BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 060038-EI

In the Matter of:

PETITION FOR ISSUANCE OF A STORM RECOVERY FINANCING ORDER, BY FLORIDA POWER & LIGHT COMPANY.
_______________________________________/

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VOLUME 11

Pages 1379 through 1564

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LISA POLAK EDGAR
COMMISSIONER J. TERRY DEASON
COMMISSIONER ISILIO ARRIAGA
COMMISSIONER MATTHEW M. CARTER, II
COMMISSIONER KATRINA J. TEW

DATE: Friday, April 21, 2006

TIME: Commenced at 9:15 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, RPR, CCR
JANE FAUROT, RPR
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(850)413-6734/(850)413-6732

APPEARANCES: (As heretofore noted.)

DOCUMENT NUMBER-DATE
03582 APR 24 8

FPSC-COMMISSION CLERK

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
163	FPSC Infrastructure Hardening Workshop - FPL Handout	1419	1505
164	Approximate Percentage of T&D Facilities Replaced in 2005	1422	1505
165	Plant Account Summary Tables FPL 2006	1424	1505
166	NOAA 2005 Atlantic Hurricane Outlook	1448	1449
167	Deposition Transcript of Wayne Olson	1515	1515

P R O C E E D I N G S

(Transcript follows in sequence from Volume 10.)

MR. BUTLER: Ms. Williams has previously been sworn.

GEISHA J. WILLIAMS

was called as a rebuttal witness on behalf of Florida Power and Light Company, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BUTLER:

Q Would you please state your name for the record?

A Geisha Williams.

Q You have previously testified in this proceeding, correct?

A Yes, I have.

Q Do you have before you 26 pages of prepared rebuttal testimony dated April 10, 2006, with attached Documents GJW-7 through GJW-10?

A Yes, I do.

Q Was your rebuttal testimony and attached documents prepared under your direction, supervision, or control?

A Yes, they were.

Q Do you have any changes or corrections to your prepared testimony or attached documents?

A No, I do not.

MR. BUTLER: I ask that Ms. Williams prepared rebuttal testimony be inserted into the record as though read.

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

MR. BUTLER: And I note that Documents GJW-7 through GJW-10 have previously been identified as Exhibits 104 to 107 and moved into evidence. With that, I would ask Ms. Williams to summarize her testimony.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF GEISHA J. WILLIAMS

DOCKET NO. 060038-EI

APRIL 10, 2006

Q. Please state your name and business address.

A. My name is Geisha J. Williams. My business address is 9250 W. Flagler St., Miami, Florida 33174.

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

A. Yes.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring an exhibit consisting of four documents, GJW-7 through GJW-10, which is attached to my rebuttal testimony.

Q. What is the purpose of your rebuttal testimony?

A. I will respond to the portions of the testimony submitted on behalf of the Office of Public Counsel (OPC) by James S. Byerley that relate to his opinions on FPL's pole inspection and vegetation management programs as well as his associated proposed disallowances of pole and conductor storm restoration costs. Additionally, I will respond to the portions of the testimonies of Hugh Larkin, Jr. and Donna DeRonne, also of OPC, regarding certain proposed adjustments to FPL's storm restoration costs.

FPL's POLE INSPECTION AND VEGETATION MANAGEMENT PROGRAMS (BYERLEY)

Q. **Mr. Byerley criticizes FPL's distribution pole inspection and vegetation management programs and calculates pole and conductor restoration costs incurred as a result of Hurricane Wilma that he contends should be disallowed because they allegedly relate to pole deterioration or to "preventable" vegetation damage to poles. Do you agree with Mr. Byerley's contentions?**

A. No. First, Mr. Byerley's criticism of the pole inspection and vegetation programs is unsupported by any credible evidence and is completely at odds with FPL's strong reliability in both hurricane and non-hurricane conditions. Specifically with respect to Hurricane Wilma, FPL's poles performed excellently, consistent with what one would expect in a hurricane of Wilma's intensity, and better than other utilities' poles under similar conditions. Moreover, vegetation management is essentially a non-issue with respect to pole damage in Hurricane Wilma, as KEMA concluded that only an insignificant percentage of poles broke due to preventable tree damage during that storm.

Second, Mr. Byerley's quantification of costs that he would disallow is preposterously inflated, even if one were to accept his flawed rationale for disallowance. Using the logic of his calculations but with realistic inputs, his proposed disallowance for pole deterioration would be reduced by over 90%, and his proposed disallowance for vegetation-related pole damage would be reduced even more, to less than 0.1% of his figure. And even these reduced figures do not reflect the netting of added costs that would be concomitant with Mr. Byerley's proposals.

POLE INSPECTIONS

Q. Does FPL have an effective pole inspection program?

A. Yes. FPL's pole inspection program, consisting of three initiatives, has produced excellent pole performance for many years under both non-hurricane and hurricane conditions. Document No. GJW-7 shows historical non-hurricane outages related to pole conditions from 1993-2005. As can be seen, these outages were negligible, averaging 125 outages per year, or just 0.14% of FPL's total outages per year. For each of the last two years, when FPL's service territory was impacted by an unprecedented seven hurricanes, the percentage of poles that had to be replaced due to these storms was less than 1% per year. This clearly demonstrates that FPL's poles, throughout its entire system, have performed consistently well. Any reliability program ultimately should be measured by the results that it achieves, and I would conclude from these results that FPL's pole inspection program has successfully ensured that FPL's pole infrastructure is sound, well-maintained and resilient.

Q. How does FPL's pole performance in hurricane conditions compare to the pole performance of other utilities facing similar hurricanes?

A. Very well. In February 2006, Davies Consulting, Inc. (Davies) prepared an independent analysis for FPL that addressed the impact of hurricanes of varying strength on pole replacements for FPL and ten other utilities. For FPL, the Davies study used pole failure rates (i.e., percentage of poles replaced) from Hurricanes Andrew (1992), Charley, Frances and Jeanne (2004), and Katrina and Wilma (2005). It compared that data to pole failure rates for the other utilities resulting from Hurricanes Hugo (1989), Floyd (1999), Isabel (2003), Ivan (2004), and Katrina and Wilma (2005). The Davies results are depicted on Document No. GJW-8. They show that (i) there is a strong correlation between the percentage of poles requiring replacement and the strength of the storms, and (ii) FPL's pole replacement rates have been consistently lower than those of other utilities for storms of comparable strength. FPL's strong pole performance relative to other utilities is a testament to the effectiveness of its pole inspection program as well as FPL's more stringent construction standards .

Q. What are the three initiatives that comprise FPL's pole inspection program?

A. First, FPL has a targeted initiative of intensive pole inspections that are performed by a contractor (Osmose) in certain geographic areas with high populations of older, creosote poles. Second, FPL routinely conducts visual inspections of its feeder poles in conjunction with its Thermovision initiative (which detects "hot spots" on electrical equipment). Finally, FPL's line crews perform careful hazard assessments of poles on which they are preparing to do work. Together, these three pole inspection initiatives help ensure the exemplary pole performance I just described.

Q. Mr. Byerley criticizes FPL for not having extended the Osmose initiative to the entire FPL pole population on a regular inspection cycle. In your opinion, would this have been appropriate for FPL to implement?

A. No. FPL wants to provide reliable electric service at the lowest possible cost for its customers. Each year, we review and evaluate numerous initiatives before selecting the ones that deliver the best value to our customers, optimizing the balance between reliability and cost. We do not fund all of the initiatives, nor should we, as the benefits of some initiatives are low relative to their costs. FPL has been extremely successful in applying this balance, as our base rates are considerably lower than they were seven years ago, reliability has improved, and our reliability results compare favorably to other utilities within the state as well as nationally.

FPL's selective implementation of the Osmose initiative is a good example of this approach. The Osmose initiative provides very thorough pole inspections, at a higher cost per pole. It made sense to incur a higher inspection cost per pole in areas where there was a population of older, creosote poles that particularly warranted close inspection. For newer poles, however, the likelihood of deterioration is low and hence it was hard to justify the higher cost per pole for an Osmose-type inspection. Accordingly, FPL limited its Osmose initiative to areas with a high percentage of older, creosote poles where the higher inspection cost would do the most good.

Q. **Mr. Byerley criticizes the visual pole inspections that are performed as part of the Thermovision intiative as ineffective in identifying pole deterioration. Is this criticism warranted?**

A. No. They are conducted by individuals who have a great deal of experience in evaluating the condition of poles. The thermographers and inspectors in the Thermovision initiative program have extensive training and utility experience. Almost all of them have been in the Thermovision initiative since its inception in 1998, and their FPL experience averages 24 years, with a range of 19-31 years.

Q. **On page 20 of his testimony, Mr. Byerley suggests that the pole inspections performed as part of FPL's Thermovision initiative must not have been effective, because they did not identify as high a percentage of deteriorated poles as the Osmose initiative? Is this a valid comparison?**

A. No. It is apples to oranges. FPL's Thermovision initiative program targets feeders, whereas the Osmose initiative does not. Because a feeder outage can impact a greater number of customers than a lateral outage, FPL's feeders are inspected more frequently than laterals. Therefore, the likelihood of finding a previously unidentified deteriorated pole on a feeder is inevitably lower than on a lateral. Additionally, approximately 80% of the poles utilized in our feeders are either concrete or copper chromium arsenate (CCA), which historically have shown virtually no signs of deterioration. The percentage of either CCA or concrete poles used in laterals is much lower. Finally, as I previously mentioned, the Osmose initiative is intentionally targeted at pole populations that are known to be older. It is hardly surprising that the percentage of such poles showing deterioration would be higher than would be the case for an inspection of the general pole population. As a result of all these factors, one would naturally expect the percentage of deteriorated poles identified in the Osmose initiative to be considerably higher than those identified through the Thermovision initiative.

Q. Do you agree with Mr. Byerley's conclusion, on page 22 of his direct testimony, that the inspections conducted by FPL's linemen through hazard assessments before they perform work on poles cannot "truly be classified as pole inspections"?

A. No. In fact, it is mystifying to me how someone with Mr. Byerley's prior experience in the electric utility industry could make such a statement.

FPL's work practices require checks to be performed prior to climbing or working on a pole. This would include work performed in a bucket truck, if that work might result in additional stress on the pole. The hazard assessment includes visual checks for issues like buckling at the ground line, unusual angle in respect to the ground, cracks, holes, hollow spots, shell rot, decay, knots, soil conditions, and burn marks. A hammer test from the ground level all the way around the pole up to six feet from ground is performed to check for decay pockets. Additionally, a screwdriver is used to prod the pole as near the ground level as possible to identify decay. Finally, in order to check the pole's stability, the pole is rocked back and forth by a pike pole or pulled with a rope. If any issues are identified, they are noted on the hazard assessment form, which crews must submit daily. Contrary to Mr. Byerley's suggestion, these steps are part of FPL crews' daily work habits. Non-compliance issues are appropriately addressed by local management.

In summary, I believe that any reasonable person would conclude that these inspections and the documentation of the inspection findings constitute a legitimate pole inspection.

Q. Mr. Byerley notes that the KEMA report and FPL internal documents make reference to "pole deterioration" as a contributing factor to pole breakage. Does Mr. Byerley correctly understand the use of that term by KEMA and FPL?

A. Clearly not. Mr. Byerley has misconstrued references to "deterioration" to mean that the poles in question had such extensive deterioration that they failed because of it. In fact, as used by both KEMA and FPL, the term simply indicates that there was visible evidence of deterioration on a broken pole when it was inspected as part of FPL's post-hurricane forensics efforts. The forensics teams made simple, binary determinations of whether or not they saw deterioration. They were not attempting to determine, and did not determine, that particular poles broke due to the visible deterioration that they observed.

Q. **Does the presence of deterioration indicate that a pole should not have been in service or that it broke because of the deterioration?**

A. No. It is expected that wooden poles will deteriorate over time, but so long as they continue to meet the applicable strength requirements, there is no reason to take them out of service. The National Electrical Safety Code (NESC), as well as FPL's internal standards, expressly recognize and allow for the natural fact of pole deterioration. I analogize pole deterioration to wear on a car tire, which is designed to wear over time. Only brand new tires show no sign of wear. Indeed, almost all car tires show signs of wear, but that does not mean they are deemed unsafe or require replacement; only when the wear exceeds established limits does one need to replace the tire. Similarly, a wooden pole is expected to deteriorate slowly over time, and the mere fact that one can see this deterioration does not mean it is unsafe or should be replaced.

Q. **Mr. Byerley made a "windshield tour" of a small portion of FPL's system in Palm Beach County, which he says helped him to conclude that FPL has an inadequate pole inspection and maintenance program. Do the results of this "windshield tour" provide a credible basis for such a conclusion?**

A. Not at all. The "windshield tour" covered far too small an area and was conducted with no sampling protocols that would allow its results to be statistically meaningful or even to provide useful qualitative insights.

Moreover, Mr. Byerley ignored pole ownership, as some of his pictures are of non-FPL facilities. There is, however, one observation that I would like to make about Mr. Byerley's "windshield tour." It was clearly intended to seek out and document evidence of deteriorated poles. Certainly some of the photographs Mr. Byerley took show visible deterioration. As I discussed above, deterioration is both expected and planned for within the design and operating standards and does not indicate that a pole should be replaced. Indeed, what is important to keep in mind is that poles in Mr. Byerley's photographs *withstood* Hurricane Wilma, in spite of their "deteriorated" condition as perceived by Mr. Byerley on his "windshield tour". It would be hard to find more convincing proof of the point I made earlier, that the mere presence of visible deterioration does not mean that the deterioration will cause a pole to break, even under hurricane conditions.

Q. On page 24 of his direct testimony, Mr. Byerley concludes that some of the poles he observed "may have been set at too shallow a depth, because the birthmarks were located 8-10' above the ground line, rather than at or slightly above the eye level of height." Do you agree with Mr. Byerley's conclusion?

A. No. While historically it was a fairly common rule of thumb that "birthmarks" will be placed on poles at a distance from the end of the pole that would allow them to be viewed at eye level when the pole is set, FPL has found that this rule of thumb can no longer be relied upon. Pole manufacturers today place their "birthmarks" at different locations on the pole. FPL's distribution poles are typically set at depths of five to seven feet, depending on the length of the pole installed. That may or may not put the "birthmark" at eye level, depending on the pole manufacturer.

Q. **What comments do you have about Mr. Byerley's observations of FPL's pole retention yard and his determination that 20-25% of the poles he observed were deteriorated?**

A. Again, Mr. Byerley inspected far too few poles for his conclusions to be meaningful. At deposition, Mr. Byerley acknowledged that he looked at only five to seven percent of the poles, and that he chose the ones to inspect based upon convenience and accessibility. Moreover, Mr. Byerley has acknowledged that his observations included no knowledge of pole ownership. As is noted in the KEMA report, approximately 45% of the poles included in the forensic sample were non-FPL poles. In any event, as I have explained, the fact there is deterioration on a pole does not mean it will fail under hurricane conditions.

Q. **On page 27 of his direct testimony, Mr. Byerley has proposed to disallow $22.6 million of restoration costs that he says were associated with the breakage of "deteriorated" poles during Hurricane Wilma. Do you agree with Mr. Byerley's proposal?**

A. No. It is fatally flawed at several levels. First, Mr. Byerley's proposal is premised on a conclusion that FPL's pole inspection program was inadequate. That conclusion is simply insupportable. Let me summarize the facts about the performance of FPL's and its pole inspection program:

(1) FPL's non-hurricane pole performance is excellent;

(2) FPL's pole performance in hurricanes has been consistent with expectations given the intensity of the hurricanes, and it compares favorably to other utilities' pole performance in hurricanes; and

(3) FPL has thorough pole inspection and maintenance programs, which have contributed to these excellent pole performance results.

In short, the evidence shows that FPL's pole inspection and maintenance record is exemplary, not deficient as Mr. Byerley's disallowance proposal would suggest.

Second, Mr. Byerley's proposal is necessarily premised upon the assumption that poles for which visible deterioration had been reported, in fact, broke because of that deterioration. However, he has no evidence to support this premise. His entire calculation is based upon the notations made by FPL's forensics teams when they inspected broken poles after Hurricane Wilma. As I explained earlier, the forensics teams recorded the presence of deterioration every time they saw it on a broken pole, irrespective of the role, if any, that the deterioration may have played in causing the pole to break. Simply put, there is no information available indicating that any pole failed due to deterioration - only that some of the poles showed a level of deterioration, a natural and expected fact among any wood pole population.

Finally, even if one accepted Mr. Byerley's insupportable conclusion that FPL's pole inspection program was inadequate and one overlooked the absence of any established link between the reported presence of deterioration and pole breakage, Mr. Byerley's calculation is based on faulty assumptions that result in a gross overstatement of his recommended disallowance. These faulty assumptions are:

(1) Over-estimating the number of FPL distribution poles replaced by approximately 900 poles. Mr. Byerley says that 7,400 FPL-owned poles failed and were replaced after Wilma. In fact, FPL estimates it replaced approximately 11,400 distribution poles, of which 4,900 were non-FPL poles and 6,500 were FPL poles.

(2) Using 1/3 and 2/3, respectively, to determine the proportion of feeder and lateral poles that are creosote. In fact, FPL's statistics show that creosote poles are approximately 20% of total feeder poles and 35% of total lateral poles.

(3) Using $6,800 as the cost of replacing a pole in storm recovery conditions (i.e., $1,700 normal replacement cost times a "storm recovery" multiplier of four). He has incorrectly used a figure for the normal replacement cost that includes other costs, e.g., costs to transfer facilities, which are not part of the pole cost. In addition, he provides no basis for his inflated "storm recovery" multiplier of four. FPL currently estimates the replacement cost for poles in storm recovery conditions to be approximately $2000, based on its 2005 storm restoration costs.

(4) His approach of using the 2004 relationship between total conductor replacement costs (Account 365) and total pole replacement costs (Account 364) to estimate the amount of conductor damage that would be associated with pole breakage results in a gross overstatement of the associated conductor damage. Account 365 includes the costs for *all* conductor restoration costs, whether or not they were associated with pole breakage. FPL's reporting systems do not specifically capture or track conductor damage caused by pole failures; however, based on FPL's experience, approximately 90% of damage to conductor during a storm results from wind, trees, and debris. Additionally, most conductor that is replaced due to pole breakage, is attached to feeder poles, which are overwhelmingly newer CCA poles. It is an accepted and common practice for conductor attached to fallen poles to be spliced and reused. In fact, the overhead guidelines that are used to give direction to foreign crews repairing facilities after a storm, state for feeder and lateral conductor that splicing is to be considered as the first option. For all these reasons, Mr. Byerley's conductor-to-pole cost ratio is substantially overstated.

Combining the effects of these adjustments to Mr. Byerley's disallowance proposal, I calculate that, using his same logic but more realistic inputs, the disallowance would be approximately $1.8 million instead of $22.6 million. Moreover, even this $1.8 million figure would be inflated, because Mr. Byerley's disallowance is premised upon the notion that the "deteriorated" poles which broke in Hurricane Wilma should have been detected and replaced earlier by more aggressive inspections. If one were to follow this logic, then the cost of the earlier more aggressive inspections, and of the pre-storm detection and replacement of the poles, should be netted against the amount he calculates for replacing the poles post-storm in order to arrive at the true incremental cost of not replacing the deteriorated poles before the storm. There are too many unknowns to calculate the precise amount that would be netted, but I am confident that it would equal or exceed the $1.8 million disallowance amount I just calculated.

VEGETATION MANAGEMENT

Q. Does FPL have a successful vegetation management program?

A. Yes. FPL's vegetation management performance (i.e., the percentage of total outages represented by vegetation-related outages) has been and is in line with other utilities in the state as well as nationally. Most recently, vegetation-related outages have decreased 21% in 2004 and another 31% in 2005. As a result, vegetation-related outages in 2005 were 45% lower than in 2003 and 14% lower than in 1999. This performance has been achieved despite some difficult challenges. Tree density (trees per mile) in FPL's service territory is twice the national average. Additionally, Florida's climate and 12 month growing season result in some of the highest tree re-growth rates in the nation.

Moreover, FPL's vegetation management program is an important component of FPL's overall maintenance and reliability program, which has achieved excellent results. FPL's SAIDI, the most relevant reliability indicator for customers since it encompasses both the average frequency and average duration of outages, compares favorably within the state and ranks in the top quartile nationally – a level of performance that could only be achieved with an effective vegetation management program.

Q. Has Mr. Byerley offered any meaningful criticism of FPL's vegetation management program?

A. No. All he has pointed to is an increase in vegetation-related outages in the 1999-2003 period. He disregards the substantial reductions in FPL's 2004 and 2005 vegetation-related outages that I just described, as well as the fact that FPL's vegetation-related outages in 2004 were below the national average and that FPL's overall reliability improved throughout the 1999-2003 period.

Q. On page 31 of his direct testimony, Mr. Byerley has proposed to disallow $11.3 million of restoration costs that he says were associated with the "preventable" breakage of poles during Hurricane Wilma. Do you agree with Mr. Byerley's proposal?

A. Absolutely not. As with his disallowance proposal concerning "deteriorated" poles, it is fatally flawed at several levels.

First, Mr. Byerley's disallowance proposal is premised on his conclusion that FPL's vegetation management program was inadequate. For the reasons I just discussed, Mr. Byerley offers no credible support for that conclusion. In fact, the reality is just the opposite: FPL has a strong program that deals effectively with the special challenges of vegetation management in Florida and is part of an overall reliability program that delivers excellent results for our customers.

Second, Mr. Byerley's proposal misunderstands FPL's use of the term "preventable" in categorizing vegetation-related pole damage. He correctly quotes the definition of "preventable" to be "standard trimming would have eliminated tree contact with distribution equipment." However, FPL often must seek permission from the owners of trees in order to trim them, and that permission is often denied. Mr. Byerley fails to recognize that damage caused by vegetation that could be trimmed using standard trimming practices is categorized as "preventable" even when it has not been trimmed because permission to do so has been refused. Clearly, it would be unfair to penalize FPL for damage caused by vegetation that it has been denied permission to trim, but that is exactly what Mr. Byerley's disallowance proposal would do. Mr. Byerley also fails to accept reality – when hurricanes strike, vegetation outages will occur, even if 100% of FPL's lines are cleared to standard. Our experience over the last two storm seasons confirms this.

Finally, even if one accepted Mr. Byerley's insupportable conclusion that FPL's vegetation management program was inadequate and one overlooked his misunderstanding of how FPL has used the term "preventable," Mr.

Byerley's disallowance calculation is again grossly overstated because of faulty assumptions:

(1) As I discussed earlier, Mr. Byerley used a pole count of 7,400, when the appropriate figure is 6,500. He again used a storm restoration cost for pole replacement of $6,800 when the correct figure is $2,000. Finally, he again used an improper ratio of conductor damage to pole damage of 88%, when the proper ratio is 10%.

(2) Mr. Byerley used a preliminary draft of FPL's Hurricane Wilma forensic team report instead of the KEMA report to identify the percentage of poles that failed with a contributing factor of trees. The KEMA report states that 21%, not 24%, of pole failures had a contributing factor of trees;

(3) Mr. Byerley has assumed that 50% of the tree-related pole failures in Wilma were "preventable." He arrived at this figure by relying on a preliminary report based on <u>Hurricane Katrina</u> data, which was superseded by the KEMA report. As can be seen in the KEMA report, the characteristics and damage of Hurricanes Katrina and Wilma were very different. KEMA concluded that there were only *three* pole breakages, a 0.3% preventable tree-related pole failure rate, in Hurricane Wilma.

