JEFF ATWATER
President of the Senate

LARRY CRETUL
Speaker of the House of Representatives

STATE OF FLORIDA
OFFICE OF PUBLIC COUNSEL

C/O THE FLORIDA LEGISLATURE
111 WEST MADISON ST.
ROOM 812
TALLAHASSEE, FLORIDA 32399-1400
1-800-342-0222

EMAIL: OPC_WEBSITE@LEG.STATE.FL.US
WWW.FLORIDAOPC.GOV

J.R. Kelly
Public Counsel

August 10, 2009

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Ms. Ann Cole, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 090079-EI

Dear Ms. Cole:

Enclosed for filing, on behalf of the Citizens of the State of Florida, are the original and 15 copies of the Direct Testimony of Daniel J. Lawton, Jacob Pous, Helmuth Schultz,III, Kimberly H. Dismukes and J. Randall Woolridge. Also enclosed are copies of the afore mentioned testimonies on compact disc.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Enclosures

Sincerely,

Charles J. Rehwinkel
Associate Public Counsel

cc: All parties of record

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for increase in rates By Progress Energy Florida	)))	Docket No. 090079-EI FILED: August 10, 2009

DIRECT TESTIMONY

OF

DANIEL J. LAWTON

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

J.R.KELLY
PUBLIC COUNSEL

Charles J. Rehwinkel
Associate Public Counsel

Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330

Attorneys for the Citizens of the
State of Florida

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DIRECT TESTIMONY

Of

DANIEL J. LAWTON

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 090079-EI

SECTION I: INTRODUCTION/BACKGROUND/SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Daniel J. Lawton. My business address is 701 Brazos, Suite 500, Austin, Texas 78701.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I have been working in the utility consulting business as an economist since 1983. Consulting engagements have included electric utility load and revenue forecasting, cost of capital analyses, revenue requirements/cost of service reviews, and rate design analyses in litigated rate proceedings before federal, state and local regulatory authorities. I have worked with municipal utilities developing electric rate cost of service studies for reviewing and setting rates. In addition, I have a law practice based in Austin, Texas. My main areas of legal practice include administrative law representing municipalities in electric and gas rate proceedings and other litigation and contract matters. I have included a brief description of my relevant educational

background and professional work experience in Exhibit No. ___ (DJL-1).

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN RATE PROCEEDINGS?

A. Yes. A list of cases where I have previously filed testimony is included in Exhibit No. (DJL-1).

Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS PROCEEDING?

A. I am testifying on behalf of the Florida Office of Public Counsel (OPC).

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

A. My testimony will address the ratemaking policy and financial implications before the Florida Public Service Commission ("Commission") surrounding the over-recoveries of depreciation expenses and the associated excess depreciation reserve. I address and pull together the recommended excess depreciation reserve flow-back to customers proposal addressed in the testimony of Mr. Pous, the ratemaking treatment of Mr. Pous' proposal addressed in the cost of service testimony of OPC cost of service witness, and the implications of these adjustments on Progress Energy Florida ("Progress" or "Company") financial metrics addressed in Mr. Woolridge's testimony.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.

A. As the evidence relates to the Progress depreciation reserve, I conclude and recommend the following:

1) Based on the Company's own evidence in this case, the Company's past depreciation rates have resulted in over-collecting at least $645,805,342 of depreciation expense resulting in an excess depreciation reserve of $645,805,642;

2) Mr. Pous' proposal to recommend a return to customers of $645,805,642 is conservative in light of the numerous additional adjustments to the requested level of depreciation expenses he recommends, which indicate the excess depreciation reserve is $858,679,855 or about 32.8% higher than the level of excess reserve recognized by the Company's own study;

3) Mr. Pous' recommendation to amortize the excess reserve over a four year period as an offset to current depreciation expense will result in correcting the excess reserve, and is consistent with sound regulatory policy and ratemaking guidelines;

4) Correcting the excess depreciation reserve over a four year period will not harm the Company's financial integrity or financial metrics; and

5) Mr. Pous' excess depreciation reserve correction proposal assures that the customers that paid the excessive depreciation charges will likely be the same customers that receive the benefits associated with correcting the excess depreciation reserve.

SECTION II: DEPRECIATION EXPENSE AND DEPRECIATION RESERVES

Q. PLEASE SUMMARIZE THE ISSUES THAT ARE BEFORE THE COMMISSION REGARDING THE EXCESS DEPRECIATION RESERVE.

A. There are three basic questions that are before the Commission in this case related to excess depreciation reserves. The first issue is: does an excess depreciation reserve exist and what is the amount of the excess reserve? The answer to this issue is addressed by Mr. Pous and he concludes an excess depreciation reserve exists in the amount of $645,805,342. Given that the Company's own evidence (depreciation study of Earl M. Robinson) supports this $645,805,342, there should be little controversy regarding this matter.

In addition, the $645,805,342 is a conservative estimate of the excess reserve. Mr. Pous recommends numerous additional adjustments to the Company's depreciation study – the results of which show an excess depreciation reserve of about $858 million or about $200 million above the level of the excess reserve adjustment acknowledged by the Company in this case.

The second issue is, how can the excess reserve be corrected? Again, Mr. Pous provides an answer by proposing a four year amortization of the excess reserve to assure that depreciation rates on a going forward basis are cost based.

The third issue: does the correction to the depreciation reserve allow the Company to maintain its financial integrity and is the correction consistent with sound ratemaking guidelines? I address this last issue in the following testimony. As is shown below, the correction to the excess depreciation reserve proposed in the testimony of the OPC witnesses is consistent with sound ratemaking policy, consistent with cost based rates, and does not impair the Company's financial integrity, and is a conservative estimate of the excess depreciation reserve level.

