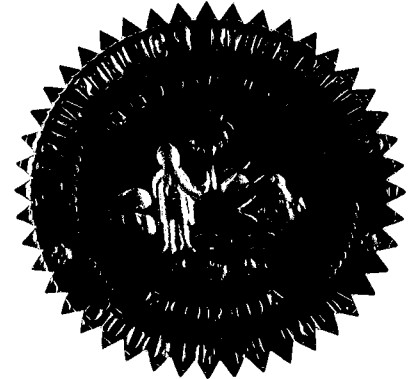


BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 060658-EI

In the Matter of:

PETITION ON BEHALF OF CITIZENS OF THE  
STATE OF FLORIDA TO REQUIRE PROGRESS  
ENERGY FLORIDA, INC. TO REFUND CUSTOMERS  
\$143 MILLION.



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VOLUME 8

Pages 1087 through 1178

PROCEEDINGS:

HEARING

BEFORE:

CHAIRMAN LISA POLAK EDGAR  
COMMISSIONER MATTHEW M. CARTER, II  
COMMISSIONER KATRINA J. MCMURRIAN

DATE:

Wednesday, April 4, 2007

TIME:

Commenced at 2:00 p.m.  
Concluded at 5:15 p.m.

PLACE:

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

REPORTED BY:

JANE FAUROT, RPR  
Official FPSC Reporter  
(850) 413-6732

APPEARANCES:

(As heretofore noted.)

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I N D E X

WITNESSES

NAME: PAGE NO.

STEPHEN A. STEWART

Direct Examination by Mr. Twomey 1090  
Prefiled Direct Testimony Inserted 1092  
Cross Examination by Mr. Burnett 1113  
Redirect Examination by Mr. Twomey 1127

DANIEL LAWTON

Direct Examination by Mr. Burgess 1130  
Prefiled Rebuttal Testimony Inserted 1133  
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EXHIBITS

NUMBER:		ID.	ADMTD.
150-155			1129
226	December 28, 2006, Fitch Credit Analysis	1160	1177
227	DL-1	1177	1177

## P R O C E E D I N G S

(Transcript follows in sequence from Volume 7.)

CHAIRMAN EDGAR: We will go back on the record.

And, Mr. Twomey, your witness.

MR. TWOMEY: Thank you, Madam Chair.

Mr. Stewart, you haven't been sworn, have you?

THE WITNESS: No, I have not.

CHAIRMAN EDGAR: Okay. If you would stand and raise your right hand. We will do that now.

MR. TWOMEY: That would be your other right hand.

(Laughter.) I want this to be semi-official, Madam Chair.

CHAIRMAN EDGAR: Thank you, Mr. Twomey.

(Witness sworn.)

CHAIRMAN EDGAR: Mr. Twomey.

MR. TWOMEY: It's all uphill from here.

STEPHEN A. STEWART

was called as a witness on behalf of AARP, and having been duly sworn, testified as follows:

## D I R E C T E X A M I N A T I O N

BY MR. TWOMEY:

Q Mr. Stewart, would you identify yourself and give your address and who you are testifying on behalf of, please.

A Yes. My name is Stephen Stewart. I'm appearing on behalf of AARP, and my address is 2904 Tyron Circle, Tallahassee, Florida 32309.

1 Q Are you the same Stephen A. Stewart who filed  
2 prefiled 17 pages of direct testimony in this docket on  
3 November 13th, 2006?

4 A Yes.

5 Q And do you have any corrections to that testimony,  
6 Mr. Stewart?

7 A Yes, I do have some corrections, and I believe they  
8 have been passed out.

9 MR. TWOMEY: Do you have that, Madam Chair?

10 CHAIRMAN EDGAR: I do.

11 MR. TWOMEY: Okay. I gave the court reporter a copy,  
12 as well, and all the parties, so I don't think there is --  
13 unless you wish, there is any need to read that, or have him  
14 read it.

15 CHAIRMAN EDGAR: No, we can do it by reference.

16 MR. TWOMEY: Pardon?

17 CHAIRMAN EDGAR: We can incorporate by reference.

18 MR. TWOMEY: Thank you.

19 BY MR. TWOMEY:

20 Q Mr. Stewart, with that correction listed on the  
21 handout to page 10 of your testimony -- let me ask you first,  
22 are there any other corrections you need to make?

23 A No.

24 Q With that correction, if I were to ask you the same  
25 questions contained in your prefiled direct testimony today

1 under oath, would your answers be the same?

2 A Yes.

3 MR. TWOMEY: Madam Chair, I would ask that Mr.  
4 Stewart's testimony be inserted into the record as though read.

5 CHAIRMAN EDGAR: The prefiled testimony will be  
6 inserted into the record as though read with the correction  
7 that has been distributed by the witness.

8 MR. TWOMEY: Thank you.

9 BY MR. TWOMEY:

10 Q And, Mr. Stewart, is it true as well that you have  
11 six exhibits to your direct testimony, SAS-1 through 6?

12 A That is correct.

13 Q Okay. And do you have any corrections to those  
14 exhibits?

15 A No, I do not.

16 MR. TWOMEY: Madam Chair, I would ask that Mr.  
17 Stewart's exhibits be identified for the purposes of the record  
18 as indicated on the staff's sheet, and I have the numbers.

19 CHAIRMAN EDGAR: Yes, Exhibits 150 through 155.

20 MR. TWOMEY: Yes, ma'am. Thank you.

21 (Exhibits 150 through 155 marked for identification.)  
22  
23  
24  
25

## 1 DIRECT TESTIMONY OF STEPHEN A. STEWART

2 ON BEHALF OF AARP

3 PROGRESS ENERGY FLORIDA, INC.

4 DOCKET NO. 060658-EI

5

6 **Q. Please state your name, address and occupation?**7 A. My name is Stephen A. Stewart. My address is 2904 Tyron Circle, Tallahassee,  
8 Florida, 32309. I am testifying as a consultant to AARP in this docket.

9

10 **Q. Please describe your educational background and business experience?**11 A. I graduated from Clemson University with a Bachelor of Science degree in  
12 Electrical Engineering in December 1984. I received a Master's degree in  
13 Political Science from Florida State University in August 1990.

14

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

22

1 In October 1991, I accepted a position with the Office of Public Counsel (“Public  
2 Counsel”) with the responsibility for analyzing accounting, financial, statistical,  
3 economic and engineering data of Florida Public Service Commission  
4 (“Commission”)-regulated companies and for identifying issues and positions in  
5 matters addressed by the Commission. I left the Public Counsel in 1994 and  
6 worked as a consultant for the Florida Telephone Association for one year.

7  
8 Since 1995 I have been employed by two privately held companies, United States  
9 Medical Finance Company (“USMED”) and Real Estate Data Services Inc. I  
10 worked with USMED for approximately four years as Director of Operations. I  
11 founded Real Estate Data Services in 1999 and I am currently its President and  
12 CEO. In June 2006 I purchased Commercial Print and Copy, a business located  
13 in Tallahassee, Florida.

14  
15 Over the last ten years I have worked for the Public Counsel on a number of  
16 utility related issues. In the last several years I have also served as a consultant to,  
17 and provided testimony for, AARP.

18

19 **Q. Have you previously testified before the Florida Public Service Commission?**

20 A. Yes. I have filed testimony with the Commission on ten occasions.

21

22

23



1 **Q. Have you prepared an exhibit detailing your qualifications and experience?**

2 A. Yes. I have attached Exhibit \_\_\_\_\_ (SAS-1) which details my qualifications and  
3 regulatory experience.

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

5 A. The purpose of my testimony is two-fold. First, I provide a brief analysis of the  
6 case relying on the evidence that has been filed to date. My analysis indicates that  
7 the Office of Public Counsel, through the testimony of its witness Dr. Robert L.  
8 Sansom, has made a compelling, and seemingly incontrovertible, case that  
9 Progress Energy Florida, Inc. ("PEF") charged its customers at least \$143 million  
10 in unnecessary, imprudent and therefore excessive fuel charges during the period  
11 1996-2005.

12  
13 Second, I provide a recommendation that urges this Commission to impose upon  
14 PEF a financial penalty in an amount sufficiently large to discourage it in future  
15 cases from intentionally benefiting its parent/affiliate companies at the expense of  
16 its customers and in violation of its statutory obligation to provide the most  
17 efficient service to its monopoly customers. I believe this Commission should  
18 provide PEF, and all Commission price-regulated companies, with a clear  
19 disincentive to conduct that intentionally harms their customers to the financial  
20 advantage of affiliates or their own shareholders. If utilities are merely required  
21 to return the financial fruits of their intentionally imprudent behavior when it is  
22 later found out, I would argue that there is, in fact, an economic incentive for



1           **Q.     What does your analysis of the evidence indicate?**

2           A.     After reviewing the case materials, I have concluded that the evidence  
3 shows PEF built two coal plants in 1984 and 1985 specifically designed to burn  
4 two different types of coal: bituminous and sub-bituminous. However, when one  
5 type of coal, Powder River Basin sub-bituminous, later became the clearly lower  
6 priced alternative, PEF failed to take advantage of the power plants' design fuel  
7 specification so it could pass the fuel savings associated with the sub-bituminous  
8 coal on to its ratepayers. Instead, PEF intentionally continued to purchase higher  
9 cost bituminous and synthetic fuel, to the clear advantage of its corporate parent  
10 and affiliates. According to OPC witness Sansom, the excessive fuel cost  
11 resulting from the failure to purchase the least-cost coal was \$143.5 million,  
12 excluding interest.

13  
14           **Q.     What evidence indicates PEF built two plants in the early 1980s**  
15 **designed to burn two types of coal?**

16           A.     First, the operating instructions authored by the manufacture of CR4 and  
17 CR5 indicate that the plants were specifically designed to burn a 50/50 mix of  
18 bituminous and sub-bituminous coal. See Exhibit \_\_\_\_\_ (SAS-2) And second,  
19 numerous correspondences addressing the site certification of CR 4 and 5  
20 reference the ability of the plants to burn the two types of coal. For example, in a  
21 letter from a principal engineer with Electric Fuels Corporation, dated April 14,  
22 1978, the engineer shares with Mr. Vierday of the Environmental & Licensing

1 Affairs Department of PEF comments about the site certification of CR 4 and 5 by  
2 PEF submitted to EPA. The comments include the following:

3 Our plan has always been, and continues to be, to diversify our coal  
4 supply by bringing it from different geographical areas of the country. For  
5 the subject supply of low-sulfur coal, this includes both eastern and  
6 western coals. The bituminous coals from the Appalachian area from the  
7 Eastern United States and from the Western States of Utah and Colorado,  
8 and the sub-bituminous coals from Wyoming currently appear to be the  
9 most attractive from a cost and availability standpoint.

10  
11 The complete document is at Exhibit \_\_\_\_\_ (SAS-3).  
12  
13

14 **Q. Did PEF's motion to dismiss OPC's petition in this case argue that the**  
15 **plants in question were not designed to burn two types of coal?**

16 A. No.

17

18 **Q. What evidence indicates that PEF should have switched to the lower**  
19 **cost Powder River Basin (PRB) sub-bituminous coal in 1996?**

20 A. The most convincing evidence that PEF should have taken advantage of  
21 the low cost PRB coal is that it was less expensive on a delivered, BTU-basis than  
22 the bituminous coal and synfuel it was purchasing from its affiliates and others.  
23 The wisdom of switching to PRB coal in 1996 is reinforced by the actions of  
24 other utilities during this time period. Data from the filed FERC Forms 423 show  
25 that Georgia Power, Alabama Power, Gulf Power, Mississippi Power, and TECO  
26 all were purchasing PRB coal and passing the cost savings to their customers  
27 during this period of time in question here. Exhibit \_\_\_\_\_ (SAS-4) shows the  
28 information reported in the FERC Forms 423. Additionally, it is important to

1 note that many of these other utilities had to make capital improvements to  
2 existing plants so that the PRB coal could be used. PEF had no such impediment  
3 to burning the PRB coal because CR 4 and 5 were specifically designed for these  
4 fuels.

5  
6 **Q. Did PEF's motion to dismiss OPC petition argue that PRB coal was**  
7 **not the lower cost alternative during the time period in question?**

8 A. No.

9  
10 **Q. Given your analysis, what do you think the Commission should do in**  
11 **this case?**

12 A. I think the Commission should do for consumers exactly what it has done  
13 for utilities over the last three years. Over the last three years utilities have  
14 petitioned the Commission to pass through significantly increased fuel costs that  
15 have been blamed on market forces that are out of the control of the utilities. Now  
16 we find that for 10 years when the free-market favored the consumers, PEF failed  
17 to look out for the consumers' best interest for reasons that appear solely related to  
18 increasing the bottom lines of its parent corporation and several affiliates. I  
19 believe basic fairness, and fundamental regulation, dictate that the PEF ratepayers  
20 receive a refund equal to the excessive fuel costs, plus accrued interest, as well as  
21 the imposition of a penalty large enough to deter PEF from engaging in this type  
22 of self-serving fuel purchasing practice in the future.

23

1           **Q.     How much of refund should the PEF ratepayers receive?**

2           A.     I have not conducted an independent analysis on the required refund.  
3           However, I have reviewed the amount testified to by OPC witness Sansom  
4           Merchant and I am comfortable with his recommendation.

5  
6           **Q.     Do you have any basis for challenging the interest calculation made by  
7           OPC witness Merchant?**

8           A.     No. The interest calculation for fuel adjustment under and over recoveries  
9           is fairly straightforward and simply involves applying the applicable commercial  
10          paper rate of interest to whatever the outstanding balance is for the successive  
11          time frames being considered. The appropriate level of interest is essentially a  
12          “fallout” number that is dependent upon the level of overcharges the Commission  
13          finds. I do not have any basis, however, for criticizing Ms. Merchant’s  
14          calculations.

