amount of money in 2005 and 2004
22 that has been put into the system, you would assume that the
23 system is probably in better shape than it was in 1992.

24 Q So that's your lay opinion?

25 A Yes.

1 Q Based on your historical data compilation, you
2 conclude that a 100 million reserve would be large enough to
3 cover 13 of the last 16 single storm seasons; correct?

4 A That's correct.

5 Q And you recommend a 150 to 200 million reserve level;
6 correct?

7 A I recommended that, yeah, in my filed testimony,
8 correct.

9 Q You didn't do any sort of analysis to see how quickly
10 a 150 to 200 million reserve would be depleted, did you?

11 A Repeat that question.

12 Q You didn't do any analysis to see how quickly a 150
13 to \$200 million reserve would be depleted or FPL would be in a
14 deficit position, did you?

15 A No, I think -- and I did not conduct that type of
16 analysis, and I think it's important that the Commission
17 understand why. Such an analysis is extremely speculative, as
18 we have heard in the hearings here the last couple of days. I
19 mean, to do that you have to predict storms and -- to figure
20 out how much damage is going to be assessed every year. So if
21 you look over the last 16 years, I would defy anybody to be
22 able to come up with an algorithm that would be able to predict
23 those storm costs or the incidence of hurricanes. I know that
24 Mr. Harris has attempted to do that. So that's why I didn't do
25 it. It's very speculative. And such an analysis, I think, to

1 base such a speculative analysis on collecting \$2 billion from
2 the ratepayers is probably not the way for this Commission to
3 go.

4 Q You agree though that the general consensus is that
5 we're in a period where there are going to be more storms;
6 correct?

7 A I agree with that. And I also agree that we're in a
8 period of a changed situation in terms of regulatory policy.
9 Unlike in years past, FPL is, can come into this Commission,
10 the Commission has proven it will act quickly and recover storm
11 costs that are prudently spent. So I think that, again, a
12 speculative analysis trying to decide when a reserve is going
13 to go negative and base that on taking money from consumers
14 today to cover something that hasn't happened is not, is not an
15 approach that the consumers are comfortable with.

16 Q And just to be clear, so you didn't do any sort of
17 analysis to see when a deficit would occur; correct?

18 A I thought it would not be, it would not be useful.

19 Q But you're recommending that based on history, a 150
20 to \$200 million reserve level would be adequate to cover most
21 but not all storm seasons prospectively; correct?

22 A From a historical data perspective, that's true. And
23 I think that that level is a reasonable level given the change
24 in circumstances that have happened in the last couple of years
25 with regard to regulatory policy. Again, I don't want to

1 repeat myself but I don't see why we need to take money out of
2 consumers' pockets for something that hasn't happened yet when
3 FPL has a mechanism in place to recover money that they spend
4 on storm restoration. I mean, I think one of the concerns
5 again that I have is that once FPL gets this money, we're going
6 to argue about what level of review we're going to have to, to
7 engage in so that they can spend it.

8 Q And assuming historical averages, you think that a
9 150 to \$200 million reserve level would cover a single storm
10 season; correct?

11 A Based on the historical data it would cover 13 out of
12 the 16 storm seasons that occurred. And that coupled with the
13 points that I've made about the change in circumstances I think
14 is more than enough to facilitate or to cover FP&L's storm
15 costs.

16 Q Assuming your average annual storm damage of
17 147.1 million over the past 16 years occurs annually on a
18 going-forward basis, your reserve would last for about one
19 year; correct?

20 A Mathematically that is correct.

21 Q Regarding the conclusion on Pages 2 to 3, Lines 22
22 and 23, and 1 to 3 of your testimony, that the storm reserve
23 level should be kept as low as is reasonably possible, you have
24 not searched for support for this position in prior orders of
25 the Commission, have you?

1 A I don't want to be difficult. Can you cite me again
2 to my testimony? It was Page 2 and 3?

3 Q Sure. It's at the bottom of Page 2 and the top of
4 Page 3, beginning on Line 22.

5 A Repeat your question. I'm sorry.

6 Q You say there the storm reserve level should be kept
7 as low as is reasonably possible; correct?

8 A Correct.

9 Q You have not searched for support for this position
10 in prior orders of the Commission, have you?

11 A I have not sought support in orders. And the
12 reason -- there's a couple of reasons why. I mean, the first
13 reason again, which I have reiterated and will mention again is
14 there's been changed circumstances in the last couple of years
15 in terms of regulatory policy. However, there is more support,
16 I think, I filed this testimony and I have had a deposition and
17 there's been rebuttal testimony and there's a hearing, I, I
18 reiterated I think it is extremely, would be extremely
19 beneficial for the consumers to keep the reserve as low as
20 possible, and I can tell you why.

21 I think, first of all, my deposition when I talked to
22 you, I think it's obvious that, that once the money is given to
23 FP&L, that the, the goal of FP&L is to then argue about what
24 kind of review we're going to have on that money, and that's
25 clear in deposition. So I think that based on that it should

1 be kept as low as possible.

2 The second thing is that in rebuttal Witness Dewhurst
3 said that the Storm Damage Reserve was irrelevant to FP&L's
4 hurricane exposure. If that's true, then why not just go with
5 the consumers' position? I think it's -- again, that would
6 argue for as low as possible. That's right in his rebuttal
7 testimony.

8 And then the third reason why I think it should be as
9 low as possible is some of the new information that we're
10 hearing in this, in this forum. The consumers are going to
11 find out that there is a benefit to FP&L Group through this tax
12 benefit, and I think they're going to be as troubled by it as I
13 am. So I definitely would reiterate that the Storm Damage
14 Reserve should be as low as possible.

15 MS. SMITH: Madam Chairman, the witness is going well
16 beyond simply clarifying the response to my simple question.

17 MR. TWOMEY: May I be heard?

18 CHAIRMAN EDGAR: Mr. Twomey.

19 MR. TWOMEY: I deny it. He has answered. She asked
20 him a question. We have had two and a half days now of
21 witnesses being allowed to say yes or no and giving a
22 reasonable answer in response to the question. He did not go
23 beyond the questions.

24 CHAIRMAN EDGAR: I think perhaps you're
25 characterization of us being halfway through the third day may

1 be even a more optimistic than I can go, but perhaps. I,
2 again, will remind all of us, concise and focused, and would
3 ask the witness to limit the answer to the scope of the
4 question.

5 Ms. Smith, question.

6 BY MS. SMITH:

7 Q Mr. Stewart, do you think it is best for the company
8 to returned to this Commission regularly for recovery of
9 reserve deficits, correct?

10 A I think it is appropriate for them to return when
11 they have to. I don't know how many storms there is going to
12 be over the next few years, but I think that given the
13 regulatory climate that it is appropriate for this, for any
14 extraordinary expenses that are due to hurricanes, that FPL or
15 any other utility, for that matter, come in here and justify
16 those expenses and go through the hearing process, yes,
17 absolutely.

18 Q And this is because you say there is a more stringent
19 review of costs in an adversarial proceeding, correct?

20 A True.

21 Q Isn't it the case that rates will increase each time
22 FPL has to return to the Commission to ask for recovery of
23 storm costs, assuming the costs are reasonably and prudently
24 occurred?

25 A That involves a lot of assumptions. How much of

1 costs are going to be disallowed, are we going to get into a
2 regulatory environment where we start sharing some costs. I am
3 not going to answer that theoretical question.

4 Q Well, you would agree if a reserve is available to
5 pay for costs, then there would be no increase in rates. But
6 if there is a deficit in the reserve and FPL petitions for
7 recovery, then rates will go up, to the extent that the costs
8 are reasonably and prudently occurred, correct?

9 A It is mathematical calculation, I will agree with
10 that.

11 Q And customer rates will be more volatile if FPL is
12 returning to the Commission regularly for recovery of deficits,
13 right?

14 A More volatile in what way, in that they are going to
15 change dramatically, or that they are going to change
16 inconsistently?

17 Q Both.

18 A It is better to take a large amounts of money and
19 spread it over 12 years or have them come in and get the money
20 that was actually spent? That would be a rhetorical question,
21 I'm not looking for a and answer, but volatility, you know I
22 would urge for volatility if we are going to have a hearing and
23 we are going to decide what are prudent costs and who is going
24 to pay for them. Right now what we are going to do is write a
25 check for \$2 billion then we are going to argue about the level

1 of review we have. So volatility is, it might be a little bit,
2 overrated.

3 CHAIRMAN EDGAR: Okay. I given latitude, we are not
4 that third day, please. Ms. Smith, a question that can be
5 answered. Mr. Stewart, answer the question that is posed, if
6 you can, and if you can't let us know that you cannot.

7 Ms. Smith.

8 BY MS. SMITH:

9 Q Regarding the more stringent review that you suggest
10 will occur if FPL returns to this Commission regularly, you
11 think that the PSC staff's ability to audit storm costs, quote,
12 is not to the level of prudence that comes out in an
13 adversarial hearing, end quote, right?

14 A I think that PSC audits are designed to do different
15 things than what would come out in an adversarial hearing, that
16 is correct.

17 Q And witnesses like yourself, quote, pour over
18 documents and provide valuable testimony, end quote, in an
19 adversarial hearing, correct?

20 A That is correct.

21 Q And you agree there was a thorough evidentiary
22 hearing following the 2004 storm season, right?

23 A With regards to --

24 Q FPL 2004 storm costs.

25 A I know there was a hearing, I was not involved with

1 the hearing.

2 Q And OPC and AARP who are sponsoring your testimony
3 were parties to that proceeding, correct?

4 A I assume so.

5 Q At the time of your deposition, you had not reviewed
6 the order in last year's FPL storm docket, correct?

7 A That's correct.

8 Q And you didn't know whether it was the case that OPC
9 and AARP did not challenge the reasonableness or prudence of a
10 single penny of FPL's storm costs in that adversarial
11 proceeding, did you?

12 A I did not read the order then, and I have not read
13 the ordered today.

14 Q And that this proceeding, do you know whether AARP
15 has served a single discovery request independently of requests
16 served by OPC or staff that explores the reasonableness and
17 prudence of FPL's 2005 storm costs?

18 A Did AARP file discovery?

19 Q Correct.

20 A Well, I think technically they filed discovery. I am
21 jointly being sponsored by OPC and AARP. The discovery that
22 was filed was a consensus among the two parties that sponsored
23 my testimony.

24 Q Do you know with respect to AARP whether they filed
25 discovery related to the reasonableness and prudence of costs?

1 A I just answered the question.

2 Q I'm going to hand you a copy of Order Number 980953,
3 we'll distribute that so everyone has it. We are not going to
4 be entering it into the record. Do you have a copy of the
5 order?

6 A Yes.

7 Q Could you please review the third paragraph on Page 4
8 of that order related to the appropriate reserve level?

9 A That would be the paragraph you have highlighted?

10 Q Correct.

11 A Okay. I have read it.

12 Q You didn't review this order regarding FPL's storm
13 reserve prior to filing testimony did you?

14 A I filed testimony in the, not particular to the FPL
15 case, I knew this order existing and I have read this order a
16 number of times previously to filing the testimony. I filed
17 testimony in the Progress Energy case and familiar with this
18 order. I have read this language three or four times.

19 Q So you knew then that the Commission said in 1998
20 that the reserve should be funded to a level to protect against
21 another Hurricane Andrew type event adjusted for inflation and
22 system growth?

23 A Yes, I'm familiar with this order, yes.

24 Q And you said at your deposition that you assumed that
25 a 150 million to \$200 million reserve would not be adequate to

1 cover costs in the events of another Andrew type storm,
2 correct?

3 A That's correct. And I would point out the reason for
4 me saying that is that since this order, things have changed,
5 and the form of the securitization legislation, and also I
6 think if you look at the beginning of this order, Commissioner
7 Deason is the only one that I recognize that is still on the
8 Commission. There are two major changes here in terms of the
9 securitization and the make-up of the Commission. And also at
10 that time, there goes with still language in a previous order
11 that talked about the utilities sharing and the costs of the
12 storms.

13 Q In that order, the Commission said that a reasonable
14 level for the reserve was \$370 million in 1997 dollar, correct?

15 A That is correct.

16 Q You agree that the \$370 million would need to be
17 adjusted to account for inflationary factors and system growth
18 to get 370,000,000 in 1997 dollars would be in 2006 dollars,
19 correct?

20 A I would agree with that.

21 Q And you agree that the general consensus is that we
22 are in a period where there are going to be more storms?

23 A I would agree that that is the general consensus and
24 that the regulatory climate has changed since this order.

25 Q But you are recommend a reserve that is fraction of

1 what the Commission decided was reasonable until 1997 dollars,
2 correct?

3 A Yes. And the reason for that is the changed
4 regulatory environment.

5 Q And this is because of the securitization
6 legislation, and you feel that the company should come back
7 regularly to securitize, correct?

8 A Not necessarily to securitize. They have the right
9 or the ability to come back and recover all storm costs which
10 was not absolutely clear in 1998 if they had that right.

11 Q One of the concerns you expressed with respect to
12 FPL's requested reserve level has to do with the transaction
13 fees associated with the bond issuance, correct?

14 A Correct.

15 Q And you assert that keeping the storm damage reserve
16 level as low as is reasonable possible will reduce interest and
17 bond issuance costs and minimize financial impact on customers
18 rates, correct?

19 A Correct.

20 Q And we agreed at your deposition that the transaction
21 costs that you are concerned about would be incurred each time
22 securitization bonds are issued, correct?

23 A Correct.

24 Q At your deposition, you are said that in making your
25 recommendation you did not consider the financing costs and

1 fees that would be associated with multiple bond issuances if
2 FPL comes in each time a deficit occurs and does a bond
3 issuance before filing testimony, correct?

4 A Right. And the reason I didn't do that is because it
5 would require a huge amount of speculation on things that are
6 not known.

7 Q If you have to do multiple bond issuances to get to
8 \$650 million worth of storm protection you agree that the
9 transaction costs would be higher, correct?

10 A That would make sense, yes.

11 Q You didn't do any analysis of the fixed costs that
12 occur with every securitization transaction, did you?

13 A I don't know how many securitization transactions
14 there are going to be. I don't even know if you are going to use
15 securitization. It could be a surcharge. Again, the reason
16 the analysis wasn't done there was there were too many
17 unknowns.

18 Q And you didn't do an analysis of the transaction
19 costs or fees associated with FPL coming in regularly and
20 recovering deficits through a different mechanism like a
21 surcharge, did you?

22 A The answer is the same as just before.

23 MS. SMITH: No further questions.

24 CHAIRMAN EDGAR: Commissioner Arriaga.

25 COMMISSIONER ARRIAGA: Mr. Stewart, how are you?

1 THE WITNESS: Fine. How are you, Commissioner.

2 COMMISSIONER ARRIAGA: Fine. Thank you.

3 I need to enhance my learning curve. Please help me
4 out. You mentioned several times changes in regulatory policy
5 and climate. Will you characterize that for me.

6 THE WITNESS: Yes. I have been involved in this
7 process since about 1991, and I testified in the Progress case
8 in 2004 where we argued for sharing which was brought before
9 the Commission in terms of storm costs, should be borne by the
10 utility to the point that it was at the bottom of their fair
11 rate of return that was our argument. There was some, the
12 Commission I think has been inconsistent over the years on how
13 to deal with that. We lost that case. And after that,
14 securitization legislation was passed. So, the whole meaning
15 of the storm damage reserve before those two incidents was that
16 the utility had money at risk. If they had \$200 million in
17 their storm reserve and a storm hit and there was \$220 million
18 worth of damage, the Commission might ask them to eat that
19 twenty million dollars, especially if they had a high rate of
20 return on the equity. That was, say, in the early '90s. That
21 has changed now.

22 As I said in my summary, FPL can incur storm costs
23 and come into this Commission and get them approved and recover
24 them. There are prudent and reasonable expenses, and there is
25 no debate over that. That is the way I understand it

1 currently. So, with that in mind, why do we need a \$650
2 million reserve for storm that haven't hit yet and may not hit.
3 I understand if they do, that we are going to have to pay for
4 that, but what I'm arguing is there is some risk associated
5 with putting that money up. That is where I see the change of
6 the regulatory climate.

7 COMMISSIONER ARRIAGA: So the specific change is the
8 possibility because of the statutes change to many come back
9 for more securitization.

10 THE WITNESS: Not necessarily securitization, but
11 come back to collect the cost even in a surcharge. And the
12 2004 case sharing was rejected. And so my assumption now is
13 that all storm expenses that are prudently expended FPL, is
14 going to come back and can get every dime of that. So my point
15 is before you -- before you could see why they wanted a
16 reserve, because they wanted to protect against an Andrew
17 because they didn't want to be out on the limb for that money
18 at the Commission's discretion. Now, you know, if you have a
19 \$200 million some damage and they have \$600 million in damage
20 they can come in and get that through a surcharge or
21 securitization. So that is why, I'm arguing that it should be
22 as low as possible, because it is very speculative of what is
23 going happen over the next ten years. Nobody really knows.

24 COMMISSIONER ARRIAGA: Thank you.

25 CHAIRMAN EDGAR: Commissioner Carter.

1 COMMISSIONER CARTER: Thank you, Madam Chairman. You
2 are saying it should be as low as possible. Should they even
3 have a reserve fund?

4 THE WITNESS: That's a good question, and I have to
5 be careful in my answer to my testimony is the way it is filed.
6 Commissioner Carter after hearing, reading the rebuttal and
7 sitting here in this hearing, I would just leave you with it
8 needs to be as low as possible. I think the risk is completely
9 with the consumers at this point. I think that FPL has done a
10 great job. And if I was on their side, I would be pushing for
11 the same thing of protecting their finances. And I think they
12 have done a good job of that. They can come back here and get
13 the expenses that they need to pay for storm costs. To this
14 date, listening to the testimony, I think the securitization is
15 a whole new methodology and there is a lot of unintended
16 consequences around the corner. I think there is a lot of
17 variables here that I hope the Commission will recognize and
18 take into account. So I will would just say that I think the
19 reserve needs to be as low as possible.

20 COMMISSIONER CARTER: Thank you, Madam Chairman.

21 CHAIRMAN EDGAR: Commissioner Deason.

22 COMMISSIONER DEASON: Mr. Stewart, in regard to your
23 opinion that there has been a change in regulatory policy, that
24 being that under current policy a company can come in and ask
25 for recovery of prudently incurred costs either through a

1 surcharge and now based upon new legislation through
2 securitization.

3 THE WITNESS: Right.

4 COMMISSIONER DEASON: My question is has there been a
5 change of policy since post-Andrew or is it just a fact that
6 since Andrew there has not been a year in which there were
7 severe enough storms and enough damage to cause the amount of
8 restoration costs to exceed the then existing reserve.

9 THE WITNESS: I think obviously the issue -- that is
10 a good point, and that issue has become paramount with the
11 expense levels that you will see in the last two years. But I
12 do think that and you might disagree but I do think when the
13 numbers weren't as big there was a debate over utilities
14 sharing those costs. There was, I believe, an order in '95
15 with Gulf about sharing some costs. The numbers now have
16 gotten a lot bigger, but I do think that the securitization
17 legislation and the decision of the Commission in 2004, you
18 know, I won't say it is 100 percent protects the utility, but
19 it is a pretty high threshold for them not to get any expenses
20 recovered. I mean, we filed for sharing argument in the
21 Progress, we didn't file that here, because we feel that that
22 at the time of the filing the testimony it was off the table.
23 Some other people don't think so, but that was our position.

24 CHAIRMAN EDGAR: This seems like an appropriate time
25 for a short break. It is 10:30, we will come back at 10:45.

1 And, Mr. Twomey, we will start with you for redirect at that
2 time. We are on break until 10:45.

3 (Recess.)

4 CHAIRMAN EDGAR: We'll go back on the record.

5 Mr. Twomey.

6 MR. KISE: Madam Chair.

7 CHAIRMAN EDGAR: Mr. Kise.

8 MR. KISE: I just had one or two friendly cross
9 questions, and I didn't know what order we were going in, and I
10 was going to interpret before you got to the Commissioners, but
11 you had already gone there.

12 CHAIRMAN EDGAR: Mr. Kise, at the opportunity for
13 cross, I asked each of the intervenors if they had cross, and
14 Mr. Shreve said that the Attorney Generals Office did not have
15 cross, and we have moved beyond that point.

16 You know, I would have -- we have moved beyond that
17 point. We are on redirect.

18 MR. KISE: So I can't ask one or two short recross.
19 I honestly don't know what Mr. Shreve agreed to, and I
20 apologize for that.

21 CHAIRMAN EDGAR: Mr. Kise, I made a point to ask if
22 the Attorney General's Office had cross, and I do feel like we
23 need to move along. Perhaps there is an opportunity for you to
24 share your questions with --

25 MR. KISE: I could very well do that, but I'm certain

1 that there may be so some objection drawn because the redirect
2 isn't within the scope of the cross. Could be.

3 CHAIRMAN EDGAR: I do believe -- well, I don't
4 believe, I know, I forwarded that opportunity, and I think it
5 is time for us to move along.

6 So we will go to re direct. Mr. Twomey.

7 MR. TWOMEY: Thank you, Madam Chair.

8 REDIRECT EXAMINATION

9 BY MR. TWOMEY:

10 Q Mr. Stewart, Ms. Smith asked you a question about --
11 to the point of whether you were concerned about increased rate
12 volatility if there was not securitization, as I recall her
13 point being. Do you recall that discussion?

14 A Yes, I recall.

15 Q Would you consider a 19 percent or greater increase
16 in rates to constitute volatility?

17 A That would be you volatile, 19 percent.

18 Q And are you aware, Mr. Stewart, whether or not
19 Florida Power and Light's 2005 fuel adjustment rate increase
20 for residential customers was 19 percent or more?

21 MS. SMITH: Objection. This question is irrelevant
22 to this proceeding.

23 MR. TWOMEY: Madam Chair.

24 CHAIRMAN EDGAR: Mr. Twomey.

25 MR. TWOMEY: She asked him if he is concerned about

1 rate volatility, rate volatility is not confined to base rate
2 volatility.

3 CHAIRMAN EDGAR: Mr. Twomey, I am going to allow the
4 question.

5 MR. TWOMEY: What was your answer.

6 THE WITNESS: I don't remember the question.

7 BY MR. TWOMEY:

8 Q Well, much as I want to, I'm not going to ask it
9 again. Did you not say you didn't know?

10 A I wasn't sure if this was the exact percentage of
11 their fuel cost increase. I did say that 19 percent was a
12 volatile number.

13 Q Thank you. Now, Ms. Smith showed you a portion of
14 the final order in the 2004 FPL storm order, right? Do you
15 recall that? Do you recall the language she read to you
16 stating that no party, no customer party had challenged the
17 reasonableness and prudence of FPL's expenditures?

18 A I do remember that.

19 Q And my question is this. Do you recall,
20 notwithstanding that statement, do you recall in the 2004 storm
21 proceeding whether or not any parties challenged recovery of
22 expenses based on the fact that they might have been
23 double-recovery or things of that nature?

24 A I do recall that, the double-counting issue.

25 Q Now, Ms. Smith challenged you, I believe, on your

1 belief in your testimony, your belief stated in your testimony
2 that you thought that these type hearings would provide more
3 stringent review than a staff audit. Do you recall that?

4 A Yes.

5 Q Now, based upon -- you have been in the hearing room
6 the last two days?

7 A That is correct.

8 Q Based upon your observation of what has occurred in
9 the last two days and the issues raised by the various customer
10 parties, are you still of the view that this type proceeding
11 provides for greater, more stringent review than the company
12 having a large reserve and spending it as they wish and then
13 having an audit?

14 A No. Yes, this is a good example of the hearing
15 process working in terms of providing a lot of new information
16 and also subjecting witnesses to questions that might provide
17 insight to unintended consequences down the road.

18 Q Thank you. She also asked you about the order that
19 related to the amounts of reserve subsequent to Andrew. Do you
20 recall that?

21 A Yes.

22 Q And, you, I think, made some reference to changed
23 circumstances and I believe you mentioned securitization, is
24 that true?

25 A That is true.

1 Q Is there anything more than securitization that you
2 believe constitute changed circumstances that would render that
3 Andrew number less effective today?

4 A Well, I think that the rebuttal witness of Mr.
5 Dewhurst makes it less relevant, where he said that the storm
6 damage reserve was irrelevant to Florida Power and Light's
7 hurricane exposure, I think that would be another example of,
8 that would make that number irrelevant.

9 Q Now, you were questioned as well on the changed
10 policy questions. And I believe Ms. Smith asked you, but
11 Commissioner Arriaga did as well, I think, and my question to
12 you is with respect to the changed policy issue, are you aware
13 of how rapidly Florida Power and Light Company was able to
14 obtain, how quickly they were able to obtain interim surcharge
15 rate relief following the 2004 storm season?

16 MS. SMITH: I'm going to object to this. It's a
17 leading question.

18 CHAIRMAN EDGAR: Mr. Twomey, can you rephrase the
19 question?

20 MR. TWOMEY: I can certainly try.

21 BY MR. TWOMEY:

22 Q What are one of the factors that you believe caused,
23 give an change to the changed policy issue in terms of
24 rapidity?

25 A Well, I mentioned that, I believe, in one of the

1 answers is that FPL can come in and get a surcharge rather
2 quickly. The order you are referring to, I think it took two
3 months, I believe, just recalling from reading the first couple
4 of pages of the order for them to get a surcharge approved.

5 Q Now, Ms. Smith asked you about, I think, the gist of
6 her question, one of them was whether you weren't concerned
7 that there would be bond and other -- bond fees and other costs
8 associated with having to have successive securitization
9 petitions. Do you recall that?

10 A Yes, I do.

11 Q Now, first, you have not limited your alternatives to
12 securitization, correct?

13 A That's correct.

14 Q And what are the others?

15 A A surcharge would be the other option.

16 Q And, with respect to the fees, do you have a view on
17 whether your recommendation for a lower reserve would favorably
18 impact the consumers with respect to the fees?

19 A The only analysis I did was you looked at an exhibit
20 by Dewhurst that just indicated that obviously if the bond
21 request was lower there is going to be a lower fees up front.
22 Again, you can't predict how many storms would be in the future
23 and what recurring costs would come from those. So I would
24 think that the fees would be lower if the storm damages reserve
25 was set lower.

1 MR. TWOMEY: That's all I have. Thank you, Madam
2 Chair.

3 MR. KISE: Madam Chair?

4 CHAIRMAN EDGAR: Mr. Kise.

5 MR. KISE: Just for record purposes, because I do
6 think this is an important issue, I just want to understand
7 that the Chair is denying the Attorney General of the state of
8 Florida an opportunity to examine this witness based upon a
9 miscommunication of counsel. I understand that you provided
10 Mr. Shreve and the Attorney General with an opportunity, I
11 apologize for the miscommunications between myself and Mr.
12 Shreve, he should have indicated we did have just one or two
13 question, he did not, but based on that I think it is
14 substantially prejudicial to deny the Attorney General an
15 opportunity to examine a witness in a administrative
16 proceeding. In fact, I didn't hear, would I don't know what
17 their opinion is, I would be surprised if even FPL wants to
18 take the public position of denying the Attorney General an
19 opportunity ask questions of a witness in this proceeding. But
20 I want to register my objection and again ask the chair,
21 respectfully, to reconsider that decision.

22 CHAIRMAN EDGAR: Mr. Kise, your objection is noted.
23 I have made my ruling. Now we will move on.

24 Mr. Twomey, you were done, is that correct?

25 MR. TWOMEY: I'm finished, we would move Exhibit 87,

1 Madam Chair.

2 CHAIRMAN EDGAR: Exhibit 87. Isn't that already in
3 evidence?

4 MS. GERVASI: Yes, ma'am, it is.

5 MR. TWOMEY: I'm sorry.

6 CHAIRMAN EDGAR: That's okay. Any other matters?
7 Commissioners? No. Okay. The witness is excused. Thank you
8 very much.

9 THE WITNESS: Thank you.

10 MS. GERVASI: Staff calls Kathy L. Welch to the
11 stand, and Ms. Welch has not been sworn.

12 CHAIRMAN EDGAR: Thank you. (Pause.)

13 Ms. Welch if you will stand and raise your right
14 hand.

15 (Witness sworn.)