Q. PLEASE DESCRIBE THE EXCESS DEPRECIATION RESERVE YOU HAVE BEEN DISCUSSING.

A. As a result of the analysis by the Company and Mr. Pous' analyses of the Company's most current depreciation rate proposal, it has been determined that the Company's depreciation reserve has an excess or surplus of at least $645,805,342. This means that customers have overpaid, through rates and charges, depreciation expense. While I am not saying that the Company charged incorrect rates, instead past depreciation estimates in rates were high.

Q. PLEASE DESCRIBE DEPRECIATION EXPENSE.

A. Depreciation expense is a charge to a company's operating expense to reflect the annual recovery or amortization of previously expended capital investment. The annual depreciation expense or charge is a non-cash expenditure or charge included in a company's annual revenue requirement to recover the previously expended capital investment over the useful life of an asset investment.

Q. PLEASE EXPLAIN WHY YOU REFER TO DEPRECIATION AS A NON-CASH EXPENSE.

A. Depreciation expense does not involve a specific payment during the test period that is subject to reimbursement in revenue requirements. Unlike test period labor or operating and maintenance expenses, which are out-of-pocket cash payments, depreciation charges are not additional cash payments. While both cash expenditures such as labor and other ordinary costs and non cash depreciation charges are included on the income statement and in the revenue requirement for setting rates and charges, there are no additional cash flows out of the company for depreciation charges.

Rather than reducing cash for depreciation charges, the depreciation expense charged to cost of service is simultaneously debited from the balance sheet by increasing the accumulated provision for depreciation, which is an offset to gross plant accounts. Depreciation is the recovery of previous balance sheet or rate base investments – the return of capital.

Q. PLEASE EXPLAIN THE ACCUMULATED DEPRECIATION CONCEPT YOU ADDRESSED IN YOUR LAST ANSWER.

A. Accumulated depreciation is the measure of all previously recorded depreciation. Thus, an asset of $100 with a five year life, depreciated at $20 per year, after two years would have a gross plant value of $100 (the original cost), an accumulated depreciation of $40 (two years of depreciation recorded) and a net plant or rate base value of $60 ($100 gross plant less $40 of accumulated depreciation). Thus, the $40 accumulated depreciation in the above example is a record of the two years' depreciation payments on the return of invested capital to the Company.

Q. DOES THE ACCUMULATED RESERVE REPRESENT A CASH ACCOUNT OR POT OF DOLLARS IN RESERVE?

A. No. The reserve for accumulated depreciation reflects the recovery of depreciation from a book perspective. The annual dollars of depreciation expense recovered by a company will be comingled with all other funds and spent on salaries, dividends, or reinvested into the company to fund other capital projects.

Q. PLEASE EXPLAIN THE INTERRELATIONSHIP OF DEPRECIATION EXPENSE AND DEPRECIATION RESERVES.

A. Companies such as Progress make numerous capital investments in production, transmission, distribution and general plant facilities to generate, transmit and ultimately deliver electricity to a customer's delivery point, i.e. the meter. These various capital investments made by the Company are made with funds from capital markets (debt, equity, or preferred stocks), or internally generated funds from annual earnings.

Once these capital investments are made (if prudent and included by the regulator as part of invested capital used and useful in providing service), the utility, through cost of service and charges to customers, is allowed to earn a return on capital investment and a return of capital investment. The return on capital is the return necessary for the utility to recover its carrying costs (cost of borrowing) to fund these capital investments. The return of capital is the annual recovery of the initial capital investment over the useful life of the facility. This annual recovery of capital is depreciation expense.

As the annual return of capital (depreciation) is recovered by the Company, an equal and offsetting adjustment is made to invested capital rate base. In other words, as capital is recovered through rates, the amount of outstanding capital for which the company needs to earn a return, declines as it has been returned or paid off through depreciation rate recovery.

Q. WHAT ARE THE GENERAL RATEMAKING GOALS OF CAPITAL RECOVERY OR DEPRECIATION RATES?

A. Generally, regulatory authorities set depreciation rates on a straight-line basis to recover a capital investment over the useful life of an asset. By straight-line recovery, I mean a recovery of an equal amount in each year of the asset life. Thus, as an example, if an investment of $100 in plant is expected to have a useful life of five years, a depreciation expense of $20.00 per year included in rates would allow recovery of $100 over the five year asset life. This example assumes no salvage value or cost of removal associated with the asset.

Q. WHAT ARE THE CONSEQUENCES OF A LOW DEPRECIATION RATE FOR CAPITAL RECOVERY?

A. If the depreciation rate is set too low then at some point in the asset life depreciation recovery will need to be accelerated to fully recover the asset costs over the asset life. The impact is customers in early years did not pay the full cost of the asset and future customers are required to pay higher rates to make up for the early year shortfall in capital recovery.

Q. WHAT ARE THE CONSEQUENCES OF AN ARTIFICIALLY HIGH DEPRECIATION RATE?

A. When depreciation rates are too high, early year customers end up paying more of the costs than future customers. In this case rates (depreciation) must be reduced to avoid further cost shifting.

Setting depreciation rates and capital recovery streams is a continuous estimating process involving forecasts of numerous variables, thus perfection is not possible or likely in the rate setting process. But, when over or under-recoveries are found to

exist, the goal should be to correct such capital recovery errors to avoid compounding the rate inequities.

Q. HOW DOES A REGULATORY AUTHORITY DETERMINE WHETHER DEPRECIATION RECOVERY AND ASSOCIATED RESERVES ARE ADEQUATE?

A. As noted above, depreciation cost recovery estimates are based on forecasts of numerous variables. Recognizing forecasts are inherently imperfect, regulatory authorities typically require periodic depreciation study updates (usually four to five years) to assure useful life and/or net salvage estimates remain reasonable and reliable for setting rates.