Combining the effects of these adjustments to Mr. Byerley's disallowance proposal, I calculate that, using his same logic but more realistic inputs, the disallowance would be negligible -- approximately $10,000 -- instead of the $11.3 million that Mr. Byerley claims. As before, this figure would need to have netted against it the incremental cost of whatever more extensive vegetation management program Mr. Byerley has in mind.

Q. Are there any other issues raised by Mr. Byerley that you would like to address?

A. Yes. Mr. Byerley makes reference to an FPL document that is contained in his Document No. JSB-17. This document was developed at my request and presented to me during the beginning of the Hurricane Wilma restoration effort. It was prepared after Hurricane Katrina but before Hiurricane Wilma, and it was intended to evaluate hurricane impacts on FPL's distribution infrastructure and explore possible alternatives for hardening that infrastructure. Because of when it was prepared, the document focused on Hurricane Katrina forensics data only and was thus somewhat overtaken by events when Hurricane Wilma struck. Near the beginning of the Hurricane Wilma restoration effort, the team that prepared the document presented its conclusions and recommendations. In reviewing the document and after hearing the presentation, I determined that this initial report provided some useful information but was not conclusive. Also, in many cases the team was unable to identify financial savings for the hardening alternatives. Simply put, FPL needed more time and information in order to conduct a thorough review and analysis.

After the presentation, the team was disbanded, as all of the members were needed to support the Hurricane Wilma restoration effort. Subsequently, KEMA was hired by FPL to conduct its review of Hurricanes Katrina and Wilma. KEMA's comprehensive report was filed as part of this proceeding. Additionally, FPL filed its 5 Point "Storm Secure" Plan with the Commission and is continuing its efforts to develop a 10-year hardening roadmap.

EMPLOYEE ASSISTANCE AND
EXEMPT EMPLOYEE OVERTIME (LARKIN)

Q. Do you agree with Mr. Larkin's position that costs to secure employees' damaged homes should not be charged to the storm reserve?

A. No. By assisting significantly impacted employees with basic needs, e.g., roof tarps for damaged roofs, ice, water, child care services, etc., employees are able to immediately focus their attention to their storm assignment. This is absolutely essential to me in being able to promptly and effectively meet the demands of our customers. This cost is directly related to the storm restoration effort and is consistent with FPL's objective to restore customers' service safely and as soon as possible.

Q. Do you agree with Mr. Larkin that exempt employees who typically do not get paid overtime should not be paid overtime for their storm restoration efforts?

A. No. FPL's policy for paying overtime to these employees during certain storm restoration efforts is appropriate. In general, the decision to pay or not pay for overtime is primarily based on the length of the restoration effort. For Wilma, an 18 day restoration effort, many of our employees worked sixteen hour days continuously for the entire restoration period. It would be unfair to not compensate them for their extraordinary effort. Additionally, it is possible for two people, who normally are in different paygrade classifications, to be performing the same function during the restoration period. As a result of their normal paygrade classification, one might be eligible for overtime while the other is not. Again, it would not be fair for only one to be compensated for their overtime. I would also note that the these overtime payments were determined in a manner consistent with overtime payments computed for those employees eligible for overtime, was limited to the amount necessary to avoid inequities, and accounted for only 1.3% ($0.8 million) of total storm related overtime.

Q. **Mr. Larkin asserts that catch-up work is not directly related to storm restoration. Do you agree with this assertion?**

A. No. I disagree with this assertion since, even now, my business unit continues to experience the effects of the 2005 storms. For example, at the end of March 2006, the Distribution operations unit is currently exceeding its O&M budget by almost $4 million, due to increased workload from backlogs in the areas of new service, customer inquiries, and relocations. Additionally, because our system is still experiencing the after effects of the storm, our restoration workload has increased by approximately 25% from 2004 levels and 13% over the already increased workload from 2005. This has caused a $5.2 million O&M variance in restoration activities, primarily consisting of overtime and contractor expense. The total impact to our first quarter spending is a $9 million variance from budget.

Q. How are you assured that these impacts are storm related?

A. We examined variances against both budget and prior year spending. We have seen an increase of approximately $7.2 million beyond our 2004 spending levels in the activities I noted above. Further examining these increases we have seen an increase in the volume of activities and their associated costs. To meet the increased workload and meet customer expectations due to the backlogs we have had to use off-system contractors at higher rates.

STORM ESTIMATES, CONTINGENCY, FOLLOW-UP PROJECTS, ADVERTISING & FLEET COSTS (DERONNE)

Q. Ms. DeRonne comments that as of March 14, 2006, FPL's total request of $906 million still contained approximately $245 million of estimates. Has this number been updated?

A. Yes. Document No. GJW-9, updates Document No. GJW-5, which was filed with my direct testimony. Additionally, GJW-9 includes a more refined cost breakdown of actual and estimated costs. As of March 31, 2006, total 2005 storm costs are now estimated to be $885.6 million. Of this total, $696.8 million (79%) is actual, $109.6 million (12%) is associated with pending invoices, and $79.2 million (9%) is associated with remaining work.

Q. Is there any remaining contingency amount included in FPL's storm restoration costs as of March 31, 2006?

A. Yes. As of March 2006, there was $7.5 million of contingency included in the 2005 storm estimate, with the majority of this amount, $6.9 million, associated with Hurricane Wilma distribution follow-up restoration work being performed by contractors. The $7.5 million contingency represents only 0.8% of our total 2005 storm cost estimate.

Q. Do you agree with Ms. DeRonne's proposed cut-off date and her other associated parameters that would require FPL to only be able to charge expenses associated with projects known today, with project start dates prior to December 31, 2006?

A. No. All projects and associated costs directly related to restoring FPL's facilities to their pre-storm condition should be charged to the Storm Reserve, whether they are known now or not. FPL attempts to quickly identify storm follow-up projects in order to restore storm-affected facilities to their pre-storm condition as soon as possible. I believe that a review of FPL's 2004 storm follow-up work would indicate that FPL has successfully achieved this. However, as further discussed in the testimonies of Messrs. Davis and Warner, there are unique circumstances and good business reasons to delay the timing of restoring FPL's damaged generating unit facilities to later dates that coincide with planned overhaul schedules. I have provided in Document No. GJW-10 a listing of projects for Hurricane Wilma that are yet to be completed, their total current estimated costs, and their project start and completion dates.

Q. Ms. DeRonne has proposed an adjustment to remove all utility advertising, media relations or public relations costs. Do you agree with her proposed adjustment?

A. No. These costs would not have been incurred had it not been for the storms and they are associated with keeping customers informed of our storm restoration status and extraordinary dangers that exist during storm restoration. In fact, after the 2004 storm season, one key lesson learned was our customers want and expect us to communicate more often with them during these events. This type of communication actually facilitates our restoration efforts.

Additionally, "thank you" advertising, designed to recognize foreign crews that assisted us in restoring service to our customers helps to encourage their continued support. Given the likelihood of continued hurricanes impacting our service territory and customers, this encouragement is a very prudent step for FPL to take. The other companies that provide the assistance find this encouragement meaningful, and it helps their regulators understand the benefits that result from allowing their manpower to be diverted away from normal operations in their service areas. Therefore, these costs are appropriately charged to the storm restoration effort.

Q. On page 10 of Ms. DeRonne's testimony, she recommends an adjustment to remove fleet vehicle costs from the 2005 storm costs. Do you agree with this adjustment?

A. No. While Mr. Davis is the appropriate witness to address these ratemaking type adjustments, I would note that FPL's actual 2005 fleet vehicle costs exceeded its 2005 budget by $3.2 million. Approximately $1.2 million of this overrun was specifically associated with increased maintenance required on our fleet as a direct result of the 2005 storms. This incremental work was accomplished by establishing a second shift and extending overtime hours at our maintenance facilities. The additional maintenance also required more parts and materials than originally budgeted. In addition to the increased maintenance work required, there are long term impacts on the fleet that are not quantifiable. As with any mechanical device, excessive usage shortens their ultimate lives.

Q. Please summarize your rebuttal testimony.

A. My rebuttal testimony responds to Mr. Byerley's unfounded criticism of FPL's pole inspection and vegetation management programs. Those programs are sound and effective, and they help ensure the solid performance of FPL's distribution system in both non-hurricane and hurricane conditions. Mr. Byerly has proposed disallowances related to the pole inspection and vegetation management programs, which are not only unwarranted but also grossly overstated. My rebuttal testimony also shows that the adjustments proposed by Mr. Larkin with respect to employee assistance and exempt employee overtime and the adjustments proposed by Ms. DeRonne for storm estimates, contingencies, follow-up projects and advertising are inappropriate and improper.

Q. Does this conclude your rebuttal testimony?

A. Yes.

THE WITNESS: Thank you. Good morning. Good afternoon, Commissioners. I wish it was morning. My rebuttal testimony addresses the testimonies of OPC Witnesses Byerley, Larkin, and Larkin, and DeRonne.

Mr. Byerley asserts that FPL's pole inspection program is inadequate, and as a result he proposes disallowances of costs associated with poles and conductors. I disagree. FPL's pole inspection program has produced excellent results under both nonhurricane and hurricane conditions. FPL's nonhurricane pole related outages have been negligible. Additionally, following each of the last unprecedented storm seasons, FPL replaced less than one percent of our poles.

Finally, when comparing FPL's hurricane pole replacement rates with other utilities, FPL's are consistently lower than that of other utilities. A testament to FPL's more stringent construction standards and the effectiveness of our pole inspection program.

Mr. Byerley has provided no credible support for his conclusion that FPL's vegetation management program may not be adequate. In fact, Mr. Byerley has ignored a number of facts, including FPL's overall reliability is and has been excellent. FPL's 2004 vegetation outages as a percentage of total outages have been below the national average. Vegetation related outages decreased 21 percent in 2004, and an additional 31 percent in 2005. All of this despite a service territory that has a tree density that is twice the national average and that has some of the fastest regrowth rates in the whole country.

Based on his insupportable conclusion associated with pole deterioration and vegetation, Mr. Byerley proposes disallowances of Hurricane Wilma pole and conductor replacement costs. Even if one accepts these conclusions, his calculations utilizing incorrect pole counts, inaccurate percentages for creosote poles, conductor and vegetation-related pole outages result in gross overstatements of disallowances. Using his same logic, but more realistic inputs, his total proposed disallowance is reduced from almost $34 million to less than $2 million.

Regarding Mr. Larkin, providing assistance to employees participating in storm restoration efforts are directly related to storm restoration and are consistent with our objective to restore service as safely and as quickly as possible.

Regarding Ms. DeRonne, I have provided FPL's updated 2005 storm cost estimate total of $885.6 million, over $20 million less than our initial filing. As of March 31st, 2006, 91 percent of this estimate is either actual or associated with pending invoices. I also have provided storm follow up projects that are yet to be completed in my testimony.

Finally, contrary to Ms. DeRonne's opinion, costs associated with communications with our customers informing them of our restoration status and the extraordinary dangers that exist during storm restoration, are appropriately charged to the storm reserve. In fact, customers want and expect us to communicate more often with them during hurricane restoration efforts.

That concludes my summary.

MR. BUTLER: Thank you, Ms. Williams. I tender the witness for cross-examination.

CHAIRMAN EDGAR: Mr. Wright.

MR. WRIGHT: Thank you, Madam Chairman. Respecting your interest in having some variety, I am going to go first this afternoon.

CROSS EXAMINATION

BY MR. WRIGHT:

Q Good afternoon, Ms. Williams.

A Good afternoon.

Q I have some questions for you about some general statements that you make in your testimony regarding FPL's strong reliability, FPL's solid performance, and such things. I can cite those to you, but I'm sure you know what I am talking about.

My first question is you testified before the Domestic Security Committee of the Florida Senate in March, did you not?

A I did.

Q Do you recall telling the committee that FPL plans for the worst?

A I remember telling the committee that in reference to hurricane restoration, we plan for the worst potential possibility given the current track or the current number of track potentials that we get from the National Hurricane Center.

Q Thank you. And just to be clear, you pretty much answered my question, but your comment regarding planning for the worst is in relation to response and restoration planning, not in relation to planning the total distribution system facilities, correct?

A That is correct. My testimony at the time of the Domestic Security Committee was specifically to our hurricane restoration performance and the question asked and answered had to do with our planning for the worst.

Q Thank you. FPL is now in the process of beginning to plan its distribution system to meet the NESC extreme wind criteria, is that correct?

A We have filed with the Commission for permission as it were to increase the strength requirements of our new construction and a number of other provisions associated with overhead construction, that is correct.

Q And will you agree with me that the NESC extreme wind criteria generally are approximately those associated with

Category 3 gusts?

A Not exactly. The NESC extreme wind criteria is regional in nature. As a matter of fact, in Doctor Brown's testimony there is an exhibit that shows the NESC wind bands, and depending on where you are in the state of Florida the extreme winds can be up to the gusts, three second gusts of a Category 3, but in other parts of the service territory could be considerably less.

Q Thank you for that clarification. Would it be correct that they are approximately equal to the Category 3 gusts in coastal areas in southeast and south and southwest Florida?

A With that specific description, I would agree.

Q Thank you. On Page 3 of your testimony, at Lines 17 through 21, you make the statement -- well, really it is just 17 and 18 -- you make the statement, "Any reliability program ultimately should be measured by the results that it achieves," and then you go on. I just want to ask you will you agree that it would be fair to say that any reliability program ultimately should be measured by the results that it achieves under the conditions experienced?

A Could you direct me -- I'm sorry.

Q Lines 17 and 18 on Page 3 of your rebuttal testimony, any reliability program?

A I just wanted to take a peak at it. All right.

Would you repeat your question now?

Q Sure. My question is will you agree that it would be fair to add under the conditions experienced to the first part of that sentence, such that any reliability program ultimately should be measured by the results that it achieves under the conditions experienced?

A I'm not sure what you mean by under the conditions experienced. Maybe you could elaborate.

Q I think -- well, I don't think, all I'm trying to get at is that a reliability program may look really good if the conditions experienced are very mild in relative terms, or it may look very bad if the conditions experienced are devastating like Andrew or Katrina in a New Orleans/Mississippi class event. And all I am trying to ask you isn't it fair to qualify that statement by putting a frame of reference to the conditions experienced. That's all I'm asking.

A I don't think so. I think that any reliability program has to really stand on its own based on the results that it achieves relative to what you are trying to accomplish. And so for the purposes of Florida Power and Light's reliability, the way that we measure our success and the way that we measure our performance is in terms of how much improvement we have been able to make over time. So by any measure, when you look at the extraordinary improvement and reliability that our customers have been able to see since 1997 to present, I think by any measure you would look at, again, it is our conditions, it is over time over the same area that that has truly been a remarkable improvement and excellent reliability for our customers. So, no, I don't agree.

Q Well, the measures you were just talking about really exclude hurricane damage, don't they?

A The measures exclude extraordinary events. Here in Florida, the Public Service Commission, and we are abiding by the rules set forth by the Public Service Commission, allow us to exclude named storms, which include, of course, named tropical storms, hurricanes, tornados, and I believe, wildfires. We had a number of wildfires in 1998, I believe, and those were excluded, as well.

In other parts of the country, utilities exclude winter storms, ice storms. They exclude tornados. In other parts of the country there are more arbitrary measures for exclusions. For example, a number of utilities simply exclude any time that any part of their service area has 10 percent or more of their customers interrupted. They exclude it without really having to have any kind of extraordinary event.

My point is just about every utility has under their Public Service Commission or Public Utility Commission rulings exclusion criteria. Our exclusion criteria is very specific, and I think very appropriate for the fact that we have these extraordinary fierce forces of nature, these hurricanes that no electric distribution system could conceivably be designed to withstand at all times.

Q And my question is aren't your customers concerned about outages following hurricanes, too? Don't they consider that to be reliability?

A I don't know if they consider it to be reliability. I think that they are absolutely concerned, and, you know, I think you are probably right, Mr. Wright. I mean, when a customer's lights are out, they don't care that it was lightning on a normal day or the fact they had an interruption associated with a hurricane. I think you make a valid point to that degree. But for the purposes of measuring and comparing performance, reliability performance of one utility versus another, it is important that you measure what, in fact, it is that your distribution system is attempting to achieve. And it is designed, all of the distribution facilities across the country are designed for normal operating conditions, and that is where the exclusions come in to be able to sort of levelize the playing field, if you will.

Q On Page 5 you make the point that FPL's base rates are lower today than they were seven years ago. I have a couple of questions about that. Will you agree that FPL has been significantly profitable over the same period?

A I think we have been profitable. I don't know that I would think significantly profitable. We have been profitable.

Q Isn't it true that FPL has earned rates of return on equity after tax in the range of 12 to 13 percent over most, if not all of that period?

A That is probably correct.

Q Isn't it also true that FPL's total rates are significantly higher than they were seven years ago?

MR. BUTLER: Would you define what you mean by total rates?

MR. WRIGHT: You bet.

BY MR. WRIGHT:

Q If you go to any of the PSC's statistics publications you can find a typical bill excluding local taxes for a thousand kilowatt hours, and I will -- and if I may, I am going to just hand the witness a page from the 2000 report showing the FPL total rate for December 31st, 1999. It's out of statistics of the Florida electric utility industry publication.

A Thank you.

Q Isn't it true that that shows that the typical bill for an FPL thousand kWh a month residential customer as of December 31st, 1999, was $70.57 excluding local taxes?

A That is what this form shows, yes.

Q And you would believe that to be true, wouldn't you?

A Yes, that is fine.

Q And would you agree that today the approximate bill is little over $108 for a thousand kWh qualify customer?

A Yes. The bottom line bill has, in fact, increased because of the fuel increases that, frankly, we have had absolutely no control over.

MR. WRIGHT: I am going to ask my partner, Mr. LaVia, to hand out a document that was prepared and distributed by FPL at the January 23rd infrastructure hardening workshop. And I would like this marked for identification, please. I think it will be 163, Madam Chairman.

CHAIRMAN EDGAR: Yes, Number 163.

(Exhibit 163 marked for identification.)

MR. WRIGHT: And I would just call it FPSC infrastructure hardening workshop-FPL. Or FPL handout, how's that?

BY MR. WRIGHT:

Q Do you recognize this document, Ms. Williams?

A Yes, I do.

Q Thank you. Does Mr. Spoor work in your division or department, whatever it is?

A Yes, he does.

Q I just want to understand how many poles you all had knocked down. And I will cut to it, your testimony says you lost -- you replaced 11,400 poles total, and I think you go on to say that about 6,500 of those were FPL poles.

A For Hurricane Wilma, that is correct.

Q Oh. So the 12,632 poles was for 2005?

A All of it, that is correct.

Q Thank you. In your testimony, you criticize Mr. Byerley's use of the four times estimated for the multiplier for replacing poles in a storm restoration environment. I'm sure you recall that line of your testimony?

A Yes. Let me see if I can find it.

MR. BUTLER: Could you point it out, please.

MR. WRIGHT: Sure. Page 13 beginning at Line 15. She criticizes Mr. Byerley for using $6,800 as compared to $1,700, that is a multiplier of four times.

THE WITNESS: I see it.

MR. BUTLER: Thank you.

BY MR. WRIGHT:

Q And then in your Exhibit GJW-9, you identify the total restoration costs experienced by -- clarify. Backup. Am I correct to understand that the $885.6 million shown as the total expenditures for storm cost-recovery for 2005 storms is the amount that FPL proposes to charge to the reserve?

A That I'm not sure of. That is probably a better question for Mr. Davis. That is the actual -- our estimate of what the costs will be. What actually gets charged to the reserve, there is a number of options that I believe he has available in terms of what actually does or does not go, so that is probably a better question for him.

Q I have been told that FPL has estimated that it is spending about $60 million on capital replacements following the 2005 storms. Does that sound about right?

A It could be. That is the type of thing that I am alluding to.

Q Well, I will ask you just do you know. Do you know whether that $60 million is included or not included in the 885 million?

A I'm not sure. I don't know. Off the top of my head I don't know. I would have to look at the details.

Q The questions I want to ask you about this generally have to do with how much you all spent on T&D, or transmission separately, distribution separately, and then everything else. And we can save a bunch of questions and a bunch of tedium if you can give me a ballpark estimate out of the $885 million as to how much was spent on distribution and transmission?

A I have that.

Q Hurray. I am so glad.

A I do have that. For powers systems, which is a combination of both distribution and transmission, the culmination of the 2005 hurricane season, the apples-to-apples number to the 885 is 782,015,000.

Q Thank you. Of that would I be correct to believe that the majority is distribution related?

A Yes.

Q The vast majority?

A What do you mean by vast?

Q More than 90 percent?

A I don't think that I can go there.

Q That's all right. Would you have an estimate as to how much was transmission out of that 782 million?

A No, I don't.

MR. WRIGHT: I am going to ask Mr. LaVia to hand out another exhibit that I prepared using some simple calculations from data presented in what has been marked as Exhibit 163, and I would ask that this be marked as Exhibit 164. Do I have the number right, Madam Chair?

CHAIRMAN EDGAR: You do, Mr. Wright.

MR. WRIGHT: Thank you.

(Exhibit 164 marked for identification.)

BY MR. WRIGHT:

Q If you would like to take a moment to look at this, I think you will see that all the numbers except where I have separated out overhead lines and underground lines correspond exactly to the numbers shown in Mr. Spoors' handout that we have already marked as 163. Does that look correct to you, Ms. Williams?

A Yes, they do.

Q I apologize for this, but somewhere along the line I have picked up the factual information in my own mind that FPL has about 63 percent of its distribution lines as overhead and 37 percent underground. Is that accurate?

A Yes, it is.

Q Thank goodness. Okay. If you would like, I mean, I doubled checked the calculations, but would you either eyeball or actually check the percentage calculations that I have shown in the right-hand column of what has now been marked as 164 and tell me if you think they are either, either extremely accurate or real close to it?

A They are close. They are not right on, but they are close, and so --

Q Thank you.

MR. BUTLER: Mr. Wright, do you have a proposed title for this exhibit?

CHAIRMAN EDGAR: We did not do that and --

MR. WRIGHT: I'm sorry.

CHAIRMAN EDGAR: Well, you were on a roll and I didn't really want to break in. We would have come back to it, but it is fine to do it now.

MR. WRIGHT: Let's just call it approximate percentages of T&D facilities replaced in 2005. If we could insert the word FPL before T&D, that would be a good thing.

CHAIRMAN EDGAR: Approximate percentage FPL T&D facilities replaced 2005.

MR. WRIGHT: Thank you.

BY MR. WRIGHT:

Q Again, I can go into more detail rather than less, but if we can get to a quick point we will do it. Will you agree, and subject to check, and I have the document that you can check it from, that FPL's projected 2006 average transmission rate base was about $1.6 billion?

A Transmission?

Q Correct.

A I don't know what it was.

Q Okay. How about FPL's distribution rate base? My number indicates based the company's MFRs from last year's rate case the distribution rate base projected for '06 is about 5.3 billion?

A That sounds right.

MR. WRIGHT: Now, I am going to go ahead and ask Mr. LaVia to hand these out. These are copies of pages from FPL's MFRs from the Docket 050045, the rate case last year, and they are -- the title will be plant account summary tables FPL 2006, and I would ask that this be marked as Exhibit 165. And just so everyone will know, what these show is the plant-in-service accounts and the depreciation reserve accounts.