16 **KATHY L. WELCH**

17 **was called as a witness on behalf of the Staff of the Florida**
18 **Public Service Commission, and having been duly sworn,**
19 testified as follows:

20 **DIRECT EXAMINATION**

21 BY MS. GERVASI:

22 Q Ms. Welch, will you please state your name and your
23 business address.

24 A Kathy L. Welch, 3625 Northwest 82nd Avenue, Miami,
25 Florida.

1 Q Thank you. And by whom are you employed and in what
2 capacity?

3 A The Florida Public Service Commission --

4 CHAIRMAN EDGAR: Ms. Welch, we having a hard time
5 hearing you. Could you make sure the mike is on or pull it
6 towards you.

7 A I work for the Florida Public Service Commission. I
8 am a public utility supervisor.

9 Q Have you prepared and caused to be prefiled direct
10 testimony in this case?

11 A Yes, I have.

12 Q And it consists of 11 pages?

13 A Yes.

14 Q Do you have any changes to make to your testimony?

15 A No, I do not.

16 Q If I were do ask you the same questions today, as
17 were posed in your testimony, would your answers be the same?

18 A Yes, they would.

19 Q I would ask that Ms. Welch's prefiled direct
20 testimony be inserted into the record as though read.

21 CHAIRMAN EDGAR: The prefiled testimony from this
22 witness will be entered into the record as though read.

23 MS. GERVASI: Thank you.

24

25

1 DIRECT TESTIMONY OF KATHY L. WELCH

2 Q. Please state your name and business address.

3 A. My name is Kathy L. Welch, and my business address is 3625 N.W. 82nd Ave., Suite
4 400, Miami, Florida, 33166.

5

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

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

9

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

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

12

13 Q. Briefly review your educational and professional background.

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

21

22 Q. Please describe your current responsibilities.

23 A. Currently, I am a Public Utilities Supervisor with the responsibilities of administering
24 the Commission's Miami District Office and reviewing work load and allocating resources to
25 complete field work and issuing audit reports when due. I also supervise, plan, and conduct

1 utility audits of manual and automated accounting systems for historical and forecasted
2 financial statements and exhibits.

3

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

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

8

9 Q. What is the purpose of your testimony today?

10 A. The purpose of my testimony is to sponsor the staff audit report of Florida Power &
11 Light Company (Company) which addresses the Company's petition for issuance of a storm
12 recovery financing order, Audit Control Number 05-292-4-1. This audit report is filed with
13 my testimony and is identified as Exhibit KLW-2. I am also sponsoring the supplemental
14 audit report which addresses supplemental audit work performed. This audit report is filed
15 with my testimony and is identified as Exhibit KLW-3.

16

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

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

20

21 Q. Please describe the work performed in the initial audit.

22 A. We reconciled 2005 storm costs recorded in FPL's filing to the company's ledger. We
23 also reconciled the remaining balance of the 2004 storm costs as shown in Exhibit A of the
24 filing to the ledger. PSC Order No. PSC-05-0937-FOF-EI approved 2004 storm costs allowed
25 for recovery. We determined that the adjustments required by this order were booked, and we

1 reviewed the detail of all storm costs for 2005. We selected samples of payroll, material and
2 supplies, vehicle charges, cash disbursements, and journal vouchers based on material dollars,
3 unusual items, and affiliate transactions and traced them to source documents. We traced
4 Payroll charges to time tickets and rate data. We traced materials and supplies to reports done
5 at the field locations that distributed the materials to the crews. We reviewed the materials
6 with a PSC staff engineer to determine the types of items expensed. We traced vehicle
7 charges to the vehicle time reports, and we traced vehicle rates to source documentation. In
8 the 2004 storm audit, we reviewed the clearing accounts and the methodology for allocating
9 these expenses for reasonableness, and in this audit we verified that the same policies were
10 still used. We traced cash vouchers to invoices and reviewed them for related storm dates.
11 We randomly traced billings from contractors to purchase orders.

12 We traced the advertising costs to print and radio scripts. We reviewed journal
13 vouchers that were not reversed and tested them to the source documents related to the type of
14 entry. The company also had a large amount of unpaid charges at the end of December that
15 were accrued. We obtained lists of these costs by division, and we requested detail for several
16 divisions. We reviewed the support for the accruals for reasonableness. We traced the
17 amount of capital additions that are projected to reduce the storm reserve to source
18 documentation. We reviewed the methodology of the calculation for compliance with Order
19 No. PSC-05-0937-FOF-EI, and we reviewed the projections to determine if they included the
20 capital items mentioned in the KEMA study. We recalculated taxes and interest. We
21 reviewed the procedure for recording retirements associated with the capital items, and we
22 traced a sample of the 2004 retirements to the documentation the company had on original
23 cost and removal costs. We compared the budget for base operation and maintenance expense
24 for 2005 to the actual costs. We reviewed internal audits performed on the 2004 storm
25 expenses.

1 We also read the procedures used to replace or repair poles and the 2004 study of
2 BellSouth poles. We tested some of the work orders to retire the poles by tracing the work
3 orders to material and supply lists and tracing normal labor costs to company documentation.
4 We traced original cost information to FPL's property accounting system.

5
6 Q. Please review the audit findings in the initial audit report.

7 A. The audit findings in this report were intended to disclose information for the
8 Commission staff analysts' consideration.

9 **Audit Finding No. 1**

10 Audit Finding No. 1 discusses the regular pay of \$26,092,000 that FPL included in its
11 estimated storm costs for 2005. The company filing includes an estimate of \$26,092,000 of
12 regular pay and \$60,334,000 of overtime pay. Included in the overtime amount is \$768,000
13 that was classified as incentives. FPL responded that this was incorrectly classified and relates
14 to exempt overtime payments made to 53 people who worked extensive hours to support
15 storm restoration but were not covered by the storm overtime policy. According to FPL, the
16 lump sum payments were made for equity reasons. There were circumstances during storm
17 restoration when two people were working extraordinary hours performing the same storm
18 jobs, but only one was eligible for overtime pay under the storm overtime policy because of
19 their regular job classification. Some employees not covered by the storm overtime policy
20 received a lump sum overtime payment.

21

22 **Audit Finding No. 2**

23 Audit Finding No. 2 discusses an accrual of \$1,413,250 for substation landscaping and
24 \$90,000 for Service Center landscaping for a total of \$1,503,250. These costs were recorded
25 for Hurricane Wilma. Other landscaping costs may have been incurred but were not selected

1 in the sample. FPL believes the landscaping is required to meet zoning requirements. If the
2 Commission decides that these costs should not be recovered, the company should remove any
3 additional landscaping costs charged to the storm reserve account.

4
5 **Audit Finding No. 3**

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10 **Audit Finding No. 4**

11 Audit Finding No. 4 discusses contingencies FPL has added to many of the accruals
12 made in December for Hurricane Wilma. Several of the accruals selected for review in
13 December 2005 for Hurricane Wilma contained accruals for contingencies.

14
15 **Audit Finding No. 5**

16 Audit Finding No. 5 discusses the fact that FPL has not prepared a billing to charge
17 other companies for repairing those companies' poles after the 2004 storms. The 2004 storm
18 pole survey was completed, and the associated billing was expected to be completed by the
19 end of February 2006. The 2004 storm pole survey indicates the company will bill BellSouth
20 for 2,483 pole replacements. As of March 10, 2006, this billing had not been completed. The
21 2005 storm pole survey was initiated but has not been completed.

22 FPL's joint use agreements state, "Whenever, in any emergency, the Licensee replaces
23 a pole of the Owner, the Owner shall reimburse the Licensee all reasonable costs and expenses
24 that would otherwise not have been incurred by the Licensee if the Owner had made the
25 replacement."

1 FPL's total unrecovered storm costs should be reduced by the amount billed to other
2 companies less the amount capitalized for the related poles.

3

4 **Audit Finding No. 6**

5 Audit Finding No. 6 discusses storm preparation costs of \$10,052,336.46 for nuclear
6 plants that were included in the storm recovery filing. These costs comprised both the
7 preparation prior to the storm hitting and restoring the plants after the storm. The preparation
8 and restoration amounts were not accounted for separately. The company does not keep track
9 of the storm preparation costs for any other FPL business unit. Actual costs booked and
10 accrued as of December 31, 2005 are as follows:

11	Hurricane Katrina	339,045.00
12	Hurricane Rita	191,123.27
13	Hurricane Wilma	6,751,506.19
14	Hurricane Wilma Accruals	2,770,662.00
15	Total	<u>\$10,052,336.46</u>

16

17 **Audit Finding No. 7**

18 Audit Finding No. 7 discusses advertising costs. Advertising charges were included in
19 the storm recovery expenses in the amount of \$2,630,218.47. Certain of these charges
20 appeared to be image enhancing. The cash voucher sample included items for advertising.
21 Some of this was for radio safety ads, some for newspaper ads informing the public of
22 expected restoration times, and some for newspaper ads thanking the public, employees,
23 contractors, etc. Because of this we obtained further data from the company regarding
24 advertising. A detailed list we compiled is included in the audit report.

25

1 **Audit Finding No. 8**

2 Audit Finding No. 8 discusses the accruals made for Hurricane Wilma that included a
3 repair of Condenser Tubes at Martin Plant Units 1 and 2. Supporting documentation indicates
4 that the tubes may have been planned for repair prior to the hurricane.

5 As supporting documentation for this accrual, the company provided an Event Report
6 for partial condenser retube at Martin Units 1 and 2. The event report identifies the event start
7 date as July 22, 2005, and stop date as October 12, 2005. It shows a planning need date as
8 August 26, 2005, and shows the need date for the parts as June 29, 2005. Under the event
9 assignment section, the event report shows March 1, 2008. The estimated cost shown on this
10 report was \$1,193,404.

11 FPL multiplied this cost by two because they claim the estimate is for only one unit.
12 The event report does not say how many units, but it does say that it was for a partial retube.
13 The total charged to the storm reserve is \$2,386,000.

14 FPL claims that hurricane damage to these units was attributed to the abrupt manner in
15 which the units were shut down and to the micro-biologic condenser tube pitting caused by
16 running the units during the hurricane. According to the company summary, the amount of
17 damage caused by the storm as compared to what should be expected for tubes of this age is
18 still under analysis.

19 We questioned FPL about this event report and the response was that the estimate was
20 only for Unit 1. The response also indicates that the replacement was not expected to take
21 place until 2008.

22 Although the need date on the report shows the retube needed to be done by 2008, it
23 appears to have been planned for 2005 before the storm occurred. FPL has responded that the
24 detail that has the 2005 dates were copied from another job and do not relate to this estimate.
25 We did not have time to verify the company assertion.

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Audit Finding No. 9

Audit Finding No. 9 addresses an

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Audit Finding No. 10

Audit Finding No. 10 discusses that the detail provided by the Power Systems Business Unit to support its accruals as of December 31, 2005 does not agree with the accrual. Power Systems provided support for its accrual at December 31, 2005. The support did not agree with the amount accrued. We requested detail to explain the differences. The support showed that FPL does not change its' overall accrual for the total storm costs when contracts come in over or under budget. If one business unit comes in under the accrued amount, the over-accrual gets transferred to Power Systems since they have the most likelihood of going over the accrued amount. The differences between the Power Systems accruals and the detail which were created by the over-accrual from the other business units follow:

<u>BUSINESS UNIT</u>	<u>STORM</u>	<u>ACCRUAL</u>	<u>SUPPORT</u>	<u>DIFFERENCE</u>
POWER SYSTEMS	WILMA	\$410,326,407.00	\$408,046,662.00	\$2,279,745.00
POWER SYSTEMS	KATRINA	30,692,965.00	30,419,812.00	273,153.00
POWER SYSTEMS	RITA	327,553.00	230,879.00	96,674.00
		<u>\$441,346,925.00</u>	<u>\$438,697,353.00</u>	<u>\$2,649,572.00</u>

Audit Finding No. 11

Audit Finding No. 11 discusses FPL's unrecovered 2004 storm costs. Exhibit A of the company filing shows \$213,307,000 of unrecovered 2004 storm costs. This is supported by Exhibit No. KMD-3 of FPL witness K. Michael Davis's testimony. The December 2005 amount of the ending deficiency on KMD-3 was estimated at \$294,680,000. The actual general ledger amount with the interest is \$293,930,364. Therefore, the estimate at December is \$749,636 more than actual. The differences relate to the estimate of the beginning balance from Commission Order No. PSC-05-0937-FOF-EI being different than actual, the December interest calculation being different than actual and an adjustment for the Commission order related to taxes on the interest.

Q. Please describe the work performed in the supplemental audit.

A. We traced the capitalized Hurricane Wilma costs to the journal entries and their source documents. We recalculated the vehicle rates for the current sample and the prior audit's transmission sample, and we reviewed the process to develop the rates for reasonableness. We traced the vehicle usage hours to internal company reports prepared by field employees as they input their work into the financial accounting management system. We traced materials and supplies items to the calculations of the average cost depending on the category of the item. We traced all payroll items in the sample to reports, time sheets, and entries recording

1 shift differential, temporary relief, regular pay, exempt overtime, and storm preparation costs.
2 We obtained job tickets for the sample selected in the initial audit and determined if the jobs
3 were storm related. We determined if time sheets were coded to the storm and recalculated
4 and traced the salary level to the payroll documentation. We obtained supporting
5 documentation for the December 2005 accruals for the Power Systems Business unit that we
6 did not have time to review in the initial audit. We also reviewed supporting documentation
7 for work that FPL has identified as follow up work after Hurricane Wilma. We traced these
8 items to supporting documentation that shows these amounts are owed. We attempted to trace
9 the repairs to event reports to determine if the maintenance was planned. However,
10 transmission and distribution staff do not prepare event reports the way the generation
11 business units do. We traced all journal vouchers in the sample to source documentation to
12 determine if they were for reasonable storm charges. We agreed all cash vouchers in the
13 sample to invoices to determine if the items are related to the storm recovery process. We
14 reviewed the 2004 storm costs to date. We verified that internal audit adjustments were made.
15 In the initial storm audit, we determined that a study was being done to determine what
16 equipment was replaced for other companies and what amount would be charged to them.
17 Our initial storm audit reported that the study would be completed by the end of February, so
18 we requested it during the supplemental audit. It has not been completed and could not be
19 reviewed.

20
21 Q. Please review the audit findings in the supplemental audit report.

22 A. The audit findings in this report were intended to disclose information for the
23 Commission staff analysts' consideration.

24 **Audit Finding No. 1**

25 Audit Finding No. 1 discusses Audit Finding No. 9 in the staff's initial audit report.

1 That finding disclosed that

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Audit Finding No. 2

9 Audit Finding No. 2 discusses Audit Finding No. 4 in the initial audit report. That
10 finding disclosed that an FPL accrual of \$72,300,000 to power distribution follow-up work for
11 Hurricane Wilma was selected as a sample amount for further review. In the supplemental
12 audit, we have determined that FPL now estimates the power distribution follow-up work for
13 Hurricane Wilma to total \$89,853,508. These amounts are based on revised estimates
14 provided on February 16, 2006. A new list of FPL's estimated power distribution follow-up
15 cost is provided in the audit report. The utility assertions of what was considered related to
16 the hurricanes can be found in the report.

17 Additionally, we have determined that FPL has reclassified \$5,073,184 from Account
18 186-Deferred Maintenance Storm to remove estimated capital asset additions included in its
19 follow-up work for Hurricane Wilma. This adjustment is not reflected in the revised schedule
20 in the audit report.

21

22 Q. Does this conclude your testimony?

23 A. Yes, it does.

24

25

1 BY MS. GERVASI:

2 Q Ms. Welch, did you prefile Exhibit Numbers KLV-1
3 through KLV-3 attached your prefled testimony?

4 A Yes, I did.

5 Q Do you have any changes to make to those exhibits?

6 A No, I do not.

7 MS. GERVASI: These exhibits I note have already been
8 admitted into evidence as Exhibit 88, 89 and 90.

9 BY MS. GERVASI:

10 Q Do you have a brief summary of your testimony?

11 A My summary is simply to say that my testimony is to
12 sponsor the audit report and the supplemental audit report
13 filed in this case.

14 MS. GERVASI: Thank you. We tender the witness for
15 cross-examination.

16 CHAIRMAN EDGAR: Is there cross the intervenors.
17 FRF, no. OPC, no.

18 MR. BECK: No questions.

19 CHAIRMAN EDGAR: Attorney General, no. FIPUG, no,
20 Seeing none, Ms. Smith.

21 MS. SMITH: Thank you, Madam Chairman. I have
22 communicated with Ms. Gervasi in advance, and she agreed that
23 we could enter the deposition transcript of Ms. Welch into the
24 record in order to abbreviate my questioning. So I would ask
25 that it be marked for identification?

1 CHAIRMAN EDGAR: We will number this Exhibit 157.

2 (Exhibit 157 marked for identification.)

3 CROSS EXAMINATION

4 BY MS. SMITH:

5 Q Ms. Welch, you are of the supervisor of the Miami
6 audit staff, correct?

7 A Yes.

8 Q And you have an accounting background?

9 A That is correct.

10 Q And about 27 years of experience with the Commission?

11 A Yes.

12 Q And you supervise the audit of FPL's 2005 storm cost,
13 correct?

14 A I did.

15 Q And you prepared some of the audit requests to FPL,
16 correct?

17 A Correct.

18 Q And most of the audit requests were prepared pipeline
19 the five staff auditors who work for you and report to you,
20 correct?

21 A Four auditors that report to me, one that works out
22 of a different district, yes.

23 Q And in total almost a thousand hours were spent in
24 the audit of FPL's storm costs, correct?

25 A Correct.

1 Q And at your deposition you characterized the staff
2 audit of FPL storm costs as thorough, correct?

3 A To the extent of what we did in the procedures, yes.

4 Q And prior to the audit, you reviewed the PSC order in
5 last year's storm docket, Order 050937, correct?

6 A Correct.

7 Q And you also reviewed the order approving the
8 stipulation and settlement in the rate case, Order 050902
9 correct?

10 A Correct.

11 Q And you reviewed a number of FPL internal audits
12 related to storm costs, correct?

13 A Correct.

14 Q And based on your review of the FPL internal audits,
15 you did not have any concerns with the way FPL was handling
16 storm restoration costs, correct?

17 A Not based on the internal audits, no.

18 Q And the things that the FPL internal auditors found
19 were corrected, isn't that true?

20 A That is correct. The 2004 and some 2005, I think
21 they are still continuing do work. I don't know.

22 Q And you and Mr. Slemkewicz in Tallahassee decided
23 that some of the items would be done by Staff in Tallahassee
24 and some by the auditors in Miami, correct?

25 A That's correct.

1 Q And Mr. Slemkewicz and the Tallahassee office would
2 handle adjustments from last year's order relative to the
3 incremental accounting approach and any offsetting adjustments,
4 correct?

5 A Correct.

6 Q And the staff auditors really only focused on
7 portions of last year's storm order, correct?

8 A That's correct.

9 Q And the goal was to ensure that the way that FPL
10 booked storm costs was consistent with that order last year,
11 correct?

12 A Correct.

13 Q And regarding last year's storm order, you said at
14 your deposition that you believed the Commission allowed the
15 offset for uncollectible accounts expense last year because
16 during storm restoration the bill collectors weren't able to go
17 out and do the work they normally do, so FPL was not able to
18 collect as much revenue as they normally do and they had to
19 write off more, do you recall that discussion?

20 A That was my belief, but I was not actively involved
21 in the hearing, I really couldn't say why the Commission
22 decided to do it. That's my understanding.

23 Q Let's turn to the audit report. In it you're not
24 making recommendations to the Commission, are you?

25 A No.

1 Q You are making or presenting options or information
2 for the Commission to consider, correct?

3 A That's correct.

4 Q And Audit Finding Number 1 addresses regular payroll,
5 correct?

6 A Yes.

7 Q In Audit Finding Number 1 you cite last year's FPL
8 storm order and you say, quote, without taking into account the
9 normal level of expenditures funded by base rates that
10 customers pay requires customers to pay twice for the same
11 costs. Is that the quote you included?

12 A Yes.

13 Q And you said you believed that the quote was talking
14 about double counting that FPL is recovering the amount through
15 base rates and also through storm recovery costs, right?

16 A Yes.

17 Q But you made no determination as to whether FPL was
18 double-counting or recovering payroll through base rates and
19 also storm costs, correct?

20 A Only to the extent of the sentence in that statement
21 that follows that that says regular pay would have been
22 incurred even if the storm had not occurred.

23 Q But you're not making a statement in Audit Finding 1
24 as to whether customers were actually paying twice, correct?

25 A No.

1 Q You are just pointing out that regular payroll has
2 been charged to the storm reserve, right?

3 A Yes.

4 Q And the Tallahassee analysts were to determine
5 whether, if there are no sales of electricity when power is
6 out, FPL, indeed, could have recovered those amounts through
7 base rates in the first place, right?

8 A Yes.

9 Q Going back to the 26 million in regular payroll that
10 you identified for disallowance, if the Commission decides to
11 remove regular payroll under Audit Finding Number 1, you agreed
12 that FPL adjusted the amount of regular payroll charged to the
13 reserve to account for amounts that it expected to recover
14 through insurance, correct?

15 A I'm sorry, could you repeat that?

16 Q You agreed that FPL adjusted the amount of regular
17 payroll charged to the reserve to account for amounts that it
18 expected to recover through insurance, those amounts weren't
19 charged to the reserve?

20 A That's correct.

21 Q And so the 26 million in regular payroll should be
22 reduced by the almost 2.5 million in expected insurance
23 recoveries that are not included in FPL's requested storm
24 recovery amount, correct?

25 A That's correct.

1 Q And if regular payroll costs are disallowed only
2 actual regular payroll costs should be disallowed, right?

3 A Correct.

4 Q And to the extent the \$26 million in regular payroll
5 includes amounts that normally would have been charged to
6 clauses, and thus was incremental to base rates, the clause
7 amounts should not be disallowed, correct?

8 A That's correct depending on how those clause amounts
9 were determined.

10 Q And staff didn't consider, audit staff didn't
11 consider whether any of the regular payroll amounts would be
12 adjusted to remove capital costs, did it?

13 A No.

14 Q And you agree that to the extent regular payroll
15 would have been charged to capital and removed from the reserve
16 when FPL made the capital adjustment, those amounts should not
17 be disallowed twice, correct?

18 A That's correct.

19 Q And regarding the \$768,000 in exempt overtime
20 payments identified in Audit Finding Number 1, you believe it
21 is fair for exempt employees to get equal pay for equal work,
22 correct?

23 A I don't have a problem with them getting paid the
24 bonus. I'm concerned with whether it should be charged to the
25 clause, or to the storm reserve.

1 Q And you say bonus, but when we spoke at your
2 deposition, we agreed that they were incorrectly mapped to
3 incentives, and, in fact, were exempt overtime payments,
4 correct?

5 A I agreed that you changed the classification. They
6 still do not look any different to me than what you classified
7 last year as bonuses.

8 Q Audit staff did not consider whether removing regular
9 payroll from the amounts charged to the reserve would encourage
10 the using of outside contractors in lieu of experienced company
11 employees who have regular jobs to do, correct?

12 A I would hope that FPL would not choose to use
13 something that cost more money just because the Commission made
14 some decision on not believing that regular pay should be
15 included in the storm reserve.

16 Q Did audit staff consider whether storm restoration
17 would be more expensive if FPL has to rely more on outside
18 contractors and foreign crews because its regular workers have
19 regular jobs to do?

20 A It probably would cost more for contract workers to
21 do the work.

22 Q Did audit staff consider that?

23 A Not in our disclosure, no.

24 Q Audit staff did not consider whether it may slow the
25 overall restoration effort to rely more heavily on outside

1 contractors or foreign crews instead of company resources,
2 correct?

3 A No.

4 Q And audit staff did not consider whether disallowing
5 regular payroll was consistent with the objective of saving
6 rapid restoration of power following storms, did it?

7 A No.

8 Q Audit Finding Number 3 relates to lawsuit settlements
9 charged to the reserve?

10 A I need to get my confidential.

11 Q I'm handing out copies of the EEI and Southeastern
12 Electric Exchange Mutual Aid agreements.

13 MS. GERVASI: Madam Chairman, at this point I would
14 like to note that both of these items that were just passed out
15 are labeled as exhibits to the deposition. And we've agreed to
16 stipulate the deposition in. In the interest of moving things
17 along, I would hope that we don't -- I don't receive a need for
18 lot of duplicative types of questions.

19 CHAIRMAN EDGAR: Thank you, Ms. Gervasi.

20 MS. SMITH: I wasn't planning to admit these as
21 exhibits. Just a couple of questions on this subject.

22 BY MS. SMITH:

23 Q Do you recognize these documents, Ms. Welch?

24 A Yes, I do.

25 Q During the course of the audit, you didn't request a

1 review of the mutual aid agreements that govern the provision
2 of emergency assistance by and to foreign utility crews, did
3 you?

4 A I did not, but I believe one of our audits did.

5 Q And did you review Section 11 of the Edison Electric
6 Institute agreement?

7 A No.

8 Q And I will read Section 11. "Requesting companies
9 shall indemnify, hold harmless, and defend the responding
10 company from and against any and all liability for lost,
11 damage, cost or expense which responding company may incur by
12 reason of damage to or destruction of any property, including
13 the loss of use thereof, which result from furnishing emergency
14 assistance, and whether or not due in whole or in part to any
15 act, omission, or negligence of responding company, except to
16 the extent that such death or injury to person or damage to
17 property is caused by the willful for wanton misconduct and/or
18 gross negligence of the responding company."

19 It goes on to provide that the company shall
20 indemnify and hold harmless all foreign utility crews who
21 assist FPL in providing assistance. Is that correct?

22 A That is correct.

23 Q And the Section 17.6 and 17.7 of the Southeastern
24 Electric Exchange Mutual Aid agreement provide similar terms,
25 correct?

1 A Correct.

2 Q And you agree that based on these provisions of the
3 mutual aid agreement that FPL is required to indemnify foreign
4 crews for lawsuits or claims that occur as part of their
5 assisting FPL in storm restoration efforts?

6 A I agree. But just as I had to you in the deposition,
7 this hasn't been pointed out because we specifically thought it
8 was wrong. We believe that the Commissioners should know the
9 different types of charges, especially when it is something
10 unusual, that are in the storm charges to that they are aware
11 and can review whether they think it is reasonable.

12 Q And you believe it is an important consideration that
13 FPL is required to indemnify and hold foreign crews harmless,
14 correct?

15 A I do.

16 Q And also regarding the amount identified in Audit
17 Finding Number 3, did you read Mr. Davis' rebuttal testimony
18 and FPL's response to the audit report?

19 A I did.

20 Q And you would agree, would you not, that to the
21 extent FPL has removed \$2.2 million in lawsuit settlement costs
22 from the amount charged to the reserve that 2.2 million should
23 not be disallowed twice, correct?

24 A Correct.

25 Q Regarding Audit Finding Number 4 related to

1 contingency portions of estimated storm costs, there is no rule
2 statute or legal requirement that provides that FPL's storm
3 costs must be known certain and paid before it can request
4 recovery of though costs, correct?

5 A None that I know of.

6 Q And do you agree that the contingent portion of
7 estimated storm costs is going down as more costs become
8 actual, correct?

9 A I believe some of it went down because of adjustments
10 that I think were in Mike Davis' rebuttal. But, yes, I do
11 believe that the contingency are going down as actual costs are
12 coming in.

13 Q Looking at Audit Finding Number 5, this relates to
14 billing other companies of replacement of their poles after
15 storms?

16 A That's correct.

17 Q And you recommended in Audit Finding Number 5 that
18 any costs in addition to the normal costs that were capitalized
19 for pole replacements for other companies' poles should reduce
20 FPL's storm costs, right?

21 A That's correct.

22 Q And have you read Mr. Davis and Ms. Williams'
23 rebuttal testimony and they relate to FPL billing other
24 entities for replacing poles during the 2004 and 2005 storm
25 seasons?