To determine the adequacy of the depreciation reserve or accrual, a theoretical reserve is often calculated in new depreciation studies. A theoretical reserve is the accumulated provision for depreciation at a point in time, assuming the most current depreciation parameters and estimates had been historically applied in setting rates. The theoretical reserve is compared to the actual reserve to determine whether there has been an over/under recovery of depreciation. In this case, applying all of Progress Energy's assumptions in the Company's depreciation study results in a theoretical reserve that indicates the actual depreciation reserve is over-funded by more than $645,805,342, which can be found at page 2-79 of the Company's depreciation study.

Q. HAS THIS COMMISSION ADDRESSED EXCESS RESERVE ISSUES IN PAST CASES?

A. Yes. There are a number of other instances in which this Commission has addressed the depreciation reserve issue and these cases are discussed in the direct testimony of Mr. Pous.

Thus, the issue of correcting over/under recoveries of capital amortization is not a new issue. This Commission has recognized the need for such corrections in numerous cases to assure rates are just and reasonable.

SECTION III: PROGRESS ENERGY'S CURRENT EXCESS DEPRECIATION RESERVE

Q. IS THERE AN EXCESS RESERVE IN THIS CASE?

A. Yes. Based on the Company's most current depreciation study, the Company has been collecting excessive amounts of depreciation. This means that current customers have been overpaying for electric service and future customers will be subsidized if this problem is not addressed.

Q. WHAT IS THE AMOUNT OF THE EXCESS DEPRECIATION RESERVE?

A. Based on the Company's depreciation study and information provided by witness Pous, the amount of excess depreciation charged to customers is $645,805,342. I have included in my Exhibit No. __ (DJL-2) a breakdown of the excess depreciation reserve by operating function.

As is demonstrated in Exhibit No. (DJL-2), based on the Company's current best estimates, customers of Progress have been charged $645,805,342 in excess depreciation. In other words, past customers have been overcharged for depreciation

and future customers will be charged less than full cost of service if this problem of past excess depreciation charges is not addressed.

Q. WHAT DOES THE DEPRECIATION RESERVE SURPLUS INDICATE REGARDING PAST DEPRECIATION RATES AND CHARGES TO CUSTOMERS?

A. These reserve surpluses mean that Progress Energy should have been recording and charging substantially lower depreciation expenses in prior years to recover the costs of using assets serving customers. But instead, customers have been charged excessive costs and the depreciation reserve is overstated. Again, Progress charged the legal rate, but the depreciation rates in cost of service were over-estimated. Only by reversing these excess charges by amortizing the excess reserve over the next few years will customers that paid the excessive rates be compensated, and the depreciation reserve corrected. Any further delay in correcting this excess reserve or employing a longer amortization period will inevitably result in continued intergenerational inequities.

SECTION IV: EXCESS DEPRECIATION RESERVE PROPOSED SOLUTION

Q. HOW SHOULD THE EXCESS RESERVE PROBLEM BE ADDRESSED IN THIS CASE?

A. Mr. Pous has proposed that the excess reserve be flowed back or corrected over a four year period. Quite simply, $161,451,336 ($645,805,342/4) of excess depreciation reserve is being employed to fund a like amount of currently requested depreciation and amortization expense annually in this case. After four years the reserve should be approximately at levels expected by current depreciation parameters and forecasts.

Mr. Pous' four year amortization proposal addresses the excess depreciation reserve problem over a period of time which is consistent with the expected time period between rate increase requests. Waiting for future studies will only result in estimating larger future excess depreciation reserves and an even larger problem to resolve.

Further, Mr. Pous' analysis indicates that the excess depreciation reserve is actually on the order of $858 million. Thus, accepting Mr. Pous' recommendations indicates that this excess reserve problem is likely to continue. Only by addressing the approximate $646 million excess reserve acknowledged by the Company in this case will this problem be minimized.

Q. WILL MR. POUS' PROPOSAL TO CREDIT DEPRECIATION EXPENSE CREATE OR HAVE ANY PRICING IMPLICATIONS?

A. No. As I understand Mr. Pous' proposal, the depreciation excess reserves will be credited based on functional category. In other words, production excess reserves go to credit production depreciation expense, transmission to transmission expense and so on as to other functions. Thus, no pricing or allocation problems are created by Mr. Pous' proposal – the excess reserves are returned or credited to customers by function in the same fashion as the excess depreciation was paid. Thus, Mr. Pous' proposal is both fair and equitable.

Q. IN YOUR OPINOIN IS THE CORRECTION OF THE EXCESS DEPRECIATION RESERVE CONSISTENT WITH THIS COMMISSION'S RULES AND POLICIES?

A. Yes. The correction of the excess reserve in this case adjusts the plant balances and reserves by function. That is there are no reserve transfers between functions. It is my understanding that the Commission's policy allows reserve transfers within the same function, but not across functions.[1] Thus, the transfer of depreciation reserves to cover costs unrelated to depreciation would not be allowable – but correcting depreciation recovery by adjusting the reserve is allowable under this Commission's policies.

Q. IN YOUR OPINION IS THE CORRECTION OF THE EXCESS DEPRECIATION RESERVE CONSISTENT WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP")?

A. In my opinion the correction of the excess depreciation reserve is consistent with GAAP. First, the goal of the excess reserve adjustment is to assure the recovery of capital investment is equalized over the useful life of the assets. Thus, the cost to customers is allocated as equitably as possible over the period for which service is obtained from the asset. The correction for the excess reserve corrects the amount of annual recovery to assure proper recovery over the expected useful life. It is an issue of proper allocation of costs and does not diminish or impair the asset value. Full costs will be recovered by the Company – the issue is how much should be recovered annually over the expected remaining life of the assets.