(Exhibit 165 marked for identification.)

BY MR. WRIGHT:

Q Ms. Williams, will you agree that as a general proposition subject to minor adjustments that I don't know about, rate base is equal to plant-in-service minus accumulated depreciation reserve?

A You know, I'm not a ratemaking expert, but that sounds about right. That is probably better questioning -- I mean, if it is going to be about ratemaking, those types of questions are probably best for someone else.

MR. WRIGHT: What I'm really trying to do, Madam Chair, and Ms. Williams, what I'm really trying to do is just get at how much you all spent to fix T&D last year as a percentage of your rate base. And if we look at the numbers, you have agreed that about $5.3 billion is pretty close to the company's distribution rate base. I will aver to you that if you do the math the corresponding math for transmission is about 1.6 billion. That gets you up to pushing $7 billion in rate base for transmission and distribution combined.

BY MR. WRIGHT:

Q And you have just told us that the company spent $782 million fixing transmission and distribution after the 2005 storms, correct?

A Correct.

Q And simple mathematics, that comes out to be about 11 percent?

A 14-1/2.

Q Okay. Thank you. And now if I compare the percentages of the facilities replaced that are shown in the table that I calculated on 164 using FPL's data from Mr. Spoor's handout, those are pretty small numbers. They range from a fraction of a percent to as much as 2.3 percent or so for overhead lines and about 1-1/2 percent for all distribution lines. And what I'm really trying to understand is ultimately what you all spent the $782 million on if you didn't spend it on replacing poles, conducts, structures, and that is it?

A Well, the $782 million is the compilation of everything that it takes to restore the system back to its prefailure state. It includes follow up work, it includes obviously restoration associated with the poles and the wires and all of it. It is soup to nuts. And obviously it is a large number, but it is a huge undertaking when you consider the 21 counties and the amount of facilities that are involved.

Q No argument that it is a huge undertaking, Ms. Williams. Referring to your Exhibit GJW-9, the sixth line down is headed on the left-hand side, line clearing. Can you tell us what that represents?

A Yes. Let me get it.

Q Nine.

A GJW-9.

Q Yes.

A Line clearing?

Q Yes.

A Is the cost for the vegetation removal, the vegetation trimming associated with the hurricane restoration effort.

Q So that is vegetation related?

A Yes, vegetation management.

Q The line immediately above that is headed or cited as it might be, external line and contractor. Can you explain what that is, please?

A Yes. That is the cost, if you will, associated with foreign utility assistance as well as contractors that come to help us in restoring power.

Q Can you give any further explanation as to what is meant by external line in that context?

A External line or foreign utilities, or it could be contractors.

Q So external line is foreign utilities?

A External line, yes, external line are -- exactly, sorry, they are foreign utilities.

Q And I am just trying to just nail it down in my own mind. The phrase external line, does that like refer to foreign utility line crews that come to work on your stuff, is that why the line is in there?

A Yes, I think so.

Q Does the phrase integrated supply chain have any meaning for you?

A Yes.

Q Please tell me what it means to you?

A The integrated supply chain is a department in our company that is responsible for really all the procurement services associated with materials and services, and they also handle all the material handling, all of the actual material delivery to those service centers so that they can actually use the material to construct the work that they are going to do or the maintenance and so forth and so on. Bit it is a centralized organization that is responsible for purchasing, negotiating, procuring, soup to nuts all of our material and services.

Q Continuing to look at Exhibit GJW-9, would I be correct to understand this to show that company payroll, regular and overtime, and the external line and contractor if added together would generally represent the nonvegetation clearing related labor costs associated with the restoration activities?

A No. There is more in external line and contractor than just labor.

Q Please tell us what else?

A It is the complete cost that the utilities that help us, for example, in the external line piece, it is the complete cost of the utilities in their support of us. So, for example, to the extent that the utility -- let me think, brings their own security with them, then the security costs would be included in that. It is a comprehensive cost, a make whole if you will. The agreement between the utilities is that we will pay for their total costs, so it is not just labor.

Q Thank you. Does it include conductor and poles or is that included in the line headed material?

A I'm not sure how the billing would work for that. We do on occasion and have actually asked utilities particularly when there has been a rush on materials, for example, this year there were so many different hurricane restoration efforts, Katrina on the Gulf Coast, Rita on the Gulf Coast, it is possible that some of the utilities that provided us assistance actually brought some material. Whether it is included in that line item or in material, I'm not 100 percent certain.

Q What is included in the line headed material, the $57 million?

A I think it is just that, the material costs.

Q FPL materials?

A I know that is it FPL material, again --

Q It may be somebody else's, too?

A I'm sorry, I don't know to that level of detail.

Q Thank you. In calculating the installed cost per pole or per any unit of something, you would include both the cost of the material involved and the cost of the labor, would you not?

A Yes, you would. And that is what I have included in my alternative $2000 per pole. It is the cost of the pole and the cost of the installation of the pole.

Q Well, if I multiply your 11,400 poles, or the 12,632 poles, let's say, by your $2000 per pole, let's use the 12.6, that gets me right at $25 million, right? 25.264, I think.

A 25,200,000.

Q Okay. That is a very small number in my view of relative numbers to either the 532 million or the $782 million. I understand the 782 includes some transmission, let's leave that out. Let's just deal with the 532, and at least some of the material you would agree has to be related to poles, right?

A Which 532?

Q The external line and contractor work?

A It may. Again, I'm not testifying that it does. It may.

Q Well, company payroll and overtime and external line and contractor would together sum up to right around $600 million, maybe a little over. Would you agree with that?

A Yes.

Q And then materials another 57 million, correct?

A Yes.

Q What all else is in that, say, $650 million minus the 25 million that you would assert FPL spent on replacing poles?

A I'm sorry, I lost you. What are you asking me again, please?

Q If I look at the numbers on your GJW-9, take the company's payroll, external line and contractor, we know what line clearing is, that is vegetation clearing related, so we will level that out, and then put the material cost in there. I get something that is -- and add those together, I am getting something that is probably 650 or $660 million?

A Including regular, overtime, external line and contractor, and what was the other?

Q Material.

A The 57?

Q Right.

A Okay. And you get --

Q 650, 660, something like that.

A That is close, yes.

Q Now I'm just trying to understand what -- you told us that your estimate for pole replacement is 25 million bucks basically. What all, what all else is in that, the rest of that 650 odd million dollars?

A There's all the costs associated with doing everything that we do with a hurricane. I mean, the poles were, were an issue, by no means, but they were not the end-all be-all reason why the costs are what they were or whether restoration took what it took.

There is an incredible amount of time that is spent doing simple things, and they sound simple but they are very,

very time-consuming of simply reworking connections in people's backyards to make sure that they can receive power. There is an enormous amount of shaking up -- I can't think of another, of another better term. When these winds come through, they loosen so many of our connections. And, as a matter of fact, in Mr. Byerley's testimony -- no, it wasn't. It was in Mr. Larkin's testimony, he speaks to the hurricanes exploiting existing weak conditions, and I do agree with that. But what he doesn't recognize in his testimony is the hurricanes create new weak conditions.

But anyway, going back to all of these connections that have to be tightened, there is a tremendous amount of work that is done in the, in the, in the hurricanes that are -- I always describe it as hand-to-hand combat -- behind people's homes reworking secondary, reworking service connections, reworking connections on transformers. It's hard to quantify that, but I know that it's an enormous amount of work and manhours and labor that's associated with doing that for both FPL crews, as well as all of the foreign contract crews that we have working with us.

If all we had to do was replace the poles, boy, that would be pretty, pretty simple because it only takes about 11 hours --

CHAIRMAN EDGAR: Ms. Williams, I think you've answered the question.

THE WITNESS: Okay. Thank you.

CHAIRMAN EDGAR: Thank you.

THE WITNESS: Sorry. I apologize.

MR. WRIGHT: And that's all I have. Thank you very much, Ms. Williams.

THE WITNESS: Thank you.

CHAIRMAN EDGAR: Mr. McGlothlin, do you have cross?

MR. McGLOTHLIN: I do.

CROSS EXAMINATION

BY MR. McGLOTHLIN:

Q Ms. Williams, please turn to Page 3 of your rebuttal. At Lines 9 and 10 you refer to pole performance under both nonhurricane and hurricane conditions. Do you see that?

A I do.

Q I have a very few questions about, that are general in nature about hurricane and nonhurricane conditions and pole performance.

Would you agree with me that it's possible for a wood distribution pole to be deteriorated in condition to the point that it should be replaced, but that it is being supported and essentially held up by the conductor that is attached to it and to adjacent poles?

A During normal conditions?

Q Yes.

A It's possible.

Q And it's possible that that same pole that's been temporarily held up would not be able to withstand a storm condition and it would fail in that situation.

A That's possible.

Q And there's some debate about the relative cost, but would you agree with me that in that situation it's more expensive to replace the failed pole after the storm than it would be to replace it under normal conditions?

A Yes.

Q Is it true that with respect to the calculation of reliability indices Florida Power & Light Company removes hurricane experience from that calculation?

A Yes. We exclude named storms including hurricanes from SAIDI and all the other reliability indices. That's correct.

Q Now a pole inspection program is one form of a reliability program, would you agree?

A Yes, it is.

Q And one function of a pole inspection program, inspection and replacement, would be to identify deteriorated poles and replace them at normal costs prior to the advent of a storm.

A Yes. It's -- you want to identify the pole. And to the extent you can, you can replace it, then you, of course, you would do so.

Q And that replacement would avoid a customer outage with respect to a deteriorated pole that is likely to fail under normal conditions, and it would also avoid a customer outage by having a sound pole in place when the storm hits and one that's able to withstand the storm?

A Yes. If you could draw that one-to-one conclusion, in other words, that your inspection and maintenance could find the pole that would be facing the hurricane winds -- and, of course, we have an enormous service territory -- then that, that makes sense.

Q Okay. At Page 5 of your rebuttal testimony at Lines 9 and 10 you comment on the manner in which FP&L reviews and evaluates initiatives before selecting those that deliver the best value to the customer; is that correct?

A Yes.

Q And so the policy and the criterion is to select programs that result in benefits to customers.

A Yes. The philosophy is to fund programs that offer the most benefit to the customers.

Q And would you agree that a pole inspection program that accomplishes the functions I described earlier of replacing defective poles prior to the storms so that customer outages are avoided either before or after would be one such benefit?

A It would. However, when you look at the relative benefits of the pole, preventing that pole from failing provides versus the relative benefits of funding other programs, it's -- you're better off funding the other programs.

Q Isn't it true that after Hurricane Wilma, Florida Power & Light Company proposed to adopt a system-wide pole inspection and replacement program that included the sounding and excavation steps associated with the more rigorous Osmose program?

A Yes, we did.

Q And that original proposal contemplated a cycle of ten years, if I recall correctly, did it not?

A Yes. Our original filing called for a ten-year cycle.

Q And is it true that FPL proposed that prior to the point in time when the Commission mandated a step of that nature?

A Yes. As part of our review of, and really of our five-point storm secure hardening plan, we looked at poles as one of those points, and decided with the increased hurricane activity, the era of hurricanes that we seem to be going into, that frankly we needed to take a hard look at every aspect of our programs, including pole inspections. And our plan will be to, of course, now follow the eight-year cycle that's been recommended by the Commission.

But I have to tell you that I fully intend, now that we're going to be capturing some very specific data on our poles, both old poles as well as new poles, that if in time it does not look like those costs are prudent because they're not resulting in real, tangible benefit to the customers, then I certainly will be coming back to the Commission whenever that time is and may be asking to reduce that cycle. That's something that I think we're all going to have to do. We all want to make sure that we do the right things for our customers, spending the money where it makes sense and ultimately ending up in having better reliability.

Q Turn to Page 13, Ms. Williams. And commenting on Mr. Byerley's use of the four times factor for the replacement cost.

A Yes, I see that.

Q You said that he used a figure that includes other costs; e.g., cost to transfer facilities. What do you mean by cost to transfer facilities?

A The actual cost to transfer equipment from one pole to the other.

Q Conductor?

A It could be conductor.

Q Okay. You say that's not part of the pole cost, but isn't it part of the cost of replacing a pole?

A Yes, it is.

Q And if you'll look at Page 14, Lines 8 and 9. You state that based on FPL's experience, approximately 90 percent of damages to conductor during a storm results from wind, trees and debris.

Let's say we have a storm situation and a pole falls during high winds. Does FPL attribute that failure to wind or to the pole?

A Well, it depends. That's where the forensics came in, right, trying to determine what the ultimate root cause was of the pole coming down in the first place.

But my purpose, I guess, in identifying this is trying to rebut the statements that were made by Mr. Byerley that you could, you could draw a conclusion, if you will, and a ratio, come up with a ratio that for every pole that falls down, you can associate with it a certain amount of conductor. And his, his, his factor is at .88; for every pole that comes down, you can assume a .88 foot of conductor. And I don't -- or not foot, but percentage of whatever is in the total amount of conductor, and that's not accurate. That's not what happens in real life, so to speak.

And, again, Mr. Byerley doesn't have experience with hurricane restoration, but I can tell you that's it's all about speed. And what you want to do is reuse wire whenever you can. And if you look at the amount of splices into that material -- splices are devices that actually enable you to connect two pieces of wire together. The amount of splices that are issued during hurricanes is amazing because we are over and over again just putting up what was there before. Remember, it's not about bettering the system, it's just about restoring it.

So the instructions we give to foreign crews, foreign contractors and, of course, our own people know it, splice it, don't put it back in place. Where we do find that we've got to put new conductor in tends to be when, and it's a judgment call, when the amount of time to extract the conductor is so great that it would slow down your restoration. You're better off cutting it in the clear and stringing, putting in new conductor. And that typically happens when you have enormous amounts of debris. Think about a tree coming down and trees are enormous, they come down, the wire is tangled in it. In that case, you typically would not splice the wire; you'd leave it alone and you'd put new wire. With poles that's not what normally happens. With poles you can reuse the wire most of the time.

Q Are you finished?

A Yes, I am.

Q In your testimony you state that FPL does not specifically capture or track conductor damage caused by pole failures, do you not?

A That's correct.

Q When you used the 90 percent of damage to conductor and attribute that to wind, trees and debris, are you suggesting that 90 percent is to nonpole causes?

A That is correct.

Q And in doing so, are you making some assessment of the, those fallen poles that occur during windstorms and determining whether it's wind or the pole?

A No. We said if the pole went down, it doesn't matter what brought it down, if the pole went down, how much of it can we attribute just to the pole. So I'm not trying to use the forensics in some kind of funky way here. We're looking at the pole comes down and this was -- the 90 percent fact came in, or the 90 percent figure, I should say, it's not a fact, came from direct experience from the people who do the work.

We asked, what have you found? We've done a lot of restorations lately. How often are you faced with a situation of having to issue new conductor with, when poles come down? And the answer was, hardly at all, maybe 10 percent of the time. Over and over again we got that from the people that do the work. And that's the basis for my testimony.

Q Would you agree that when the decision is made to splice existing conductor rather than replace a conductor that the activity represents a cost?

A Yes, it does.

Q And where the pole brings down the conductor, would you agree that the cost of splicing and mounting that conductor should be associated with the, the cost of the pole?

A Say that second part -- repeat the question, please, if you will.

Q I'll try. I think you agreed that the, the activity of splicing rather than replacing cable represents a cost in itself?

A Yes, it does.

Q So in a given situation, whether the conductor is spliced and reused or whether the conductor is replaced, if that is occasioned by a deteriorated pole, then there is a cost in that situation that goes beyond the cost of the pole itself.

A Yes. But it would be a much smaller cost because of the relative amount of time needed to splice is so much smaller than the amount of time needed for putting in new conductor.

Q Did you develop the $2,000 estimate?

A Yes. We came up with that based on the billings that we actually will be providing to BellSouth actually for the 2005 poles that we replaced that belong to them. So we looked at what the actual cost that we incurred were from a labor, vehicle and material perspective, and it's going to depend, every pole is going to be a little bit different. Bigger poles are going to be more expensive than smaller poles. But on average it's about a $2,000 per pole cost. That's correct.

Q Are you aware that the corresponding amount for the 2004 storm season was significantly higher than 2000?

A Yes, it was. I know what that cost was. And we made -- I mean, we looked at the manhours and the cost per manhour and we made some significant productivity improvements in 2005 over 2004, which I think is very good for us and for our customers, and were able to reduce the effective rate, if you will, per pole.

Q If you'll look at Page 19, you comment on Mr. Byerley's reference to the JSB-17, which was the Katrina forensic compilation. Do you see that?

A Yes. Let me refresh my memory.

Okay. I see it, yes. I remember it.

Q You mentioned in your testimony that the document was developed at your request. It's true, is it not, that you also chose the team who prepared that report?

A Yes, I did.

Q And isn't it true that you regarded those team members as qualified for the purpose?

A Yes.

Q And, in fact, you regard them as bright and capable people?

A Very bright and capable.

Q And you don't disagree with the data that they evaluated, it's the conclusions that they reached; is that correct?

A For the most part. Although the data that they used, it was the raw forensics data. The -- what I mean by that is before it was adjusted for statistical validity and those types of things, but it was collected by the forensics teams and used by them. That's correct.

MR. McGLOTHLIN: Those are all my questions.

CHAIRMAN EDGAR: Thank you, Mr. McGlothlin.

Mr. Kise.

MR. KISE: Thank you. I just have a couple of questions.

CROSS EXAMINATION

BY MR. KISE:

Q Ms. Williams, could you please turn to Page 17 of your rebuttal testimony.

MR. BUTLER: I'm sorry. The page reference again?

MR. KISE: Seventeen.

BY MR. KISE:

Q Are you with me?

A Yes. Yes.

Q Okay. There at lines 17 through 19 there's a statement about Mr. Byerley failing to accept reality. "When hurricanes strike vegetation outages will occur even if 100 percent of FPL's lines are cleared to standard. Our experience over the last two storm seasons confirms this. Do you see where I'm reading?

A Yes.

Q How -- I'm just -- I need some clarification on that last statement. What does your experience, FPL's experience over the last two storm seasons confirm? I mean, are you saying there that 100 percent of FPL's lines were, in fact, cleared to standard?

A No, I'm not saying that at all.

Q Okay. Okay. What are you saying there about the, the -- at the risk of opening this up to a very long answer, but if you can make it short, that would be helpful. I just don't understand how those two concepts relate together.

A When we trim a circuit, and of course we have all of our circuits identified, we know that this circuit was just trimmed, trimmed to standard, work completed, and then right after that we experienced a hurricane, we still had tree-related outages on that circuit. That's the basis for my, my statement.

Q You had -- these aren't, these wouldn't -- you're saying tree-related outages but not hurricane tree-related outages, just ordinary tree-related outages?

A No, sir. I'm saying hurricane-related tree outages on circuits that had just been cleared to standard. That's, that's what I'm trying to say in my testimony.

Q Okay. I think I have that now.

Also, just following up really briefly on a statement you made in response to, I think, one of Mr. Wright's questions, just for clarification, I think you said hurricanes create new weak conditions; is that right?

A Yes, they do.

Q So then after the, the 2004 season concluded, as a result of those storms there would have been created new weak conditions; right?

A Yes, sir. That's correct.

Q Okay. And then as of at least May of 2005 you were aware, were you not, that we had an approximately 70 percent chance of an advanced hurricane season, of an above normal hurricane season in 2005; right?

MR. BUTLER: I'd object to the question. I'm not sure where the 70 percent figure is coming from.

MR. KISE: I'm just asking her if she was aware of it.

THE WITNESS: No.

BY MR. KISE:

Q You were not?

A No.

Q Okay. What do you rely on in terms of, of -- did you say again -- well, let me, let me shortcut this.

Does that assist in refreshing your recollection as to what you may have been aware of as of May 16th?

A No. I've never seen this document.

Q So then you weren't aware of -- I think you said in your direct testimony or yesterday, somewhere, that you rely on the National Hurricane Center for your predictions, you don't rely on folktales. That's what we heard the other day, you rely on the National Hurricane Center. So when you're told folktales, you don't bother to check on them, I know that. But if the National Hurricane Center tells you something, that's what you rely on; right?

MR. BUTLER: I would object to the characterizations in Mr. Kise's question.

MR. KISE: I'm just repeating her testimony, Mr. Butler. That's what she told us the other day. She doesn't rely on folktales, she relies on the National Hurricane Center. So now I have shown her a document in an attempt to assist in refreshing her recollection as to what she was aware as of on or about May 16, 2005.

She says that doesn't help, so now I'm going to have to ask her what it is that she, in fact, relies on.

CHAIRMAN EDGAR: Mr. Kise, I'm going to allow the question. I am going to ask similarly as to my request last evening at roughly approximately this time, let's maintain decorum. And I personally would request a little less sarcasm.

MR. KISE: If the witness -- yes, Chair. I will do so.

BY MR. KISE

Q I think this is a fairly straightforward question but I'll start again.

Are you saying that as of May 16th, 2005, you were not aware that we had a 70 percent chance of an above normal hurricane season?

MR. BUTLER: I'm going to object to the question again as lacking foundation. If he wants to put into evidence as an exhibit something and then talk about what the sources of it are and that sort of thing, that's fine. But at this point what we've got is a series of questions that are apparently based on a sheet of paper that he has handed the witness and nothing else.

MR. KISE: I was optimistic that I wouldn't have to go through that entire procedure. However --

CHAIRMAN EDGAR: Optimism abounds. But I am not clear as to the foundation, and so let's start there, if we could.

MR. KISE: Okay. Okay. Then I need to have what she has there -- at least we can assume -- I don't need a copy of it. And I don't have extra copies of it because, frankly, I did not think the witness would at all dispute something taken from the National Hurricane Center, which she herself says she relies on. But, nevertheless, I would ask that that be marked as whatever number we're up to. 159, 160?

CHAIRMAN EDGAR: I am at 166.

MR. KISE: 166, for identification purposes.

CHAIRMAN EDGAR: For identification purposes.

(Exhibit 166 marked for identification.)

MR. BUTLER: And I'd like to see a copy of it. I think it's a very understood part of the procedure of this body that parties who are making exhibits available for witnesses to be cross-examined are to provide you and the Commissioners and provide the counsel for the witness copies of what they're going to be talking about.

MR. KISE: And your statement is well-founded. You are absolutely correct. I would never in my wildest dreams have anticipated any dispute over an official prediction by the National Hurricane Center. In fact --

MR. BUTLER: I'm not disputing it. I haven't even seen it.

MR. KISE: I know you're not. May I borrow the witness's copy so I may show it to Mr. Butler briefly?

CHAIRMAN EDGAR: You may borrow the copy from the witness that you gave her.

In fact, and I was hesitating, but we're at about two hours and that's quite frankly generally when I need to stretch. So we will take ten minutes and come back shortly before 6:00.

(Recess taken.)

CHAIRMAN EDGAR: We'll go back on the record. And let's see.

MR. KISE: Madam Chair, I think we've worked this out.

CHAIRMAN EDGAR: I'm so pleased.

MR. KISE: I am too. And you have Mr. Butler to thank for being very reasonable. We are going to simply agree to move 166 into the record. And you have a copy of it there. I really do apologize for not having copies. But you have a copy of -- and we'll --

CHAIRMAN EDGAR: I do now have a copy and I thank you for that.