1 A Yes, I have.

2 Q And would you agree that if FPL has already made a
3 credit to the storm reserve for amounts billed to other
4 companies for 2004, and estimated amounts for replacement
5 during 2005, it would not be appropriate to reduce FPL's 2005
6 storm costs by that same amount, correct?

7 A I haven't reduced the cost and the way they
8 determined the costs, but I agree it shouldn't be removed
9 twice.

10 Q Turning to Audit Finding Number 8, during your
11 deposition we discussed this audit finding, and the fact that
12 FPL has stated it adjusted its storm estimate by approximately
13 2.8 million in March when it determined that an entire retube
14 was needed, so it was a capital expenditure. Do you remember
15 that discussion?

16 A I do.

17 Q And you would agree to the extent that amount was
18 part of an FPL capital adjustment in March it should not be
19 removed twice, correct?

20 A Correct.

21 Q Quickly going back to Audit Finding Number 7, just a
22 couple of questions. This relates to advertising. You believe
23 that public safety advertising such as reminding customers to
24 stay away from live wires and providing them the phone number
25 to report outages should be encouraged and not discouraged,

1 correct?

2 A I think it should be encouraged, I'm just not sure
3 where it should be charged.

4 Q And the same with respect to advising customers of
5 the status of restoration?

6 A Correct.

7 Q And during your deposition, you said that
8 extraordinary costs are generally not included in the cost of
9 providing service for purposes of setting base rates, correct?

10 A When rates are set, correct.

11 Q And advertising related to hurricanes is not
12 something that occurs on an annual basis, is it?

13 A No, it doesn't.

14 MS. SMITH: I have no further questions.

15 CHAIRMAN EDGAR: Ms. Gervasi.

16 MS. GERVASI: We have no redirect.

17 MR. KEATING: Madam Chair, as a housekeeping matter,
18 I do want to, and I apologize for not having done this when Ms.
19 Welch took the stand, but make sure that the record contains
20 the confidential version of her testimony and audit report
21 only. I do want to hand that to the court reporter, and I can
22 provide you copies as well.

23 CHAIRMAN EDGAR: Ms. Gervasi, do we need to move
24 Exhibit 157 into the record.

25 MS. GERVASI: We can do that.

1 CHAIRMAN EDGAR: Let's do that for neatness.

2 MS. GERVASI: Thank you.

3 (Exhibit 157 admitted into the record.)

4 MS. GERVASI: We would also like to go ahead and
5 identify this confidential information as an exhibit, as the
6 next available exhibit.

7 CHAIRMAN EDGAR: So that would be 158.

8 MS. GERVASI: Thank you.

9 CHAIRMAN EDGAR: Ms. Gervasi, can you give us a
10 title.

11 MS. GERVASI: Confidential portions of audit report
12 and supplemental audit report.

13 CHAIRMAN EDGAR: Are there any objections to the
14 confidential exhibit? Seeing none, Exhibit Number 158 will be
15 moved into the record as evidence.

16 MS. GERVASI: Thank you.

17 (Exhibit 158 marked for identification and admitted
18 into the record.)

19 CHAIRMAN EDGAR: And the witness is excused.

20 Thank you, Ms. Welch.

21 (Recess.)

22 CHAIRMAN EDGAR: We will go back on the record.

23 Mr. Keating.

24 MR. KEATING: Yes, Madam Chair, a couple of points.

25 First of all, we have talked to the other parties, and I don't

1 believe there's any objection if we were to take the next staff
2 witness listed here, Joseph Jenkins, out of order following
3 Mr. Noel, Mr. Fichera and Ms. Klein.

4 CHAIRMAN EDGAR: Is there any objection?

5 MR. BECK: No objection.

6 CHAIRMAN EDGAR: No objection. No objection. No
7 objection. Then we will take those witnesses out of order.

8 MR. KEATING: I'm sorry?

9 CHAIRMAN EDGAR: Then we will take those witnesses
10 out of order.

11 MR. KEATING: The second matter addresses how we're
12 going to handle Mr. Noel, Mr. Fichera, and Ms. Klein, as well
13 as FPL rebuttal Witness Olson and Dewhurst to an extent. What
14 the parties have agreed is for those witnesses, each witness
15 will take the stand, be sworn in if they haven't already, and
16 provide you a summary of their testimony. And in lieu of
17 cross-examination, the deposition transcripts for each of those
18 witnesses would be moved into the record.

19 The witnesses would be available for the Commission,
20 any of the Commissioners to ask questions, but we think this
21 will, this will move this along and get us through at least a
22 few hours that we wouldn't otherwise have on the, on the
23 calendar for the rest of the day.

24 CHAIRMAN EDGAR: Are there objections, questions or
25 comments from any of the parties or the Commissioners on the

1 proposal that Mr. Keating has given us?

2 MR. BECK: Cochran, with respect to Mr. Dewhurst, are
3 you going to qualify that?

4 MR. KEATING: Yes. Mr. Dewhurst's rebuttal testimony
5 covers more than just rebuttal of Mr. Noel, Fichera and
6 Ms. Klein. What we propose, and I think what's been agreed
7 with respect to Mr. Dewhurst, is that that portion of his
8 rebuttal testimony, parties would waive cross on, but that
9 there are other portions of his rebuttal testimony that would
10 still would be subject to cross-examination, and obviously he's
11 available for any questions from the Commission on any portion
12 of his testimony.

13 CHAIRMAN EDGAR: Mr. Beck.

14 MR. BECK: Yes. That's our understanding, that we're
15 free to question Mr. Dewhurst about anything other than the
16 rebuttal to the three staff witnesses.

17 MR. KISE: And on that point, Madam Chair.

18 CHAIRMAN EDGAR: Mr. Kise.

19 MR. KISE: On that point, just for clarification,
20 I've been given assurances by FPL that we won't get into a
21 debate if we skirt the line. I mean, just in case there is
22 some question that comes close to what they might consider to
23 be that area of testimony, we're not going to be completely
24 precluded. We're trying to streamline the process. I'm sure
25 we won't have that problem at all, but I'm just trying to make

1 that point to be very clear today.

2 CHAIRMAN EDGAR: I appreciate the cooperative spirit.
3 Mr. Keating.

4 MR. KEATING: With that, staff would call what would
5 be its next witness on the list, Mr. Michael Noel. And what
6 Mr. Noel, when he reaches the witness stand, I do not believe
7 he has been sworn yet.

8 CHAIRMAN EDGAR: Thank you. We'll come back to him.
9 Mr. Noel, when you're ready, if you will stand and raise your
10 right hand, we'll go ahead and swear you in.

11 MICHAEL L. NOEL
12 was called as a witness on behalf of the staff of the Florida
13 Public Service Commission and, having been duly sworn,
14 testified as follows:

15 DIRECT EXAMINATION

16 BY MR. KEATING:

17 Q Mr. Noel, will you please state your name and
18 business address for the record.

19 A I'm Mike Noel. My business address is 44 Wall
20 Street, New York, New York.

21 Q And are you the same Michael Noel who prepared
22 testimony that was prefiled in this docket consisting of 14
23 pages?

24 A I am.

25 Q Okay. If I were to ask you today the questions

1 presented in your prefiled testimony, would your answers be the
2 same as those that you provided in your testimony?

3 A They would.

4 Q Okay. Do you have any corrections to make to your
5 prefiled testimony?

6 A I do not.

7 MR. KEATING: I would ask that Mr. Noel's prefiled
8 testimony be entered into the record as though read.

9 CHAIRMAN EDGAR: The prefiled testimony will be
10 entered into the record as though read.

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DIRECT TESTIMONY OF MICHAEL L. NOEL

1
2 **Q. Please state your name and business address.**

3 A. Michael L. Noel, Saber Partners, LLC, 44 Wall Street, New York, New York

4 **Professional Qualifications and Education**

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

6 A. I am a member of Saber Partners, LLC, and serve as a Senior Managing Director and
7 Senior Advisor.

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

9 A. I serve in a senior advisory position which includes participating in business strategy
10 and procurement of new business; meeting with Saber Partners' clients and potential clients
11 such as public service commissions; meeting with senior officers of the utilities and
12 investment banks with which we work; and assisting in the development and review of
13 presentations we make to our clients and potential clients.

14 **Q. Please describe your educational background and professional experience.**

15 A. I have a Bachelor's degree in Finance from California State University at Long Beach
16 where I graduated cum laude. I also have a Master's degree in Business Administration from
17 the University of Southern California where I graduated summa cum laude.

18 I began working with Southern California Edison Company (Edison) as a
19 Financial Analyst, where I enjoyed a thirty-year career prior to my retirement. During those
20 thirty years, I also worked as the Manager of Financial Planning, Manager of Corporate
21 Planning, Treasurer, Vice President of Finance, and Senior Vice President and Chief Financial
22 Officer. I was a member of the Officers' Council, which was composed of the Company's top
23 five officers. I also served as Senior Vice President and Chief Financial Officer at the
24 Company's parent, Edison International Company. Some of my other assignments included
25 serving as an officer and on the Board of Directors for two of Edison International's non-

1 regulated subsidiaries, Edison Mission Energy Company and Edison Mission Land Company.
2 During my career at Edison, I was a member of the Los Angeles Society of Financial
3 Analysts.

4 In 1998, subsequent to my retirement, I established Noel Consulting Company,
5 providing financial advice to corporations and financial institutions. The business evolved
6 into one of working with Saber Partners (since 2002) and serving on several Boards of
7 Directors. I have served on seven corporate boards, and at the current time I serve on three:
8 Avista Corporation (an electric and gas utility serving the Pacific Northwest), HighMark
9 Funds (a mutual fund family) and SCAN Health Plan. I currently serve or have served in the
10 leadership positions of Chairman of the Board, Chairman of the Audit Committee, Chairman
11 of the Compensation Committee, Chairman of the Governance Committee and a member of
12 the Finance Committee. On the three boards where I currently serve, I am a named Audit
13 Committee Financial Expert under the Sarbanes-Oxley Act. I am a member of the National
14 Association of Corporate Directors, and in 2004 I co-authored an article for that organization,
15 "Board Transformation: Does Change Have a Chance?"

16 **Purpose of Testimony**

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

18 A. The purpose of my testimony is to describe in what respects utility securitization
19 financings are different from those traditionally transacted in the utility industry and why the
20 uniqueness of ratepayer-backed securitization bonds requires them to be marketed differently
21 from traditional utility bonds. In addition, I will give a professional opinion on whether the
22 proposed transaction should be sold through a competitive bid or negotiated offering process.
23 I also will describe why an active commission, with the assistance and advice of a financial
24 advisor, is in the best interest of ratepayers, and discuss the potential savings that could result
25 from the Commission's involvement.

1 **Q. Can you provide some of your background and experience with utility financings**
2 **while you were at Southern California Edison?**

3 A. Yes. During most of my career at Edison, the power needs in our service territory
4 were growing rapidly. We were building plant and equipment that required billions of dollars
5 of external financing, including large nuclear and coal plants. As a result, I oversaw dozens of
6 financings and billions of dollars of debt and equity offerings in the U.S. and internationally.

7 **Q. Did Edison accomplish those financings through competitively bid or negotiated**
8 **offerings?**

9 A. In California at that time, the California Public Utilities Commission (CPUC) worked
10 under a "rebuttable presumption" that financings must be done on a competitive-bid basis
11 unless the Company could show that a negotiated offering could produce a lower cost and was
12 in the best interest of ratepayers. So, in the majority of cases, especially with debt offerings,
13 we issued our securities by forming multiple underwriting groups and having them submit
14 sealed bids. The lowest-cost bidding syndicate was awarded the deal.

15 **Q. Why did the CPUC believe that a competitive bid was likely to produce the lowest**
16 **cost for ratepayers?**

17 A. This view was held because Edison was typically issuing first mortgage bonds
18 ("FMBs"). There was nothing unique or special about these bonds. The investment banking
19 firms were purchasing FMBs from us and then re-selling the bonds to investors who
20 understood the bonds well, including the underlying credit worthiness of the bonds. Investors
21 knew what they were getting and were well acquainted with the appropriate pricing for those
22 bonds in the marketplace. This made it possible for us to bring the bonds to market quickly
23 and get them sold efficiently. It also provided a benefit to the Company of not having to
24 provide proof to the CPUC that we indeed received the lowest cost for our bonds. That was
25 inherently assumed in the competitive-bid process.

1 **Q. Were there instances of Edison doing negotiated offerings?**

2 A. Yes, there were many. Examples of some of these negotiated deals include nine
3 offerings in Europe, the world's first corporate "Shogun Bonds" (dollar-denominated bonds
4 sold in Japan), currency swaps where Australian and New Zealand dollars were swapped for
5 U.S. dollars, and interest-rate swaps to convert floating-rate obligations into fixed-dollar
6 obligations.

7 **Q. Couldn't those issues have been done through a competitive bid?**

8 A. Theoretically, yes. However, from a practical standpoint, no. In order to obtain the
9 lowest-cost of funds for the benefit of ratepayers, we believed it necessary to work diligently
10 to communicate with the rating agencies and potential investors the unique characteristics and
11 underlying credit of these securities which were not well understood. It involved a team of
12 underwriters selected by us. It also included our management and financial staff and
13 attorneys. All of those parties, to one extent or another, traveled--often internationally--to
14 meet with the rating agencies and potential investors, making presentations and answering
15 their questions. These were not simple, straightforward offerings. It took time and effort to
16 conduct educational sessions with investors and hard-fought negotiations with the
17 underwriters who first purchased the securities from us before re-selling them in the
18 marketplace. We had to first assure ourselves and then the CPUC that we had obtained the
19 lowest cost of funds. We were required to file exhibits, and if necessary, testify before the
20 CPUC regarding our results. If we couldn't show ratepayer savings, we faced disallowances
21 in our rate cases.

22 **Q. With that in mind, would you recommend that Florida Power & Light**
23 **Company's (FPL) proposed storm-recovery bond issue, the first utility securitization**
24 **issue in Florida, be sold through a competitive bid or through a negotiated offering?**

25 A. Saber Partners will evaluate both options, but in my opinion, it's likely that this issue

1 will need to be sold through a negotiated offering. First, although the benefits and value of a
2 securitization offering are becoming more widely known to bond investors, these bonds still
3 are not being sold or traded at the yields they should command. There is more education to do
4 both in the U.S. and internationally. I believe that a robust effort on the part of FPL and the
5 underwriters to reach a broad array of investors and to educate them on the incredible features
6 these bonds hold can bring down the yields in a meaningful way. This first Florida
7 securitization issue is a large one, and even a few basis points of savings on the bonds' yield
8 can benefit ratepayers significantly. Second, interested investors will want to scrutinize this
9 first-time Florida issuance to see how it may differ from securitization bonds that have been
10 issued in other states. Investors will want to be certain that Florida's pledges of safety to the
11 investor are not weaker than similar pledges in other states. That will take some added effort
12 on the part of FPL and the underwriters to talk with investors and get them comfortable with
13 such items as the State's pledge and the true-up mechanism. The true-up mechanism will be
14 an especially important topic because investors will speculate on how effectively and
15 efficiently the true-up mechanism will work if another large hurricane were to strike Florida.
16 Investors have no experience with bonds issued to pay for hurricane recovery costs and the
17 bond-safety features that would kick in because no other state has issued storm-recovery
18 bonds. Investors will need to get comfortable with the assurances that the Florida mechanisms
19 would provide. By contrast, a competitively bid offering would, by definition, not enable the
20 much-needed and thorough communication program that this offering will require to achieve
21 the best price for the bonds. As a result, I believe the costs to ratepayers likely would be
22 higher with a competitively bid offering.

23 **Q. In either type of issuance, are the interests of ratepayers aligned with the interests**
24 **of the underwriters?**

25 **A. No.** The interests of underwriters are fundamentally adverse to the interests of

1 ratepayers. Underwriters will want to negotiate for relatively high rates of interest so that their
2 sales forces will be able to sell the storm-recovery bonds with the least effort, satisfying the
3 desires of their investor clients for high interest rates. Underwriters also will negotiate for the
4 highest possible underwriting fees.

5 There is nothing inherently wrong about the interests of underwriters being
6 adverse to the interest of ratepayers. It is part of the market system. But this fundamental
7 adversity of interests is important to keep in mind in selecting underwriters, in negotiating
8 underwriters' fees, in negotiating a marketing plan, and especially in negotiating the final
9 prices and interest rates with underwriters and investors. This will be especially true in
10 connection with storm-recovery bonds where 100% of the economic burden will be borne by
11 ratepayers.

12 In addition, we must recognize that some abusive practices and malfeasance by
13 underwriters in the public capital markets is well documented and we must always be diligent
14 in our dealings. See EXH MLN-1 which provides examples of such occurrences, including
15 severely under-priced public offerings, and alleged overcharging of state and local
16 governments for U.S. treasury securities. These cases add support for Commission
17 involvement and oversight in the issuance of the storm-recovery bonds.

18 For all of these reasons, it will be vital for the Commission, with the assistance
19 of a qualified and independent financial advisor without any potential conflicts of interest, and
20 cooperation of FPL, to be vigilant and play an active and visible role throughout the process of
21 structuring, marketing and pricing storm-recovery bonds. As Alan Greenberg, the chairman of
22 Bear Stearns, a large underwriting firm, once said "We believe everybody is honest, but they
23 are more honest if you watch them like a hawk."

24 **Q. Will the interests of ratepayers and FPL be aligned in the underwriting of the**
25 **storm-recovery bonds?**

1 A. Not entirely. While FPL has a general business interest to keep overall customer rates
2 low, FPL will have no obligation to repay the storm-recovery bonds and will have no
3 responsibility to pay any of the costs. All costs will be borne solely by the ratepayers;
4 therefore FPL will have a less-than-normal economic incentive to achieve the lowest possible
5 cost. FPL may have other incentives; indeed it may have corporate policies to achieve the
6 lowest costs and to keep rates low, but in this storm-recovery bond transaction, all of the
7 traditional checks and balances on FPL will be missing. FPL's highest priority in this
8 transaction likely will be to get the issuance done quickly, with cost taking a lower priority.

9 In more typical debt and equity offerings, utilities have strong incentives to
10 negotiate hard with underwriters for the lowest possible interest rates as well as the lowest
11 possible underwriting fees. Utilities also have strong incentives to minimize other issuance
12 costs. Because a utility's allowed rate of return on rate base generally is adjusted only
13 periodically to reflect changes in the utility's blended cost of capital, the benefit from a low
14 net cost of funds is captured at least in part by the utility's shareholders, and the detriment
15 from a high net cost of funds is borne at least in part by the utility's shareholders during the
16 period of regulatory lag. Consequently, at least in the short run, the utility's shareholders must
17 bear a part of the detriment from a high net cost of funds. These same consequences and
18 incentives do not come into play in connection with ratepayer-backed bonds.

19 **Q. Why do you believe that FPL's proposed securitization issue needs the oversight**
20 **of the Commission?**

21 A. Ratepayers need to be represented during the entire process because they are the sole
22 obligors for this debt. Without the Commission's oversight, the bond pricing will not be as
23 high due to less aggressive marketing and the transaction documents will probably not have
24 the desired protections for ratepayers. The extra cost borne by ratepayers from an inefficient
25 transaction and potential liabilities could be significant.

1 **Q. Why couldn't the Commission simply rely on FPL and its investment bankers to**
2 **ensure the lowest cost for the benefit of ratepayers, without Commission involvement**
3 **and without a financial advisor?**

4 A. First, although I believe FPL would be well intentioned, it is human nature to not
5 invest the time and effort needed to produce maximum ratepayer savings when there is no
6 adverse consequence to management or its shareholders for a mediocre result. In
7 securitization offerings, ratepayers are totally and solely responsible for the repayment of the
8 bonds. For example, in my experience in a securitization transaction in another state,
9 management showed its indifference in many ways. It assigned mid-level personnel to the
10 task and didn't show leadership in directing the investment bankers to keep the plan on
11 schedule. This utility allowed the investment bankers to miss deadlines and produce less than
12 satisfactory drafts of the "Roadshow," which is an Internet-based investor-education slide
13 show with accompanying voice-over. The utility also allowed the investment bankers to
14 assign inexperienced personnel to the production of the Road Show, so it continually missed
15 the mark until senior, experienced bankers eventually stepped in at the financial advisor's
16 urging. Moreover, management often pressured the Commission's financial advisor to bring
17 the issue to market well before it was ready, given all she missed deadlines and inadequate
18 preparation. We often heard, "Let's go. We need our money." I don't recall ever hearing the
19 utility speak of obtaining the lowest cost of funds for ratepayers.

20 Second, as I alluded to earlier, there is an inherent flaw in the process of selling
21 securities. Many people don't realize that the underwriters first buy the bonds from the utility
22 before re-selling them to investors. Hence, the underwriters have an incentive to buy the
23 bonds from the issuer with a cushion built in so that they can sell the bonds to investors at a
24 price that will provide the underwriters with a more robust profit. Underwriters also deal with
25 large insurance companies, mutual funds and other financial institutions who threaten to move

1 | their business from Investment Banker-A to Investment Banker-B if Investment Banker-A
2 | does not sell the bonds at an “attractive” price (i.e., a low price) to its largest clients.
3 | Furthermore, investment banks operate under the principle of transacting deals quickly, with
4 | as little effort as possible and with pricing that will move the bonds out the door. It is a high-
5 | volume, high-turnover, high-margin business. Their sales force moves day-to-day from one
6 | transaction to another, one phone call to another, and they don’t like to be bothered with
7 | having to get involved in understanding the story of why securitization bonds hold excellent
8 | value and then having to explain that story to their customers. Hence, without oversight from
9 | a financial advisor who is experienced in the financial markets and understands in detail the
10 | inner-workings of securities pricing conventions, and without a broad-based investor group to
11 | provide maximum competition for the bonds, an inexperienced or uninvolved commission will
12 | not get the lowest interest rates and the lowest fees on behalf of ratepayers.

13 | **Q. How then does Saber Partners propose that a group of underwriters be hired who**
14 | **will work to achieve the lowest cost of funds for ratepayers?**

15 | A. Saber Partners believes in conducting a competitive process for the selection of
16 | underwriters. First, Saber Partners has successfully innovated a “pay-for-performance”
17 | compensation plan in other states that it proposes be adopted in Florida. Traditionally, utilities
18 | have selected investment bankers on a fixed-fee arrangement. That is, once the investment
19 | bankers have been selected, the vast majority of the economics (i.e., compensation) is decided.
20 | At that point, the investment banking firm has little incentive to perform other than to try to
21 | ensure it is included in the next deal. Sometimes, a utility will put an underwriter in a deal or
22 | promise to include it in the next deal because of other business the underwriter is doing with
23 | the utility, such as making loans to the utility. Saber Partners believes in hiring underwriters
24 | who: (a) have proven themselves in other securitization issues and who have reasonable fees,
25 | and then providing them incentives to bring investors to the table at the appropriate price for

1 the bonds rather than trying to bring in a few big-ticket orders at unfavorable prices in order to
2 satisfy their favorite customers; (b) bring new investors to the deal; and (c) do a great job with
3 the communications effort. This, we propose, would be done through a selection and
4 compensation process that has both competitive and negotiated aspects in a joint effort
5 involving FPL, the Commission and the Commission's financial advisor, as has been done
6 successfully in other states. Although the underwriters then selected would become part of the
7 team, they would be competing among each another to provide excellent results and to be
8 rewarded accordingly.

9 **Q. Are you familiar with the actions and protocols which Mr. Fichera has referred to**
10 **in his testimony as "best practices" in utility securitization bond issues?**

11 A. Yes, I am.

12 **Q. Regarding these "best practices," what is your opinion of this approach for this**
13 **proposed transaction?**

14 A. I find this approach to be a well-reasoned and sound approach. It is one I endorse
15 based on my years of experience in overseeing financings and being a Chief Financial Officer.

16 **Q. What studies have you reviewed that measure the impact of Saber Partners'**
17 **advice on the costs of ratepayer-backed-bond transactions?**

18 A. In addition to my own involvement in some ratepayer-backed bond pricings, I have
19 reviewed the Wisconsin Public Service Commission's analysis, Exhibit MLN-2, and
20 Citigroup's compilations of data on many transactions, along with data Saber Partners has
21 compiled with the help of some investment banking firms.

22 **Q. Can you identify the completed transactions and the pending transactions where**
23 **Saber Partners was the financial advisor or will be the financial advisor?**

24 A. Yes. Exhibit MLN-3 provides that information. Saber Partners has acted as the
25 financial advisor in six transactions and has five transactions pending in four states.

1 Q. In the six completed transactions in Exhibit MLN-3, is it true that Saber Partners
2 and the Commissions followed an active, "best practices" role?

3 A. Yes.

4 Q. What about the pending transactions?

5 A. In West Virginia, Wisconsin and Texas, Saber Partners has been authorized by those
6 Commissions to employ "best practices" as part of its active role in those transactions.

7 Q. Do you have any comments on the upcoming storm-recovery bond financing in
8 Florida?

9 A. Yes. A major issue in this proceeding is whether the Commission should grant Saber
10 Partners authority to play an active role as its financial advisor.

11 Q. Have you reviewed data on the performance of Saber Partners in its transactions
12 compared to transactions where Saber was not the financial advisor?

13 A. Yes, I have. First, as I mentioned earlier, the Wisconsin Public Service Commission
14 authored a study in 2004, "Analysis of the Potential Savings from Using Saber Partners." I
15 have included in EXH MLN-2 two tables taken directly from that study. The first shows the
16 average number of basis points saved when Saber Partners has been the financial advisor
17 versus transactions where Saber was not the financial advisor. The first table shows that the
18 "Savings Attributable to Saber" ranged from 14-19 basis points.

19 The second table is similar, but it shows comparisons by maturities. It concludes that
20 "Savings Attributable to Saber" ranged from 5 basis points on a one-year maturity to 29 basis
21 points on a 15-year maturity.

22 It is important to note that the Wisconsin Public Service Commission analysis was
23 undertaken for that Commission by its economist to test the credibility of the alleged "Saber
24 effect," not to measure expected dollar savings. It also was not intended as a testimonial to
25 Saber Partners. Rather, it reflects one commission's approach for testing the credibility of a

1 potential financial advisor. Saber Partners believes the favorable results that came out of the
2 study is because of the “best practices” process Saber Partners employs.

3 **Comparison of Yield Spreads (basis points)**

4 **(Benchmark: LIBOR Swap Rate)**

	Saber Advised	No Saber Advice	Savings Attributable to Saber
No. of Tranches	16	38	***
Mean Yield Spread	26	45	19
Median Yield Spread	26	40	14

9
10 **Comparison of Yield Spreads (basis points)**
(Benchmark: LIBOR Swap Rate)

Term to Maturity (Years)	Saber Advised	No Saber Advice	Savings Attributable to Saber
1	19	24	5
2	20	27	7
3	21	30	9
4	23	33	10
5	24	36	12
6	25	39	14
7	26	42	16
8	28	45	17
9	29	48	19
10	30	51	21
11	31	54	23
12	33	57	24
13	34	60	26
14	35	63	28
15	37	66	29

19
20 I have also included in EXH MLN-2 a chart from the Wisconsin Public Service
21 Commission study where interest-rate spreads were plotted for ratepayer-backed bond
22 transactions. As you will see, the “Saber Deals” plot points are quite consistently more
23 favorable (i.e., at lower interest-rate spreads) than the “non-Saber” plot points.

24 **Q. Are there any more Exhibits you would discuss in confirming Saber Partners’**
25 **effectiveness in providing ratepayer savings?**

1 A. Yes. I have included as Exhibit MLN-4 a chart showing data prepared and provided by
2 Lehman Brothers and charted by Saber Partners. The horizontal bars show interest-rate
3 spreads relative to a commonly used benchmark for states with multiple ratepayer-backed
4 bond issues from 2001 to 2005. This schedule includes a timeline which indicates that, when
5 a utility came to market without an advisor or with an advisor that wasn't Saber Partners, that
6 deal was followed by a Saber-advised deal with more favorable interest-rate spreads to the
7 benchmark. In each case, the differential in Saber's favor was significant. That difference
8 translated to meaningful savings for ratepayers.