15  
16          **Q.     Do you believe that paying interest on the overcharges that are alleged by Dr.  
17          Sansom is a sufficient inducement for PEF not to engage in the similar  
18          behavior in the future of overcharging its customers by not buying the least-  
19          cost fuels available to it?**

20          A.     No, I do not. The payment of interest merely recognizes the time value of money  
21          and is integral to virtually all situations in which the Commission finds that a  
22          regulated utility appropriately either overcharged or undercharged its customers  
23          during the course of a cost-recovery clause hearing. If PEF is not required to pay

1 interest on whatever the overcharges are found to be in this case, then it still  
2 would have benefited itself, at the expense of its customers, by receiving an  
3 interest-free loan from those customers. The payment of interest cannot be  
4 considered a "penalty."

5 On the other hand, if the Commission finds that PEF either (1) intentionally  
6 overcharged its customers by buying affiliated-supplied bituminous coal or  
7 synfuel instead of lower-cost sub-bituminous coal, which I believe is the case, or  
8 (2) that the overcharges resulted by more benign PEF mismanagement, then I  
9 believe the Commission must impose a financial penalty of sufficient size to deter  
10 PEF from engaging in behavior resulting in these overcharges again. In my  
11 opinion, the requirement for a penalty, and its amount, should be significantly  
12 greater if PEF's self-serving behavior was intentional, not just inept. Again, I  
13 believe PEF's decision to continue purchasing affiliated coal instead of the less  
14 expensive PRB sub-bituminous coal was clearly intentional and that its decision  
15 was motivated by a desire to increase its corporate parent's and its affiliates'  
16 profits.

#### 17 18 **PEF'S IMPRUDENCE**

19 **Q. Please summarize the key findings of Dr. Sansom that you believe**  
20 **demonstrate PEF's imprudence and the resulting need for a penalty to deter**  
21 **future such behavior.**

22 **A.** First, I believe Dr. Sansom's testimony and supporting exhibits conclusively  
23 demonstrate that the CR 4 and 5 units were specifically designed to burn a

1 “design basis” fuel consisting of a 50/50 blend of bituminous and sub-bituminous  
2 coals. Dr. Sansom’s exhibits supporting this finding consist primarily of  
3 engineering documents stating this fuel specification, as well as the Department of  
4 Environmental Regulation’s (“DER”) operating permit requiring it. There should  
5 be no doubt by this Commission with respect to the fact that CR 4 and 5 have  
6 always been physically and operationally capable of burning 50/50 blend of  
7 bituminous and sub-bituminous coals.

8  
9 I accept Dr. Sansom’s expert opinion that PEF’s decision not to burn the 50/50  
10 design basis fuel blend in the 1980’s had no adverse economic consequences on  
11 the utility’s customers because bituminous coal was then more economical than  
12 sub-bituminous coal.

13  
14 I also accept Dr. Sansom’s expert opinion that by the early 1990’s certain  
15 developments in the mining of sub-bituminous coal led to it becoming a more  
16 economical choice than bituminous coal. I likewise accept Dr. Sansom’s  
17 conclusion that this shift in pricing for sub-bituminous coal and its transportation  
18 was (1) “widely disseminated within the coal and utility markets and industries at  
19 the time;” (2) “that numerous utilities in the Midwest and Southeast shifted from  
20 bituminous coal to sub-bituminous coal to take advantage of the clear opportunity  
21 to lower fuel costs that sub-bituminous coal afforded them;” (3) that PEF knew, or  
22 should have known, about the price shift at the time other utilities were taking  
23 advantage of it; (4) that “for a full decade after it should have shifted to a 50%



1 Powder River Basin (PRB) sub-bituminous coal blend with bituminous coal, PEF  
2 continued to burn bituminous coal and a product of bituminous coal treated with  
3 oil called synthetic fuel or 'synfuel'," which synfuel PEF frequently purchased  
4 "from companies in which its parent, Progress Energy, Inc. held ownership  
5 interests;" and (5) that during the 1996-2005 time frame, "sub-bituminous coal  
6 was available from the Powder River Basin of Montana and Wyoming at  
7 delivered prices via the water route to Crystal River Units 4 and 5 cheaper than  
8 either the bituminous coal or the synfuel that PEF purchased."

9  
10 **Q. Earlier you said you believed PEF's fuel overcharges were intentional, which**  
11 **conduct you said compelled a significant penalty. What basis do you have**  
12 **for concluding that PEF's overcharges were the result of intentional acts?**

13 A. I believe PEF had a continuing obligation to provide its customers with electric  
14 service based on the least-cost fuels reasonably available to it. As demonstrated  
15 by the recent fuel adjustment hearings, generating fuels comprise a very large  
16 percentage of both a utility's operating costs and its customers' total monthly  
17 bills. Competent utility management must necessarily always be alert to  
18 opportunities to reduce its fuel costs consistent with fuel supply security. As  
19 demonstrated by Dr. Sansom's testimony and independent documents I have  
20 examined, PEF either knew, or reasonably should have known, that it could have  
21 purchased PRB sub-bituminous coals for CR 4 and 5 at a lower delivered cost  
22 than what it was paying for either the bituminous coal or synfuel it was  
23 purchasing primarily from affiliates during the 1996-2005 time frame. At least as

1 early as 1996, PEF essentially came to an economic, ethical, and regulatory fork  
2 in the road where it was required to test the interests of its customers versus those  
3 of its affiliated companies. In simple terms, PEF was faced with either  
4 purchasing the lower cost PRB sub-bituminous coals for CR 4 and 5 to the clear  
5 benefit of its customers or with continuing the practice of fueling those units with  
6 higher cost coal and synfuel purchased from, and often transported by, affiliated  
7 companies. Unfortunately, PEF chose to benefit its affiliates by continuing to  
8 purchase the higher cost fuels. As I said earlier, PEF's course of action was  
9 contrary to that of many other utilities that elected to switch to the less expensive  
10 sub-bituminous coal, even when doing so required expensive capital  
11 improvements to their generating units to accommodate burning the sub-  
12 bituminous coal. Again, PEF designed CR 4 and 5 to sub-bituminous coal and  
13 could have burnt it immediately with no plant modifications. It appears to me that  
14 PEF was playing a "zero-sum" game and that it chose to ignore its customers'  
15 interests in order to help itself.

16  
17 **Q. What do you mean?**

18 A. As best I can tell from the evidence contained in the prefiled testimony  
19 and discovery to date, PEF could have exclusively bought its affiliates'  
20 bituminous coal and synfuel during the 1996-2005 time frame, or it could have  
21 bought lower-cost sub-bituminous coal from non-affiliated companies sufficient  
22 to provide the 50/50 design fuel mix, but it could not simultaneously do both.  
23 PEF's fuel purchasing alternatives did not present it with a "win-win" situation



1 penalty equal to 10 percent of the overcharges it ultimately finds should be  
2 refunded to PEF's customers.

3 **Q. Do you believe the Commission has the legal authority to levy a**  
4 **penalty against PEF?**

5 A. Yes, I do. I recall the Commission used its authority under Section  
6 366.095, Florida Statutes, to penalize Gulf Power Company for mismanagement  
7 during the early 1990s. That statute states:

8 The commission shall have the power to impose upon any entity  
9 subject to its jurisdiction under this chapter that is found to have  
10 refused to comply with or to have willfully violated any lawful rule  
11 or order of the commission or any provision of this chapter a penalty  
12 for each offense of not more than \$5,000, which penalty shall be  
13 fixed, imposed, and collected by the commission. Each day that such  
14 refusal or violation continues shall constitute a separate offense.  
15 Each penalty shall be a lien upon the real and personal property of  
16 the entity, enforceable by the commission as a statutory lien under  
17 chapter 85.

18  
19  
20 **Q. What did the Commission do in the Gulf Power Company case and**  
21 **how do you think that decision is applicable to this case?**

22 A. In 1990 Gulf Power Company ("Gulf") filed a rate case with this  
23 Commission asking for an additional \$26.3 million in annual revenues and a  
24 return on equity of 13 percent. In its final order the Commission found Gulf's  
25 reasonable range of return on equity lay between 11.75 and 13.50 percent with a  
26 mid-point of 12.55 percent. However, the Commission determined that Gulf's  
27 mismanagement in a number of areas warranted a fifty basis point reduction in the  
28 equity mid-point used to establish annual revenues. The Commission discussed  
29 the mismanagement issues, saying:

1 The record is clear: Gulf Power Company admitted that corrupt  
2 practices took place at Gulf Power Company from the early 1980s  
3 through 1988, including but not limited to theft of company  
4 property, use of company employees on company time to perform  
5 services for management personnel, utility executives accepting  
6 appliances without payment, and political contributions made by  
7 third parties and charged back to Gulf Power Company. The  
8 majority of the unethical/illegal activities involved Jacob Horton, the  
9 Senior Vice President of Gulf Power Company. Mr. Horton was  
10 killed in a plane crash on April 10, 1989.  
11

12 The Commission went on to conclude that:

13 This record reflects a disregard for the ratepayers and public service,  
14 however. Accordingly, we will reduce Gulf Power Company's ROE  
15 by fifty (50) basis points for a two year period. This results in a  
16 final ROE of 12.05%.

17  
18 This final ROE is well within the parameters established as fair and  
19 reasonable by expert testimony of record. This reduction in the  
20 authorized ROE for a two year period is meant as a message to  
21 management that the kind of conduct discussed above, which was  
22 endemic for at least eight years at this company, will not be tolerated  
23 for public utilities which operate in Florida. We have limited the  
24 reduction to a two year period to reflect our belief that Gulf Power  
25 has turned the corner on dealing with the extensive and long-  
26 standing illegal/unethical behavior within the company.  
27

28 (Emphasis supplied.) I have attached relevant pages of the Commission order  
29 imposing the penalty as Exhibit \_\_\_\_\_ (SAS-5) and the Florida Supreme Court  
30 decision upholding the penalty as Exhibit \_\_\_\_\_ (SAS-6).

31 **Q. Do you believe PEF's conduct in this case rises to the level that it**  
32 **warrants a financial penalty comparable to that imposed by this Commission**  
33 **on Gulf Power Company?**

34 A. Yes I do. In fact, I believe the PEF's behavior and the resulting financial  
35 harm to its customers is substantially greater than that involved in the Gulf Power

1 Company case and that, therefore, the need for a penalty is even greater. It is my  
2 view that the evidence clearly indicates PEF intentionally chose to use a higher  
3 priced fuel when a lower priced fuel was available. While a competent, well  
4 managed utility would have purchased the least-cost coal, the fact that PEF's  
5 parent company profited from the decision introduces a profit motive for its  
6 actions that trumps mere incompetence and leads me to believe the decision was  
7 indeed intentional. As demonstrated by Dr. Sansom's testimony and exhibits,  
8 while other utilities were retrofitting plants to take advantage of PRB coal, PEF  
9 was "retrofitting" its permit for CR 4 and 5 by excluding the ability to burn the  
10 less expensive design fuel, while specifying the more expensive, affiliate-supplied  
11 synfuel. This allowed the parent company to profit at the expense of PEF's  
12 customers.

13 **Q. Why do you believe this case is more egregious than the Gulf Power**  
14 **Company case?**

15 A. While this Commission found that Gulf Power Company's management  
16 engaged in a number of "corrupt practices" that could not be tolerated and had to  
17 be penalized, the fact is that Gulf's behavior had very little quantifiable direct  
18 adverse economic consequences on its customers. By contrast, the evidence in  
19 this case shows that PEF directly harmed its customers in the amount of \$143.5  
20 million, if you accept Dr. Sansom's calculation, in order to benefit its parent and  
21 affiliates by a comparable amount. If ever a case cried out for penalty to send  
22 management a message that conduct disregarding its ratepayers and public service

1 will not be tolerated, this is it. I believe a ten percent penalty would send that  
2 message.

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

4 A. Yes.

5

Docket No. 060658-EI

Corrections to prefiled direct testimony of Stephen A. Stewart

At page 10, on lines 3 and 4, strike the phrase “as well as the Department of Environmental Regulation’s (“DER”) operating permit requiring it” and replace it with the following language “to include the Instructions for the Care and Operation of Babcox & Wilcox Equipment furnished on Contract RB-588 for Florida Power Corporation Crystal River Plant Unit 4, which instructions include the following language: “The guarantees for this unit are based on firing a 50/50 blend of Eastern bituminous and Western sub-bituminous coal.” Sansom Exhibit RS-2, page 3 of 6. Additional documentation supporting Dr. Sansom’s conclusion that the units were specifically designed to burn a 50/50 blend of Eastern bituminous and Western sub-bituminous coal is the apparent Babcock & Wilcox report of predicted boiler performance based on fuel consisting of a “50/50 blend, Eastern & Western.” Sansom Exhibit RS-2, page 4 of 6. Lastly, further supporting the fuel design specification of the units, is an “excerpt from Florida Power Corporation Application for site certification in Crystal River 4 and 5,” Table 3.2-2, titled Alternative Florida Power Corporation Performance Coals Weight Blends, 50/50 Basis, apparently sourced from a 1978 Black and Veatch document. Sansom Exhibit RS-2, pages 5,6 of 6.”



1 BY MR. TWOMEY:

2 Q Mr. Stewart, have you prepared a brief summary for  
3 your testimony?

4 A Yes, I have.

5 Q Would you deliver it, please?

6 A Yes. Good afternoon, Commissioners. Following the  
7 filing of the petition in this case, and Public Counsel Witness  
8 Sansom's testimony supporting it, I was asked by AARP to review  
9 the case at that point to determine whether AARP could provide  
10 additional support to the consumers' case presented by the  
11 Office of Public Counsel.

12 Having read the petition and Mr. Sansom's testimony,  
13 I concluded that Mr. Sansom appeared to make a strong case that  
14 Progress Energy had made imprudent coal fuel purchases to the  
15 distinct disadvantage of its customers. More than that, it  
16 appeared to me, at least based on what Mr. Sansom had testified  
17 to, that the utility had intentionally decided to purchase more  
18 expensive coal than it could have otherwise obtained on the  
19 open market, and that it appeared reasonably clear that it had  
20 knowingly done so in order to benefit its or its corporate  
21 parent shareholders.