MR. KISE: Yes. And I assume we can just use the title that they've used, the NOAA 2005 Atlantic Hurricane Outlook, and it has a date.

CHAIRMAN EDGAR: We can.

MR. KISE: With that agreement, I have no further questions for this witness.

I told you we'd work it out.

CHAIRMAN EDGAR: Mr. Butler, do you have comment?

MR. BUTLER: Comment? No. I'm okay with the arrangement we made.

CHAIRMAN EDGAR: Okay. Good. Thank you, both of you. Give me just a minute. You caught me by surprise, so give me a second here to catch up. Okay. And, Mr. Kise, you said you were done with your cross; is that correct?

MR. KISE: Yes.

CHAIRMAN EDGAR: Okay. Thank you. Are there further questions from any of the other intervenors? Mr. Twomey? No. Executive Agencies? No. FIPUG? No. Okay. Are there questions from staff?

MS. GERVASI: Yes, ma'am. Thank you.

CROSS EXAMINATION

BY MS. GERVASI:

Q Ms. Williams, would you please turn to Mr. Byerley's prefiled Exhibit Number JSB-16, which is in evidence as Exhibit 81. Do you have a copy of that?

A Which number was it again, please?

Q JSB-16.

A Yes. Which page?

Q Page 6 of 10.

A Yes, I have it.

Q Do you see the footnote at the bottom of the page that says, "NF completed 49 percent of the poles targeted for replacement in 2001"?

A Yes.

Q And the remaining poles were not replaced due to O&M budget constraints in the area; correct?

A Yes.

Q NF stands for FPL's North Florida Management Area; is that right?

A It does.

Q Was it normal during 2005 for poles to not be replaced due to O&M budget constraints in the specific management area?

A In 2005?

Q Yes.

A Not that I'm aware of, no.

Q Could you please turn to Mr. Byerley's Exhibit JSB-17 in evidence as Exhibit 82 to Page 9 of that exhibit.

A Yes.

Q This exhibit indicates that wind-caused damage begins at 39 miles an hour and that FPL's distribution facilities are not designed to withstand winds greater than 118.6 miles per hour; is that right?

A That's correct.

Q How does FPL know that wind-caused damage starts at 39 miles an hour?

A I don't know what the source was for the creation of this particular page.

Q Does FPL know that wind-caused damage starts at 39 miles per hour?

A I don't know where they got this.

Q Regardless of what it says on that page?

A I don't know where they got this, so I can't really quite answer the question. So does FPL know? I don't know. It was presented. I'm assuming that the team had a basis for it.

Q So you don't know whether FPL knows that wind-caused damage starts at 39 miles per hour?

A I don't know the source that they used. I'm sorry. I don't know what source they used.

Q I'm asking from your direct knowledge.

MR. BUTLER: I'm sorry. Please let the witness finish answering the question. I also have to ask you what you mean by "FPL knows." I mean, are you asking the witness what she knows or are you asking is this --

MS. GERVASI: I'll rephrase.

MR. BUTLER: -- corporate knowledge or what?

BY MS. GERVASI:

Q Do you know personally whether wind-caused damage starts at 39 miles an hour?

A That's what this document says, and I would take it to be correct.

Q Thank you. Could you please turn to Mr. Byerley's Exhibit Number JSB-2 at Page 7? That's Exhibit 67 in evidence.

A Yes.

Q Could you take a look at photograph number 25, which is the top left photograph on that page?

A Yes, I see it.

Q Can you tell whether that shows a temporary or a permanent repair?

A That is a temporary repair that's a picture of a pole that's actually braced, and would then be taken care of as part of a follow-up repair.

Q Thank you. Just to be clear on what you believe should be charged to the storm reserve, would the cost of installing braces as shown in that photograph be included in the storm charges in accordance with FPL's petition in this case?

A Yes. Yes, they would.

Q If this pole is scheduled for replacement, would the pole replacement costs also be something that FPL would include in the storm charges?

A Yes, we would.

Q Regarding this specific brace in the photograph, does FPL or, rather, do you know if the brace was installed in 2005 or whether it was installed in 2004?

A I can't assert for sure that it was installed in 2005, but that's my belief because of the follow-up work that we did after the 2004 storms to take care of these types of things.

Q Does the company document when braces such as these are installed?

A We don't document them at the time of the actual brace being installed. But as part of a follow-up process where we actually do patrols and assess what work there is remaining, we do document that the braces are there and that they have to be made permanent, repairs have to be made permanent.

Q Thank you. Based on experience, is a pole such as the one shown in that photograph number 25, can you tell whether it's likely to withstand the stress of a Class 1 or 2 hurricane?

A In its current condition?

Q Yes.

A It's -- no, I would -- I can't, I can't say that it's exactly designed the way we'd want it to be, so probably not.

Q Would it withstand a tropical storm or a strong thunderstorm in your opinion, if you know?

A I don't know.

Q Could you please turn to Mr. Byerley's Exhibit JSB-2 at Page 20, and referring to photograph number 79, which is on the bottom left of that Page 20.

A Photograph number 79?

Q Yes.

A I'm sorry. I don't have number 79.

Q Do you have Page 20 of 22 of Exhibit JSB-2?

MR. BUTLER: Is it the photograph on the lower left?

MS. GERVASI: Yes, it is.

MR. BUTLER: Okay.

THE WITNESS: I don't -- I can't, I can't find it. I'm sorry.

MS. GERVASI: That's okay. We'll get you a copy.

THE WITNESS: All right. Okay. Number 75. Thanks, Joe. Okay. All right. I see it.

BY MS. GERVASI:

Q Can you tell whether that photograph shows a pole with a bolted brace similar to the pole that we were just looking at in photograph number 25?

A That's what it looks like, yes.

Q Do you know whether FPL keeps records which would indicate when the brace was installed on that pole on photograph number 79?

A No. But since these are pictures of a pole pile, the pole graveyard it's been called, at our physical distribution center, which is where we put all of the poles that were reclimated from the field as a result of the 2005 hurricane, I would say that this was probably in 2005.

Q Is it your understanding that all of the poles in photograph 79 held FPL electric facilities, FPL-owned facilities, the lines and the wires?

A Probably the great, great majority, yes.

Q Okay. Thank you.

Did FPL make permanent repairs to all damaged distribution facilities prior to the storms of 2005?

A I would say the first storm of 2005 was in July, Katrina -- Dennis. We were just short of completing the follow-up repairs on our laterals and feeders. We completed 100 percent, I think, like mid-August. But a tiny, tiny amount was left over. So I can't say that it was 100 percent in this area.

Q Thank you. Will FPL have completed and made permanent all repairs to all damaged distribution facilities prior to June 1st of 2006?

A For the feeder and laterals, distribution feeder and lateral follow-up repairs, yes, we will.

Q Thank you.

This is for purposes of understanding FPL's storm cost tracking methodology. And I'd like to pose a hypothetical to you using Mr. Byerley's photograph number 79 on Page 20 of his Exhibit JSB-2.

Assume that the broken pole with the brace on it as shown in that photograph is an FPL-owned pole that was repaired in 2004, and also assume that FPL scheduled a replacement prior to the 2005 storm season. Would I be correct to conclude that the cost for bracing the pole and the planned replacement would have been included in FPL's estimate of 2004 costs?

A Yes.

Q And then continuing on with that same hypothetical, assuming for good reasons that the pole replacement was not completed prior to the storm season of 2005 and that as a result of the storms the pole failed and FPL replaced it, what -- my question to you based on that, what documentation process exists that protects FPL's customers from paying twice for poles that were scheduled for replacements and included in the 2004 storm costs but didn't get completed prior to the 2005 storm season?

A Well, let me --

MR. BUTLER: Madam Chairman, I'm sorry. I don't believe --

CHAIRMAN EDGAR: Mr. Butler.

MR. BUTLER: -- this relates to any of Ms. Williams' rebuttal testimony. And probably to the extent it's an accounting question, if it is posed properly to anybody, it would be to Mr. Williams -- I'm sorry. Geez. I'm getting tired. To Mr. Davis.

CHAIRMAN EDGAR: Ms. Gervasi.

MS. GERVASI: We would be -- sorry. We would be happy to defer the question and we'll ask Mr. Davis. Thank you.

CHAIRMAN EDGAR: Okay.

BY MS. GERVASI:

Q Ms. Williams, would you please turn to the KEMA report. Do you have a copy of that?

A Yes, I do.

Q To Page 60 of RSB-1, the KEMA report.

A Okay. I have it.

Q And if you will look at the end of the first paragraph after the table where the report indicates about the 11 judgments for possible design overload that could be personal judgments from a small group of inspectors. Do you see where I'm at?

A Yes.

Q Do you agree with that assessment?

A Yes, I do.

Q I believe you've testified that already on cross-examination this evening that the forensic team was comprised of bright and capable people; correct?

A No. The forensic -- the forensic team is comprised of bright and capable people. However, the team that I was speaking of earlier is a different team. It's a team that actually did the analysis, a separate team that did the analysis of the forensic work. The forensic team captured the data, and then this hardening analysis team, if you will, analyzed the data. And earlier I was speaking about the latter, the hardening team. Notwithstanding, the, the forensics folks are, are very capable.

Q But the folks who analyzed the data may not be?

A They both are. They're all very capable.

Q Then would it be -- it wouldn't be good management practice for FPL to ignore the comments made by members of either of those teams, would it?

A No, absolutely. And I don't, I don't think that I'm doing that. What -- I think what this particular comment is, is pertaining to is it's specific to Hurricane Katrina, I believe, if I read this possibly. And they're saying that given the relatively low winds that were experienced relative to, say, Hurricane Wilma, that it is the judgment of the KEMA people that it could be individual personal judgments as it pertains to potential overloads as opposed to actual overloads. I think that that's what they're saying, and I think it's possible. I would agree with that.

Q Thank you. Could you please turn to Page 61 of the KEMA report.

A Yes.

Q At the beginning of the second to last full paragraph on that page, it indicates that KEMA relied on verbal data from FPL regarding the number of poles issued for Hurricanes Wilma and Katrina. Do you see that?

A The paragraph that starts, "As verbally verified by FPL"? Yes, I see that.

Q Why did KEMA have to rely on verbal data from FPL. Do you know?

A In terms -- they probably asked us how many poles were issued for hurricane replacement and we gave them the data. We probably showed them the number is 11,371 for Wilma and something less for, for Katrina. I think that they're relying on our word, so to speak, as opposed to looking at accounting records or purchasing records. I believe that's what's meant by that. But you'll have to ask -- it's too late now, but Dr. Brown would have probably been a better person.

Q Thank you. Would you please turn once again to Mr. Byerley's Exhibit JSB-16, Page 6 of 10?

A JSB. JSB-16, page?

Q Page 6.

A JSB-16?

Q Page 6 of 10.

A Exhibit 16?

Q Yes. JSB-16. Yes.

A All right. Okay.

Q There is a footnote at the bottom that states that "NF completed 49 percent of the poles targeted for replacement in 2001." Do you see that?

A Yes.

Q "The remaining poles were not replaced due to O&M budget constraints in the area." Correct?

A I see that.

Q Were the wooden poles that were not replaced due to budget constraints marked for replacement for safety concerns?

A But this is speaking to 2001.

Q Yes.

A So you're asking me -- I'm sorry. What was your question again?

Q I'm asking you whether or not those poles that were marked for replacement were marked for replacement for safety concerns.

MR. BUTLER: I have to object to this. I really don't see how this relates to Ms. Williams' rebuttal testimony.

MS. GERVASI: Ms. Williams rebuts Mr. Byerley's testimony. If she doesn't know the answer, "I don't know" is a perfectly acceptable answer.

MR. BUTLER: Well, that's not what I'm doing. I'm objecting to the question. I just don't think the question is within the scope of her rebuttal testimony. It's just kind of boring down deeply into some documents that were attached to Mr. Byerley's testimony. There's nothing that I can think of out of Ms. Williams' testimony where she's refuting something about this where the questions would be appropriate.

CHAIRMAN EDGAR: Ms. Gervasi, can you tie it to the witness's testimony?

MS. GERVASI: I'm sorry. I couldn't hear you.

CHAIRMAN EDGAR: Can you tie your question to the witness's testimony?

MS. GERVASI: Yes, I can. I can rephrase.

BY MS. GERVASI

Q Ms. Williams, does the National Electrical Safety Code require FPL to replace facilities that are unsafe?

A Yes, it does.

Q If there are remaining -- if there were remaining poles that were marked for replacement but not replaced due to budget constraints for whatever reason, how would you know that FPL is in compliance with the requirements of the National Electrical Safety Code?

A Well, I believe, and I certainly don't have the National Electric Safety Code in front of me, but I do believe that there is a certain amount of time that is available to go ahead and take care of those things. And so I'm confident that we were able to do that in the allotted time, but I can't assert to it absolutely as I sit here right now.

Q Thank you. I just have a few more questions.

If you would please turn to Page 31 of the KEMA report.

A Yes.

Q If you will please take a look at the third paragraph under Section 4.1. And this is a discussion of FPL's examination of both FPL-owned and non-owned poles; correct?

A Yes.

Q It states that FPL does not always know the final remedies undertaken by the pole owners, no process is in place to track what, what third parties do to the poles determined by FPL inspections and need attention; correct?

A That's correct.

Q Do you know if KEMA is correct about that assertion?

A I don't know if they're really correct about that. I do believe though that it's a process that needs to improve. Whether it's as bad as this, I don't know. But it's clearly a process that requires our, our improvement in terms of better coordination between the utilities.

Q Is it possible that some of FPL's facilities prior to the 2005 storm season were attached to poles that may not have met the requirements of the National Electrical Safety Code or of FPL's Distribution Engineering Reference Manual?

A It's possible, although in 2005 I don't believe -- and this is -- I don't believe that we knew of poles that needed to be replaced going into the storm season that had not been.

Q Thank you.

A It's possible, however.

MS. GERVASI: Thank you. I have no further questions.

CHAIRMAN EDGAR: Thank you.

Mr. Butler.

MR. BUTLER: Thank you.

REDIRECT EXAMINATION

BY MR. BUTLER

Q Ms. Williams, Mr. McGlothlin asked you some questions about, excuse me, funding for a pole inspection program as opposed to funding other reliability programs. Would you please explain the circumstances under which it might be more appropriate to fund reliability programs other than a pole inspection program?

A Yes. It's all about relative benefits of the various programs that are available to us to fund. The customer interruptions or the number of outages, reliability related issues associated with poles have historically been negligible, very, very small in nature, 158 in 2004, 160 in 2005 pole-related outages, again, out of over a million poles. As opposed to funding, for example, vegetation management initiatives or funding switch cabinet initiatives or cable rehabilitation initiatives where the impact are considerably larger. So in making decisions about which programs to fund, the relative value to the customer absolutely has to be taken into account, and that was the basis of my answer.

Q Thank you. You were asked some questions, excuse me, about JSB-17 in Mr. Byerley's, attached to his testimony, and this is the document entitled "Hardening Distributions Infrastructure."

A Yes.

Q The date upon which this analysis was performed came from what hurricane or hurricanes?

A The data came from the forensics teams strictly for Hurricane Katrina.

Q Okay. Do you consider Hurricane Katrina and the data collected from it to be representative for FPL's overall hurricane experience in the 2005 season?

A Not at all. The Hurricane Katrina, the damage, the profile, if you will, of the damage and the experience that we had with Katrina was completely different than what we saw with Hurricane Wilma. In terms of the causes, the main contributors to the outages that we had were very different in Wilma than they were in Katrina.

Q You explained just a few moments ago, but I, excuse me, I'd like to clarify in a particular context, you were shown by Mr. Kise in a document, a NOAA press release from May of 2005 concerning the expectations for the 2005 hurricane center -- season. I want to ask you about the concept of follow-up work. Would you explain, first of all, what that is, please?

A Yes. Follow-up work is the work that we do after hurricanes to make, to bring our storm, our system back to the prefailure state. I mentioned that hurricanes create new weak points: Connections become loosened, if you will, poles lean, that type of a thing. And the follow-up work first looks to identify all these different conditions that have to be addressed and then it actually physically corrects the issues. And it's a very big part of our post-restoration work for feeders and for laterals.

MR. KISE: Madam Chair?

CHAIRMAN EDGAR: Mr. Kise.

MR. KISE: I'm not quite certain, I could certainly be mistaken, particularly at this late hour. I think I was mistaken at this time last night. But nevertheless --

CHAIRMAN EDGAR: I remember that.

MR. KISE: Yeah, I think everyone -- I do as well. One of those moments.

At all events, I do not recall asking the witness anything about follow-up work or anything even close to that in my examination. I think this is outside the scope of redirect.

CHAIRMAN EDGAR: Mr. Butler?

MR. BUTLER: I don't think it is. I mean, I think clearly the import of what Mr. Kise had distributed as Exhibit 166 is that there was some expectation for an active hurricane season in 2005. I'm simply wanting to have the witness to provide some background on what was done in anticipation of that 2005 hurricane season.

MR. KISE: Madam Chair.

CHAIRMAN EDGAR: Mr. Kise.

MR. KISE: I think you will recall, in fact, I think you were very happy to receive our stipulation that I would, in fact, just introduce the document, and you will recall I did not ask the witness any questions about the document. We withdrew it from in front of her, put the document in evidence.

I don't know -- Mr. Butler is assuming he knows what's in my mind with respect to this document. But since I didn't ask for any questions about it, I don't think it's proper for redirect.

CHAIRMAN EDGAR: Mr. Butler, I was going to say that I don't know what the import of the document is. Let's move along.

MR. BUTLER: Okay.

CHAIRMAN EDGAR: Thank you.

BY MR. BUTLER:

Q Ms. Williams, you were asked about a photograph numbered 79 in Mr. Byerley's Exhibit JSB-2. Do you still have that available to you?

A Yes, I do.

Q And this is a picture of some poles at the FPL pole retention yard or pole pile as you described it, correct?

A Yes.

Q Do you have any way of knowing, looking at the poles in there whether they are FPL owned poles or non-FPL-owned poles?

A I know that the green poles are ours. Other than that, once the pole has weathered to a certain point it is difficult to determine whether it is an FPL pole or somebody else's pole.

MR. BUTLER: Those are all the redirect questions I have. Thank you.

THE WITNESS: Thank you.

CHAIRMAN EDGAR: Let's take up the exhibits.

MR. WRIGHT: Madam Chair, I move 163, 164, and 165.

CHAIRMAN EDGAR: Are there objections? I am seeing none, so we will enter 163, 164, and 165 into evidence.

MR. WRIGHT: Thank you.

CHAIRMAN EDGAR: Mr. Kise.

MR. KISE: And, Madam Chair, I would move 166 into evidence pursuant to the stipulation between counsel.

CHAIRMAN EDGAR: Mr. Butler.

MR. BUTLER: That's right. That's fine.

CHAIRMAN EDGAR: 166 will be entered into evidence.

(Exhibits 163 through 166 admitted into evidence.)

CHAIRMAN EDGAR: Okay. Let's take a keep breath for a second and see where we are. I've got 6:30ish. And, I'm sorry, Ms. Williams, you are excused.

THE WITNESS: Thank you.

CHAIRMAN EDGAR: I am showing four more witnesses and probably a little discussion and a little discussion. I realize, of course, that it will have to be approximate, but let's take a survey and just kind of see where we are. And, Mr. Butler, why don't we start with you. Can you give me a feel, an estimation as the next and remaining four witnesses are proffered? And I will kind of ask the same about cross, just so we will all have the same information at the same time.

MR. BUTLER: There is a stipulation I understand as to Mr. Olson and Mr. Dewhurst, which ought to at least limit the examination time for them. Of course, for Mr. Gower and Mr. Davis, they are our witnesses, so it's mostly out of our hand as to how long the examination will take for them.

CHAIRMAN EDGAR: Mr. Beck, Mr. Kise, can you give us a feel, realizing that it is --

MR. KISE: Sure. I certainly can, Madam Chair.

CHAIRMAN EDGAR: Thank you.

MR. KISE: With respect to the remaining witnesses, as it stands now I have questions only for Mr. Dewhurst. I don't have any questions -- I mean, I don't want to preclude myself if I hear something, but I certainly don't anticipate any questions for any of the witnesses with the exception of Mr. Dewhurst. And with respect to Mr. Dewhurst, based on his examination the other day, I would anticipate that would not take -- and what I mean by that is how he answers questions, I would not accept that would take longer than about 15 or 20 minutes.

CHAIRMAN EDGAR: Thank you. Mr. Perry.

MR. PERRY: I don't have any planned questions for any of the witnesses, so I would just have any clarifying questions as they came about.

CHAIRMAN EDGAR: And I am not using this as a mechanism to foreclose questioning, again, just for planning purposes.

Mr. Twomey.

MR. TWOMEY: Madam Chairman, I only have questions for Mr. Dewhurst and I would anticipate depending upon the length of his responses, of course, to run between 30 and 40 minutes.

CHAIRMAN EDGAR: Thank you. Captain Williams.

CAPTAIN WILLIAMS: Ma'am, we do not have any planned questions either for any of the remaining witnesses.

CHAIRMAN EDGAR: Thank you.

MR. LAVIA: Madam Chairman, Jay LaVia. I got the night shift for the Federation.

CHAIRMAN EDGAR: Short straw?

MR. LAVIA: We don't anticipate any questions, but we don't want to waive our right to ask them.

CHAIRMAN EDGAR: Absolutely. Mr. Beck.

MR. BECK: Madam Chairman, I have just a few minutes of questions for Mr. Gower. Mr. Davis, 15 or 20. Maybe 10 to 15 for Mr. Dewhurst. Just approximations, of course.

CHAIRMAN EDGAR: Okay. Staff?

MR. KEATING: I believe we only have a few questions for Mr. Davis.

CHAIRMAN EDGAR: Okay. And I appreciate the cooperation of all of you, and let's go ahead and call Mr.

Olson. We will forge ahead for a little while longer. I remain optimistic.

Mr. Litchfield.

MR. LITCHFIELD: Thank you, Madam Chairman. Mr. Olson was sworn yesterday, or actually Monday. And as Mr. Butler indicated, Mr. Olson will be taking the stand subject to the stipulation that Mr. Cochran outlined earlier, so I will be presenting him, and he will present a short summary and then will be available for questions from the bench.

CHAIRMAN EDGAR: Thank you.

WAYNE OLSON

was called as a rebuttal witness on behalf of Florida Power and Light Company, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LITCHFIELD:

Q Mr. Olson, you appeared earlier in this case --
A Yes.
Q -- in connection with your direct testimony?
A Yes.
Q Did you also prepare and cause to be filed 33 pages of prefiled rebuttal testimony?
A Yes, I did.
Q Do you have any changes or revisions to that testimony today?

A No, I do not.

Q If I were to ask you the same questions contained in your rebuttal testimony, would your answers be the same?

A Yes.

MR. LITCHFIELD: Madam Chairman, I would ask that Mr. Olson's prefiled rebuttal testimony be inserted into the record as though read.

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

THE WITNESS: Could I also note that there are two exhibits attached to my rebuttal testimony?

MR. LITCHFIELD: Yes, I was going to ask you about those.

BY MR. LITCHFIELD:

Q You have two Exhibits WO-11 and WO-12 attached to your rebuttal testimony?

A Yes.