9 **Q. Does a lowest cost standard ensure that the standard is achieved?**

10 A. No. Exhibit MLN-4 shows that, despite a lowest cost standard in the New Jersey
11 statute, the result is not always the lowest cost relative to the value of comparable securities.
12 In New Jersey from 2001 – 2004, the companies, underwriters, and the Commission advisors
13 were allowed to place qualifications on the lowest cost standard in their certifications. Rather
14 than being strictly held to a lowest cost standard in the certification process, the Companies
15 and their underwriters were allowed to 1) qualify certain aspects of their certifications with
16 terms such as “reasonable”, and 2) avoid accountability for their certifications. In contrast, for
17 the 2005 transaction for Public Service Electric & Gas (PSEG), the New Jersey Commission
18 and its financial advisor eliminated these provisions by adopting the Texas financing order
19 certification model. The results speak for themselves.

20 **Summary of Testimony and Recommendations to Commission**

21 **Q. Can you briefly summarize your testimony?**

22 A. I hope I have accomplished my goal of showing why securitization bonds are different
23 from traditional bonds and, hence, need to be marketed differently. Securitization bonds
24 contain incredible value for investors, and if FPL, the Commission, and its financial advisor,
25 working together with the investment-banking group selected, can effectively communicate

1 the value and safety of these bonds, Florida ratepayers will enjoy the lowest cost of funds
2 available in the marketplace. I also hope I have shown that a commission's active
3 involvement, with Saber Partners acting as its financial advisor, can result in meaningful
4 savings for ratepayers.

5 **Q. Can you list your recommendations to the Commission?**

6 A. I recommend that the Commission direct FPL to work in a collaborative manner with
7 the Commission and its financial advisor in the selection of underwriters and the structuring,
8 marketing and pricing of the bonds, while following the "best practices" outlined by Mr.
9 Fichera in his testimony.

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

11 A. Yes it does.

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1 BY MR. KEATING:

2 Q And, Mr. Noel, did you prepare or cause to be
3 prepared four exhibits to your prefiled testimony labeled
4 MLN-1 through MLN-4?

5 A Yes.

6 Q And do you have any corrections today to make to
7 those exhibits?

8 A No, I don't.

9 MR. KEATING: Madam Chair, I believe these exhibits
10 have already been marked and admitted with the other prefiled
11 exhibits in this case.

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CHAIRMAN EDGAR: Thank you.

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1 BY MR. KEATING:

2 Q Mr. Noel, have you prepared a summary of your
3 testimony?

4 A I have, Mr. Keating.

5 Q If you would, go ahead and provide that summary.

6 A Good morning, Commissioners. As you've just heard,
7 I'm Mike Noel. I'm a member of Saber Partners. I joined the
8 Saber team in 2002, and I've been involved in four
9 ratepayer-backed bond transactions in which Saber Partners has
10 been the financial advisor. Prior to my affiliation with
11 Saber, I spent a 30-year career in finance with Southern
12 California Edison, and I concluded my career there as its Chief
13 Financial Officer.

14 Over the course of my career, my finance team and I
15 issued dozens of bond issues worth billions of dollars, and it
16 was always my objective to obtain the best pricing I could.
17 While doing that, my primary loyalty was to my shareholders.
18 If a financing were mismanaged or mispriced in any way, my
19 company was subject to disallowances by the California
20 Commission, and my shareholders ultimately would have to bear
21 that burden. The transaction we are discussing today is indeed
22 a bond offering, but it is clearly a different kind of bond
23 offering.

24 In this case, Florida ratepayers, not shareholders,
25 are solely responsible for bearing all the costs of the

1 transaction. Because of the difference, and I consider it a
2 significant difference, ratepayers deserve to have a seat at
3 the table in all aspects of this transaction. This Commission
4 acting with and through its financial advisor can, in my
5 opinion, provide that seat at the table for ratepayers as a
6 ratepayer's advocate.

7 Based on my 30 years of experience in finance, I, and
8 I believe many other utility CFOs, would welcome a financial
9 advisor as a fully participating team member in this process,
10 especially if that advisor were someone who not only had a
11 career in investment banking and expertise in the financial
12 markets, but also a proven, successful track record in
13 ratepayer-backed financings.

14 Ratepayer-backed bonds are sold primarily to large
15 institutions, mutual funds, insurance companies, pension funds
16 and the like. These investors are highly sophisticated and
17 they are tough negotiators. Because of the system inherent in
18 the financial markets for negotiating and selling securities,
19 underwriters are put in a difficult position of attempting to
20 serve two masters in marketing these bonds. The bond issuer is
21 seeking the lowest cost and expects the underwriter to help him
22 attain that, but the institutional investor reminds the
23 underwriter that he, the investor, does a lot of business with
24 the underwriter, so the pricing should be reasonable. This is
25 not a, this is a not-so-subtle message saying in effect I might

1 move my business to one of your competitors if the pricing
2 doesn't meet my expectations.

3 As a result, there's a need for an independent,
4 well-informed and experienced financial advisor to help tighten
5 up this push/pull relationship and, in doing so, represent the
6 best interests of the ultimate obligor, in this case the
7 ratepayer.

8 For me, a team composed of a respected company
9 finance staff, a group of highly regarded and motivated
10 underwriters selected by the team and an involved Commission
11 working through its financial advisor would make a powerful
12 combination and could produce a highly successful, lowest cost
13 offering for the benefit of Florida ratepayers.

14 Mr. Fichera, CEO of Saber Partners, will be
15 discussing with you this morning the best practices that Saber
16 follows and recommends for ratepayer-backed bonds. In that
17 regard, I would like to highlight something for you that I
18 believe as a former CFO is essential to those best practices,
19 and that is, the Commission, through its staff and its
20 financial advisor, should be intimately involved in all stages
21 of the structuring, marketing and pricing of the bonds and,
22 most importantly, in the pricing of the bonds in a realtime
23 basis.

24 In wrapping up, I'd like to point out that in two of
25 the exhibits to my testimony, MLN-2 and 4, the effectiveness of

1 Saber's involvement has been documented by independent third
2 parties. In both cases, the analysis showed that Saber
3 Partners has produced significant ratepayer savings in all six
4 of the transactions in which Saber has been the advisor with
5 the active involvement from the respective Commission.

6 The independent analyses also showed a stark contrast
7 in results compared to deals which either had no financial
8 advisor at all or where the advisor perhaps took a more
9 laissez-faire approach. Hence, I believe the results show that
10 Saber indeed makes a difference.

11 In conclusion, I urge the Commission to adopt a best
12 practices approach to this transaction that allows for
13 transparency and accountability with the active involvement of
14 the Commission and its financial advisor in realtime throughout
15 the transaction, all of which, I believe, will benefit the
16 ratepayers of Florida.

17 Thank you, and that concludes my summary.

18 MR. KEATING: Thank you, Mr. Noel. Madam Chair,
19 pursuant to the agreement of parties to waive cross on this
20 witness, he is available for questions from the Commissioners
21 at this time, if there are any.

22 CHAIRMAN EDGAR: Commissioners, questions?

23 Commissioner Arriaga.

24 COMMISSIONER ARRIAGA: Thank you, Madam Chair.

25 Mr. Noel, good morning.

1 THE WITNESS: Yes, Commissioner, good morning.

2 COMMISSIONER ARRIAGA: I've been listening to the
3 last two days, especially the opening statements and through
4 some testimony the issue of involvement by the Commission. I
5 also heard that the company may have a financial advisor. So
6 my first question would be how, how would the interaction be
7 between the company's financial advisor and a potential
8 Commission financial advisor? How does that work?

9 THE WITNESS: You're talking about the company being
10 FPL?

11 COMMISSIONER ARRIAGA: Yes. It's the only company in
12 this proceeding, I think.

13 THE WITNESS: I just wanted to be sure I understood
14 the question.

15 COMMISSIONER ARRIAGA: Okay.

16 THE WITNESS: In deals we've done in the past, often
17 the Commission will appoint a point person on staff, for
18 example, and that point person would deal with Saber Partners
19 with the company, and we would interact hopefully with each
20 other in a very cooperative way.

21 COMMISSIONER ARRIAGA: No. But I meant if the
22 company, FPL, hires a financial advisor to represent them, how
23 does the interaction work between the two financial advisors?

24 THE WITNESS: Well, we, we collaborate on any of the,
25 for example, the documents that are being drawn up, we both

1 comment on those. We work with the attorneys, the
2 underwriters, and we're constantly working with each other. I
3 may be missing the point here, but --

4 COMMISSIONER ARRIAGA: No. I'm going to ask the
5 Chair if she allows a series of questions, okay, so we can go
6 ahead and interact.

7 CHAIRMAN EDGAR: Yes.

8 COMMISSIONER ARRIAGA: The point is I'm trying to
9 make this process once approved, if approved, as agile as
10 possible. And we have a company that is possibly going to be
11 represented by a financial advisor. We have a Commission that
12 is trying to decide whether we can hire a financial advisor or
13 be represented by a financial advisor. I'm trying to figure
14 out if that interaction is going to in any way be prejudicial
15 to the process of pricing, of getting this thing done as
16 quickly as possible and to the best advantage of the consumer.

17 THE WITNESS: It should be prejudicial in a favorable
18 way. And that is we're working together with the same
19 objectives to complete the transaction on as timely a basis as
20 we can, and that includes moving the documents along, the
21 filings with the SEC. So I regard it as a positive to the
22 transaction.

23 COMMISSIONER ARRIAGA: But do you understand that the
24 interests of the company may not be the interests of the
25 Commission? So how could it be complimentary?

1 THE WITNESS: I understand what you're asking. We
2 certainly hope it will be complimentary. There will be times
3 when the advisors or the company or the, with the financial
4 advisor of the Commission, for example, will have differences
5 of opinion, and there will be times, in my opinion, that we'll
6 need to come to the Commission and ask for a resolution of
7 those differences.

8 COMMISSIONER ARRIAGA: And if there are two financial
9 advisors, there is a double cost here involved, isn't there,
10 that may be, have to be paid by the consumer, the cost of the
11 financial advisor to the company and the cost of the financial
12 advisor to the Commission?

13 THE WITNESS: I believe the company pays for its own
14 financial advisor.

15 COMMISSIONER ARRIAGA: That's what I wanted to figure
16 out.

17 THE WITNESS: Yeah. Mr. Fichera could speak to that,
18 I know.

19 COMMISSIONER ARRIAGA: We'll get to that later.
20 Okay.

21 I was also led to, to believe, maybe wrongly, that by
22 having a Commission financial advisor, we could incur some kind
23 of SEC liability, and I asked this question yesterday.

24 THE WITNESS: I was here and I heard that.

25 COMMISSIONER ARRIAGA: Is that possible?

1 THE WITNESS: Well, I'd have to say it's possible.
2 In my opinion, it's very remote. When, when liability is
3 incurred, it's typically when an interest payment is not made,
4 a principal payment is not made. And as I think you heard from
5 Mr. Olson's testimony, these bonds are regarded, you know,
6 they're AAA, they're regarded as it's very unlikely that a
7 payment will be missed because of the procedures you put in
8 place to make the true-ups, you know, on a timely basis.

9 In the final analysis, though, I'm not an attorney.
10 I would, I would suggest you, you get an opinion from your own
11 attorneys.

12 COMMISSIONER ARRIAGA: Thank you. And then let's
13 assume the company would insist, FPL again, the company is FPL,
14 they would insist in placing some kind of language in the
15 prospectus to indicate that the Commission could incur certain
16 SEC liabilities. Will that hurt the quality of the bond?

17 Maybe I can ask this to Mr. Fichera when he comes up,
18 if he's the most appropriate person.

19 THE WITNESS: As long as there's no -- and I think, I
20 think you should ask it of him.

21 COMMISSIONER ARRIAGA: Okay.

22 THE WITNESS: As long as there's no innuendo there
23 that could be misinterpreted, I don't think the bond buyers
24 would be as concerned about your liability as they would about
25 their own circumstance. They'll be representing their own

1 interests here. And as we've heard and we've seen in these
2 past transactions, these bonds are extremely secure. So I
3 think it's remote that any of this sort of thing would happen.

4 COMMISSIONER ARRIAGA: Well, thank you. When
5 Mr. Fichera comes up, we'll go over it again. Thank you, Madam
6 Chair.

7 CHAIRMAN EDGAR: Commissioners, further questions?
8 Mr. Keating.

9 MR. KEATING: I just want to make sure as a
10 housekeeping matter that we do mark, and I do not have a copy
11 with me at this point, I believe FPL does, that we mark
12 Mr. Noel's deposition transcript.

13 CHAIRMAN EDGAR: We have not done that. That will be
14 Exhibit Number 159. Thank you.

15 (Exhibit 159 marked for identification.)

16 And so Exhibit Number 159, deposition of Michael
17 Noel, April 26th, 2006, will be entered into the record as
18 evidence.

19 (Exhibit 159 admitted into the record.)

20 Mr. Keating?

21 MR. KEATING: We have nothing else for this witness.
22 Thank you.

23 CHAIRMAN EDGAR: Okay. And then the witness is
24 excused. Thank you very much.

25 THE WITNESS: Thank you, Commissioners. I appreciate

1 the opportunity.

2 MR. KEATING: Staff will call its next witness,
3 Mr. Joseph Fichera. And, again, this witness was not
4 previously sworn and will need to be sworn.

5 CHAIRMAN EDGAR: Thank you. If you'll raise your
6 right hand.

7 JOSEPH S. FICHERA

8 was called as a witness on behalf of the staff of the Florida
9 Public Service Commission and, having been duly sworn,
10 testified as follows:

11 DIRECT EXAMINATION

12 BY MR. KEATING:

13 Q Mr. Fichera, would you please state your name and
14 business address for the record.

15 A My name is Joseph S. Fichera. My business address is
16 care of Saber Partners, 44 Wall Street, New York, New York.

17 Q And are you the same Joseph Fichera who prepared
18 testimony consisting of 58 pages that was prefiled in this
19 docket?

20 A Yes, I am.

21 Q If I were to ask you today the same questions that
22 are in your prefiled testimony, would your answers be the same?

23 A Yes, they would.

24 Q And do you have any corrections to make to your
25 prefiled testimony at this time?

1 A No, I do not.

2 MR. KEATING: Staff would ask that Mr. Fichera's
3 prefiled testimony be moved into the record as though read.

4 CHAIRMAN EDGAR: The prefiled testimony from this
5 witness will be entered into the record as though read.

6 BY MR. KEATING:

7 Q And, Mr. Fichera, did you prepare or cause to be
8 prepared six exhibits to your prefiled testimony, labeled
9 JSF-1 through JSF-6?

10 A Yes, I did.

11 Q And do you have any corrections to make to those
12 exhibits?

13 A No, I don't.

14 MR. KEATING: Again, these exhibits have already been
15 marked and entered into evidence.

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DIRECT TESTIMONY OF JOSEPH S. FICHERA

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Q. Please state your name and business address.

A. Joseph S. Fichera, Saber Partners, LLC, 44 Wall Street, New York, New York.

Professional Qualifications, Education, and Experience

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

A. I am a member of Saber Partners, LLC and serve as its Chief Executive Officer. I am also the President and Manager of the firm's broker-dealer subsidiary, Saber Capital Partners, LLC (together with Saber Partners, LLC, "Saber").

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

A. I manage the organization and execute assignments for clients by providing confidential, independent, senior level analysis, advice, and execution for chief executive officers, regulators, elected officials, chief financial officers, treasurers and others.

Q. Please describe your educational background and professional experience.

A. I have a Bachelor's degree in Public Affairs from Princeton University's Woodrow Wilson School of Public and International Affairs. I also have a Master's degree in Business Administration from Yale University's School of Management. In 1995-1996, I was an executive fellow in residence at the Woodrow Wilson School of Public and International Affairs at Princeton.

I have worked in the fields of finance and investment banking since 1982. I began as an Associate in the Public Finance Department of Dean Witter Reynolds (now a part of Morgan Stanley) from 1982-1984. I then served as Vice President in Corporate Finance at Smith Barney Harris Upham (now a part of Citigroup) from 1984-1989. I became a Managing Director, Principal in Corporate Finance and Capital Markets at Bear Stearns and Co, Inc. from 1989-1995. Following my fellowship at Princeton in 1996, I served as Managing Director and Group Head of Prudential

1 Securities Business Origination and Product Development Unit from 1997-2000. With several
2 colleagues from the utility, law, and banking industries, I formed Saber Partners, LLC in 2000.
3 Saber Capital Partners was formed in 2003 and is registered with the National Association of
4 Securities Dealers to participate in mergers and acquisitions and investment banking services. We
5 do not underwrite or trade securities. I hold a general securities principal license (Series 24) from
6 the U.S. Securities and Exchange Commission ("SEC") as well as a general securities representative
7 license (Series 7 and 63).

8 Since forming Saber, I have been engaged in a number of complex assignments in the energy
9 and finance field. I served as a chief financial advisor, along with the Blackstone Group, to the
10 governor of the State of California during 2001 in response to the state's energy crisis. I also have
11 served as the chief financial advisor to five state utility commissions or their agents (Texas,
12 Wisconsin, West Virginia, Vermont, and New Jersey) on the use of securitization and specifically
13 on the structuring, marketing, and pricing of approximately \$5 billion in bonds. I have also been
14 engaged as an advisor to the SEC and ExxonMobil Corporation, among others.

15 I currently serve on the Board of Advisors of Princeton's Center for Economic Policy Studies.
16 I am also Chairman of the Princeton Economics Department Advisor Council. In that capacity, I
17 served as an advisor to Federal Reserve Chairman Ben Bernanke when he was the Chairman of the
18 Economics Department of Princeton University in the 1990s.

19 **Q. During your career on Wall Street, have you participated in any underwritings?**

20 A. Yes. The primary focus of my positions from Associate to Managing Director was first to
21 execute underwritings and private placements of debt and equity issuances. My role then evolved to
22 providing strategic advice to corporate treasurers, chief financial officers and chief executive
23 officers in addition to working on financing teams.

1 My responsibilities included all negotiations with these officers and counsel on the structuring,
2 marketing, and pricing of security offerings. I also led or participated in corporate reorganizations
3 and restructurings. My underwriting experience included direct negotiations with corporations,
4 utilities, and investors concerning the structuring, marketing and pricing of debt and equity
5 securities. My primary role was as the bookrunning underwriter, sole manager or senior manager. I
6 also have experience as a co-managing underwriter of debt and equity securities.

7 As an underwriter, I received three "Deal of the Year" awards from industry publications.
8 These are awards for transactions that independent observers who follow the profession closely
9 consider to be important or worthy of being brought to the attention of one's peers. In 1990, I
10 received the award from "Institutional Investor" magazine for a preferred stock transaction. In
11 1991, I received this award again for an investor-owned utility debt reorganization in the tax-
12 exempt bond market. In 2003, I was recognized with a similar "Deal of the Year" award from
13 "Asset Securitization Report" for a utility securitization offering.

14 **Q. Have you performed investment banking, underwriting or advisory work for FPL?**

15 A. Yes. On two separate occasions, FPL hired me to perform financial advisory work: first,
16 while I was a Managing Director at Bear Stearns in 1993, and seven years later when I was a
17 Managing Director at Prudential Securities in 2000. Bear Stearns and Prudential Securities did not
18 have prior investment banking relationships with FPL, and neither was considered to be one of
19 FPL's regular bankers. In each instance, I served as FPL's financial advisor, dealer-manager and
20 bookrunning underwriter on the restructuring of certain then-outstanding high-coupon fixed-rate
21 debt that FPL had sold through another underwriter.

22 **Q. Have you participated in transactions involving the use of securitization by utilities?**

1 A. Yes. To date I have participated in six utility securitization offerings, and I am involved in
2 five pending transactions, including the securitization transactions proposed by Florida Power &
3 Light Company ("FPL") and Gulf Power Company ("Gulf Power") in Florida.

4 **Q. Please describe your role in these transactions and the nature of your work.**

5 A. As I noted, Saber has been engaged as the financial advisor to five state utility commissions or
6 their agents (Texas, Wisconsin, West Virginia, Vermont, and New Jersey) on the use of
7 securitization and specifically the structuring, marketing, and pricing of approximately \$5 billion in
8 bonds. I have been the CEO of Saber overseeing those assignments. My most extensive
9 securitization experience has been as financial advisor to the Public Utility Commission of Texas
10 ("PUCT") in five separate offerings from 2001 to 2005.

11 In many ways, the Florida Commission finds itself in a position similar to the PUCT in 2000
12 when it issued its first securitization orders. At that time, billions of dollars of utility securitization
13 bonds had already been issued across the country, but Texas was about to undertake its first
14 transaction. Underwriters advised that the market was well established with known "generic" rates.
15 Nevertheless, the PUCT deliberated extensively on the matter and developed a framework for
16 implementing a securitization program for Texas that would protect ratepayer interests while
17 respecting the right of the utility to receive bond proceeds. The PUCT adopted a framework
18 requiring Commission involvement and approval of all aspects of the financing, from the structuring
19 through the pricing of the securities. The Texas Commission also adopted a system of independent
20 and fully accountable certifications which it could use to evaluate whether ratepayer benefits had
21 been maximized and whether ratepayer risks had been minimized.

22 My duties have generally included the items summarized in EXH JSF-1, Duties of the
23 Financial Advisor, and were included in the financing orders of the Public Utility Commission of
24 Texas, the first of which was issued to Central Power & Light Company. My duties were similar,

1 the costs and charges are borne by ratepayers. Yet, despite the good will of FPL and its
2 shareholders, ratepayers are simply not represented in a meaningful way in this matter that directly
3 affects them. Consequently, the perspective of ratepayers must be reflected throughout the
4 proposed securitization transaction in order to maximize ratepayer benefits and minimize ratepayer
5 risks.

6 From a survey of other jurisdictions, I will detail for the Commission a set of “best practices”
7 for efficiently completing a new utility securitization program at the lowest possible cost to
8 ratepayers while fully protecting ratepayer interests in the transaction. I will describe how these
9 “best practices” have evolved over a number of years in securitization transactions in other states. I
10 will also identify the possible ratepayer economic benefits and increased regulatory protections that
11 have come from adoption of a “best practices” standard.

12 Finally, I will use these standards to evaluate FPL’s petition and identify terms and conditions
13 that the Commission should include in a financing order so that ratepayers are protected from
14 unnecessary risks and costs associated with the issuance of any storm-recovery bonds. I believe the
15 evidence will show that by following these recommendations, the proposed securitization program
16 will comply with the governing statute, protect ratepayer interests, and be consistent with good
17 regulatory practices in Florida and other states. With the cooperation and collaboration of FPL,
18 these recommendations will help maximize ratepayer benefits and minimize ratepayer risks and
19 costs.

20 **Q. How did you determine what could be considered best practices?**

21 A. I examined the financing orders for all utility securitization transactions from 1997 to present.
22 I then looked at the interest rate and pricing results by comparing each transaction’s set of interest
23 rates, by maturity, to a relevant benchmark security interest rate. This revealed a set of “credit

¹ Section 366.8260, Florida Statutes.

1 spreads” for each transaction.² A “credit spread” is the difference between two interest rates of
2 similar weighted average lives, one of which usually is from a “benchmark” security such as a U.S.
3 treasury note rate.

4 In all, 36 transactions were reviewed to find the “lowest cost” transactions based on the credit
5 spread achieved for identically rated bond offerings with similar weighted average lives. In
6 addition, I looked for terms and conditions in the financing order, examined practices in the
7 structuring, marketing, and pricing of the securities, and performed a general review of the terms
8 and conditions of ancillary agreements such as servicing agreements, administration agreements,
9 amendment provisions and other matters that affect ratepayer costs or liabilities. Based on this
10 review, I identified a set of “best practices” that are listed and explained in more detail later in my
11 testimony based on my professional experience over 24 years of finance and direct experience in six
12 utility securitizations.

13 Overview of Securitization

14 Q. What is securitization?

15 A. Securitization is the process of issuing highly-rated securities through special purpose,
16 bankruptcy-remote entities. Typically, property with a dependable cash flow is transferred by the
17 sponsor (in this case, FPL) to a special purpose entity (“SPE”) through a “true sale.” For purposes
18 of achieving the necessary legal protections under federal bankruptcy law, a true sale is achieved
19 through an absolute transfer of the sponsor’s entire right, title and interest in the property to the
20 SPE, a legally distinct party, for fair market value, with sponsor retaining no residual ownership
21 interest in the property. The transferred property is then pledged by the SPE to secure the payment
22 of debt service on the bonds that the SPE issues. The transferred property can either be tangible or

² My review was focused on all offered transactions since 2000 because the convention for quoting credit spreads in the market for utility securitizations changed from being based off of United States Treasury securities to Interest Rate Swaps.

1 intangible. For example, the transferred property might be a physical asset (e.g., a plant), an
2 intellectual asset (e.g., a patent), or an intangible asset (e.g., the right to a particular revenue stream.)

3 Securitization creates a separate and independent credit based on the risk associated
4 with the cash flows from the pledged property that supports the payment of principal and interest to
5 investors. As a result, securitized debt instruments do not burden the assets or revenues of the
6 sponsoring utility and instead are payable solely from the pledged property. This means ratepayers
7 are solely responsible for payment.

8 **Q. Please discuss how securitization has been used by electric utilities in other states.**

9 A. State legislatures, public utility commissions and investor-owned utilities have used
10 securitization to raise funds for several different purposes deemed to be in the public interest. To
11 date, securitization has been used or is pending to fund energy conservation programs,
12 environmental control facilities, electric power purchase costs, and stranded costs arising from
13 deregulation. (See EXH JSF-2)

14 A defining and common feature of these securitization transactions is that they all have been
15 made possible by specific enabling state legislation that has established a legal framework for the
16 creation of a new type of intangible property right under state law. This new intangible property
17 will, in general, initially be owned by the utility. Like any other property owned by the utility, this
18 new property right can be pledged as collateral in a financing. In this case, the property created is
19 the right to bill, charge, and collect a specific charge on some or all retail electricity consumers in a
20 given electricity transmission and distribution service territory.

21 The enabling legislation allows utility commissions to issue irrevocable financing orders that:
22 (a) segregate a component of the retail rate charged to consumers throughout the territory; (b) cause
23 the right to receive this rate component to be treated as a present interest in property that can be
24 bought, sold, and pledged; (c) authorize the utility to sell this property to a bankruptcy-remote, SPE;

- 1 (d) authorize the SPE to issue debt instruments secured by a first priority lien on this property; and
2 (e) require the utility to use net proceeds from the transaction for specified purposes.

3 There have been 36 issues of securitized utility bonds since 1994 totaling \$36.55 billion
4 dollars. In none of these transactions has the utility or its shareholders been responsible for any
5 portion of the costs or charges associated with securitized bonds. Consequently, the financing is
6 unlike any of the utility's other obligations. The economic burden of repaying these securitized
7 bonds falls squarely on the ratepayers in the service territory; hence they are aptly referred to as
8 "ratepayer-backed" bonds.

9 Initially, ratepayer-backed bonds were issued primarily for the recovery of stranded costs in
10 states that had de-regulated their electricity markets. In 2004-2005, ratepayer-backed bonds began
11 to be used for purposes other than the recovery of stranded costs. Certain state governments and
12 their regulators authorized its use for refinancing of a bankruptcy-related regulatory asset
13 (California), unrecovered electric power purchase costs (New Jersey), environmental facilities
14 (Wisconsin and West Virginia), buy-downs from contracts with independent power producers
15 (Vermont), storm cost recovery (Florida), and any corporate purpose (Idaho).

16 **Expected Benefits and Protections for Ratepayers**

17 **Q. What are the expected economic benefits associated with using securitization in Florida**
18 **to finance storm-recovery costs?**

19 A. There are two basic sources of economic benefits (savings):

20 First, significant savings occur when ratepayer-backed bonds are used to replace
21 conventional utility debt and equity financing. It is effectively off-balance-sheet and non-recourse
22 to the utility. The utility is fully protected. This means that the utility can finance the asset or
23 expense in question with nearly 100% debt rather than its normal capital mix of about 50% debt and

1 50% equity without any impairment of its credit structure. The ratepayer savings are even greater
2 for a utility like FPL that has a high equity level in its capital structure.