22 I told AARP that I thought that if Progress  
23 intentionally benefitted its shareholders at the expense of  
24 customers that it should be penalized in addition to merely  
25 having to refund any fuel overcharges. If not, Progress and

1 other utilities would not be dissuaded from similar misdeeds in  
2 the future.

3           It is my view that the utility should be penalized  
4 for intentionally acting against the interests of its customers  
5 to the advantage of its shareholders during the course of the  
6 fuel adjustment recovery as well as during the course of the  
7 base rate case. Fuel and other recovery clauses involve as  
8 much annual revenue, if not more, than base rates, and it seems  
9 to me that an intentional utility effort to benefit itself at  
10 the clear and corresponding harm to its customers should be  
11 penalized whether it was accomplished through base rates or  
12 through a recovery clause like in this case.

13           If it turns out that the utility did not act  
14 imprudently and acted in the best interest of its customers,  
15 then you should let them keep all the money that they recovered  
16 from the customers through the fuel clause. On the other hand,  
17 as it initially appeared to be in this case, if the utility  
18 intentionally bought more expensive fuel to benefit its  
19 affiliated companies than it could have otherwise, then it  
20 should be penalized for that mismanagement in addition to being  
21 required to just return the overcharges and the associated  
22 interest.

23           That concludes my summary.

24           MR. TWOMEY: Madam Chair, we would offer Mr. Stewart  
25 for cross.

1 CHAIRMAN EDGAR: Thank you. And I will begin at my  
2 left. Mr. McWhirter, any questions on cross?

3 MR. McWHIRTER: No questions.

4 MS. BRADLEY: No questions.

5 MR. BURGESS: No questions.

6 CHAIRMAN EDGAR: Mr. Burgess, you said no questions?  
7 Okay. Mr. Burnett.

8 MR. BURNETT: Thank you, Madam Chair.

9 CROSS EXAMINATION

10 BY MR. BURNETT:

11 Q Good afternoon, Mr. Stewart.

12 A Good afternoon.

13 Q Mr. Stewart, in your prefiled testimony, you come to  
14 the conclusion that, quote, it's seemingly uncontrovertible  
15 that PEF should be penalized based on the allegations that Mr.  
16 Sansom has in his direct testimony in this matter, correct?

17 A That is correct.

18 Q In coming to this conclusion, you did not conduct any  
19 independent analysis of the facts alleged by Mr. Sansom,  
20 correct?

21 A That's correct.

22 Q So if Mr. Sansom made a mistake in his testimony, you  
23 carry that mistake into your testimony, as well, correct?

24 A As I have told you in my deposition, that's correct,  
25 yes.

1           Q     Now, at the time you filed your testimony, you had  
2 not read any of PEF's testimony because it did not exist yet,  
3 correct?

4           A     That's correct.

5           Q     So naturally you did not have the benefit of PEF's  
6 testimony when you came to the conclusion that it is  
7 uncontrovertible that my company should be penalized, correct?

8           A     That's correct.

9           Q     And you did not rely on all the thousands of pages of  
10 discovery that have taken place in this docket when you  
11 prepared your testimony because that didn't exist yet either,  
12 correct?

13          A     That's correct.

14          Q     So naturally you didn't have the benefit of those  
15 thousands of pages of discovery when you came to the conclusion  
16 that it is uncontrovertible that my company should be  
17 penalized, correct?

18          A     That's correct.

19          Q     And you didn't consider any of the depositions that  
20 took place in this case when you prepared your testimony  
21 because they had not occurred yet either, correct?

22          A     That's correct.

23          Q     And, again, you didn't have the benefit of them when  
24 you came to the conclusion that it is uncontrovertible that my  
25 company should be penalized, correct?

1 A That's correct.

2 Q You did not have the benefit of the site inspection  
3 that took place at Crystal River 4 and 5 when you prepared your  
4 testimony, because that had not happened yet, correct?

5 A That's correct.

6 Q And, finally, you did not have PEF's rebuttal  
7 testimony when you prepared your testimony because, again, it  
8 did not exist, correct?

9 A That's correct.

10 Q Now, at the time of your deposition a few weeks ago,  
11 you had not even read PEF's testimony in this case, correct?

12 A That's correct.

13 Q And you admitted to me that if you did read PEF's  
14 testimony, you may change your mind about whether my company  
15 should have a penalty leveled against it, correct?

16 A I think my answer to you was that the purpose of my  
17 testimony was to make a case for a penalty if this Commission,  
18 after reviewing the record, that they intentionally overcharged  
19 other customers, so that would be correct.

20 Q The last part of your answer there was that my  
21 statement was correct?

22 A Right.

23 Q Okay. And you also told me that if you ever did read  
24 PEF's testimony, you would believe the facts, and they were  
25 true, without independent analysis just like you did for Mr.

1 Sansom, correct?

2 A I might want to be referred to the deposition on that  
3 so I could review it.

4 Q I state here, "I know in your testimony that you seem  
5 to accept a lot of what Doctor Sansom said as true. Would you  
6 afford PEF that same benefit, and if it made sense to you as  
7 you read it, would you accept PEF's testimony as true, as well?  
8 I think the history that I have in providing testimony is that  
9 obviously when I get on the stand and defend my testimony, I  
10 want to be confident in what I'm providing, and I will do the  
11 research to understand if there is a weakness in our case, and  
12 if so, how they were addressed. Yes, I will do that."

13 "Nothing special about Doctor Sansom, you would  
14 afford PEF the same review, and if it just made sense on its  
15 face, would you take that as true just like you did with him?  
16 Right. I mean, again, I'm an engineer, so A plus B equals C."

17 Shall I go on?

18 A If you want to. I mean, I think that is consistent  
19 with my summary where I stated that if this Commission finds  
20 that they did not intentionally overcharge the consumers, then  
21 that would be the case. My testimony, the thrust of my  
22 testimony is that there is a precedent to levy a penalty if it  
23 is found that Progress intentionally overcharged their  
24 customers for the fuel that they bought.

25 Q And if you did afford my company that same courtesy,

1 again, you may change your mind as to whether or not a penalty  
2 would be due, correct?

3 A I think in the question, you said if it made sense,  
4 and if there was a silver -- the point I made in the  
5 deposition, if there was a silver bullet, or some smoking gun  
6 that proved that you did not overcharge your customers, that I  
7 would accept that.

8 Q Thank you. You recommend a 10 percent penalty  
9 against my company in this case, correct?

10 A That's correct.

11 Q And that is just an arbitrary number that you made up  
12 because it feels right to you, correct?

13 A In reviewing penalties that were assessed by this  
14 Commission, there was no standard formula applied. The driving  
15 force was that the penalty could not be obviously beyond --  
16 affect their reasonable rate of return for a utility. So 10  
17 percent is somewhat of an arbitrary number; however, it is a  
18 penalty that is significant enough to get at what we are after,  
19 which is an incentive not to engage in behavior that is  
20 intentional.

21 Q But nonetheless, sir, it is, in fact, an arbitrary  
22 number that you made up because it feels right to you, correct?

23 A I would say it's no less arbitrary than the penalty  
24 the Commission levied in the Gulf Power case, so it's arbitrary  
25 in that sense.

1 Q I would like to refer you to Page 27 of your  
2 deposition, on Line 9, where you say, "And it is an arbitrary  
3 number." And then on that same page where I say, "And I'm not  
4 trying to be cute about this, but did 10 percent just sort of  
5 feel right to you?" And you answer, "That would probably be a  
6 good way of putting it, yes."

7 Did I read that correctly?

8 A Yes.

9 Q Thank you. Sir, I would like to show you a page from  
10 our prehearing order in this matter, and draw your attention to  
11 Issue 5. Do you see that up there on the screen?

12 A Yes, I see it.

13 Q I will read that out loud. "If the Commission  
14 determines that PEF willfully violated any lawful rule or order  
15 of the Commission, or any provision of Chapter 366, Florida  
16 Statutes, should the Commission impose a penalty on PEF and  
17 what should the amount of that penalty be?"

18 Did I read that correctly, sir, as you see it on the  
19 screen?

20 A Yes.

21 Q Now, keeping that standard in mind that I just read  
22 to you, you cannot name one Commission rule that PEF has  
23 allegedly violated in this case, can you?

24 A I don't think that I need to name a rule in terms of  
25 a penalty based on the precedent that was set in the Gulf Power



1 case. I think that if you review the Gulf Power case that the  
2 language that was used in that case was a disregard for the  
3 utility customers. So, I would think that embodied in the  
4 statutes that regulate or that give jurisdiction to the Public  
5 Service Commission, that the Supreme Court has upheld that  
6 decision in the Gulf Power case. And, in the Gulf Power order  
7 it cites that the penalty is based on Gulf Power's disregard of  
8 the utility customer and public service.

9 Q Thank you, Mr. Stewart. Let me try again. Keeping  
10 that standard in mind that I just read to you, you cannot name  
11 one Commission rule that PEF has allegedly willfully violated  
12 in this case, can you?

13 A I would hope, and I'm not completely familiar with  
14 every rule of the Commission, but I would hope that if a  
15 utility overcharges for fuel intentionally that there would be  
16 a violation of some rule in this Commission.

17 Q Sir, let me again draw your attention to your  
18 deposition, Page 25, Line 7, where I ask you, "So no willful  
19 violation of a Commission rule that you know of?" Answer, "Not  
20 that I know of. I'm not saying that they haven't willfully  
21 violated a rule, but that is not part of my testimony."

22 Did I read that correctly?

23 A Yes, you did. I think it is consistent with what I  
24 just said.

25 Q And you, sir, cannot name one Commission order that

1 PEF has allegedly willfully violated in this case, can you?

2 A Again, if I cite the Gulf Power order, I would think  
3 that if Progress has overcharged intentionally with regards to  
4 the fuel costs, that it would be consistent with disregard for  
5 the rights of the consumer, and so I would cite that order.

6 Q Sir, I draw your attention, again, to your  
7 deposition, at Page 25, Line 15, where I say, "Okay. How about  
8 the same question for a Commission order; anywhere in your  
9 testimony where you contend that PEF has violated willfully any  
10 Commission order?" Your answer, "Subject to check, I don't  
11 believe so."

12 Did I read that correctly?

13 A Subject to check. I checked, and I think that the  
14 Gulf Power order is clear in stating that this Commission has  
15 the authority to levy a penalty when a utility disregards the  
16 rights of the ratepayers and the public service that is  
17 demanded from a regulated monopoly.

18 Q Mr. Stewart, you cannot name any provision of Chapter  
19 366 of the Florida Statutes that PEF has allegedly willfully  
20 violated, can you?

21 A I think 366 is replete with language that would  
22 afford this Commission the leeway, again, to level a penalty if  
23 Progress is found -- if they find that Progress has  
24 intentionally overcharged for fuel costs.

25 Q Again, sir, I will draw your attention to your

1 deposition, at Page 21, beginning at Line 14, "Okay. I'm just  
2 trying to drill down here. At the time you wrote your  
3 testimony, did you have that statute in front of you? No, that  
4 would be something that I probably just pulled from my years of  
5 being before the Commission, because I did not go and look up a  
6 statute."

7 "Do you recall what chapter it may be in the Florida  
8 Statutes? No, I do not."

9 Did I read that correctly, sir?

10 A Yes, you did, and it does come from my years of  
11 experience. And if you go to 366, there are numerous citations  
12 that address the public interest of the utility consumer, the  
13 provision of electric service and the associated efficiency,  
14 that this Commission has the jurisdiction to prescribe fair and  
15 reasonable rates and charges. So there is a number of  
16 citations in 366 that would give this Commission leeway to levy  
17 a penalty.

18 Q Mr. Stewart, it has been awhile since I have asked  
19 about your qualifications, but please refresh my memory. Are  
20 you an attorney, sir?

21 A No, I'm not. And you knew that.

22 Q Sometimes my memory, like others, does fade.

23 Mr. Stewart, even if this Commission finds that PEF  
24 committed some sort of benign mismanagement in this case, you  
25 would agree with me that such behavior would not be intentional

1 or willful conduct, correct?

2 A That would be for the Commission to decide.

3 Q Sir, I will ask you again. Even if this Commission  
4 finds that PEF committed some sort of benign mismanagement in  
5 this case, you would agree with me that such behavior would not  
6 be intentional or willful conduct, correct?

7 A Well, it depends on how they -- you are saying the  
8 Commission finds benign mismanagement. I'm not saying I would  
9 agree with their position, but it's going to depend on what  
10 they find, it isn't going to depend on what I'm thinking.

11 Q Mr. Stewart, I will draw your attention again to your  
12 deposition at Page 13, beginning at Line 17, where I ask you,  
13 "So benign mismanagement, that would obviously not be  
14 intentional mismanagement? It would be less than intentional,  
15 right?"

16 "And it wouldn't be like willful conduct? Right,  
17 that's the point I'm trying to make here."

18 Did I read that correctly?

19 A That is correct.

20 Q And, similarly, if this Commission were to find that  
21 PEF engaged in some sort of inept behavior in this case, you  
22 would agree with me that such behavior would not be intentional  
23 or willful conduct, correct?

24 A Could you ask that question again?

25 Q Yes, sir.

1           And, similarly, if this Commission were to find that  
2 PEF engaged in some sort of inept behavior in this case, you  
3 would agree with me, you would agree with me that such behavior  
4 would not be intentional or willful conduct, correct?

5           A     It would depend on how inept it was.

6           Q     And, again, sir, to your deposition at Page 13,  
7 beginning on Line 23 on to 14, Line 4, "Okay. I have the same  
8 question for inept behavior, which is down on 12 of your  
9 testimony, the same distinction there. I'm sorry." And I talk  
10 about your testimony a bit, and I say, "you used the term there  
11 inept behavior." "Correct, that is the same point."

12                   "Same point, not intentional, not willful?" Your  
13 answer, "Right."

14                   Did I read a correctly?

15           A     You read it correctly.

16           Q     Finally, sir, you made clear in your deposition,  
17 didn't you, that you have no direct proof that my company  
18 intentionally or willfully did anything wrong in this case,  
19 correct?

