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 27

Pages 3810 through 4023

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A CONVENIENCE COPY ONLY AND ARE NOT
THE OFFICIAL TRANSCRIPT OF THE HEARING,
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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: Concluded at 8:08 p.m.

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

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

PARTICIPATING: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
316	List of PSC orders	3841	
225-230			3906
231			3906

P R O C E E D I N G S

(Transcript follows in sequence from Volume 26.)

CONTINUED CROSS EXAMINATION

BY MR. REHWINKEL:

Q. Now, what you provided the Commission for guidance with respect to GAAP is contained in, basically, this approximately a page of testimony, correct?

A. Yes. For me it was the clearest evidence of what the principle is that should be applied associated with changes in estimates.

Q. Okay. Now, the average remaining life or remaining life approach that you would propose, that to some degree, but to a much lesser degree, restates depreciation, does it not?

A. No, it does not restate depreciation.

Q. It does not correct depreciation reserve variance?

A. No, it does not restate depreciation expense in the sense that previously recognized depreciation expense is not adjusted in any way.

Q. In your research regarding the Commission's long-standing policy about correcting depreciation reserve variances, you didn't find any discussion about

GAAP, did you?

A. Not that I can recall.

Q. And I think you may have alluded to it earlier or you may have expressly stated it, but you would agree with me, would you not, that GAAP is not binding upon the Public Service Commission with respect to how they treat depreciation expense or depreciation reserves, correct?

A. Yes. Clearly, GAAP is not -- shouldn't drive necessarily the Commission's actions. I think more significantly is the precedential value of a decision here in establishing depreciation policy where a final depreciation study is then subject to review. And as a result of changes in estimates, creates some uncertainty about the ability to recover long-term the investments that the company performing that study has assumed have already been recovered. That is my point about assets being written up to the tune of $650 million, that I would hope that this Commission, that is the policy issue that they focus on, not necessarily the debits and credits of GAAP, if you will.

Clearly, Commission actions have historically, perhaps maybe not in this one, but in other jurisdictions have done things that don't necessarily fall within GAAP. But here I think this Commission is being asked to do something that is radically different than what has been done before.

Q. Okay. In this testimony that you have offered with respect to the GAAP relevance to this issue, there is nothing in here that you have cited that talks about whether there is any certainty or lack of certainty with respect to the company recovering its investment through depreciation rates, is there?

A. No. That was my opinion about that. I would certainly defer to other witnesses that will follow me to perhaps give their perspective on what investors' reactions would be to this level of uncertainty.

Q. Okay. You are not testifying anywhere that I have seen in your -- in your prepared rebuttal testimony that if the Commission were to adopt the Public Counsel's proposal with respect to returning or to flow back the positive theoretical reserve variance, you don't testify anywhere in here that it creates an uncertainty with respect to being able to recover your assets through the regulatory process, do you?

A. No, I did not testify to that. I addressed the GAAP accounting associated with -- you opened that perspective when you said should the Commission be driven by GAAP in making these decisions, and I thought you were asking my opinion of that. I think there are others who will follow that are far more equipped to provide a perspective on what investors' reactions might be to such a significant uncertainty.

Q. Well, when you use the word uncertainty, are you seriously contending that the Public Service Commission would not allow you to recover through depreciation your investment in plant and equipment?

A. No. I think the uncertainty I am referring to is that there is one thing I am certain of and that is that this theoretical reserve balance will change. It could very well move that it does not meet the expectations that we currently think. It may very well end up being a deficit.

As I pointed out earlier in my opening comments, a lot of this relates to production plant. There is some great uncertainty around what the asset lives of our coal plants are, for example. So I think that is what I am suggesting, that if I have to, I will put my bean hat on here for a moment just to account for this. That I have to essentially wait for -- every four years for a depreciation study to be performed to determine what I really recovered in plant. That is what we would be suggesting here is that I thought I recovered a certain amount, I then subject myself to this theoretical determination of what I should have recovered, and I somehow true that all up, and it is that uncertainty that I am referring to. And in the proposal that you have made, that is a $650 million increase in plant that needs to be recovered in the future.

Q. I didn't see anywhere in your testimony where you took issue with Mr. Pous' testimony that he had calculated that depreciation reserve deficiency on a theoretical basis to be $858 million, did I?