Q Consisting of two pages each.

MR. LITCHFIELD: And, Madam Chairman, those have been premarked and have been entered into the record.

CHAIRMAN EDGAR: Thank you.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF WAYNE OLSON

DOCKET NO. 060038-EI

APRIL 10, 2006

I. INTRODUCTION

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

A. My name is Wayne Olson. My business address is 11 Madison Avenue, New York, New York.

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

A. Yes.

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

A. Yes. I am sponsoring an exhibit, which consists of Document Nos. WO-12 and WO-13 attached to this rebuttal testimony.

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

A. My testimony responds to points raised by Staff Witnesses Fichera, Klein and Noel. Rate reduction bond ("RRB") markets have become very efficient over time and new issue pricing has less risk and reward than it used to. With respect to the bond issuance process, I note that there is continuing experimentation in the market in this regard, with a menu of available options. In an era of tightened spreads and increased market liquidity, it is less likely that the incremental costs and additional time associated with the activist approach will be justified. I will then present what I consider the essential elements of a successful, cost effective issuance process and discuss various aspects of the issuance process in some detail. I conclude with some observations about the exposure of issuers and their control persons to liability under the securities laws and about the investment characteristics of rate reduction bonds.

II. CURRENT MARKET AND HISTORICAL TRENDS

Q. Please recapitulate briefly from your direct testimony some key elements of the market environment for storm recovery bonds.

A. Storm recovery bonds ("SRBs") are one of a class of securities generically known as rate reduction bonds ("RRBs"), and referred to in Mr. Fichera's testimony as ratepayer-backed bonds. They have historically been considered a type of asset-backed security ("ABS") although they have characteristics of corporate and public-sector securities as well. ABS are traded at interest yields that are quoted in terms of their "spread to swaps," that is, the differential between the ABS yield and the yield on interest rate swaps of comparable average life. Spreads are measured in basis points. A basis point is 1/100 of a percentage point, equal to the difference, for example, between 4.51% and 4.50%.

Q. Mr. Noel's Exhibit MLN-2 reviews some history of the RRB market and reaches a conclusion that, during the period from mid-2000 to mid-2004, the services of Saber Partners as financial advisor on a new issue of RRBs

was worth somewhere in the range of 15 to 20 basis points of yield on a 10-year bond. What is your view of this study?

A. I think it has little relevance to the issues facing the parties to this docket, because market conditions have changed considerably since the study was performed, rendering the conclusions not meaningful for predicting results in today's markets.

Q. Can you elaborate?

A. The study hearkens back to a time when spreads in the high-grade capital markets were much higher, more volatile and less predictable than they are today. For example, from 2000 to 2003, spreads on the 10-year RRBs bounced back and forth between 30 and 50 basis points over the 10-year swap rate, then dropped throughout 2003 and into 2004. In contrast, since mid 2004, spreads on RRBs have been steadily grinding tighter and tighter with very little volatility. Similar patterns have occurred in the markets for other asset backed securities and for high-grade utility bonds.

Document No. WO-12 provides a graphic depiction of these phenomena. The first page of the document shows RRB spreads to swaps for 2, 5, 7 and 10 year bonds from late 2000 to the present. The second page shows spreads to Treasuries for a 7-10 year "A" utility bond index, 10-year RRBs, 10-year fixed-rate credit card securities and 10-year swaps over the same timeframe. I think they demonstrate vividly that the first six years of this decade have been a "tale of two markets." There was considerably more risk and reward for issuers in the highly volatile market of 2000-2003 than in the lower rate, less volatile environment of 2004 to today.

Q. How has this dramatic change in market environment affected the differentials between Saber-advised and non-Saber-advised deals that were discussed in Exhibit MLN-2?

A. Document No. WO-13 is intended to re-produce the graphs that were presented in Exhibit MLN-2, except that the time period under study is not 2000-2004 but 2004-2006. During this recent timeframe, there were six public rate reduction bond offerings, three of which involved Saber as an advisor and three of which did not. The results for issuers appear to be random, as between the two sets of offerings. Some were a little better or worse than others, but not by much. In general these graphs show no particular pattern. They depict a liquid, efficient market where the risks and rewards for issuers are much lower.

Q. What other trends are there that might be relevant to storm recovery bonds?

A. In the past two years, high-grade credit spreads have become tighter in most sectors and the differential between tiers of credit has narrowed considerably. This trend has been noted with concern from the Fed, as it implies that lenders are receiving less and less return for taking credit risk.

In the same period of time, ABS have gone from being one sector out of many to being the largest single sector of the U.S. debt capital markets other than

Treasuries and agencies. Last year, there were about $1.2 trillion in new issuance of term ABS and approximately $900 billion in asset-backed commercial paper outstanding. This compares with $675 billion in new issuance of high-grade corporate term debt and $125 billion of corporate commercial paper in 2005. In other words, ABS accounted for over $2 trillion in financings, while high-grade corporate securities were less than $1 trillion.

This dominant position of the ABS market for the past two years has been associated with a dramatic tightening of ABS spreads and an increase in market liquidity. RRBs have been part of this trend.

Q. What do you conclude regarding Exhibit MLN-2 attached to Mr. Noel's testimony?

A. From the data in Document No. WO-13, it is difficult to detect any systematic difference in new-issue pricing performance between Saber-advised and non-Saber advised deals in the past two years. What it does tend to show is that, as noted by Mr. Fichera in his testimony, "[p]ast performance is not a guarantee of future results. The process must adapt to changing market conditions."

Q. Exhibit JSF-5 to Mr. Fichera's testimony contains a graph attributed to Lehman Brothers and a table attributed to your firm. What significance do you think these have?

A. With respect to the Lehman Brothers graph, I agree with Mr. Fichera's statement that fixed-rate credit card securities ("fixed-rate cards") are a good comparison for RRBs, as they tend to be the lowest-yielding asset class (other than RRBs) in the ABS universe. The graph shows that, as ABS credit spreads in general have tightened over time, RRB credit spreads have tightened relative to fixed-rate cards, to the point where the two currently trade very close to one another. Focusing on the 9-10 year WAL (weighted-average life) portion of the graph, it reflects the fact that RRBs, which were first introduced in 1997, have matured as an asset class to the point that they are as familiar a commodity as credit card securitizations, which were first introduced about ten years earlier.

The Credit Suisse table cited by Mr. Fichera does not demonstrate a difference between Saber-advised and non-Saber-advised issues, in terms of their new-issue pricing performance relative to fixed-rate cards, in the market environment of the past two years.

III. ISSUANCE PROCESS

A. Alternative Approaches

Q. Has there been an evolution in the rate reduction bond market with respect to Commission Staff involvement in the issuance process?

A. Rather than an evolution, I would say that there has been experimentation with different approaches to the issue of regulatory involvement in the issuance process.

Q. Does it follow that the most recent transactions from Texas and New Jersey are "state of the art"?

A. Not necessarily. In 2005 alone, there were several different approaches, like a "menu" of options.

For example, the NSTAR transaction in Massachusetts on February 15, 2005 used a "conduit" municipal issuance vehicle. California had previously used this method but more recently, in the PG&E transactions on February 3, 2005 and November 3, 2005, California used a "Bond Team" consisting of the Commission's general counsel, the director of the energy division, other Commission staff, outside bond counsel and an independent financial advisor to oversee the process. New Jersey (PSE&G, September 9, 2005) used a designated Commission representative with an independent financial advisor. In Texas (CenterPoint, December 16, 2005), the Commission acted through its financial advisor, which acted as co-equal decision-maker with the utility and was vested with veto power.

Q. Have there been further developments since the conclusion of the 2005 transactions you just referenced?

A. Yes. Even after their 2005 transactions, both the Texas and New Jersey Commissions continue to reconsider and experiment with their review processes. The New Jersey Board of Public Utilities experimented with the Saber-recommended process on one small transaction in 2005, but for its upcoming transaction it reverted to the financial advisor that it had employed in prior transactions. The Texas Commission, in an open meeting on February 23, 2006 regarding the application of AEP Texas Central for a financing order, authorized its executive director to hire Saber Partners as financial advisor on that upcoming transaction at fees capped at $500,000 (including $100,000 for legal expenses), an amount equal to roughly half of that paid in the 2005 Texas securitization transaction and a third of that paid in the 2004 transaction. The scope of services for this upcoming Texas transaction is not yet determined, to my knowledge.

Q. Do you think it is possible for the issuance process for rate reduction bonds to be a collaborative one between the utility and the Commission, while enabling each to fulfill its responsibilities with respect to the transaction?

A. Yes.

Q. What do you think are the essential elements of a collaborative securitization process?

A. The essential elements of a collaborative securitization process can be thought of in roughly chronological order. In describing these, I will use the term "bond team" as a generic term to refer to the Commission and/or Staff personnel assigned to the task plus their outside legal and financial advisors and the "working group" to refer collectively to the bond team plus the utility, the underwriters and their respective counsel. I believe the essential elements are as follows:

1. Early agreement among the working group on a transaction timeline, the tasks to be completed and the checkpoints along the way.

2. Working group review and discussion of operative documents, offering documents, sales presentation materials (which may be considered offering documents) and a marketing plan. Forms of legal opinions should be circulated among the working group as they are developed, although this may be later in the process.

3. Regularly scheduled conference calls of the working group to discuss the progress of the execution of the marketing plan, next action items and any other issues as they arise. It may be advisable to circulate agendas prior to the calls and to keep minutes, to assure transparency.

4. Review of pricing indications before they are communicated to the market. To facilitate this review, the financial advisor or the underwriters should prepare and distribute a "pricing book" documenting market conditions relevant to the pricing discussion. Additionally, the utility should prepare a pro forma issuance advice letter for review by the bond team. The book-building progress should be discussed with the working group at frequent intervals.

5. Any approvals required for closing, other than ministerial items, should be delivered at or before pricing.

6. Post-closing review of the upfront bond issuance costs, such as legal fees and printing costs, as provided by the Florida statute. This may involve fact-gathering during the issuance process, to facilitate the review.

B. Saber Scope of Services and "Best Practices"

Q. Are you familiar with the scope of services provided by Saber Partners in some of the prior Texas transactions?

A. Yes. I was involved in all but one of the Texas transactions.

Q. What aspects of that scope of services would you like to bring to the attention of the Florida Public Services Commission (the "Commission")?

A. For convenience, I will organize my response by reference to Mr. Fichera's Exhibit JSF-1.

In Exhibit JSF-1, the "General Duties of the Financial Advisor" strike me as statutory duties of the Texas commission itself. This Commission will need to determine the extent to which it can and should fulfill its statutory duties acting through an outside consultant.

Under "Specific Duties of the Financial Advisor," Saber had the duty "to veto any proposal that does not comply...." I would have expected a consultant to advise Staff of its concerns about a particular issue and Staff to discuss them with the utility, not for the consultant to exercise veto power over the conduct of the deal. Additionally, Saber had up to two business days *following* the pricing to give notice of non-compliance, which effectively gave Saber a veto power *after* the bonds have already been sold. In my opinion, the ability to veto a transaction which has already been priced and confirmed with investors is an extraordinary power which should not be vested in an outside financial advisor, if it is to be used at all. For reasons that I discuss more fully below, I believe that all required approvals should be delivered at or before pricing. Post-pricing disapproval could have had significant adverse effects on customers' long-term interests.

Under "General Authority of the Financial Advisor," Saber had "authority to participate fully and in advance in all aspects...including all plans and decisions related to the pricing, marketing and structuring of the transition bonds." I think a review process can be successfully conducted through a systematic process involving regular update calls, detailed briefings and other information requested by Staff without involving Staff's outside consultant in every meeting, phone call, plan, detail and decision.

Saber had "equal rights with the utility" and "decision-making authority co-equal with the utility with respect to the structuring and pricing of the bonds. Thus, all matters relating to the structuring and pricing of the transition bonds [had to] be decided jointly by the utility and the Commission's Financial Advisor." In my experience, co-equal decision-making is a process that is likely to produce friction and inefficiency, where one of the co-equal decision makers bears significantly more of the direct costs, opportunity costs and legal risks (including securities law liability) than the other.

Q. Are these observations relative to Exhibit JSF-1 equally applicable to the corresponding points in the discussion of "best practices" on pages 47-51 of Mr. Fichera's testimony?

A. Yes. Mr. Fichera's proposed "best practices" are consistent with his work on the Texas transactions.

C. Incentives and Dynamics of the Issuance Process

Q. Mr. Fichera has raised some concerns about the incentives of the participants in the issuance process. What is your view of the incentive structure of rate reduction bond transactions?

A. The utility has an incentive to achieve lowest yield on the RRBs, not because of a direct economic impact, but because it will want to maintain the relative value spread between its triple-A RRBs and its lower-rated debt securities. However, as with any issuer, the drive for lowest interest rate will be constrained by time, expense and the ultimate uncertainty of the marketplace.

The underwriter has an incentive to achieve the lowest yield on the RRBs, not only because of the usual desire to put itself in a position to do future business with the parties and other state commissions or utilities, but also because of the need to enhance the value (or avoid reducing the value) of its trading inventory. Underwriters who have significant secondary market positions in ABS have a powerful incentive to be disciplined in the pricing of new issues. For example, Credit Suisse's inventory of ABS averages about $1.25 billion at any given time. Spread risk is generally not hedgeable. If spreads widen on new issues, the firm's profit on the inventory it holds tends to shrink or become negative.

The Commission has an incentive to achieve lowest yield on the RRBs for the benefit of customers, balanced against the interests of customers and the utility in seeing the transaction done expeditiously and efficiently.

The financial advisor to the Commission, like the underwriters, has the incentive to achieve the lowest possible cost of funds at the time of pricing in order to enhance its opportunity for future business. Unlike the utility, however this goal is not constrained by any limits on time and expense, because these are at the cost of the utility or the customers and do not show up in pricing spreads. If given control over the process, whether directly or indirectly, the financial advisor can zealously pursue its goal without taking into account these other important considerations. Additionally, the advisor has little incentive to be sensitive to the utility's exposure to incremental legal risks, because these have no adverse impact on the advisor and may have a positive impact on pricing spreads. Unlike the Commission, the advisor has no duty to consider any interests of the utility.

Q. Does this incentive structure lead to a collaborative and collegial process when the Commission vests negotiating authority and veto power in the financial advisor?

A. Not in my experience. I have found that the process in such cases is adversarial by nature, regardless of the good will of the parties. I don't see how it could be otherwise, given the incentive structure. The requirement for "consensus" as a practical matter requires unanimity on every decision. However, the parties are naturally at odds on almost every decision as to how much time and expense to incur in the marketing of the bonds, how much risk to assume in the way that the offering documents are drafted, and when to price. The financial advisor under such a framework has little incentive to spare any expense of time or resources or to consider any legal risk on the part of the utility.

Q. Do you think the dispute resolution process proposed by Mr. Fichera would solve the problem of such disagreements?

A. I don't know whether this would work in practice. The issuance of securities is a complex process with a myriad of details to be attended to and many points of decision making along the way. With an asymmetrical incentive structure, the points of contention may be too numerous to be resolved through such a process. However, if such a process is implemented, I would recommend that if Staff and its financial advisor have a "difference of professional opinion" about something, they should resolve it among themselves, such that any presentation to the Commission would be solely by Staff and FPL.

Q. What would tend to make the process more collaborative and collegial?

A. I think two items would be beneficial toward this end. The first would be to make the roles clear such that ultimate authority for decisions and responsibility for the process is clearly vested in one party or the other. The second would be direct and active exercise by Staff of its role, rather than effectively vesting it in an outside financial advisor.

Q. Can you give an example of how collegiality can break down among persons of good will, given the incentive structure?

A. The divergence of incentives is quite pronounced when issues arise relative to the prospectus and the internet road show (which is considered a "free-writing" prospectus under federal securities regulations that become effective on December 1, 2005). The financial advisor's incentive is to induce the issuer (by indicating a willingness to veto the transaction) to make aggressive statements containing positive disclosure regarding the investment merits of the bonds. This incentive is not counterbalanced by sharing the issuer's liability for possible violation of federal securities laws. The utility's view of such language, in contrast, will be strongly impacted by this counterbalancing concern, because such statements may result in securities law liability on the issuer and the utility.

Under the federal securities laws, positive disclosure requires careful drafting and close scrutiny of each statement, not only to verify its truth, but to make sure that nothing is said or implied that could potentially be construed after the fact as misleading to investors, even if unintentionally. However, careful wording necessarily reduces the impact of the statements, so these two positions are directly at odds in ways that can be irreconcilable. When two co-equal decision makers approach the drafting of the prospectus and the internet road show with these divergent incentives, legal costs mount up, time frames extend and the atmosphere becomes non-collegial.

D. Certification as to Lowest Cost of Funds

Q. Do you think it is appropriate to require certifications that lowest cost of funds has, in fact, been achieved?

A. No. Certifications ought to relate to facts that are knowable. While it may be possible to certify what steps were taken in the pursuit of the lowest cost of funds, it is not knowable whether the lowest cost of funds has been achieved.

Q. Why do you say that it is not knowable whether lowest cost of funds has in fact been achieved in any particular situation?

A. I do not know anyone who can say for sure when he or she has gotten top dollar when selling or rock bottom when buying, no matter how diligently they have strived for this goal. This is true because price discovery costs time and money; there is always one more possible buyer or seller that could be pursued, and the market itself does not stand still but is in constant motion over time.

For example, a person buying or selling a car might use internet services, newspaper advertisements and/or visits to local car dealers to obtain a series of bids or offers for the vehicle. No one will ever know for sure whether a better bid or offer could have been obtained if they had used other websites, tried other newspapers or visited dealers in a more distant market area.

Q. Why not require certifications regarding lowest cost of funds, even though it's not literally knowable, in order to motivate the highest possible standard of care?

A. Anyone agreeing to give such a certification is in a difficult position. Since it is not possible to determine whether absolute lowest cost of funds has been achieved in any particular situation, each party giving such a certification, including the commission's financial advisor, will tend to go to extraordinary lengths, not necessarily to achieve lowest cost, but rather to satisfy itself that someone else could not argue that lowest cost of funds was ***not*** achieved.

Q. Why is this undesirable?

A. This will tend to lead to higher issuance costs, longer delays in the transactions and heavier demands on the personnel of the utility. To the extent that any trade-offs might be desirable between cost of funds and any other considerations, the absolute lowest cost of funds standard would not permit anyone with liability to make such a judgment call. For example, while there is a public interest in seeing the utility complete its financing, replenish its storm reserve for the 2006 hurricane season and get on with the normal task of providing electricity to customers, such a concern is not permitted to enter the equation of "lowest cost of funds."

If there is a perceived misalignment of incentives, I think the desired result should be to motivate the utility and the underwriters to exert the same standard of care and diligence that they would if the utility were transacting for its own account. Since an absolute standard implies that they must literally leave no stone unturned, it will induce them to go on turning over stones even after the point where, under ordinary circumstances and dealing for their own account, they would have judged the law of diminishing returns to have set in.

Q. Do you think that a "lowest cost of funds" standard is necessary to assure a fair market price for customers?

A. No. There are at least three reasons.

First, the Commission's financial advisor is thoroughly familiar with rate reduction bond transactions and is able to advise the staff when a suggested pricing level would represent a fair deal for customers in light of market conditions, the terms of the financing order and the agreed upon process and timing.

Second, the market for asset backed securities in general and rate reduction bonds in particular is highly liquid and broadly understood. The liquidity and breadth of the ABS market have become even more pronounced in recent years, as I have discussed.

Third, as noted in my direct testimony, the new-issue process for asset backed securities is similar to that for high-grade corporate bonds and requires a similar level of care and due diligence on the part of the utility. FPL is a highly regarded participant in the high-grade corporate bond market and has the expertise and corporate culture necessary for conducting a well-run issuance process in storm recovery bonds.

Q. **Do you agree that being held to a strict or unqualified standard as to lowest cost ensures achieving the objectives of the transaction?**

A. No, because there are conflicting effects. As stated above, such a standard tends to lead to higher issuance costs and longer delays, each of which is inconsistent with an overall objective of completing the transaction efficiently and expeditiously at the lowest total cost.

E. Authorization at Time of Decision, Not Afterward

Q. Why do you recommend that all required authorizations and approvals (save those relating to confirming arithmetic accuracy of calculations) be delivered at or before pricing?

A. A pricing call involves a confirmation of prices for bonds at a particular moment in time, at which ownership and economic risk is agreed by all parties to pass from issuer to underwriters and from underwriters to investors. The terms of trade are confirmed orally by conference call with reference to benchmark pricing that is supplied on electronic screens real-time by one or more agreed-upon market information services. Once trades are confirmed orally, they are considered final and binding on all parties. Written confirmations that follow are intended as a bookkeeping discipline, for the parties to agree on arithmetical accuracy. Buyers will typically enter into (and sellers will close out) hedging transactions immediately upon oral confirmation. A failure to issue the bonds post pricing, which would follow from the refusal of one party to deliver its required certificate, would have enormous consequences for all parties, and would certainly compromise the ability of Florida utilities to employ this financing method in subsequent transactions.

IV. APPLICATION OF THE SABER PROGRAM IN TEXAS

Q. How long should it take to bring a rate reduction bond transaction to market?

A. The relevant measurement is from the date that the financing order has become final from a regulatory perspective, and upon settlement with all parties or expiration of all applicable judicial appeal periods.. At this point, if the registration statement is ready to file and the rating agency presentation prepared, the process can be completed within 60 days, barring review by the SEC or extensive comment on documents (particularly legal opinions) by the rating agencies.

Q. How long has it taken for Texas deals to go from the non-appeal date to the pricing?

A. By Credit Suisse's estimate, it has ranged from 55 to 232 days (from about 2 to 8 months), with the average of the four most recent deals being about 167 days (about 5.5 months).

Q. To what do you attribute this extended time frame?

A. I think it is primarily due to extended discussions among the parties (with significant attorney involvement) achieving no resolution for extended periods of time.

Q. Did the competitive selection process for underwriters that was initiated and organized by Saber Partners result in a reduction of the issuance costs borne by the customers of Texas utilities?

A. In the first four of the five Texas transactions to date, the evidence does not favor such a conclusion. In the requests for information ("RFIs") for prospective underwriters, respondents were not asked to specify an underwriting fee proposal. In each of these transactions, the underwriting fee agreed to up front was identically 0.48%. In each case, the underwriters' fee was reduced by approximately 0.06%, to approximately 0.42%, but customers did not receive the benefit this fee reduction (approximately $1.6 million in total) because it was made payable to Saber Partners as part of the advisory fees discussed below.

Q. **Was the fifth transaction different?**

A. Yes. The RFI for the CenterPoint offering required prospective underwriters to suggest an underwriting fee. In its response to the RFI, Credit Suisse suggested a fee lower than the 0.48% previously charged. In connection with the selection process for underwriters, a commissioner spoke directly with my firm and asked if we would agree to a still lower figure, which Saber confirmed at 0.40% on fixed rate bonds and 0.375% on floating rate bonds. The fee reduction accomplished through this process, approximately $1.7 million, was not paid to Saber but went directly to the benefit of customers.