20           A     That's correct. My testimony is based on --  
21 basically, I wanted to bring up the point that the Commission  
22 has the leeway to penalize Progress if it is found in this  
23 hearing that they intentionally overcharged the customers for  
24 the cost of the fuel.

25           Q     And the first two words of your answer, I believe,

1 were that's correct?

2 A That's correct.

3 MR. BURNETT: Thank you, sir. No further questions.

4 CHAIRMAN EDGAR: Questions from staff?

5 MS. BENNETT: No, Madam Chair.

6 CHAIRMAN EDGAR: Mr. Twomey.

7 MR. TWOMEY: Just a couple, Madam Chair.

8 CHAIRMAN EDGAR: Excuse me, Mr. Twomey. Give me just  
9 a moment.

10 I'm sorry, Commissioner Carter, I did not mean to go  
11 by you.

12 COMMISSIONER CARTER: Thank you, Madam Chairman.

13 Sometimes I get a little challenged myself. Right is left,  
14 left is right.

15 Mr. Stewart, you gave an analysis based upon the  
16 information presented by Mr. Sansom where you find that there  
17 has been an overcharge of \$143 million, that is correct?

18 THE WITNESS: That's correct.

19 COMMISSIONER CARTER: And, additionally, you said  
20 based upon that same information provided by Mr. Sansom, that  
21 there should be a 10 percent penalty attached, something like a  
22 punitive damage award or something?

23 THE WITNESS: Something similar to what was done in  
24 the Gulf Power case that was included in my testimony.

25 COMMISSIONER CARTER: Okay. In Mr. Sansom's

1 analysis, what would you say would be probably the most  
2 significant determinant that allowed you to come up with this  
3 \$143 million? And I'll walk through it with you if you need  
4 to.

5 THE WITNESS: Yes. As Mr. Burnett pointed out, the  
6 testimony that I filed was not based on -- it was filed before  
7 the company filed their testimony. It was based on the motions  
8 to dismiss, or the motion filed by Public Counsel, the motion  
9 to dismiss, and Mr. Sansom's testimony. So what I tried to do  
10 in the beginning of my testimony is rely on the record that was  
11 there without any independent analysis to provide a concise  
12 argument in favor of Mr. Sansom's position.

13 And then with the bulk of my testimony, the main  
14 point being that if this holds up true through the hearing and  
15 the process, that this Commission has leeway based on  
16 precedence to levy a penalty against Progress. And the reason  
17 for that penalty is an incentive for other utilities not to  
18 engage in the same behavior.

19 So, the beginning part of my testimony is accepting  
20 the pluses and minuses of a testimony that hasn't been through  
21 a hearing yet, okay? So that is what I put in the front, and  
22 the back of the testimony is giving you the -- or making the  
23 argument that you have the jurisdiction to levy a penalty if  
24 you find that they intentionally overcharged for fuel.

25 COMMISSIONER CARTER: Permission to follow up.

1           You have been here all three days?

2           THE WITNESS: No, I have not.

3           COMMISSIONER CARTER: You have just been here today?

4           THE WITNESS: Just today, yes.

5           COMMISSIONER CARTER: Okay. I was going to ask, my  
6 question would have been that based upon what you have had  
7 heard, have you found any additional information that would  
8 support the perspective on the 143 million for the overcharge  
9 for the fuel and the justification for the 10 percent penalty.  
10 That's is what I was going to ask you, if you had been here.

11           Now, let me ask it this way then, if I may. Having  
12 had the opportunity since your deposition to review the  
13 documents, which I presume that you have?

14           THE WITNESS: Since my deposition I have not reviewed  
15 any of the documents. And, again, to point out, Commissioner  
16 Carter, this is a very complicated case, and the point of this  
17 testimony is if you find that they intentionally overcharged  
18 for fuel, that there is precedence and you have jurisdiction to  
19 levy a penalty. That is sort of the main point of my  
20 testimony.

21           COMMISSIONER CARTER: Okay. This is not a question,  
22 this is just a comment. You were saying about complicated.  
23 You know, we have a lot of interesting cases, but I haven't  
24 found anything in my short tenure that I have been here that  
25 would qualify as being complicated because the bottom line is



1 really the bottom line, and that is how much would be levied  
2 upon the customers. And that's why I try to -- every time I  
3 look at one of these cases, I look at it from the standpoint to  
4 where whatever happens there is a customer at the end of  
5 whatever decision that's made, and that customer has to write a  
6 check every month, or use their debit card, or whatever the  
7 case may be. So, there is nothing more complicated than that.

8 I'm a bottom line kind of person, you know. In South  
9 Georgia we didn't have all of those complicated formulas in  
10 school, we just had reading, writing, and arithmetic. And I'm  
11 trying to get the arithmetic right, and so I was hopeful that I  
12 could get a basis for that, but I'm just not seeing it right  
13 now. So, maybe in another witness or so, Madam Chairman, I can  
14 get that. Thank you.

15 CHAIRMAN EDGAR: Mr. Twomey.

16 MR. TWOMEY: Thank you, Madam Chairman.

17 REDIRECT EXAMINATION

18 BY MR. TWOMEY:

19 Q Mr. Stewart, was your conclusion that a penalty might  
20 be warranted conceived out of thin air?

21 A No, it was not.

22 Q And what was it in connection with?

23 A It was in connection with the Gulf Power order and  
24 the Supreme Court decision on that order.

25 Q And what was it prompted by, in addition to those?

1           A       It was prompted by the fact that -- the belief that  
2 if there was something intentionally done that there needed to  
3 be a incentive for the behavior not to be repeated again in the  
4 future.

5           Q       Okay. In that regard, do you think there are  
6 circumstances under which only a 10 percent penalty might not  
7 be sufficient to modify a utility's behavior if it's found to  
8 have intentionally benefitted its shareholders at the expense  
9 of its customers?

10          A       Well, that would be up to the Commission. The thing  
11 that would guide me on that is that I think the Supreme Court  
12 has been clear that it must be bracketed by their reasonable  
13 rate of return.

14          Q       Well, and do you know what the -- do you recall what  
15 the penalty was in the Gulf case?

16          A       I can look it up. I believe it was a 50-basis-point  
17 penalty against -- off the approved return on equity.

18          Q       Okay. Now, at the time you wrote your testimony,  
19 irrespective of whether you had any specific rule, order, or  
20 statute in mind, was it then your understanding and belief that  
21 the Florida Public Service Commission had an obligation to  
22 penalize companies and a responsibility to penalize companies  
23 if they, in fact, were found to have intensely benefitted their  
24 shareholders at the clear expense of their customers?

25          A       I think that it was my position that I knew that they

1 had the jurisdiction and that they had the leeway to do that.

2 Q Now, finally, with respect to whether a penalty  
3 should be imposed on Progress Energy in this case, are you  
4 willing, in fact, to leave that to the Commission's  
5 determination of whether, in fact, there was an intentional act  
6 by which the company benefitted itself or shareholders at the  
7 expense of its customers?

8 A Yes, definitely.

9 MR. TWOMEY: Thank you. That's all.

10 CHAIRMAN EDGAR: Okay. We need to go ahead and admit  
11 the Exhibits 150 through 155?

12 MR. TWOMEY: I will ask that you do, please.

13 CHAIRMAN EDGAR: Thank you. Okay. They will be  
14 admitted into evidence.

15 (Exhibits 150 through 155 admitted into evidence.)

16 CHAIRMAN EDGAR: And the witness is excused.

17 THE WITNESS: Thank you.

18 MR. TWOMEY: Thank you very much, Madam Chair.

19 CHAIRMAN EDGAR: Okay. We can move into rebuttal.  
20 And, Mr. Burgess, I believe we agreed that we would take up  
21 Witness Lawton first.

22 MR. BURGESS: Thank you, Madam Chair. I would ask  
23 Dan Lawton to the witness stand.

24 Madam Chairman, I don't believe Mr. Lawton was here  
25 at the beginning of the hearing, so I don't believe he has been

1 sworn.

2 CHAIRMAN EDGAR: Okay.

3 (Witness sworn.)

4 DANIEL LAWTON

5 was called as a witness on behalf of the Citizens of the State  
6 of Florida, and having been duly sworn, testified as follows:

7 DIRECT EXAMINATION

8 BY MR. BURGESS:

9 Q Would you please provide your name and business  
10 address, please?

11 A Yes. My name is Daniel Lawton. My business address  
12 is 816 Congress Avenue, Austin, Texas.

13 Q And would you state for whom you are presenting  
14 testimony today?

15 A I am presenting testimony on behalf of the Office of  
16 Public Counsel.

17 Q And did you submit prefiled testimony that has been  
18 prefiled in this case in this docket?

19 A Yes, I did.

20 Q Do you have any changes to make to the testimony that  
21 was prefiled?

22 A None that I'm aware of.

23 Q If the questions that are posed in your written  
24 submission were posed today, would your answers be the same?

25 A Yes, they would.

1 MR. BURGESS: Madam Chair, if I could, I would ask  
2 that the prefiled testimony submitted by Dan Lawton be moved  
3 into the record as though read.

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

6 MR. BURGESS: Thank you.

7 BY MR. BURGESS:

8 Q Mr. Lawton, do you have any exhibits attendant to  
9 your prefiled testimony?

10 A Yes. I believe there was one schedule attached with  
11 my background or an appendix.

12 MR. BURGESS: Madam Chair, I don't know if there was  
13 an exhibit number identified or corresponding to Mr. Lawton's  
14 exhibit, but --

15 CHAIRMAN EDGAR: Ms. Holley, I'm not seeing that.

16 MS. HOLLEY: Yes, and I don't think there was,  
17 because I think at one point we had that exhibit identified and  
18 we were instructed by Mr. McGlothlin to take it out because he  
19 didn't actually have an exhibit attached to his prefiled.

20 MR. BURGESS: Right, it's a statement of  
21 qualification.

22 MS. HOLLEY: Which was not an exhibit. If we do need  
23 to attach it as an exhibit, we can just number it as an exhibit  
24 to the hearing, Number 226, if that needs to be done.

25 MR. BURGESS: I just want to follow the process that

1 the Commission prefers, it doesn't matter to us whether it's  
2 considered prefiled testimony or an exhibit attached.

3 CHAIRMAN EDGAR: I do not have an attached exhibit.

4 MS. HOLLEY: I don't believe there was one then, in  
5 that case.

6 CHAIRMAN EDGAR: Is it contained within prefiled  
7 testimony?

8 MS. HOLLEY: I believe it is within the text of the  
9 prefiled testimony.

10 CHAIRMAN EDGAR: All right. Thank you.

11 THE WITNESS: I didn't mean to create any confusion.

12 MR. BURGESS: No, I believe that is my fault.

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1                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2                                   **DOCKET NO. 060658-EI**

3                                   **REBUTTAL TESTIMONY OF DANIEL J. LAWTON**

4                                   **ON BEHALF OF CITIZENS OF THE STATE OF FLORIDA**

5    **QUALIFICATIONS, BACKGROUND AND INTRODUCTION**

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

7    A.     My name is Daniel J. Lawton and my business address is 12113 Roxie Drive,  
8           Suite 110 Austin, Texas 78728.

9    **Q.     By whom are you employed?**

10   A.     I am a principal in the firm of Diversified Utility Consultants, Inc. ("DUCI").

11   **Q.     Please describe your educational background and work experience.**

12   A.     I have been working in the utility business as an economist for the last 25 years.  
13           Consulting engagements have included electric utility load and revenue  
14           forecasting, cost of capital and financial analyses, revenue requirement/cost of  
15           service issues, prudence inquiries, and rate design/cost allocation studies in  
16           litigated rate proceedings as well as developing rate studies for municipally  
17           owned utilities. In addition to my duties at DUCI, I also have a law practice  
18           based in Austin, Texas. My main areas of practice include Administrative Law  
19           representing municipalities in utility rate matters before regulatory agencies and  
20           contract matters and litigation. I have included a brief description of my relevant  
21           educational background and professional experience in my Schedule (DJL-1).

22   **Q.     Have you previously filed testimony in rate proceedings?**

1 A. Yes. A list of cases where I have previously filed testimony is included in my  
2 Schedule (DJI-1).

3 **Q. On whose behalf are you filing testimony in this proceeding?**

4 A. DUCI has been retained by the Office of Public Counsel (“OPC”) to review and  
5 respond to the direct testimony of Progress Energy Florida, Inc.’s (“PEF” or  
6 “Company”) witness Steven M. Fetter.

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

8 A. As noted above, the purpose of my testimony is to address the issues raised in the  
9 direct testimony of Company witness Steven M. Fetter. Specifically, I will  
10 address the following topics raised by Mr. Fetter’s testimony:

- 11 a) the appropriate standard/regulatory policy that a regulator should consider  
12 in reviewing fuel costs;
- 13 b) the investment community expectations regarding regulatory finality and  
14 the recovery of prudently incurred costs;
- 15 c) the potential impact on utility capital costs and rates resulting from  
16 consistent application of regulatory requirements and standards; and
- 17 d) when are fuel costs final as a matter of regulatory policy.

18 My analysis of these issues is based on my background in utility regulation as a  
19 consultant and advisor to regulatory authorities.

20 Additionally, I will comment briefly on the implications, in terms of the issue of  
21 PEF’s prudence and the Commission’s ability to consider the prudence question,  
22 of certain factual assertions made and supported by other OPC witnesses.



1 **Q. Have you reviewed the testimony of OPC witness Robert L. Sansom?**

2 A. Yes, I have read the testimony of Mr. Sansom to get an idea of the issues  
3 underlying the \$134.5 million (before interest carrying cost) prudence related  
4 damage claim in this case. I have not independently investigated any of the  
5 underlying fact issues raised in Mr. Sansom's testimony or those of other  
6 witnesses.

7 **Q. Please address how fuel costs are generally recovered and reviewed.**

8 A. There is typically a distinction between base rates and fuel rates. Base rates are  
9 set to recover a utility's non-fuel operating costs plus a reasonable return on used  
10 and useful utility investment. Base rates are set prospectively based on a utility's  
11 actual cost in cost of service employing a test year of operations adjusted for  
12 known and reasonably measurable changes.