Q. WHAT IS YOUR UNDERSTANDING OF HOW MR. POUS' PROPOSED ADJUSTMENT TO CORRECT THE EXCESS DEPRECIATION RESERVE WILL BE TREATED IN COST OF SERVICE?

[1] FPSC Order No. PSC-94-1199-FOF-EI, September 30, 1994.

A. Mr. Pous' overall findings indicate an excess depreciation reserve of at least $646 million. This level of excess reserve is consistent with the Company's own study. Amortizing this amount over a four year period results in a $161,451,336 annual adjustment (reduction) to depreciation expense. It is my understanding that a cost of service adjustment will reduce depreciation expense in cost of service by the $161,451,336 recommendation and increase rate base by one half of the annual expense adjustment or $80,725,668.

Q. WHAT IS THE CASH FLOW IMPACT TO THE COMPANY OF CORRECTING THE EXCESS DEPRECIATION RESERVE?

A. The cash flow impact is a $161,451,336 reduction in depreciation expense offset by a $12,147,032 increase in return and taxes associated with the increase in rate base. I have included this calculation in my Exhibit No. ___ (DJL-3). Thus, the net impact to the Company's pre-tax cash flow is a net reduction of about $149,304,304.

Q. HOW WILL MR. POUS' PROPOSAL AMORTIZE THE $646 MILLION EXCESS DEPRECIATION RESERVE OVER FOUR YEARS IMPACT PROGRESS?

A. Employing the four year amortization, annual depreciation expenses will be reduced by about $161 million per year. This adjustment will reduce cost of service dollar for dollar that is $161 million. Given that depreciation is not a cash expense, there is no forgone cash recovery by Progress. Instead, the flow of cash to Progress will be reduced. Instead, the rate of recovery of depreciation is adjusted so as to correct the identified excess reserve deficiency. Because recovery of capital is changed by the depreciation adjustment, after four years the level of invested capital will be $646

million higher than it would be absent this adjustment. Again, Progress is not being denied recovery of any cash expense, rather the rate of amortizing invested capital is changed to correct for past accelerated capital recoveries.

Q. WILL MR. POUS' ADJUSTMENT TO CORRECT THE EXCESS DEPRECIATION RESERVE IMPACT THE COMPANY'S CASH FLOW?

A. Yes. By reducing revenue requirements by about $161 million per year, the direct result for a non-cash expense (depreciation), the cash flow paid by customers to the Company will be reduced by this $161 million amount. The cash flow to the Company consists of net income (revenues less expenses) plus depreciation, plus deferred income taxes.

Various measures of cash flow from operations are employed as measures of a firm's financial metrics. One simple measure as described above can be calculated off the Company's rate filing schedule is shown in my Exhibit No. __ (DJL-4).

Thus, under the Company's rate filing assumptions, Progress will have (if the full rate increase is granted) $1,133,646 of cash before income taxes. This amount reflects $574,577 of return to pay interest on debt, preferred stock, and income or return for equity shareholders. The $357,871 is the depreciation and amortization request of the Company, which, if granted, represents the return of capital investment. Lastly, the $201,198 of income taxes represents federal and state current and deferred taxes. Deferred taxes are taxes not currently payable to the taxing authority and are funds available (cash flow) for other business purposes.

Generally, the impact of Mr. Pous' depreciation correction to the excess reserve is to reduce the claimed non-cash depreciation expense of $357,871 by about $161 million

before adjustment to Florida retail. The impact of this adjustment is to reduce cash flow by about $161 million. In other words, rather than a cash flow of $1,133,646 (shown in Schedule (DJL-4) the annual Company cash flow will be about $976,646 ($1,133,646-$161,000).

Q. WILL MR. POUS' CORRECTION OF EXCESS DEPRECIATION IMPACT THE EARNINGS OF THE COMPANY?

A. No. The return authorized by this Commission will not be impacted by correcting the excess depreciation reserve.

Q. WILL THERE BE AN IMPACT ON EXPENSES FOR CALCULATING INCOME TAXES AS A RESULT OF MR. POUS' CORRECTION TO THE ACCUMULATED DEPRECIATION RESERVE?

A. No. Whatever depreciation expense is allowed by the Commission will still be used in the tax calculation. Under Mr. Pous' recommendation, about $161 million of the annual depreciation expense is funded not from increasing customer rates, but instead by reducing the excess depreciation reserve (which was paid by customers in past years).

SECTION V <u>IMPACTS ON FINANCIAL INTEGRITY</u>

Q. IN YOUR OPINION, WILL CORRECTING THE EXCESS RESERVE EMPLOYING A FOUR YEAR AMORTIZATION HARM THE COMPANY'S FINANCIAL INTEGRITY?

A. Correcting the excess depreciation reserve will not harm the Company's financial integrity, although there will be an impact on cash flow financial metrics. It is important to note that under Mr. Pous' proposal cash will decrease by $149 million per anum (see Schedule DJL-3), but at the end of four years rate base will be higher in the amount of $646 million. Thus, Mr. Pous' correction decreases the accumulated provision for depreciation (a rate base reduction) and corrects the depreciation reserve to appropriate or theoretically correct levels. Over the term (4 years), the Company remains whole. Only the recovery period of capital investment changes – no adjustment or reduction is made to the Company's investment.

