BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

PETITION FOR INCREASE IN RATES BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090079-EI
PETITION FOR LIMITED PROCEEDING TO INCLUDE BARTOW REPOWERING PROJECT IN BASE RATES, BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090144-EI
PETITION FOR EXPEDITED APPROVAL OF THE DEFERRAL OF PENSION EXPENSES, AUTHORIZATION TO CHARGE STORM HARDENING EXPENSES TO THE STORM DAMAGE RESERVE, AND VARIANCE FROM OR WAIVER OF RULE 25-6.0143(1)(C), (D), AND (F), F. A. C., BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090145-EU

VOLUME 26
Pages 3645 through 3809

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PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING:
CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Wednesday, September 30, 2009

TIME: Commenced at 11:00 a.m.
Concluded at 3:15 p.m.

PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	CLARA C. ROTRUCK Court Reporter (850) 222-5491
PARTICIPATING:	(As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:	ID.	ADMTD.
219		
315		3676
	3802	

PROCEEDINGS

(Transcript follows in sequence from Volume 25.)

CROSS EXAMINATION (continued)

BY MR. MOYLE:

Q On page 7, you're asked the question why the company has increased its nuclear fuel levels for 2009 and 2010. Do you see that on page 7, line 5?

A Yes, sir.

Q And just by the fact that you're asked that question leads me to believe that your fuel levels were at a lower number or figure or volume for the years before 2009, is that correct?

A We had -- we were not maintaining as much inventory, additional inventory in the years prior to that.

Q And in the years prior to that all your nuclear plants have been able to run efficiently, effectively and reliably, correct?

A Yes, the answer is correct to that, but let me just add a clarification.

In the nuclear fuel supply, between about post -- in the '60s and '70s, up through around 2003, there was a relatively large capacity of fuel, of uranium in enriched capability in the United States, a

pretty stable amount of nuclear power plants in the United States, in the country, and the cost was relatively stable.

On or around 2003, the market started to see a large number of nuclear power plants in the rest of the world. Roughly, there's a hundred in the United States, there's 400 in the world and that number is increasing, so we saw an increase in demand. Mines had stopped mining and the amount of enriched product that was available coming out of the enrichment plants started to decrease.

Price in that time was roughly $10 a kg, a kilogram. On or around 2003, it started to increase, and in the time frame of 2006 to 2008, as we started to decide whether we needed to have strategic capacity, we saw about four market things occurring. One is price went from in the roughly $10 a kg in that period of time, from there to $70, with a spike of $150. We saw major mines in the world trying to come on. One particular one, for example, this is a very -- there's sufficient uranium available in the world, it's just getting more difficult to find it, or more difficult to mine it. One particular mine, for example, is Cigar Lake in northern Canada. When that mine comes on line, it will be 13 percent of the world's availability of

highly -- of enriched -- or of uranium. That facility now is eight years behind, it flooded eight years behind, now not to come on until 2015 to 2018. Also, a major mine in -- Ranger Mine in Australia, it's an open mine, got a cyclone and filled up.

Those two mines coming off market at the same time of the availability of Russian fuel coming in, going away in 2003, really put a crunch on both the capacity of the uranium, capacity of the conversion. As I mentioned in my testimony, the U.S. plant, Comfordyme, and the Hope facility in Canada both went off line for over a year, so we saw in the case of that.

We're bringing on additional -- the industry is bringing on additional enrichment as we speak. And equally, you've got -- at the time that we started looking at whether or not we were going to bring on strategic inventory, the number of potential nuclear power plants in the United States and in the world was a significantly high number. Even today, that we have not, as I have mentioned, not had a direct problem with getting fuel, there's -- each of those supply chains have aging plants and have potential. These are coming in from different countries. You have both supply issues, and it's also a case of where you have to have just in time the product needs to be directly where it

needs to be.

So our intent is to ensure that CR-3, in the case of the Florida, has the fuel it needs at the time so we do not have to go to the spot market and we don't have to either run the plant at reduced capacity, thus affecting fuel costs to the ratepayers of Florida, or potentially shutting the unit down. So we have decided from a risk profile to add the strategic inventory to ensure that doesn't occur.

Q Right, and the strategic inventory is essentially buying more than you need so if all of a sudden, something happens, you'll have it available, correct?

A That's correct.

Q I was kind of thinking of an analogy, in a household, it might be buying enough cereal to last you not only this year, but next year, correct, something like that?

A It is extra inventory. We keep it in the conversion, which is -- allows us to get past two of the supply chain areas without too much additional cost, which we can then deploy to the enrichment.

Q Yes, sir. And the answer that you gave to the question, you know, you've spent a lot of time talking about the mines and the fuel supply. I think you used a

2003 date as to when you started seeing this --

A Right.

Q -- issue, correct?

A The market moving up.

Q And you didn't take strategic steps to increase your inventory in 2003, 2004, 2005, 2006, 2007 or 2008, correct?

A We did not until roughly, started making the decisions in the 2007 and '08 time frame.

Q But with respect to actually taking action, that would be in 2009 and the test year 2010, correct?

A We had started to contract for the enrichment in the 2008 time frame.

Q Okay. And you would agree, would you not, I don't know, you've been in the fuels business, but that with respect to your description about uranium, that you might have a similar description about coal supply or about natural gas supply, you know, markets: There are things that happen in markets, some suppliers go out of business, some have interruptions, that is not necessarily an unusual occurrence as it relates to uranium, correct, vis-à-vis other fuels?

A I think the diff- -- the answer is correct, with the clarification that the difference is there's far fewer suppliers in the conversion, enrichment and

manufacturing portion, that we have roughly the same -- we have quite a few mines in countries we can get the uranium from.

Q And with respect to that enrichment and conversion process, that is the process that government gets involved with, correct --

A No --

Q -- in terms of monitoring or oversight?

A The government is involved in the licensing of those facilities, so I'm not sure whether your question is with the monitoring side.

Q If I wanted to go buy enriched uranium from one of these manufacturing plants, could I do that?

A I cannot answer that question.

Q On page 6, I guess you had said -- page 6, line 6, you said uranium is found in many locations worldwide. I took that to suggest that uranium as a raw product is not in short supply, is that correct?

A Uranium -- that is a correct statement. It's just what it takes to mine it and how long it takes to bring a mine into production.

Q Do you know, as we sit here today, whether the U.S. government has a strategic interest in assuring that uranium -- enriched uranium supplies are available to nuclear power plants in this country?

A Restate the question, please.

Q Sure. As we sit here today, do you know if the United States government has an interest in assuring that enriched uranium supplies are available to nuclear power plants operating throughout this country?

A My answer would be the U.S. government is not involved in ensuring there's sufficient -- it is commercially, there's a facility being brought on line in New Mexico, there's another one being brought on line in Ohio. The government does offer potential loan guarantees, which I know the facility in Ohio, but those are brought on by private entities.

Q If I could direct your attention to line -- I'm sorry, page 8, line 11, you state, quote, "Strategic inventory is a uranium stockpile that we do not expect to consume except in rare emergency situations." Do you see that?

A Yes.

Q Okay. Given the hundred-plus years of operation of nuclear power plants, has there ever been a rare emergency situation to date?

A To date, the -- Progress Energy has not had that circumstance occur. I do know of several utilities which had to go to the spot market because of supply interruptions.

Q So to the extent that there was a supply interruption, the consequence is you have to go into the spot market and you may have to pay a higher price, correct?

A If it's available.

Q Okay.

A But again, that's the uranium portion. The problem may also be in supply interruption in the next two phases downstream of the uranium itself.

Q And another reason that you're asking this Commission to approve additional fuel is so that you can basically hedge against future prices, isn't that right?

A Price hedging, the answer would be yes, with a qualified. Price is one. The decision was more around ensuring we had the supply. Price is a secondary item. The price would be the element which the customer in Florida would see if we were still able to get the supply, but supply interruption was of a greater importance.

Q I took on page 8, your sentence on line 19 that says, quote, "The uranium inventory also insulates ratepayers from potential large swings in nuclear fuel costs associated with volatile prices for individual deliveries," to communicate that there was a hedging element.

A There's only a hedging element associated with if we had to go to the market to get spot, either uranium or conversion or enrichment, of which conversion and enrichment, there's less availability of that on the spot market than, say, the uranium side.

Q Okay. And given our conversation, and I appreciate the information, but wouldn't you agree that as we sit here today, given the history of the operation, the safe, successful, reliable operation of the company's nuclear generating fleets at inventory levels that were not as high as being asked for for 2010, the rate case, that you could continue to successfully operate the nuclear plants without this additional inventory safely and reliably, correct?

A Restate the question so I can answer with a yes or no.

Q Okay. Given our discussion and the fact that Progress Energy has operated safely and reliably nuclear power plants for a combined total of over a hundred years in the Carolinas and in Florida at fuel levels lower than what's being sought from this Commission, for moneys that are being sought from this Commission, you would not have a concern, would you not, about continuing to be able to safely and reliably operate the nuclear power plants in Progress Energy Florida's

territory at the fuel levels that previously existed?

A Let me answer the question this way. The answer is, I'm not concerned about the safe operation of the plant, but that's really not why we're hedging nuclear fuel, because one of the safe operations would be to shut the unit down. So for the answer of safe and reliable, I'm not concerned.

In the case of ensuring from a risk perspective where the marketplace is today and the capacity for shortfalls in the four supply chain areas, I'm concerned to ensure that we have sufficient fuel at the right time to ensure that we're getting the lowest cost fuel to the customer.

Q What if the ratepayers said to you, "Look, we don't want to endanger the operation of a nuclear power plant, we don't want you to have to shut it down," you've never had to shut it down previously for lack of fuel, correct?

A We have not previously had to shut the reactor down for --

Q And if the ratepayer said, "I'd rather not have to pay the money now, but I would rather be exposed to some risk on the spot market in the future," that could be an option, could it not?

A The strategic inventory is a risk mitigation

activity that we'd have to take all input in, but as we stand now as a company, both in the Carolinas and Florida, we're maintaining a strategic inventory to ensure no supply interruption.

Q So the answer would be yes to my question?

A The answer would be, our company position today is that strategic inventory is in the best interests of the customers.

Q But the risk, if you don't have it, is you have to go into the spot market, correct?

A Spot market, or potentially shut the units down, moving over to other fuel sources if we had a supply interruption in one of the, either the uranium enrichment or the conversion.

Q And as we sit here today, you obviously know a lot about the markets, but you don't have any information to suggest that there will be a supply disruption and that uranium, enriched uranium will not be available in the future, correct?

A If I was sitting here today with the market prices and -- I would say no to that answer. In 2008, when we were making these decisions, with the mines that were out of service at the time and the two conversion plants down, we were very concerned, and those plants are very old and only one of them is just now coming

back in service.

Q But that concern has been mitigated somewhat since then?

A It has been mitigated, but a major source of uranium and enrichment, which takes care of the conversion, and the enrichment goes away in 2013 when the Russian fuel supply backs off out of the United States, so my concern would be in the post-2013 time frame.

Q Just a couple more questions, if I could.

How do you transport enriched uranium?

A Enriched uranium is -- you have a U.S. Six, which is in containers that look a lot like a -- about a five-gallon container, it's a little bit more than that, and that is shipped by trucks by the fuel -- by the enrichment facility, that's shipped by trucks to a manufacturing facility, depending on the vendor you use, in our case, it's AREVA, to make it into a pellet.

Q And then ultimately when it shows up at the plant, is it shipped by rail or by truck or --

A It is converted from pellets to fuel assemblies, and the fuel assemblies are shipped by truck.

Q Okay. So another option, to the extent that you're thinking strategically, wouldn't it also make

some sense maybe if you were going to do this to have fuel at one location, maybe in South Carolina, so, depending on needs at particular power plants, you might be able to run it down to Crystal River or run it up to North Carolina? I mean, that would be another way to look at this, would it not?

A The answer to that is no, mainly because the four reactors that we have, each -- once it enters the -- from the enrich facility, each of our core reloads, it's an engineered product, it's engineered for that particular reload, in terms of enrichment, the number of fuel assemblies, so that is different between the four. Once it's pelletized, it goes into four different type fuel assemblies, so that that would not work that way.

Q Okay.

MR. MOYLE: That's all I have. Thank you.

CHAIRMAN CARTER: Thank you.

Mr. LaVia?

MR. LaVIA: I have a few questions.

CHAIRMAN CARTER: You're recognized.

CROSS EXAMINATION

BY MR. LaVIA:

Q Good morning, Mr. Donahue. I'm also going to focus a little bit on nuclear fuel inventories.

On page 7 of your testimony, lines 13 through

14, you state, "This inventory level allows a minimum of over two years of forward operations of CR-3."

The first question is, what does "minimum of over two years" mean? Can you give me a better idea of what time period you have covered?

A The way I would put it is, for example, in CR-3, as we speak today, it's going into a refueling outage, which we will load a half a core in. At that time, our strategic inventory right now is sufficient for about 85 percent of a reload for the refueling outage in 2011.

Q So it could be longer than two years?

A Well, roughly our refueling is every 24 months, so we may -- it fluctuates to basically about the year in advance. We actually start making fuel assemblies to show up on site about five months in advance, so that that strategic inventory level will fluctuate. As I said, through this particular time period in '09 and '10, it's roughly 85 percent of a reload.

Q How did the company pick the period of two years to be the strategic inventory?

A In this particular case, it's because of Crystal River Unit 3 has a two-year refueling recycle, so that's how we picked that, is based on the refueling

cycle.

Q What are the refueling cycles for your plants in North Carolina?

A Good question. Brunswick unit is a 24-month cycle similar to Crystal River, and Harris and Robinson are 18 months.

Q Do you know if there's an industry average or standard for uranium inventory?

A We have benchmarked the industries. It's depending on the risk profile and the contracts and where individual utilities are getting their inventory from. So I could not give you an industry number for inventory levels.

Q Are you knowledgeable enough to be able to testify whether the majority of utilities operating nuclear facilities are keeping to your inventories?

A I'm not knowledgeable enough to give you that information.

Q In that same question, in line 13, you estimate an $80 million cost base in 2010 based on a price of $200 per kilogram --

A Yes.

Q -- of uranium. What is the current price?

A Current price today is in the $50 range for uranium, and then you have conversion on top of that.

Q So how does this -- is this a very conservative estimate, this $200 per kilogram?

A Yes, it is. The actual inventory price we assign is at the average uranium price or conversion price that we have for the full reload for Progress Energy Florida.

Q So this stockpile would cost a lot less than $80 million?

A I'll have to stick with the testimony as written down here.

Q I'm asking you, given that you just testified that the current price is $50 per kilogram, could it cost a lot less than $80 million?

A I would have to take a look at exactly how that number was created, so I --

Q You didn't create that number?

A My staff did support that number, and I cannot explicitly say. The average reload price today at CR-3 is in the range of about $80 million, so that's about what the reload was for Crystal River this refueling, so -- the total cost, including the enrichment, so I believe that's where the $80 million came from.

Q Did the company have a target inventory for 2007?

A In 2007, we did not have a target inventory.

Q So it was zero?

A We maintained a small working amount to ensure that we were having -- we did not have a target.

Q Did the company have a target inventory for 2008?

A In 2008 we were working toward this target inventory of obtaining roughly one reload.

Q You are working towards it. Did you have a target inventory for 2008?

A Our target was to obtain sufficient fuel for an inventory of one cycle.

Q Which would be the number that -- the 400,000 kilograms?

A That's correct.

Q And I think in response to some questions asked by Mr. Moyle, you testified that there was a crunch in 2003 that led the company to develop this policy of having a target inventory, is that correct?

A No, what I said is between 2003 and roughly up through around 2006, we've seen a ramp-up in the 2007 and 2008 time frame that fuel prices went from 60, back to 60, with a spike to around 140.

Q But you also testified there has been a ramp-down in some of those pressures, too, has there not?

A There has been a ramp.

MR. LaVIA: No further questions.

CHAIRMAN CARTER: Thank you.

Staff, you're recognized.

MS. FLEMING: We have no questions for this witness.

CHAIRMAN CARTER: Commissioner Skop?

COMMISSIONER SKOP: Thank you, Mr. Chairman.

Good morning, Mr. Donahue.

THE WITNESS: Good morning, Commissioner.

COMMISSIONER SKOP: Just a couple of follow-up questions with respect to some of the questions that you've been asked.

If I could turn your attention, please, to page 7 of your testimony, rebuttal testimony, please. And on line 7, it discusses the company's inventory plan is -- for nuclear fuel is to maintain inventory. Am I correct to understand that that supply chain inventory including the raw materials, being the U308 yellowcake, as well as the work in progress for enrichment, and that does not mean the individual fuel rods, it's all the processes that would lead to the production of the ultimate fuel rod and bundles that would go into the respective reactor, or --

THE WITNESS: That's correct, Commissioner. We maintain roughly, if you take a rough average, is

about one-eighth of the inventory is in uranium yellowcake, seven-eighths is in UF6 conversion, and we maintain the inventory at that point, which covers two of the supply chains, and then we can send it on to the engineered enrichment from there. So we maintain it, there is a combination of uranium and conversion.

COMMISSIONER SKOP: Okay. And on line 9 you state that CR-3 basically has fuel outages, or scheduled fuel outages, where one-half of the fuel assemblies are replaced --

THE WITNESS: That's correct.

COMMISSIONER SKOP: -- is that correct?

Okay. Without getting outside the scope, there's a whole optimization process associated with replacement of the fuel rod bundle assemblies to the extent that the fuel burn and the reactor characteristics, is that correct?

THE WITNESS: That is correct.

COMMISSIONER SKOP: And that -- in response to your testimony to Mr. Moyle's question, you can't just take a fuel rod assembly and dump it into a different reactor? It's very sensitive to not only the specific reactor, but where it's placed in the fuel rod assembly, is that correct?

THE WITNESS: That's correct. The fuel

assemblies are designed specific for the particular design, of which Crystal River is an AREVA design, so it has specific fuel.

COMMISSIONER SKOP: And also the pellets that comprise the fuel rods are also optimized accordingly for the reactor characteristics, is that correct?

THE WITNESS: That is correct.

COMMISSIONER SKOP: So basically, in a nutshell, absent the -- obtaining the raw material and the enrichment process, ultimately the fuel rod assemblies are custom-built for each individual reactor, is that correct?

THE WITNESS: That is a correct way to put that, it's custom-built.

COMMISSIONER SKOP: All right. Now, when they do outages, is that -- you said every other year. Can you be a little bit more specific? Is that every 12 to 16 months, or 16 to 18 months?

THE WITNESS: Basically for Crystal River Unit 3, it's every 24 months, give or take a little bit, and it's generally in the fall of the odd years, so the outage this year is in 2009 and ongoing. The next outage will be in the fall of 2011.

COMMISSIONER SKOP: So is it correct to understand that for a reload schedule, that would be --

encompass two of those outages, whereas the entire fuel complement of the reactor would be changed out in those two outages, is that correct?

THE WITNESS: The -- restate your question, please.

COMMISSIONER SKOP: You've mentioned $80 million for 2010 for inventory for reload. Does that reload comprise one-half of the fuel assembly -- one-half of the fuel rod assemblies, or does that comprise the entire two-year refuel cycle?

THE WITNESS: Well, the best way to answer that is that the answer is yes, it complies for one reload, which is one-half the core.

COMMISSIONER SKOP: So basically the -- instead of stockpiling, if you will, for two outages, you're only doing it for the next expected outage so that you will have the raw materials and the enriched product and the fuel rod assemblies ready for change-out, is that correct?

THE WITNESS: That is correct.

COMMISSIONER SKOP: Okay, so the inventory turn on those -- on that $80 million investment is basically within the time frame that you specified? I believe you said 14 months for the fuel -- hold on for one second -- for the scheduled fuel outage I think you

said is every 14 months?

THE WITNESS: Fueling outage is every 24 months, but we start to actually make the custom-engineered product about ten to 12 months beforehand, so yes.

COMMISSIONER SKOP: So that inventory turn, then, is 24 months on the $80 million --

THE WITNESS: That would be the best way to take a look at that.

COMMISSIONER SKOP: Okay, great, thank you.

Now, with respect to -- I guess you mentioned that the reason that the inventory investment or change in strategy was made primarily was for supply interruption risk, is that correct?

THE WITNESS: That's correct.