13 A. Fuel rates and charges are established so that the utility recovers its actual  
14 prudently incurred costs no more, no less. As a practical matter, regulatory  
15 authorities cannot embark upon and decide a new rate case with each variation in  
16 fuel prices. Regulatory authorities generally employ a fuel factor to address  
17 market fluctuations in fuel prices. A fuel factor applicable at any one time is  
18 typically derived from the sum of a utility's known and uncollected historical  
19 costs for fuel plus the reasonably projected costs of fuel. The latter element  
20 renders the fuel factor sum a mere estimate of the utility's fuel costs.

21 Because actual fuel costs may and probably will vary from the fuel cost estimate,  
22 the utility will collect more or less than its actual fuel costs. Such over / under  
23 collections are addressed through subsequent fuel factor true-up calculations.

1 **Q. Are fuel costs subject to a reasonableness or prudence review by regulators?**

2 A. Yes. Some jurisdictions subject fuel purchasers to periodic reconciliation review.

3 My understanding of the process in Florida is that the fuel expense fluctuations  
4 are addressed through a continuous fuel adjustment proceeding. Such a process  
5 works to the utility's benefit in that fuel cost charges are collected close in time to  
6 the actual charge, thus reducing regulatory lag and operating cash flow issues.

7 But, it is also my understanding that Commission precedent and decisions by the  
8 Florida Supreme Court make clear that the continuous fuel adjustment proceeding  
9 does not "... divest the commission of the jurisdiction and power to review the  
10 prudence of these [fuel] costs." (*Gulf Power Company v. Florida Public Service  
11 Commission*, 487 S.2d 1036, 1037 (Florida 1986)).

12 **Q. What is your understanding of how fuel costs are recovered and reviewed in  
13 Florida?**

14 A. Utilities are allowed to collect fuel related expenses on an ongoing basis. In other  
15 words, it is a forward looking cost recovery clause. There is no specified time  
16 limit for reconciliation or review of the fuel costs, once known, for  
17 reasonableness. The issue of review on reconciliation was addressed by this  
18 Commission in its Final Order No. 12645 where it stated:

19 **At the true-up hearing that follows an annual period, a**  
20 utility will still be free to present whatever evidence of  
21 prudence it chooses to provide...

22 We will therefore accept any relevant proof a utility  
23 chooses to present at true-up, but we will not adjudicate the

1 question of prudence, nor consider ourselves bound to do  
2 so until all relevant facts are analyzed and placed before us.  
3 We will be free to revisit any transaction until we explicitly  
4 determine the matter to be fully and finally adjudicated.

5 (In re: Investigation of Fuel Adjustment Clauses of Electric Utilities, Docket No,  
6 830001-EU, Order No. 12645 at 9. Florida Public Service Commission  
7 (November 3, 1983)). A number of issues are made clear by this Commission  
8 decision. First, utility companies were invited to present whatever evidence of  
9 prudence to prove up fuel costs. Failure by the utility only delays the final  
10 adjudication of the issue. Second, the Commission made it clear that prudence  
11 issues related to fuel costs will not be finally decided until all relevant facts are  
12 before the Commission. Again, the Commission could not have been clearer.  
13 OPC's prudence challenge regarding past coal procurement is in line with the  
14 Commission's previous rulings on fuel cost reviews.

15 **Q. Have you reviewed company documents that acknowledge that the**  
16 **regulatory authority has the jurisdiction and POWER TO disallow**  
17 **imprudent fuel expenditures?**

18 A. Yes. The Progress Energy 10-K filed on March 10, 2006 at page 33 addresses  
19 risk factors associated with fluctuating fuel prices and states: "[w]hile each state  
20 commission allows electric utilities to recover certain of these costs through  
21 various cost recovery clauses, there is the potential that a portion of these future  
22 costs could be deemed imprudent by the respective commissions." Thus, the  
23 Company recognizes and reports in its financial filings a potential risk of recovery

1 of fuel expenses if such expenses are deemed imprudent expenses by the  
2 regulator.

3 **Q. Does Mr. Fetter's testimony also acknowledge that investors expect a**  
4 **regulated company be reimbursed only its prudent expenditures?**

5 A. Yes. Mr. Fetter states:

6 "Investors provide financing to a utility so that company  
7 management can construct and maintain infrastructure adequate to  
8 ensure that customers receive reliable service. In return, regulators  
9 must take timely action to provide an appropriate capital markets-  
10 based return to investors along with providing reimbursement of  
11 company expenditures that are prudently made."

12 (Direct Testimony of Steven M. Fetter at 3:16-20) No utility or investor can  
13 reasonably expect that imprudent expenditures be reimbursed by customers. All  
14 parties in this case agree that imprudent expenditures should not be passed on to  
15 customers. Moreover, the investment community does not expect imprudent  
16 expenditures to be passed on to the customers.

17 **Q. At page 6 of Mr. Fetter's testimony, he addresses the standards he believes**  
18 **are appropriate in this case as a matter of regulatory policy. do you have any**  
19 **comments?**

20 A. Yes. I have a number of comments. First, the appropriate standard in this case is  
21 prudence. In other words, based on a consideration of all relevant facts, did the  
22 Company pay and pass on to customers' excessive prices for coal costs as detailed

1 in Mr. Sansom's testimony? I do not have a problem with Mr. Fetter's prudence  
2 standard outlined at pages 6-7 of his testimony. I do have a problem with his  
3 effort to ignore the Commission's pronouncements and claim the issue is out of  
4 reach, as it is OPC's position, as presented in the testimony of other OPC  
5 witnesses, that PEF did not present all relevant facts bearing on prudence in  
6 earlier phases of the continuous fuel cost recovery proceeding. Acceptance of Mr.  
7 Fetter's position would reward PEF for such omissions and send the message that  
8 selective presentations are more likely to avoid scrutiny than to expose the utility  
9 to the possibility of subsequent disallowances. I am sure the Florida Commission  
10 is quite able to properly apply the prudence standard without any assistance from  
11 experts.

12 **Q. Mr. Fetter at page 8 of his testimony raises the issue that the Company is**  
13 **being held to long-term or perpetual jeopardy related to major fuel**  
14 **procurement decisions. Do you have any comments?**

15 A. Yes, the Company's fuel procurement decisions are subject to review by the  
16 regulators. As I noted earlier in my testimony, the Supreme Court of Florida has  
17 concluded that the "...authorization to collect fuel costs close to the time they are  
18 incurred should not be used to divest the commission of the jurisdiction and  
19 power to review the prudence of these costs." (*Gulf Power Company v. Florida*  
20 *Public Service Commission*, 487 S.2d 1036, 1037 (Florida 1986)) There is no  
21 magical date for such a review and there certainly is no concealment of material  
22 facts standard as proposed by Mr. Fetter, although I am aware that OPC witnesses  
23 Robert Sansom and Joseph Barsin have asserted in rebuttal testimony that PEF

1 has been disingenuous and misleading with some of its principal “defenses” to  
2 OPC’s Petition. While I do not agree with Mr. Fetter’s claim that “concealment  
3 of material facts” is a prerequisite to a prudence review where relevant facts not  
4 previously known or considered are presented, the matters discussed by these  
5 witnesses would be relevant to a determination of prudence.

6 **Q. Please provide examples of what you have in mind.**

7 A. For instance, Mr. Sansom will testify that when OPC observed that PEF had not  
8 awarded a contract to the lowest bidder in its 2004 RFP, PEF’s explanation was  
9 that the bidder offered Powder River Basin sub bituminous coal, which PEF is not  
10 allowed to burn under the terms of its environmental permits. Mr. Sansom will  
11 testify that PEF failed to add at the time that PEF obtained authority to burn a  
12 blend of PRB and bituminous coals from the Governor and Cabinet under  
13 Florida’s Power Plant Siting Act, but subsequently elected to exclude PRB coal  
14 from the scope of its application for a federal Title V air permit, only later to point  
15 to the resulting lack of authority as justification for not purchasing the most  
16 economical fuel.

17  
18 Similarly, I am informed that the utility witnesses have testified the units would  
19 not have produced energy at the same high output with the 50/50 design blend of  
20 coals that provides the basis for Mr. Sansom’s adjustment. In their rebuttal  
21 testimony OPC witnesses Joseph Barsin and David Putman will point to design  
22 criteria guaranteed by the vendors to produce the same high output when burning  
23 the 50/50 blend that PEF achieved with bituminous coal. They also will refer to

1 PEF's failure to test Crystal River Units 4 and 5 with the 50/50 PRB/bituminous  
2 blend of coals on which equipment specifications were based at the outset of  
3 operations, when contractors' and designers' performance guarantees could have  
4 been enforced if necessary.

5 **Q. How does this latter point bear on PEF's prudence?**

6 A. Accepting OPC's witnesses' factual assertions, it appears to me that one of two  
7 things must be true. The first possibility is that when it elected to test the units'  
8 performance with bituminous coal instead of the 50/50 blend on which vendor  
9 guarantees were based, PEF was confident of the units' ability to produce at the  
10 guaranteed high levels—in which case PEF's current claims that the units were  
11 incapable of producing at the guaranteed level during 1996-2005 are contradictory  
12 and not credible. The other possibility is that PEF was severely imprudent when  
13 it failed to test the units on the blend while vendor guarantees were in force, in  
14 which case the Commission should protect customers from all effects and higher  
15 costs stemming from that imprudence. In either case, the matters discussed by  
16 OPC's witnesses are highly relevant to the question of prudence. The  
17 Commission should not be foreclosed from considering them simply because the  
18 utility chose not to present them earlier.

19 **Q. At page 9 of Mr. Fetter's testimony, he asserts that putting the utility to the**  
20 **burden of affirmatively providing "all" information about fuel procurement**  
21 **decisions would essentially drag the fuel process down to a snail's pace, if not**  
22 **a halt. Do you agree?**

1 A. No. Utilities prove up the reasonableness and necessity of costs and procurement  
2 decisions everyday before regulatory commissions across the country. Certainly,  
3 when the Company seeks a base rate change, it proves up costs for approval. Fuel  
4 costs are no different and Mr. Fetter's assertion that such a prove up is akin to  
5 rocket science is just wrong. The utility need only provide the information it  
6 believes is necessary to meet its burden of proof. If the utility provides too little  
7 and fails to meet its burden, costs are disallowed. If the utility makes its case,  
8 then costs are allowed. This is not a new, difficult or unfamiliar process for any  
9 regulated utility.

10 **Q. What about Mr. Fetter's claim that the utility would be placed in the**  
11 **untenable position of having to affirmatively provide every detail of the fuel**  
12 **procurement decision?**

13 A. Again Mr. Fetter seems to be sounding the alarm where no problem exists. The  
14 Company needs to prove its fuel procurement decisions were prudent. Providing  
15 sufficient detail to support the reasonableness of the procurement decision is what  
16 is required. This is the same approach a utility uses to support cost claims in a  
17 base rate case.

18 **Q. At page 9, Mr. Fetter states that finality "subject to certain conditions"**  
19 **should attach no later than the fuel true-up process. Do you have any**  
20 **comments?**

21 A. Yes, I have a number of comments. First, this Commission has already  
22 considered this issue in Order No. 12645 and declined to adopt such an approach.  
23 Specifically on this issue, the Commission stated, "...at the end of each six-month



1 period, we will consider only the question of comparing projected to actual  
2 results. Questions of prudence require careful and often prolonged study.” The  
3 Commission went on to state:

4 “From now on, each utility will be required at true-up only to  
5 demonstrate how the amounts actually expended for fuel and  
6 purchased power compare with the amounts projected for the prior  
7 six-month period. Although the burden of proving the prudence of  
8 its actions will remain with the utility, the question of prudence  
9 will arise only as facts regarding fuel procurement justify scrutiny.  
10 Hopefully, we will be presented with complete analyses of  
11 procurement decision in a timely manner.”

12 It would appear that the Company has never presented to the Commission a  
13 complete analysis of coal procurement decision along with a request for a final  
14 decision on this issue. Now, Mr. Fetter suggests that the Company’s fuel  
15 procurement should escape review because the issue has been dormant for a  
16 sufficient amount of time. Such an approach or solution as suggested by Mr.  
17 Fetter is not consistent with previous Commission Orders on this matter.

18 Second, Mr. Fetter’s suggestion that approval at true-up be a final order as to  
19 prudence is a recipe for mischief for utility companies. As this Commission  
20 stated in its Order No. 12645, prudence reviews of fuel procurement decisions are  
21 “complex” subject matters often involving a large “quantity” and “quality” of  
22 evidence. (Order No. 12645 at 9) These prudence review cases are not what the

1 Commission or stakeholders envisioned for the true-up process. Thus, Mr.  
2 Fetter's suggestion of finality at the true-up hearing would ignore a reasonable  
3 prudence review — or in the alternative, defeat the purpose of expedited fuel  
4 review.

5 Again, if the Company seeks finality, they need to marshal the evidence sufficient  
6 to satisfy a prudence inquiry on fuel procurement and petition the Commission for  
7 a final order on the matter.

8 **Q. At page 9 of Mr. Fetter's testimony, he asserts that there is ambiguity as to**  
9 **the point in the fuel cost process at which regulatory finality attaches. Do**  
10 **you agree?**

11 A. No. The fuel costs become final and not subject to additional review when the  
12 Commission says they are final i.e after review. Commission precedent and the  
13 Florida Supreme Court ruling in *Gulf* support this conclusion. Moreover, the  
14 Company's filings with the SEC recognize fuel cost procurement is subject to  
15 prudence review. There is no ambiguity – fuel costs are subject to review. Again,  
16 if the Company seeks finality as Mr. Fetter suggests, then the Company that  
17 maintains and controls the data and information regarding fuel procurement  
18 should file a petition with the Commission seeking final review—and present all  
19 relevant facts in support of its request.