Q. **According to Mr. Fichera's testimony, Credit Suisse, as CenterPoint's financial advisor, proposed an underwriting fee of 0.55% on that transaction, but the final fee negotiated by Saber was 0.38%. In response to FPL Interrogatory No. 24, Mr. Fichera indicated that the competitive process was initiated and organized by Saber in cooperation with the utility. What is your response?**

A. I presented the figure 0.55% in my testimony in that docket simply as an estimate based on historical averages. It was not a prediction of the outcome of CenterPoint's competitive process. CenterPoint did not propose to hire any underwriters at such a fee. The fee negotiation is described in my previous response. If the fee negotiation element of the underwriter selection process in the CenterPoint deal was initiated by Saber, I am unsure why it was not employed in the four prior Texas transactions.

Q. **Has the Texas issuance process, which applied many of Mr. Fichera's proposed "best practices," involved significant legal and financial advisory fees?**

A. Yes. Over the five Texas transition bonds, according to filings in the respective dockets, legal fees have totaled approximately $21.5 million, or an average of $4.3 million per deal. This is about $11.6 million more than the $9.9 million originally budgeted in the related financing orders. The financial advisory fees totaled $6.7 million, or about $1.3 million per deal, of which $5.7 million were awarded pursuant to a single RFI process conducted in 2000.

Q. **Have the incremental issuance costs been justified by reduced interest costs?**

A. Putting aside the indirect costs of such a process in terms of time and resource commitment by the parties as well as the Commission, I do not know how to estimate with any precision either the quantifiable incremental issuance costs attributable to the activist approach that Mr. Fichera has advocated or the basis-point savings that may have resulted from it. However, I would like to suggest an analytical approach to "boxing in" the trade-off between issuance costs and interest costs. This involves calculating how much a basis point in interest cost is worth in today's dollars.

Q. How can we measure the value of a basis point in interest cost savings relative to a dollar amount of incremental issuance costs?

A. The value of a basis point of interest cost can be expressed as a dollar-price equivalent, which is the change in the dollar price of a bond that would result from a one-basis-point change in its yield. A "dollar-price" is the amount paid for a bond, net of accrued interest, expressed as a percentage of its face amount. The dollar-price equivalent of a basis point, multiplied by the face amount of bonds, will give the amount of money in today's dollars that a basis point of savings is worth over the life of the bonds.

Q. Can you give an illustration?

A. Set forth below, for the illustrative structure of FPL's proposed bond issuance presented in Document No. WO-2 to my direct testimony, is the dollar-price equivalent of a basis point change in yield for each of the four tranches of that particular structure and for the deal as a whole.

Tranche	Balance	Weighted Average Life	Dollar Price Equivalent of 1 bp	Dollar Value of 1 bp
A1	$201,000,000	2.0	0.0187%	$37,507
A2	$240,000,000	5.0	0.0437%	$104,808
A3	$106,000,000	7.0	0.0585%	$61,999
A4	$503,000,000	10.0	0.0771%	$387,914
	$1,050,000,000	**7.0**	**0.0564%**	**$592,228**

Stated another way, every basis point of additional interest rate has a present value cost of about $600,000, or about 0.056% of the face amount of the bonds.

Q. Is there another common approach, if we don't have cash-flow models to make such calculations?

A. Yes. The calculation above is a transparent way to derive the index that equates dollars today to interest paid over time. The "duration" of a bond is a different calculation that results in a substantially identical index of the dollar-price equivalent of a basis point. For example, the duration of the structure in Document No. WO-2 is approximately 5.6 years, corresponding to a 0.056% movement in dollar price from a 1 basis point change in yield.

Q. Is the original duration of the Texas transactions at time of issuance available?

A. Yes. On a weighted average basis across all five deals it is approximately 6.1 years.

Q. How is this helpful?

A. Using this data point we can estimate the basis point equivalent of any amount of issuance costs. For example, $10 million of issuance costs represents about .21% of the $4.75 billion aggregate face amount of the bonds. This is equivalent to about 3.4 basis points of incremental issuance costs (0.21% dollar price divided by 6.1 years duration equals 0.034% per year). So $10 million of incremental costs would be justified if the interest cost savings were more than 3.4 basis points and not justified if they were less. If $5 million is a more appropriate estimate, then 1.7 basis points would be the interest-cost savings that would justify it. If $15 million, then 5.0 basis points would be needed to balance the equation.

For a frame of reference, $10 million is equal to the sum of (a) the amount by which the financial advisory fees of $6.7 million have exceeded the rate of $500,000 per deal, plus (b) half of the amount by which the actual legal fees in Texas ($21.5 million) have exceeded the caps imposed in their financing orders ($9.9 million).

Q. Do you have any conclusion as to whether the incremental costs of the activist approach in Texas were justified by any savings in interest cost?

A. I do not. As I said, I don't know how to estimate with any precision either of these two variables. What I have presented is a method of finding the interest-cost equivalent of an issuance cost or vice-versa, and have given an illustration of the order of magnitude of the numbers involved and the relationships between them. However, it is important to consider whether the incremental costs of the activist are justified. In an era of tightened spreads and increased market liquidity, it is less likely that the incremental costs and additional time associated with the activist approach will be justified.

V. DISCLOSURE

Q. What is a "free-writing" prospectus?

A. Under the long-standing securities law for public transactions, the legal document that constitutes an offer of securities to investors is called a prospectus (or a statutory prospectus). Under regulations that became effective on December 1, 2005, the concept of a "free-writing" prospectus was created. A "free-writing" prospectus is any written communication, other than a statutory prospectus, which would otherwise constitute an offer under the previously existing regulatory environment. A "free-writing" prospectus can take any form including an e-mail or webcast (i.e., investor presentations). The effect of this new legislation is that issuers and their control group now have securities law liability for any ancillary writings containing issuer information that may be communicated to investors, as if the information were contained in the prospectus itself.

Q. What liability does an issuer of securities, like the SPE, have when its storm-recovery bonds are offered to the public for sale?

A. When securities are registered with the SEC and sold to the public, the issuer (the SPE) is "absolutely liable" for material misstatements and omissions. That is, it is liable for losses caused by any untrue statement of material fact in the prospectus or the omission to state a material fact necessary to make the statements made not misleading. A material fact is a fact to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security.

Q. Will FPL be equally responsible with the SPE for securities law liabilities?

A. A controlling person such as FPL is, in that capacity, liable with the issuer (the SPE) unless it did not know, and had no reasonable grounds to believe in the existence of, the facts creating the liability.

Q. What is a due diligence defense?

A. Securities law provides underwriters with the "due diligence" defense that protects an underwriter who had, after reasonable investigation, reasonable grounds to believe that there was no material misstatement or omission. The legal opinions customarily delivered with new issues of securities are intended (among other things) to document part of this investigation and support the due diligence defense. One of these opinions is called the "10(b)-5" opinion (named for a section of a federal statute) giving counsel's opinion as to whether the prospectus contains material misstatements or omissions.

Q. Can the issuer or FPL avoid liability through a due diligence defense, supported in part by a 10(b)-5 opinion?

A. No. Their liability under federal securities law is absolute and not subject to a defense that they performed due diligence and relied on a 10(b)-5 opinion of counsel.

Q. Could anyone indemnify the SPE or FPL against securities law liabilities?

A. Even if the transaction documents were revised to expressly contemplate an indemnity of the SPE and FPL against securities law liabilities, agreements to indemnify issuers and controlling persons in federal securities law cases are generally regarded as contrary to public policy and unenforceable because they can mitigate the force of the statutory obligations imposed on the indemnified parties.

Q. There is a statement in the CenterPoint prospectus that "the broad-based nature of the true-up mechanism and the state pledge described above, along with other elements of the Bonds, will serve to effectively eliminate, for all practical purposes and circumstances, any credit risk associated with the Bonds (i.e., that sufficient funds will be available and paid to discharge all principal and interest obligations when due)." Do you think that statement is true?

A. Yes.

Q. Why then has it caused so much controversy?

A. First of all, it is not a fact; it is a conclusion. I happen to think it's true, but that doesn't make it a statement of fact. It is like a representation and warranty, where the issue does not go to whether the parties think the statement is true, but rather to the allocation of liability if someone makes a successful claim that the statement is false or misleading. Thus, it is also true that the statement has the effect of exposing the utility and the underwriters to a greater risk of liability, if a problem ever did arise with the bonds.

Q. Wouldn't the issuing SPE, and by extension FPL's customers, also be placed at risk?

A. Probably. However, the SPE, and by extension FPL's customers, are already responsible (collectively) for the repayment of the principal and interest on the bonds. In the unlikely event of a default on the bonds, this statement potentially puts the utility on the hook for these obligations, although the intention was that it should not be liable for the SPE's debts.

Q. **If the statement is true, why not require the utility to make the statement, in order to persuade investors of the superior investment merits of the bonds?**

A. In my experience, professionals who purchase securities for multi-billion-dollar portfolios generally "get it" very quickly. Rate reduction bonds are not a complicated credit. Once investors understand two things--the power of having a legally protected right to collect a dedicated tariff from all the customers of a major utility, and the right to adjust that charge as necessary to meet debt service--they realize that it is hard to conceive of a scenario in which the bonds will not pay as agreed.

Thus, I doubt that the statement enhances the marketability of the bonds, other than by suggesting that, if anything did go wrong with the bonds, investors would have a very good case to collect from the utility, the underwriters and potentially the Commission through securities law litigation. If the statement came from the Commission rather than the Issuer (by language in the financing order quoted in the prospectus), the Issuer's and the utility's liability should be diminished.

Q. **If a 10(b)-5 opinion can be given by counsel, why should either the Issuer or the utility have any potential liability?**

A. As noted above, while a 10(b)-5 opinion affords some protection to underwriters, it does not insulate the Issuer or the utility (as a controlling person) from potential liability.

VI. SRBs AS ASSET BACKED SECURITIES

Q. Do you agree with Mr. Fichera's statement that storm-recovery bonds do not fall precisely in the asset-backed securities market?

A. Yes, but they do not fall precisely into any other market either.

Q. What are the advantages to the asset-backed securities market?

A. As I have noted, it is the largest single sector of the U.S. fixed-income market other than Treasuries and agencies and offers unmatched liquidity as a result. Under SEC rules, ABS issuers file on Form S-3 and once a registration statement is effective, they can circulate "term sheets," which are abbreviated and simplified summaries of the offering, without necessarily delivering a full-blown preliminary prospectus at the same time. Under U.S. banking rules, asset-backed securities rated "AA" or better are classified as per se 20% risk weighted. Asset-backed investors have embraced the RRB product and been the major source of liquidity for it, helping it to reach the historically tight spreads shown in Document No. WO-12.

Q. Are RRB issuers generally missing an opportunity by not promoting these securities as corporate or agency securities?

A. No. These markets are well aware of the merits of the asset class. Because of their excellent credit and hybrid nature, new issue RRBs are marketed by

Credit Suisse in both the ABS and corporate markets and are shown to agency and international investors as well. The pricing book typically reflects interest from a variety of investors. If the true value of these securities is greater than the current trading levels reflect, it is not because the market is unaware of the merits of the credit relative to other high-grade fixed-income investment opportunities. The value proposition is open daily to any investor who thinks the securities are worth more than current trading levels, to vote for them with his or her dollars.

Q. Is the market value of RRBs a function of the representations, warranties and covenants of the utility?

A. As a general proposition, the "package" of representations, warranties and covenants underlying a bond issue is essential to the creditworthiness of the security. However, given the high minimum standards on these packages that are imposed by the rating agencies for their "AAA" ratings, I am unaware of any pricing differentiation or "tiering" from one issuer or one state to the next, relating to differences in their packages of representations, warranties, and covenants.

Q. What is your perspective on "de-registration," that is, ceasing to file quarterly and annual reports with the SEC after the first 10K, given fewer than 300 holders, as permitted under federal securities laws?

A. De-registration is a common practice. I am not aware of any issuer suffering a pricing disadvantage in the marketplace because of de-registration, provided that the issuer provides a user-friendly website with a high-quality investor relations section, where the reports that are specified in the transaction documents are posted regularly and promptly.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BY MR. LITCHFIELD:

Q Have you prepared a summary of your rebuttal testimony for the Commission?

A Yes, I have.

Q Would you please present that at this time.

A Thanks. Good evening, Commissioners. My rebuttal testimony responds to points that have been raised by Staff Witnesses Noel, Fichera, and Klein regarding the nature of the oversight process that should be implemented by Commission staff to protect the interest of FPL's customers in connection with the issuance and sale of the storm-recovery bonds.

FPL's proposed form of financing order contemplates a preissuance review process by which the Commission and its team would be involved in every critical step of the issuance process and thereby assure transparency and accountability. It is not necessary for the financing order to specify all of the particulars of the due diligence process that the Commission ultimately adopts. There is nothing in the proposed form of financing order that would preclude the Commission's team from a very extensive involvement in the process.

With respect to the specific issue of realtime pricing, FPL has already indicated room for flexibility on the point. The testimony of these three witnesses contends that FPL's Commission review process is inadequate to protect FPL's customers even though the financing order clearly doesn't need to cast it in stone. This is true because their program goes far beyond oversight transparency and due diligence. Their fundamental premise is that the Commission should act by and through its financial advisor, and that its financial advisor should have co-equal decision-making authority with the utility, and must directly participate in all aspects of structuring, marketing, and pricing.

I believe that this co-equal decision-making process is inherently flawed and not in the best interest of the transaction, particularly where the decision-making authority is vested in an independent investment banking firm. My direct experience on transactions with the approach advocated by these witnesses is that it will by nature result in a process which is more adversarial than collaborative. Dual decision-making is difficult under the best of circumstances and tends to become adversarial when the incentives of the parties are not perfectly aligned.

A actual decision-making process, as opposed to a transparent review process, requires that consensus, that is unanimity be reached on every single detail. The resulting inefficiencies of this process can result in extended time frames and higher costs. Co-equal decision-making does not properly align authority with legal liability. Only the issuer and the utility have statutory issuers or controlling parties liability for the prospectus and the other offering materials, and it is inappropriate for parties who bear no liability or a lesser degree of liability to have co-equal decision-making authority over these documents.

The one exception to co-equal decision-making which the witnesses advocate is that the Commission retain a unilateral right to veto the transaction, not in realtime, but up to three days after the bonds have been priced and sales have already been confirmed with investors. Investors do not look at pricing of a bond as a tentative event. Pulling back a one billion dollar bond offering from the market after it has been priced and sold to investors would be a disastrous event inflicting great harm to FPL and its customers as well as to any subsequent issuer of storm-recovery bonds.

To my knowledge, only two Commissions have actually employed this co-equal decision-making process in completed transactions. There is evidence to suggest that these Commissions continue to experiment with and rethink their approach to oversight of the issuance process. One of them has reverted to its prior financial advisor for its upcoming securitization, and the other Commission has reevaluated the costs associated with this approach, as noted in my rebuttal testimony, although the specifics of their oversight processes and these upcoming transactions have not yet been determined to my knowledge.

The co-equal approach is said to create dramatic savings in issuance costs. My experience is that to the contrary the approach tends to increase the scope of services and the related fees to the Commission's investor banker, the time required to bring bonds to market, and the related legal fees. Evidence has been presented purporting to show that the co-equal approach offsets these incremental issuance costs by producing a lower cost of funds. The primary evidence is a regression analysis relating to the younger days of rate reduction bonds and to time of high volatility in the debt capital markets, and which compares Saber-advised (phonetic) transactions against transactions that had other advisors or no financial advisor at all, which is a comparison of questionable relevance.

My rebuttal testimony demonstrates that the rate reduction bond market has gone through a maturation in the last few years and that the debt capital markets have become dramatically -- characterized by dramatically tighter spreads, lower volatility, and increased liquidity. As a result, in my judgment this type of data has no bearing on transactions brought under current market conditions.

Today's debt capital markets are hotly competitive. New issues of rate reduction bonds are eagerly anticipated, broadly distributed, and strongly bid for at very tight credit spreads. The option process described in my direct testimony leaves no room for market manipulation by buyers or sellers.

The relevant question in the current docket is not whether to have a transparent process with due diligence as extensive as the Commission deems advisable, which I have not heard anyone dispute, but to select a process that is the most cost-effective for a mature market such as storm-recovery bonds in today's highly liquid and competitive marketplace.

This concludes my summary. I am happy to answer any questions, including with respect to matters discussed earlier.

CHAIRMAN EDGAR: Commissioners?

Commissioner Arriaga.

COMMISSIONER ARRIAGA: Good evening. The transparent review process that you are referring to, is this an after the fact review process whereby things have been done and there is no return?

THE WITNESS: No, I would envision it in another way, and let me explain. For example, in the case of the PG&E transactions in California, the financing order has exactly one finding of fact and one ordering paragraph relating to the process, and yet my understanding is that there was an organizational meeting of all hands, there were weekly calls in advance of every specific occurrence in the transaction. During the time of marketing there were more frequent calls. There was a tremendous amount of documentation of everything that was happening, and at least I would envision prior to every important step that everyone be in agreement before we go forward.

COMMISSIONER ARRIAGA: One more question, Madam Chair.

CHAIRMAN EDGAR: (Indicating yes.)

COMMISSIONER ARRIAGA: The process you are suggesting, does it imply that the Commission delegate its decision-making authority to a financial advisor that has no fiduciary responsibility to the Commission?

THE WITNESS: My understanding is that the proposal of the three witnesses I referred to --

COMMISSIONER ARRIAGA: No, I am referring to your proposal. I'm sorry for interrupting.

THE WITNESS: No, I would suggest a team concept. In my view staff would be the appropriate place for that authority assisted by outside advisors.

COMMISSIONER ARRIAGA: You are suggesting that in your proposal the Commission delegate the authority either to the staff or to a financial advisor and specifically to a financial advisor with no fiduciary responsibility to the Commission?

THE WITNESS: I would not propose delegating to a party outside the Commission.

COMMISSIONER ARRIAGA: You propose delegating it to the staff?

THE WITNESS: Yes, assisted by outside advisors.

Outside counsel and outside financial advisors.

COMMISSIONER ARRIAGA: Commissioner Deason made a comment before about participation by a Commissioner or a group of Commissioners. A Commissioner he said specifically in that decision-making process. How do you see that?

THE WITNESS: I think that is workable in the concept of a team. You know, investment bankers always work in teams, right? They are multiple disciplines that need to be brought to bear to make good judgments about the process, and a Commissioner as part of a team is a good idea.

COMMISSIONER ARRIAGA: Thank you.

CHAIRMAN EDGAR: Commissioner Carter.

COMMISSIONER CARTER: Thank you, Madam Chair. Maybe a couple of questions.

CHAIRMAN EDGAR: You are recognized for a series of questions.

COMMISSIONER CARTER: Thank you. Mr. Olson, you are familiar with the names of Enron, WorldCom, and Adelphi, right?

THE WITNESS: I have heard of them.

COMMISSIONER CARTER: Okay. You know that those are some of the largest bankruptcies in American business history, right?

THE WITNESS: Yes.

COMMISSIONER CARTER: So, you are not suggesting that the Public Service Commission sign off on a billion dollar bond and just go away, are you? That is not what you are suggesting, is it?

THE WITNESS: No, I don't think anyone has made that suggestion.

COMMISSIONER CARTER: So how would it work with the Commission having -- consistent with what Commissioner Deason said, how would it work with the Florida Public Service Commission having a position at the table, if you will, on behalf of the ratepayers based upon your scenario?

THE WITNESS: As I said, within the construct in the financing order, I think, one could put together teams, a team of professionals on the Commission side that are part of the transaction from day one. Normally when we do a transaction with a private sector client acting purely for its own interest, they will want to have organizational calls on at least a weekly basis. They want to know everything that is going on. They want to know exactly what happens next and whether all steps have been accomplished. When we are in the market they want to know with increasing frequency what investors are showing interest in the bonds, and when it comes close to pricing every day. And I would expect that a due diligence process would want to participate in all of those conversations.

COMMISSIONER CARTER: One final follow-up, Madam Chairman.

CHAIRMAN EDGAR: Commissioner Carter.

COMMISSIONER CARTER: So you are saying, and maybe I missed it. I was talking about Commissioner Deason's suggestion about maybe one or more of the Commissioners actually being at the table in this process. Did I miss your response to that?

THE WITNESS: No. My suggestion would be that the responsibility would be vested in a team of professionals and it would make sense to me for a Commissioner to be among those.

COMMISSIONER CARTER: Thank you.

CHAIRMAN EDGAR: Commissioners, any further questions for this witness? No. Then the witness is excused. Thank you.

THE WITNESS: Thank you.

MR. LITCHFIELD: And, Madam Chairman, a point of procedure. We had agreed to have Mr. Olson's deposition entered into the record, so we would like to mark that and enter it at this time.

CHAIRMAN EDGAR: Yes, Mr. Litchfield, thank you. And that will be Exhibit Number 167.

MR. LITCHFIELD: And it would be titled deposition of Wayne Olson. And we have copies for the court reporter and for the Commission redacted based on agreement between staff and Florida Power and Light.

CHAIRMAN EDGAR: 167. Deposition of Wayne Olson dated Friday, February 14, 2006. Exhibit Number 167 will be entered into the record as evidence.

(Exhibit 167 marked for identification and admitted into evidence.)

MR. LITCHFIELD: The witness was excused, I believe?

CHAIRMAN EDGAR: The witness was excused. If I miss something, please tell me.

MR. LITCHFIELD: No, I think I heard it. I'm not sure the witness heard you.

CHAIRMAN EDGAR: Okay. The witness was excused. Thank you very much.

And we are ready for the next witness. We are ready when you are.

MR. ANDERSON: Florida Power and Light Company calls as its next witness Mr. Hugh A. Gower. We will give him a moment to get settled.

And, Madam Chairman, this witness needs to be sworn.

CHAIRMAN EDGAR: Thank you.

Mr. Gower, if you will stand and raise your right hand we will do that now.

(Witness sworn.)

MR. ANDERSON: May we proceed?

CHAIRMAN EDGAR: Mr. Anderson.

HUGH A. GOWER

was called as a rebuttal witness on behalf of Florida Power and

Light Company, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. ANDERSON:

Q Good evening, Mr. Gower.

A Good evening.

Q Could you please sit a little closer to your microphone so we can hear you?

A Certainly.

Q Thank you. Would you please tell us your name and address?

A My name is Hugh Gower. My address is 7988 Beaumont Court, Naples, Florida.

Q How are you employed?

A I am self-employed since 1992. I do consulting with public utilities on economic regulation and cost containment, and I sometimes provide testimony before regulatory commissions or courts.

Q Have you prepared and caused to be filed 38 pages of prefiled direct testimony in this proceeding?

A Yes, I have.

Q Do you have any changes or revisions to your prefiled direct testimony?

CHAIRMAN EDGAR: Are you on direct? I thought we were on rebuttal.

MR. ANDERSON: I'm sorry, rebuttal. I'm very sorry.

CHAIRMAN EDGAR: That's all right.

BY MR. ANDERSON:

Q Of rebuttal testimony in this proceeding?

A Yes, rebuttal testimony.

Q Do you have any changes or revisions to your prefiled rebuttal testimony?

A I do not.

Q If I asked you the same questions contained in your prefiled rebuttal testimony, would your answers be the same?

A Yes, they would.

MR. ANDERSON: We would ask that the prefiled rebuttal testimony of the witness be inserted into the record as though read.

CHAIRMAN EDGAR: The prefiled rebuttal testimony of this witness will be entered into the record as though read.

BY MR. ANDERSON:

Q Are you sponsoring any exhibits to your testimony?

A Yes, I am.