COMMISSIONER SKOP: Now, with respect to CR-3, subject to check, would you agree that the fuel savings on that -- or do you know what the fuel savings on that -- using that nuclear generation over other fossil fuels would be on an expected cost basis?

THE WITNESS: No, I don't have that number exactly.

COMMISSIONER SKOP: Okay. Wouldn't you agree just generally that it would be, subject to check, hundreds of millions of dollars, if not more?

THE WITNESS: I would say yes. Our lowest-cost fuel is our nuclear generating facility.

COMMISSIONER SKOP: On page -- this is my final question. On page 8 of your rebuttal testimony, lines 19 through 23, you discuss that having uranium inventory also insulates ratepayers from potential large swings in nuclear fuel costs associated with volatile prices for individual deliveries, do you see that?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: Okay. Is it true that in 2007, with what some have deemed to be the nuclear renaissance, that the pricing for raw material, being the U308 yellowcake, increased sharply?

THE WITNESS: Yes, it did.

COMMISSIONER SKOP: And --

THE WITNESS: I don't know if -- I think you had multiple things going on. You did have the nuclear renaissance, you had the worldwide nuclear renaissance, and then additionally, the two mines went out of service -- well, the one mine, Ranger, went out of service, which is 20 percent of the market in the world, and then the Canadian mine did not come on, which put a perturbation which spiked for about a year.

COMMISSIONER SKOP: Okay. So I guess, in summary, the basis for having the strategic inventory

that you refer to on line 10 of page 8 of your rebuttal testimony is essentially twofold. It would be to have that supply interruption risk, but also having some form of intrinsic hedge against price fluctuation, is that correct?

THE WITNESS: That's correct.

COMMISSIONER SKOP: And I think that on line 23 that you allude to it without saying -- I don't want to put words in your mouth, but I'm trying to understand the significance of your testimony on lines 22 and 23 where you make the analogy of if the spot market price is higher than the inventory cost, that there would be, I think, cost savings. Can you elaborate on that briefly?

THE WITNESS: Let me take a look at the words for one second.

COMMISSIONER SKOP: Okay.

THE WITNESS: Again, I believe in the context that I was trying to talk here, in the context I was trying to talk here is that by having strategic inventory, it does allow us to go to the market when we're low on inventory or we're in the process of getting the additional fuel we need for the reload to most optimally pick the time to buy the uranium for Crystal River, which does give us a lower price

increase -- or lower price if the spot market goes down.

Our general contracting strategy is not to be in the direct spot market and to have a mixed portfolio of suppliers that are under contract for more than just one reload, so again, the predominant concern is there may be product in the supply chain available, but to keep the price to the customer at something that is predictable.

COMMISSIONER SKOP: And then just finally on page 9 of your rebuttal testimony, lines 16 through 20, you generally discuss the process for conversion of the fuel, and I think that you mentioned in response to a question that you use AREVA, is that correct?

THE WITNESS: AREVA is our current contracted supplier for the end fuel assembly products.

COMMISSIONER SKOP: Okay. So that has to go all the way through the production chain, and then they manufacture and assemble the final --

THE WITNESS: That's right. They take the enriched product and then make it pelletized and put it into the custom fuel assemblies.

COMMISSIONER SKOP: Okay, I think that was my only question.

I just had one comment, Mr. Chair, that I'd like to direct to Mr. Moyle, and I don't know if

Progress might have a comment, and I'm fine with it either way.

But it gave me -- when you asked the question specifically to the delivery of the fuel rod assemblies and what method that would happen, I just have some concerns related, and they may be unfounded, but related to security of transport. So if it would be appropriate, if the delivery method is not pertinent, if it might be possible to strike that. I don't know if that matters to you, Mr. Moyle, or the company, but I just --

MR. MOYLE: I don't -- I was trying to understand whether you could have a central place to store this stuff and you didn't need all the -- I don't have a strong feeling, from a process-wise, it might be kind of interesting to -- you know, we would have to backfill pretty hard, I think, to take it off, given the fact that you got TV and all kinds of --

COMMISSIONER SKOP: That's fine. I just had a concern --

MR. MOYLE: I mean, it's not critical to the question.

COMMISSIONER SKOP: I guess my concern was delivery schedule or delivery method of enriched fuel, which is not a big deal either way, but --

MR. MOYLE: I was trying to find out whether I could knock on the door and say, "I'd like to buy some enriched uranium."

COMMISSIONER SKOP: I don't know, they might not trust you, as a former Gator offensive lineman, I don't know. You might have a problem.

CHAIRMAN CARTER: Mr. Moyle, you might not have to knock on the door, you could probably put a shoulder to it and get in there.

Redirect -- anything further from the bench?

Redirect?

MS. TRIPLETT: Mr. Chair, before I do that, if I could address Commissioner Skop's concerns and maybe alleviate some of his concerns, and I appreciate and we certainly are very obviously concerned about the security of the nuclear facility at Crystal River, but I think that the level of detail being so high level and not into specifics, we're okay with that, but certainly agree that any more detail in terms of delivery of the nuclear fuel would give us concern, but again, we appreciate the Commission raising that.

And to redirect, there is no redirect.

CHAIRMAN CARTER: Okay. Exhibits?

MS. TRIPLETT: Yes, sir, we would move Exhibit 219.

CHAIRMAN CARTER: Are there any objections?

MR. MOYLE: No objection.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 219 admitted into the record.)

CHAIRMAN CARTER: Anything further for this witness?

You may be excused.

THE WITNESS: Thank you.

CHAIRMAN CARTER: Call your next witness.

MS. TRIPLETT: PEF calls Jeff Kopp.

CHAIRMAN CARTER: You may proceed.

MS. TRIPLETT: Thank you, sir.

Whereupon,

JEFF KOPP

was called as a witness on behalf of Progress Energy Florida and, having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. TRIPLETT:

Q Good morning, sir. Could you please introduce yourself to the Commission and provide your address?

A Yes, good morning. My name is Jeff Kopp. My business address is 9400 Ward Parkway, Kansas City, Missouri.

Q Who do you work for and what is your position?

A I work for Burns & McDonnell Engineering, and I'm an engineer in the Development Department of our Business and Technology Services Division.

Q Have you filed rebuttal testimony in this proceeding?

A Yes, I have.

Q Do you have that with you?

A Yes, I do.

Q Do you have any changes to make to that testimony?

A No, I do not.

Q If I asked you the same questions in your prefiled rebuttal testimony today, would you give me the same answers that are in your prefiled rebuttal testimony?

A Yes, I would.

MS. TRIPLETT: Mr. Chairman, we request that Mr. Kopp's prefiled rebuttal testimony be entered into the record as though read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

In re: Petition for rate increase by Progress Energy Florida, Inc.
Docket No. 090079-EI

REBUTTAL TESTIMONY OF JEFFREY T. KOPP

I. INTRODUCTION

Q: Please state your name and business address.

A: Jeffrey (Jeff) T. Kopp, Burns & McDonnell Engineering Co., 9400 Ward Parkway, Kansas City, MO, 64114.

Q: By whom are you employed, and in what capacity?

A: I am employed by Burns & McDonnell Engineering Company. I am an Engineer in the Project Development Department of the Business & Technology Services Division of the company.

Q: What is your educational background?

A: I have a Bachelor's Degree in Civil Engineering from the University of Missouri - Rolla, and a Masters of Business Administration from the University of Kansas.

Q: What is your employment history?

A: I have 10 years total experience working as an engineer and 8 years of experience as a consultant in the electric power industry. My background includes project management, engineering design, site dismantlement estimates, asset due diligence, feasibility studies, siting studies, and project development.

Q: Have you been involved in dismantlement studies for other facilities?

A: Yes. I have been involved in numerous dismantlement studies, and served as project manager on the majority of them. I have helped prepare dismantlement studies on all types of power plants utilizing various fossil fuels. These demolition estimates have been utilized in rate cases, have been used to estimate the liability associated with site demolition and retirement at the end of the facilities' useful lives, and have been used to satisfy Financial Accounting Standard 143, or utilized for actual unit demolition planning.

II. TERMINAL NET SALVAGE

Q: What is the purpose of your testimony?

A: My testimony will address Progress Energy Florida's (PEF) dismantlement study prepared by Burns & McDonnell Engineering Company (B&McD) and respond to the issues raised by Jacob Pous ("Pous") in his direct testimony filed on behalf of the Office of Public Counsel ("OPC") regarding the Terminal Net Salvage value calculated in the study.

Q: Were you involved in PEF's dismantlement study prepared by B&McD, and if so what was your role?

A: Yes. I served as the B&McD project manager for the preparation of the study.

Q: Have you reviewed Pous's testimony?

A: Yes. I have reviewed Pous's testimony, specifically Section IV F, which references the Terminal Net Salvage Value of PEF's fossil plants.

Q: What does Pous assert with respect to B&McD's dismantlement study?

A: Pous claims that the fossil dismantlement study does not justify PEF's request for Terminal Net Salvage. He bases this assertion on two separate "levels of review." He first addresses the various options associated with the final retirement of the generating facilities under utility regulation that he claims are available to PEF. The second "level of review" is the quantification of the cost of removal once an option for removal is selected. Pous's arguments in both "levels of review" are invalid for several reasons, as I discuss below.

Q: Pous claims that several options, such as re-selling the units, are available to PEF in the context of dismantling fossil units in this study. Are these other options available to PEF?

A: No, they are not. Pous states in his testimony that "the options available to the Company range from the worst case scenario of total dismantlement and site restoration, to the best case scenario corresponding to the sale of the facility at an amount significantly above net book value." (Testimony at p. 71) However, these are not viable options given the regulations in Florida related to the calculation of net terminal salvage value in utility dismantlement studies. B&McD prepared the dismantlement study at the request of PEF pursuant to the Florida Administrative Code Rule 25-6.04364, Electric Utilities Dismantlement Studies. This rule states in subsection (1) that "Each utility that owns a

fossil fuel generating unit is required to establish a dismantlement accrual." Subsection (2)(c) of the rule defines dismantlement cost as "the costs for the *ultimate physical removal and disposal of plant and site restoration*, minus any attendant gross salvage amount, upon final retirement of the site or unit from service." (emphasis added). This definition clearly states that the basis of the dismantlement costs should be for physical removal of the facilities. It does not allow for a range of possibilities from total dismantlement to a sale of the facility. It limits the basis of the study to dismantlement only. B&McD's fossil dismantlement study for PEF based its costs, consistent with the rule, on the assumption that, upon dismantlement, each generating unit will be physically removed from the site, the materials will be disposed of, and the site will be restored.

Q: Is the basis of the B&McD dismantlement study being full dismantlement and site restoration consistent with the previous dismantlement studies?

A: Yes. B&McD reviewed the dismantlement study prepared in 2004 by Sargent & Lundy (S&L). Full dismantlement and site restoration was the basis of the 2004 study as well as the previous studies that were accepted by the Florida Public Service Commission.

Q: Do you have any comments about Pous's statements regarding generating facilities that have been sold rather than demolished?

A: The statements Pous makes regarding the sale of generating facilities are irrelevant in this case since Florida Administrative Code Rule 25-6.04364 explicitly defines the basis of the study as full dismantlement. In any event, it is highly speculative to assume that any third party would want to purchase a generating unit that PEF has decided is cost

effective to stop running and dismantle. Pous himself admits that the "vast majority" of sales of generating units occur in de-regulated areas. (Testimony at p. 72). Since Florida is clearly not a de-regulated state for electric generation purposes, it is too speculative to assume that the sale of these units is a viable option.

Q: Pous also states that "even though the company is not legally required to dismantle and restore the site to a greenfield condition, it has elected to charge customers for that scenario." Is this an accurate statement?

A: No. The dismantlement study is not based on restoring the site to a "greenfield" condition. The industry standard use of the term greenfield is indicative of undeveloped land that is typically either in a natural state, or utilized for agricultural purposes. If B&McD were to prepare an estimate to restore a site to a greenfield condition, we would typically assume that everything that had been installed as part of the development of the site would be removed, including all underground facilities, in order to return it to a greenfield condition. This is not the basis of the dismantlement study that B&McD prepared. We have assumed that only facilities and equipment located 2 feet below grade and above will be removed. All undergound piping, foundations, etc. located greater than 2 feet below grade will be abandoned in place. This is consistent with Florida Administrative Code 25-6.04364, Subsection (2)(b) that states that the site should be restored to a "marketable or useable condition."

Q: Is the assumption that facilities and equipment be removed to a depth of 2 feet below grade reasonable?

A: Yes. Florida Administrative Code Rule 25-6.04364 does not give specific guidance on this, therefore, B&McD utilized this assumption consistent with the previous PEF dismantlement studies presented to the Florida Public Service Commission. B&McD has seen regulations in other states with removal depth requirements typically between 2 and 4 feet below grade. This allows for the site to be reseeded as greenspace or even used for agricultural purposes. Removal of equipment and facilities to 2 feet is consistent with the concept of restoring the site to a marketable condition, and is the minimum removal depth that B&McD would recommend.

Q: What does Pous argue in his second "level of review" with respect to the quantification of the Company's costs in the fossil dismantlement study and how do you respond?

A: Pous states that the Company's approach to dismantlement is "reverse construction," meaning that each piece of the facility is dismantled piece by piece, as compared to some sort of explosive or blast. This is not an entirely accurate statement. Pous assumes that all demolition activities will be performed in this manner. In reality, a combination of demolition techniques will likely be required to dismantle the facilities in a safe and effective manner, consistent with Florida Administrative Code Rule 25-6.04364, Subsection (2)(b). In the original 1993 dismantlement study prepared by S&L, a demolition contractor, U.S. Dismantlement Corporation (USDC), was retained to assist with the development of the demolition costs. There is no indication that PEF or S&L dictated to USDC that "reverse construction" techniques be employed for all demolition activities. The manhour estimates from this study have been used as the basis and been

updated for each subsequent submittal. The 2004 study that was used as the starting point for B&McD's 2008 dismantlement study states that the demolition approach was to "maximize efficiency."

Q: Can you please expand on your statement that a combination of demolition techniques will be required?

A: Pous implies in his testimony that either "reverse construction" can be utilized and the facilities be demolished piece by piece, or that demolition through the use of explosives can be utilized. He illustrates this example with the demolition of a power plant stack in Oklahoma, in which a stack was demolished by explosives. While it is true that demolishing a single concrete stack with the use of explosives and allowing it to break apart along a predefined "fall line" may be the least cost and best alternative for that piece of equipment in that particular situation, it is not the single best alternative for all equipment and facilities. Based on the equipment, location, regulations, and regard for safety, different techniques will be required for different pieces of equipment throughout the different sites. The use of explosives and allowing a structure to break apart along a predefined "fall line" may be appropriate for a concrete stack, but would not be a feasible approach to demolishing a boiler, boiler building, and turbine building.

Q: Why would the use of explosives and allowing a structure to break apart along a predefined "fall line" not be appropriate for a boiler, boiler building, and turbine building?

A: A concrete stack could be demolished in this manner due to the fact that it is mainly concrete, with some steel. With the use of explosives, the base of the stack will be broken, and it will continue to break along the "fall line" until the entire stack has fallen. This technique would not work on a boiler, boiler building, and turbine building, which consist of mainly steel, because they would not break apart along a predefined "fall line."

Q: Are there other techniques available utilizing explosives to reduce the costs of demolishing these structures?

A.: Yes. In B&McD's experience, a common approach to demolishing these structures would be to use explosives on the base support beams to drop the structure on its side. This would not cause the structure to continue to break itself apart like in the case of the concrete stack, but it would bring the entire structure closer to the ground making it easier to cut apart. The structure would still need to be cut into manageable pieces by the demolition crews in order to allow the scrap metal to be hauled off for salvage value and allow the remaining demolition debris to be placed in an on-site landfill or hauled to an off-site landfill. The use of controlled explosions would only be used after all asbestos has been removed from the structure and major pieces of equipment, such as steam turbines, had been removed from the structure.

Q: Generally, what are your conclusions regarding Pous's statement that the dismantlement costs assume "reverse construction" and that the estimates are therefore too high?

A.: The original manhour estimates were prepared by a demolition contractor. There is nothing in the original study that would indicate that the demolition contractor was limited to using reverse construction techniques only for all activities. B&McD reviewed these manhour estimates in the context of our experience with other demolition studies, other demolition contractor bids we have received, and other actual demolition projects with which we have been involved. The manhour estimates are in line with our expectations for these facilities. The manhour estimates are also consistent with using a combination of techniques for demolition, including controlled explosions to lay structures down prior to cutting them into manageable sized pieces. Generally, B&McD believes that the manhour estimates in the dismantlement study are appropriate.

Q: What about the case in Nevada that Pous cites, in which the actual demolition costs came in at 30 cents on the dollar compared to the demolition estimates?

A: Pous did not provide the Nevada Power Company cost estimates or the actual demolition cost and scope, therefore, at this point in time, it is impossible for me to make an assessment of the cause of the difference in the costs. However, in B&McD's experience, there are a variety of reasons that the demolition costs from demolition contractors could have come in at a much lower cost than the original estimates. These differences could include but are not limited to any of the following: (1) Dramatic changes in scrap value; (2) the ability to sell major equipment (steam turbines, GSU's, etc.) for reuse rather than scrap; and (3) major omissions in scope by the demolition contractor. It is impossible to determine the reason for the difference between the estimated cost and the actual costs without further information about this specific case.

However, generally speaking, this is a single example that does not necessarily translate to PEF's case. There are undoubtedly numerous cases in which actual demolition costs have been higher than the demolition cost estimates prepared by an engineering firm. Using this Nevada Power Company example alone is misleading and inaccurate.

Q: You mention that one of the differences in cost could be the result of omissions in scope by the demolition contractor. Please elaborate.

A: I have seen instances where B&McD has prepared a cost estimate for site dismantlement and restoration, such as the study it did for PEF in this case, and also separately received bids from demolition contractors. In some cases demolition contractors provided bids at a substantially lower cost than B&McD's cost estimates, because the demolition contractor was only quoting the cost to demolish the above grade structures that are mainly steel with a significant scrap value. The contractor's quote did not include any scope of work to provide site restoration. The contractor's cost estimates also excluded the costs to remediate any hazardous materials, such as asbestos. By limiting their scope to the facilities with significant scrap value, the demolition contractors were able to keep their costs low. However, this would be inconsistent with Florida Administrative Code Rule 25-6.04364, Subsection (2)(b) that states that the site should be restored to a "marketable or useable condition." Without knowing if the Nevada Power Company site, upon which Pous relies, was restored to a marketable or useable condition, it is impossible and inappropriate to compare this project to the PEF case.

Q: What about Pous's assertion that the use of a 20% contingency factor is not reasonable?

A: There are two parts of his assertion with which I disagree. First he states that the Company has proposed a very high side cost estimate. (Testimony at p. 77). I disagree that the Company has proposed a very high side cost estimate. I believe that B&McD has tried to capture as accurately as possible the actual demolition cost that PEF will need to incur when it dismantles each of its fossil fuel generating units. Pous assumes that those costs include pre-cutting members, beams, piping, etc. high above the ground and then carefully lowering them. In some cases it will be necessary to precut certain components and lower them to the ground. In some cases, structures will be dropped on their side and then cut up. In all cases, all metal components will have to be cut to manageable sizes to be loaded for hauling in a manner that maximizes the quantity of metal in a load. The metal will be required to be cut up and hauled to a scrap dealer in order to obtain scrap value for the metal, which is used to offset a significant portion of the demolition costs. There is not a viable alternative for eliminating the manhours required to cut up these components. Therefore, I disagree with his statement that this is a very high side cost estimate.

Secondly, he implies that a contingency is only warranted on a low side cost estimate. The application of a contingency is an standard industry approach in the preparation of cost estimates. Contingency is applied to cover unknowns. This is applied on top of the basic estimated cost. As mentioned in Pous's testimony, a contingency covers issues such as potential weather delays, which are not accounted for

in the base cost estimate. A contingency is therefore appropriate with every cost estimate, irrespective of how Pous would characterize such an estimate.

Q: What about Pous's suggestion that negative contingency may be warranted?