20 **Q. Does Mr. Fetter acknowledge that past commission orders authorizing Fuel**  
21 **cost recovery also stated that such fuel cost is subject to prudence review?**

22 A. Yes, but then Mr. Fetter's asserts that the future prudence review language  
23 contained in the Commission's Final Orders is merely a reservation of right to

1           revisit those prudence determinations in the case of concealment of information  
2           by the utility. Mr. Fetter has created this reservation of rights and concealment  
3           standard out of whole cloth. Regulatory commissions do not revisit final orders –  
4           final means final. But, Mr. Fetter asserts that the Florida Commission makes one  
5           set of prudence determinations when it initially authorizes fuel cost recovery. If  
6           the Florida Commission finds out there was a concealment of information, the  
7           Commission can go back and revisit its final order. Talk about holding a  
8           company in perpetual regulatory jeopardy. Mr. Fetter’s analysis should be  
9           ignored as in most instances regulatory finality is never achieved.

10   **Q.   Mr. Fetter asserts at page 13 that the Company regularly briefed**  
11   **Commission staff and OPC on fuel procurement, coal procurement records**  
12   **were open and accessible and the Company made regular required filings**  
13   **setting out details of its coal procurement process. In you opinion, does that**  
14   **process substitute for a prudence review?**

15   **A.**   No. First, these filings were made with the Florida Commission, but the  
16           Commission still put the Company on notice that its final costs are subject to  
17           prudence review. Thus, the Commission has made clear that fuel procurement  
18           prudence issues have not been resolved. Second, if all these records and details  
19           are readily available, then it would have been a rather simple matter for the  
20           Company to have filed a petition with the Commission requesting a final review  
21           of fuel cost procurement. It is the Company, not Commission Staff or OPC, that  
22           has the burden of production, persuasion and proof on these matters. Third, based  
23           on OPC’s testimony, as discussed above it appears that many factors that bear on

1 PEF's prudence were not presented to the Commission in the utility's supporting  
2 submissions.

3 **Q. At page 16 of Mr. Fetter's testimony, he discusses timelines as an important**  
4 **matter in regulatory decision making. Please comment.**

5 A. I agree that stockholders and potential investors track regulatory and judicial  
6 proceedings through the time of a final and non-appealable order has been  
7 rendered. But, I do not agree that OPC's claim in this case would turn the  
8 investment goal of regulatory finality on its head. Instead of blaming OPC for  
9 raising an issue regarding customers' overcharges, Mr. Fetter should question  
10 why the Company never came forward with all information relevant to a prudence  
11 determination regarding past coal and/or fuel procurement. Mr. Fetter admits the  
12 information is readily available. Mr. Fetter admits that previous Commission fuel  
13 orders put the Company on notice that such fuel expenses were subject to  
14 prudence review. Yet, Mr. Fetter never addresses why the Company never sought  
15 resolution of this matter. Instead of answering the basic question, Mr. Fetter  
16 resorts to demonizing OPC's proposal in this case.

17 **Q. Mr. Fetter asserts at pages 26-30 of his testimony that credit rating agencies**  
18 **would not look favorably on the Commission's acceptance of OPC's**  
19 **proposed disallowance. Please comment.**

20 A. If the Commission were to determine that the Company was imprudent in coal  
21 procurement and disallowed \$134.5 million of over-charges – certainly credit  
22 rating agencies would have concerns with Company management and practices.  
23 However, it is not the function of the Commission to rescue imprudent

1 management from costs that arise from its imprudence—and that include higher  
2 capital costs, if any. The Commission should shield customers from any such  
3 higher capital costs in the same way it should filter out any unreasonable fuel  
4 charges from the costs borne by customers. In this case, the Commission is the  
5 finder of fact and will determine whether Company management was prudent in  
6 fuel procurement. Turning the issue on its head and asserting the Commission  
7 would cause credit market problems is just not correct; any credit market  
8 problems arising from a disallowance will be the result of management conduct.  
9 This Commission has consistently stated through its orders that all fuel costs can  
10 be subject to a future prudence review. PEF enjoyed the benefit of the current  
11 recovery of costs; now that the Commission is exercising the jurisdiction and  
12 power to make that prudence review based on relevant facts, neither Wall Street  
13 nor the Company can credibly claim they are stunned. (Steven Fetter Direct at  
14 29:14)

15  
16 Moreover, Mr. Fetter never outlines the alternative to the prudence review. That  
17 alternative is to allow the Company to escape any review and, even if costs are  
18 imprudent, to allow such excess charges be passed on to customers. For example,  
19 if the utility were to squander its annual earnings by wasteful spending or  
20 depositing such amounts in the Gulf of Mexico, credit rating agencies would  
21 likely react unfavorably to such reckless behavior. But, that does not mean that  
22 the regulatory authority should increase rates to recover past earnings in an effort  
23 to bail out a Company's poor management and avoid the cost of adverse impacts

1 on credit facilities. Instead, customers should be protected from imprudent  
2 expenditures *and* any higher capital costs resulting from the disallowance of those  
3 imprudent expenditures. No rating agency expects that a regulatory authority  
4 should allow imprudent costs resulting from failed management to be passed on to  
5 customers.

6 **Q. have the issues raised by mr. fetter regarding rating agency concerns related**  
7 **to a prudence disallowance been raised in the past?**

8 A. Yes. Mr. Fetter makes many of the same arguments that were discussed in the  
9 1980's across the country regarding nuclear prudence disallowances. During the  
10 1980's, billions in electric power plant investments were disallowed as imprudent  
11 investment and industry responded that such disallowances were a violation of the  
12 implicit "regulatory contract" between regulators and regulated firms. Regulators  
13 were accused of renegeing on their end of the deal employing 20-20 hindsight.  
14 Utilities argued that the abrogation of the regulatory contract would cause Wall  
15 Street to increase capital costs along with a resistance to further investment  
16 activities.

17  
18 Some utilities that were found to be imprudent and incurred large prudence  
19 disallowances were downgraded — not because of regulatory opportunism, but  
20 because of imprudent actions by utility management. One empirical study of  
21 these regulatory disallowances concluded, "[s]pillover effects from regulatory  
22 disallowances may have actually led to a net increase in investment, due to the

1 positive effects on firms building non-nuclear generating units.” (Regulatory  
2 Opportunism and Investment Behavior: Evidence From the U.S. Electric Utility  
3 Industry, Thomas P. Lyon and John W. Mayo, June 2000.)

4 The construction process of nuclear plants required enormous capital  
5 expenditures over a long period and such expenditures were subject to regulatory  
6 disallowance. Thus, any claim by Mr. Fetter that utility expenditures are not  
7 subject to a disallowance exposure over long periods of time is not quite correct.

8 Commission determination of fuel procurement costs in this case could have a  
9 similar effect. Utilities will be on notice that fuel costs will be reviewed by the  
10 Commission and prudent utility management will make all efforts to assure fuel  
11 expense requests are just, reasonable and at the lowest cost possible.

12  
13 As stated earlier, this Commission has put all on notice that the Commission is  
14 free to revisit any fuel transaction until the matter is fully and finally adjudicated  
15 as to the prudence of fuel procurement. Unless an issue of fuel procurement was  
16 specifically and finally adjudicated, the Commission can address these prudence  
17 issues. (In re: Investigation of Fuel Adjustment Clauses of Electric Utilities,  
18 Order No.12645 at 9 (November 3, 1983)).

19 **Q. Will the proposed disallowance have a large impact on the company’s annual**  
20 **earnings?**

21 **A.** Yes. I would expect a \$134 million disallowance would substantially impact  
22 annual earnings. Any disallowance could be spread over time at the

1 Commission's discretion to ameliorate any negative impact on earnings and any  
2 negative impact on the Company's Cost of Capital.

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

4 **A. Yes.**



1 BY MR. BURGESS:

2 Q Do you have a summary of your testimony that you  
3 could provide for the Commission today?

4 A Yes, I do. Commissioners, my name is Daniel Lawton,  
5 and I'm an economist, and I testify and work in electric  
6 utility rate matters, gas utility rates matters. And I'm also  
7 an attorney, and I represent a lot of municipalities in rate  
8 proceedings in Texas.

9 Now, the purpose of my testimony here today is I have  
10 been asked to address the testimony of company Witness Steven  
11 M. Fetter, and basically my testimony can be broken down into  
12 four issues that I address that Mr. Fetter raised in his, I  
13 think it is his rebuttal testimony in this case. The first  
14 issue that Mr. Fetter raised is with regard to the regulatory  
15 policy and practices in fuel reviews, and whether or not the  
16 Commission should at all as a matter of good regulatory policy  
17 take a look back at these fuel costs that are in question in  
18 this proceeding.

19 Mr. Fetter takes the position that the Commission has  
20 essentially already reviewed all of these costs in its annual  
21 fuel factor cases. And he asserts that prudence reviews, if  
22 reviewed at all, ought to be reviewed if there is a finding of  
23 a misstatement or a concealment of material facts.

24 On this issue, my testimony basically states, and I  
25 rely upon previous Commission Order 12645, which set out in a

1 generic basis that prudence would not be reviewed in the annual  
2 fuel factor filings, but rather would be reserved for a later  
3 date. So that's one piece of guidance that I relied upon.

4           The second piece of guidance is that the company was  
5 invited by the Commission previously, it has been a  
6 longstanding invitation, to provide the Commission any relevant  
7 facts it deems necessary to prove up the reasonableness and  
8 necessity of its fuel costs. That also can be found in Order  
9 12645. As additional guidance on this issue, I looked at the  
10 Florida State Supreme Court in the Gulf Power case, which  
11 clearly sets out that because the Commission has these annual  
12 fuel filings and reserves the prudence question, it does not,  
13 the Commission is not divested of a later look into these  
14 prudence issues. And that comes straight from the Supreme  
15 Court in Florida.

16           So the bottom line -- and, Commissioner Carter, you  
17 said you are a bottom-line kind of guy, and that's where I'm  
18 going -- on this issue, the prudence of these costs have not  
19 been reviewed by the Commission previously, and that's based on  
20 Order 12645. Moreover, the Supreme Court in the state clearly  
21 gave this Commission guidance that you can take a look back.

22           The second set of issues that Mr. Fetter addressed is  
23 with regard to the investment community expectations of what  
24 commissions do. And everybody in this case on both sides of  
25 the docket would all agree that the investment community and

1 stakeholders all expect one thing, and that is that the  
2 utilities be allowed to recover a reasonable return on prudent  
3 investment plus its prudent expenditures. There is no  
4 stakeholder, and I point this out in my testimony, that expects  
5 regulatory commissions, whether it be a bondholder investor or  
6 a rating agency, that would expect a utility commission to pass  
7 on to consumers unreasonable and unnecessary costs. So, if  
8 there is a finding of imprudence, then the Commission clearly  
9 could meet those expectations of the investment community that  
10 those costs ought to be eliminated.

11           The next area that Mr. Fetter raises is the potential  
12 impact of such a disallowance could have on the company's cost  
13 of capital and ultimately consumer rates. It is analogous to  
14 the issue we all heard in the '80s, 1980s with regard to  
15 electric utility plants that were nuclear in nature and a lot  
16 of imprudence findings around the country. A lot of folks in  
17 the investment community were saying that regulatory  
18 commissions would be violating the regulatory compact if they  
19 disallowed these large amounts of costs.

20           Well, as it turns out, the commissions found if there  
21 were imprudent costs, and I believe even Mr. Fetter when he was  
22 a commissioner found imprudent costs, they were disallowed. So  
23 the utilities that did get hit with an imprudence finding,  
24 sure, their capital costs may have gone up because of bond  
25 rating changes. Whether or not that happens here, I haven't

1 seen any evidence. But, most importantly, the consumers should  
2 be shielded from any increased costs of capital.

3           Lastly, Mr. Fetter raises one last issue, and that is  
4 when are fuel costs final. And he is, again, taking the  
5 position that the fuel costs were final in these annual true-up  
6 proceedings. Commissioners, my testimony states that the fuel  
7 costs are final when you say they are final, and if this  
8 Commission says that it has authority to go back and look at  
9 these costs that are pointed out or found to be imprudent, then  
10 you certainly have that authority. And that is what my  
11 testimony addressed.

12           Thank you.

13           MR. BURGESS: Madam Chair, we tender the witness.

14           MR. McWHIRTER: No questions.

15           CHAIRMAN EDGAR: No questions. No questions. No  
16 questions. No questions.

17           Mr. Burnett.

18           MR. BURNETT: Thank you, Madam Chairman.

19                           CROSS EXAMINATION

20 BY MR. BURNETT:

21           Q     Good afternoon, Mr. Lawton.

22           A     Good afternoon, Mr. Burnett.

23           Q     Mr. Lawton, when a regulator reviews fuel costs, you  
24 would agree with me that the single standard they are looking  
25 for is prudence or lack of prudence, correct?

1           A     Either the word prudence or reasonableness and  
2 necessity, which is, again, akin to prudence.

3           Q     Okay. And you believe that the determination of  
4 whether fuel costs are prudent is a relatively straightforward  
5 process, correct?

6           A     Yes. Sometimes it can be more complex than others,  
7 but it's either prudent or it's not.

8           Q     Now, in your deposition do you recall me asking about  
9 the types of information that a regulator would need to  
10 determine whether fuel costs are prudent or not?

11          A     Yes. We had some discussions about the filing  
12 requirements and the types of things that one would want to  
13 look at, yes.

14          Q     And in response to some of my questions you told me  
15 that some of the information a regulator may want to look at in  
16 determining whether fuel costs are prudent are heat rates,  
17 would you agree?

18          A     Heat rates, depending upon the factors involved.  
19 Each fuel imprudence investigation will fall on the facts  
20 surrounding that issue, so each issue could be different.

21          Q     Okay. And conceivably forced outages may be some  
22 information they would want to consider?

23          A     Yes, sir.

24          Q     Capacity factors?

25          A     Yes, sir. And heat rate and forced outages relate to

1 capacity factors.

2 Q Fuel cost comparisons?

3 A Yes. And I think we discussed in particular gas, is  
4 the gas costs that you purchased consistent with the market  
5 price. Is your portfolio of gas purchases consistent with what  
6 a reasonable prudent utility would do, whether it's spot, or  
7 month ahead, or long-term contracts.