Q. WHAT FINANCIAL RATIOS AND METRICS ARE IMPORTANT IN EVALUATING A COMPANY'S FINANCIAL INTEGRITY?

A. There is no one key financial metric or group of financial ratios that if attained will result in achieving a particular bond rating level. But, the ratios are helpful in evaluating a company's financial integrity as these financial ratios are helpful in broadly defining a particular company's position relative to a bond rating category. Again, these financial ratios are not used by rating agencies as a prerequisite for achieving or maintaining a specific debt rating.

Key financial metrics and ratios include cash flow-to-debt ratios, a short-term measure of leverage risk, interest coverage ratios measuring earnings coverage of fixed cost interest, and debt to total capital ratio – another measure of leverage. For electric utilities the financial ratio medians by bond rating category are show in my Exhibit No. ___ (DJL-5).

Q. HAVE YOU CALCULATED THE COMPANY'S FINANCIAL METRICS ASSUMING MR. POUS' $646 MILLION EXCESS RESERVE ADJUSTMENT IS IMPLEMENTED IN THIS PROCEEDING?

A. Yes. Included in Exhibit No.(DJL-5) are the results of the excess reserve correction on the financials of the Company. First, this analysis evaluates the impact of only the excess reserve adjustment so that the Commission can evaluate the impact of correcting the excess reserve on the Company. As is discussed below, correcting the excess reserve has a small impact on the Company's cash flow financials. Second, only cash flow is affected by this adjustment. Financial ratios such as "debt ratio" are unaffected by the correction of the excess reserve.

As is demonstrated by the results shown in Exhibit No. (DJL-5), the Company's cash flow ratios decline slightly, but remain well above industry averages. Progress maintains financial integrity after correcting for the excess depreciation.

Q. WHAT DO YOU CONCLUDE REGARDING THE IMPACT OF CORRECTING THE EXCESS DEPRECIATION RESERVE ON THE COMPANY'S FINANCIAL METRICS?

A. Correcting the excess reserve is warranted in that the impact on customers of this correction far outweighs the slight impact on the Company's cash flow financial measures.

Q. *IN YOUR CASH FLOW ANALYSIS, HAVE YOU TAKEN INTO CONSIDERATION OTHER CASH FLOW IMPACTS TO PROGRESS?*

A. I have included the impact of a 7.50% overall cost of capital, but no other adjustments to cost of service which may impact cash flow. There will be a number of witnesses in this case that make additional adjustment proposals that will impact cash flow. For example, alternative return, depreciation and income tax recommendations will come

before the Commission in this case. My analysis focuses solely on the excess depreciation reserve impact and demonstrates that the cash flow reduction allows Progress to maintain solid financial metrics.

Q. BASED ON YOUR ANALYSIS OF THE EXCESS DEPRECIATION RESERVE AND THE CORRECTION PROPOSED BY MR. POUS, WHAT ARE YOUR CONCLUSIONS IN THIS CASE?

A. The excess depreciation reserve, which currently exceeds $646 million of excess depreciation costs collected from customers, should be corrected in this case as recommended by witness Pous. First, if not corrected the situation, in terms of cost shifting, is likely to become worse, not better.

Correcting the excess depreciation reserve does not cut one dollar of cash expense from Progress – correction of the excess depreciation reserve addresses timing of recovery. Customers have paid excess depreciation in past years accelerating the Company's capital recovery. Correcting the excess reserve assures customers pay the true cost of service: no more, no less. Progress will still recover its capital investment, but not on an accelerated basis.

Q. ARE THERE ADDITIONAL REASONS WHY THE COMMISSION SHOULD CORRECT THE EXCESS DEPRECIATION RESERVE?

A. Yes. The Company has requested a substantial increase approaching $500 million annual increase in this case. The economic times and conditions faced by the Company and consumers are well documented and slow recovery is expected. The correction of the excess reserve is an opportunity for this Commission to correct the

excess reserve and reduce the rate increase by about $149 million without harming Progress. Such rate reduction does not disallow cash expenditures, but instead corrects the rate of asset recovery. For all of these reasons the Commission should correct the excess reserve at this time as proposed by OPC witness Pous.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

DOCKET NO. 090079-EI
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Direct Testimony of Daniel J. Lawton has been furnished by U.S. Mail and * hand delivery on this 10th day of August 2009, to the following parties:

John T. Burnett
Progress Energy Service Company, LLC
P.O. Box 14042
St. Petersburg, FL 33733-4042

*Mr. Paul Lewis, Jr.
Progress Energy Florida, Inc.
106 East College Ave, Suite 800
Tallahassee, FL 32301-7740

*Bill McCollum/Cecilia Bradley
Office of Attorney General
The Capitol – PL01
Tallahassee, FL 32399-1050

Scott Boyd
Administrative Procedures Committee
Executive Director and General Counsel
Holland Building, Room 120
Tallahassee, FL 32399-1300

J. Michael Walls/ Diane M. Tripplett
Carlton Fields Law Firm
P.O. Box 3239
Tampa, FL 33601-3239

*Anne Cole
Commission Clerk
2540 Shumard Oak Blvd
Tallahassee, FL 32399

Connissa Pease
1550 S. Belcher Road #513
Clearwater, FL 33764

Vicki G. Kaufman/Jon C. Moyle, Jr.
Florida Industrial Power Users Group
118 North Gadsden Street
Tallahassee, FL 32301

Robert Scheffel Wright/ John T. LaVia
Young van Assenderp
Florida Retail Federation
225 South Adams Street, Suite 200
Tallahassee, FL 32301

Joseph L. Adams
IBEW System Council U-8
4314 N. Suncoast Blvd.
Crystal River, FL 34428

James W. Brew/F. Alvin Taylor
PCS Phosphate – White Springs
1025 Thomas Jefferson St. NW, 8th Flo
Washington, DC 20007