A: I have never seen a case where a cost estimator prepared a cost estimate and then applied negative contingency. Pous's suggestion that a negative contingency be considered is not only inconsistent with industry standards, it is inconsistent with Florida Administrative Code Rule 25-6.04364. Subsection (2)(a) of that rule defines and permits contingency costs to be included in the cost estimates to account for "unforeseeable elements of cost within the defined project scope."

Q: Pous discusses an instance in which a demolition contractor paid $1 million for the right to demolish the King generating plant. Is this a reasonable scenario?

A: Similar to the Nevada Power Corporation case referenced by Pous, he has not provided the demolition cost details and scope associated with this project. Therefore, at this point in time, it is impossible for me to make an assessment of the reason that the contractor would have paid for the right to demolish the King generating plant. Again there are numerous potential reasons that the contractor would have paid for the right to demolish the King generating plant that may not apply to the PEF facilities. Plants vary in the level of costs required for demolition and site remediation and vary in the level of scrap metal and salvageable equipment. The only thing I do know about the King generating plant is that, according to Pous, scrap metal prices were at an all-time high when the plant was dismantled. (Testimony at p. 78) In any event, details of this project would

need to be reviewed to determine if this project is comparable to any of the PEF facilities prior to relying on the King generating plant to draw any conclusions about the PEF facilities.

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Q: Pous takes the King generating plant example and concludes that the Company's method for estimating costs for fossil dismantlement is neither accurate or economically efficient. Do you agree?

A: No. In fact, the scrap metal prices B&McD used in the dismantlement study are quite high and were near their all time highs. B&McD elected to use these values because they were accurate prices at the time of the study, and would result in conservatively low net retirement cost estimates. Contrary to Pous's statement, the theory used in the dismantlement study uses an economically efficient theory of dismantling the facilities at a time of high scrap metal prices.

Q: Yes, but Pous states that the scrap metal market will experience high prices once the economies of China and India begin to grow at substantial rates. Do you agree?

A: Yes. I agree the scrap metal market will experience and increase in prices over the current market pricing, however, it is very speculative to think that they will rise above the rates reflected in the B&McD study anytime in the near future. Again, the B&McD study was completed during a period of very high scrap metal prices. If the study was completed today using the current, lower scrap metal prices, the cost to dismantle would be higher than what the Company is currently proposing.

Q: Pous claims that there is an error in B&McD's calculation in labor costs. Do you agree that an error was made in the calculation?

A: No. I don't agree that there was an error made in the calculation. There was, however, an error in a previous discovery response regarding the calculation of labor costs. In response to Florida's Office of Public Council OPC's Fifth Interrogatories No. 189, we incorrectly stated that the study used an average of local union wage rates and the pay scales listed in the 2008 RS Means Heavy Construction Cost Data, 22nd Annual Edition ("RS Means book"). While B&McD reviewed the pay scales listed in the RS Means book, B&McD decided to utilize only the local union wage rates in the study. The local union wage rates more accurately represent the cost of the local workforce that would perform the work, as compared to the pay scales listed in a national publication such at the RS Means book. This assumption was consistent with the previous studies performed by S&L.

Q: Do you agree with Pous's recommendation that a 60% reduction be applied to the Company's request in this proceeding?

A: No. Pous's 60% reduction is based on the Nevada Power demolition example he provides as one example of how a demolition methodology resulted in lower costs than a "reverse construction" methodology. (Testimony at p. 80). Arbitrarily applying a 60% cost reduction based on a single case from a state on the other side of the country is unreasonable. As I explain above, there are numerous reasons that the cost estimate prepared by the engineering firm on behalf of Nevada Power could have varied so much from the actual demolition costs. It is unreasonable to assume that these same factors,

that lead to the actual price being lower than the estimated price in Nevada Power's case, would all apply to PEF's case. Pous's proposed reduction is arbitrary and not based on any real analysis of PEF's specific generation fleet. By contrast, in preparing the B&McD study, I personally reviewed each of the Company's units and developed detailed cost estimates based on the specific and unique characteristics of those units. The cost estimates provided in the B&McD study are reasonable and supported by actual analysis. Therefore the Company's requested costs for dismantling its fossil generating units should be approved in their entirety.

Q: Does this conclude your testimony?

A.: Yes.

BY MS. TRIPLETT:

Q Mr. Kopp, do you have a summary of your prefiled rebuttal testimony?

A Yes, I do.

Q Would you please summarize your testimony for the Commission?

A I will.

Good morning, Commissioners. My name is Jeff Kopp, and I'm employed by Burns & McDonnell Engineering Company. I'm an engineer in the Project Development Department of the Business and Technology Services Division of the company.

The purpose of my rebuttal testimony is to address PEF's dismantlement study prepared by Burns & McDonnell and respond to issues raised by OPC Witness Pous regarding the terminal net salvage value calculated in the study.

Mr. Pous claims that the fossil dismantlement study does not justify PEF's request for terminal net salvage. He first claims that there are various options associated with the final retirement of the generating facilities under utility regulations that he claims are available to PEF, including selling the units. However, these are not viable options, given subsection (2)(c) of Rule 25-6.04364 of the Florida Administrative Code,

which states that the basis for the dismantlement cost should be physical removal of the facilities, not for resale.

Mr. Pous also states that the company has elected to charge customers for returning the sites to a greenfield condition. This statement is not true. The dismantlement study is not based on restoring the site to a greenfield condition. Burns & McDonnell have assumed only that the facilities and equipment located two feet below grade and above will be removed. All underground piping, foundations and et cetera, located greater than two feet below grade will be abandoned in place. This is consistent with Rule 25-6.04364.

Mr. Pous also states that PEF's approach to dismantlement is reverse construction, meaning that each piece of the facility is dismantled piece by piece as compared to an explosive blast. In reality, a combination of demolition techniques will likely be required to dismantle the facilities in a safe and effective manner consistent with Rule 25-6.04364(2)(b).

In summary, Mr. Pous's proposed reduction is arbitrary and not based on any real analysis of PEF's specific generation fleet. The cost estimates provided in the Burns & McDonnell study are reasonable and supported by actual analysis. Therefore, PEF's

requested cost for dismantling its fossil fuel generating units should be approved in their entirety.

This concludes my summary. I'm prepared to answer any questions you may have.

MS. TRIPLETT: We tender Mr. Kopp for cross-examination.

CHAIRMAN CARTER: Thank you.

Mr. Rehwinkel, you're recognized.

MR. REHWINKEL: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q Good morning. My name is Charles Rehwinkel, I'm with the Office of Public Counsel, and I wanted to ask you a few questions about your rebuttal of Mr. Pous.

Can I get you to turn to page 9 of your rebuttal testimony? We will skip page 3.

Now, in this part of your testimony, beginning on line 12, carrying forward through to the next page --

A Yes.

Q -- your criticism of Mr. Pous regarding the Nevada situation is that he doesn't provide the Nevada cost estimates or the actual demolition cost and scope, is that correct?

A Yes.

Q Now, can you tell me why you would need that

information?

A Yes. In order to analyze why there was a difference between the estimate and the actual demolition cost, I would need to see the basis of both of those documents to see that the scopes were the same between the two documents, to see when both of those were performed, to see if there were changes in major assumptions during that time period, such as scrap value, which can have a large impact on the cost estimates, and to see if the actual demolition performed was the same as the estimate as far as removing all of the equipment that was included in the estimate.

Q Okay. So your testimony here today is not that what Mr. Pous is testifying about is wrong, your testimony is that you cannot verify that it's applicable to PEF's dismantlement estimates, correct?

A I would say that my testimony is that I cannot state that this Nevada case is comparable to PEF's case, and therefore this reduction in cost does not necessarily translate to PEF's case.

Q So is it true that you could have, with some level of expense and effort, done your own investigation and looked into this Nevada situation?

A Not necessarily, no. If those are not publicly available documents, if that was -- if those

estimates were prepared internally and were not subject to public availability, then, no I could not have reviewed those.

Q But if they were, it would have taken some effort and cost on your or your firm's part to make those comparable analyses?

A I don't know. That was not requested of me.

Q Okay. But it's your testimony that it would have been helpful to make the comparability analysis if you had had all the detail that you list, or at least all the detail that you list on pages 9 and 10, correct?

A My testimony is that without that detail I cannot compare the two cases. So yes, that detail, seeing both the cost estimate and the demolition contract and cost, would be required for me to make that comparison.

Q So what you're saying is that just Mr. Pous saying it and putting it on a piece of paper was not sufficient for you to make the correct comparability analysis, is that correct?

A Yes, I would say that, yeah, Mr. Pous just giving me this simple bit of information, that the cost estimate versus the actual cost were different, is not enough for me to make a comparison between this specific generating facility and PEF's specific generating

facilities.

Q Okay, thank you.

Can I ask you to turn to page 12 of your rebuttal testimony, and once you're there, direct you to lines 12 through the end of that page, onto page 13, lines 1 through 3, and ask you, are you familiar with the Q&A here?

A Yes.

Q Okay. So the issue here is relating to Mr. Pous's testimony about the demolition of the King generating plant in -- I think it's in St. Lucie, Florida, is that right?

A I don't know the location.

Q Okay. So -- I apologize. Your testimony here is that, I think it's on lines 14 through 15, is that Mr. Pous has not provided demolition cost details and scope associated with this project, is that correct?

A Yes.

Q And that lack of detail is analogous to the concern that you raise with respect to the Nevada case, is that correct?

A Yes, that's correct. In order to evaluate a cost estimate, we would need to see a scope supporting that cost.

Q Now, your testimony is not that what Mr. Pous

testifies to is incorrect, it's just that you can't verify that, is that correct?

A I would say my testimony is that there is not a sufficient level of detail provided for us to compare this specific case to any of PEF's specific generating facilities.

Q And what you think Mr. Pous should have done was to provide that level of detail in order to sustain his contention about the demolition costs or demolition methodologies that might be available to PEF, is that right?

A Again, I would just say that in order to evaluate this cost of this particular generating facility, the scope of that cost estimate would need to be provided.

Q And part of the reason that you state that is, I think as reflected on lines 17 through 21, is that there are different factors that apply to different plants with respect to the demolition activities and the level of effort and cost that's required to demolish and remediate that site, is that right?

A Yeah. Essentially -- yes, what I'm saying there is that, you know, there are very site-specific issues as well as contractor-specific issues to their scope and what exactly they're doing to remove that

facility.

Q And what you would have liked to have seen in order to make that comparison between this King generating plant and PEF's situations is those site-specific factors, is that right?

A I would need to see -- yes, I would need to see details of the facility and the scope of the demolition estimate.

Q Okay, thank you, Mr. Kopp.

MR. REHWINKEL: Those are all the questions I have.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Mr. Moyle?

MR. MOYLE: I have a few.

CROSS EXAMINATION

BY MR. MOYLE:

Q Good morning. I'm Jon Moyle, I represent FIPUG, and I just want to follow up briefly on a couple of things.

If you assumed that the King plant and the one in Nevada that Mr. Pous relied on, if you assume that they do have similar characteristics to Progress Energy -- are you with me?

A I'm with you, yes.

Q Okay, because you don't know whether it does

or it doesn't, correct?

A Definitely not, no, I do not.

Q Okay, so assume it does. Wouldn't it logically follow that if you make that assumption, then Mr. Pous's recommendation of a 60 percent reduction should be followed?

A I think that's a pretty broad jump to assume that these facilities are similar, as well as the scope of the demolition.

Q But just for the purposes of the question, assume that they are. Logically, doesn't it follow, then, if you assume that they are, that his recommendation of a 60 percent reduction in the cost is a sound recommendation?

A No, I would not agree with that statement, because we have done -- our firm did a detailed review of each of these facilities owned by PEF, we did a review of cost to do the demolition, as well as the current scrap metal values, to come up with the net project cost, and that analysis is far superior to comparing another plant in a completely separate state.

Q You have a Master's in business from Kansas, is that right?

A Yes.

Q Okay. Do you recall from any of your

education with respect to business how a company comes up with a contingency amount for budgeting purposes?

A No, I do not recall. But I guess if your question is about how contingency is developed for this cost estimate, this is a cost estimate contingency rather than a budgeting contingency for a company, so I'm not sure if that's what you're getting at.

Q Is there a difference?

A Again, I'm not -- I'm not familiar with the budgeting contingency for a company. I prepared a cost estimate contingency based on our cost estimator's typical numbers that they use and their methodology.

Q Do you have any familiarity with construction cost estimating?

A Yes.

Q And isn't it true that oftentimes in construction cost estimating, a contingency factor of ten percent is used?

A I would say that the contingency percentage is based on the cost estimator's best judgment of the unknowns for that particular cost, and it would be for the -- it would be specific to that cost estimate. So I wouldn't say ten percent is a typical number.

Q But you have seen it used, correct?

A I have seen several different numbers used for

different projects, yes.

Q Including ten percent?

A Yes.

Q And the number you use in this is a 20 percent contingency, isn't that right?

A Yes.

Q I mean, these -- usually contingencies are developed because there's a lot of uncertainties and a lot of risk, isn't that -- you know, if you have a high contingency, isn't that true?

A Contingencies are to cover unknowns of what will occur when you actually perform the project versus what you assume in the cost estimate, yes.

Q And with respect to demolition, with respect to a construction project, typically demolition, there's not as many moving parts, there's not as many variables as there is, then, as compared to vertical construction, correct?

A I don't think I would agree with that statement that there's -- I guess as far as less unknowns, no. I think when you're dealing with a demolition project where you've got a facility that's been installed for 30-plus years by the time it's retired, operating with fossil fuels, there are a lot of unknowns as far as facilities of this vintage. That

could be underground contamination or things that you may run into in the process of demolishing and restoring a site. So I would say there are more unknowns with a demolition project of a fossil fuel plant.

Q What did you assume for the purposes of your study with respect to environmental conditions? You just mentioned possible contamination. Did you assume contamination when you put your numbers together?

A Any known contamination we included a cost for. Contingency would cover any unknowns, including unknown contamination.

Q But as we sit here today, you don't have any reason to know or suspect that any of these sites have contamination, correct, that were part of your study?

A Again, there were -- there's some known contamination as far as asbestos that we're remediating. So anything that we know about is included directly in the direct cost, and any unknowns that are not known would be in the contingency.

Q Okay. So you didn't -- with respect to subsurface conditions, you didn't make any assumptions or you don't have any information about contamination?

A I can't cite any specific examples, but I do know that we discussed with all plant managers at our site visits any history of spills that they knew of, and

in areas where there were known spills, we would have included a cost for cleanup in that area.

Q Now, Mr. Pous suggests that it might be better for ratepayers if these plants, rather than knocked down and salvaged, if they were resold, correct?

A He does suggest that, but as I stated in my summary, our estimate is based on complying with the Florida Administrative Code 25-6.04364, which clearly states that, "Dismantlement costs are for the ultimate physical removal and disposal of the plant and site restoration minus any attendant gross salvage amount upon final retirement of the site or unit from service." That's the basis of our study.

Q Okay. Are you familiar that there is a process in Florida law to request a rule waiver?

A No. I'm not an attorney.

Q Okay. Well, just assume -- assume that there is, and I just want to have a brief discussion on the notion of selling a plant versus knocking it down and selling the scrap.

I think you indicated, or you would agree that the sale of a plant is a better option for ratepayers to the extent that there can be value received for a plant, correct, assuming it could operate? And I think you even suggest in some other jurisdictions that's been

done, correct?

A I'm not sure if I suggested that or if that was Mr. Pous, but I guess if the question is is it less costly to sell a plant than to tear it down, then yes, it's less costly to sell one.

Q And with respect to the reference about that being done in other jurisdictions, are you aware of that?

A I'm aware that plants have been sold. I don't know that those plants have been sold at the end of a useful life. The plants that I have seen sold were more distressed assets that were in bankruptcy. So I -- again, the basis of our study is the end of the useful life when Progress finds that these facilities are no longer economically viable to operate. So I think that if you're assuming that somebody else would find them economically viable to operate and then sell them, that's very speculative.

Q Okay, and assume that to be the case. You would agree, would you not, if that were the case, that that would be a better road to travel as compared to salvaging the plant, correct?

A Again, I think that's very speculative, but if that option was available at the time, certainly it's more cost-effective to sell a plant than to tear one

down, but again, I think it's very speculative to assume that's even an option.

Q Okay. And you speculated in your testimony, did you not, I mean, you speculated with respect to the Nevada plant that there might be all kinds of things out there that make it dissimilar as compared to Progress, correct?

A No, I would not agree with that statement. I would say I stated what I did not know. I did not speculate on anything of what the facility was or was not. I simply stated that there were a lot of unknowns that I would need to be aware of in order to compare that facility to the PEF facilities.

Q On page 9, lines -- starting on line 16, when you were asked about the Nevada plant --

A I'm sorry, page 9?

Q Page 9, line 16, you say, quote, "However, in B & McD's experience, there are a variety of reasons that the demolition" -- I mean, "that the demolition cost from demolition contractors could have come in at a much lower cost than the original estimates," and then you go on and list some possibilities about what may have occurred, correct?

A No. I think if you read that, what I'm listing is Burns & McDonnell's experience with other

facilities.

Q But you're referencing it with respect to the Nevada situation, correct?

A I'm referencing the Nevada situation to list potential areas. I'm not speculating on whether or not any of those issues are true about the Nevada facility. I'm simply stating that in Burns & McDonnell's experience with other generating facilities, we have seen demolition costs from other demolition contractors come in differently because of these reasons.

Q So you're not telling this Commission or suggesting to the Commission that any of the reasons that you have identified could apply to the Nevada situation, is that correct?

A I'm not saying that they do or they do not. They could; I don't know. I think that's what I'm -- my testimony is that I don't have enough information about this Nevada facility and the cost estimate and the scope to state why the costs were different.

Q You have kind of said here are some possibilities and maybe one of them applies or maybe it doesn't, is that right?

A I'm saying here are some examples that we have seen on other projects. These could or could not -- without any additional detail on these specific

projects, I can't state whether or not these factors apply to this case.

Q For the purposes of your study, what level of condition -- there's a question about greenfield status on page 5 --

CHAIRMAN CARTER: Mr. Moyle, let me just ask you for -- you're getting ready to go into another line?

MR. MOYLE: Yes, sir.

CHAIRMAN CARTER: It's been two and a half hours. We'll come back -- let's come back at ten after, and we will go on and be on our regular lunch schedule.

(Brief recess.)

CHAIRMAN CARTER: We are back on the record, and when we last left, Mr. Rehwinkel, you were on cross-examination. You're recognized, sir.

MR. REHWINKEL: I've concluded with Mr. Kopp.

CHAIRMAN CARTER: It's Mr. Moyle. I should have brought my notes back. Mr. Moyle, you're recognized, sir.

MR. MOYLE: Thank you. I was just getting ready to have a discussion with the witness about the greenfield condition.

BY MR. MOYLE:

Q And you reference that on page 5 of your testimony. And you also reference the Florida

Administrative Code that says the site should be restored to a, quote, "marketable or usable condition." Do you see that?

A Yes.

Q And with respect to the purposes of your analysis, what level of remediation, if any, did you assume would need to take place to restore the site to a marketable or usable condition?

A Basically everything two foot below grade or above would be removed. Any contamination, if there were any, would be cleaned up. The site would be graded to achieve proper drainage, and it would be seeded and restored to vegetated green space.

Q What was your targeted soil conditions, was it residential conditions or no, in terms of the cleanup?

A I didn't have a targeted soil condition other than bringing in topsoil to support vegetation.

Q You're familiar with the distinction between various soil levels, brownfields, greenfields, DEP has different conditions with respect to soil conditions, are you aware of that?

A I'm not aware of those conditions, no, sir.

MR. MOYLE: That's all I have. Thank you.

CHAIRMAN CARTER: Thank you, Mr. Moyle.

Mr. Wright?

MR. WRIGHT: No questions, Mr. Chairman.

CHAIRMAN CARTER: Staff?

MR. YOUNG: No questions, Mr. Chairman.

CHAIRMAN CARTER: Commissioners?

Redirect?

MS. TRIPLETT: No redirect and no exhibits.

CHAIRMAN CARTER: And no exhibits, okay. Anything further for this witness?

You may be excused.

Call your next witness.

MR. WALLS: Progress Energy calls Mr. Garrett.

CHAIRMAN CARTER: You may proceed.

Whereupon,

WILL GARRETT

was called as a witness on behalf of Progress Energy Florida and, having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. WALLS:

Q Would you please introduce yourself to the Commission and provide your business address?