8 Q Sure. And also you mentioned summaries of any  
9 significant atypical events, they may want to know that?

10 A Sure. If there is an atypical event that caused fuel  
11 costs to increase, they would want an explanation.

12 Q The price of fuel?

13 A Well, obviously the price of fuel is what's in  
14 question, yes.

15 Q Sure. Information about fuel procurement policies?

16 A Yes. To the extent you have a policy, information on  
17 it to assure that you followed your own guidelines and  
18 policies.

19 Q And then you also told me that a commission may want  
20 to have descriptions of fuel portfolios that the utility held?

21 A Sure. As I mentioned earlier, like a gas purchase  
22 portfolio.

23 Q Mr. Lawton, prior to filing your testimony in this  
24 case, you didn't go back and review all of PEF's fuel filings  
25 from 1996 to 2005 to see if some or all of that information was

1 in any of those, did you?

2 A That's correct. That was not my assignment in this  
3 case, and I don't want to waste the OPC's money.

4 Q Sure. And you didn't know at the time you filed your  
5 testimony what a PSC Form 423 was, correct?

6 A That's correct, or a 422, or whatever you are asking  
7 about.

8 Q Sure. So you naturally didn't know what kind of  
9 information is included in those forms?

10 A No, I didn't know what information was included in  
11 those forms. I do know that the Commission requires them, and  
12 in every order does say that the resolution of the prudence  
13 issue has not been finally resolved and we will look at that or  
14 reserve that for the future. So dispute all these forms that  
15 you file, the Commission still reserves it for the future. So  
16 I'm not going to go look at it in this case.

17 Q Sure. Let me just ask you about a couple more,  
18 though?

19 A Sure.

20 Q You didn't know what's contained in PEF's monthly  
21 Schedule A filings, did you?

22 A No, I have never seen one.

23 Q And, similarly, you didn't research what's included  
24 in PEF's monthly GPIF report?

25 A No.

1 Q You didn't investigate the annual fuel audit process  
2 in Florida and what information is collected in that, correct?

3 A That's correct.

4 Q And you didn't investigate what sort of information  
5 is exchanged in quarterly meetings that the fuel docket parties  
6 have with PEF, correct?

7 A Correct. That's outside the scope of my assignment  
8 in this case.

9 Q And bear with me for just one last one.

10 A Sure.

11 Q And you didn't investigate whether or not parties in  
12 Florida in the fuel docket can do discovery, correct?

13 A I don't recall that question.

14 MR. BURGESS: Madam Chair, if we're going to be going  
15 back to where we are putting on the overhead excerpts of the  
16 deposition, I would like the witness to be able to have a copy  
17 of the deposition and be able to take the time necessary to  
18 make sure the context is as it is being represented and have  
19 the opportunity to reach a comfort level with it.

20 CHAIRMAN EDGAR: Mr. Burgess, I think that's a  
21 reasonable request.

22 Mr. Burnett, can you be helpful with that?

23 MR. BURNETT: Absolutely.

24 THE WITNESS: What page are we on?

25 MR. BURNETT: Go to Page 39, sir.



1 BY MR. BURNETT:

2 Q I just wanted to draw your attention on Page 39,  
3 Line 17. You can let me know when you get there.

4 A Yes. I stated I didn't know the process or  
5 procedure, nor have I inquired. Again, because it wouldn't be  
6 relevant to the scope of my analysis.

7 Q Yes, sir. And I asked you some questions about your  
8 background, too. You have never petitioned the Florida Public  
9 Service Commission for a prudence determination on behalf of an  
10 investor-owned utility, correct?

11 A No.

12 Q You've never been a commissioner on a public  
13 utilities commission or a public service commission, correct?

14 A No. I advise commissions in Texas. The cities are  
15 regulators with original jurisdiction, and I represent them.

16 Q Yes, sir. In your prefiled testimony and in your  
17 opening summary you just gave, you give some information in  
18 your testimony about the expectations of the investment  
19 community, correct?

20 A Yes, I talked about that.

21 Q You have never worked at a credit rating agency like  
22 Fitch, or Moody's, or Standard or Poor's, correct?

23 A No, I haven't worked at them. The closest I get to  
24 that is I do a lot of cost of capital testimony around the  
25 country.

1 Q Mr. Lawton, I'm close to wrapping up here. I just  
2 wanted to hand out a document that I read to you in your  
3 deposition.

4 MR. BURNETT: Madam Chairman, may I have this marked  
5 with the next number?

6 CHAIRMAN EDGAR: I'm at 226. Can you give us a  
7 title?

8 MR. BURNETT: Yes, ma'am. December 28th, 2006, Fitch  
9 Credit Analysis.

10 CHAIRMAN EDGAR: Thank you.

11 (Exhibit 226 marked for identification.)

12 BY MR. BURNETT:

13 Q Mr. Lawton, I would like to draw your attention to a  
14 paragraph in Page 2 of that document. It has got Bates number  
15 8809 on the bottom.

16 A Yes, I have already read it.

17 Q Excellent. Not to belabor the record, but I wanted  
18 to read one -- I will read the paragraph, and then I wanted to  
19 ask you two questions, I believe, about it.

20 "The Florida Office of Public Counsel filed a  
21 petition with the FPSC asking it to require PEF to refund  
22 143 million of past fuel recovery charges and sulfur dioxide  
23 allowance costs, plus interest, on August 10, 2006. The OPC  
24 alleges that PEF did not utilize the most economic resources of  
25 coal at the Crystal River plant from '96 to 2005. While the

1 FPSC has already approved fuel purchases in those years in  
2 prior annual fuel filings, a full hearing on this matter will  
3 be held in the spring of 2007.

4 "The outcome of this matter cannot be determined at  
5 this time, but in Fitch's view, the fact that the costs were  
6 already approved by the FPSC lessens the risk of an adverse  
7 decision. However, PEF's existing credit metrics could likely  
8 withstand an adverse outcome within the current ratings, but an  
9 adverse decision would indicate a more challenging regulatory  
10 environment in Florida."

11 Thank you for bearing with me for reading that, Mr.  
12 Lawton. I wanted to ask you the question, you told me in your  
13 deposition that based on this paragraph, Fitch doesn't  
14 apparently appreciate what the regulatory environment is truly  
15 like in Florida, correct?

16 A Well, yes, in terms of the statement that the costs  
17 were already approved, and I think I pointed out in all the  
18 orders that Fitch is referring to the Commission put in a  
19 sentence clearly stating that these costs are subject to a  
20 future prove up on prudence and reasonableness and necessity.  
21 So that part of the order clearly says it is not a finally  
22 adjudicated matter. Fitch, on the other hand, seems to think  
23 it was.

24 Q Sure. So at least as of December of last year, Fitch  
25 apparently had a misperception about what the Commission has

1 been doing in fuel clause?

2 A Right. And apparently the Company hasn't cleared  
3 that up with Fitch. You know, the various companies when they  
4 do their rating review, apparently your client hasn't told them  
5 that those orders weren't final.

6 MR. BURNETT: Okay. Thank you very much, Mr. Lawton.

7 THE WITNESS: You're welcome.

8 CHAIRMAN EDGAR: Other questions from staff?

9 MS. BENNETT: No questions.

10 CHAIRMAN EDGAR: Questions, Commissioners?

11 Commissioner Carter.

12 COMMISSIONER CARTER: Good afternoon.

13 THE WITNESS: Good afternoon, Commissioner. I'm  
14 sorry, I was looking the other way.

15 COMMISSIONER CARTER: Thank you. It is so refreshing  
16 to have somebody that is listening out there. I wanted to ask  
17 you -- my preface statement is that I have heard -- you heard  
18 my discussion with Mr. Stewart about the basis for the  
19 143 million and the 10 percent punitive damages charges. Do  
20 you remember that?

21 THE WITNESS: Yes, I remember those questions, and I  
22 remember Mr. Stewart's testimony. I was here.

23 COMMISSIONER CARTER: Were you here yesterday?

24 THE WITNESS: Yes, I was, Commissioner.

25

1           COMMISSIONER CARTER: So you heard me when I asked  
2 the question yesterday about the \$60 million to retrofit for  
3 the capital improvement costs to the plant, and the \$2 million  
4 per year for the operation and maintenance costs?

5           THE WITNESS: Yes, I remember that.

6           COMMISSIONER CARTER: And you were here this morning  
7 when I asked about the -- what was it, 41 million, 51 million,  
8 about the costs for fuel?

9           THE WITNESS: Yes, I believe that was Mr. Heller, was  
10 it, this morning?

11           COMMISSIONER CARTER: I believe so. I believe so.  
12 So you can understand and appreciate where I am, can you not?

13           THE WITNESS: Yes, I do. You have got a --

14           COMMISSIONER CARTER: And the reason being, here is  
15 why I'm asking you this, is that -- on the one hand is if you  
16 look at the case from one perspective, it's like asking the  
17 Commission to make a decision on something that may or may not  
18 even be a justiciable issue. On the other hand, depending on  
19 how you look at the case, it is a matter of whether or not the  
20 costs that were put upon, or placed on the consumers or the  
21 customers -- let's be correct about this, the customers are the  
22 people that pay the freight -- in terms of whether or not it  
23 was reasonable, or whether or not it was unreasonable.

24           THE WITNESS: Right.

25           COMMISSIONER CARTER: So that is the kind of context

1 that I'm bringing to all of this.

2 THE WITNESS: Right.

3 COMMISSIONER CARTER: First, I would like to ask you  
4 in the context of the basis for the \$143 million, can you help  
5 me understand the basis for that? And then after that, in all  
6 fairness, I'm going to ask you about the 10 percent. And then  
7 although you are not Progress Energy's witness, I'm going to  
8 ask you about the 60 million and the 40 million and all like  
9 that. Is that okay with you?

10 THE WITNESS: Sure. That is okay with me, but let me  
11 preface it with a point. That was not my assignment in this  
12 case. I have read, for example, Mr. Sansom's testimony, and I  
13 can tell you the basis for his damage disallowance is the  
14 143 million that we've talked about.

15 COMMISSIONER CARTER: Hang on. Madam Chairman -- let  
16 me ask you this, then -- maybe I should hold my questions about  
17 the 60 million and all of that, and just ask him about the  
18 information related to Mr. Sansom. I don't think it would be  
19 fair for me to ask him that.

20 CHAIRMAN EDGAR: Commissioner Carter, that is your  
21 choice.

22 COMMISSIONER CARTER: Thank you.

23 THE WITNESS: Well, I can put your question in  
24 context from a regulated analyst perspective. Regulators such  
25 as yourself are faced with the competing numbers all the time.

1 We have on the one hand, Mr. Sansom saying there is a damage  
2 claim of 143 million. We have the company on the other hand  
3 saying, well, there is \$60 million of costs. And Mr. Heller  
4 this morning talking about costs, and then \$2 million a year.

5 Typically, when analyzing this from a regulator  
6 perspective, what regulators typically look at is when the  
7 issue at hand was decided. In this case when they decided not  
8 to burn a blend of this coal, or I think the period started in  
9 '96 when the economics shifted from Mr. Sansom's testimony,  
10 when they decided this did the company have a policy or  
11 explanation outlining why it made its decision, okay? That is  
12 typically what you look at in a prudence analysis.

13 If it didn't, then the company has to come forward,  
14 and they are coming forward now as you see, with testimony  
15 saying that, well, we didn't do it because we would have had  
16 60 million more in costs. That's a different kind of review  
17 for a regulator. That is kind of a hindsight analysis that the  
18 company is employing here.

19 And so you have to -- I would caution you to be  
20 cautious of such analyses. And I know yesterday I heard  
21 testimony of explosions or something might happen. So that's  
22 the only perspective I could put all of those numbers out there  
23 for you. You would look for a policy or a reason why this  
24 company decided at the time it made the decision, why did it do  
25 it. And, if they don't have one, then you would be -- I would

1 advise you to be cautious about the evidence that's presented  
2 after the fact, because it is a hindsight kind of analysis.

3 COMMISSIONER CARTER: Okay. So, basically, it's your  
4 position, and I think I heard you correctly, if I didn't  
5 straighten me out on it, is that you are saying that no  
6 determination has been made in this case as to the prudence of  
7 the fuel charges for the time period covered? Did I hear you  
8 correctly?

9 THE WITNESS: That is my testimony, and it is  
10 consistent with the fuel orders issued by this Commission each  
11 and every year over this period.

12 COMMISSIONER CARTER: And I also heard you to say  
13 that the justification for that perspective is Commission  
14 orders and a Florida Supreme Court case?

15 THE WITNESS: Yes. As well as the annual orders are  
16 consistent with it. If you look at any annual order, the most  
17 recent order issued by this Commission on fuel factors, I think  
18 you issued it in December of '06 or January '07, it says that  
19 the reasonableness and necessity of these costs are subject to  
20 a later prove up or prudence review.

21 COMMISSIONER CARTER: And based upon that  
22 perspective, it is your view that notwithstanding -- let me  
23 qualify by saying communication. I think that would be an  
24 appropriate term that you would use. Notwithstanding  
25 communication held by staff and the utility during that --



1 communications is okay to use, isn't it?

2 THE WITNESS: Sure.

3 COMMISSIONER CARTER: Notwithstanding the  
4 communication held by staff and the utility during this time,  
5 no determination of the appropriateness, or the reasonableness,  
6 nor the prudence to the fuel charges had been made at any  
7 point?

8 THE WITNESS: That is correct. The only people in  
9 this room that can determine prudence is this Commission, you  
10 three Commissioners. That's what I believe your statute says,  
11 that you have to review the costs and can only allow the  
12 reasonable and necessary costs to be passed on. That is your  
13 charge as a Commissioner. Communications by staff to the  
14 company or any third party, they can believe or not believe  
15 there is prudence, that doesn't decide the question. Only you  
16 can do that, Commissioner Carter.