3 There are two reasons why financing in this way saves money. First, the cost of equity is
4 much higher than the cost of debt. A 5% cost of debt and an 11% cost of equity are typical values
5 in today's environment. In addition, savings occur by the avoidance of income taxes that would
6 otherwise have to be paid on the equity return. These savings accrue directly to the ratepayers in
7 the form of lower overall rates than would otherwise be levied.

8 The second source of savings comes from pricing these ratepayer-backed bonds in the capital
9 markets commensurate with their extremely high credit quality. In general, the better the credit
10 rating, the lower the interest cost. By separating the operating utility from the issuer of the bonds
11 and isolating the cash flow, the credit associated with ratepayer-backed bonds will be evaluated by
12 investors as independent of the sponsoring utility and independent of the traditional debt of the
13 utility. Conventional utility debt has numerous risks associated with its repayment. Those risks will
14 not be present in connection with ratepayer-backed bonds.

15 In addition, the enabling legislation in Florida and any financing order for storm-recovery
16 bonds will create a credit that should allow the bonds to get the highest possible credit rating
17 available in the market. Furthermore, and most importantly, because the broad-based storm-
18 recovery charge will be imposed on substantially all retail electric consumers in FPL's service area,
19 and because the storm-recovery charge will be automatically adjusted periodically to whatever level
20 is necessary to repay the storm-recovery bonds on time over the life of the bonds, as required by
21 Florida's enabling statute, like all other ratepayer-backed bonds, storm-recovery bonds will be rated
22 "AAA". This is the top category in the credit rating system.

23 **Q. Are the pricing savings from ratepayer-backed bonds automatic?**

1 A. No. The savings commensurate with this top-quality credit are not automatic. Not all "AAA"
2 rated bonds trade at the same yield. There are a number of steps, which are discussed later in my
3 testimony, that are required at the time ratepayer-backed bonds are structured, marketed, and priced
4 to achieve the lowest cost available in the market and to capture the full economic value of the
5 unique government guarantees embodied in the legislation and the irrevocable nature of the
6 financing order. (See EXH JSF-3)

7 Also, in using the best practices I identify, the Florida Public Service Commission ("FPSC")
8 and FPL can work to maximize ratepayer benefits and to improve ratepayer protections.

9 **Q. Is "lowest cost" an appropriate standard?**

10 A. Yes. The proceeds of a bond issuance are cash dollars. Issuers want to raise the maximum
11 amount of dollars at the lowest possible cost. Underwriters have a vested interest in urging the use
12 of a standard of "reasonable cost" because "reasonable" covers a range of outcomes. For any long-
13 term financing, that range might represent millions or tens of millions of dollars in extra costs. One
14 might choose to use a reasonable cost standard to reimburse a doctor, where there are differences in
15 both the type and quality of care. However, one dollar has the same quality as another dollar, and a
16 bond issuer only wants the most dollars for the lowest cost. There is no reason to pay any more for
17 a bond issue than is necessary. With a lowest cost standard, the emphasis is on eliminating waste
18 and inefficiency which otherwise might occur under a "reasonable cost" standard.

19 **Q. Has a "lowest cost" standard been applied elsewhere?**

20 A. Yes. Throughout my almost 25 years in corporate finance, every treasurer, chief financial
21 officer or other finance official I have dealt with or observed always strove for the lowest cost
22 financing when pursuing a debt offering in which they or their shareholders were responsible. This
23 is simply an axiom of sound financial management. A prudent person never wants to pay more than

1 absolutely necessary for capital. If the prudent person is responsible for repaying the debt, that
2 person will want the lowest cost transaction possible.

3 In authorizing ratepayer-backed bonds, some states have placed a lowest cost standard in the
4 enabling legislation, while others pursue it as a matter of policy. The states of Wisconsin, Texas
5 and New Jersey have it in their statutes. In West Virginia, though it was not in the statute, the
6 sponsoring utility, consumer representatives, Commission staff, and other interveners all agreed in a
7 joint stipulation on the utility's application that the "lowest cost" standard would be applied to the
8 financing. I expect the West Virginia Public Service Commission will adopt a financing order some
9 time during the week of April 1, 2006, approving the issuance of ratepayer-backed bonds to finance
10 SO² abatement facilities for Allegheny Power and adopting this "lowest cost" standard.

11 **Q. Have ratepayer-backed bonds been issued under a clearly identifiable lowest cost**
12 **standard?**

13 A. Yes. In Texas and New Jersey, Saber has overseen the issuance of approximately \$5 billion of
14 bonds in six transactions with a "lowest cost" standard. Wisconsin and West Virginia have
15 transactions pending with such a standard.

16 **Q. Are underwriters and investors cooperative in achieving the lowest cost?**

17 A. It varies. Some are excellent, and others are not. Some are more cooperative than others.
18 Fundamentally, underwriters have an inherent conflict of interest in determining the cost of the
19 bonds for issuers. Underwriters are the initial purchasers of the bonds, generally purchasing the
20 bonds from the issuer at an agreed discount and then reselling the bonds to investors at face value.
21 The higher the interest rate, the easier it is to resell the bonds at face value. Therefore, it is in the
22 underwriters' economic interest to get a higher interest rate to make it easier to induce their
23 customers, the investors, to buy the bonds. Investors also want as high an interest rate as possible.
24 But most underwriters also wish to respect issuers' interests. Many are well-intentioned and try to

1 balance these conflicting interests in the best possible way, though their legal relationship is
2 commercial, and no fiduciary relationship exists.

3 Nevertheless, the parties who represent the interests of the real obligors (in this case the
4 ratepayers) would be involved in a pricing process that pits them against the interests of the
5 underwriters and the investors. It is therefore the responsibility of the real obligors' representatives
6 to create a competitive process among underwriters and investors so as to achieve the greatest
7 leverage in negotiations and therefore the lowest possible cost.

8 Some underwriters and some investors attempt to use their size and market power to induce
9 higher interest rates on bonds they purchase and re-sell. All underwriting firms are profit
10 maximizers.

11 Some underwriters will be more competitive on a specific bond issue when they anticipate
12 economic gain flowing from future transactions or from related business if they perform
13 successfully. Others might seek solely to maximize their income from the transaction. Still other
14 underwriters might have lower compensation hurdles and might be willing to be more aggressive in
15 distribution and pricing. These are elements of a market-based negotiation and sale of bonds. It is
16 important for any issuer of bonds to have experience with market participants and with negotiating
17 hard to achieve the best deal possible. Nothing is automatic.

18 For example, Credit Suisse (CS) (formerly Credit Suisse First Boston), FPL's current advisor,
19 demonstrated a willingness to work under a "lowest cost" standard and be judged by the Texas
20 Commission for purposes of establishing its compensation. Later in my testimony, I will describe
21 the best practices in the ratepayer-backed bond structuring, marketing and pricing process that will
22 have the greatest chance to achieve the lowest possible cost to ratepayers.

23 **Q. Does FPL's petition have a financing standard or objective?**

1 A. No. It is silent on the subject of the bonds' cost to ratepayers as well as the subject of
2 negotiation with underwriters and investors.

3 **Q. Does Section 366.8260, Florida Statutes, authorize the FPSC to include provisions in a**
4 **financing order that are designed to ensure the lowest cost of funds and other ratepayer**
5 **protections?**

6 A. Yes. Section 366.8260(2)2.j, Florida Statutes, specifically directs the FPSC to "[i]nclude any
7 other conditions that the commission considers appropriate and that are not otherwise inconsistent
8 with this section." This authorizes the FPSC to impose conditions that are designed to ensure the
9 lowest possible storm-recovery charges and the greatest ratepayer protections possible.

10 **Q. What are the necessary features to make utility securitization possible?**

11 A. The necessary features generally include an enabling statute for the commission to issue an
12 irrevocable financing order approving a ratepayer-backed bond transaction, a state pledge never to
13 interfere with the bondholders' rights to collect payment, and regulatory approval of an irrevocable
14 financing order imposing a non-bypassable charge on ratepayers with a periodic adjustment
15 mechanism (often called a "true-up mechanism") that will adjust the charge automatically, as
16 necessary, to ensure timely payment of the bonds.

17 **Q. Please explain the true-up mechanism and state pledge.**

18 A. In utility securitizations, enabling state legislation includes a specific pledge that the state will
19 not modify or impair the special property right so long as securitized ratepayer-backed bonds
20 authorized by a commission's financing order remain outstanding. In addition, financing orders
21 include a periodic true-up process that guarantees the Commission will adjust the segregated rate
22 component pursuant to a pre-approved formula at least annually to whatever level is necessary to
23 pay principal and interest on the securitized ratepayer-backed bonds on time.

1 Thus, repayment of the bonds is fully guaranteed by the state's pledge and its regulatory
2 authority to implement the true-up mechanism, not the state's taxing authority or full faith and
3 credit. This is a unique form of government guarantee.

4 **Q. Why are the true-up mechanism and state pledge necessary for a utility securitization?**

5 A. These features are necessary to raise the funds in the most efficient, least costly manner. With
6 these and other structural features in place, a top quality AAA rating can be achieved. Without such
7 a rating, all of the potential economic benefits of securitization might not be obtained. But that is
8 only one component of the process of obtaining these benefits.

9 **Q. Please explain the role of the SPE in the transaction.**

10 A. Like the state pledge and true-up mechanism, the SPE structure is necessary to separate the
11 ratepayer-backed bond's credit from the utility's credit and makes the AAA rating achievable.

12 The special property right is granted to a utility by the enabling statute. It is sold by the utility
13 to its bankruptcy-remote SPE. The SPE is nominally owned by the utility for the convenience of
14 the transaction and for tax reasons, but should be responsible to the Commission. The SPE has only
15 minimal equity capital (typically 0.5% of the SPE's total assets), but its other activities are restricted
16 by its formation documents and the Commission in accordance with requirements of the financing
17 order so that it is unlikely to become insolvent by reason of unrelated activities.

18 The SPE purchases the property from the utility and raises the amount needed to fund the
19 purchase price by issuing ratepayer-backed bonds. At or about the time bonds are sold, the parties
20 have to agree to the fair market-value price the SPE will pay the utility for the property. The fair
21 market-value price will depend upon the yield inherent in the property (which is based upon the
22 yield on the bonds) and the strength of covenants, representations and warranties given by the
23 utility to the SPE. Like the market value yield, these covenants, representations and warranties

1 should be actively negotiated, with the final terms not settled until immediately before the
2 marketing period begins.

3 **Q. Please describe the specific duties involved in FPL's role as servicer to the SPE?**

4 A. The servicer calculates, bills and collects the storm-recovery charges associated with the
5 storm-recovery bonds on behalf of the SPE and remits them to the bondholders' trustee. It also
6 performs duties related to implementing the true-up mechanism so as to ensure that collections are
7 sufficient to ensure timely payment of principal and interest on the bonds.

8 **Q. Will FPL be compensated for providing these services?**

9 A. Yes. Under the Servicing Agreement proposed by FPL, FPL would be paid 0.05% of the
10 initial principal amount of the bonds by the SPE each year for performing these services, regardless
11 of FPL's incremental cost to provide these services. This type of arrangement is not unusual
12 because bankruptcy law considerations require the relationship between FPL and the SPE to be
13 "arms-length" for purposes of the transaction. However, absent some adjustment, this arrangement
14 will potentially require FPL's ratepayers to pay more through storm-recovery charges than FPL's
15 incremental cost of providing the services.

16 **Q. In your experience with ratepayer-backed bonds issued in other states, have**
17 **commissions linked servicer fees to the incremental cost incurred by the utility to perform the**
18 **servicer duties?**

19 A. Yes. In ratepayer-backed bond transactions in California, Montana, Connecticut and New
20 Jersey, the financing orders explicitly directed that the utility's other rates are to be adjusted so as to
21 prevent recovery by the utility in excess of its verifiable incremental costs.³

22 **Q. How often should FPL in its role as servicer be required to prepare, file, and process the**
23 **true-up mechanism required by Section 366.8260, F.S., and the Financing Order?**

1 A. FPL proposes to make true-up filings twice a year or more frequently if necessary to maintain
2 its bond ratings. True-ups every six months will make for more accurate collections and will
3 increase the likelihood that the storm-recovery bonds will be paid on schedule. That likelihood is
4 also perceived by investors as adding value. Investors will likely take comfort from knowing that
5 the timeliness and adequacy of storm-recovery charge collections will be excellent, and those
6 factors could provide added value when investors are pricing these securities, to the benefit of
7 ratepayers.

8 **Q. Why is this important from the ratepayers' perspective?**

9 A. To the extent that investors perceive that the repayment schedule might be missed through
10 either a default or simply an extension (deferral) of a principal payment, they will likely want to be
11 compensated with increased yield for bearing that risk. To the extent that the risk or the perceived
12 risk can be reduced, storm-recovery bonds will become more attractive to more investors at a lower
13 cost to ratepayers.

14 **Q. How often should FPL in its role as servicer be required to remit to the SPE the storm-**
15 **recovery charges it collects from ratepayers?**

16 A. The shortest possible time should be required. Daily is preferable.

17 **Q. Why is this important from the ratepayers' perspective?**

18 A. First, until the money is turned over to the trustee, it is commingled with FPL's other funds.
19 Investors are concerned that if anything should happen to FPL, the money might get tied up in a
20 court proceeding and eventually delay payment to them. Second, while collected and not remitted
21 to the trustee, the money would be earning interest. Unless it is made clear that this interest income
22 is the property of the SPE and therefore used to pay principal and interest and expenses in order to

³ See fn. 4.

1 reduce future storm-recovery charges, FPL will keep this additional income at the expense of
2 ratepayers.

3 **Q. In your experience with ratepayer-backed bonds issued in other states, have**
4 **commissions required the utility, acting as the servicer for the transaction, to indemnify its**
5 **ratepayers against an increase in the servicer fee in the event of default due to negligence,**
6 **misconduct, or termination for cause?**

7 A. Yes. This has been required in states where commissions have relied on an active financial
8 advisor to represent ratepayer interests. In the five prior Texas ratepayer-backed bond transactions,
9 ratepayers received indemnification from the servicer for such events.

10 **Q. Why is this important from the ratepayers' perspective?**

11 A. The servicer is a critical participant in the transaction throughout the life of the ratepayer-
12 backed bonds. Negligence or other malfeasance can result in losses because the cost of retaining a
13 third party servicer to replace FPL is estimated to be many times higher than the cost of FPL
14 continuing to be the servicer. Investors generally will be protected against these losses through
15 operation of the true-up mechanism. Ratepayers will be protected only if they can rely on the
16 servicer and if they are entitled to indemnification from the servicer if any loss results from the
17 servicer's negligence or malfeasance.

18 **Q. What makes a successful ratepayer-backed bond transaction?**

19 A. A successful ratepayer-backed bond transaction produces the greatest economic value from
20 the property—i.e., raises funds at the lowest possible cost and least liability to ratepayers as
21 represented by covenants, representations, and warranties of the utility to the SPE and for the
22 benefit of ratepayers. If the measure of success were to simply sell ratepayer-backed bonds and
23 raise cash, regardless of the security's cost, a "successful" transaction would need very little
24 attention. There are many investors that would be happy to own a high quality investment product

1 with a high interest rate. (Indeed, many large investors have made it known that this is exactly what
2 they want and some underwriters are more than happy to oblige.) However, raising funds at the
3 lowest possible cost and least liability to ratepayers requires more attention to structuring, more
4 effort within the capital markets, and more due diligence on the part of regulators and the utility.

5 In this petition, FPL does not take into account ratepayer cost considerations. FPL argues that
6 the test for success should be simply whether the total storm-recovery charge will be less than the
7 current rate surcharge. By not emphasizing the lowest cost possible in absolute terms, FPL's
8 proposal leaves open the possibility of waste and inefficiency in the financing process. Cost matters
9 to ratepayers when they are footing the entire bill.

10 **Q. Are all the elements for a successful securitization present in this petition?**

11 A. No. There are both substantive and procedural deficiencies in the FPL petition which will be
12 addressed later in this testimony. These should be addressed early so that the Commission and FPL
13 can work in a cooperative manner to complete the transaction expeditiously.

14
15 **Comparison to Other Securities**

16 **Q. Is a comparison to other securities important to ratepayers?**

17 A. Yes. To determine whether ratepayers have received all the benefits from securitization, the
18 legislation and the financing order, and to have a benchmark for success, it is important to compare
19 storm-recovery bonds to other securities in the market. All securities price in relation to other
20 securities, their terms, conditions, representations, warranties and other factors making up their
21 credit and their market. Only by knowing and examining these and other factors can one determine
22 whether a ratepayer-backed bond transaction has been successful or not.

23 **Q. How do ratepayer-backed bonds compare with corporate bonds?**

1 A. Ratepayer-backed bonds are a corporate security with a unique form of government guarantee.
2 The guarantee is not based upon the government's taxing authority but rather on the exercise of the
3 government's regulatory authority over rates charged for the consumption of electricity and the
4 transmission and distribution of electricity.

5 Ratepayer-backed bonds are arguably superior to all other corporate securities, secured or
6 unsecured, because of the quality of the credit supporting the bond issue. First, by using an SPE,
7 the property supporting the bonds is isolated from the claims of the creditors and the liabilities of
8 the utility or government. There are no other operating, capital, or interest expenses that can have a
9 claim on the cash flow from the property. Second, the charge is on an essential commodity,
10 electricity, which is vital to almost everything we do. Third, the charge is applied broadly to all
11 customers and cannot be avoided however electricity is supplied or consumed. Finally, the
12 government has made a pledge, not only not to interfere in the transaction in any way, but also to
13 guarantee that the government will use its regulatory authority to support the bonds. This creates a
14 direct, explicit, unconditional and irrevocable obligation in the financing order to adjust the level of
15 the broad-based charge regularly to whatever level is necessary to guarantee the timely repayment
16 of the bonds.

17 These features result in an incredibly strong credit independent of the utility. In fact, in every
18 instance where ratepayer-backed bonds have been issued in the utility industry, they have been rated
19 AAA, and not one has ever been downgraded from AAA. A big part of the financial advisor's job
20 is to work hand in hand with FPL and the underwriters to ensure that more and more potential
21 investors understand this high-quality security so that storm-recovery bonds can be sold at the
22 highest price to investors and thus at the lowest cost to ratepayers.

23 **Q. With respect to credit fundamentals, how do ratepayer-backed bonds compare to**
24 **corporate bonds?**

1 A. The certainty over the cash flow to repay ratepayer-backed bonds is unmatched in any
2 corporate bond, including utility first mortgage bonds. The credit fundamentals of ratepayer-backed
3 bonds are superior in that they are senior obligations. They are fully secured and do not compete
4 with any operating expenses of the utility.

5 The certainty over the cash flow comes not only from the isolation of and the broad-based
6 nature of the charge, but also from the true-up adjustment mechanism. This adjustment mechanism
7 is a form of credit enhancement unique to ratepayer-backed bonds. It is mandated by the enabling
8 legislation and implemented by the Commission. It requires all of the utility's customers to make
9 up any shortfall in collections for any reason. This essentially means that all customers share in the
10 liabilities of all other customers. In this respect, the structure is similar to the "joint and several"
11 liability structure of the Federal Home Loan Bank Board, another AAA rated issuer of taxable
12 bonds that garners some of the lowest interest rates from the market.

13 **Q. With respect to various investment characteristics, how do ratepayer-backed bonds**
14 **compare to corporate bonds?**

15 A. Ratepayer-backed bonds are a corporate security with several superior features. In a recent
16 offering of similar bonds in Texas, underwriters (including FPL's advisor, CS) and others described
17 the credit compared to utility corporate bonds succinctly in an investor presentation:

18 "The (securitization) bond is a plain vanilla, senior secured sinking fund
19 bond...there are no complicated structures, subordinations or special
20 features. The money comes from the same source, the customer's
21 electric bill, as first mortgage bonds do but with no utility operating
22 expenses crowding out the flow of funds to investors. In addition, there
23 are special protections in the law for bondholders with a government
24 guarantee to implement an adjustment mechanism to provide expected
25 revenues for timely payment of principal and interest. This makes the
26 revenue source guaranteed by law and not subject to the vagaries of
27 utility rate cases. To ensure timely payment, a regularly required
28 adjustment of the revenue source is also guaranteed by law, again not
29 subject to the vagaries of utility rate cases meaning there is effectively
30 no credit risk for all practical purposes." (Comments made by Lee Mallet

1 of Credit Suisse in an Internet Roadshow for the Texas Transition Bond
2 offering of CenterPoint Energy, December 2005)
3

4 Point by point, when compared to FPL secured first mortgage bonds, for example, the superior
5 credit quality of storm-recovery bonds becomes clear. The revenue that supports the repayment of
6 storm-recovery bonds is collected under an irrevocable financing order as opposed to a general rate
7 order. Unlike first mortgage bonds, whose related revenue stream is subject to a periodic challenge
8 in a rate case, storm-recovery charges are not subject to traditional ongoing regulatory review, and
9 therefore there is none of the typical regulatory risk associated with storm-recovery bonds. To
10 guarantee that expected revenues will be sufficient to make timely interest and principal payments
11 on the storm-recovery bonds, the FPSC by law must directly, explicitly, unconditionally, and
12 irrevocably guarantee in the financing order to adjust the charge to whatever level is necessary to
13 provide the expected revenue to meet the payment schedule. FPL's first mortgage bonds do not
14 have this feature.

15 The importance of these protections became evident following the energy crisis in California
16 in the early part of this decade. As a result of the crisis, some of California's major electric utilities'
17 debt fell to below investment-grade ratings. Despite those downgrades, and as a further highlight of
18 the benefits of securitization, the ratepayer-backed bonds previously issued for the benefit of these
19 California utilities continued to be rated AAA, and they continue to be rated AAA today.

20 Like ratepayer-backed bonds issued for the benefit of California utilities, storm-recovery
21 bonds are not subject to such risks. They are to be issued through a bankruptcy-remote entity, and
22 the revenues generated by storm-recovery charges will clearly be the property of the issuer, will be
23 dedicated to the repayment of principal and interest on storm-recovery bonds, and cannot be
24 diverted to other purposes.

25 **Q. With respect to various investment characteristics, how do ratepayer-backed bonds**

1 **compare to asset-backed securities?**

2 A. Ratepayer-backed bonds are financial instruments that have been analyzed and compared to
3 asset-backed securities because of some of the structural features of ratepayer-backed bonds, most
4 notably the use of an SPE as the issuer.⁴ Asset-backed bonds are bonds backed, for instance, by
5 credit-card receivables and student loans.

6 The fundamental difference between storm-recovery bonds and typical asset-backed securities
7 is the absence of an asset that meets the traditional definition included in all asset-backed securities.
8 Asset-backed securities are backed by a discrete pool of receivables or other financial assets.
9 Indeed, Mr. Olson's testimony discusses home-equity loans, automobile receivables, student loans
10 and credit card balances, equipment leases, trade receivables, franchise fees, and royalties as
11 examples of financial assets that support asset-backed securities. The characteristics of those types
12 of instruments are not directly analogous to storm-recovery property.⁵ Moreover, the
13 characterization of ratepayer-backed bonds as "asset-backed securities," and the comparison of
14 ratepayer-backed bonds to these other more complex and risky instruments has caused confusion
15 among potential investors which in turn has driven up yields on ratepayer-backed bonds.

16 In the most recent offering of ratepayer-backed bonds, Texas Transition Bonds issued in
17 December 2005 for the benefit of CenterPoint Energy, the underwriters, which included Mr. Olson
18 and CS, presented specific side-by-side comparisons of these bonds to three different types of
19 corporate securities: asset-backed securities such as credit card receivable-backed bonds, utility
20 first mortgage bonds, and U.S. agency securities. The underwriters concluded that the best
21 comparable corporate securities were U.S. agency securities, such as debt obligations issued by
22 FNMA and FHLC. I agree with that conclusion.

⁴ In the case of ratepayer-backed bonds, the isolation of an asset in an SPE does not necessarily make securities offered by that SPE an asset-backed security.

1 **Q. Why is this distinction between asset-backed securities and ratepayer-backed bonds**
2 **important to ratepayers?**

3 A. The capital markets are segmented into many distinct segments that price and trade securities
4 with different conventions and therefore different outcomes for those with the economic burden of
5 repaying newly issued debt. The most obvious example of the different segments is between the
6 debt and equity securities. Even within the debt capital markets (also known as the fixed income
7 market) there are numerous segments. Within the United States domestic markets, for example,
8 municipal bonds trade separately from corporate securities. There is further differentiation among
9 corporate securities offered by finance companies versus securities offered by industrial companies
10 versus securities offered by utilities. In addition, there is a distinct market for asset-backed
11 securities, which is dominated by securities backed by home mortgages.

12 Within investment banks, underwriting firms, and broker-dealers, these market segments are
13 often covered by separate organizational units with separate bankers, traders and salesmen. The
14 capital available, as well as the underwriting, trading, and risk management policies may vary
15 significantly among the market segments within the firm.

16 The customers of investment banks are also segmented. Large mutual funds, for example,
17 operate under strict investment criteria and follow specialized investment strategies set by money
18 managers. Because certain monies are designated only to certain "types" of investments, investment
19 banks may seek fees and profits from supporting these large customers to the exclusion of smaller
20 accounts, and marketing and sales efforts for utility securitizations can become more complicated.

21 The labeling of a security within one of these market segments, regardless of how accurate
22 that is, will influence how investors value the security's credit features and other factors. This, in
23 turn, affects the cost of the security.

⁵ In fact, the Office of Chief Accountant of the Securities and Exchange Commission has specifically ruled that transition property, which is very similar to storm recovery property, is not a financial asset. Like transition property, storm-

1 **Q. Don't all securities that have an identical "AAA" rating price identically?**

2 A. Absolutely not. There are wide discrepancies in pricing between and among securities of the
3 same rating, even within the same market segment. See EXH JSF-3, which compares pricing on the
4 recent CenterPoint transaction and comparable AAA rated credits. These discrepancies can be
5 dramatic and expensive to ratepayers in the pricing of ratepayer-backed bonds.

6 Some of the minor discrepancies can be attributed to structural differences, such as the
7 sinking-fund schedule. Further, the size of the offering can affect investors' perception of the
8 ability to buy and sell a security easily. This is known as the bonds' "liquidity." These differences
9 may also result from the relative efforts of issuers to educate the market and investors about their
10 respective securities.

11 The differences in pricing among AAA rated securities underscores the fact that the ratepayers
12 backing these bonds will not automatically receive the benefit of the best price for the bonds simply
13 because the bonds are AAA rated. In fact, all of these discrepancies can be minimized or eliminated
14 through proper structuring, marketing and pricing of ratepayer-backed bonds.

15 **Q. Is there a name generally used among market professionals to describe this comparison**
16 **between similarly rated securities that carry different interest rates?**

17 A. Yes. It is called the "relative value" of the security.

18 **Q. Are there any structural reasons that would account for the pricing differences between**
19 **ratepayer-backed bonds and similarly rated securities?**

20 A. Yes, but they would only account for a small portion of the difference. Other factors
21 affecting price relate to investor perception of the credit, the structure and the perceived liquidity
22 (ability to buy and sell it in the secondary market) of the security, distribution efforts, transparency
23 of pricing and trading, and other technical and fundamental factors.

1 **Q. How does appealing to the appropriate investor segment affect the cost of ratepayer-**
2 **backed bonds?**

3 A. Appealing to the appropriate investor segment creates the baseline by which investors value
4 the security and, in part, determines the interest rate they will accept to hold the ratepayer-backed
5 bonds. For example, an investor who wishes to make a quick trading profit would want a very high
6 interest rate on the bonds. Investors who are very concerned about maintaining their principal for
7 the long-term and who do not expect to sell the bonds in the near future may accept a lower interest
8 rate because those investors are more concerned about long-term risk than a quick profit. Foreign
9 investors who want safety in U.S. dollars (e.g., China) might also be willing to accept lower yields
10 than U.S. domestic hedge fund managers who have high yield targets for their investment portfolio
11 in order to keep attracting capital inflows to their funds.