A Yes, my name is Will Garrett. I'm the comptroller at Progress Energy Florida. My business address is 299 First Avenue North, and that's in St. Petersburg, Florida.

Q And you were sworn as a witness this morning, correct?

A Yes, I was.

Q Have you filed -- prefiled rebuttal testimony and exhibits in this proceeding?

A Yes, I have.

Q Do you have your prefiled rebuttal testimony and exhibits with you?

A I do.

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

A Yes, I do, some minor typographical corrections.

First, on page 15, line 20 --

CHAIRMAN CARTER: Hang on one second. Just hold on for a second, give me a minute here.

THE WITNESS: Sure.

CHAIRMAN CARTER: Would you start over with your corrections there?

THE WITNESS: Yes.

On page 15 of my rebuttal testimony, line 20, about the middle part of that sentence, it should read "2009," not "2005." In other words, that's the current depreciation study, not the prior year's, or the previous study. It's the current study as filed.

Next, on page 22, on line 23, the reference to that exhibit is incorrect, it should be "WG/2." [sic] Again, that's line 23 on page 22. That should be "WG-3."

Again, another exhibit reference correction on page 28, line 13, the reference to those FERC orders is "WG-4," not "WG-3." Again, that's "WG-4."

And lastly, if you would turn to Exhibit WG-2, there are a number of headings here on that exhibit, page 1 of 1. Under "Prior Study," instead of "average service life," that should read "service life," so strike the word "average." And also, going to the right, under "Current Study," the same correction should be made, it should be "service life," not "average service life." And to the far right, that should be an increase, decrease, and again, "service life," strike the word "average." And those are all my corrections.

BY MR. WALLS:

Q And Mr. Garrett, if I ask you the same questions in your prefiled rebuttal testimony today with those corrections, would you give me the same answers?

A Yes, I would.

MR. WALLS: We request that Mr. Garrett's prefiled rebuttal testimony be entered into the record as though read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

MR. MOYLE: Mr. Chairman, just one point?

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: He spends a lot of time talking about FERC and FERC orders and here's what I think FERC said, and I don't really think that's appropriate. The FERC orders speak for themselves and can be referenced by the parties. I don't really think it's proper for this witness to be testifying as to what FERC's view is. FERC operates based on rules and orders, and his section of his testimony talking about FERC policy I think ought to come out.

CHAIRMAN CARTER: Let's cross that bridge when we get to it.

MR. MOYLE: I just understood when, in the prehearing order, it says that when they move to put the testimony in, that's the time to register an objection, so --

CHAIRMAN CARTER: Interesting. Ms. Brubaker?

MS. BRUBAKER: I'm trying to remember exactly what the OEP says. I think we can certainly address it at this time.

Mr. Moyle, could you identify for us the

specific pages and line numbers?

MR. MOYLE: Sure. It starts on page 28 and he goes on for a couple of pages there through 29, down to line 13, talking about FERC policy.

MS. BRUBAKER: Mr. Chairman, I'll be happy to offer my thoughts on this if you'd like, or would you like to hear from the parties first?

CHAIRMAN CARTER: Yes, let's do that. I have heard from Mr. Moyle. Let me hear from Mr. Walls.

MR. WALLS: Well, first I would say that according to the OEP, motions to strike any portion of prefiled testimony and related portions of exhibits shall be made in writing no later than the prehearing conference. That was not done with respect to this testimony, so I believe it's waived.

Second, Mr. Garrett is referring to these FERC as a matter of what policy supports his view of the Commission's policy, and that's certainly relevant for him to take into account, as a witness and the comptroller of the company, what he would look around to support the policy that this Commission should follow. And certainly what FERC does is applicable to that, just as they have relied on Commission orders in this jurisdiction and other jurisdictions and in numerous of their testimonies, so I see no real difference there.

MR. MOYLE: Just briefly, his point is a valid one with respect to what they believe, but with respect to testimony that says here's what FERC does, here's FERC's policy, that's kind of the point that I'm trying to make. Evidence by a witness as to what FERC does should not be the basis for any finding.

MR. WALLS: I believe the Commission is quite capable to read the FERC orders that are provided and draw its own conclusions.

CHAIRMAN CARTER: Ms. Brubaker?

MS. BRUBAKER: First of all, I'll start, thanks to my ready and able counsel, I can now read for you from the OEP, that, "Motions to strike any portion of the prefiled testimony and related portions of exhibits of any witness shall be made in writing no later than the prehearing conference." I note that while we did strike some testimony earlier in this proceeding, that was by agreement of the parties. So it does appear that the request to strike the testimony is untimely.

I do agree that -- to me, the witness is speaking to his understanding of FERC policy and FERC orders. I think we're all capable of reading those orders, and -- and stating what our understanding of that policy is. To the extent that Mr. Moyle disagrees

with the witness's conclusions as to that policy, he certainly has the opportunity to address that either through cross-examination or in his briefs.

CHAIRMAN CARTER: Overruled. You may proceed.

BY MR. WALLS:

Q Mr. Garrett, I believe you were going to provide your summary?

A Yes.

Good morning, Commissioners. As PEF's comptroller, I report directly to the Progress Energy chief accounting officer with direct responsibility for all accounting matters impacting PEF. I have over 24 years of public and private accounting experience, serving regulated investor-owned utilities as a CPA.

My rebuttal testimony addresses the proposals of FIPUG and OPC to lower actual accumulated depreciation reserves by up to $646 million. It's my testimony that these proposals have no foundation in generally accepted accounting principles followed by enterprises in general, and it's a well-accepted fact that changes in depreciation estimates are to be recognized in financial statements on a prospective basis and not through the retroactive restatement of prior period results.

To lower actual depreciation reserves through

an arbitrary reduction in current period depreciation expense is a restatement of prior period results. It's clear in accounting guidance that changes in depreciation estimates are to be recognized over the remaining life of the assets in question. I have provided a number of FERC and Florida Public Service Commission orders that support that this accounting principle has been adopted consistently in regulatory proceedings.

From a cost-of-service perspective, I recognize that the Commission has considerable discretion in setting depreciation levels. Depreciation is a significant expense, as it is the means by which PEF recovers the historical investment and future net salvage of our property.

As I indicate in my rebuttal testimony, $472 million of the $645 million reserve variance, or 73 percent, is largely attributed to production assets due to life extensions, particularly at our Crystal River nuclear power plant. The change in future service lives are based on additional company investments in these assets and our operating experience with these plants. The recovery of both these additional and historical investments is best accomplished using average remaining life methodology for depreciation approved by this

Commission, which treats current customers and future customers fairly and equitably, as customers pay only the remaining net book value and future net salvage of our property based on the best available estimates at the time depreciation rates are updated. The recognition of these changes and estimates over any period short of the remaining useful lives of the existing assets would be arbitrary and unfounded and will produce an unsustainable windfall for current customers, in that they will pay lower costs for the use of these assets than future customers.

Under OPC's proposal, actual accumulated depreciation reserves would be reduced by 646 million. With the expiration of the annual depreciation reduction of approximately $162 million, this will put upward pressure on rates to future customers of approximately $259 million.

In comparison, PEF's proposed cost of service reflects the full benefit of a rate base reduction for the historic recovery of property investments reflected in actual accumulated depreciation reserves. Furthermore, these reserves reduce future depreciation expense levels, resulting in overall current benefit to customers of $127 million.

This concludes my summary comments.

MR. WALLS: Ms. Triplett reminded me I'm not sure we got a ruling on the entry of his rebuttal testimony in the record --

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

In re: Petition for rate increase by Progress Energy Florida, Inc.
Docket No. 090079-EI

REBUTTAL TESTIMONY OF WILL GARRETT

I. INTRODUCTION AND SUMMARY.

Q. Please state your name and business address.

A. My name is Will Garrett. My business address is 299 First Avenue North, St. Petersburg, FL 33701.

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

A. I am employed by Progress Energy Service Company, LLC as Controller of Progress Energy Florida, Inc. ("PEF" or "the Company").

Q. What are your responsibilities in that position?

A. As legal entity Controller for PEF, I am responsible for all accounting matters that impact the reported financial results of this Progress Energy entity. I have direct management and oversight of the employees involved in PEF Regulatory Accounting, Property Plant and Materials Accounting, and PEF Financial Reporting and General Accounting. In this capacity, I am also responsible for the retention of AUS Consultants and Mr. Earl Robinson to prepare the Depreciation Study for the Company that was filed with the Florida Public Service Commission ("FPSC" or the "Commission") in this docket with Mr. Robinson's direct testimony.

Q. Please describe your educational background and professional experience.

A. I joined the company as Controller of PEF on November 7, 2005. My direct relevant experience includes 2 ½ years as the Corporate Controller for DPL, Inc. and its major subsidiary, Dayton Power and Light, headquartered in Dayton, Ohio. Prior to this position, I held a number of finance and accounting positions for 8 years at Niagara Mohawk Power Corporation, Inc. (NMPC) in Syracuse, New York, including Executive Director of Financial Operations, Director of Finance and Assistant Controller. As the Director of Finance and Assistant Controller, my responsibilities included regulatory proceedings, rates, and financial planning, having provided testimony on a variety of matters before the New York Public Service Commission. Prior to joining NMPC, I was a Senior Audit Manager at Price Waterhouse (PW) in upstate New York, with 10 years of direct experience with investor owned utilities and publicly traded companies. I am a graduate of the State University of New York in Binghamton, with a Bachelor of Science in Accounting and I am a Certified Public Accountant in the State of New York.

Q. Have you previously filed testimony before the Commission in this proceeding?

A. No.

Q. What intervenor testimony are you addressing in your rebuttal testimony?

A. I have read and I am addressing in my rebuttal testimony the direct testimony of Mr. Jacob Pous and Mr. Daniel Lawton filed on behalf of the Office of Public Counsel

("OPC") and the direct testimony of Mr. Jeffry Pollock filed on behalf of the Florida Industrial Power Users Group ("FIPUG").

Q. What is the purpose of your rebuttal testimony?

A. I address the recommendation by intervenor witnesses Mr. Pous, Mr. Lawton, and Mr. Pollock that the calculated hypothetical variance of about $646 million between the Company's book depreciation reserve and the theoretical depreciation "reserve" in the Company's Depreciation Study should be paid to customers in the form of an annual reduction in depreciation expense over a period of time. This recommendation rests on the characterizations by these witnesses that this variance represents an "excessive" or "surplus" reserve that means PEF has over-collected and PEF customers have overpaid depreciation expense. They also argue the Commission has a long-standing policy of returning such "excessive" reserves to customers. (see, e.g., Pous Test., p. 16, L. 14 and L. 24-25).

Simply put, these characterizations and arguments are not true. The theoretical depreciation "reserve" is a calculated reserve, not a real depreciation reserve, and the variance between the theoretical and book depreciation reserves under this calculation does not mean PEF customers have paid more than they should have paid. Their recommendation also is contrary to the industry-standard, average remaining life method, which addresses reserve variances by adjusting rates over the remaining asset lives. The Commission's long-standing policy is in fact to apply the average remaining life methodology to resolve reserve variances. Their recommendation also ignores the benefits customers have already received from the changing depreciation

estimates that are reflected in the calculated reserve variance and the costs customers will incur if their recommendation is accepted. Finally, their recommendation is contrary to the Federal Energy Regulatory Commission ("FERC") depreciation accounting under the Uniform System of Accounts, which are adopted by rule in Florida, and Generally Accepted Accounting Principles ("GAAP"). For all these reasons, as more fully explained below, this recommendation must be rejected.

Q. Do you have any exhibits to your rebuttal testimony?

A. Yes. I have prepared or supervised the preparation of the following exhibits:

- Exhibit No. ___ (WG-1), explanation chart of theoretical to book depreciation reserve variance;
- Exhibit No. _____(WG-2), PEF chart of production plant terminal dates;
- Exhibit No. ___ (WG-3), a composite exhibit of the Commission orders cited by the intervenor witnesses and other Commission depreciation orders I cite;
- Exhibit No. ___ (WG-4), a composite exhibit of decisions by the Federal Energy Regulatory Commission ("FERC") regarding depreciation principles;
- Exhibit No. ___ (WG-5), PEF's response to OPC Interrogatory No. 56; and
- Exhibit No. ___ (WG-6), revenue requirement impact of intervenors proposed amortization.

These exhibits are true and accurate.

Q. Please summarize your rebuttal testimony?

A. The following is a summary of my testimony:

- The existence of theoretical reserves for accumulated depreciation in excess of book reserves, i.e. a theoretical "surplus," should be addressed through the established and long standing depreciation policy of the Commission by consistent application of the remaining life depreciation method.
- The proposed accelerated reduction to actual accumulated book depreciation reserves to refund alleged "surpluses" by intervenors does not fully reflect the implications of such a proposal and ignores future rate implications.
- The retroactive application and adjustment to book accumulated depreciation reserves to reflect current depreciation estimates is not supported by Generally Accepted Accounting Principles.

DEPRECIATION RESERVE ISSUE

Q. Did the Company file a Depreciation Study with the Commission in this proceeding?

A. Yes. Pursuant to Rule 25-6.0436(8)(a), F.A.C., the Company is required to prepare and file a Depreciation Study with the Commission every four (4) years. The Company last prepared and filed with the Commission a Depreciation Study in 2005 as part of the Company's base rate proceeding at that time. Pursuant to Section 11b of the Stipulation and Settlement of the Company's 2005 base rate proceeding, which was approved by the Commission in Order No. PSC-05-0945-S-EI, the Company further agreed to update its Depreciation Study on or before July 31, 2009.

The Company retained Mr. Earl Robinson with AUS Consultants to prepare its 2005 Depreciation Study and its 2009 Depreciation Study. As indicated in Mr. Robinson's direct testimony in this proceeding, AUS Consultants is a consulting firm specializing in preparing depreciation studies and other financial studies for the utility industry. Mr. Robinson is a Certified Depreciation Profession, a founding member and past President of the Society of Depreciation Professionals, and has over forty (40) years experience in the utility industry, including depreciation analyses. Mr. Robinson is also providing rebuttal testimony in this proceeding.

The Company's 2009 Depreciation Study was prepared based on the Company's continuing property records ("CPR") through the end of December 2007 with pro forma adjustments to account for the changes in the Company's depreciable assets through 2009. The Company's Depreciation Study employed the Straight Line Method, Broad Group procedure, and Average Remaining Life technique to determine the appropriate depreciation rate for the depreciable asset property groups over the remaining lives of those assets in order to determine the depreciation expense necessary for the Company to recover its capital investment in the property used and useful for electric service to its customers. As Mr. Robinson explained, the Straight Line Method, Broad Group procedure, and Average Remaining Life Technique used in the Company's 2009 Depreciation Study are the most widely used depreciation method, procedure, and technique in the utility industry.

Q. Do any of the intervenor witnesses claim that a different depreciation method, procedure, or technique should have been used by the Company?

A. No, they do not. Mr. Lawton does not address the Company's depreciation methods, procedures, or techniques at all. Mr. Pous agrees that the straight-line method is normally employed for utility depreciation proceedings (Pous Test., p. 26, L. 2-3), the average life group procedure is used by the vast majority of utilities (Id., at L. 8-9), and that most utilities rely on a remaining life technique in utility rate matters (Id. at L. 21-22). Mr. Pollock apparently agrees too, going so far as to note that the remaining life technique for determining depreciation rates is prescribed by the Commission rule. (Pollock Test., p. 41, L. 18-21). Mr. Pous and Mr. Pollock challenge only the application of the average remaining life technique to the calculated depreciation reserve variance and Mr. Pous challenges the application of that depreciation technique to some but not all Company FERC account property groups. Mr. Robinson and I will address Mr. Pous' and Mr. Pollock's recommendation with respect to the calculated depreciation reserve variance and Mr. Robinson will address Mr. Pous' recommendations with respect to some but not all of the Company's FERC property accounts. Mr. Crisp will also address Mr. Pous' and Mr. Pollock's claims that certain generation assets should have longer lives than the Company proposes in its depreciation study.

Q. What is the intervenor witnesses' recommendation that you are addressing in your rebuttal testimony?

A. Mr. Pous recommends that the Company's calculated hypothetical variance of approximately $646 million, that appears in its 2009 Depreciation Study at Exhibit No. ___ (EMR-2), Table 5F-Future (Pro Forma), at pages 2-74 to 2-79, be amortized over

four years, reducing depreciation expense, according to his calculations, by $161 million a year over that four-year period of time. (Pous Test. P. 14, L. 19-20). Mr. Pollock does not go that far, arguing that $100 million of the claimed "surplus" reserve should be amortized annually for three (3) years. (Pollock Test., p. 49, L. 1-9). Properly understood, then, Mr. Pous and Mr. Pollock want to return to current customers between $300 million and $646 million in depreciation expense collected over the time these depreciable assets have been in service from prior and current customers under depreciation rates ***previously approved by this Commission***. This recommendation is contrary to the very same depreciation methods they recognize are industry standards, contrary to regulatory ratemaking principles and prior Commission policy, and contrary to accepted utility accounting standards.

Q. Do the intervenor witnesses give any reasons for recommending such a departure from industry and regulatory practice and standards?

A. Yes, they do, but their "reasons" are built on a false premise that (1) directly challenges this Commission's prior orders determining fair, just, and reasonable rates, including depreciation rates, and (2) fails to account for the reasons for the variance in the first place and any resulting benefit to customers. The intervenor witnesses assume the variance between the depreciation book reserve and the calculated theoretical reserve represents an "excess" or "surplus" reserve. Based on that faulty assumption they make several highly charged accusations, that PEF has "collected more than is needed," customers have "over paid" or "paid a disproportionate share," and that PEF's rates are "neither fair nor equitable," resulting in claimed intergenerational inequities. (See, e.g.

Pous Test., p. 30, L. 15-16; Pollock, p. 43, L. 10-11). They then spend their time explaining how their recommendations are supposed to work and repeatedly saying that a reduction in depreciation expense of $300 million to $646 million does not harm the Company or customers. Other than the mere citation to Commission orders they claim support their recommendation (see Pous Test., pp. 32-33), and Mr. Lawton's unsupported statement that this recommendation is consistent with GAAP (see Lawton Test., p. 14, L. 12-13), they offer no analysis whatsoever of the reasons for the variance between the calculated theoretical reserve and book depreciation reserve, the Commission orders they cite, or regulatory ratemaking and accounting principles.

Q: Please explain the concept of a theoretical reserve.

A: The theoretical depreciation reserve is a calculated, hypothetical "reserve" that is measured once every four years in the utility's depreciation study under the Commission rule. See Rule 25-6.0436(1)(k) and (6)(d), F.A.C. This mathematical calculation compares the Company's accumulated book reserve under prior and current approved depreciation rates to the "prospective" theoretical reserve "based on proposed rates." (Id.). Because the book depreciation reserve represents prior and current rates, and the theoretical reserve is based on proposed rates for the future when, of course, rates are set, the only way to perform this mathematical calculation is to assume that the "proposed" rates have always been in effect. Mr. Pous agrees, acknowledging that the calculation of the theoretical reserve calculates the reserve at a point in time "if current depreciation parameters (i.e., current life and salvage estimates) had been applied from the outset." (Pous Test., p. 30, L. 7-11) (emphasis supplied). This assumption, of

course, is not true, but it is the only way to mathematically perform the comparison of a prior period to the prospective period that the mathematical comparison of the book to theoretical depreciation reserve requires.

Q. Is there in fact a depreciation reserve "surplus?"

A. No, there is not. There is no actual cash surplus in an account for the Company's depreciation reserve. The depreciation reserve is an accounting function that reduces rate base to reflect the cumulative wear and tear experienced by the investment that has been dedicated to providing customer electrical service. The money received from customers, which includes the recognition of the utilization of investments as used and useful assets recovered through depreciation expense, is cash-flow available to be used by the Company to replace and repair consumed Electric Plant in Service, build new power plants, substations, and lines, pay employees, and pay all other expenses of providing customers with quality electric service. These accumulated book reserves are not funded liabilities that are supported by readily convertible to cash investments. A material reduction to these reserves reflected in the cost of service charged customers as proposed by intervenors will lower cash flow and increase PEF's external financing requirements.