17 COMMISSIONER CARTER: If I may be --

18 CHAIRMAN EDGAR: Commissioner Carter.

19 COMMISSIONER CARTER: Thank you so kindly. I  
20 appreciate what you are saying, because, see, that gets to the  
21 kernel of where I'm trying to head here, is that what you are  
22 saying is instead of determining whether or not there should be  
23 a penalty on Progress or determining whether or not there  
24 should be proceeds to enlarge the infrastructure for the  
25 burning, what we really should be doing at this point in time

1 is having a prudency determination in the context of the  
2 expenditures made for fuel from '96 to '06.

3 THE WITNESS: Well, that's the issue that the Office  
4 has raised, and that is what Mr. Sansom's testimony addresses.

5 COMMISSIONER CARTER: And that is what you are saying  
6 too, right?

7 THE WITNESS: Yes. Absolutely. I agree Mr. Sansom  
8 has raised an issue and that's the issue that I think was teed  
9 up, as they say, for the Commission. And now we have this  
10 hearing and that is what all the discovery and the evidence is  
11 addressed towards.

12 COMMISSIONER CARTER: Madam Chairman, thank you for  
13 your indulgence. So, basically, any information, or evidence,  
14 or testimony, or documentary evidence, or anything to the  
15 contrary should be at best collateral, but probably at worst  
16 irrelevant unless we are determining whether or not the  
17 expenditures made for the fuel was prudent during the time  
18 period covered in this case?

19 THE WITNESS: Well, you're going to have to determine  
20 whether this collateral evidence, as you have ascribed a  
21 meaning to it, is relevant or not in terms of your entire  
22 decision. The decision to make, as the Office has brought  
23 forward, is did the company spend 143 million more for fuel  
24 than it should have. That is the issue as I see it. And if  
25 there is other evidence addressing collateral issues, if that

1 helps you in your determination, great. If it doesn't, so be  
2 it.

3 COMMISSIONER CARTER: Excuse me, Madam Chairman. But  
4 the bottom line is for all practical purposes is that we should  
5 concern ourselves, in your opinion, and I'm not asking you to  
6 take anybody's position or anything like that, we are just  
7 having a discussion. You know, two guys at the water cooler.  
8 In your opinion, it is primarily a determination that the  
9 Commission is in a position right now where we are making a  
10 determination of whether or not the expenditures made for fuel  
11 during the time period covered from 1996 to present, to 2006 in  
12 this matter before us is whether or not the expenditures for  
13 fuel made by Progress Energy Florida was prudent or not.

14 THE WITNESS: That is correct. Was it reasonable and  
15 necessary, or prudent, as you point out. And I think Mr.  
16 Sansom says, look, you built the machine or the generator to  
17 burn two types of coal, and you could blend it, and it would  
18 have been cheaper had you blended the coal and bought this  
19 other coal; and then you have a competing side by the company.

20 COMMISSIONER CARTER: And Mr. Sansom's perspective is  
21 that had you burned the coal that the plant was designed for  
22 you would have spent \$143 million less on fuel?

23 THE WITNESS: That's correct, and ultimately  
24 customers. The bottom line, customers would have spent 143  
25 million less on their bills.

1           COMMISSIONER CARTER: And such that, since they have  
2 spent 143 -- in Mr. Sansom view, which you adopt, since they  
3 have spent 143 million more on fuel than they should have, not  
4 only should they reimburse the customers the 143 million, but  
5 there also should be a 10 percent punitive damage award here.

6           THE WITNESS: I don't know about the 10 percent. I  
7 haven't analyzed Mr. Stewart's testimony, and I don't know that  
8 this Commission has done additional prudence disallowances of,  
9 for example, this 10 percent that Mr. Stewart brought up. But  
10 if that is evidence currently before you, and if you, as a  
11 Commissioner, think that's appropriate -- if I hit them with  
12 this other 10 percent and I can do it because there is  
13 precedent, if that is the case, this will keep companies like  
14 Progress from doing these types of things again, and having  
15 that slip by, well, then it is in your discretion to do it.

16           MR. BURNETT: Commissioner, I'm sorry, I just can't  
17 let that one go. He is assuming that Progress did things that  
18 slipped by.

19           (Simultaneous conversation.)

20           COMMISSIONER CARTER: He is just giving his opinion  
21 right now is all he is doing.

22           CHAIRMAN EDGAR: Mr. Burnett --

23           COMMISSIONER CARTER: That is all he is doing.

24           MR. BURNETT: Understood. I just wanted the record  
25 to reflect that has not been established.

1           COMMISSIONER CARTER: Well, the record is such that a  
2 Commissioner is asking the witness a question is where we are  
3 now.

4           MR. BURNETT: Yes, sir. Please forgive me.

5           COMMISSIONER CARTER: Had you finished?

6           THE WITNESS: Yes.

7           COMMISSIONER CARTER: And, Madam Chairman, I beg your  
8 indulgence on this. The fact of the matter remains that we  
9 have been here it seems like forever, and --

10          CHAIRMAN EDGAR: And we're not done yet.

11          COMMISSIONER CARTER: And I'm really just trying to  
12 get to the bottom line, that is all we are really trying to do.  
13 We have had testimony over the last several, three days here  
14 about a charge for fuel, an overcharge for fuel of \$143  
15 million. A discussion of whether or not in addition to the  
16 \$143 million there should be another \$14.3 million as a penalty  
17 for punitive damages. We have had discussion here about in  
18 order to have the utility plants be able to burn the coal in  
19 question it would cost them \$60 million in infrastructure  
20 improvement plus \$2 million per year in maintenance costs,  
21 which now we are up to about \$80 million, and then within the  
22 context of just the fuel itself, between 51 and \$40 million,  
23 depending on whose numbers you take. And the bottom line is  
24 really the bottom line.

25          And really, I think that we have had a lot of puffery

1 in what we have been presented with, but we are really just  
2 trying to get to the bottom line. And I'm not trying to tell  
3 the witnesses what to say, but if you want us to make a  
4 determination of whether or not these are prudent, or  
5 imprudent, or whether or not this situation is something that  
6 we should be dealing with even on a justiciable manner, then I  
7 think that it would be helpful to me if everyone was to kind of  
8 stick to the bottom line and get to the facts. And, you know,  
9 don't take me to New York to get me across the street.

10 Thank you.

11 CHAIRMAN EDGAR: Thank you, Commissioner.

12 Commissioner McMurrin for a question.

13 COMMISSIONER McMURRIAN: Thank you, Chairman.

14 Mr. Lawton, I have asked some of these same  
15 questions, I think it was in the context of our discussion on a  
16 motion to dismiss which preceded this hearing.

17 THE WITNESS: Yes.

18 COMMISSIONER McMURRIAN: And since your testimony, I  
19 think, goes at least along these lines, can you tell me what  
20 activities should the Commission be doing in the context of our  
21 annual fuel hearings, what additional things would we need to  
22 do in order to determine prudence in the course of fuel  
23 hearings?

24 THE WITNESS: Sure. If I could, and it will be  
25 direct. I'm flying back, that's why I had to come up early,

1 and I appreciate the Commission's indulgence in letting me get  
2 out of here. Not that I don't like Tallahassee. I have a  
3 prudence review case that I'm going to, and I can tell you what  
4 we are doing in Texas.

5 And, typically -- and I'm not saying follow the Texas  
6 model, by any means. But, typically, the utility comes in  
7 twice a year, it has a fuel factor adjustment like your utility  
8 has once a year. That's an interim rate that is set, because  
9 you can't embark on a rate case every time fuel costs change.  
10 So we have these interim rates.

11 After three years, the utility is required to come in  
12 and file a fuel reconciliation case; that is, reconcile the  
13 past three years of costs. You bought a whole lot of gas, you  
14 might have been hedging on gas. These expenditures were passed  
15 through. We want to know, as the Commission, and all utilities  
16 do this, were those costs reasonable and necessary.

17 Now, this case that I will be litigating starting the  
18 13th in Austin, it covers three years and the case will last  
19 three, maybe four days if we are lucky. But we will have  
20 covered a billion and a half dollars worth of fuel expenditures  
21 over the three years. We will cover the gas procurement  
22 practices, the atypical events that I was asked about in my  
23 examination earlier, all of these issues. So, typically, you  
24 know, this Commission has to decide for itself what it wants to  
25 look at, but my advice is that this case, this problem has gone

1 on for, I think it is since 1996, and it hadn't been uncovered  
2 that the coal costs that the company had expended and passed on  
3 to consumers in these annual reviews may have been a bit  
4 excessive.

5           And, if there were more periodic time periods, or  
6 possibly some kind of company filing requiring the resolution  
7 of these issues on a more periodic basis, whether it is two  
8 years, three years, or five years, it may help you in avoiding  
9 these issues. Now, how far back we go in this case, I mean,  
10 you are being asked to go back ten years, I believe. I mean,  
11 you're going to have to decide how far back you want to go.

12           . COMMISSIONER McMURRIAN: Just a follow-up. So you  
13 are not suggesting that there is a necessary call for  
14 additional audits or anything like that? I mean, are you --  
15 maybe I should ask this. You are pretty familiar with our  
16 annual process and how we look at -- we are looking at a course  
17 of three years and each year that we take up the fuel costs.

18           THE WITNESS: Right.

19           COMMISSIONER McMURRIAN: And as I understand what you  
20 are saying in Texas, that every three years you are sort of  
21 looking at the past entire three years. But it seems similar  
22 to me. I guess I'm not really understanding the difference in  
23 what they're doing and what we're doing.

24           THE WITNESS: Well, in your case, the question is do  
25 you get a full review of the two-year historical period --



1 well, the one-year forecast obviously is a forecast that will  
2 be reviewed again someday, and then you have your actuals  
3 versus your forecast kind of analysis. Things that aren't  
4 captured in those types of analyses are the fuel procurement of  
5 coal, for example, in this case. That clearly was an issue  
6 that was not captured. Moreover, I think the Commission has,  
7 in its annual orders that you were just asking about, stated  
8 that, you know, prudence and reasonableness and necessity is  
9 for a future day. I think it is reserved, these issues. But,  
10 there are some costs that need to be looked at more frequently,  
11 I think.

12 COMMISSIONER McMURRIAN: Thank you.

13 THE WITNESS: You're welcome.

14 CHAIRMAN EDGAR: Mr. Burgess.

15 MR. BURGESS: No redirect.

16 CHAIRMAN EDGAR: Mr. Burnett, you had an exhibit?

17 MR. BURNETT: Yes, ma'am. We would move 226, I  
18 believe.

19 CHAIRMAN EDGAR: Mr. Burgess, any objection? This  
20 was the Fitch Credit Analysis.

21 MR. BURGESS: Right. This is not something that -- I  
22 don't know what the prehearing order called for as far as  
23 identification of exhibits. This is not something that we  
24 created, so, I mean, with the recognition that this is a  
25 publication that we are not vouching for its results and we are

1 not speaking to the veracity of any of their conclusions, I  
2 don't object.

3 CHAIRMAN EDGAR: It will be given the weight that the  
4 Commission determines it to be due. Okay. Exhibit 226 will be  
5 entered into the record as evidence.

6 MS. HOLLEY: Madam Chairman, I apologize.

7 CHAIRMAN EDGAR: Ms. Holley.

8 MS. HOLLEY: Going back to Mr. Lawton's prefiled  
9 testimony, he did, in fact, have a prefiled Exhibit DL-1 that  
10 was provided with his prefiled testimony consisting of eight  
11 pages. Ms. Bennett is handing out copies to all the parties.  
12 And I think the most appropriate thing to do would be just mark  
13 it as 227 in our list, identified as DL-1, and just move it  
14 into the record along with all the other exhibits.

15 CHAIRMAN EDGAR: Okay, thank you. And, actually, I  
16 do now see it now that I have the proper notebook and testimony  
17 in front of me. Occasionally paper shuffling difficulties that  
18 we all have. So thank you for bringing that to our attention.  
19 And, Mr. Burgess, as we had discussed earlier when Mr. Lawton  
20 first sat down, we will go ahead and mark this as 227.

21 MR. BURGESS: And I so move it.

22 CHAIRMAN EDGAR: Mr. Burnett, seeing no objection?

23 MR. BURNETT: No objection.

24 CHAIRMAN EDGAR: No objection. We will enter Exhibit  
25 227 into the record, and it will be resume, background?

1 MS. HOLLEY: DL-1, I think will work.

2 CHAIRMAN EDGAR: DL-1 will work. Okay.

3 MR. BURGESS: Thank you, Ms. Holley.

4 (Exhibits 226 admitted into the record. Exhibit 227  
5 marked for identification and admitted into the record.)

6 CHAIRMAN EDGAR: Okay. Any other housekeeping  
7 matters before we dismiss this witness?

8 Seeing none. Thank you, Mr. Lawton.

9 THE WITNESS: Thank you. I appreciate it.

10 (Transcript continues in sequence with Volume 9.

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1 STATE OF FLORIDA )

2 : CERTIFICATE OF REPORTER

3 COUNTY OF LEON )

4

5 I, JANE FAUROT, RPR, Chief, Hearing Reporter Services  
6 Section, FPSC Division of Commission Clerk, do hereby certify  
7 that the foregoing proceeding was heard at the time and place  
8 herein stated.

7

8 IT IS FURTHER CERTIFIED that I stenographically  
9 reported the said proceedings; that the same has been  
10 transcribed under my direct supervision; and that this  
11 transcript constitutes a true transcription of my notes of said  
12 proceedings.

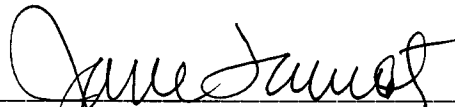
10

11 I FURTHER CERTIFY that I am not a relative, employee,  
12 attorney or counsel of any of the parties, nor am I a relative  
13 or employee of any of the parties' attorney or counsel  
14 connected with the action, nor am I financially interested in  
15 the action.

13

DATED THIS 16th day of April, 2007.

14



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JANE FAUROT, RPR

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Official FPSC Hearings Reporter  
FPSC Division of Commission Clerk  
(850) 413-6732

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