*Katherine Fleming/Keino Young
Caroline Klancke, Erik Sayler
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Richard D. Melson
705 Piedmont Drive
Tallahassee, FL 32312

Kay Davoodi, Director Utility Rates
c/o Naval Facilities Engineering Comma
1322 Patterson Avenue SE
Washington Navy Yard, DC 20374

Audrey Van Dyke
c/o Naval Facilities Engineering Comma
720 Kennon Street, SE Building 36 R
Washington Navy Yard, DC 20374

Marco Iannella
701 Milwaukee Ave.
Dunedin, FL 34698

Charles J. Rehwinkel
Associate Public Counsel

EXHIBITS

OF

DANIEL J. LAWTON

DANIEL J. LAWTON
LAWTON CONSULTING
B.A. ECONOMICS, MERRIMACK COLLEGE
M.A. ECONOMICS, TUFTS UNIVERSITY

Prior to beginning his own consulting practice Diversified Utility Consultants, Inc., in 1986 where he practiced as a firm principal through December 31, 2005, Mr. Lawton had been in the utility consulting business with a national engineering and consulting firm. In addition, Mr. Lawton has been employed as a senior analyst and statistical analyst with the Department of Public Service in Minnesota. Prior to Mr. Lawton's involvement in utility regulation and consulting he taught economics, econometrics, statistics and computer science at Doane College.

Mr. Lawton has conducted numerous financial and cost of capital studies on electric, gas and telephone utilities for various interveners before local, state and federal regulatory bodies. In addition, Mr. Lawton has provided studies, analyses, and expert testimony on statistics, econometrics, account, forecasting, and cost of service issues. Other projects in which Mr. Lawton has been involved include rate design and analyses, prudence analyses, fuel cost reviews and regulatory policy issues for electric, gas and telephone utilities. Mr. Lawton has developed software systems, databases and management systems for cost of service analyses.

In addition, Mr. Lawton has developed and reviewed numerous forecasts of energy and demand used for utility generation expansion studies as well as municipal financing. Mr. Lawton has represented numerous municipalities as a negotiator in utility related matters. Such negotiations ranges from the settlement of electric rate cases to the negotiation of provisions in purchase power contracts.

A list of cases in which Mr. Lawton has provided testimony is attached.

UTILITY RATE PROCEEDINGS IN WHICH TESTIMONY HAS BEEN PRESENTED BY DANIEL J. LAWTON

ALASKA REGULATORY COMMISSION		
Beluga Pipe Line Company	P-04-81	Cost of Capital
JURISDICTION/COMPANY	**DOCKET NO.**	**TESTIMONY TOPIC**

FEDERAL ENERGY REGULATORY COMMISSION		
Alabama Power Company	ER83-369-000	Cost of Capital
Arizona Public Service Company	ER84-450-000	Cost of Capital
Florida Power & Light	EL83-24-000	Cost Allocation, Rate Design
Florida Power & Light	ER84-379-000	Cost of Capital, Rate Design, Cost of Service
Southern California Edison	ER82-427-000	Forecasting

LOUISIANA PUBLIC SERVICE COMMISSION		
Louisiana Power & Light	U-15684	Cost of Capital, Depreciation
Louisiana Power & Light	U-16518	Interim Rate Relief
Louisiana Power & Light	U-16945	Nuclear Prudence, Cost of Service

MINNESOTA PUBLIC UTILITIES COMMISSION		
Continental Telephone	P407/GR-81-700	Cost of Capital
Interstate Power Co.	E001/GR-81-345	Financial
Montana Dakota Utilities	G009/GR-81-448	Financial, Cost of Capital

New ULM Telephone Company	P419/GR81767	Financial
Norman County Telephone	P420/GR-81-230	Rate Design, Cost of Capital
Northern States Power	G002/GR80556	Statistical Forecasting, Cost of Capital
Northwestern Bell	P421/GR80911	Rate Design, Forecasting

FLORIDA PUBLIC SERVICE COMMISSION		
Progress Energy	070052-EI	Cost Recovery

NORTH CAROLINA UTILITIES COMMISSION		
North Carolina Natural Gas	G-21, Sub 235	Forecasting, Cost of Capital, Cost of Service

OKLAHOMA PUBLIC SERVICE COMMISSION		
Arkansas Oklahoma Gas Corporation	200300088	Cost of Capital
Public Service Company of Oklahoma	200600285	Cost of Capital
Public Service Company of Oklahoma	200800144	Cost of Capital

PUBLIC SERVICE COMMISSION OF INDIANA		
Kokomo Gas & Fuel Company	38096	Cost of Capital
PUBLIC UTILITY COMMISSION OF NEVADA		

Nevada Bell	99-9017	Cost of Capital
Nevada Power Company	99-4005	Cost of Capital
Sierra Pacific Power Company	99-4002	Cost of Capital
Nevada Power Company	08-12002	Cost of Capital

PUBLIC SERVICE COMMISSION OF UTAH		
PacifiCorp	04-035-42	Cost of Capital
Rocky Mountain Power	08-035-38	Cost of Capital

SOUTH CAROLINA PUBLIC SERVICE COMMISSION		
Piedmont Municipal Power	82-352-E	Forecasting

PUBLIC UTILITY COMMISSION OF TEXAS		
Central Power & Light Company	6375	Cost of Capital, Financial Integrity
Central Power & Light Company	9561	Cost of Capital, Revenue Requirements
Central Power & Light Company	7560	Deferred Accounting
Central Power & Light Company	8646	Rate Design, Excess Capacity
Central Power & Light Company	12820	STP Adj. Cost of Capital, Post Test-year adjustments, Rate Case Expenses
Central Power & Light Company	14965	Salary & Wage Exp., Self-Ins. Reserve, Plant Held for Future use, Post Test Year Adjustments, Demand Side Management, Rate Case Exp.
Central Power & Light Company	21528	Securitization of Regulatory Assets
El Paso Electric Company	9945	Cost of Capital, Revenue Requirements, Decommissioning Funding