Q. Does the comparison of the book depreciation reserve to the theoretical depreciation reserve create a depreciation reserve "surplus" or "deficiency"?

A. No, not in the way the intervenor witnesses use those terms. There is no actual "theoretical" depreciation reserve account on the Company's books. That's why it is

called the "theoretical" depreciation reserve; it does not really exist. There is only the book depreciation reserve account on the Company's books.

The theoretical reserve is not an exact measurement for determining the condition of the actual accumulated depreciation reserves. As a result of this mathematical comparison between the theoretical and actual accumulated depreciation reserves there can be, as in this case, a variance between the calculated theoretical reserve and the book depreciation reserve where the book depreciation reserve is larger than the calculated theoretical reserve. This difference may be called an excess or a surplus to indicate that there is in fact a difference by which the depreciation book reserve exceeds the theoretical depreciation reserve. But this difference or variance cannot be said to be an "excess" or "surplus" the way the intervenor witnesses use those terms, namely, to mean that PEF has over-charged and customers have over-paid the depreciation expense.

The assertion that the "excess" or "surplus" means PEF has over-collected and customers have over-paid is non-sensical, relies on the false assumption that the proposed rates have always been in effect, and further says that the Commission's prior approval and collection of these rates from customers for the past was wrong. This assumption only serves to allow the theoretical-to-book depreciation comparison calculation to be made. The "proposed" rates have not always been in effect, in fact, they will be in effect only for a future period of time, commencing in 2010, if approved by the Commission. Rather, the depreciation rates that have been in effect *were approved by the Commission – not once, but twice in the last seven years*. Indeed, Rule

25-6.0436(2)(a). F.A.C. provides that no utility shall change any existing rate or charge any new depreciation rate without Commission approval.

The intervenor witnesses' recommendations that the alleged "excess" or "surplus" (which does not exist) of the book depreciation reserve over the calculated theoretical reserve should be paid back to customers is therefore improper. Their recommendation requires the Commission to make prospective rate adjustments based on the application of the "proposed," future depreciation rates under the "prospective" theoretical reserve to the past period represented by the "accumulated" book reserve. See Rule 25-6.0436(6)(d), F.A.C. The Commission cannot adjust prospective rates based on future depreciation rate estimates applied to a prior period of time. That is improper retroactive ratemaking. It is also a direct attack on the propriety of the prior and current Commission-approved depreciation rates.

Q. Were the Company's prior and current depreciation rates approved by the Commission?

A. Yes. Most recently, the Company's depreciation rates were approved in Order No. PSC-05-0945-S-EI in Docket No. 050078-EI. That Order approved a Stipulation and Settlement between the Company and the intervenors, including OPC and FIPUG. At paragraph 11a(3) of that Stipulation, PEF, OPC, and FIPUG agreed that PEF shall apply the depreciation rates consistent with those set forth in the Depreciation Study that PEF filed in Docket No. 0500078-EI as modified by Exhibit 2 to the Agreement. That Depreciation Study was the 2005 Depreciation Study prepared for PEF by Mr. Robinson and AUS Consultants. The Commission expressly found in Order No. PSC-

05-0945-S-EI, page 6, that the Stipulation "establishes rates that are fair, just, and reasonable, and that approval of the Stipulation is in the public interest."

Prior to this Order, the Company also settled its prior base rate proceeding in Docket No. 000824-EI. That settlement, which again included PEF, OPC, and FIPUG, was approved by the Commission in Order No. PSC-02-0655-AS-EI dated May 14, 2002. The Commission approved the Company's depreciation rates and again found that the Stipulation established rates that are fair, just, and reasonable. Consistent with Rule 25-6.0436(2)(a), the Company's depreciation rates prior to the settlement of its 2001 base rate proceeding in Order No. PSC-02-0655-AS-EI were approved by the Commission.

Q. If there is a variance between the calculated theoretical reserve and the accumulated book reserve do you agree with Mr. Pous' assertion at page 30 that it nevertheless means that the utility has collected more than is needed?

A. No. Mr. Pous is careful to limit that assertion to "that point in time," referencing the very moment the calculation is performed. This is a meaningless statement when the Commission is setting depreciation rates prospectively for a more extended time period. If the calculation was performed at another specific point in time, the calculated variance will be different. The Company's assets for its generation, transmission, and distribution system are constantly changing, with additions and retirements every day. Furthermore, depreciation rates depend on estimates of asset service lives, salvage, retirements, and cost of removal, among other factors. As new events occur, and as more experience is acquired or as additional information is obtained regarding the

Company's assets and operations, depreciation estimates will change. That is why the Commission requires the Company to update its depreciation study at least every four years.

In addition to the fact that the Company's assets are constantly changing, setting depreciation rates is based on estimations and no estimates can be said to be entirely accurate. Mr. Pous in fact recognizes that estimating depreciation rates is not an exact science, acknowledging that "depreciation is a forecast or estimation process that is never precisely accurate" and that "[a]ny process that involves estimates will result in actual values that differ from predicted values." (Pous Test., p. 26, L. 17; p. 35, L. 18-19). Despite his recognition of the inherent lack of certainty in estimating depreciation rates, Mr. Pous wants to treat the current calculated theoretical reserve variance to the depreciation book reserve as if it is absolutely 100 percent accurate, such that the full amount of the reserve variance should be returned to customers over four years. This inherent fallacy in his recommendation cannot be overcome. In fact, Mr. Pous never tries to overcome it, instead he chooses to ignore it.

The Company's prior and current depreciation rates, however, were based on the best estimates at that time given the information available --- or they were agreed to by all the parties -- including OPC and FIPUG -- in the prior rate case settlements. Therefore, one cannot assume from the mere calculation of the theoretical reserve that the Company's current rates unreasonably required current customers to pay more (or less) that their fair share of the Company's plant assets as the intervenor witnesses do. Instead, those prior and current depreciation rates represented the best or agreed-upon depreciation estimates at that time, based on the system changes and information then

available. Similarly, the Company's new depreciation study accounts for changes in prospective life and net salvage values to reflect the Company's current experience with its depreciation plant and the Company's best estimate of what future depreciation rates should be.

Q. Do you agree with the intervenor witnesses that the Company's current variance between the theoretical and book depreciation reserve is so significant that the Commission should take action to eliminate it by refunding the amount to customers?

A. No. The principles underlying the existence of the calculated theoretical reserve variance to the accumulated book reserve that I have explained above do not change because of the amount of the variance. Further, an understanding of the calculated theoretical reserve variance and the primary drivers behind it will put this reserve variance in perspective. Mr. Pous, Mr. Pollock, and Mr. Lawton completely ignore and fail to analyze the primary drivers behind the variance between the theoretical and book depreciation reserve in the Company's current depreciation study.

In evaluating the magnitude of the estimated theoretical reserve variance it should be noted that it is approximately $646 million at 12/31/09 (Table 5f – Future Pro Forma Page 2-79 of 2009 PEF Depreciation Study) compared to an estimated $714 million at 12/31/07 (Table 5 Page 2-157 of ~~2005~~ 2009 PEF Depreciation Study) or 14.3% and 16.7% of the PEF accumulated book depreciation reserve, respectively. First, this is not a substantial percentage when you consider PEF's capital expenditure program to meet current and future customer service needs has added almost $2.5 billion in

depreciable assets to the Company's system over the comparable time period. Secondly, it appears that the averaging remaining life is working as the estimated theoretical reserve variance declined $68 million based on the application of current approved depreciation rates during this time period.

Additionally, over seventy (70) percent of the calculated theoretical reserve variance to the book depreciation reserve arises in the Company's production plant accounts involving the Company's power plants. See Exhibit No. ___ (WG-1) to my rebuttal testimony. The significant drivers here are the extension of production plant service lives. The Company increased the service lives for its Anclote oil-fired steam plant and its Crystal River Units 1 and 2 coal-fired plants by several years and significantly extended the service lives for its coal-fired steam plants at Crystal River Units 4 and 5 by fourteen years since its last depreciation study. See Exhibit No _____(WG 2). These extended service lives drive the calculated theoretical to book variance up, because the theoretical reserve calculation assumes the proposed life extension assumptions for these generation units were known and factored into the depreciation rates the day these generation units became operational. That assumption, of course, is not true, but again, it is a necessary assumption to perform the theoretical reserve calculation. There is now a longer period of time to collect these production account balances than before, so the proposed depreciation rates upon which the theoretical reserve is calculated will, all else being equal, be lower than the current rates upon which the book reserve is calculated, and that calculation is made over the entire operational life of the production assets.

It does not mean that the Company's current depreciation rates for these same production plant assets, based on the information available at the time the current rates were set, were wrong or unreasonable. The fact that over time, a facility that was expected to be in operation for 40 years may now be able to continue operating for 50 years does not mean that customers have over paid. It just means some of the depreciation estimates, namely the service lives for these production assets, have changed based on additional Company investments in these assets, operating experience with the assets and changing operational conditions. The result is a change in the depreciation rates going forward to account for these changes in estimates. Customers will benefit from the longer service lives for this asset because the impact of this change in estimate lowers the depreciation rate and lowers the resulting depreciation expense.

Nowhere is this more clearly seen than with the Company's nuclear unit, Crystal River Unit 3 ("CR3"). The nuclear production accounts represent 25 percent of the calculated theoretical to book depreciation reserve variance. See Exhibit No. ___ (WG-1) to my rebuttal testimony. In its 2005 Depreciation Study, the Company assumed for the first time that it will obtain a license renewal extension from the Nuclear Regulatory Commission ("NRC") for CR3 extending the life of the unit from 40 years to 60 years. The Company, however, does not yet have that NRC license extension for CR3 and does not anticipate receiving it until 2011 at the earliest. The point is not, as Mr. Pous asserts, that PEF is likely to obtain the license extension. (Pous Test., p. 37, L. 16-17). PEF agrees it is likely that PEF will obtain the requested license extension for CR3. The point is, PEF does not have the license extension and will not have it for a couple more years, but the Company, nevertheless, gave customers the benefit of the lower

depreciation rates that arise from extending the period to recover the depreciable nuclear production account balances over 60 years rather than 40 years commencing with its 2005 Depreciation Study. The Company's decision to extend the service life of CR3 before PEF obtained the NRC license extension has resulted in lower rates to customers than would otherwise been the case.

Finally, the Company has provided customers with an extended period of stable base rates. Base rates were lowered as a result of the Company's settlement of its 2002 base rate proceeding and maintained thereafter with the exception of limited increases to account for two new generation units added to the Company's system. The Company's depreciation rates were an integral part of the settlements that maintained base rates for almost a decade. OPC and FIPUG both agreed to the settlements of the Company's last two base rate proceedings that included the settlement of all Company rates, including depreciation rates. The Commission should not allow them to challenge the rates achieved under those settlements with their proposals now to return to customers depreciation expenses properly paid by customers under those settlements.

Q. What is the appropriate regulatory treatment of the calculated variance between the theoretical and the book depreciation reserves in the Company's current depreciation study?

A. The appropriate and reasonable regulatory treatment is to adjust the Company's depreciation rates prospectively over the remaining service lives of the depreciable plant, just as the Company proposes in its Depreciation Study. In fact, the average remaining life depreciation method automatically accounts for reserve imbalances under

the calculated theoretical reserve comparison to the book depreciation reserve through the re-setting of rates over the remaining life of the plant assets. This approach is in the best long-term interests of customers because it provides a gradual, levelized, and systematic approach to factoring into depreciation the changes in estimates in the Company's Depreciation Study consistent with industry standard depreciation methodology and utility practice.

While Mr. Pous criticizes the Company for applying the average remaining life method to correct any reserve imbalance as "business as usual" (Pous Test., p. 34, L. 9-12), he himself agrees on the very next page that "[w]hen reserve imbalances occur, they are normally treated through the remaining life process." (Pous Test., p. 35, L. 23-24) (emphasis supplied). Indeed, in the Company's 2005 base rate proceeding, Mr. Pous agreed that prospective treatment of imbalances created as a result of changes in depreciation estimates under the remaining life technique was appropriate. He proposed to "return" the full reserve imbalance calculated by the Company in its 2005 Depreciation Study to customers using the remaining life process, (he proposed amortizing his additional calculation of the reserve imbalance by his own changes in depreciation parameters for the Company over a four year period). (Pous Test., Docket No. 050078-EI, Pous Test., p. 33, L. 22-25). Likewise, Mr. Pollock agrees that the remaining life method allows for the un-depreciated portion of plant in service to be recovered over the average remaining life of the assets. (Pollock Test., p. 41, L. 20-22). In fact, he apparently proposes to use the remaining life method to resolve the reserve imbalance for over one-half of the calculated reserve imbalance with his proposal to return to customers $100 million over three years. (Pollock Test., p. 49, L. 1-10). The

intervenor witnesses themselves demonstrate the propriety and reasonableness of the Company's depreciation study in this regard.

Q: Do Mr. Pous, Mr. Lawton, and Mr. Pollock explain the full impact of their recommendations on the Company and its customers?

A. No, they do not. The intervenor witnesses focus solely on the short-term reduction in depreciation expense that occurs as a result of their recommendations. They do not explain what changes necessarily follow from their recommendations and what the impact of those changes are on customers and the Company.

First, they overlook the current benefit reflected in the Company's proposed revenue requirements related to the calculated theoretical reserve "surplus." As a result of the higher book depreciation reserve currently on PEF's books, this serves to lower rate base eligible for a return. Customers are currently receiving the benefit of the lower rate base. As illustrated in my Exhibit No. __ (WG-6), Page 1 of 3, the impact of the $646 million theoretical reserve "surplus" as a reduction to rate base results in a direct benefit to customers in the current proposed depreciation rates as this "surplus" is part of the rates derived from the application of the average remaining life depreciation method, and it lowers 2010 revenue requirements by $127 million.

Second, customers may pay lower rates now under the intervenors' recommendation but they will pay significantly higher rates immediately thereafter. Intervenor witnesses Pous and Pollack completely ignore the large increase to revenue requirements of up to $258.6 million and $145.1 million, respectively, after the three to four year amortization as a result of their recommendations. As illustrated in Exhibit

No. __ (WG-6), page 2 of 3, Witness Pous' recommendation would result in a $161.5 million reduction in 2010, but would increase revenue requirements by as much as $258.6 million in 2014 after the four year amortization period was completed. As illustrated in Exhibit No. __ (WG-6), Page 3of 3, witness Pollack's recommendation would result in a $100 million reduction in 2010, but would increase revenue requirements by as much as $ 145.1 million in 2013 after the three year amortization was completed.

Q: Would the intervenors' proposals have any other financial impacts?

A: Yes their proposals would adversely impact the cost of capital as outlined in detail in the rebuttal testimony of Michael J Vilbert. In summary, the proposed reduction in depreciation expense levels will increase the Company's need to raise capital to fund this rate reduction, as much as $646 million over the five year period ending in 2013. Therefore, as this reduced cash flow weakens the Company's credit ratios the cost of debt may increase. The cost of equity will increase because of the uncertainty and risk introduced to investors as this retroactive ratemaking approach introduces risk that the Commission's previous decisions could be reversed in the future. These considerations and real impacts are not reflected in intervenors' proposals.

Q: **Did Mr. Pous and Mr. Pollack's proposed depreciation rates reflect fully their proposed reduction in book accumulated depreciation reserves?**

A: No, Witnesses Pous and Pollack do not recalculate their proposed depreciation rates for the average remaining life methodology using their proposed theoretical reserve as a book reserve. This would in fact serve to increase depreciation rates.

Q. Do you agree with the intervenor witness assertions that applying the average remaining life method to address the theoretical and book depreciation reserve imbalance results in intergenerational inequity?

A. Absolutely not. In fact, the intervenor witnesses' recommendations will result in intergenerational inequity. Under their recommendations, current customers will receive back depreciation expense reductions paid by prior customers under previously approved depreciation rates. The only way to justify this windfall to current customers is for them to directly challenge the propriety of this Commission's prior orders setting rates, including depreciation rates, by claiming that PEF has over-collected and customers have over-paid depreciation expense. This is simply not true.

Evaluation of Prior FPSC Orders

Q. The intervenors claim their recommendations with respect to the theoretical reserve variance are consistent with prior Commission Orders. Is that correct?

A. No, it is not. While they cite Commission orders they claim support their recommendations they never explain what these orders actually say. There is a reason for this omission in their testimony, the Commission orders do not support what they recommend. I have included copies of these orders and the ones I add as a composite exhibit to my rebuttal testimony, Exhibit No. ~~(WG-2)~~ WG-3.

Mr. Pous first cites Order No. 19901, issued August 30, 1988, in Docket No. 880053-EI regarding Gulf Power Company's ("Gulf") depreciation study. This Order supports the Company's position, not Mr. Pous' recommendation. The context in which Order No. 19901 was issued begins almost four years earlier with the issuance of Commission Order No. 13681 on September 17, 1984, which addressed Gulf's request for approval of new depreciation rates. Prior to this request, Gulf's depreciation rates had been based on the "whole life" methodology but, pursuant to Rule 25-6.0436(7), Gulf's then-current depreciation study was required to be based on the average remaining life methodology. This one-time transition from whole life to remaining life depreciation produced a reserve deficiency. In addressing the variance created by the change in depreciation methodology, the Commission articulated a policy adopting the remaining life methodology to address reserve variances in its 1984 Gulf Order. The following quotation from Order No. 13681 expresses this Commission policy:

> "While it is possible to make the reserve correction of these accountsthrough the new depreciation rates allowed for embedded plant, we have chosen to amortize this reserve deficit over the composite remaining life of the associated investment. ... We are ordering a 19-year amortization schedule for use in recovering the reserve deficit associated with the Transmission, Distribution and General Plant accounts."
> (Emphasis added).

Mr. Pous ignores this statement of general Commission policy regarding the treatment of overall reserve variances and the fact that Gulf's reserve variance was created by a one-time change in depreciation methodology. Mr. Pous instead refers to an issue in Gulf's next depreciation study regarding a surplus in one particular reserve account related to the Job Development Investment Tax Credit (JDIC). In Order No. 19901, cited by Mr. Pous, the Commission simply authorized a reserve account transfer

which allowed the account surplus created by the implementation of the JDIC to be used as a contribution toward the 19-year remaining life amortization of the overall reserve deficiency that the Commission established in Order No. 13681 from Gulf's prior depreciation proceeding.

As this Order indicates, the Commission has authorized the limited use of intra-reserve account transfers to address specific equipment or facility reserve issues under its rule authorizing the investigation of depreciation rates for the "possibility" of corrective reserve account transfers. Rule 25-6.0436(7)(b), F.A.C. Mr. Lawton acknowledges this limited policy, noting the Commission policy allowing reserve transfers within the same function, but not across functions. (Lawton Test., p. 14, L. 2-4). Lawton cites Commission Order No. PSC-94-1199-FOF-EI, where the Commission approved certain recommended reserve transfers to correct variances brought about by the unitization of certain production plants and previously unanticipated dismantlement costs of certain units. This is certainly not what Mr. Pous, Mr. Lawton, and Mr. Pollock are recommending the Commission do by forcing the utility to pay customers back depreciation expenses paid by other, prior customers under Commission-approved rates.

Q. Did this policy change by the time of the 2001 Commission Order cited by Mr. Pous?

A. No. Mr. Pous does cite Order PSC-01-2270-PAA-E1, issued November 19, 2001, regarding the depreciation study for the Marianna Division of Florida Public Utilities Company. Far from supporting the severe departure from remaining life depreciation principles that witnesses Pous, Lawton, and Pollock recommend, however, this case

deals with corrective action taken by the Commission to remedy a negative reserve balance created when specific plant investments, which in fact *had not been made*, were removed from a reserve account. Again, the Commission simply authorized a reserve transfer which applied a surplus from another reserve account to offset the deficiency in the corrected plant account. Importantly, the surplus was not flowed back to ratepayers through a shortened, arbitrary amortization, as the intervenor witnesses propose, but instead was used to maintain the utility's depreciation rates based on remaining life principles.

Order No. 19438, issued June 6, 1988, regarding a change in Tampa Electric Company's depreciation rates, cited by Mr. Pous is also not a supportive "example." In this order, as in the 1988 Gulf depreciation order discussed above, the Commission was addressing a prior order in which it had found that the most efficient mechanism for addressing the unique depreciation impact on customers from implementation of the JDIC was through a depreciation reserve adjustment. As before, the adjustment is tailored to address a specific situation created by a federal tax initiative. Other specialized amortization schedules approved by the Commission in this order were designed to address unrecovered investment in specific assets that were being taken out of service earlier than would normally be the case if not for a change in technology, federal and state regulations, or other equipment-specific issues.