Q These are labeled as HHE-1 through HHE-5, right?

A That is correct.

MR. ANDERSON: These have been premarked and admitted, I believe the record reflects, as Exhibits 113 through 117.

CHAIRMAN EDGAR: Thank you.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF HUGH A. GOWER

DOCKET NO. 060038-EI

APRIL 10, 2006

Q. Please state your name, address and occupation.

A. My name is Hugh Gower and my address is 7988 Beaumont Court, Naples, Florida 34109.

I am self employed as a consultant on public utility financial, economic regulation and cost containment and control matters. I also provide expert testimony on topics related to public utility economics and rate regulation in cases before public service commissions and courts.

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

A. No.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring an exhibit consisting of five documents, HAG-1 through HAG-5, which is attached to my rebuttal testimony.

Q. Please summarize your educational and professional background.

A. I practiced public accounting for more than thirty years following receipt of a Bachelor of Science degree in Accounting and Economics from the University of Florida. Although I have experience in a number of industries, I specialized in the public utility area. I am, or have been, registered as a Certified Public Accountant in several states and I am a member of the American Institute of Certified Public Accountants and the Florida Institute of CPAs. Further information regarding the nature of my work experience is contained in an appendix to my testimony.

PURPOSE AND SUMMARY

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

A. The purpose of my testimony is to rebut assertions made and adjustments to FPL's actual storm damage repair and service restoration costs ("restoration costs") proposed by OPC witnesses Hugh Larkin, Jr. and Donna DeRonne ("OPC witnesses" or "OPC").

I will also explain methods of cost accounting which are used by businesses in general as well as by public utilities and comment on which are appropriate in dealing with storm events.

I will explain my evaluation that the adjustments OPC witnesses propose are inconsistent with the regulatory framework which underlies cost-based ratemaking which has been and will be of great importance to utilities and their customers.

Q. Please summarize your findings and recommendations from your evaluation of OPC witnesses Larkin and DeRonne's testimony and of the adjustments they propose to FPL's storm restoration costs.

A. First, the very foundation for OPC witnesses' proposed adjustments to FPL's restoration costs is that there has been a double recovery of these costs. This is a mere assumption and is false. Evidence shows that, to the contrary, no double recovery occurred and the effect of 2005 storms activity adversely impacted FPL's earnings (even though all restoration costs were excluded from earnings in reliance on regulatory precedents allowing for recovery).

Second, although OPC witnesses characterize their adjustments as "incremental costing", their work is, at best, a misapplication of incremental costing methods and is unsupported by any competent analysis.

Third, OPC witnesses' proposals are in conflict with the regulatory framework which underlies cost-based ratemaking which has benefited both customers and utilities alike. The "incremental costing" adjustments OPC witnesses propose should be rejected because they are not in the best interests of either customers or FPL.

REGULATORY FRAMEWORK

Q. Can you summarize your analysis of how the recommendations of OPC witnesses Larkin and DeRonne conflict with the regulatory framework of cost-based ratemaking?

A. Yes. In order to do this, it will be necessary to first lay out the elements of that regulatory framework.

Q. Is the setting of utility rates on the basis of actual costs widespread?

A. Almost universally, regulators with responsibility for setting the rates or prices for public utilities in the United States do so on the basis of the affected utility's actual cost of providing service to customers. This is the method historically applied by the FPSC. Use of cost-based ratemaking has a long history and is used because the regulated companies are not subject to market forces or competition to limit either their prices or profits to the same degree as companies which offer products or services in completely open, competitive markets.

Over a period of many years, the application of cost based ratemaking in numerous cases and the decisions of regulators and courts have developed a regulatory framework which defines the rights and obligations of utility customers and of utilities to maximize the benefits for both. This includes the procedures for determining fair and reasonable prices for utility services based on "cost of service".

Q. How does this regulatory framework affect the determination of fair and reasonable prices based on "cost of service"?

A. The term "cost of service" is exactly what it implies and is conceptually simple, but its application can be complex and it is often misunderstood, misinterpreted or misapplied. Under this regulatory framework, fair and reasonable prices include all and only the costs of activities undertaken by the utility to provide service. Costs are limited to those reasonably and prudently incurred for the provision of service. In addition to fuel, labor, supplies, taxes, depreciation and other operating expenses, utilities are entitled to include in their prices a reasonable return on the capital their owners and lenders have invested for the provision of utility service. These costs are usually measured for a year's period of time (called a "test period") and are matched against the quantity and quality of service expected to be provided during the period. "Cost of service" includes the cost of resources used or consumed during that period rather than the total amount the utilities may be committed to spend or may have already spent for such resources, or the total return on capital the utilities will need for all the years investors' capital is expected to be devoted to utility service. Further, expenses of activities unrelated to the provision of utility service are excluded from the price of utility services as are returns on capital not devoted to utility service.

Q. How are operating expenses, taxes and depreciation limited to those devoted to utility service in the cost-based rate setting process.

A. Operating expenses, taxes, depreciation, etc. are routinely accounted for and reported by utilities using the Uniform System of Accounts ("USOA") prescribed by FERC and adopted by this Commission. The USOA, through its detailed instructions, limits amounts recorded in "operating expenses" to the cost of those resources consumed to conduct utility operations. Amounts applicable to non-utility activities are recorded in designated accounts separate and apart from those for utility operations. Likewise, USOA instructions explicitly separate construction related expenditures and costs from utility operating accounts.

In most cases, compliance with the USOA is subject to audit and verification by the utility regulators' staffs. This provides a high level of assurance that amounts recorded in utility operating expense accounts are appropriately limited to the operating costs of providing utility service and are appropriately classified for use in a rate setting proceeding.

Q. What does the capital upon which the utility investors are entitled to a return consist of?

A. The capital upon which utility investors are entitled to a return consists of debt and equity capital invested in the utility company. Equity capital generally consists of common stock outstanding, other paid-in capital and earnings retained in the business. Some utilities also issue preferred stock shares to finance part of their business. Debt capital generally used by utilities would include mortgage bonds, debentures and long-term notes of various kinds. In Florida, a utility's capital structure for ratemaking purposes also includes customer deposits and interim bank debt financing, if any, as well as cost free capital sources such as deferred income taxes.

Although the total amount of capital invested in any utility enterprise is easily identified from the company's books and records, in cases where the utility is subject to more than one jurisdiction (federal and state for example), provides more than one kind of utility service, has non-utility operations or capital invested in utility assets under construction and not yet providing utility service, what part of that total capital is devoted to utility service it is not easily determinable. In such cases, the amount of capital devoted to utility service is estimated using the contra values of assets shown on the utility's books. The book value of assets devoted to the provision of utility service can be identified from detailed records generally available and utility rate analysts use such values to compute an amount called "rate base". Although "rate base" is derived from book asset values it really represents the amount of capital which investors have supplied for the provision of utility service. This is the amount of capital upon which investors are entitled an opportunity to earn a reasonable return.

Q. How do regulators who employ cost-based rate regulation determine what to allow utilities as a reasonable return on capital devoted to public service?

A. The capital structure of each regulated company is reflected on its books of account and shown on its annual reports to regulators. These records show how much of the utility's capital structure is common equity, preferred stock, debt or cost free capital. The cost of preferred stock and debt can be calculated. The cost of common equity is usually estimated using stock market data. The weighted cost of all forms of capital employed by the utility, including any cost free capital, is the "reasonable return" which regulators allow on investors' capital ("rate base").

These cost-based rate regulation practices yield prices for utility service based on historic original costs rather than current values of the resources devoted to utility service. No adjustment is made to the allowed return—or prices for service—when the market value of the utility's outstanding securities is greater than the amounts originally received by the utility from their issuance. Likewise, no adjustment to prices for service is made when the current value of assets devoted to utility service is greater than their original historic cost.

Courts have held that, however calculated, a reasonable return is one which is sufficient for the utility to maintain its credit standing and financial integrity, sufficient to attract capital at reasonable costs and commensurate with returns being earned on investments attended by corresponding risks.

Q. Are utility investors protected from risk when rates are set in this manner?

A. No, utility investments are not risk free. While the rate of return allowed on utility investors' capital is generally lower than might be earned in some other types of businesses, this does not signal the complete absence of risk. As with any business, utility investors carry the risk of the success or failure of the business. Among others, this includes normal weather variations, customer usage, and management's ability to control costs, competition from other providers, inflation, regulatory lag, market risks and product risk. It is the reasonable assurance that cost based rate regulation will be applied in such a way that the utilities have an opportunity to recover the necessary, reasonable and prudent costs of providing service which keeps required returns on capital lower than in some other kinds of businesses.

History shows that due to factors both related and unrelated to the specific utility, some investors have suffered substantial capital losses, while others more fortunate realized capital gains on their investments. Clearly, investors are exposed to capital losses on the utility securities they hold.

Q. **When a utility seeks to change its rates or prices under this regulatory framework, do regulatory authorities accept actual costs contained in the Company's books and reports for purposes of calculating the price needed to cover cost of service?**

A. The actual amounts shown on the utility's books are the starting point for evaluating revenue requirements. However, in addition, actual revenues and costs are scrutinized and frequently adjusted to make sure that the cost of service is representative of that expected to be required to support the normal level of service in the future when the new rates will be in effect. For example, nonrecurring, out-of-period or extraneous expenses would be excluded (or allowed on a levelized basis) from operating expenses used for rate setting following the rules or practices and procedures applicable in the jurisdiction where application for approval of a rate change is made.

Q. **Can you provide examples of transactions which would be nonrecurring, out-of-period or extraneous items which might be excluded from cost of service for rate setting purposes?**

A. Receipts or disbursements from the settlement of litigation relating to events over which disputes arose in prior years would be examples of both nonrecurring and out-of-period items. Unexpected proceeds from insurance claims could be both extraneous and nonrecurring. Other examples of costs excluded from a test year's cost of service (or included on a levelized basis) would include debt redemption costs, extraordinary property losses, fuel conversion costs or natural gas conversion costs.

The effects of abnormal weather such as severe tropical storms and hurricanes are considered to be nonrecurring or are for other reasons excluded from cost of service. In most cases, revenues and expenses for the test period are adjusted to amounts associated with normal weather so that revenue requirements are set to exclude the effects of all abnormal weather.

Q. Are all rates and prices of utilities set as you have just briefly described?

A. For many years this was the general approach. However, it became necessary to alter this procedure when the price of major cost of service components became volatile and difficult to predict. For example, after many years of relatively stable energy costs, by the mid 1970s the prices of oil, gas and coal began to rise so rapidly that general rate proceedings to change prices enough to recover those costs could not be prosecuted with sufficient speed and became administratively and economically infeasible. Thus, fuel costs were, for the most part, separated from "base rates" and covered by special billing factors. A number of other costs are also included in billing factors separate from base rates for a variety of reasons. This simplifies and expedites the regulatory process for dealing with these items by narrowing the issues which need to be considered, while limiting recovery to actual costs and providing adequately for their recovery by utilities.

Q. Are the extraordinary or nonrecurring expenses you mentioned excluded from cost of service because they are not necessary, reasonable or prudent expenses applicable to the provision of utility service?

A. No, on the contrary, they are clearly necessary, reasonable and prudent costs of providing utility service. They are excluded from a test period cost of service to avoid rates being set to cover costs which are volatile or abnormally high in one period. Other methods of providing for the recovery of such costs are available, such as amortization over a period of years, or the use of separate billing factors. Key to the success of the cost-based rate setting process is the assurance provided that utilities will have an opportunity to recover all necessary, reasonable and prudently incurred costs.

Q. Why is there a separate storm cost recovery factor?

A. In the course of a general rate proceeding which adjusts base rates to an appropriate level, the cost of storm restoration is, for the most part, excluded from costs upon which rates are based as a (hopefully) nonrecurring item. Although some amount of cost may be included to allow for a build up of a reserve against future natural disasters, for the most part these costs are excluded to mitigate the rate impact when storm events occur and so that base rates do not include amounts for events which may or may not occur and/or because the actual restoration costs are difficult to predict.

Q. Are the costs of storm damage repair and service restoration necessary costs which utilities should be entitled to recover?

A. Clearly such costs are necessary, reasonable and prudent costs of providing utility service including the restoration of service following a storm event. As the greatest part of such costs is excluded from base rates, the only reasonable regulatory treatment is to allow utilities an opportunity for after-the-fact recovery of the actual amount of storm restoration costs (not covered by a reserve) through a special billing factor.

Q. Please summarize the relationship between utilities and customers under the regulatory framework of cost-based rate making.

A. Under this regulatory framework, utilities are obligated to provide safe, adequate, reliable service to all customers willing and able to pay for service within their designated service area. Utilities are able to establish reasonable rules and regulations concerning matters as safety, payment terms and other commercial aspects. Utilities providing service under such regulation are, as are all businesses, entitled to legal protection of their privately owned-property. Among other things, this means that utilities are entitled to charge a fair and reasonable price which covers the costs they incur to provide service and are also protected against confiscation of their property. A reasonable opportunity to recover all necessary, reasonable and prudently incurred costs of providing service (including return) is a key element of this regulatory framework.

Customers are entitled to safe, adequate and reliable service, and customers must pay the fair and reasonable prices set or approved by the applicable regulatory commission and which are limited to the actual costs of providing service.

Q. Has this regulatory framework benefited utilities and their customers?

A. Yes, this regulatory framework has benefited both utilities and their customers. Utilities benefit because where this framework is employed in a stable, responsible manner, it is easier for utilities to finance the facilities required to meet customers' needs.

Customers also benefit because this regulatory framework assures adequate, reliable service at prices lower than they might otherwise be. Importantly, regulation helps avoid duplicate facilities which might otherwise exist and also avoids price increases as current values increase.

In view of the capital intensity of the industry, the generally lower capital costs have also significantly lowered utility prices. Finally, this regulatory framework avoids wide swings in prices which might otherwise occur when substantial variations in demand or resource availability arise.

STORM COST RECOVERY PRICIPLES

Q. **One of the "principles" Mr. Larkin asserts (Page 4) should underlie the restoration costs approved for recovery in this case is "...The Public Service Commission should look to the business risk which was borne by FPL's customers in regard to the storm damage they incurred as a proxy for the business risk which FPL should have to bear" do you agree?**

A. No, I do not. The primary reasons Mr. Larkin's "principle" should not be relied upon were well summarized in the 1996 Order No. 14859 (contained in Document No. HAG-1) issued by the Hawaii Public Utilities Commission (HPUC) in deciding a similar hurricane storm cost issue involving Citizens Utilities Company. Because the same basic principles of utility regulation should be applied in the FPL case, I quote the HPUC reasoning:

> "As pointed out by the Consumer Advocate...the legislature has charged this commission with the authority to balance the interests between the utility's ratepayers and its shareholders with respect to who should bear the...restoration and repair costs. After considerable review, consideration, and balancing of these interests, we do not find it just, reasonable, or in the public interest to require Citizens' shareholders to bear any of the ...restoration and repair costs.
>
> Our decision is based in a large part on the long-standing regulatory compact. The regulatory compact has two

aspects: (1) in return for a monopoly franchise, utilities accept the obligation to serve all comers; and (2) in return for agreeing to commit capital necessary to allow the utilities to meet the obligation, utilities are assured a fair opportunity to earn a reasonable return on the capital prudently committed to the business. In Wash. Util. and Trans. Comm'n v.Puget Sound Power & Light Co. ,62 P.U.R. 45th 557,581 (1984), the Washington Commission explained the regulatory compact in this fashion:

> "The social and economic compact of utility regulation begins with the premise that a regulated utility has an obligation to serve the public. A utility possesses an unending obligation to provide service to anyone within the service territory of that utility who demands service in accordance with approved tariffs. However, in order for the social duty to serve to be viable, the compact must also provide for a utility to recover expenses it prudently undertakes to meet the obligation."

Q. Mr. Larkin criticizes the basis on which storm restoration costs are recovered in Florida as "customer supplied insurance". Is he correct in this assertion?

A. No he is not. Rule 25-6.0143 of the Florida Administrative Code (shown in

Document No. HAG-3) specifies relative to the use of Account 228.1 Accumulated Provision for Property Insurance-

> "(1)(a) This account may be established to provide for losses through accident, fire, flood, storms, nuclear accidents and similar type hazards to the utility's own property or property leased from others, which is not covered by insurance. This account would also include provisions for the deductible amounts contained in property loss insurance policies held by the utility as well as retrospective premium assessments stemming from nuclear accidents under various insurance programs covering nuclear generating plants…."

While Mr. Larkin's characterization disparages the provisions of the rule, the assignment of property loss risks in this fashion has been in place for a number of years and was chosen as the method most consistent with the interests of both customers and utilities. The Commission's Rule as well as its regulatory treatment for many years recognize both the extraordinary nature of hurricanes, accident, fire, flood, nuclear accidents and similar type hazards as well as the necessity and prudence of carrying out restoration. Historically the Commission has tried to levelize the impact of such costs on rates.

COST ACCOUNTING PRACTICES

Q. Is the incremental cost method which OPC witnesses propose to apply in this case a valid costing method?

A. Yes, it is a valid costing method, but not as proposed by OPC.

Q. Can you explain why their proposals are not valid application of the incremental costing method?

A. Yes, but first it would be helpful to explain how and when businesses utilize incremental and other costing methods.

Businesses which undertake multiple activities or provide multiple products of services must employ some cost accounting method to assign costs and expenses to those activities, products or services and obtain information for a number of purposes. Two choices are fully distributed or fully allocated costs ("fully distributed") and incremental costs.

Q. Can you briefly explain those costing methods?

A. Incremental costs generally mean those costs incurred to perform some incremental activity or produce additional products or services. Fully distributed cost generally means that all actual costs for a period are assigned to the activities performed or products or services produced during the period.

Q. Is either method appropriate in any circumstance?

A. Whether costs can appropriately be assigned on a fully distributed or incremental basis depends on not only the uses for which cost information is needed, but also the circumstances under which activities are performed or products or services produced.

Incremental cost accounting is more apt to be employed by enterprises involved in providing products or services competitively or where the resources needed to produce such products or services are separate and distinct from those required for a company's other products and services. Fully distributed cost accounting is more often employed by businesses whose expenses are largely common to all its activities or products and services. Utilities are one of the latter type businesses and in practice generally employ fully distributed cost methods consistent with the USOA accounting instructions as well as predominant regulatory practices.

Q. Can you illustrate circumstances in which these cost accounting methods might be applied?

A. Yes. Assume for purposes of illustration that a manufacturer of bicycles produces a certain number of its product each year and that its work is carried out in a rented plant by one supervisor and four employees. This manufacturer sees that there is a market for tricycles in addition to the bicycles it produces. In considering whether to enter the market with this additional product, it finds that two manufacturing employees (in addition to those already employed) will be needed. In addition, it ascertains that additional manufacturing floor space along with different size wheels and certain additional materials will be required. The sum of the cost of these additional resources would be the incremental cost of adding tricycles to its production. Using this information, the manufacturer can determine the price with which it can compete in the tricycle market. By adding these incremental costs and the expected revenues to its existing bicycle revenues and production costs, the manufacturer can ascertain whether it would be better off doing so. The manufacturer can make this determination using either the incremental or fully distributed cost method.

Q. **Are there circumstances in which one of these cost accounting methods would not be appropriate or provide useful information?**

A. Yes. Assume further that in investigating the possibility of adding tricycles to its production, the manufacturer finds that it is unable to rent or otherwise acquire usable manufacturing space and that it is unable to employ the two additional employees it will need to manufacture tricycles. Its alternative is to shut down part of its bicycle manufacturing and utilize that space and two of its workers presently involved with the bicycle manufacturing to undertake the tricycle production. But because of its bicycle sales orders and delivery commitments, it will have to put its remaining bicycle manufacturing staff-- or all of its staff-- on overtime. In these circumstances, the previously identified incremental costs would not be useful for either pricing tricycles or evaluating whether the manufacturer would be better off to make the additional product. At a minimum, in order to make proper incremental cost calculations, the manufacturer would have to consider the overtime for bicycle and/or tricycle production which would result from undertaking the tricycle manufacturing. It would also have to take into account the cost of any other resources it redeployed from bicycle production to tricycle production. Its old bicycle cost information supplemented with the original "incremental cost" information would not provide true cost information nor would it be useful in evaluating whether it would be better off to add the tricycle product or not.

Q. **How does this illustration relate to FPL's storm restoration costs in this docket?**

A. OPC witnesses Larkin and DeRonne's proposal to "cost" storm restoration efforts using "incremental" costs is flawed just as in the second scenario in the hypothetical example I just described. First, it excludes some costs clearly caused by the storm restoration activities. Overtime, employee assistance, vacation buy-backs and back-fill work come easily to mind as do some of the other labor and transportation costs which, although actually devoted to the storm restoration, they propose be excluded. Like the hypothetical bicycle manufacturer, FPL's normal business activity and service provision has been seriously disrupted by the additional activities of dealing with storm events. Normal service is, until service restoration can be completed, disrupted. In such situations, it's "all hands to the rescue" and normal work activities are temporarily suspended but must be completed at a later time. Clearly, incremental costing in such circumstances does not fairly recognize the true cost of storm restoration. The actual restoration costs need to be known and, since such costs were excluded when base rates were set, must be properly accounted for or an opportunity for their recovery will be denied. Requiring the use of the "incremental" cost method for storm events as OPC witnesses propose would result in a recovery amount less than the actual storm damage repair and service restoration costs prudently incurred by FPL.

MISAPPLICATION OF INCREMENTAL COSTING

Q. **Why do OPC witnesses Larkin and DeRonne recommend use of "incremental" costing for FPL's storm restoration costs?**

A. Both OPC witnesses suggest that use of "incremental" costs is necessary because the cost of internal resources devoted to storm restoration are "covered by base rates" and use of actual costs will result in a "double recovery" by FPL.

Q. Is this correct?

A. No it is not. Assuming arguendo that the cost of such internal resources were included in base rates (whenever they were set), what Mr. Larkin and Ms. DeRonne seem not to have observed is that customer consumption does not continue during the service interruptions storms cause. And when there is no consumption, there is no revenue with which to recover such costs.

Q. What evidence of "double collection" do Mr. Larkin and Ms. DeRonne provide?

A. None. The comments of U.S. Court of Appeals Judge Prettyman in the Mississippi River Fuel Corp. v. Federal Power Commission (163, F. 2d 433,437 (1947)) case (contained in Document No. HAG-4) are apropos to this situation:

"Expenses (using that term in its broad sense to include

> not only operating expenses but depreciation and taxes) are facts. They are to be ascertained, not created, by the regulatory authorities. If properly incurred, they must be allowed as part of the composition of rates. Otherwise, the so-called allowance of a return upon investment, being an amount over and above expenses, would be a farce."

Although Judge Prettyman's comments addressed expenses, they are also applicable to revenues. They do not exist on the basis of an assumption; they need to "be ascertained".

Q. **Mr. Larkin cites a definition in Kohler's Dictionary for Accountants as support for the use of "incremental" costs. Are OPC witnesses Larkin and DeRonne's proposed adjustments of actual storm damage and service restoration costs based on incremental costs?**

A. No, they are not. Mr. Larkin and Ms. DeRonne have misapplied incremental costing by basing their proposed adjustments to the amount of restoration costs for 2005 largely on the difference between actual non-storm related costs and original departmental budgets. Such budget-actual variances do not represent incremental costs. Further, no effort was made to determine what part of the variance, if any, was due to the storms. They also ignore incremental offsetting costs. For example, OPC proposes to exclude millions of dollars of regular payroll of employees who worked on the restoration effort and correctly charged their time to storm restoration costs. OPC would remove this entire amount from storm recovery while ignoring the millions of directly related cost increases because backfill and catch up costs were incurred to perform essential activities which, but for storms, would have been performed by those employees involved in the restoration effort.