El Paso Electric Company	12700	Cost of Capital, Rate Moderation Plan, CWIP, Rate Case Expenses
Entergy Gulf States Incorporated	16705	Cost of Service, Rate Base, Revenues, Cost of Capital, Quality of Service
Entergy Gulf States Incorporated	21111	Cost Allocation
Entergy Gulf States Incorporated	21984	Unbundling
Entergy Gulf States Incorporated	22344	Capital Structure
Entergy Gulf States Incorporated	22356	Unbundling
Entergy Gulf States Incorporated	24336	Price to Beat
Gulf States Utilities Company	5560	Cost of Service
Gulf States Utilities Company	6525	Cost of Capital, Financial Integrity
Gulf States Utilities Company	6755/7195	Cost of Service, Cost of Capital, Excess Capacity
Gulf States Utilities Company	8702	Deferred Accounting, Cost of Capital, Cost of Service
Gulf States Utilities Company	10894	Affiliate Transaction
Gulf States Utilities Company	11793	Section 63, Affiliate Transaction
Gulf States Utilities Company	12852	Deferred acctng., self-Ins. reserve, contra AFUDC adj., River Bend Plant specifically assignable to Louisiana, River Bend Decomm., Cost of Capital, Financial Integrity, Cost of Service, Rate Case Expenses
GTE Southwest, Inc.	15332	Rate Case Expenses
Houston Lighting & Power	6765	Forecasting
Houston Lighting & Power	18465	Stranded costs
Lower Colorado River Authority	8400	Debt Service Coverage, Rate Design
Southwestern Electric Power Company	5301	Cost of Service

Southwestern Electric Power Company	4628	Rate Design, Financial Forecasting
Southwestern Electric Power Company	24449	Price to Beat Fuel Factor
Southwestern Bell Telephone Company	8585	Yellow Pages
Southwestern Bell Telephone Company	18509	Rate Group Re-Classification
Southwestern Public Service Company	13456	Interruptible Rates
Southwestern Public Service Company	11520	Cost of Capital
Southwestern Public Service Company	14174	Fuel Reconciliation
Southwestern Public Service Company	14499	TUCO Acquisition
Southwestern Public Service Company	19512	Fuel Reconciliation
Texas-New Mexico Power Company	9491	Cost of Capital, Revenue Requirements, Prudence
Texas-New Mexico Power Company	10200	Prudence
Texas-New Mexico Power Company	17751	Rate Case Expenses
Texas-New Mexico Power Company	21112	Acquisition risks/merger benefits
Texas Utilities Electric Company	9300	Cost of Service, Cost of Capital
Texas Utilities Electric Company	11735	Revenue Requirements
TXU Electric Company	21527	Securitization of Regulatory Assets
West Texas Utilities Company	7510	Cost of Capital, Cost of Service
West Texas Utilities Company	13369	Rate Design

RAILROAD COMMISSION OF TEXAS		
Energas Company	5793	Cost of Capital
Energas Company	8205	Cost of Capital
Energas Company	9002-9135	Cost of Capital, Revenues, Allocation
Lone Star Gas Company	8664	Rate Design, Cost of Capital, Accumulated Depr. & DFIT, Rate Case Exp.
Lone Star Gas Company-Transmission	8935	Implementation of Billing Cycle Adjustment
Southern Union Gas Company	6968	Rate Relief
Southern Union Gas Company	8878	Test Year Revenues, Joint and Common Costs
Texas Gas Service Company	9465	Cost of Capital, Cost of Service, Allocation
TXU Lone Star Pipeline	8976	Cost of Capital, Capital Structure
TXU-Gas Distribution	9145-9151	Cost of Capital, Transport Fee, Cost Allocation, Adjustment Clause
TXU-Gas Distribution	9400	Cost of Service, Allocation, Rate Base, Cost of Capital, Rate Design
Westar Transmission Company	4892/5168	Cost of Capital, Cost of Service
Westar Transmission Company	5787	Cost of Capital, Revenue Requirement

TEXAS WATER COMMISSION		
Southern Utilities Company	7371-R	Cost of Capital, Cost of Service

SCOTSBLUFF, NEBRASKA CITY COUNCIL		
K. N. Energy, Inc.		Cost of Capital

HOUSTON CITY COUNCIL		

Houston Lighting & Power Company		Forecasting

PUBLIC UTILITY REGULATION BOARD OF EL PASO, TEXAS		
Southern Union Gas Company		Cost of Capital

DISTRICT COURT CAMERON COUNTY, TEXAS		
City of San Benito, et. al. vs. PGE Gas Transmission et. al.	96-12-7404	Fairness Hearing

DISTRICT COURT HARRIS COUNTY, TEXAS		
City of Wharton, et al vs. Houston Lighting & Power	96-016613	Franchise fees

DISTRICT COURT TRAVIS COUNTY, TEXAS		
City of Round Rock, et al vs. Railroad Commission of Texas et al	GV 304,700	Mandamus

EXCESS DEPRECIATION RESERVE

BY OPERATING FUNCTION

LINE NO.	FUNCTION	AMOUNT
1	Steam	$182,334,463
2	Nuclear	$160,603,058
3	Combined Cycle	$129,572,375
4	Gas Turbine	$472,509,896
5	Transmission	$58,147,181
6	Distribution	$118,646,176
7	General	<$3,497,912>
8	Total	$645,805,341