Q. What about Mr. Pous' reliance on the Commission's Order in the General Telephone Company proceeding, does that support his recommendation?

A. Not at all. In fact, Mr. Pous' reliance on Order No. 14929, issued September 11, 1985, establishing new depreciation rates for General Telephone is particularly difficult to understand. One might have expected depreciation experts such as the intervenor witnesses to appreciate the unique circumstances of the telephone and communication industry as a whole regarding the difficulty in estimating the useful lives of depreciable assets because of premature obsolescence resulting from, as the Commission put it, "substantial developments in the area of technology and competition." It is virtually common knowledge that the telephone industry has and continues to be plagued with technical obsolescence that drives significant retirements much earlier than would have been initially expected, a problem that is exacerbated by the anticipation of wide-spread competition. As the Commission stated in the cited order, "we believe it is our duty and in the best interest of the Company and ratepayers to move forward with re-prescription of the Company's intrastate depreciation rates." The circumstances and facts in this case, and the regulatory response required, have no relevance to PEF's current depreciation study.

Indeed, in a later Commission decision, Order No. 16269 dated June 20, 1986 involving West Florida Natural Gas Corporation's application for new depreciation rates, the Commission noted that the effect of prior rates and allocations resulted in surpluses in some accounts and deficits in others but "[b]ecause these imbalances have not been brought about by technological changes, such as those seen in the telephone industry, we believe that the appropriate treatment is to apply the standard remaining life rate to write-off each account's imbalance over the remaining life." (emphasis supplied). The Commission reiterated its policy of applying the average remaining life

method to "write-off" or resolve "each account's imbalance" in the absence of technological changes that required more rapid amortization. That is exactly the situation with respect to PEF's current depreciation study and exactly what PEF proposes, to "write-off" each "account's imbalance" through the remaining life method.

Q. Did the Commission do what Mr. Pous recommends in any of the other Commission Orders he cites?

A. No. Mr. Pous also cites to Order No. 22115, issued October 31, 1989, regarding the establishment of new depreciation rates for City Gas Company. The intervenor witnesses have again ignored the context in which this order was issued. Instead, they have focused on the implementation specifics of a Commission policy without regard to the policy itself. In this case, the policy that gave rise to the recovery schedule discussed in Order No. 22115 was addressed in Order No. 13538 issued in the predecessor proceeding. In that order, the Commission stated: "We are ordering two amortization schedules for use in recovering the reserve deficit. That portion of the deficit that is attributable to changes in prospective life and salvage values is to be amortized over the composite remaining life of the embedded plant, which is estimated to be 24 years. That portion of the deficit that is attributable to past incorrect estimates of life and salvage factors and historic technological change and growth should be recovered over a shorter period. Therefore, we are ordering a 5-year amortization period for this portion of the deficit." (emphasis supplied). The Commission took the same action in Order No. 13918, another telephone utility depreciation order cited by Mr. Pous. (Pous Test., p. 33, L. 3). The policy described by the Commission in which

reserve variances attributable to changes in prospective life and salvage values are amortized over the assets' remaining life is instructive, since this is precisely the kind of changes that brought about the reserve variance in the Company's current depreciation study. The Company's study is consistent with Commission policy.

This statement of the Commission's policy is similar to what we understand to be the Federal Energy Regulatory Commission's ("FERC's") policy. In 2008, the FERC rejected a utility request to decrease accumulated depreciation below amounts previously accrued because the over accrual was not shown to result from an accounting error but rather was the result of a change in estimates in setting depreciation rates. As a result, in such cases the FERC determined that the over or under accrued provisions for depreciation should be corrected prospectively by an upward or downward adjustment in the depreciation rate. Startrans IO, LLC, Docket Nos. EC08-33-000, EC08-33-001, March 31, 2008, included in Exhibit No. __ (WG-4) to my rebuttal testimony.

Indeed, as far back as the 1970's, the FERC has stated that, because of the estimates inherent in depreciation accounting, "it is the Commission's policy that over or under provisions for depreciation are corrected prospectively by an upward or downward adjustment in the depreciation rate," rather than by transfers to or from the accumulated provision for depreciation. See Michigan Wisconsin Pipe Line Company, Docket No. RP83-27-002, 1983 FERC LEXIS 1967, April 8, 1983, quoting Equitable Gas Company, 56 FPC 1655 at 1657 (1976). (Id.). The FERC reaffirmed this policy in 1992, holding that a utility's depreciation study was not a basis to adjust the recorded balance in the utility's depreciation reserve. The FERC noted that accumulated

depreciation was dependent on a number of assumptions and that, as new events occur and more experience is acquired or additional information obtained, depreciation estimates will change. The FERC then stated that it "does not use depreciation studies to adjust past depreciation charges that were properly recorded in prior periods based on the depreciation practices and information at the time they were recorded. Changes in depreciation estimates resulting from new information or subsequent developments or from better insight or improved judgment should be accounted for in the period of change and future periods, but not through retroactive restatement of prior period's depreciation amounts." Carnegie Natural Gas Company, Docket No. FA89-16-000, August 7, 1992. (Id.). The FERC policy, consistent with the Commission policy, is to apply the average remaining life methodology of adjusting prospective depreciation rates to address any reserve variances. PEF's 2009 Depreciation Study is consistent with this policy.

Q. What about his other "example" cited on page 32 of Mr. Pous' direct testimony, does it support his recommendation?

A. No. Order No. PSC-97-0499-FOF-E1, issued April 29, 1997, regarding Florida Power & Light's ("FPL's") proposal for plant life extensions is a unique situation unlike PEF's current situation. Like many of the other orders quoted in Mr. Pous' testimony, this order addresses a specific deficiency associated with a specific facility under FPL's particular and unique circumstances at the time. These unique circumstances are explained by Mr. Terry Deason, who was a Commissioner at the time of this decision, in FPL's current base rate proceeding. They are also reflected in the Commission's

statement in the Order that the accounting adjustments "will facilitate the establishment of a level "accounting" playing field between FPL and possible non-regulated competitors." It should be clear at this point that it is not unusual for the Commission to establish accelerated amortization schedules to address equipment or facility-specific reserve issues. It is another thing entirely to suggest that amortization be accelerated well ahead of the composite remaining lives of all depreciable equipment and facilities to address the non-specific, overall net variance from every reserve account.

Q. But Mr. Pous claims the Commission has stated a policy of addressing reserve differences or intergenerational inequities as fast as possible at pages 32 and 33 of his direct testimony. Is he correct?

A. No. Mr. Pous has taken a statement from the Commission's order out of context. With respect to Order No. PSC-93-1839-FOF-E1, issued December 27, 1993, regarding the depreciation study for the Marianna Division of Florida Public Utilities Company, he quotes from the order as follows: "According to our Staff such deficiencies should be recovered as fast as possible, unless such recovery prevents the Company from earning a fair and reasonable return on its investment." This statement, of course, reflects the opinion of the Commission staff at that time, not the Commission itself. Suffice it to say that the Commission did not order a change in the rates of customers as a means to accelerate the write-down of this reserve variance, as the intervenor witnesses have proposed in the present case. Instead, the Commission employed the practice of reserve transfers to address the matter in that case, as it has done in many of the cases cited by the intervenor witnesses.

Also, in Order No. 13427, issued June 15, 1984, which Mr. Pous also cites, the Commission was investigating the appropriate accounting and ratemaking treatment of nuclear power generators. This order has no relevance to a discussion regarding the treatment of depreciation reserve variances. In the order, the Commission states: "Further, our principle purpose in the case was not to correct deficiencies in revenue recovery, but to correct an accounting and ratemaking problem. We determined that the current method of recovery of decommissioning costs was deficient from both an accounting standpoint and a ratemaking standpoint." The issue of reserve variances in PEF's Depreciation Study is neither an accounting nor a ratemaking problem, since the Commission satisfactorily dealt with the accounting and ratemaking aspects of this issue in many proceedings over the years based upon the best available information at the time and by applying sound remaining life depreciation principles.

Moreover, the statement quoted by Mr. Pous concerns the then-pending question of whether the Commission should establish a funded or unfunded nuclear decommissioning reserve. This is not an issue pending before the Commission in this proceeding.

It is quite clear after actually analyzing the Commission Orders that the intervenor witnesses cite that they do not support their recommendations and, in fact, support the Company's position. The long-standing policy of the Commission is not to resolve reserve variances that arise from the calculated theoretical reserve comparison to the book depreciation reserve by re-stating reserves and adjusting past depreciation charges that were properly recorded in prior periods by refunding customers depreciation expenses, as the intervenor witnesses recommend. Rather, the long-

standing Commission (and FERC) policy is to correct any such reserve variances prospectively by a downward (or upward) adjustment in depreciation rates through the remaining life methodology, just as PEF proposes in its Depreciation Study.

Generally Accepted Accounting Principles (GAAP)

Q. Mr. Lawton claims that Mr. Pous' recommendation is consistent with GAAP. Is he correct?

A. No, he is not. He provides no support whatsoever for this assertion. In fact, Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" (FAS154) provides in relevant part that a "change in accounting estimate shall be accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both. A change in accounting estimate shall not be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods." (FAS154-paragraph 9). A change in accounting estimate is defined to include "a change that has the effect of ... altering the subsequent accounting for existing or future assets or liabilities" and further "result[s] from new information." Examples included "service lives and salvage values of depreciable assets." (FAS154-2d). Under GAAP, if there is a change in a depreciation-related accounting estimate, the impact is reflected in the current and future periods as a prospective change and not through restatement or retrospectively adjusting amounts previously reported. Thus, Mr. Lawton is wrong. Mr. Pous (and Mr. Pollock's) recommendation is not consistent with GAAP, it is inconsistent with GAAP. It is my opinion that the amortization of

accumulated book reserves to reflect a retroactive adjustment to depreciation expense violates GAAP. The theoretical reserve calculation essentially applies depreciation rates and assumptions retrospectively, but the disposition of reserve variances created by that calculation should be handled as a change in estimate that is recognized prospectively, in compliance with FAS 154. The current, Commission-approved methodology of average remaining life depreciation accomplishes this objective.

OTHER ACCOUNTING ISSUES.

Q. Mr. Pous claims that the Company has inappropriately accounted for Contributions In Aid of Construction (CIAC) in violation of NARUC Interpretation No. 67 at pages 105-106 and 116 of his testimony. Is he correct?

A. No, Mr. Pous is incorrect. He is asserting this position without specific exceptions noted in his testimony in order to account for CIAC as recoverable savage. The Company receives reimbursements from third parties for new capital construction or for capital replacement projects. These are to be accounted for in accordance with the Uniform System of Accounts in the Code of Federal Regulations (CFR) 18 Part 101, Electric Plant Instructions (excerpt below – emphasis added):

> 2. *Electric Plant to Be Recorded at Cost.* D. The electric plant accounts shall not include the cost or other value of electric plant contributed to the company. **Contributions in the form of money or its equivalent toward the construction of electric plant shall be credited to accounts charged with the cost of such construction.** Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledgers of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions concurrently be recorded as a credit.

Thus, reimbursements from third parties for the construction of assets shall be charged as a credit to Electric Plant in Service, account 101. PEF complies and properly accounts for these items as prescribed by the Uniform System of Accounts. Additionally, these items charged as contributions in aid of construction do meet the criteria noted by Mr. Pous from the NARUC guidance he sites. PEF enters into contractual arrangements with third parties for amounts charged as CIAC.

Q: Does the Company also receive third party reimbursements for the retirement of plant?

A: Yes, the Company receives reimbursement for the sale of scrap or salvage of utility assets. These are to be accounted for in accordance with the Uniform System of Accounts in the Code of Federal Regulations (CFR) 18 Part 101, Electric Plant Instructions (excerpt below – emphasis added):

> 2) When a retirement unit is retired from electric plant, with or without replacement, the book cost thereof shall be credited to the electric plant account in which it is included, determined in the manner set forth in paragraph D, below. If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to electric plant shall be charged to the accumulated provision for depreciation applicable to such property. **The cost of removal and the salvage shall be charged or credited, as appropriate, to such depreciation account.**

These are properly accounted for as a gross salvage which is an offset to the costs of removing the retired asset and included in the Company's

accounting records as gross salvage, a credit to the accumulated depreciation reserve.

Q: Does the Company have any concern that its accounting records are incorrect as Mr. Pous suggests?

A: No, PEF has properly accounted for both its contribution of aid for construction and salvage charges.

Q: Does Mr. Pous site any specific examples of incorrect accounting to support his assertion?

A: No, Mr. Pous does not cite any specific examples that the Company has not applied proper accounting procedures.

Q. Mr. Pous claims that the Company's continuing property records differ from the actual work order reported values based on one example he provides at page 115 of his testimony. Is Mr. Pous right?

A. No, he is not. In fact, the Company's continuing property records demonstrate on their face that he is wrong and he either doesn't understand how retirements, cost of removal and gross salvage are recorded or he is intentionally misrepresenting the records. Mr. Pous claims he reviewed five work orders relevant to Account 356 – Transmission Overhead Conductors and Devices in 2005 that reflect a total

level of gross salvage of approximately $250,000. He claims that the Company's reported value in its continuing property records for Account 356 is zero for 2005 and, therefore, concludes that all of the Company's CPR are suspect. (Pous Test., p. 115). He is correct that the entry for gross salvage for 2005 in Account 356 is zero, but the entry for gross salvage for 2006 in that account is $249,263.32, or approximately $250,000. (See Exhibit EMR-2, page 8-87). These work orders commenced in 2005 and the property removed was retired that year but the work was not completed and the project was not closed out until 2006 when the gross salvage of approximately $250,000 was properly recorded. This process was explained in detail in answer to OPC Interrogatory No. 56, which is attached as Exhibit No. ___ (WG-5) to my rebuttal testimony.

Q. Have the Company's Continuing Property Records and work orders been maintained consistent with regulatory and industry standards?

A. Yes, the Company's Continuing Property Records (CPR) and work orders (WO) have been maintained consistent with regulatory and industry standards. These standards consist of practices and procedures established based upon Generally Accepted Accounting Principles (GAAP), the FERC Code of Federal Regulations (CFR), and Florida Public Service Commission guidance as appropriate.

This guidance is summarized in the Company's capitalization policy which is intended to provide the basis for determining what costs represent capital assets in the accounting records. All assets recorded as Electric Plant in Service are recorded at original cost which consists of all expenditures that are necessary

to bring the asset to working condition for its intended use. The components of construction costs as outlined in the policy are based upon information obtained from FERC Electric Plant Instructions No. 3, Item A.

From a process perspective, asset costs are accounted for in work orders (also referred to as projects) as established in the Oracle Project Accounting system and transferred to the PowerPlant system which is the Company's Fixed Asset Sub ledger. (The Power Plant System is an industry standard used by over 75% of the investor owned utilities in North America.) PowerPlant tracks status (i.e. Active, In-service, Posted to CPR) changes for all capital projects and maintains all asset records. The system records asset values, calculates depreciation, and retires assets from the books. The underlying principles for the property unit catalog and the general regulations governing the PowerPlant System are referenced from the Electric Plant Instructions of the FERC Uniform System of Accounts. Certain interpretations and clarifications are driven by actions of the Florida Public Service Commission.

CONCLUSION

Q: Please summarize your conclusions.

A: In summary the application of the remaining life approach to setting depreciation rates as proposed by the Company reflects the Commission's long standing preferred practice in setting depreciation rates. The existence of a theoretical reserve and the calculated reserve "surplus" or "deficit" is nothing more than a measured impact from retroactive application of current facts and circumstances.

The method adopted by prior Commission precedent and supported by the Company reduces customer rates both now and the long term, thus eliminating the significant rate volatility introduced by the intervenors' approach. It results in clear immediate and significant reduction in rate base and depreciation expense that treats customers fairly. Alternatively, to adjust actual book accumulated depreciation reserves to the theoretical reserves as proposed by intervenors, is retroactive ratemaking and an inappropriate application of the remaining life approach in setting depreciation rates and these proposed depreciation reductions should be rejected.

Q. Does this conclude your testimony?

A. Yes, it does.

MR. WALLS: And we now tender Mr. Garrett for cross.

CHAIRMAN CARTER: Mr. Rehwinkel, are you first? You're recognized.

MR. REHWINKEL: Thank you.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q Mr. Garrett, good afternoon. My name is Charles Rehwinkel, at the Public Counsel's office, and I'm going to ask you to turn to page 2 of your rebuttal testimony. And I think you state in lines 2 through 16 of your rebuttal testimony your experience in regulatory matters with Progress and with prior companies, is that correct?

A That's correct.

Q Now, isn't it true that you have never testified on the issue of a reserve, a material reserve variance regulatory treatment before a Public Service Commission?

MR. WALLS: Objection; assumes facts not in evidence.

MR. REHWINKEL: I'm asking him if he has.

MR. WALLS: You assume that it was a material variance.

CHAIRMAN CARTER: Just rephrase, Mr.

Rehwinkel.

BY MR. REHWINKEL:

Q You've never testified, have you, on the regulatory treatment of reserve variances, have you?

A Except in this case, no.

Q In fact, you've never testified on depreciation before, have you?

A No, not specifically on depreciation, other than its inclusion in revenue requirements for electric and gas company in New York.

Q Okay. And you used to be an auditor with Price-Waterhouse, is that correct?

A That's correct.

Q And as an auditor with Price-Waterhouse, you had clients?

A Yes, I did.

Q You never gave a client an opinion that any treatment of a reserve variance would violate generally accepted accounting principles, did you?

A An opinion?

Q Yes, sir.

A I have advised clients on a number of accounting matters. I can't recall if I specifically advised them regarding a reserve transfer.

Q Let's me ask the question this way: You have

never advised a client that correction of a reserve variance would violate SFAS 154, correct?

A First of all, 154 was issued in 2005, and the period in which I was advising clients was prior to that.

Q So the answer to my question would be no?

A Would -- no.

Q And you're not an attorney, correct?

A I'm not an attorney.

Q And you are, I, think as you stated, the legal entity comptroller for PEF, correct?

A Yes.

Q And that's a full-time job, correct?

A Oh, yes.

Q Now I could ask you to turn to page 3 of your testimony.

You state at the bottom of page 3, specifically beginning on lines 21 forward, "The Commission has a longstanding policy, in fact, to apply the average remaining life methodology to resolve reserve variances," do you not?

A Yes, I do.

Q Now, isn't it true that you did not review each and every Florida Public Service Commission order on depreciation in preparation for this testimony?

A No, I did not review every single order. That would have been even a larger full-time job.

Q Okay. And you had someone help you do the analysis of Florida Public Service Commission orders on depreciation, did you not?

A Yes, I did.

Q And would one of those people have been an attorney?

A Attorneys, as well as internal -- both internal, as well as external counsel, and also internal resources.

Q Okay. So isn't it also true that you do not personally review all Public Service Commission orders on depreciation in order to independently develop an opinion as to the, quote, longstanding policy that you testified to?

A Well, I try very diligent to be as current as I can be on what the current Commission practices are in this area, but -- so -- and as I, in my rebuttal testimony, I think, cite a number of orders that kind of lay out what I think that policy is.

Q Okay, but you cannot testify to this Commission that they have developed a policy where each and every treatment of a reserve variance is as you recommend, isn't that true?

A Well, the Commission certainly has the latitude to establish policy as they see fit.

Q But my question is that you cannot testify that each and every case, they have treated reserve variances as you propose in this case, correct?

A Yes, in each and every case, I don't know that for a fact, but the ones that I do cite here I think clearly lay out a pattern of policy or acknowledgement of policy.

Q Isn't it true that you have not cited an order that uses the term *established* or *longstanding* depreciation policy of the Commission with respect to treatment of reserve variances?

A I don't know if I can answer that, whether specifically the words *longstanding* were used in the orders.

Q Well, is it your testimony to this Commission that you have independently determined that they have developed a longstanding policy to apply the average remaining life methodology to resolve reserve variances?