As a result of these errors and omissions, OPC's proposed "incremental" cost does not accurately capture the true actual "incremental" costs of storm restoration to the extent that FPL employed internal resources in that effort.

OPC's calculation of "incremental" costs has further significant problems with measurement.

Q. What measurement problems are inherent in OPC's proposed "incremental cost" of storm damage and service restoration?

A. In its effort to prevent their assumed double recovery of costs by FPL, OPC proposes to exclude from charges to the storm damage reserve the "base rate recoverable" cost of resources utilized in the service restoration effort. In addition to the unanswered question of whether there has, in fact, been a double recovery, another question which needs to be considered is whether the amount of costs "recovered through base rates" during the period of the service restoration can be determined when base rates were set in years prior to the storm event.

Q. Why is this a question which should be considered?

A. Staff has acknowledged in its response to interrogatory No. 49 that "...it is unclear what specific costs of any kind are included in base rates".

Q. Do you agree with staff that it's unclear what specific costs are included in base rates?

A. Yes, I do. This is a conclusion which is true in most circumstances and the reason is that rates represent prices found by regulators to be fair and reasonable on the basis of evidence presented in a rate case. Normally, rates – the actual prices – are set by relating the total cost of service and the sales volumes found allowable for the test period and which are expected to be representative of operating conditions when the new rates will be applied. In addition, a number of other factors are usually considered in devising the actual tariff prices. These include the number of customers, value, customer usage characteristics, conservation, consistency with prior charges, ease of administration and customer understanding. Consequently, actual tariff rates are rarely equal to the exact amount of cost of service approved in a rate filing for each class of customer or each volume category within classes.

It would be unreasonable to expect that the relationship between the key variables used in the calculation of rates, such as number of customers, weather, demand and sales volumes, as well as operations expense and capital investment levels would remain the same as they were during the test period. These variables change for any number of valid reasons. The longer it has been since the test period used for rate setting, the more improbable the determination with any degree of reliability a quantifiable amount of any particular current cost of service element (such as depreciation, operations expense or income taxes) such rates recover. Prices set on any basis cannot provide a lasting link to or preserve the relative values between the key variables which were the basis for their calculation.

Q. Is the fact that a cost element was included in a budget for a period affected by storm activity certain proof of "double recovery" by FPL?

A. No it is not. OPC's conclusion that an amount included in an operating budget for a period several years subsequent to an actual test period from which rates were set represent a like amount currently recovered from customers in base rates is an assumption rather than a fact. Even if it could be determined that a cost is "included in base rates", recovery of any cost through base rates takes place only to the extent that actual revenues cover such costs. Unfortunately, OPC has focused only on what costs might have been included in base rates, whenever they were set, and ignores whether there were sufficient revenues in the periods affected by storm activity to cover such costs. OPC simply assumes there has been a double recovery. In addition to failing to consider revenues for the periods affected by storm activity, OPC's proposed adjustments are subjective in nature and have no substantive analysis or support.

Q. Explain how OPC's adjustments are subjective and without substantive analysis or support.

A. OPC proposes to identify "incremental costs" by subtracting from actual service restoration costs differences between budget and actual costs for 2005 without sufficient analysis to determine if the variance is storm related or not. Such calculations are subjective and incomplete.

At deposition Mr. Larkin was asked:

> "Q. Is it your opinion that differences between budgeted and actual amounts relied upon by Larkin and Associates, in applying the incremental cost method, could only have been caused by charging costs to the storm cost?
>
> A. It is a conclusion we reached…"

(Larkin deposition, page 47, line 16, attached as Doc. No. HAG-2)

Q. Mr. Larkin criticizes FPL for its assertion that use of a budget amount is not a good way to identify incremental costs. Do you agree with Mr. Larkin?

A. No, I do not. Mr. Larkin defends his criticism on the basis that FPL has based numerous projected rate case data elements, including revenues, expenses and plant investment balances on its budget process. While this is no doubt true, the broken link in his "connection" is that budgets do not identify "incremental" costs. Rather their purpose is to identify the total actual cost of resources used to carry out numerous operating and non operating activities. Further, no rate case test period approved by the Commission that I'm aware of included storm restoration costs (other than relatively small accruals to set up the storm reserve)...or any other effects of major storm activity. Rate case filings include normal weather only.

It's also true as Mr. Larkin asserts that the Commission has approved projected rate case data derived at least initially from use of FPL's budget system. For the same reason noted above, this has nothing to do with "incremental costs" since budget data does not deal with that type of costing. Further, attempts to use "incremental costs" represent a departure from the reasonable and fair cost accounting directives contained in the USOA. Essentially, the USOA directs accounting for the actual costs of all activities undertaken in the provision of utility service, construction or other activities.

INCONSISTENCY WITH USOA

Q. Mr. Larkin cites USOA Plant Accounting instruction No. 10 dealing with improvements to minor items of property as an example of the USOA supporting use of incremental costs. Do you agree that this is support in the USOA for use of incremental costs?

A. No, I do not. Rather than supporting incremental costing, it is support for use of an estimate when the actual cost of an improvement cannot be identified directly.

Mr. Larkin ignores the overriding and more directly applicable USOA instructions which make it clear that actual costs are the overriding accounting objective in the USOA instructions.

A good example is Accounting Instruction 9, "distribution of pay and expenses of employees" (included as Document No. HAG-5) which states:

> "The charges to electric plant, operating expenses and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work..."

In addition, Electric Plant Instructions 3, "components of construction cost" (also included in Document No. HAG-5) states:

> "A. For major utilities, the cost of construction properly includable in the electric plant accounts shall include where applicable, the direct and overhead costs as listed and defined hereunder..."

Items listed include contract work, labor, materials and supplies, transportation, special machine service, shop service, protection, injuries and damages, privileges and permits, rents, engineering and supervision, general administration capitalized, engineering services, insurance, law expenditures, taxes, allowance for funds used during construction, earnings and expenses during construction, training costs, studies, and asset retirement costs. Each of these categories is explained in some detail, but the thrust is clearly to provide a fully distributed cost accounting for construction activities (as opposed to incremental costs).

INCONSISTENCY WITH REGULATORY FRAMEWORK

Q. OPC witness Larkin suggests on page 21 of his direct testimony that the "weather effects" of storm outages are similar to normal heating or cooling season variations and should be borne by stockholders. Do you agree?

A. No, I do not. Mr. Larkin might not have thought this assertion through completely. The weather effects of major storm events are clearly unlike and far more extreme than normal weather variations. Aside from the suspension of consumption and revenues due to outages (which do not occur in normal weather conditions), as evidence in this case shows, the costs of service restoration can be enormous. Such risks are not covered by the returns normally allowed by regulators.

Q. Do regulatory authorities generally employ incremental cost accounting methods?

A. No. In my experience, the predominant cost accounting method used for regulatory purposes is the fully distributed method. This is the method used for assignment of costs between jurisdictions, between classes of customers or between regulated and non regulated activities.

Aside from inconsistency with other cost assignments which are an intrinsic part of utilities' routine accounting practices and procedures, OPC's methodology understates the actual cost of storm restoration. The actual cost of such efforts is important information for management, regulators and other interested parties. Provided with the actual cost of storm restoration, all parties can then make more informed decisions as to recovery or other matters. Most importantly, since actual storm restoration costs have been, for the most part, excluded from base rates, their exclusion from the storm recovery factor would mean such costs would never be recovered.

Q. Would it be possible to use the incremental cost method to determine the actual cost of the storm restoration incurred by FPL?

A. If done properly, it could. When viewed in light of the fact that the cost of such storm recovery efforts has been largely excluded from cost of service used to set rates, the entire cost of the restoration effort is the "incremental cost" of the storm events.

Q. Does the use of internal resources which would have otherwise been deployed to normal operations and maintenance activities in the storm

recovery effort result in a double recovery of costs by FPL?

A. No, it does not. If a double recovery were to occur, it would be apparent that FPL was better off having suffered the storm damage than if it had not. For this to occur in spite of the loss of kilowatt hour sales and revenues for the periods affected by storm activity, amounts charged to normal operations and maintenance expenses would have had to decline by a greater amount than the revenue loss so that its operating income for such periods would go up instead of down. When asked at deposition whether this is true, Mr. Larkin responded

> "Well, that's almost a mathematical certainty." (Larkin deposition at p. 44, Doc. No. HAG-2)

In reaching their conclusion that there has been a "double recovery" OPC witnesses have ignored evidence to the contrary. As shown clearly on Mr. Davis' Document No. 10, even if FPL is granted recovery of all of the storm restoration costs it has requested in this proceeding, the 2005 storm events will have reduced its pre tax income by $47 million.

When the facts are considered, it is clear that FPL is not better off than before the storm events and there most definitely has been no double recovery of costs.

Q. At page 22 of her testimony, Ms. DeRonne suggests reducing FPL's 2005 storm restoration costs by the $9,095,845 FPL billed to other utilities under the mutual assistance program. What is her basis for this?

A. Ms. DeRonne's basis is that other utilities that assisted FPL in its restoration effort billed FPL for that assistance and FPL properly included those amounts in its cost of storm restoration. She apparently failed to notice that the cost of assistance FPL provided and billed to other utilities was not included in either FPL's storm restoration costs or its operations and maintenance expenses for 2005. If directed to reduce to its storm restoration costs by the amount of these billings, it would mean that FPL would have to absorb such costs. This treatment comports with no costing theory I know of and would be patently improper and unfair.

THE RIGHT APPROACH TO COSTING STORM RESTORATION

Q. What is the right approach to costing the storm damage repair and service restoration efforts?

A. The right approach is one which supports the fundamental principle that FPL should be entitled to recover all storm restoration costs. (This does not mean that a mere assumption of inclusion in base rates or in revenues is conclusive evidence of being "recovered".) The actual cost approach which had been used prior to the 2004 storm cost recovery proceeding is the most straight forward of any cost accounting choices, is consistent with USOA directions and supported by existing well controlled accounting procedures already in place. Unless evidence of a double recovery of costs exists, it is the most reasonable and practical approach to follow.

It is not impossible to employ an incremental cost method to identify and account for the costs of storm damage and service restoration and meet the objective of providing for recovery of all such costs. It is, however, a more difficult method to apply and may unnecessarily increase the internal accounting costs and/or regulatory costs without providing any commensurate benefit.

Q. Should the amount of storm damage repair and service restoration costs include contingencies for work not yet done?

A. Yes. It is necessary and appropriate to estimate the costs of work yet to be done in order to get the best measure of the total cost of such efforts so that appropriate rates can be determined. This is in principle no different than estimating the costs of future pension obligations, nuclear fuel disposal costs, nuclear plant decommissioning costs or fossil plant dismantlement costs—except that estimates for storm recovery costs do not require projections for so many years. A contingency reflects the fact that because of the extent and complexity of the restoration effort there is a great likelihood that either additional restoration work or higher costs of identified work, or both, will develop as the effort progresses. If such costs were not estimated and included in charges to the Storm Damage Reserve and charges to customers, the current charges to customers would be understated and future customer charges would be overstated.

Q. Is it proper to accrue for the cost of restoration work not done by the date set by the FPSC for "cut off" of charges to the storm reserve?

A. Yes, it is. In many cases actual known restoration work is postponed for reasons of operating economies. These should be accrued for and included in charges to the storm reserve. Denial of the inclusion of such costs could be an incentive for uneconomic decisions which would not benefit customers.

SUMMARY

Q. Please summarize your testimony.

A. OPC witnesses Larkin and DeRonne have provided no evidence to support their assertion of a double recovery by FPL, but have merely assumed it to be so. The actual facts contradict these assertions.

The cost accounting methods proposed by Mr. Larkin and Ms. DeRonne are at odds with the guidance in the USOA and predominant regulatory practices and are inappropriate for use in the circumstances following a major storm event. Such cost accounting methods are not easily applied and on an ongoing basis would increase FPL's accounting costs without providing and commensurate benefits. Further, OPC witnesses have clearly misapplied the incremental cost method in this case and the adjustments to FPL's restoration costs would result in a significant under recovery by FPL.

Cost based ratemaking has provided enormous benefits to FPL and its customers and the FPSC should take great care to preserve the regulatory framework upon which it is based.

The adjustments which OPC witnesses Larkin and DeRonne propose to apply "incremental costing" are in conflict with the regulatory framework of cost based ratemaking and should be rejected as not being in the best interests of FPL or its customers.

Q. Does this conclude your testimony?

A. Yes it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF HUGH A. GOWER

DOCKET NO. 060038-EI

APPENDIX

Q. **Briefly describe the nature of your work experience.**

A. From 1975 until 1992, I served as the Southeastern Area Director of the public utility and telecommunications practice for Arthur Andersen & Co. (now Andersen LLP). This area of the practice included work for electric, gas, telephone, water & wastewater utilities, motor carriers and airlines. I had responsibility for supervising the work done for clients, training of firm personnel and administrative matters, in addition to the direct responsibility for work done for numerous clients in this and other areas of the practice.

Serving those clients for which I had direct responsibility, I performed independent audits of the financial statements issued by public utilities and other companies in reports to investors and regulators. I participated in and supervised audits of various statements and schedules and other data required either annually or in connection with rate applications before federal or state regulatory authorities. I have also provided services in connection with the issuance of billions of dollars of securities by public utilities. I have consulted with public utilities and others regarding the economic effects of business transactions or rate-making matters as well as the proper accounting for the economic effects of such transactions or matters.

I have directed revenue requirement studies involving analysis of rate base, operating revenues and expenses as well as the analysis of specific transactions or alternative rate-making proposals for various cost-of-service components. I have also directed studies to determine the proper assignment of cost of service between customer classes, regulatory jurisdictions or between regulated and nonregulated operations. I have provided expert testimony in cases before regulatory commissions and courts.

I participated in the development of accounting and management information systems designed to promote close control over utility resources such as materials, fuel and construction costs. I have directed the preparation of financial forecasts, conducted independent reviews of financial forecasts and directed the development of financial forecasting models. I participated in management audits, the purpose of which was to assess whether management systems and procedures promoted economy and efficiency in utility operations. I have directed detailed reviews of organization, operating procedures and operating costs for several utilities covering such areas as production, distribution, transportation and administrative areas. I have also assisted utilities with the analysis of root causes of differences between actual costs and original budgets for nuclear plant construction projects.

I have directed depreciation studies which, based on analyses of utility plant investments, retirement transactions, salvage or cost of removal, developed equitable depreciation rates with which to affect capital recovery during the service lives of the assets. I also developed plans which were accepted by regulators to equitably assign the future outlays for spent nuclear fuel disposal, nuclear plant decommissioning and fossil plant dismantlement costs to customers receiving service, considering the effects of inflation, the time value of money and other variables.

I was a representative of the American Institute of Certified Public Accountants on the Telecommunications Industry Advisory Group which advised the Federal Communications Commission on certain matters in connection with the development of its Uniform System of Accounts (Part 32). In this connection, I chaired the Auditing and Regulatory Subcommittee which dealt with issues involving compliance with generally accepted accounting principles ("GAAP") when regulatory rate-setting methods were based on practices at variance with GAAP.

BY MR. ANDERSON:

Q Mr. Gower, have you prepared a summary of your testimony?

A Yes, I have.

Q Would you please provide your summary to the Commission?

A Yes, I will. And good evening, Madam Chair and members of the Commission. I will be very brief. My testimony is in rebuttal to certain proposals and assertions made by and adjustments proposed by OPC Witnesses Larkin and DeRonne.

My testimony begins with a description of the regulatory framework which underlies cost-based ratemaking, which this Commission and virtually every other Commission in the country has employed for many years. Although that is an old topic, it is very important to have that benchmark against which to measure the proposals which Mr. Larkin and Ms. DeRonne are making.

The key thing is that there are significant benefits to customers from properly applied cost-based ratemaking. First of all, as you well know, no increase in price can be made by the utility without this Commission's approval. Secondly, prices are limited to actual cost. Thirdly, under cost-based ratemaking, prices are lower because the duplicate facilities that might be in existence under competition are avoided.

Also, price increases due to current value pricing or price increases due to supply and demand imbalances such as those each of us face every time we go to the gas pump today, are also avoided. And, finally, lower capital costs made available to utilities by this kind of regulation makes utility prices much lower. Those lower capital costs are possible in large part because of the reasonable assurance of the recovery of reasonable and prudent costs which this kind of regulation provides. And that is important in this case because the OPC witnesses want to deny the recovery of reasonable and prudent costs.

Now, the foundation for Mr. Larkin and Ms. DeRonne's proposal is that it is necessary to prevent double recovery of costs, and everyone can agree with that. That is motherhood, apple pie, and the American flag. Unfortunately, these witnesses do nothing but assume that there will be double recovery. They have made no analysis, they have just assumed. And the fact is there is no double recovery. As shown in one of Mr. Davis' exhibits, the effects of the storm, lost revenues offset by the expenses which might normally be devoted to normal operations, but which were applied to the storm restoration still reduce the company's pretax operating income by $47 million.

OPC witnesses claim to have applied incremental costing to the storm restoration cost incurred by FPL. Again, there was no analysis and no work done by these OPC witnesses, which Mr. Larkin admitted in his deposition. They just concluded that certain budget variances were related to the storm, and they proposed to reduce FPL's reasonable and prudently incurred costs by those amounts. They made no effort to determine whether those variances were, in fact, related to the storm, and they ignored budget variances in which actual costs exceeded the budgets. So it is very one sided. This is not incremental costing. And, in fact, it is not even good accounting.

OPC proposals in my view ought to be rejected by the Commission because they are based on unsupported assumptions and no competent analysis. It would result in an underrecovery of actual reasonable and prudent costs of storm restoration which FPL incurred. This conflicts with the regulatory framework of cost-based ratemaking and it is not in the best interest of either FPL's customers or FPL. That concludes my summary.

MR. ANDERSON: Mr. Gower is available for any questions.

CHAIRMAN EDGAR: Mr. Beck.

MR. BECK: Thank you, Madam Chairman.

CROSS EXAMINATION

BY MR. BECK:

Q Hello, Mr. Gower.

A Good evening.

Q Mr. Gower, would you turn to Page 4 of your testimony, please?

A Certainly, if you will give me just a moment here. You can see why I am an accountant.

(Off the record briefly.)

Sorry about that. That was not intended to be comic relief. All right. Mr. Beck, I'm sorry for that interruption. I have Page 4.

Q Thank you, Mr. Gower. It's just like home, sort of. The sort of thing I do at home.

Mr. Gower, you are on Page 4 of your prefiled rebuttal testimony?

A I am.

Q At Line 7 there is a question that says is the setting of utility rates on the basis of actual cost widespread, and the first sentence in your answer is that almost universally regulators with responsibility for setting the rates of prices for public utilities in the United States do so on the basis of the affected utility's actual cost of providing service to customers. Do you see that?

A Yes, I do.

Q Are you generally familiar with the rate case that Florida Power and Light filed in January of 2005?

A Only that there was a filing which purported to show the need for a rate increase and that it was disposed of by a settlement agreement.

Q And are you aware that they filed for a rate increase of approximately $430 million a year beginning in January of 2006?

A That figure rings a bell. I have not examined that filing, but that is what I understand.

Q Now, if you know, was Florida Power and Light's proposed rates in their rate case based on their actual cost of providing service to customers?

A I do not know. I would presume so, since it was filed with this Commission.

Q Do you know whether the company used budgets and forecasts of future costs for the purpose of setting rates?

A I do not know, but if they followed the practice that they followed for many years they would have.

Q What is your view on the use of budgets for the purpose of setting rates?

A Well, I don't think budgets, per se, are used. The budget system that Florida Power and Light has may have been a vehicle with which to develop projections of costs for whatever the test period in the case was. But the evidence presented to the Commission is not a budget, it is in the form of cost data based on the Uniform System of Accounts. In other words, the Uniform System of Accounts shows various investments, operating revenues, and operating expenses. That is not as I understand it exactly what the company's budget develops.

Q Would you accept subject to check that the company used a forecasted 2006 test year in their filing?

A Yes, I would.

Q And that they filed their case in January of 2005?

A Certainly.

Q And assuming, if you will, that they filed their case in January of 2005, that would mean their budgets or forecasts would have had to have been prepared no later than late 2004, would it not?

A That is probably correct.

Q Do you think the use of forecasts that precede the beginning of a test year by more than a year is sufficiently reliable for the purpose of setting rates?

A Let me be sure I understand your question. Your question is the length of the period of time between the test period data and when the forecast was made?

Q Yes.

A Well, I have had no involvement in this particular rate filing. I do know that a number of companies have presented evidence on the basis of projections to this Commission, and that includes Florida Power and Light Company, and in my view, in the past, they certainly have been reasonable and accurate for purposes of setting rates, but I have no knowledge of this rate filing.

Q And rate filings would typically -- and if you know about Florida Power and Light tell me, would typically include all the normal operating costs of the company, would they not?

A Again, accepting the fact that I know nothing of how this case was filed, what would normally take place is that projections of both revenues and expenses as well as investment levels for normal operations would be made. That is normal weather and normal levels of service, and then those services would be costed on the basis of normal operations and normal expenses.

Q Okay. And that would include normal levels of salary, would it not?

A It would.

Q And normal levels of overtime?

A If overtime is applicable, yes.

MR. BECK: Mr. Gower, that is all I have. Thank you.

CHAIRMAN EDGAR: Are there other questions for this witness on cross? I'm seeing no, no, no, no, no. Okay.

Staff.

MR. KEATING: No questions.

CHAIRMAN EDGAR: Commissioners? No questions.

Mr. Anderson.

MR. ANDERSON: Yes, one question.

REDIRECT EXAMINATION

BY MR. ANDERSON:

Q Mr. Gower, you were asked some questions a moment ago about preparations for filing of rate cases, is that right?

A That is correct.

Q In making the projections, would a company make adjustments for extraordinary or nonrecurring items?

A Absolutely. As I indicated in response to Mr. Beck's question, those projections are based on normal operating conditions, normal weather. They would exclude things like hurricanes, because that is not normal operations. And, in fact, when a hurricane occurs, to the extent that the system is damaged, the company goes out of the business of providing service in a normal fashion and goes on a very rapid service restoration effort. So that is not part of normal operations, and none of the costs would be in the normal operating costs.

MR. ANDERSON: That is all we have.

CHAIRMAN EDGAR: Mr. Gower, thank you. You are excused.

THE WITNESS: Thank you.

(Transcript continues in sequence with Volume 12.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTERS

COUNTY OF LEON)

WE, JANE FAUROT, RPR, and LINDA BOLES, RPR, CRR, Official Commission Reporters, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that we stenographically reported the said proceedings; that the same has been transcribed under our direct supervision; and that this transcript constitutes a true transcription of our notes of said proceedings.

WE FURTHER CERTIFY that we are not a relative, employee, attorney or counsel of any of the parties, nor are we a relative or employee of any of the parties' attorneys or counsel connected with the action, nor are we financially interested in the action.

DATED THIS 22nd day of April, 2006.

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