A. No. But I don't think he took exception to using the $645 million that -- $648 million that we calculated.

Q. Okay. So you would agree that he calculated the surplus at $858 million, correct?

A. I'm not sure how he calculated that. I know there is a number in his testimony that says that, but I have no knowledge of how he calculated it.

Q. Okay. And would you also agree that he testified that it could be even greater had he looked at all of the accounts with the same rigor that he did the ones that he did?

A. Well, actually, during his cross he seemed quite confident in that, that he almost assured us that when we look at this again there will be -- you know, don't worry, there will be, if I remember correctly, there will be additional surpluses there. I would love to have that type of foresight to understand how one can do that. I think we are dealing with the facts as we know them today, which is we have calculated a theoretical reserve variance, that is all it is.

Q. So, the reason I asked you that is I guess you were suggesting that the surplus or the positive variance could go negative. It could go more positive, too, couldn't it?

A. Again, the only thing I am certain of is that it will change.

Q. Okay. And we are also positive that it is at least 646 million, right?

A. As of that point in time it is $646 million.

Q. Now, Mr. Pous recommends $162 million income statement credit, more or less, correct?

A. Yes. The reduction to depreciation expense just associated with this matter.

Q. Yes.

A. He also recommended, if I recall, another 113 million, roughly, in downward adjustments due to depreciation parameters.

Q. Right. And we can keep those separate?

A. Yes. I am addressing the theoretical reserve variance.

Q. So my question is Mr. Lawton recommends $100 million income statement impact, correct?

A. Yes.

Q. Okay. Is that one still violative of SFAS 154?

A. As I read it, it does.

Q. Okay. What if it was a $50 million credit, would that be violative of SFAS 54 -- 154?

A. As a principle, yes, but now we are getting into numbers that $50 million over the course of four years is dramatically different than a $646 million reduction.

Q. So you are saying that the application of SFAS 154, as you view it, is a matter of degree and judgment?

A. No, I said the principle is the same as we apply it. Materiality certainly comes into play whether or not you could still report under GAAP a particular depreciation reduction.

Q. Okay. Is materiality a component of applying 154?

A. I think materiality is a component of interpreting accounting principles at all times.

Q. So every accounting pronouncement is applied with respect to materiality?

A. Yes, I think accounting pronouncements are applied given consideration to materiality, yes.

Q. Okay. But you would also agree that materiality is different based on the circumstances, even with respect to the same set of financial statements, would you not?

A. Could you rephrase that?

Q. Let me ask it to you this way. If you are doing -- if you are auditing a company, and you are looking at kind of how you would sample certain transactions, there is a materiality -- there is a materiality that guides the design of your audit, correct?

A. Yes.

Q. Okay. And that materiality is different than the materiality that you are talking about here, correct?

A. In the context you just gave of a sampling size?

Q. Yes, sir.

A. I guess it would depend on what somebody was trying to audit, and what attributes they were looking at, and -- I am talking about the bottom line impact to net income reported results. I, for one, think a $162 million reduction to depreciation expense and its impact on operating results is material.

Q. Okay.

A. I think that is relatively clear. And I think not only that, the cumulative effect of it, of $648 million or $46 million is significant and material.

Q. Okay. Now, you don't use the word material anywhere in Page 32 and 33 with respect with SFAS 154, do you?

A. I was laying the principle. And, quite frankly, the principle that I also then point back to in terms of regulatory adoption where I think it has been consistent with that principle.

Q. Okay. But the answer to my question is, no, you don't use material.

A. I saw no need to put some materiality guideline of my own on top of what seems to be very clear guidance in terms of how to account for change in estimates associated with depreciation.

Q. And there is not -- within 154 there is not any express guidance with respect to how materiality impacts the application of this accounting pronouncement to this situation, meaning Mr. Pous' recommendation, is there?

A. No, it would be impractical for an accounting pronouncement to provide materiality guidelines for every possible application that might be involved in adopting it.

Q. Okay. I'm sorry. So the Public Service Commission couldn't look at SFAS 154 and determine what was material -- I mean, where the materiality threshold was, could they, with respect to applying that pronouncement to this issue in this case?

A. Well, in all due respect, I am the one who is responsible for accounting matters. I have to make that determination in the accounting for our financial records. The Commission, their responsibility strikes me is more around the establishment of the cost of service and what actions they think are appropriate relative to the proposals and the evidence that is before them. In other words, it seems like they will -- the Commission certainly will handle the ratemaking considerations, but at the end of the day, the company management is responsible for how these transactions or how those effects would be accounted for.