A Yes, in terms of the orders that I have looked at, the ones that I have outlined here in the rebuttal testimony, my opinion is that they have had a longstanding policy of using the average remaining life methodology to resolve reserve in analysis.

Q So that opinion that you're giving the Commission is a non-legal opinion, right?

A That's correct.

Q That opinion is based on the orders that you have attached?

A Yes.

Q Okay. Let me ask you to turn to page 6 of your rebuttal testimony, and direct you to lines 17 through 20. There's a phrase in lines 19 through 20 that is, "the most widely used depreciation method, procedure and technique in the utility industry." Do you see that?

A Yes, I do.

Q And you're referring there to the straight-line method, broad group procedure and average remaining life technique, is that correct?

A That's correct.

Q Now, this is -- you're just repeating what Mr. Robinson testified to, correct?

A Well, I don't think I'm just repeating. The words there are based on Mr. Robinson's explanation, but I've had considerable dialogue with him about these techniques.

Q Okay, but we've established you have not testified on depreciation, except as perhaps an input to

a regulatory calculation, correct?

A An input to a revenue requirements calculation, yes.

Q Yes, sir. So you have not done some sort of survey or developed the expertise in testifying around the country in order to be able to independently make this statement, correct?

A No. That's why I engaged a depreciation expert.

Q So when I said, "Correct," and you said no, you meant -- you did agree with me, right?

A I agree. Yes, I'm sorry, yes.

Q Okay, that's fair. I don't try to ask tricky questions, but I know they come across that way, I'm sorry.

So just to be sure, what you're stating here is either repeating what Mr. -- and "here" meaning on line 6 -- on page 6, lines 17 through 20 -- is either what Mr. Robinson testified to or what he told you about, is that correct?

A Yes, it's based on my discussions with him, and also I would add that it's pretty clear that this seems to be the -- well, not seems, this is the method that the utilities here in Florida file depreciation studies under.

Q What's more important, is it not, is how the Commission treats it, not necessarily how the company proposes, correct?

A Yes, and as I said in my opening comments, the Commission clearly has a significant amount of latitude in how they establish the cost of service.

Q Okay, if I could get you to turn to page 10 of your rebuttal, please?

Now, there is a Q&A there that asked, "Is there in fact a depreciation reserve surplus," and -- on line 5, and then line 6, you say, "No, there is not. There is no actual cash surplus in an account for the company's depreciation reserve." Do you see that?

A Yes, I do.

Q Is anyone contending -- I mean, you're not rebutting a contention by a party that there is a cash surplus in an account, correct?

A No, I think it's more to lay some groundwork around -- I think there are some inferences that are made by Intervenors that these are excess or surplus in nature.

Q On page 11, lines 10 through 13, you further address that issue, and you use the term on line 12, "PEF has overcharged customers." Now, does any one of the Intervenor witnesses actually make that claim, that

PEF has overcharged customers?

A Well, again, I think in the context of how the words "excess" and "surplus" are used, I think you could draw some inferences that suggest that we have. I don't -- my personal opinion is that no one -- I don't think we have, that we have overcharged customers in any way, so it's clear that this reserve variance is not attributed to some type of error associated with that.

Q But you can't point to any testimony of either Mr. Pous or Mr. Pollock where they say that PEF has overcharged customers in the sense of charging illegal or unauthorized rates, can you?

A Again, I can't point specifically at this moment to testimony, but again, the context in which those words "excess" or "surplus" are used, it does seem to imply that.

Q Is it your testimony that PEF or its predecessor companies has never used the term *depreciation reserve deficiency*?

A We have used that term. I think the term *surplus* has been used as well.

Q Okay. So a deficiency is just the counter to surplus in terms of the variance, how you characterize a variance in the theoretical reserve, correct?

A Yes, I would agree that it's how you

characterize a variance.

Q So if PEF came to the Commission and said they had a depreciation reserve deficiency, it wouldn't be fair to characterize -- to say that they had undercharged customers, would it?

A I think -- yes, I think that would follow.

Q So it's really more of a nomenclature thing, isn't it, semantics, if you will? *Surplus, deficiency,* they're just English language words to describe the qualitative nature of the variance, correct?

A Yes, I think it is. I think, again, foundationally what I was trying to set here is that this so-called excess, surplus, whatever we would like to call the variance, is not a real reserve that's sitting anywhere on our books. It's not funded in any way. It -- the reserves that are on our books are actual accumulated depreciation reserves, not some theoretically based number.

Q Can I get you to turn to page 12 of your rebuttal?

A I'm there.

Q You state on lines 9 through 12, starting with the word "Commission," "The Commission cannot adjust prospective rates based on future depreciation rate estimates applied to a prior period of time." Do you

see that?

A Yes.

Q And you further state that that would be retroactive -- improper retroactive ratemaking?

A Yes.

Q Okay. Now, is this statement here aimed at the proposal to flow back or accelerate the depreciation reserve variance over four years advanced by Mr. Pous?

A Yes, it is.

Q Okay. Is it your testimony that Mr. Pous is proposing to use the depreciation reserve variance flowback, if you will, to adjust depreciation rates?

A Well, I think he -- I would say no, not depreciation rates. The level of depreciation expense that's recovered, he clearly is offsetting that level of recovery by, as you termed, flowback.

Q Okay. So there is a difference, is there not, between depreciation rates and depreciation expense, correct, for ratemaking purposes?

A Yes, there are -- yes, that's true.

Q And so just to be clear, your criticism is -- it appears to me to be based on how rates would be affected if this flowback or accelerated adjustment is made. Am I wrong in that?

A My criticism of this approach is that it's

taking prospective rates and, based on those prospective rates, recalculating where we should be at a point in time in terms of the accumulated recovery of our plant investments and net salvage. And in doing so, it then compares to what actual decisions have been made in terms of recovery levels. That variance is then disposed of through a reduction in ongoing recoveries of depreciation expense. And I do think that's a form of retroactively applying that estimate by saying no, we should not be -- we should not have collected or we should not have these reserves, these accumulated reserves, on our books associated with the historical recovery of those investments.

Q But you would agree, would you not, that Mr. Pous's testimony with respect to depreciation advances two distinct proposals: One, he offers his opinion about what the level of depreciation rates should be, correct?

A Yes, he does.

Q And two, he offers his opinion about the level of the depreciation reserve, theoretical depreciation reserve and how it ought to be treated for ratemaking purposes in this matter, correct?

A Yes, he does, and they are substantial, material adjustments. They essentially reduce our

annual recovery of depreciable plant by in excess of several -- couple hundred million dollars, and actually reduce our ongoing recovery of depreciable plant to well under $200 million a year. So yes, I do criticize that approach, especially given the company's existing plant balance well in excess of $12 billion.

Q My question was just what you understood the nature of it to be, but that's fine.

A I understand the nature and the significance of it.

Q Okay. We will get into that.

Mr. Pous's recommendation with respect to the treatment of the variance and theoretical reserve doesn't impact his recommendation with respect to the calculation of depreciation rates and the depreciation expense that flows from those rates, correct?

A Would you ask that again?

Q Mr. Pous's proposed regulatory treatment for the depreciation reserve variance does not affect his recommendation with respect to what the depreciation rates should be, correct?

A Yes, his rates, as he proposes, as I understand it, does not reflect the $162 million reduction annually in depreciation expense. He, in essence, calculates depreciation expense based on his

parameters, and then, if you will, if I can use the term *take a haircut*, reduces that further by the $162 million, never reflecting that the book reserves have then been adjusted downward by that $162 million.

Q So you would agree with respect to this statement here on page 12, lines 9 through 12, "as the depreciation rates are not being proposed to be changed with regard to the level of the theoretical depreciation reserve variance," correct?

A Well, as I think of depreciation rates, I would answer yes, he does not adjust his rates, but he clearly adjusts his annual level of recovery.

Q Okay. Yeah, I mean, there's no dispute that depreciation expense is at issue with respect to how that reserve variance is treated, correct?

A Yes.

Q Okay. Now, the next sentence in that section of page 12, on lines 10 through 11, says that, "That is improper retroactive ratemaking." Do you see that?

A Yes.

Q Okay. You're not a lawyer, correct, we have established that?

A We have established that.

Q Are you giving an opinion to the Commission that this violates the legal standard of retroactive

ratemaking established by this Commission and the Supreme Court of Florida?

A I'm not expressing a legal opinion.

Q Have you evaluated or has anybody evaluated and helped you develop this opinion about retroactive ratemaking based on the case law and the Commission precedent on retroactive ratemaking?

A I'm not aware of such an analysis, no.

Q So you did not inquire as to what the legal standard for retroactive ratemaking was before the Florida Public Service Commission?

A No, I did not have, again, a specific analysis of that done by counsel. I certainly consulted with our counsel as we drafted this rebuttal, and in particular -- again, my belief, as I stated earlier, is that this notion of retroactive ratemaking stems from the application of these prospective estimates as if they had existed, and therefore draws the conclusion that prior recovery levels are incorrect.

Q Is it your understanding that the remaining life methodology of correcting a reserve imbalance, a theoretical reserve imbalance, does what Mr. Pous does, but just over a longer period of time?

A Yes, I think it does accomplish that over the average remaining service lives.

Q So Mr. Pous is recommending to this Commission that they return -- that they adjust -- let me start over again.

Mr. Pous is recommending to this Commission that they adjust the reserve imbalance by crediting -- by debiting the accumulated depreciation reserve $161 million and crediting the income statement $161 million, isn't that essentially what his recommendation is, that that be done over four years?

A Each and every year for four years, that's correct.

Q That's the basic T account, debits and credits, correct?

A That's right.

Q Now, is it --

A I guess I would add that, in contrast, if I might, the average remaining service life accomplishes the same thing, but over the remaining service lives of the assets. And, in a way, it does that -- well, one, it uses just the actual accumulated depreciation reserves. It does not create this artificial reduction for some short period of time, like in this four-year period, and to be followed by, logically, then, an increasing level of depreciation requirements since those actual books -- reserves would have been reduced

by this 640-some million dollars.

Q So you would agree with me, would you not, that this $646 million would be flowed back to the benefit of the customers via an, in effect, credit and income statement of, instead of over four years, over 21 years, right?

A Again, I don't really see it as flowing back this surplus as much as recognizing the recovery of the company's current net book value based on actual accumulated reserves, depreciation reserves, which, again, reflects historical recovery of those investments over the average remaining service life of that plant.

Q But you would agree with me, would you not, that, boiled down to its essence, the flowback of what has been identified as a theoretical reserve variance occurs over 21 years instead of four years when you compare the two methodologies, correct?

A At this point in time I would agree with that, followed by if I did an update of that, we could arrive at a different conclusion, because that so-called variance, the theoretical reserve, that's why it's called theoretical, would have changed.

Q The next sentence in that paragraph there, or the last sentence in that paragraph, from lines 11 to 12, says, "It" -- and I'm assuming we're talking about

Mr. Pous's proposal -- "is also a direct attack on the propriety of the prior and current Commission-approved depreciation rates." That's your testimony, right?

A Yes, that's what it says there.

Q Okay. Are you saying, by testifying to this, that if the Commission made any adjustment to correct the depreciation reserve variance, and whether it was to correct a deficiency or a surplus, that that would be somehow violative of past Commission orders?

A Well, perhaps the word "direct attack" is a rather strong one, and I was at the time writing this not in a gentler spirit of mind, if you will.

Q I think we all have been there before.

A But I do think it does impose the current depreciation parameters, or estimates, if you will, impose those critically against what decisions have been made in the past by suggesting, again, that these accumulated reserves, actual recoveries that have been recognized by the company of their investments, that those recoveries somehow should have been greater or less than what they actually are.

Q We can move off of those three sentences and ask you to go to the next page, page 13 of your rebuttal. I guess really continuing from the prior page to the top of page 13, you reference --

CHAIRMAN CARTER: Is this a new line, Mr. Rehwinkel?

MR. REHWINKEL: Yes, sir.

CHAIRMAN CARTER: Let's pick it up after lunch. 2:15.

(Lunch recess at 12:57 p.m.; reconvened at 2:18 p.m. and continued as follows:)

CHAIRMAN CARTER: We're back on the record, and when we last left, we had Mr. Rehwinkel doing cross-examination. Before we do that, I'm going to recognize staff for a preliminary matter. Staff, you're recognized.

MS. BRUBAKER: Thank you. Before we begin, I would like to enter an appearance on behalf of Mr. Adam Teitzman as advisory counsel to the Commission.

CHAIRMAN CARTER: To the Commissioners, right?

MS. BRUBAKER: Yes, sir, the Commissioners.

CHAIRMAN CARTER: Very good.

Any other preliminary matters before we resume the cross-examination?

MS. BRUBAKER: There are none that I'm aware of.

CHAIRMAN CARTER: Any preliminary matters of the parties?

Okay. Mr. Rehwinkel, you're recognized, sir.

MR. REHWINKEL: Thank you, Mr. Chairman.

BY MR. REHWINKEL:

Q Mr. Garrett, if I could ask you, SFAS 154, you've testified about that in your testimony, correct?

A Yes, I did.

Q Was that accounting pronouncement a codification of existing accounting principles as they relate to restatements or corrections?

A No, I think it was more than that. I think it was really an initial step in moving towards, ultimately, adoption of international reporting standards, financial reporting standards.

Q But with respect to principles of accounting as they would impact the restatement or correction of financial statements, that was not necessarily a new statement, isn't that correct?

A No, that's not correct. It actually proposed alternative accounting treatment for changes and error corrections, as it was titled, "Accounting Changes and Error Corrections," so it was more than just a codification of existing pronouncements.

Q But there was some codification of existing accounting principles in there, correct?

A There were some --

Q For purposes --

A Yes, there were some, but as I said, I think it was intended more to align current GAAP with ultimately moving towards IFFRS, which is I-F-F-R-S.

Q Okay. Could I get you to turn to page 11 of your rebuttal testimony?

A I'm there.

Q On lines 14 through 17, you state that "The assertion that the 'excess' or 'surplus,'" and you've put those two words in quotes, "means PEF has overcollected and customers have overpaid is nonsensical, relies on the false assumption that the proposed rates have always been in effect, and further says that the Commission's prior approval and collection of these rates from customers for the past was wrong." Do you see that?

A Yes, I do.

Q Did I read that correctly?

A You did.

Q You are aware, are you not, that there have been instances where theoretical reserve variances have been corrected on a faster than average service life basis, aren't you?

A I'm aware of where theoretical variances and particular deficits have been.

Q So the answer to my question is yes?

A Yes, I'm aware of where theoretical reserve variances that were deficits were recorded over a period greater than the average remaining service life.

Q There isn't any distinction from a theoretical standpoint between a deficit or a surplus with respect to the objections you raised in your testimony, is there?

A Yes, I think there's a pretty significant distinction. In the case of a deficit, it certainly -- if one looks underneath that to analyze what might cause it, it may very well be due to assets that are no longer in service, and therefore being recovered, if one continues to apply the average remaining service life approach, would be recovered over that group's composite rate over the remaining life of those assets.

In the case of surplus, that could be driven by a number of factors, but generally, certainly as I said in my opening comments, in our context, it's largely due to production plant associated with the change in those useful lives, and therefore those assets are still in service and providing benefits to our customers. So they're very different.

Q You were here yesterday?

A Yes, I was.

Q And you heard a lot of testimony about JBC-7

with Mr. Crisp?

A I heard some of that.

Q Do you know what that exhibit is?

A No, I don't have that in front of me.

Q Okay. Did you hear some testimony about -- I guess my question to you was, do you know what that is?

A I don't recall exactly. I think it had something to do with the terminal lives of the plants.

Q It's a document you've seen before, right?

A Yes, I think I have. I just don't have it in front of me.

Q Okay. Well, I don't really need to refer to it, other than to kind of understand -- or to ask you some questions about maybe really some hypotheticals, but you would agree with me that that document had service lives as they were determined and used in the 2005 depreciation study for generating units?

A It might be helpful if I had a copy of it, or is it similar to the one that I have proposed here?

Q I should have asked if I could approach the witness. Actually, what I gave you was an interrogatory response for 174, which I think were Mr. Robinson's work papers, but I will represent to you that that's the same document.

CHAIRMAN CARTER: No lunch tomorrow, Mr.

Rehwinkel.

COMMISSIONER EDGAR: But that's because we're going to be done tonight, Mr. Chairman.

CHAIRMAN CARTER: Okay. Go ahead, Mr. Rehwinkel.

BY MR. REHWINKEL:

Q That document there, do you recognize that as what Mr. Crisp attached to his testimony as JBC-7?

A Yes, I do.

Q So more to the left-hand side of the page, there is a column that has the 2005 service lives, do you see that? Retirement dates, parenthesis, previous study --

A On the previous study --

Q Yes, sir. I shouldn't call those service lives, those are just terminal dates for those units, correct, retirement dates?

A Yes.

Q And then on the right-hand side under, "Possible Retirement Dates, System Planning," it has the new terminal dates for units that were -- those same units, and I think there was a lot of testimony those are the dates that were used for determining the plant service lives. Do you see that?

A Yes.

Q Now, if, and this is a hypothetical, but if on the right-hand side under the "Possible Retirement Date" columns, for whatever planning reasons that Mr. Crisp's organization determined were appropriate, those dates were actually shortened, or those were brought nearer in time than the ones on the left-hand side, the 2005 study dates, that would generate shorter lives and higher depreciation expense for those -- relative to those units, correct?

A In looking at just -- I would say yes, if we're just isolating the impact of changing the terminal date, either shortening it in your example there, that would follow that it would increase the amount of depreciation requirement associated to recover those assets over that shorter period of time.

Q And that's the kind of decision that could create, all other things being equal, that's the kind of thing that could create a deficiency in a theoretical reserve variance, correct?

A Yes.

Q Okay. So if you assume for the purposes of my hypothetical that you had, for planning purposes, a scenario where the only thing you did was increase the service lives -- well, first of all, if you had a situation where you had no variance whatsoever in your

reserve, your theoretical reserve and your book reserve were roughly equal, so you wouldn't have a variance, do you understand?

A I understand that. It's highly unlikely that would ever occur, but --

Q But it could happen.

A I think it would be purely coincidental.

Q Sure. But it could happen, correct?

A A lot of things could happen.

Q Have you ever seen a situation where a company went from a deficiency to a surplus in their theoretical reserve?

A Yes, and I have seen where they've gone the other way.

Q But to go from a deficiency to a surplus, certain -- I mean, you might, in some point in time, if you recalculated reserve, you might be close to or at zero as you were transitioning from a deficiency to a surplus, right?

A It's possible.

Q And it's just a number on a continuum, right, zero?

A It's -- yes, in the sense that it's a point-in-time estimate, at some point, yes, you could magically have recalculated them out and it would be

zero.

Q Okay. I'm not trying to trick you or anything, I'm just trying to establish a hypothetical where you would be at zero.

A I'm trying to be responsive that it's highly -- your hypothetical is highly unlikely to ever occur that you would be exactly at zero.

Q Okay. So you're at zero and you change the service lives of your generating units and you change them by extending them. Relative to that point in time where you were at zero, if nothing else changed, you would create a theoretical reserve surplus, correct?

A Yes, you would.

Q Now, let's go back to that hypothetical and our highly unlikely zero amount, and you've shortened the service lives of those plants for planning purposes, not because they were being retired the next day or anything like that, but just because the planning folks figured that the terminal date would be nearer in time rather than farther out. Do you follow me?

A Yes.

Q If you did that, and all other things were equal, you would create a deficiency, correct?

A Yes.

Q Okay. So between those two scenarios where

you had a deficiency or a reserve that were purely created by those planning decisions that would either, on one hand, extend the lives of the units, or on the other hand, shorten the lives of the unit, would there be any reason for treating those variances differently with respect to the Commission's correction of those variances?

A Well, I think my answer would be that there really isn't any reason to do anything. The average remaining life approach would be using the actual accumulated depreciation reserves in both of your scenarios, and there would be no need to adjust anything, because the net investments of the company would be appropriately recovered over their expected future life.

Q So my question to you is, is there any reason to treat the deficiency different than the surplus with respect to correcting those reserves, under that scenario that I gave you?

A Again, under that scenario, my opinion would be there would be no need to do anything, to make any correction.