ESIMATE OF CASH FLOW IMPACT

OF CORRECTING EXCESS DEPRECIATION RESERVE

LINE NO.	DESCRIPTION	AMOUNT
1	Expense Reduction	$161,451,336
2	Rate Base Increase	$80,725,668[1]
3	Requested RoR	9.21%[2]
4	Return Increase	$7,435,834[3]
5	Tax Expansion Factor	1.6338[4]
6	Increase Revenue Requirement	$12,147,032[5]
7	Revenue Requirement Impact / Cash Flow	$149,304,304[6]

[1] Line 1 divided by 2, average rate base impact
[2] Schedule D-1a
[3] Line 3 times Line 2
[4] Schedule C-44
[5] Line 5 times Line 4
[6] Line 6 Less Line 1

PROGRESS ENERGY CASH FLOW PER RATE REQUEST

TEST YEAR ENDING DECEMBER 31, 2010

LINE NO.	DESCRIPTION	AMOUNT (000'S)
1	Net Operating Income	$574,577[1]
2	Depreciation & Amortization	$357,871[2]
3	Income Taxes	$201,198[3]
4	Cash Flow Before Tax	$1,133,646
5	Cash Flow After Current Income Tax	$932,448

[1] Company Schedule A-1
[2] MFR E-1, Attachment 2 of 3, Page 1 of 2
[3] Id. Deferred Income Tax is estimated at $171,299

PROGRESS ENERGY FINANCIAL METRICS PER RATE REQUEST AND ADJUSTED FOR EXCESS DEPRECIATION RESERVE

LINE NO.	DESCRIPTION	A COMPANY REQUEST AMOUNT (000,S)	B OPC ADJUSTMENT FOR EXCESS RESERVE AMOUNT (000,S)	C	D COMPANY REQUEST W OPC ROR ADJUSTMENTS AMOUNT (000,S)
1	RATE BASE	$6,238,617	$6,238,617		$6,238,617
2	REQUESTED RATE OF RETURN	9.21%	9.21%		7.50%
3	JURISDICTIONAL NET OPERATING INCOME REQUEST	$574,577	$574,577		$467,896
4	CURRENT NET OPERATING INCOME	$268,546	$268,546		$268,546
5	CLAIMED NET OPERATING INCOME DEFICIENCY	-$306,031	-$306,031		$199,350
6	NET OPERATING INCOME MULTIPLIER	1.6338	1.6338		1.6338
7	REVENUE INCREASE REQUESTED	$499,996	$499,996		$325,700
8					
9	NET OPERATING INCOME W/ INCREASE	$574,577	$574,577		$325,700
10	DEPRECIATION EXPENSE	$357,871	$196,420		$196,420
11	FEDERAL INCOME TAX	$201,198	$201,198		$182,677
12	TOTAL CASH FLOW W/FIT	$1,133,646	$972,194		$704,797
13	TOTAL CASH FLOW W.O/FIT	$932,448	$770,996		$522,120
14					
15	INTEREST EXPENSE	$189,404	$189,404		$189,404
16	DEBT AMOUNT (LONG TERM)	$2,637,596	$2,637,596		$2,878,498
17	DEBT PERCENTAGE	42.28%	42.28%		44.19%
18					
19	PRE-TAX METRICS				
20	CFO/INTEREST X	5.985	5.133	3.0-4.5	3.721
21	CFO/DEBT %	42.98%	36.86%	25%-45%	24.48%
22	DEBT PERCENTAGE	42.28%	42.28%	35%-50%	44.19%
23					
24	AFTER-TAX METRICS				
25	CFO/INTEREST X	4.92	4.07	3.0-4.5	2.76
26	CFO/DEBT %	35.35%	29.23%	25%-45%	18.14%
27	DEBT PERCENTAGE	42.28%	42.28%	35%-50%	44.19%
28					
29	SOURCES:				
30	COLS A&B LINES 1-9 COMPANY SCHED A-1, LINES 10-11 PER COS				
31	LINE 12 IS SUM OF LINES 9-11				
32	LINE 13 IS SUM LINES 9-10				
33	LINE 15 WTD DEBT TIMES RATE BASE (INCL. ST DEBT)				
34	LINE 20: LINE 12/LIN 15				
35	LINE 21: LINE 12/ LINE 16				
36	LINE 22: COMPANY CLAIMED DEBT RATIO SCHED. D 1a				
37	LINES 25 & 26: EXCL. FIT				
38	COLUMN B CALCULATIONS REFLECT REDUCTION FOR EXCESS RESERVE				
39	COLUMN D REFLECTS A 7.5% ROR & EXCESS RESERVE				

KEY UTILITY FINANCIAL RATIOS

	Bond Rating		
DESCRIPTION	**AA**	**A**	**BBB**
EBIT interest coverage (x)	4.2	3.4	2.8
Total Debt/Capital (%)	51.7	55.9	58.8
Funds from Operations interest coverage	5.1	4.0	3.5
Funds from operations / total debt	35.5	23.8	20.4

Where:

1) EBIT interest coverage =

$$\frac{\text{earnings from operations before interest and taxes}}{\text{gross interest less (capitalized interest + interest income)}}$$

*EBITA interest coverage =

Earnings from operations before interest, tax, depreciation, amortization

2) Total Debt / Capital =

$$\frac{\text{Long-term debt + debt equivalents}}{\text{Total capital (debt, preferred, equity)}}$$

3) Funds from operation interest coverage =

$$\frac{\text{Net income from operations + (depreciation, amortization, deferred tax)}}{\text{Gross interest – (capitalized interest + interest income)}}$$