Q. Okay. Well, you are aware, are you not, that the staff of the Public Service Commission has CPAs on it, aren't you?

A. Yes.

Q. Okay. And you would also agree with me, would you not, that if the Public Service Commission were to adopt Mr. Pous' proposal in totality, and that were to be put in an order and the order were to become final for all purposes, whether you appealed it or not, and you implemented that order, you would not be in violation of GAAP, correct?

A. No, that is not that my testimony.

Q. If you did what the Public Service Commission said, and it was lawful under the laws that govern this case, you are saying that that would violate GAAP?

A. Again, the Commission has latitude for establishing the cost of service and how they want to handle matters in rates. The exclusion of something like the reduction of an accumulated depreciation reserve in establishing rates doesn't make that GAAP. In fact, clearly in FAS 71 it points to the fact that the regulator's actions cannot reduce liabilities unless they created them. So I think that is an example of where they may choose to include or exclude particular liabilities within the rate-setting process, but it doesn't mean that that's GAAP. It doesn't make those liabilities go away.

CHAIRMAN CARTER: Excuse me, Mr. Rehwinkel. I just kind of want to give everyone a heads up. Jane, our court reporter, is going to be with us for the duration. So she is going to be the only one on board, so I am going to try to stagger some breaks in for her.

We will start with this one here, and we will come back probably at a quarter of. And what I will try to do like maybe on a two-hour cycle.

Jane, does that work for you?

And then we'll give her breaks so we can make it to 8:00 tonight. So, see you guys at -- what time did I say, quarter of?

(Off the record.)

COMMISSIONER McMURRIAN: Mr. Rehwinkel, go ahead.

MR. REHWINKEL: Thank you, Madam Chairman.

BY MR. REHWINKEL:

Q. Okay. Mr. Garrett, I guess hopefully that break will cause me to shorten my questions for you. I am enjoying this immensely, but I don't think anyone else is.

Let me ask you, the bottom of Page 32, on Line 23, continuing on to the next page, you state, "It is my opinion that the amortization of accumulated book reserves to reflect a retroactive adjustment to depreciation expense violates GAAP." Do you see that?

A. Yes.

Q. Okay. Now, when you say violates GAAP, are you stating that it is in your opinion inconsistent with SFAS 154?

A. Yes. Among some other input that I received, I mentioned earlier that I also discussed this matter with our outside auditors and looked to other references beyond 154, but I thought this was the clearest example or the clearest principle of where that principle is laid out.

Q. Okay. Now, I could be mistaken, and I think I wrote the word down reserve transfers when you mentioned DeLoitte & Touche, is that correct?

A. Yes.

Q. Okay. Is it DeLoitte & Touche's opinion that even reserve transfers are violative of GAAP?

A. Yes, in some circumstances.

Q. Okay. There is no one here from DeLoitte & Touche to testify to that, is there?

A. No, there is not.

Q. Okay. If you were to stipulate to an adjustment similar to what was stipulated to in 2002, but the amount was $400 million instead of 250, and you were to stipulate based on the facts and circumstances that caused the company to agree to a settlement, would -- and it was treated the same way as it was in 2002 with respect to the company incorporating into the next depreciation study, would that violate GAAP?

A. That is not a scenario that I considered. My testimony was directed specifically to yours and FIPUG's proposal to amortize very specific amounts.

Q. Okay. Well, let's just take the 2002 order, if that had been entered into today, or let's say if that had been entered into on January 10th, 2006, would that violate GAAP?

A. Again, I haven't -- I haven't considered those circumstances.

Q. Okay. Let's look at Page 25, if you would, please, of your rebuttal. And this is on Lines 9 through 19, you reference a 1988 Gulf Power depreciation order, is that correct? Well, actually -- yes.

A. I'm sorry, are you on Page 20 --

Q. I'm sorry, 25.

A. 25.

Q. Lines 19 -- I mean, I'm sorry, 9 through 19. You discuss a Gulf Power depreciation order?

A. Yes, in the context of a Tampa Electric matter.

Q. Okay. Now, you reference JDIC, job development investment tax credits, correct?

A. Yes. That was of subject matter in that order.

Q. Okay. And those tax credits were created as part of a tax reform act sometime in the 1980s, is that right?

A. I couldn't tell you if that was the case or not.

Q. Okay. So were you doing public accounting for utilities back in the '80s?

A. Yes, I was.

Q. Okay. And so you know what JDICs are, do you not?

A. I really don't know what this is in reference to.

Q. Okay. You know what tax credits are, do you not?

A. I do know what tax credits are.

Q. And for utility accounting purposes, you understand that tax credits are permanent tax timing differences associated with purchase of eligible plant and equipment, correct?