Q What if -- let's go back to those two hypothetical scenarios. If you increased the value of the theoretical reserve in a positive way based on your

planning assumptions about generating units such that the depreciation, theoretical depreciation reserve surplus was ten percent of the accumulated depreciation reserve on your -- would you still utilize the remaining life approach to correcting that variance?

A Again, based on -- yes, I would, because based on the, what I understand to be the driver in your hypothetical, it's the change in the expected useful life of the asset. So in order to properly, it seems to me, to then match recognition of expense over that useful life, there would be no need to do anything. I would merely depreciate the net book value of that asset over its now-assumed useful life.

Q Okay. And on the other side of the coin, if you had a deficiency driven entirely by planning assumptions with respect to the retirement dates of the generating units and it created a deficiency greater -- a deficient theoretical reserve variance of greater than ten percent of the total accumulated depreciation reserve, would there be any reason to treat that differently than remaining life correction?

A No, I think given, again, your hypothetical, based on what I understand to be the driver associated with that, the deficit was driven by a shorter useful life, and therefore, using the average remaining life

straight line depreciation method would recover the assets over that life.

Q Has Progress ever come in and asked for a correction to their theoretical reserve deficiency over a period less than what remaining life would generate?

A I'm not aware if they have.

Q You wouldn't know one way or the other?

A No. I -- I'm not aware of any specific circumstances I could give you.

Q Did you do any research when you were looking at these Commission orders to determine how Progress specifically had been treated with respect to correcting depreciation, theoretical depreciation reserve variances?

A Well, in the orders that I refer to, I don't recall Progress being mentioned in particular. A deficit, I think, is the example you're asking for.

Q Okay. Well, did Progress ever seek to have depreciation reserve deficiencies corrected on amortization schedules?

A Again, I'm not aware of that, but I wouldn't be surprised that that had been done. It's a practice that, even in the orders that I cite, has been followed.

Q Let me ask you to turn to page 14, please, of your rebuttal, and on lines 16 through 18, if I could

direct you to read that, please?

A Again, lines 16 through 18?

Q Yes, sir.

A "The company's prior and current depreciation rates, however, were based on the best estimates at the time given the information available, or they were agreed to by all the parties, including OPC and FIPUG, in the prior rate case settlements," which I think are referred to above that.

Q Okay, so is it your testimony that depreciation rates that are the product of a stipulation are as valid for purposes of reviewing Commission policy embodied in Commission orders as depreciation rates that are generated after a contested hearing?

A No, I don't think they're equivalent. I think in the context of establishing, certainly, the recovery level that the Commission has determined to reflect in the cost of service, it's relevant, but I don't think it's precedential in any way that acknowledgment of a settlement then dictates policy, because, again, settlements could be a culmination of a variety of interests.

Q So if we go back to -- you cite on page 13 the 2005 stipulation. Actually, I think you start on line -- on page 12 and you refer to the 2005 settlement.

A Yes.

Q Now, was there any adjustment to depreciation expense other than what was proposed in the company's study in that case?

A Not that I'm aware of.

Q Okay. You also reference a 2002 settlement, do you see that?

A Yes.

Q Was there any adjustment to depreciation reserve as a result, other than what the company proposed in their depreciation study in that case?

A Yes, there was.

Q What was that?

A There was a reduction to depreciation expense and the accumulated depreciation reserves, if I recall correctly, of $250 million over a four-year period of time.

Q Did that order violate Commission policy? The order that approved that stipulation, did it violate a longstanding Commission policy?

A That order was -- no, I don't think it did. It was -- the Commission took action on a settlement.

Q And you state here on page 13, lines 6 through 7, that, "The Commission approved the company's depreciation rates and again found that the stipulation

established rates that are fair, just and reasonable." Do you see that?

A Yes, I do see that.

Q So when the Commission found that depreciation -- well, let's go back for a second.

When you talk about rates, what are you talking about there, the end user rates or depreciation rates?

A I'm referring to the depreciation rates, the actual rates that would be applied to depreciable plant to arrive at depreciation expense.

Q Did it also -- is it your opinion -- or is it your contention there that this language that you reference here also referred to the depreciation expense that was generated as a result of that settlement?

A I think that the rates were different than -- the rate component did not include, as I understand it, the $250 million depreciation reduction, so the rates were determined using the depreciation study, and a reduction to depreciation expense of $250 million was recognized over that four-year period of time.

Q Well, you're not contending, are you, that the Commission's order approving the stipulation only applied to the depreciation rates and not to the credit in the depreciation -- in the income statement of about

62 and a half million dollars related to the flowback over four years of the $250 million, are you?

A I think the -- well, what I'm indicating here is that, as I understand the settlement, and this predates my arrival to Progress in 2005, but as I understand what was done there, the depreciation rates were approved and an additional reduction to the cost of service associated with depreciation was reflected, of annually the $62 million that you refer.

So in some regards, I do see them separate. I see a recognition of the depreciation rates that should be applied to depreciable plant during that four-year term, and then a recognition of what the Commission felt was appropriate for establishing the cost of service over that period of time as well.

Q But the Commission's order does not carve out depreciation rates for approval as fair, just and reasonable, and then make a determination separately with respect to the credit in the income statement of 62 and a half million dollars as agreed to by the parties, does it?

A I think it did in the sense that it didn't address how this $250 million would be ultimately reflected in rates, in depreciation rates, until it pointed, if I recall the settlement correctly, it

pointed to the 2005 study that was to be filed. So I do see those as somewhat independent decisions; that on the one hand, rates were approved, a cost of service determination was made, and a final disposition of that reserve reduction would be reflected in a 2005 depreciation study.

Q Now, what -- everything you just said, is that -- that's contained in the order and/or the stipulation that the order approves?

A I don't have the order in front of me, but again, that's my recollection of how it was to be handled. Again, the 2005 depreciation study ultimately reflected that approach, because it then allocated the $250 million reserve reduction in accordance with, I believe, provisions of that stipulation.

MR. REHWINKEL: Okay. Mr. Chairman, if I may, you probably will be shocked to know that I have a copy of that order here.

Mr. Chairman, if I may approach, I'd like to --

CHAIRMAN CARTER: You may approach. Do you want to cite it for the record?

MR. REHWINKEL: This is the order that's cited on page 13 of Mr. Garrett's testimony on line 5, PSC 02-0655-AS-EI.

CHAIRMAN CARTER: You may approach.

MR. WALLS: Is that the entire order with the stipulation?

MR. REHWINKEL: It is a 32-page order.

CHAIRMAN CARTER: You may proceed.

BY MR. REHWINKEL:

Q Mr. Garrett, can you point to me in that order where you think that the Commission looks at the depreciation rates differently than it looks at the 62 and a half million dollar credit in the income statement related to the four-year flowback of $250 million of the depreciation reserve variance?

A Yes. On page 18 of the Attachment 1, it states, "Each calendar year during this period, FPC will also record a $62.5 million credit to depreciation expense and debit to the bottom-line depreciation reserve, and may at its option record up to an equal annual amount of an offsetting accelerated depreciation expense and a credit to the bottom-line depreciation reserve. Any such reserve amount will be applied first to reduce any reserve excesses by account as determined in FPC's depreciation studies filed after the term of the stipulation, and settlement thereafter will result in reserve deficiencies. Any such reserve deficiences will be allocated," et cetera, et cetera, et cetera.

So clearly it points to a future event of how the depreciation expense reduction would be ultimately reflected in depreciation rates, i.e., it looks to the study to be filed, the 2005 study, depreciation study, of how to then account for that annual $62.5 million credit to depreciation expense.

Q When was the credit in the income statement first recognized of the 62 and a half million dollars?

A I don't know exactly when it was first recognized.

Q What year?

A I assume it was recognized annually, as it provides here.

Q Okay. So 2005 would have been the first year?

A Two thousand -- no, the first year to recognize it would have been the first year of the term of the settlement, which I believe was 2002.

Q I'm sorry, yes. 2002 it was --

A Right. And the point I'm trying to make here is that that was not part of the depreciation rates that were then used by the company as plant additions were made throughout the term of the settlement, so its impact on rates was not known until the 2005 depreciation study was filed.

Q Well, would correction of a depreciation

reserve affect the establishment of depreciation rates, these are the rates that would apply to the various plant balances?

A Not necessarily.

Q Actually not at all, right?

A Well, it depends whether or not the depreciation reserve adjustments, if those accumulated depreciation reserves were then used in subsequent studies for arriving at what net plant balances were necessary to be recovered in those studies.

Q But the reserve -- I'm making a distinction between expense and rates. How you treat the reserve for purposes of correction of a variance might affect expense, but it should not affect the setting of rates as they apply to plant balances, correct?

A No, I do not agree with that. Ultimately, if those accumulated depreciation reserves are used for purposes of establishing the net book value of assets to be recovered, it will affect future rates. And that's exactly what happened in 2005.

Q In 2005, isn't it true that the theoretical reserve variance was adjusted by the $250 million that's referenced in that 2002 stipulation and order? It was reduced, correct?

A Not at the end of 2005. Until the Commission

took action on the proposed depreciation rates, that -- as I understand how the 2005 study was presented, it presented approximately a $700 million depreciation reserve variance that was then reduced once the $250 million was allocated, and that was done when the Commission took action on proposed new rates, depreciation rates, effective 1/1/06.

Q And by taking action, that was essentially the 2005 order you cite on page 13, correct?

A Yes, the 2005 settlement and stipulation.

Q Okay. Now, once that $250 million was recognized against the $754 million reserve variance in the 2005 study, the actual variance was $504 million, correct?

A No, because the -- I don't agree with that. The theoretical reserve was calculated as of the end of December, 2005, so the reduction or the effect of adopting the new rates was not remeasured until the current proceeding that we have before us. So the theoretical reserve variance as we reported was $700 million, December '05.

MR. REHWINKEL: Mr. Chairman, I would like to pass out an exhibit.

CHAIRMAN CARTER: Okay, Mr. Rehwinkel, we're up to No. 315.

MR. REHWINKEL: And this would be entitled PEF 2005 Depreciation Study, and it's not the study, it's one page, I don't want to scare anybody. This is actually Table 5-F on page 2-69.

MR. LaVIA: The entire Table 5-F, or --

MR. REHWINKEL: I'm sorry, no, it's just Table 2-69. I have the balance -- 2-63 through 2-68, I have these pages if you would like me to provide them to the witness.

THE WITNESS: It's not necessary, I'm familiar with this page.

CHAIRMAN CARTER: You may proceed.

BY MR. REHWINKEL:

Q I think while we were passing it out, you said you're familiar with 2-69, Mr. Garrett?

A Yes, I am.

Q Okay. What this shows in the total depreciable plant line under column H, "Reserve Variance," is a variance of $754,049,932, is that right?

A That's correct.

Q And is that the 700 million that you were referring to?

A That's correct.

Q Okay. And that would be the reserve as of the end of 2005, correct, or the variance as of the end --

A Yes, the variance as of the end of 2005.

Q Okay. And then we see the allocation of retail reserve debit of $250 million in column K, right?

A Yes.

Q So is it your testimony that as of the effective date of this stipulation for the next year's rates, that the reserve balance would be -- the theoretical reserve variance would be $504 million, give or take?

A No, that's not my testimony. My testimony would be that, as indicated on the schedule you handed out, that the reserve variance was $754 million.

Q So it would be your contention that the $250 million never reduced the depreciation reserve variance on a theoretical basis?

A No, it did when the $250 million debit was ultimately recognized in the book accumulated depreciation reserves for purposes of calculating the theoretical reserve variance, which would have been effectively accomplished through this reserve allocation on 1/1/06.

Q Okay. I thought I asked you on 1/1/06 would the reserve variance be --

A Well, we calculated it as of 12/31/05.

Q Okay, but on -- as of 1/1/06 --

A We didn't calculate a theoretical reserve variance. We did the study as of -- this is *pro forma* rates as of 12/31/05.

Q Okay. When the Commission recognized or adopted a stipulation with the $250 million debit to the accumulated depreciation, did that violate GAAP?

A Could you rephrase that, please?

Q Yes, sir. When the Commission approved, in that order that you have, the 2002 order approving the stipulation that you cite on page 13, line 5, when they adopted that order with the $250 million debit to depreciation reserve, did they violate GAAP?

A Well, if I may, I view how this was recognized differently than I think you just characterized it.

What I read in page 18 was a $62.5 million credit to depreciation expense and a debit to the bottom-line depreciation reserve. The reduction to expense, as I said in my opening remarks, I believe the Commission has considerable latitude on how to establish the cost of service. And in these particular circumstances, that reduction was in accordance with GAAP. So the recognition of that credit was also recognized -- reduction of depreciation expense as reflected in the cost of service was also recognized for GAAP purposes.

Q How was that $62.5 million credit to expense any different for GAAP purposes than a $161 million credit to depreciation expense proposed by Public Counsel?

A Well, there's considerable difference. For one --

Q For purposes of GAAP, I'm sorry, I should have added that.

A Yes, I tend to connect the dots to GAAP.

For one, there have been a number of developments in insight or interpretation of what appropriate GAAP should be since this adoption of this settlement. I would point out that this is a material, adjustment that you're referring to, the 161 million, which essentially, if you can follow the debits and credits for a moment, at the end of the day writes up assets by the tune of $650 million. I will acknowledge there are very rare circumstances where the writeup of assets for GAAP purposes is appropriate unless it's involved in some kind of reorganization or purchase accounting. That's clearly not what we have here.

Q Where's here?

A Since -- well, that we have a purchase or a restructure, a reorganization of any kind that would trigger a remeasurement of the asset values.

So what's being proposed today is a, I believe an unprecedented level of a writeup in assets at $648 million, so it's considerably more material than what was dealt with here.

But beyond materiality, there have been developments within accounting, one I've referred to, FAS 154, which was issued in 2005, and I also provided, during discovery, I provided input that I had when -- to staff in a discovery response input that we received from D&T about certain concerns -- and Deloitte & Touche, they're our external auditors -- in 2007 in which they raised concerns about reserve transfers, which essentially this is, that is, a reduction in accumulated depreciation reserves, which, again, I want to emphasize has the effect of writing up assets.

Q Is there any Deloitte & Touche testimony -- is there any mention of Deloitte & Touche in your testimony?

A Again, I referred to FAS 154 because I think it's the most clear principle that's also consistently adopted within the regulatory filings that I also cited.

Q Okay. Let's start with this $250 million, it's in Exhibit 315. That right there, and you see in the column AK, it says the word "debit." So $250 million -- your accumulated depreciation is a

credit balance, correct?

A I'm not sure I'm with you, what document you're on.

Q I'm sorry, this is on --

A Oh, you're back on 260 -- I'm sorry. I'm with you.

Q Accumulated depreciation is a credit balance, correct?

A Uh-huh.

Q Is an offset to your debit balances, your plan accounts, right?

A Uh-huh.

Q And this says, "allocation of retail reserve debit of $250 million." So isn't it true that this debit here is a writeup, to use your words, of assets of $250 million?

A Ultimately, yes. Yes, it is.

Q So that occurred -- and this order was issued when, in April of 2005, is that what the order, the 2002 -- oh, that was 2002 order.

A May of 2002 --

Q Okay.

A -- yes. And again, that was significantly prior to the issuance of 154 and also the guidance that I mentioned that I provided in discovery based on 2007

information.

Q We'll get to that.

Material, you said it was material, that that $646 million is material and 250 million is not material, is that right?

A Well, I think for me both of them are significant. The proposal, though, of writing up the assets of $650 million creates some very unique challenges, I'll put it that way, but certainly is unprecedented in terms of its size, in its impact to rates, rate base, and ultimately creates issues in terms of the ability to adopt it, because of the magnitude of the expense reduction.

And I think perhaps an example might be useful to try to illustrate that. If you take depreciation expense for nuclear, our nuclear Crystal River plant as an example, and maybe perhaps, subject to check, the depreciation for a particular prime account related to electric equipment at Crystal River, the annual depreciation requirement under our proposal would be $3.2 million, so under the study, depreciation expense or recovery levels would be $3.2 million.

The magnitude of reflecting a $162 million expense reduction would be, for that account, is 43 million of its share of the theoretical reserve

variance, or $10 million annually. So what the Intervenors would have you decide is that we would need to take depreciation expense of 3.2 million, reduce it and actually make it negative by $10 million a year.

There lies the problem from a GAAP perspective. We would have to, essentially, for the next four years restate depreciation levels that have been previously recorded, because we're not -- we would only be recognizing three million on an ongoing basis.

So to sum it up, how radical a proposal this is, is it would require no depreciation expense for a plant that clearly is providing service to existing customers, and to reduce expense to zero and beyond and make it negative, I would propose to you, is not GAAP.

Q Mr. Pous's recommendation is not account-specific, is it, with respect to where the credit hits?

A He proposes to reduce the $161 million in annual depreciation expense. He doesn't mention how he's going to do it, so we would have to come up with an appropriate way to reflect that that would also adjust rates prospectively in a logical manner. In the prior stipulation that you referred to, that manner is laid out. I think we've covered that ground. That manner is very prescriptive of how that was supposed to be handled, and ultimately I think the company complied

with that. Your proposal is not.

Q So from a materiality standpoint, we can agree there is $99 million difference between Mr. Pous's recommendation and -- on an annual income statement impact and the 62 and a half million dollars from the 2002 order, correct?

A Yes. As it relates to just the depreciation reduction, it's more than $100 million greater than what was recommended here, or what was reflected in the 2002 --

Q I was just subtracting 62 and a half from 161.

A Yes, approximately 100 million.

Q Okay. So you're saying from a materiality standpoint, somewhere between the 99 and zero -- or somewhere between 62 and 161 is where that materiality threshold is?

A No, it's not just materiality. I also mentioned that there is additional accounting guidance that's been provided since this stipulation in 2002 that certainly gives me reason to pause before I would say that a $650 million reduction to accumulated depreciation reserves is in accordance with GAAP.

Q But I was just focusing on the materiality aspect for now.

A It's one element.

Q Okay. And with respect to materiality, can you tell me where in SFAS 154 it gives you a bright line about where it's material and where it's not?

A Well, 154 doesn't cover necessarily how regulated enterprises establish cost of service. It clearly establishes how changes in estimate should be handled.

What I think I'm pointing out is that, again, I think the Commission has considerable latitude in establishing the cost of service. If they, for whatever reason, chose to, as in my example, reduce the recovery for our nuclear power plant to zero, I think GAAP would recognize that there is some latitude in accomplishing that. To take it negative, to make it actually requiring a restatement of prior periods' depreciation, that's where I think we start having GAAP issues.

Q Okay. So you think, just to use your approach, the Commission could do this without objection from you, as long as it didn't affect the CR-3 depreciation expense amounts in a negative way?

A No, that's not what I said. I said I think they have considerable latitude in how to establish the cost of service. I think, as I proposed in here, that the cleanest way to comply with GAAP, given what I provided in my rebuttal testimony of how generally the

principle of accounting estimate changes are accounted for, is under the average remaining service life approach. That's the cleanest way to avoid, if you will, GAAP issues. I responded to what was proposed by the Intervenors in terms of the level of depreciation expense reduction and whether or not that was in accordance with GAAP, and my opinion is that it has problems.

Q Let's look at page 32 of your testimony. Let's skip ahead and talk about GAAP. And are you there?

A Yes, I am.

Q Okay. So lines 5 of page 32 through the rest of that, through line 6 of page 33, is where you discuss the GAAP -- actually, where you discuss SFAS 154 as it applies, in your opinion, to Mr. Pous's and Mr. Lawton's proposal, correct?

A Yes, and also, I also refer to Commission actions and the application of how they have accounted for changes in estimates, either in the FERC jurisdiction or within the Florida Public Service Commission -- by the Florida Public Service Commission.

(Brief pause at 3:15 p.m.)

(The transcript continues in sequence with Volume 27.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)

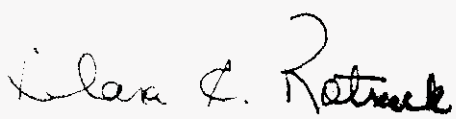
COUNTY OF LEON)

I, CLARA C. ROTRUCK, do hereby certify that I was authorized to and did stenographically report the foregoing proceedings at the time and place herein stated.

IT IS FURTHER CERTIFIED that the foregoing transcript is a true record of my stenographic notes.

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

DATED this 5th day of October, 2009, at Tallahassee, Leon County, Florida.



CLARA C. ROTRUCK