12 Furthermore, appealing to a broad base of investors, rather than targeting a small group of
13 large accounts, will create greater competition. Large investor accounts often believe they have
14 “market power” and therefore can demand higher yields for quick execution with their capital.
15 Although underwriters are sometimes willing to oblige them, competition with other underwriters
16 and investors can drive the market to lower costs.

17 **Q. How will marketing and investor education affect the cost of storm-recovery bonds?**

18 A. Consider the analogy of trying to sell a home. If the seller simply puts out a sign in his/her
19 yard and accepts the first offer that is given from whoever drives by, that will be one price. But if
20 the seller lists the home with an agent who creates marketing materials that clearly and accurately
21 explain the benefits of the house and even conducts an open house for prospective purchasers so as
22 to educate them on the property and then receives offers from multiple bidders that will be another
23 price. The latter likely will be a significantly higher price.

1 The difference in price achieved will largely be a factor of how well the home was marketed,
2 i.e. how well prospective investors understood the value of the home relative to competing
3 investments.

4 In issuing bonds, there are specific rules and regulations to follow, disclosure and marketing
5 documents to be filed with regulators, and the bonds will compete with multiple contemporaneous
6 investments. But investors' fundamental valuation comes from an understanding of the credit, its
7 liquidity, "relative value" and the functioning of the capital markets.

8 Accurate market education does not happen by itself. It usually occurs only if undertaken and
9 pursued vigorously by those who have a stake in the outcome. For example, FPL, as well as almost
10 all other corporations, spends a great deal of shareholder resources in promoting and educating the
11 market for its stock. The management invests this time and energy because it believes that from
12 true market education and a better understanding of its company, the valuation of the company's
13 stock will increase for the benefit of shareholders. The management also targets efforts at lenders to
14 lower the company's borrowing costs because it expects to need debt capital on an ongoing basis.

15 With storm-recovery bonds, because FPL is not responsible for any costs of borrowing, as it
16 otherwise would be in a traditional debt offering, FPL has no stake in the outcome other than to
17 receive the cash and improve its balance sheet as quickly as possible. Moreover, the transaction is
18 likely viewed from FPL's perspective as a one-time offering, or, at the very least, an infrequent
19 offering, so its need to make a concerted effort to educate the market regarding the benefits of
20 storm-recovery bonds is diminished.

21 While well intentioned, FPL management also is distracted by independent concerns
22 stemming from the fact that its current debt is a direct obligation of its shareholders, and storm-
23 recovery bonds are not. Therefore, there is little incentive for FPL to invest time and effort in

1 educating the market, expanding the market, or creating as broad a competition as possible for this
2 or other storm-recovery bond issuances.

3 As the beneficiary of the storm-recovery bond issue, FPL can and should work collaboratively
4 and collegially with the Commission, staff and advisors to achieve a successful lowest cost
5 financing. The Commission, through the use of independent advisors with a duty of loyalty and
6 care to the Commission, can and should take a co-leadership role with FPL in marketing and in
7 investor education efforts. A joint and collaborative effort can best serve the interests of ratepayers
8 while fully addressing the financing needs of the utility.

9 **Q. Will all credit risk be eliminated in connection with storm-recovery bonds?**

10 A. No. It is possible to imagine extraordinary facts or circumstances in which holders of storm-
11 recovery bonds will not receive payments of principal or interest when they come to be legally due
12 and owing. For example, if the entire human population in FPL's entire electric service area were
13 suddenly destroyed by a nuclear attack that made the service area uninhabitable, holders of storm-
14 recovery bonds would not receive payments of principal or interest when they come to be legally
15 due and owing. However, this is not practical. In all practical circumstances, I expect models
16 prepared by the underwriters for the rating agencies will show that the faithful application of an
17 automatic mechanism pursuant to which the Commission has committed to apply a pre-approved
18 mathematical formula to increase the storm-recovery charge to whatever level is forecasted to be
19 necessary (taking into account the most recently updated forecasts of electricity usage, collection
20 curve and write-offs) to ensure timely payment of scheduled principal, interest and other amounts
21 payable in respect of the storm-recovery bonds will eliminate all credit risk.

22 **Q. Have ratepayer-backed bonds ever been sold using prospectuses or other marketing**
23 **materials which characterized the credit risk in this way?**

1 A. Yes. The two most recent prospectuses pursuant to which ratepayer-backed bonds were sold
2 to the public for the benefit of Texas utilities state that the broad-based nature of the true-up
3 mechanism and the State Pledge will serve to effectively eliminate, for all practical purposes and
4 circumstances, all credit risk associated with those ratepayer-backed bonds.⁶

5 **Q. In which transaction was this language first used?**

6 A. This language was first used in a 2004 Texas transaction for TXU Electric Delivery Company.

7 **Q. Did Saber participate in that 2004 TXU Electric transaction?**

8 A. Yes. Saber served as financial advisor to the Public Utility Commission of Texas.

9 **Q. Did Saber draft this language and insist that it be included in the prospectus and other**
10 **offering documents for the 2004 TXU Electric utility securitization transaction?**

11 A. No. The language was proposed and drafted principally by two nationally recognized outside
12 legal counsel for TXU Electric, the sponsoring utility. For the reasons described earlier in my
13 testimony, Saber believed that an accurate description of the State Pledge and the automatic true-up
14 adjustment mechanism, together with a better plan for engaging investors regarding the inherent
15 strength of the credit supporting ratepayer-backed bonds, could lead to narrower credit spreads
16 against benchmark securities than had been achieved in connection with prior ratepayer-backed
17 bonds. Saber believed this could be achieved through a better understanding by investors of the

⁶ See CenterPoint Energy Transition Bond Company II, LLC's prospectus dated December 2, 2005, in connection with \$1,851,000,000 principal amount of Senior Secured Transition Bonds, Series A, page 34:

"The broad-based nature of the true-up mechanism and this pledge by the State of Texas, along with other elements of the transition bonds, will serve to effectively eliminate, for all practical purposes and circumstances, any credit risk associated with a series of transition bonds (*i.e.*, sufficient funds will be available and paid to discharge all principal and interest obligations on such series of transition bonds when due)."

(<http://www.sec.gov/Archives/edgar/data/1336265/000090514805004777/0000905148-05-004777.txt>.) See also TXU Electric Delivery Transition Bond Company LLC's prospectus dated May 28, 2004, in connection with its \$789,777,000 principal amount Transition Bonds, Series 2004-1, page 56:

"The broad-based nature of the true-up mechanism and the State Pledge will serve to effectively eliminate, for all practical purposes and circumstances, any credit risk associated with the transition bonds (*i.e.*, that sufficient funds will be available and paid to discharge all principal and interest obligations when due)."

(<http://www.sec.gov/Archives/edgar/data/1100179/000095012004000393/0000950120-04-000393.txt>)

1 fundamental risks of those ratepayer-backed bonds. Saber asked TXU Electric to propose language
2 for inclusion in the prospectus and other offering documents for the 2004 ratepayer-backed bonds.
3 This would explain the powerful, positive effects of the State Pledge and the automatic true-up
4 adjustment provisions with greater clarity than had been done in offering materials for prior
5 ratepayer-backed bonds.

6 **Q. Do you believe this language has accurately described prior ratepayer-backed bonds in**
7 **connection with which it has been used?**

8 A. Yes. In each case the underwriters constructed detailed and sophisticated financial models to
9 test whether interest and principal on the ratepayer-backed bonds would be paid when legally due,
10 even under severe stress scenarios. For example, Fitch Ratings, in a 2005 Presale Report explaining
11 to investors the basis for assigning a “AAA” rating to \$1,857,000,000 of ratepayer-backed bonds
12 being issued for the benefit of CenterPoint, stated:

13 “ . . . ‘break the bond’ cases provide an alternative means by which to
14 measure the potential effects of rapid, significant declines in power
15 consumption. The magnitude of several decreases is evaluated in these
16 stress cases, which focus on the break-even point for the bonds at the
17 specified year and beyond.

18
19 “In these scenarios, the structure is able to withstand a maximum
20 consumption variance of approximately 26.5% in year one, 61.5% in
21 year five, 88.0% in year 10, and 41% in year 14. . . . Despite these
22 extreme variances in each case, due to the true-ups, the [securitized
23 charge] is adjusted annually and is still able to pay all debt service by
24 the legal final maturity date.”⁷
25

26 None of these are “practical circumstances”, especially in the context of an electric system as
27 large and diverse as CenterPoint’s. Once similar, detailed and sophisticated financial models are
28 constructed to model storm-recovery bonds to be issued for the benefit of FPL, I anticipate these
29 studies will reach similar conclusions.

1 **Q. Did CenterPoint and its outside legal counsel readily agree to include the same credit**
2 **risk disclosure language that TXU Electric drafted and included in the prospectus and other**
3 **offering materials for its 2004 ratepayer-backed bonds?**

4 A. No. This kind of disclosure is not traditional. Also, the outside counsel to CenterPoint were
5 different from the outside counsel to TXU Electric and were not as experienced in ratepayer-backed
6 bond transactions. (Furthermore, experience with other transactions has shown that counsel used in
7 different transactions often seem to change the work of other counsel without necessarily adding
8 value.) This kind of disclosure is not traditional because it is highly unusual for securities to have
9 the extraordinary credit features associated with ratepayer-backed bonds compared to all other
10 securities offered in the capital markets. The initial reaction of CenterPoint and its outside counsel
11 was to question including this statement in the prospectus and other offering materials. But after
12 they had the benefit of the results of the modeling studies described above, and after conducting
13 their own factual and legal evaluation, CenterPoint agreed to include this language in the prospectus
14 and other offering materials.

15 **Q. Did CenterPoint's outside legal counsel deliver standard "10b-5" comfort to the**
16 **underwriters, the trustee and the rating agencies in connection with the 2005 ratepayer-**
17 **backed bonds?**

18 A. Yes. At closing, like TXU Electric's outside legal counsel, CenterPoint's outside legal
19 delivered the following standard securities law 10b-5 comfort to the underwriters, the trustee and
20 the rating agencies:

21 " . . . no facts have come to our attention that lead us to believe that . . .
22 the Final Prospectus, as amended, supplemented or modified [excepting
23 operating statistics, financial statements, and other financial and
24 statistical information] as of the date hereof contains, any untrue
25 statement of a material fact or omitted to make the statements therein, in

⁷ Fitch Ratings, *Asset-Backed Presale Report, CenterPoint Energy Transition Bond Company II, LLC, 2005 Series* (November 8, 2005) at page 6.

1 light of the circumstances under which they were made, not
2 misleading.”
3

4 Nationally recognized underwriter’s counsel also reviewed and accepted the disclosure
5 language. This was the same case in the 2004 TXU Electric transaction.

6 **Q. Do you believe this disclosure language accurately describes all ratepayer-backed bonds?**

7 A. Not necessarily. For example, some states have imposed caps on the authorized levels of the
8 securitized charge for some or all classes of customers. Examples include California, Pennsylvania
9 and New Hampshire. In those situations, careful analysis would be required to determine whether
10 there are any practical circumstances in which such caps might prevent the automatic true-up
11 adjustment from rising to the level required to make timely payment of all legally due principal and
12 interest.

13 **Q. Do you anticipate that this disclosure language will accurately describe the credit risk
14 associated with storm-recovery bonds to be issued for the benefit of FPL?**

15 A. Yes. Of course, it will be necessary for the underwriters to construct detailed and
16 sophisticated financial models specific to FPL to test whether interest and principal on the storm-
17 recovery bonds will be paid when legally due, even under severe stress scenarios. But so long as
18 the Commission imposes no cap on the permitted levels of storm-recovery charges and maintains
19 strict limits on consumers’ ability to bypass the storm-recovery charge, I anticipate these models
20 will confirm that the broad-based nature of the true-up mechanism and the State Pledge will serve to
21 effectively eliminate, for all practical purposes and circumstances, any credit risk (i.e., that
22 sufficient funds will be available and paid to discharge all principal and interest obligations when
23 due) associated with the storm-recovery bonds issued for the benefit of FPL

24 **Q. Has a state commission ever specifically found that the broad-based nature of the true-
25 up mechanism and the State Pledge will serve to effectively eliminate, for all practical**

1 **purposes and circumstances, all credit risk associated with ratepayer-backed bonds?**

2 A. Yes. Such specific findings of fact were included in the most recent financing order issued by
3 the Public Utility Commission of Texas⁸ and in the financing order issued by the Wisconsin Public
4 Service Commission.⁹

5 **Q. Are there any other special features that could be associated with ratepayer-backed**
6 **bonds ?**

7 A. Yes, the bonds may qualify for a 20% risk weighting under the Basel Accord in the United
8 Kingdom, Ireland and other countries. Recently, similar ratepayer-backed bonds issued from Texas
9 qualified for this treatment from regulators in the United Kingdom.

10 **Q. What is risk weighting, and why is it important to ratepayers in Florida?**

11 A. A 20% risk weighting has little to do with the credit risk of the bonds but has to do with
12 certain international credit standards for banking institutions that could be major investors in storm-
13 recovery bonds and could create greater competition for the storm-recovery bonds. A 20% risk
14 weight can help dramatically expand the market for these securities to increase competition and
15 lower costs. See EXH JSF-4, for a further explanation of the benefits of risk weighting. The FPL
16 application is silent as to whether FPL would attempt to structure the storm-recovery bond
17 transaction in a way to qualify for 20% risk weighting.

⁸ PUCT's 2005 Financing Order issued to CenterPoint (Docket No. 30485), Finding of Fact 107:

"The broad-based nature of the true-up mechanism and the pledge of the State of Texas embodied in PURA § 39.310, along with the bankruptcy remoteness of the special purpose entity and the collection account, will serve to effectively eliminate for all practical purposes and circumstances any credit risk associated with the transition bonds (i.e., that sufficient funds will be available and paid to discharge all principal and interest obligations when due)."

⁹ Wisconsin PSC' 2004 Financing Order issued to Wisconsin Electric (Docket 6630-ET-100), Finding of Fact 73:

"The broad-based nature of the true-up mechanism and the State Pledge will serve to effectively eliminate, for all practical purposes and circumstances, all credit risk associated with the environmental trust bonds (i.e., that sufficient funds will be available and paid to discharge all principal and interest obligations when due.)"

1 **Q. Were any ratepayer-backed bonds sold overseas in the most recent Texas transaction as**
2 **a result of a 20% risk weighting?**

3 A. Yes. Over \$1 billion in orders were received from overseas investors, and one-third of the
4 bond issue was sold to investors interested in the 20% risk weighting. Even though only \$600
5 million of these orders were accepted, \$1 billion in orders from a small group of investors is
6 indicative of the potential market that could be developed for storm-recovery bonds. This likely
7 would add to competition and lower costs.

8 **Q. Do you believe that there is much “value added” left in the markets for ratepayer-**
9 **backed bonds, such that thorough education and market expansion efforts by an active**
10 **financial advisor would be effective in lowering costs?**

11 A. Yes. As shown in my EXH JSF-3, recent ratepayer-backed bonds such as the CenterPoint
12 transaction which priced in December 2005, are not yet valued by the market as equivalent to
13 comparable AAA-rated debt issues to the extent they should be. The Exhibit includes debt issued
14 by U.S. government-sponsored entities such as Freddie Mac and Fannie Mae, sovereign credits such
15 as the European Investment Bank, AAA-rated debt issued by industrial firms such as Pfizer and
16 Johnson & Johnson, and “asset-backed” credit card securities.

17 Ratepayer-backed bonds are priced barely more favorably than AAA-rated asset-backed credit
18 card securities, and substantially less favorably than all other AAA-rated debt. This is despite the
19 fact that ratepayer-backed bonds have virtually none of the risks associated with either asset-backed
20 credit card securities or AAA-rated debt issued by industrial firms. Thus, one may conclude that,
21 with investor education and market expansion, the pricing of ratepayer-backed bonds can improve
22 and reflect their inherent relative advantages over comparable asset-backed securities.

23 The 2005 CenterPoint transaction was still a record transaction, with a lower yield and lower
24 ratepayer costs than any and all previous ratepayer-backed bond transactions of similar size and

1 maturities, particularly on the important long maturities of 10 and 13 years (important because the
2 interest on these maturities are paid for 10 and 13 years vs. interest on, say, 2-year debt being paid
3 for only two years). Texas ratepayer-backed bonds have consistently priced at least as well as the
4 best credits in the asset-backed securities market, but with substantial upside (i.e., lower interest
5 rates) still possible for the credit and size of issuance once investors come to fully appreciate the
6 relative value of ratepayer-backed bonds.

7 8 **Structuring, Marketing and Pricing**

9 **Q. Please describe what is meant by the phrase “structuring, marketing, and pricing” of**
10 **ratepayer-backed bonds?**

11 A. “Structuring” refers to the legal documentation and the delineation of rights, duties,
12 responsibilities and actions of various parties to the transaction under current and anticipated market
13 conditions affecting the bonds and the interaction with investors. Structuring also refers to the
14 specific payment schedule for the bonds, the maturity, aggregation of cash flows in tranches (a
15 series of maturities within the bond issue) and the method and frequency of payment.

16 “Pricing” refers to the actual interest rate and costs assigned to the bonds in exchange for cash.
17 Generally, the bonds are first sold to a group of investment banks (underwriters) who resell the
18 bonds to investors.

19 “Marketing” is an aspect of “structuring” and “pricing.” It refers to the communication of the
20 terms, conditions, credit and relative-value investment thesis to the underwriters and potential
21 investors in preparation for pricing.

22 **Q. Regarding ratepayer-backed bonds issued in other states, have commissions been**
23 **actively involved in the structuring, marketing, and pricing of these transactions after the**
24 **issuance of the financing orders?**

1 A. Yes. Commissions in Texas, New Jersey, and California--and prospectively Wisconsin--have
2 been actively involved in the structuring, marketing and pricing of ratepayer-backed bonds.
3 Significantly, the California Public Utilities Commission, which was one of the first states to
4 sponsor ratepayer-backed bonds, initially did not participate actively after issuing its financing
5 orders in 1997 and 1998. However, when a second round of ratepayer-backed bonds was
6 authorized in 2004, the California Commission created an active role for a Commission financing
7 team to approve all matters post financing order. The Texas Commission has had the most active
8 post-financing order participation.

9 Two transactions in the past year illustrate the results that can be achieved by an active and
10 involved commission in the structuring, marketing and pricing of ratepayer-backed bonds. In
11 September 2005, Public Service Electric and Gas Company of New Jersey sponsored the issuance
12 of \$102 million of ratepayer-backed bonds. Saber served as financial advisor to the New Jersey
13 Commission and CS was the lead underwriter. Normally a transaction of this size might have been
14 difficult to sell because of its small size relative to other competing investments. However,
15 according to a report written by CS to the New Jersey Commission,

16 "The extensive marketing of these bonds conducted by CS,
17 Barclays and M.R. Beal, with active participation by Saber, led to
18 the unprecedented (low) pricing spreads, despite the disadvantage
19 of relatively small tranche sizes."
20

21 In December 2005, CenterPoint Energy of Texas initially offered \$1.2 billion of ratepayer-
22 backed bonds to the market. Saber was the financial advisor with joint decision-making
23 responsibility with the issuer. The Commission acted by and through the financial advisor. CS was
24 one of the bookrunning underwriters. In this case, the large size of the transaction, coupled with the
25 timing of the issuance at the end of the year (which traditionally is not a good time to sell securities)
26 posed special challenges. Nevertheless, the ratepayer-backed bonds received worldwide investor

1 demand at record-low credit spreads. The transaction was increased to \$1.85 billion with over one-
2 third of the bonds being sold to foreign investors for the first time ever. This transaction was also
3 notable because of the large amount of bonds sold with very long maturities which are the type of
4 bonds most costly to ratepayers. Yet, the credit spread levels achieved by the Texas Commission
5 for ratepayers through these Texas ratepayer-backed bonds on the longest maturities were
6 significantly below all other previously offered ratepayer-backed bonds in any state.

7 CS is the current storm-recovery bond advisor to FPL. Barclays is the current storm-recovery
8 bond advisor to Gulf Power. Both firms have been able to work well under the active oversight of
9 other state commissions and their financial advisors after the financing order has been issued and up
10 to the time ratepayer-backed bonds were issued. There is no reason why these same firms should
11 not be able to work collaboratively with the FPSC and Saber after a financing order has been issued
12 and up to the time the storm-recovery bonds are issued in the proposed transactions as well.

13 **Q. Does a lowest cost standard create more cost for ratepayers than a lesser standard?**

14 A. Pursuing a lowest cost standard might require transaction participants to work harder, but not
15 necessarily at higher economic cost. FPL proposes almost \$12 million in issuance expenses. It is
16 appropriate to expect the best possible outcome for such costs. Otherwise waste and inefficiency
17 might arise from the process. Indeed, not pursuing the lowest cost almost guarantees higher total
18 cost because there is no incentive or accountability to get anything better. Among the transaction
19 costs, the greatest economic cost to ratepayers is the interest rate on the bonds which ratepayers will
20 be paying for 12 years. This dwarfs any single up-front transaction cost. One eighth of one per cent
21 of \$1 billion outstanding for about 7.5 years will cost ratepayers \$9.4 million in nominal dollars.
22 “Reasonable” is not an appropriate standard to apply, especially when the potential cost is so
23 substantial. Moreover, without involvement in real time, there will be no way for the Commission
24 to know that the transaction was priced at the lowest interest rate possible.

1 This is one reason why care needs to be taken, in cooperation with FPL, in selecting
2 experienced transaction participants and others. It is essential to put together a team which shares a
3 similar objective and commitment to excellence, which can provide economies of scale and which
4 is responsive to competitive pressures and economic incentives. If the economic incentives are
5 properly aligned with proper oversight, underwriters, counsel, advisors and others will work in the
6 most cost-effective, collaborative manner with the Commission and the utility to achieve the lowest
7 cost objective. If there are no incentives or no accountabilities in the process, waste and
8 inefficiencies are likely to occur. The standard of “lowest cost” with accountability compels the
9 transaction parties to achieve the best transaction possible and to avoid a poorly executed, badly
10 priced transaction.

11 Some may argue that an active Commission increases utility legal costs and that this is a
12 reason not to have active Commission involvement in protecting ratepayer interests after a financing
13 order has been issued. A review of past legal costs associated with all publicly-offered ratepayer-
14 backed bonds with or without an active commission, staff, or an advisor shows no discernible
15 pattern.

16 Finally, some expenditures can provide savings as well as protection against adverse
17 consequences. For example, is hiring an independent auditor cost effective? Does having a public
18 utility commission increase electricity rates?

19 **Q. How does having active Commission involvement in the structuring, marketing, and**
20 **pricing of ratepayer-backed bonds after the issuance of the financing order ensure lowest**
21 **cost?**

22 A. An active Commission that is involved throughout the structuring, marketing, and pricing of
23 the ratepayer-backed bonds is important because ratepayers are the sole source of funding for these
24 bonds. The financing order is irrevocable, and therefore the interests of ratepayers need to be fully

1 reflected at every step of the process. FPL and its agents have specific interests in the outcome of
2 this transaction, and those interests might diverge in some respects from those of ratepayers.
3 Nevertheless, a cooperative and collaborative effort can occur to reach a common goal.

4 In this case, the nature of the financing process is such that many decisions affecting ratepayer
5 costs and risks cannot be known until after a financing order has been issued. FPL accepts that
6 there should be a post-financing order-review process but has proposed a process that omits
7 Commission approval of some of the most important final terms and conditions ultimately affecting
8 ratepayers. By having transaction oversight and approval by the Commission at every step after
9 issuance of the financing order, the Commission can work with FPL during all critical stages to
10 ensure that the lowest cost is achieved.

11 **Q. Why is it necessary for the Commission to engage an experienced financial advisor to**
12 **assist in its legislative duty?**

13 A. The Commission and its staff have many years of experience in reviewing and approving the
14 issuance of traditional utility debt and equity securities. But the Commission and its staff do not
15 have experience in reviewing and approving ratepayer-backed bonds where the utility has little or
16 no incentive to minimize the rate of interest or the costs of issuance, or to offer reasonable
17 representations, warranties and covenants for the benefit of ratepayers to whom they owe no
18 fiduciary duty.

19 Through storm-recovery charges, FPL ratepayers will be paying the cost of outside legal and
20 financial advisors retained by FPL even though these professionals have a duty of loyalty and care
21 to protect the interest of FPL's shareholders. It is important that ratepayer interests are similarly
22 protected in this transaction by experienced and active professionals that have a duty of loyalty and
23 of care to ratepayers.

1 With the help of experts intimately familiar with the legal and financial nuances of ratepayer-
2 backed bonds, the Commission can ensure that ratepayers' interests are protected. Actively
3 involved independent financial advisors add tremendously to the Commission's ability to reach this
4 goal. For example, corporations and financial advisory firms interface regularly with public capital
5 markets, whereas utility commissions do not. Financial advisors are intimately familiar with the
6 structuring, marketing, and pricing of ratepayer-backed bonds, as well as the participants in the
7 corporate, "asset-backed" and international securities markets. Therefore, a financial advisor
8 provides critical information and perspective to the Commission to discharge its duties.

9 **Q. What have been the benefits to ratepayers/commissions of active financial advisor**
10 **involvement in the structuring, marketing, and pricing of ratepayer-backed bonds issued in**
11 **other states?**

12 A. The benefits have taken the form of reduced ratepayer risks, improved ongoing regulatory
13 oversight of the SPE, transparency in the pricing process to maintain the integrity of the process and
14 trust of consumers, and enhanced economic benefits for ratepayers. Commission involvement also
15 has created a knowledge base in the Commission of a significant new financing technique for
16 possible future use within the state.

17 **Q. Is there any evidence that active Commission oversight of the process in pursuing the**
18 **lowest cost has saved ratepayers dollars in other transactions?**

19 A. Yes. The five Texas Transition Bond transactions, for example, consistently have out-
20 performed other similar transactions and even secondary market levels from 2001 to the present. A
21 study presented to Saber by Citigroup in 2003 estimated that the three Texas transactions done by
22 the time of the study saved ratepayers \$18 million in net present value interest savings compared to
23 similar transactions. One year later, an economist on the staff of the Wisconsin Commission
24 conducted an analysis of the four Saber-managed Texas transactions and concluded:

1 “Statistical analysis of actual securitization data suggests that for a
2 10-year securitization issue, Saber’s advice would reduce the yield
3 spread on the security by about 15 to 20 basis points. For a \$500
4 million security, this amounts to a savings of \$750,000 to
5 \$1,000,000 per year. The savings estimates are statistically robust
6 in that several different approaches provide similar answers.
7

8 “This analysis confirms the strong recommendation received from
9 the staff of the New Jersey Board of Public Utilities and Texas
10 Public Utility Commission that Saber’s advice adds substantial
11 value for the ratepayer. It also confirms some of the concerns of
12 our staff that the proposed deal [in Wisconsin] in this proceeding
13 reflects a potentially less-than-cost-effective relationship-type
14 arrangement between the utility and its investment bankers, rather
15 than a more competitively arranged deal.” (from “Analysis of the
16 Potential Savings from Saber Partners”. Steven G. Kihm,
17 Economist and Certified Financial Analyst, October 2004)
18

19 Moreover, in helping state commissions oversee this process, Saber has conducted
20 competitions for underwriting positions and has recommended payment for underwriters through a
21 system based on performance. As a result of these two innovations, underwriting and structuring
22 fees borne by ratepayers were substantially reduced from the amounts that utilities had proposed to
23 pay underwriters. For example, in Texas, CenterPoint and its financial advisor proposed a fee of
24 0.55% of the principal amount of the ratepayer-backed bonds, or approximately \$10.2 million. The
25 final fee negotiated by Saber was 0.38% of the principal amount, or \$7 million, which was a net
26 savings of approximately \$3 million in up-front fees. Saber was paid \$925,000 in that transaction.
27 In the 2005 Public Service Electric and Gas transaction in New Jersey, the utility had proposed an
28 underwriter, Citigroup, for a structuring fee of approximately \$500,000 plus 0.50% of the principal
29 amount, with 80% guaranteed to Citigroup regardless of how it performed for ratepayers in the
30 transaction. Saber created a competitive process and selected new underwriters, reduced the
31 structuring fee by \$400,000 and the underwriting fee to 0.48%, with a majority of the fee to be paid
32 based on performance in a competitive process among all underwriters rather than guaranteed to the
33 lead manager regardless of performance.