A. Yes, they may be.

Q. Okay. And for ratemaking purposes, these tax credits are considered cost-free -- well, they are not cost-free capital, they have a capital cost that is calculated pursuant to the Internal Revenue Service Code, correct?

A. Could you rephrase that?

Q. Well, let me ask -- I will withdraw that question and ask it this way. The JDIC -- well, investment tax credits are treated as -- they are recorded in the capital structure for ratemaking purposes, correct?

A. Yes, we do have some investment tax credits that are.

Q. And these are unamortized investment tax credits associated with plant acquisition from earlier periods, right?

A. Again, yes, I assume so.

Q. And, isn't it true that the Gulf Power order that you reference in your testimony dealt with the confluence of two situations, one a reserve -- a theoretical reserve deficiency for Gulf Power, and a revenue requirements windfall associated with the investment tax credits that Gulf Power received for its plant and equipment purchases?

A. Yes, I believe that was the subject. My principle focus was on how the theoretical deficiency was handled or the deficiency was handled in the order.

Q. That is what I wanted to ask you about. Investment tax credits for a new -- these job development investment tax credits were a relatively new creation in the tax code at that time, correct?

A. Yes. Again, I don't have intimate knowledge on what these tax credits were related to.

Q. Okay.

A. Back in 1988.

Q. But what happened, I think at that time, if you would accept, is that the company did not have a rate case, but they had a windfall in their revenue requirements and there was, if you will, a credit out there; and with respect to reserve deficiency, there was essentially a debit, and the Commission offset those two in treating this reserve deficiency, did they not, and didn't change rates?

A. Yes. Again, my focus on looking at this order was really related to how the unrecovered plant investment related to certain SCATA (phonetic) systems was handled, in particular how it was recovered.

Q. Okay. But what the Commission did was to take circumstances that they found themselves in with respect to the availability of tax credits, as it impacted the ratemaking process, and they used that to offset a reserve deficiency, did they not?

A. Yes. It appears that that was done. Again, my principle focus here was that it addressed an unrecovered balance associated with equipment that was amortized over a two-year period of time.

Q. Okay. On Page 26 you reference a West Florida

Natural Gas order on Lines 16 through 23. Do you see that?

A. Yes, I do. I'm there.

Q. Okay. And I think the purpose for you referencing this order is the language about using remaining life to write off imbalances in certain accounts, is that correct?

A. Yes, that is correct.

Q. Okay. And when you did your review of the order for purpose of this testimony and your opinion about Commission's policy, did you make any inquiry into the level of this depreciation reserve imbalance as it compared to the overall accumulated depreciation reserve of West Florida Natural Gas?

A. No, I did not. It appeared that -- again, my focus was on really how they dealt with an imbalance that was brought about by technological change, and specifically in the telephone industry, and what policy or what -- how that was treated in prospective depreciation.

Q. Okay. But doesn't this order kind of embody for you the Commission's long-standing policy that you testified to?

A. Well, it reflects, if I understand it, an approach associated with, in this case, an imbalance associated with unrecovered plant. So in that regard, yes, I think it does embody that. It is relatively small numbers compared to what we are discussing here. I think it refers to an imbalance of $13,481.

Q. Okay. So you would agree that that would not be a material depreciation reserve imbalance, correct?

A. Today, no.

Q. What about for this?

A. 1986. I don't -- I haven't looked at the financial statements of West Florida Natural Gas Corporation, but I am going to go out on a limb and suggest that it is probably not material.

Q. Okay. Thank you.

All right. Let's look at Page 29, and here at the bottom of Page 29, Lines 15 through the end of that page and carrying over to Page 30, you reference a 1997 Florida Power and Light order, and you also reference Mr. Terry Deason. Do you see that?

A. Yes, I do.

Q. Okay. Now, you are not adopting Commissioner -- Mr. Deason's testimony as a part of your testimony, are you?

A. No, I'm not, I just found it informative.

Q. And it is true, is it not, that Mr. Deason's testimony has not been entered into the record of any proceeding before this Commission, correct?