1 Further confirming evidence is found in ratepayer-backed bond pricings in relation to other
2 market comparables. In the Olson and Dewhurst testimony, FPL compares ratepayer-backed bonds
3 to asset-backed securities. The lowest yielding fixed-rate asset-backed securities are credit card-
4 backed bonds. In a study prepared by CS and presented to Saber, CS showed that when Texas
5 ratepayer-backed bonds and similar bonds from other states were compared to generic fixed-rate
6 credit card bonds on the date of issue for the important approximate 10-year tranche, Texas
7 ratepayer-backed bonds consistently achieved lower costs and by a wide margin. This “relative
8 value” shows the effectiveness of a program over time. This same result was confirmed by
9 Citigroup (FPL’s former advisor) in 2003 and by Barclays (Gulf Power’s advisor) and Lehman
10 Brothers in 2005. (See EXH JSF-5)

11 Finally, the financial press and other independent observers have commented on Texas
12 ratepayer-backed bond transactions and other ratepayer-backed bond transactions that have involved
13 an active Commission in the structuring, marketing and pricing of bonds to protect ratepayer
14 interests. Some of those articles are included in EXH JSF-6. Of course, past performance is not a
15 guarantee of future results. The process must adapt to changing market conditions.

16 **Q. How is the standard of lowest cost and maximum ratepayer protections measured?**

17 A. Determinations of lowest cost and the level of ratepayer protections are evaluated through a
18 collaborative effort of transaction participants based on both quantitative and qualitative factors,
19 respectively, including examination of similarly priced transactions, similarly rated securities,
20 trading patterns, and investor indications of interest, among other factors. Since pricing is the
21 culmination of a process, it is important that each element of the process be examined as it is
22 occurring in real time. And since there is no meaningful opportunity to make a post-transaction
23 review given the nature of the transaction, transparency and accountability during the process are

1 essential. Thus, the Commission should oversee the transaction to ensure that it is completed at the
2 lowest cost to ratepayers and with maximum ratepayer protections.

3 **Q. Have you encountered any resistance from underwriters to your recommended process**
4 **for selecting and compensating bookrunners and members of the underwriting syndicate?**

5 A. Yes, at times. Whenever innovations and changes to the business-as-usual approach toward
6 any process are introduced, some resistance can be anticipated. There were some instances of
7 underwriters who made it clear that our requirement for “performance-based compensation” was
8 unacceptable to them, and they did not participate in a transaction. We were confident, however,
9 that competition would produce better results for ratepayers, and those beliefs were later
10 substantiated when other underwriters did step forward, accepted our terms and successfully worked
11 with us on those deals.

12 **Q. Have other underwriters cooperated in the pursuit of a lowest cost standard in utility**
13 **securitization transactions?**

14 A. Yes. In the recent CenterPoint transaction, there were twelve underwriters, including FPL’s
15 current advisor, CS, and the advisor to Gulf Power, Barclays Capital. Each firm had to submit a
16 response to a detailed questionnaire prepared by Saber about the potential offering.

17 The following is CS’s response to one of our questions:

18 “The firm is willing to bring all of its resources to bear in the
19 transaction and hold its people accountable for achieving the
20 lowest possible cost of funds.... The firm is willing to coordinate
21 all aspects of the transaction with CenterPoint, PUCT and Saber
22 Partners.”
23

24 Barclays Capital gave the following in response to the Saber CenterPoint questionnaire:

25 “Barclays will provide its marketing plan which details how our
26 firm as Bookrunner will develop the value proposition and then
27 market the securities to create the greatest competition for the
28 bonds in all market segments in order to achieve the lowest cost of
29 funds.”

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Q. With respect to this proposed storm-recovery bond transaction, are you concerned that there may be insufficient interest on the part of underwriters if the FPSC adopts the use of “performance-based compensation” that Saber has recommended to other commissions?

A. No, we are not. Given the track record in prior transactions where we were able to obtain robust participation among underwriters, we have demonstrated significant benefits to ratepayers, improved the regulatory process for reviewing these unique transactions in a timely and thorough way, and at the same time provided incentives to underwriters to improve their performance and lower the costs to ratepayers while meeting the financing needs of the sponsoring utility.

Collaboration and Cooperation in the Securitization Process

Q. Can you briefly describe how Saber intends to interact with FPL, its financial advisor, the underwriting syndicate and the FPSC and its staff in this assignment?

A. Saber is committed to meeting its obligation to minimize the net costs of doing this transaction so as to reduce/mitigate ratepayer burdens of recovering storm-recovery costs approved by the FPSC. In meeting that obligation, we hope that we can establish a collaborative and collegial working environment to assure an effective and timely sale of storm-recovery bonds at the lowest possible cost.

Saber proposes that the Commission, through staff and its financial advisor, will have oversight over the principal storm-recovery bond transaction documents including, but not limited to, the Servicing Agreement, the Administration Agreement, the LLC Agreement, the Sale Agreement, and the Indenture among others. It is possible that Saber, staff, and FPL will have differences of professional opinion on strategy and wording of these transaction documents. That is

1 to be expected in a negotiating environment. In case of a stalemate on any issue, Saber proposes that
2 Saber, staff, and FPL will make written presentations of their views to the FPSC.

3 In six prior transactions, Saber relied upon “best practices” summarized in this testimony to
4 help sell \$5 billion of ratepayer-backed bonds (using numerous nationally known underwriting
5 firms in the syndicates) at lower yields and transaction costs than similar contemporaneous
6 transactions. I see no reason why the various participants in this transaction will not be able to work
7 cooperatively to implement these “best practices” as part of a successful transaction.

8 **Q. Is the length of time it takes to complete a transaction a fair measure of success in**
9 **ratepayer-backed bond transactions?**

10 A. No. The length of a transaction depends on many factors, such as the speed of the rating
11 agencies’ evaluations, efficiency of the underwriters in developing the marketing plan, whether new
12 markets or marketing strategies are being developed, and whether the utility and/or underwriters
13 work collaboratively with the commission and its advisors in assisting the commission in its
14 oversight function. In some cases, ratepayer-backed bond transactions have been delayed
15 significantly by appeals of the financing orders. In other cases, the rating agencies and securities
16 registration processes have been the most time consuming aspects of a transaction. However, many
17 items can be done concurrently.

18 Because FPL is not responsible for the costs or charges of the transaction, and the financing
19 order is irrevocable, FPL and the underwriters might want to complete the transaction quickly with
20 less than optimal effect on the pricing. FPL and some of the underwriters also might be tempted to
21 implement a final structure that increases storm-recovery bond charges in return for weaker
22 covenants, representations and warranties than might be strongly urged by Saber and by
23 underwriters appointed in collaboration with the Commission.

1 The best measure of the effectiveness of a transaction is not how fast it is completed but what
2 the ultimate value received for ratepayers is. Was the cost as low as possible under existing market
3 conditions, and was the liability to ratepayers minimized? Of course, in a rapidly rising interest rate
4 environment, the speed of issuance might take a higher priority than in a stable or declining interest
5 rate environment. However, predicting interest rates is a highly speculative endeavor. Even
6 economists have been unable to predict interest rates reliably.

7 **Best Practices: Recommended Procedures**

8 **Q. You have referred to the “best practice” standards for guiding the ratepayer-backed**
9 **bond financing process. Can you briefly describe the approach?**

10 A. Yes. Based on experience gained from past transaction and our professional experience and
11 judgment, Saber has distilled from past transactions a set of concrete steps the Commission can take
12 to ensure that the interests of ratepayers are protected through a cost-effective issuance of storm-
13 recovery bonds. These steps represent a set of best practices. None of these steps represents a
14 radical departure from existing practices; on the contrary, most represent best practices previously
15 put in place by other state commissions. These cost saving steps are summarized as follows.

16 The Commission should:

17 1) Participate in the selection of underwriters, counsel and other transaction
18 participants and should define the responsibilities of each to the extent that each is to be paid from
19 bond proceeds. To assist it, the Commission should utilize experienced experts and financial
20 advisors with a duty of loyalty and care solely to the Commission, absent any conflicts of interests
21 with FPL, underwriters or investors.¹⁰ The Commission will act by and through staff and its advisor

¹⁰ See Wisconsin PSC’s 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 7 (“The Commission shall oversee all negotiations regarding the structuring, marketing, and pricing of the environmental trust bonds and, without limitation, the selection of underwriter(s), counsel, trustee(s) and other parties necessary to the transaction and to review and approve the terms of all transaction documents.”)

1 to serve as a joint-decision maker with FPL in all matters related to the structure, marketing and
 2 pricing of the storm-recovery bonds.

3
 4 2) Carefully review and negotiate all transaction documents and contracts that
 5 could affect future ratepayer costs to ensure accuracy and compliance with all laws, rules and
 6 regulations.

7
 8 3) Ensure that all statutory limits which benefit ratepayers are strictly enforced.

9
 10 4) Establish procedures to ensure that all savings are transferred to ratepayers.¹¹

11
 12 5) Require that the storm-recovery bonds be offered to the broadest market
 13 possible to garner lower interest rates for the benefit of ratepayers through increased competition
 14 among underwriters and investors.¹²

¹¹ See the California PUC's 2004 Financing Order issued to PG&E (Decision 04-11-015 November 19, 2004), pages 40 and 41 ("To the extent PG&E's incremental costs to provide this service are less than the servicing fee revenue from the Bond Trustee, PG&E will return that excess revenue to consumers through the ERBBA."); New Jersey BPU's 2005 Financing Order issued to PSE&G (BPU Docket No. EF03070532), Ordering Paragraph 22 ("However, if the Servicing Fee is greater than the actual incremental costs to service the BGS Transition Property, other rates of the Petitioner shall be adjusted to reflect the difference between actual servicing costs and the Servicing Fee."); Montana PSC's 1998 Financing Order issued to Montana Power (Docket No. D97.11.219; Order No. 6035a), pages 6 and 7 ("The full amount of the market-based servicing fee will be included in the FTA charges. However, as long as Applicant is servicer, Applicant proposes a ratemaking mechanism that will provide a credit to ratepayers equal in value to any amounts it receives as compensation, since these servicing costs will generally be included in the Applicant's overall cost of service."); California PUC's 1997 and 1998 Financing Orders issued to PG&E (Decision 97-09-055 September 3, 1997), SCE (Decision 97-09-056 September 3, 1997), SDG&E (Decision 97-09-057 September 3, 1997) and Sierra Pacific (Decision 98-10-021 June 24, 1998), page 6 ("The full amount of the market-based servicing fee will be included in the FTA charges. However, as long as PG&E is servicer, PG&E proposes a ratemaking mechanism which will provide a credit, after the rate-freeze period, to residential and small commercial ratepayers in PG&E's Rate Reduction Bonds Memorandum Account equal in value to any amounts it receives as compensation, excepting only amounts needed to cover incremental, out-of-pocket costs and expenses incurred by PG&E to service the RRBs. These types of expenses would include required audits related to PG&E's role as servicer, and legal and accounting fees related to the servicing obligation. Thus, the only net ratemaking impact will be such incremental expenses.").

¹² In support of this best practice, it will be useful for the financing order to include a variety of findings, including (a) each SPE is responsible to the Commission in connection with its issuance of storm-recovery bonds; (b) storm-recovery property is not a receivable; (c) the State Pledge and the automatic true-up adjustment mechanism constitute a State of Florida guarantee of regulatory action to ensure payment of principal and interest on the storm-recovery bonds (*see e.g.*, Wisconsin PSC 2004 Financing Order issued to Wisconsin Electric (Docket 6630-ET-100), Ordering Paragraph 1: "The approval of this Financing Order, including the true-up provisions, by the Commission constitutes a guarantee of state regulatory action to ensure repayment of the environmental trust bonds and associated costs."); California PUC 2004

1
2 6) Require transparency and accountability in the distribution, initial pricing and
3 in the secondary market for storm-recovery bonds to support the integrity of the process and ensure
4 competition.

5
6 7) Direct the Commission staff and outside experts such as its financial advisor to
7 participate fully and in advance in all aspects of structuring, marketing and pricing the storm-
8 recovery bonds and instruct them to challenge any decision they believe would not result in the
9 lowest all-in cost of funds to ratepayers.¹³ This should include:

10 a) establishing and clearly communicating goals and objectives with FPL and
11 potential underwriters throughout the process;

12 b) reviewing, analyzing and proposing revisions to all documentation to better
13 protect ratepayers, including specific certifications, representations,
14 indemnities, and warranties that are accurate, appropriate and comply with
15 all laws, rules and regulations.

16 c) evaluating and approving offering methods such as competitive bid,
17 negotiated sale or combinations thereof, to determine the most effective
18 offering method with the least risk;

Financing Order issued to PG&E (Decision 04-11-015 November 19, 2004), Ordering Paragraph 40: “All true-up adjustments to the DRC shall guarantee the billing of DRC charges necessary to generate the collection of amounts sufficient to make timely provision for all scheduled (or legally due) payments . . .”); and (d) if all private consumers of electricity in FPL’s service area cease to consume electricity and/or fail to pay storm-recovery charges, the automatic true-up adjustment mechanism will cause state and local governments in FPL’s service area to be payors of last resort.

¹³ See Ordering Paragraph 26 of the Texas PUC’s 2005 Financing Order issued to CenterPoint PUC Docket No. 30485); Ordering Paragraph 21 of the Texas PUC’s 2002 Financing Order issued to Central Power & Light (Docket 21528); Ordering Paragraph 21 of the Texas PUC’s 2002 Financing Order issued to TXU Electric (Docket No. 21528); Ordering Paragraph 21 of the Texas PUC’s 2002 Financing Order issued to Reliant Energy (Docket No. 21665); Ordering Paragraph 17 of the New Jersey BPU’s 2005 Financing Order issued to PSE&G (BPU Docket No. EF03070532); Ordering Paragraph 7 of the Wisconsin PSC’s 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100).

- 1 d) valuating the performance of underwriters of prior securitized ratepayer-
2 backed bond offerings;¹⁴ including in any offering or bidding syndicate one
3 or more underwriters without a prior relationship with FPL; tying any
4 negotiated underwriter compensation to performance;ⁱ
- 5 e) requiring underwriters, if a negotiated process is selected, to develop a
6 written marketing plan and implement robust marketing efforts
7 emphasizing the need to broaden distribution and to attract non-traditional
8 investors;
- 9 f) establishing a regularly scheduled (weekly) conference call between senior
10 representatives of the issuer, other transaction participants, the
11 Commission, and the financial advisor to update the Commission on
12 relevant information;
- 13 g) requiring FPL and potential underwriters or advisors to carefully monitor
14 market conditions to minimize foreseeable pricing risks, such as year-end
15 pressures, economic announcements, or other outside events, and to
16 document their marketing efforts and pricing recommendations.
- 17
18 8) Requiring accountable certifications from the underwriter, FPL and the
19 Commission's financial advisor as to actions taken to achieve the lowest cost of funds at the time of
20 pricing under then-current market conditions.¹⁵

¹⁴ See Ordering Paragraph 26 of the Texas PUC's 2005 Financing Order issued to CenterPoint PUC Docket No. 30485); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Central Power & Light; Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to TXU Electric (Docket No. 21528); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Reliant Energy (Docket No. 21665); Ordering Paragraph 17 of the New Jersey BPU's 2005 Financing Order issued to PSE&G (BPU Docket No. EF03070532); Ordering Paragraph 7 of the Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric (Docket 6630-ET-100).

¹⁵ See Texas PUC's 2005 Financing Order issued to CenterPoint (PUC Docket No. 30485), Finding of Fact 110: "The Commission's financial advisor or designated representative shall require a certificate from the bookrunning

1 9) Providing that the Commission is to have authority to enforce the provisions of
2 the financing order, the Servicing Agreement, the Sale Agreement, the Indenture and other
3 transaction documents for the benefit of ratepayers.¹⁶

4
5 **Financing Order Recommendations**

6 **Q. Please explain the importance of having these ratepayer protections in the transaction**
7 **documents or in the financing order issued in this case.**

8 A. In a complex legal arrangement such as a securitization, terms, conditions, representations and
9 warranties concerning all contracts need to be evaluated from an arms-length, dispassionate
10 perspective. The personalities of the people involved in the transaction need to be set aside, while
11 the risks, costs and liabilities are independently evaluated and policies are developed.

12 From the Commission’s and ratepayers’ perspective, the storm-recovery bonds are issued
13 under an irrevocable order that cannot be changed by the Commission. The term of the bonds could
14 be as long as 12 years. Yet, the bond and corporate structure submitted by FPL for approval could
15 be changed after the transaction is complete in several critical areas by a simple amendment of
16 various documents. At best, these changes will not materially affect ratepayers; at worst, these
17 changes could be detrimental to ratepayers.

18 In addition, FPL’s obligations as servicer (in essence the collection agent for the SPE which
19 provides funds to the bondholders) are under a specific contract with the SPE known as the

underwriter(s) confirming that the structuring, marketing, and pricing of the transition bonds resulted in the lowest transition bond charges consistent with market conditions and the terms of this financing order.” See also Wisconsin PSC’s 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 37: “Following determination of the final terms of each series of environmental trust bonds and prior to issuance of the environmental trust bonds, the Commission may require any certificates from the Applicant’s underwriters.”

¹⁶ See e.g., Wisconsin PSC’s 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 17 (“The Commission, acting on its own behalf or through the Attorney General, may enforce this Financing Order and related transaction documents, including those contemplated by the Affiliated Interest Final Decision, for the benefit of Wisconsin ratepayers to the extent permitted by law including, the enforcement of any ratepayer indemnification provisions in connection with specified items in the servicing agreement.”)

1 Servicing Agreement. That contract, like any other contract for services, has certain provisions
2 concerning performance, care, liabilities, and indemnities. All of these could affect ratepayers at
3 any time during the life of the storm-recovery bonds. Yet the Servicing Agreement is essentially
4 between affiliated parties with all of the liabilities associated with the agreements falling to
5 ratepayers under the storm-recovery charge and the true-up mechanism.

6 Saber strongly believes regulatory oversight should be preserved concerning the transaction
7 documents for the life of the storm-recovery bonds. With an increasing number of mergers in the
8 electric industry, it is important for the FPSC to look beyond the next few years and put in place
9 ratepayer protections that survive even in the case of a merger and new management. Ever-
10 changing corporate structures require close scrutiny by the FPSC since future owners may have a
11 different attitude about this transaction 5-10 years into the future.

12 **Q. Please explain why you recommend active Commission oversight.**

13 A. Ratepayers need to be represented in the transaction. In the absence of Commission oversight
14 with the use of its own independent experts and advisors reviewing the financing order and the
15 underlying contracts, there is no opportunity past the issuance of the financing order to review
16 potential changes to the contracts that could impose additional costs or risk on the ratepayers.

17 **Q. How can the benefits to ratepayers be maximized and extended?**

18 A. By adopting the “best practices” procedures summarized earlier in my testimony, the
19 Commission will be “at the table” for all negotiations affecting ratepayers in advance of any
20 decisions affecting ratepayers. Because any retrospective review of the pricing would be
21 speculative without the real time access to the information available to the underwriters and
22 investors, the only way to protect ratepayers is to provide for Commission approval of all future
23 decisions affecting ratepayers before they are made final. The Commission should not make
24 decisions based on draft language but on final terms and conditions in real time. For this to be a

1 meaningful review and decision process, it cannot be restricted or restrained in terms of time and
2 consideration.

3 **Q. What specific ratepayer protections should the Commission include in the financing
4 order for the proposed issuance of storm-recovery bonds?**

5 A. At this time, we have not completed our final analysis of FPL's form of financing order.
6 Many decisions still need to be made closer to the time of offering and after feedback from the
7 rating agencies and others. However, there are a number of general deficiencies that we have
8 identified that are part of our overall recommendations for improving the Financing Order.

- 9 • Change the Servicer's standard of care from "Gross Negligence" to
10 "Negligence."
- 11 • Require the Servicer to indemnify ratepayers for any losses resulting from the
12 Servicer's breach.
- 13 • In case of a Servicer default, prohibit termination of the Servicing Agreement
14 without prior FPSC approval.
- 15 • Require that any Servicer "float" benefit Florida ratepayers rather than FPL
16 shareholders.
- 17 • Mandate continuing disclosure to the SEC and the general public to increase
18 liquidity for storm-recovery bonds and lower ratepayer costs.
- 19 • Include an accurate description of credit risk in marketing documents.
- 20 • Describe accurately the government's role in the transaction.
- 21

22 **Q. What aspects of FPL's petition and proposed financing order are consistent with
23 petitions and financing orders approved by other state commissions?**

1 A. The general transaction structure appears to be consistent with most, but not all, other
2 financing orders.

3 **Q. What aspects of FPL's petition and proposed Financing Order are unique compared to**
4 **petitions considered and financing orders approved by other state commissions?**

5 A. The most unusual aspects of FPL's application involve the pre-issuance document review
6 process and the issuance advice letter process as described above. To our knowledge, there is
7 nothing similar to it in any other utility securitization transaction.

8 **Q. Have you reviewed the procedures for Commission participation in the issuance of**
9 **storm-recovery bonds after a Financing Order has been issued, set forth as Findings of Fact**
10 **54 through 59 of the proposed form of Financing Order attached as Exhibit B to FPL's**
11 **Petition for Issuance of a Storm Recovery Bond Financing Order?**

12 A. Yes.

13 **Q. Do you find any of those proposed procedures troubling from the perspective of**
14 **protecting the interests of ratepayers?**

15 A. Yes. The entire program seems designed to limit the ability of the Commission's staff and
16 financial advisor to participate actively and in advance in all aspects of structuring, marketing and
17 pricing storm-recovery bonds. In particular, proposed Findings of Fact 57 and 58 appear to be
18 designed to exclude the Commission's staff and financial advisor from participating in any way
19 after 5:00 p.m. two business days before the storm-recovery bonds are to be offered for sale,
20 including the actual pricing of storm-recovery bonds. In most transactions, this is the time when the
21 most crucial negotiations take place, including the actual pricing of the bonds. Indeed, after the
22 second business day before the storm-recovery bonds are issued, proposed Finding of Fact 59
23 specifically contemplates a marginalized role for the Commission in which it would serve as a mere
24 recipient of finalized documents that become effective "without further Commission action".

1 In addition, this pre-issuance negative check-off review process proposed by FPL is unduly
2 burdensome to the Commission and to ratepayers. First, the timetable that it provides for
3 Commission review appears arbitrary and rigid. Second, it would not be able to adapt to changing
4 market conditions so as to possibly accelerate the storm-recovery bond transaction if conditions
5 warrant.

6 **Q. Has this process ever been used anywhere in the U.S. capital markets or internationally?**

7 A. No, not to our knowledge, nor has FPL submitted any evidence that this process ever has been
8 used elsewhere.

9 **Q. Has a similar, limited review process been proposed in connection with ratepayer-**
10 **backed bonds proposed to be issued for the benefit of utilities in any other state?**

11 A. Yes. A similar process initially was proposed in an Application for Financing Order,
12 Approval of Affiliated Agreements, and Related Relief filed jointly by Monongahela Power
13 Company and The Potomac Edison Company with the West Virginia Public Service Commission
14 on May 24, 2005. We understand these utilities have employed the same legal counsel as FPL. But
15 in testimony given in a public hearing before the West Virginia Public Service Commission on
16 January 18, 2006, a representative for the applicant utilities acknowledged that subsequent
17 discussions with other parties had persuaded the applicant utilities that the originally proposed
18 procedures were not necessary or appropriate, and the applicant utilities proposed that the West
19 Virginia Commission, acting principally through its staff and financial advisor, be actively involved
20 at all times and in all stages of the structuring, marketing and pricing of the proposed ratepayer-
21 backed bonds and that there was no need for the originally proposed limiting procedures. As I
22 mentioned earlier, I expect the West Virginia Public Service Commission will adopt a financing
23 order some time during the week of April 1, 2006, approving the issuance of ratepayer-backed
24 bonds and accepting this revised recommendation.

1 **Q. How have other state commissions ensured that the financing costs associated with**
2 **ratepayer-backed bonds, including the interest rates and all other costs associated with the**
3 **issuance of the bonds, resulted in the lowest cost to the ratepayers?**

4 A. Other state commissions with active financial advisors have instructed those financial advisors
5 as well as commission staff to participate actively and in advance in all aspects of the structuring,
6 marketing and pricing of ratepayer-backed bonds. This has included the earliest drafts of
7 transactions documents and initial contacts with rating agencies as well as investor presentations
8 and the actual negotiations with underwriters at the moment of pricing of the ratepayer-backed
9 bonds. Fundamentally, FPL's application asks for approval of costs based on estimates with no
10 procedure for determining whether the most important costs, the interest costs, are the lowest
11 possible for the benefit of ratepayers.

12 **Comments on the Testimony of Company Financing Witnesses**

13 **Q. Have you reviewed the testimony and exhibits of FPL's financing witnesses in this case?**

14 A. Yes, I have.

15 **Q. What are your reactions to their testimonies?**

16 A. Let me start with Mr. Olson's testimony. First, please note that I have worked with Mr. Olson
17 first as a colleague in the late 1990's at Prudential Securities and then in recent securitization cases
18 in New Jersey and Texas where his firm was one of the lead managers for the transactions. We
19 were able to complete the deal and sell about \$102 million of securitized ratepayer-backed bonds in
20 New Jersey and \$1.8 billion of such bonds in Texas. I am optimistic that we can work
21 collaboratively in Florida to complete this storm-recovery bond transaction economically and save
22 ratepayers meaningful amounts of money through an efficient process using Saber's "best practices"
23 as the guide.

1 Mr. Olson does a very good job describing the asset-backed securities market. One problem is
2 that storm-recovery bonds do not fall precisely in that market. In fact, the characterization of storm-
3 recovery bonds as pure “asset-backed securities” has caused the bonds to be inappropriately judged
4 from a quality and credit perspective. Mr. Olson has repeatedly acknowledged this fact in other
5 jurisdictions where CS has worked with Saber, notably Texas and New Jersey.

6 For a potential \$1 billion offering, Mr. Olson suggested that only three or four underwriters
7 are necessary to sell the securities, and that all should be active in the ratepayer-backed bond
8 market. He is correct that this may be all that is necessary to sell the bonds, but he does not address
9 whether this syndicate size or this offering process protects ratepayer interests and will produce the
10 lowest cost of funds.

11 In general, Mr. Olson has identified the key issues and offered his professional opinion on
12 how to address and resolve them for the benefit of his client, FPL. Saber has been retained to
13 provide its professional opinion on those issues from the point of view of its ultimate client, FPL
14 ratepayers.

15 **Q. Do you have any comments on Mr. Dewhurst’s testimony?**

16 A. Mr. Dewhurst does not address how FPL would structure, market or price the storm-recovery
17 bonds so as to achieve the lowest cost of funds or provide any standard of ratepayer protection. For
18 example, it is unlikely that FPL would allow other bonds for which the full economic burden for
19 repayment would fall on FPL and its shareholders to be structured, marketed and priced by an
20 unrelated third party who was not responsible in any way for the burden of repayment and was fully
21 compensated for its actions regardless of the result. In addition, Mr. Dewhurst does not address the
22 offering process to be employed.

23
24 **Summary of Testimony and Recommendations to Commission**

1 **Q. Can you list your recommendations to the Commission?**

2 A. I recommend that the Commission: (1) conform the proposed Financing Order based on
3 application of “best practices” as outlined in this testimony, and (2) approve oversight by the
4 Commission acting by and through its staff and its financial advisor for participation in real-time on
5 all matters related to the structuring, marketing, and pricing of the storm-recovery bonds.

6 **Q. How do you expect the transaction to proceed?**

7 A. FPL, and its advisors, and the Commission, staff, and its advisors can work collaboratively
8 and congenially to expeditiously complete this important transaction and establish this new
9 financing technique for the benefit of ratepayers and the utility. We look forward to working with
10 the transaction team.

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

12 A. Yes, it does.

1 BY MR. KEATING:

2 Q And, Mr. Fichera, have you prepared a summary of your
3 testimony?

4 A Yes, I have.

5 Q If you could present that summary.

6 A Thank you for the opportunity to address the
7 Commission directly. As a financial advisor, Saber Partners
8 has completed six utility securitizations with four pending,
9 totalling for about \$7 billion. This includes assignments in
10 Texas, Wisconsin, Vermont, New Jersey, West Virginia, as well
11 as Florida. In each case we had a fiduciary duty to the
12 Commission and to ratepayers.

13 As you know, representing the Saber Partners team in
14 this proceeding are a former regulator, Rebecca Klein, a former
15 chief financial officer, Mike Noel, and myself, a former
16 underwriter and current investment banker. As Mr. Noel pointed
17 out, the fundamental characteristic of this financing versus
18 all other financings is that the full economic burden of
19 repayment falls squarely on ratepayers. Not a penny of
20 shareholder funds are spent or even at risk. My testimony
21 focuses on the unique situation this creates for the Commission
22 to consider.

23 Perhaps \$1 billion will be raised, and the natural
24 question for the people who are responsible for paying it back
25 is: At what cost? If you told your brother-in-law that you

1 would agree to pay his mortgage, wouldn't you want to have
2 final say over the interest rate and terms?

3 You are being asked to use your powerful regulatory
4 authority in ways that have not been previously done in Florida
5 and to forego future regulatory review in order to create a
6 bond of unusual strength, a completely separate credit from
7 FPL. The reason for this is that in doing so you expect to get
8 the lowest cost of funds available in the market at the time.
9 If cost doesn't matter and the best deal possible doesn't
10 matter, then we can save much time and expense and fees and
11 just sell these bonds at whatever rate underwriters and
12 investors want. But cost does matter.

13 The capital markets are often thought of as a black
14 box of buyers and sellers rapidly exchanging millions of
15 dollars. They are thought to produce efficient results because
16 each participant pursues its own economic interests, and prices
17 are determined through competition and the free flow of
18 information. But there needs to be a balance of competing
19 interests in any negotiation. In this transaction, the balance
20 is broken.

21 The people responsible for repaying the bonds, the
22 ratepayers, are not at present represented at the negotiating
23 table. They are not protected. Unless the Commission acts to
24 represent those interests, the results are likely to be skewed
25 against ratepayers' interests because that's how the capital

1 markets work.

2 In all top-rated securities, even AAA securities do
3 not price the same. There are differing views. Nothing is
4 automatic except that self-interest rules. As Mr. Olson of
5 Credit Suisse said to you yesterday, he represents his own
6 interests, as FPL does of its own interests. The lack of
7 representation of ratepayer interests can affect the pricing,
8 the transaction documents in every aspect of the deal. Now
9 nothing will occur without the hard work and collaborative
10 efforts of the parties involved. We believe the Commission and
11 the company can work together and they can create the balance
12 necessary to manage competition among underwriters and
13 investors.

14 Eleven states have done these transactions and have
15 been a learning curve ever since. My testimony describes the
16 evolution of the best practices available to the Commission,
17 and these cover three areas: Ratepayer representation and
18 protection, the decision-making standard, and written
19 certifications.

20 The first element is effective representation of the
21 interests of the Commission and ratepayers at every step
22 through the conclusion of the process. Decisions affecting
23 ratepayers should be made in conjunction with someone with a
24 specific and direct fiduciary duty to ratepayers.

25 Now, the next element is the decision-making

1 standard, a critical element. The standard should be the best
2 possible deal for ratepayers at the time of pricing, the lowest
3 possible cost of funds. Anything less allows for less than
4 optimal results. Why is this? Simple common sense. Without a
5 lowest-cost, best-priced standard, why bother? There is little
6 incentive for additional effort.

7 Now I've been an underwriter for almost 20 years.
8 I've served on the other side of the table with issuers and
9 investors. I have been intimately involved in every aspect of
10 the offering process, and in particular six ratepayer-backed
11 transactions. The capital markets are full of opportunities
12 and risks. The facts are that unless you negotiate hard on
13 your behalf with Wall Street with sophisticated investors and
14 large institutions with differing views, you will leave
15 substantial amounts of money on the table. Each side is
16 looking out for their own economic interests.

17 So without a clear standard and a negotiating
18 position that includes the potential for saying no when
19 evaluating offers, underwriters and investors will have
20 negotiating leverage to dictate a final cost to ratepayers.
21 Remember, the best way to lose control of the sale price of
22 your house is to tell prospective buyers that you must sell
23 your house today because you really need the money now.
24 Pricing leverage will quickly shift.

25 The final element is for key transaction

1 participants, FPL underwriters, your financial advisors, to
2 deliver written representations to the Commission certifying
3 what they have done has led to the lowest cost of funds
4 consistent with market conditions at the time of pricing. It's
5 a basic business principle. Put it in writing.

6 Any prudent person would want it in writing. For
7 example, investors want documentation before they give up their
8 money. They don't rely on oral representations solely before
9 investing. With Sarbanes-Oxley and a heightened need to
10 maintain public confidence in business, certifications have
11 become a normal part of business best practices. The
12 certification process, by the way, has been employed
13 successfully in Texas and New Jersey and is required by the
14 states of Wisconsin and West Virginia Public Service
15 Commissions. Several major underwriters have delivered these
16 certificates on Saber transactions, along with all Florida
17 utilities.

18 The Florida ratepayers deserve no less. We are
19 completely committed to working with the Commission and staff
20 and FPL to make this a successful and timely offering. Our
21 goal is to work cooperatively in a collaborative process with
22 all parties, but never to sacrifice ratepayer interests for
23 mere sake of expediency.

24 We believe the Commission should be the final
25 decision-maker and we will provide all the information and

1 analysis that you need to reach a fair and equitable resolution
2 of these complex issues. That concludes my summary.

3 MR. KEATING: And again per the agreement of the
4 parties, cross-examination of this witness has been waived and
5 he is available for any questions from the Commissioners.

6 CHAIRMAN EDGAR: Thank you. Commissioner Arriaga,
7 you are recognized for a series of questions.

8 COMMISSIONER ARRIAGA: Thank you so much.

9 Hello, Mr. Fichera.

10 THE WITNESS: Hello, sir.

11 COMMISSIONER ARRIAGA: I think it's good afternoon
12 now.

13 THE WITNESS: Right.

14 COMMISSIONER ARRIAGA: You heard some of my
15 interaction with Mr. Noel a few minutes ago; correct?

16 THE WITNESS: Yes, I did.

17 COMMISSIONER ARRIAGA: Is it necessary for me to
18 repeat or could you help me out and try to give me some
19 answers?

20 THE WITNESS: With regards to the roles of the
21 different financial advisors, we represent different interests
22 in the transaction but not overlapping interests. There will
23 be multiple counsels on the transaction, some representing the
24 underwriter, some representing the company, some representing
25 the trustee, other parts, so their financial advisor to the

1 Commission would be representing the ratepayers' interests and
2 the Commission's interest and would be doing more of a due
3 diligence function.

4 The role of the financial advisor to the utility will
5 have different aspects. They'll probably be doing the
6 financial model. Actually most of their work should be done by
7 the time we get into the transaction price, the transaction
8 mode, and we could actually bring in -- and in terms of having
9 underwriters do more of that as part of their compensation so
10 as to eliminate any duplicate efforts on that part. So from a,
11 from the roles here, this is what you want is actually people
12 representing the interests. If we -- if you're not there,
13 nobody is really going to be raising the issues about the
14 ratepayer interest. And as you point out, their interests are
15 their interests. They will necessarily -- they may have good
16 intentions about ratepayers, and I think they do, but there
17 also will be times where they'll be counter, shareholder
18 interests will be against ratepayer interests in certain
19 matters and you have to negotiate.

20 COMMISSIONER ARRIAGA: That was one of the issues and
21 I appreciate the answer. The next one was the issue of
22 liability, Commission liability, because we have, we may decide
23 or in the event we decided to retain a financial advisor, some
24 language may be introduced in the offering that would
25 explicitly state that the company does not have any, or has to

1 share the liability with us in front of the SEC.

2 THE WITNESS: I've heard that and I don't understand
3 it in terms of what the liabilities could be and such. In
4 general, securities law liabilities, and we're talking about,
5 and I think there's been a series of interrogatories that went
6 back perhaps on that, is basically we all have the same
7 interest to make sure that their, the documentation and the
8 transaction, there are no materially false or misleading
9 statements. We all have that, that same interest in mind. And
10 ratepayers and shareholders should have, are aligned on the
11 interest of that.

12 With regards to specific liabilities being assigned
13 to the Commission simply because you have a financial advisor,
14 as I said, we participated in six transactions. That has never
15 been brought up, it's never been discussed. If there's
16 something new, I don't know about it. I think it would be
17 something we'd want to consult with counsel about, but I don't
18 see how you would be getting any additional liability.

19 And even if you did get any additional liability, it
20 wouldn't hurt the bonds in any, in any manner or shape or form
21 to say that there's another entity that has some, some sort of
22 securities law liability.

23 But, again, as Mr. Noel pointed out, we're trying to
24 fathom where would you, where would there ever be a risk. The
25 only risk would be if something went wrong with the bonds.

1 Already the testimony of their witnesses said that they cannot
2 imagine a situation, and we can't imagine a situation, of how
3 principal and interest would be missed. So, again, I, I think
4 this is what we call a red herring. We don't really know, but
5 it's something that we would want to consult with counsel and
6 would confer with you directly.

7 I think staff has retained independent counsel who
8 can probably brief you in more detail about, about this.

9 COMMISSIONER ARRIAGA: Let's change the topic a
10 minute. Pricing. The pricing of the bond, the -- and I
11 understand this is a very important moment because that's, at
12 that time that the offering is made and the pricing is made
13 it's really important that, to lower those interest rates as
14 much as possible.

15 What would your participation be in that moment or
16 through that process?

17 THE WITNESS: Well, we would be part of the
18 Commission's eyes and ears throughout the process in order, in
19 evaluating the information that would be given by the company
20 and by the underwriters and by the, in the marketplace. We
21 would be doing what we would call due diligence on that, making
22 sure that it is correct, asking questions for further
23 information about it to verify different pieces of it.

24 For example, underwriters will say, well, we did a
25 broad marketing. And we might ask, well, how many people did

1 you contact? And they might say, well, who's asking? Well, we
2 say, well, the Commission representing the ratepayers is
3 asking. And why is this important? Because if you have a
4 narrow offering to only, let's say, favored investors, 30 or 40
5 investors, you may get a different price than if you have a
6 broad offering to maybe four or 500, 600 investors.

7 So we'll, we'll test, we'll kick the tires to make
8 sure that the offering document -- we'll make sure that what is
9 being said, we'll meet with their sales force, we'll oversee
10 the process of actually the orders as they come in. We'll talk
11 to other market participants who aren't in the transaction who
12 might have some information to tell us about this in terms of
13 making sure that the information that we are getting is true
14 and accurate.

15 Now I was on the other side of the table, so I've got
16 to let you know that as -- we appreciate the candor of
17 Mr. Olson. As he says, he's representing his own interests
18 when he's the underwriter. And this is, you know, the world is
19 an arms-length world, so if you don't ask the right questions,
20 don't expect to get the right answers. He's under no duty to
21 tell me everything if I don't ask him the questions, if there's
22 somebody there that isn't asking those questions. Now FPL will
23 probably ask a lot of questions. We may -- they may be the
24 same questions; they might not be the same questions.

25 So we need -- we'll be in that process checking,

1 we'll be looking at, we'll be doing economic analysis,
2 financial analysis, comparing these proposed transactions to
3 other benchmark securities. We'll be looking at what happened
4 in the previous transactions that we participated and others.
5 And all of that will come together hopefully and there will be
6 an agreement.

7 And I think the key item, as I said in my summary,
8 you have to retain the ability to say no when they make an
9 offer. Because if the marketplace or an investor thinks you
10 are going to, you're going to take whatever offer they make no
11 matter what, well, we turn over the checkbook. Why would they
12 ever need to negotiate if you're never going to be, possibly
13 walk from the transaction? So it is a credit -- you need to be
14 credible in terms of saying that you want the best possible
15 deal. You're not going to take any rate.

16 And, therefore, all of this has to come together in a
17 dynamic realtime process and a decision needs to be made. Now
18 we've done it six times in different states, and it has been
19 very successful, as the Wisconsin Public Service Commission in
20 their analyses said it did in terms of the four transactions
21 that they analyzed. Citigroup did an independent analysis
22 that's part of a -- well, I think we gave that in discovery.
23 Other people have done so.

24 It is that sort of dynamic of competition, making
25 sure that the competition -- and we would be the eyes and ears

1 of the Commission facilitating the process and making sure that
2 there's, the integrity aspect of the process is there,
3 transparency, and then keeping the competitiveness up there and
4 telling, making a recommendation to you, signing our name on a
5 piece of paper that puts our reputation and our liability up
6 there that what we believe was the best interests of the
7 ratepayer. And if we don't think that, we won't sign it.

8 COMMISSIONER ARRIAGA: One last question, Madam
9 Chair.

10 During the proceedings here, just recently we were
11 talking about the size of the offering, whether it, it could be
12 increased by the amount of the storm reserve that the
13 Commission may or may not approve. So let's say we
14 hypothetically approve what the citizens are offering, 150 some
15 million dollars, and we get a series of yearly hurricanes as
16 has been predicted. What -- and I understand that these bond
17 offerings are costly. What is more reasonable, to do one bond
18 offering -- I'm not talking about cost wise -- for a lump sum
19 or to do several yearly or several every two years, whenever
20 the hurricanes come, for smaller amounts?

21 THE WITNESS: That's a good question. We did
22 originally propose in December for all the utilities to
23 consider what we call the potential shelf offering, meaning to
24 just raise what, the amount that you need right now and then
25 access the market in the future when you then need more money

1 rather than doing an entire lump sum payment.

2 Part of it is when you do a huge, a larger amount,
3 you have what we call negative arbitrage. You're borrowing the
4 money at 5 percent and you're going to be holding it and
5 investing it at only 2 percent, so it's costing you an
6 additional amount. That's not as big a problem right now
7 because interest rates at the short end and the long end are
8 pretty flat. If we were back in a normal yield curve, it would
9 be pretty clear to say that we would be losing some money by
10 raising more than we absolutely had to.

11 So I would argue that -- the other part of the
12 evaluation would be this. I think the company would say, look,
13 when something happens, we need the money fast. And it's
14 better to have it in my checking account than to have to go to
15 the capital markets. And that's true too. And that's why we'd
16 want, you would want to try to do some things to streamline the
17 process to offering so you wouldn't be going through another
18 120 days, doing this all over again, and incurring the fees.

19 I think that it could be structured. We've talked
20 with staff about being able to do a more serious one, one in
21 which we established a standardized financing order, where we
22 had simply preapproved amounts and could draw it down. But
23 it's a little late to think about that now because the company
24 basically rejected discussing that with us in December when we
25 wanted to discuss it, what was called a programmatic approach

1 and a shelf offering, and they decided to go ahead with an
2 individual offering. Well, that's their choice, that's what
3 they've done.

4 So at this point we don't have the, the efficiencies
5 that we would probably want, so it would probably make sense to
6 raise a certain, the amount right now of, that you are
7 determining is prudent for that.

8 That's a long-winded question. I didn't want to say
9 on one hand this and on the other hand that, but in some ways
10 there is that. If we had done this ahead of time, we might
11 have been able to give you more flexibility. We weren't able
12 to. We're doing it on an individual financing order basis. I
13 think we did talk about possibly doing a rulemaking on some
14 other things that might be able to be addressed for the future.

15 And I think -- I would encourage us to do that after
16 this proceeding and after the Gulf proceeding so that --
17 because this, this potential problem is going on, you know, for
18 the foreseeable future. So why not streamline it and keep, and
19 get it to be a nimble, low cost transaction wise as well as a
20 low bond cost when you come to the marketplace?

21 And we'd be glad to help you as your financial
22 advisor.

23 CHAIRMAN EDGAR: Commissioner Carter.

24 COMMISSIONER CARTER: Thank you, Madam Chair, if I
25 may be recognized for two questions, please.

1 Thank you, Mr. Fichera. You said that, and I believe
2 I heard you say that you've been involved in about six of these
3 transactions in states and you've got about four more pending.
4 Did I get that right?

5 THE WITNESS: Yes.

6 COMMISSIONER CARTER: I think I also heard you say
7 that this is not like the other transactions that you've done
8 in other states. What were you trying to say in terms of -- I
9 think from what I heard you say, it implied the lack of
10 protection for ratepayers or something. Did I get you right?

11 THE WITNESS: The matter before you is the extent to
12 which ratepayers will be protected in the transaction in the
13 structuring, marketing and pricing. As proposed by the
14 company, we believe that these are, the proposal by the company
15 of the procedure for staff after a financing order, staff
16 review and staff involvement or actually lack of involvement in
17 pricing is unlike anything we've seen anywhere else. It's
18 never been, that procedure has never been used by any of the
19 other states that have done these transactions, it has not been
20 used by the states that we've been involved in, and we know of
21 no precedent for the procedure.

22 The procedure was, and one of their interrogatories
23 said, modeled after a proposal in West Virginia. But the
24 Commission just issued a financing order in West Virginia
25 rejecting the same procedure that FPL similarly proposed and

1 provided for a best practices involvement of the Commission all
2 the way through pricing.

3 So the difference is this issue right before you.
4 What role would the Commission have in the structure,
5 marketing, and pricing, and how would it be -- would it be in
6 realtime or not? And the comparison to the other transactions,
7 it was in realtime. What is on the table right now proposed by
8 the company is not. And that's the distinction. And the
9 proposal from your financial advisor and from us is to model
10 those best practices of those other jurisdictions to be in
11 realtime involvement.

12 COMMISSIONER CARTER: Thank you, Madam Chairman.

13 THE WITNESS: Is that -- did I answer your question?

14 COMMISSIONER CARTER: Thank you.

15 CHAIRMAN EDGAR: Commissioner Deason.

16 COMMISSIONER DEASON: Yes. Thank you. I think we
17 agree that ratepayers need protection. And it's your position
18 it needs to be done on a realtime basis, and it's -- I'll throw
19 it out here and then give you an opportunity. And there needs
20 to be the ability for there to be a negative answer, for
21 someone to say no, that this is not acceptable, and that we
22 need that ability on a realtime basis; is that correct?

23 THE WITNESS: Unfortunately the way the law and the
24 structure of the bond issue, it doesn't give you a chance to
25 change anything after the fact. And, therefore, once it's

1 done, it's done.

2 Now one of the issues in the case, and it has been
3 discussed, and I don't know whether it's a formal issue, was
4 whether the word "issuance costs," which you do get to look at
5 on a retrospective basis, includes the interest rate. And I
6 believe that the company's position is that the issuance cost
7 does not include the interest rate, it just includes some of
8 the transaction participants. Well, the transaction
9 participants are real money. But compared to the interest
10 rate, it's not the most important thing. So what would happen
11 is that the proposal on the table keeps the Commission --
12 you're sort of at the table until 24 to 48 hours before the
13 pricing and then they ask you to leave the room and, look,
14 we'll take it from here. And once it's taken from there, it's
15 fixed.

16 Now in, I did see in Mr. Dewhurst's testimony that he
17 thought that, well, the Commission still could have penalties
18 to the, if something egregious happened on an after-the-fact
19 basis. And he cross-referenced a section of the law that, when
20 we looked it up, my attorneys advised me that it, that the
21 maximum penalty under that section of the law referenced in his
22 testimony was \$5,000 per occurrence. So we didn't think it was
23 an effective deterrent.

24 What other jurisdictions have looked at is to say,
25 why, why are we going to get into this? You know, let's just

1 do this on a collaborative, cooperative basis. We ought to be
2 able to agree together. You, the company will get the same
3 amount of money whether we're there or not. But our ratepayer
4 who is going to get the bill can be protected by our
5 involvement and our due diligence and our working together on a
6 cooperative manner.

7 COMMISSIONER DEASON: I think you just indicated in
8 your response that while issuance costs can be significant,
9 they pale in comparison to the costs that are derived from the
10 actual interest rate on the issuance; correct?

11 THE WITNESS: That is correct.

12 COMMISSIONER DEASON: Okay. And that's determined
13 during this, this last, the very last phase, the last 48 hours,
14 I believe, as you characterized it; is that correct?

15 THE WITNESS: Well, it's the last minute. I mean,
16 it's when you come down to the pricing -- I'm sorry, did I cut
17 you off?

18 COMMISSIONER DEASON: No. No.

19 THE WITNESS: When you get down to the pricing,
20 Mr. Olson did make a mistake in saying yesterday that he would
21 get a predetermined amount of a fee. He would like it to be
22 predetermined, but we think it's subject to negotiation up to
23 the moment that the deal is cut in terms of what we do. We can
24 have an estimate and such. And because we have to look at all
25 the interests going here in terms of such, it could be under

1 some scenarios that you might be willing to pay a higher fee if
2 you could get a lower rate because you have to look at it on an
3 all-in-cost basis. That is, you -- the interest rate, the
4 underwriting fee all gets done at that point in time when you
5 come to, when you come to a deal. And it's not 48 hours in
6 advance. You might make a guesstimate or an estimate at that
7 point in time. But the market can change rapidly in 24, 48
8 hours. And not only that, you need to make sure that you've
9 pushed all the way, you know, in terms of what they call
10 pricing tension.

11 Remember, underwriters also deal with those investors
12 day in and day out. They would love to, to, they would love to
13 have a high quality security at a very high rate. Why not? I
14 would too. It's okay for that. It's not okay for me to sell
15 it to them that way. I want to get the greatest value for
16 this.

17 COMMISSIONER DEASON: To effectively negotiate the
18 most favorable arrangement cost-wise and other for the
19 ratepayers there needs to be the ability to say no. Who
20 ultimately should have that ability to say no?

21 THE WITNESS: The Commission. In every jurisdiction
22 that we had, we've worked, the Commission had the ultimate
23 authority to accept or reject the recommendation so that -- of
24 its own financial advisor as well as the company.

25 COMMISSIONER DEASON: Let me -- in answer to a

1 previous question you've indicated that it's -- to achieve that
2 goal of the most favorable cost arrangement for the ratepayer,
3 that that may boil down to the very last second. How is the
4 Commission going to do that if it is a, a decision that has to
5 be made, say, during the last five minutes of this process?

6 THE WITNESS: Okay. The way the pricing process does
7 this is that you can set the conditions. What we did in Texas
8 and what we did in New Jersey was that that pricing would be a
9 tentative, would actually be a tentative pricing. It would not
10 be -- it's not done until the Commission gives its final
11 approval or not approval. Where we had, and I think Ms. Klein
12 will tell you about the Texas process, was that we had a
13 procedure in which what we call an issuance advice letter would
14 be filed within one business day of that tentative pricing.

15 The Commission had two ways of making sure of that.
16 One is the procedures leading up until that time, and then the
17 review of that actual information, including certifications
18 from the company, the underwriters, and ourselves as to what
19 happened. We would then notice a meeting, we would notice the
20 meeting prior to the time of pricing to be available for you to
21 look at that and then either decide to stop the transaction or
22 to allow it to proceed.

23 And, therefore, you have -- we usually gave three
24 business -- one business day for that, another business day for
25 your advisor to review all of that, and then the third business

1 day would be the Commission's action.

2 So you basically have 72 hours to make sure in terms
3 of reviewing that everything at that point in time was
4 appropriate. And so we build in a time frame for you to be
5 able to look at that.

6 But we also have created a process prior to that time
7 where we are involved in realtime in terms of gathering, doing
8 the due diligence and being involved in the decision-making
9 process so that hopefully when everything comes together, the
10 rest of this is just perfunctory. You still -- nothing is,
11 nothing is wrong. We haven't been misled by anybody. We
12 haven't been, nothing has been held under the table or any of
13 those kinds of things.

14 This doesn't mean you have a second look. It's not
15 allowing you to reject a transaction because after the time of
16 pricing the next morning there was an event that interest rates
17 dropped. It all goes back to at that time of pricing, 202
18 (phonetic).

19 So we build in three business days, we build in a
20 procedure of written certifications for you to review, we build
21 in a collaborative process prior to that time so that there are
22 no surprises. See, that's one of the deficiencies that we see
23 in the proposal right now is that they thought about giving you
24 something on 30 days and then giving you something in 48 hours.
25 But you're not involved anywhere in-between, so you don't know

1 what were the issues that went into this. So you want to be
2 involved at the table, not outside the room where they hand you
3 a set of documents.

4 COMMISSIONER DEASON: So there should be Commission
5 involvement throughout this process, the collaborative process
6 all the way up until the final decision is made; is that right?

7 THE WITNESS: That's right. And acting through your
8 staff and your financial advisor being the extension of
9 yourself gathering the information, doing the review, being in
10 the meetings, providing -- Ms. Klein will be able to tell you
11 about the interactive process that was in Texas.

12 COMMISSIONER DEASON: Have any of the other states
13 actually had a Commissioner involved in the process as the
14 Commission's designee?

15 THE WITNESS: Once they did, New Jersey, on a formal
16 basis. In the last Texas transaction, one of the Commissioners
17 acted on an informal basis in that case, in that basis. And in
18 other jurisdictions there's been no, no direct designation of
19 one Commissioner versus the others. They wanted to do it as a
20 team approach and just had staff talking to them; when it might
21 be necessary, there would be a meeting.

22 COMMISSIONER DEASON: But that is possible -- that
23 did work in the New Jersey situation; is that correct?

24 THE WITNESS: Did it work?

25 COMMISSIONER DEASON: Did it work?

1 THE WITNESS: Oh, yes, it did. It's one -- to have a
2 designee. Now the designee didn't, wasn't that active until
3 the last day of it, but that's his choice. It was his -- I
4 mean, it can be anybody's in terms of choice, in terms of doing
5 that. You're the client.

6 COMMISSIONER DEASON: Thank you.

7 CHAIRMAN EDGAR: Mr. Keating.

8 MR. KEATING: I believe we need to identify
9 Mr. Fichera's deposition transcript.

10 CHAIRMAN EDGAR: Yes. That will be Exhibit Number
11 160. 160.

12 (Exhibit 160 marked for identification.)

13 CHAIRMAN EDGAR: Deposition of Joseph Fichera,
14 Wednesday, April 5th, 2006, will be entered into the record as
15 evidence.

16 (Exhibit 160 admitted into the record.)

17 MR. KEATING: And I believe if there's nothing else,
18 that Mr. Fichera could be excused.

19 CHAIRMAN EDGAR: Thank you. Mr. Fichera, you are
20 excused.

21 I'm thinking one more. What do you think,
22 Mr. Keating? One more. Okay. Commissioners, why don't we go
23 ahead and bring the next witness, Ms. Klein, to the stand, hear
24 from her, have the opportunity for questions, and then take a
25 lunch break after that.

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MR. KEATING: Thank you.

(Transcript continues in sequence with Volume 10.)

1 STATE OF FLORIDA)

2 : CERTIFICATE OF REPORTERS

3 COUNTY OF LEON)

4 WE, JANE FAUROT, RPR, and LINDA BOLES, RPR, CRR,
5 Official Commission Reporters, do hereby certify that the
6 foregoing proceeding was heard at the time and place herein
7 stated.

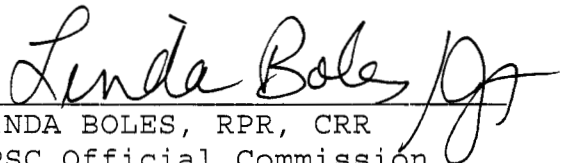
8 IT IS FURTHER CERTIFIED that we stenographically
9 reported the said proceedings; that the same has been
10 transcribed under our direct supervision; and that this
11 transcript constitutes a true transcription of our notes of
12 said proceedings.

13 WE FURTHER CERTIFY that we are not a relative,
14 employee, attorney or counsel of any of the parties, nor are we
15 a relative or employee of any of the parties' attorneys or
16 counsel connected with the action, nor are we financially
17 interested in the action.

18 DATED THIS 22nd day of April, 2006.

19 

20 JANE FAUROT, RPR
21 FPSC Official Commission
22 Reporter
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25 LINDA BOLES, RPR, CRR
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