A. In this proceeding, no.

Q. Well, in any proceeding?

A. Well, it was provided in the FPL's current base rate case.

Q. It has been filed.

A. Yes.

Q. But it has not not been admitted into evidence there, has it?

A. That I don't know. I can't answer that.

Q. Okay. Has he testified yet in that matter?

A. Again, I'm not following the lineup of the witnesses.

Q. I'm asking because you raised it in your testimony.

A. No, again, I had access to what was filed and found it informative.

Q. Okay. And your testimony is not that Commissioner -- Mr. Deason's testimony is based on some kind of special knowledge he had with respect to this matter as a Commissioner, is it?

A. No.

Q. Okay. And you are also not testifying that he is stating anything other than what can be found on the record of any Public Service Commission proceeding, correct?

A. I'm sorry, could you --

Q. You are not testifying -- you are not representing to the Commission that his testimony is based on anything other than what can be found on the public record, correct?

A. Yes, I think that is correct.

Q. And isn't it true that Commissioner Deason took office at the Public Service Commission in February of 1997?

A. I don't know when Mr. Deason took office.

Q. Okay.

A. Again, I found it informative, given that this particular order that I cite was -- he was a Commissioner that participated in it, and it seemed to have some important opinions about what was intended there.

Q. Okay. Did he participate in the vote in that case?

A. I don't know. Again, I just saw that he was a Commissioner that participated in it.

Q. Okay. Was that an order that went -- based on a case that went to hearing?

A. I can't answer that. I'm not sure.

Q. Okay. You don't know if it was a PAA order?

A. I mean, the document I have here is a PSC order, so --

Q. Did Commissioner Deason reference this order in his testimony?

A. Yes, I believe he did.

Q. Did you review any of Mr. Deason's statements in any agenda conferences relating to Florida Power and Light as part of your research?

A. No, I did not. My review was limited to this order, and as I mentioned, the testimony that he filed in the FP&L case.

Q. Okay. Did you review any of his statements that he might have made on Friday, March 22nd, 2002 at an agenda conference related to Florida Power and Light?

A. No, I did not.

Q. So, would you accept, subject to check, that at that agenda conference he stated on Page 34 of the special agenda conference transcript, "We know that if -- if we underdepreciate or overdepreciate there has to be corrective measures taken after the next study. And my effort -- I mean, my concern is to try. I want the depreciation reserves to be as accurate as possible."

Have you ever seen anything where he said that?

A. No, and I don't refer to it here in my rebuttal testimony.

Q. Okay. But you are refer to his view of how depreciation reserves ought to be handled, correct?

A. Yes, I do. Again, based on the limited -- the testimony that was filed in the FP&L case.

Q. Did you review any statements he might have made to the effect that, "I would hope that after the conclusion of this settlement, if it is approved, that we would not find ourselves in a situation where depreciation reserves are way out of balance from where they should theoretically be"?

A. No, I did not review that. As I stated here on Page 30 of my testimony, what I thought was of particular relevance here was that it was not unusual for the Commission to establish accelerated amortization schedules to address equipment or facility reserve requirements. And I think it seems to me from, as I read this, that it is ultimately intended to reduce long-term revenue requirements or rate base over the long-term. At least that was my takeaway as I looked at this order, which is contrary to what is before us today.

Q. Okay. Let me ask you to turn to Page 30 of your rebuttal testimony?

A. I am there.

Q. And in Q&A beginning on line 9, continuing on down there, you reference a Marianna Division of Florida Public Utilities Company order, and you quote the order, which I think is an order of the Commission that says on Line 15, "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." Do you see that?

A. Yes, I do.

Q. Now, you state then, I think, following that quote, that this statement, of course, reflects the opinion of the Commission staff at that time, not the Commission itself. What do you mean by that?

A. Well, I mean that based on the statement before the quotation of that, that that was the opinion of the staff at that time.

Q. But it is a statement that is in the Commission's own order, isn't it?

A. Yes, it is a statement -- it does appear in the order, yes.

Q. Okay. Now, you are not contending, are you, that the Public Service Commission's depreciation staff doesn't possess vast depreciation knowledge, are you?

A. Absolutely not. I'm not contending that at all.

Q. Okay. Were you given a copy of the Exhibit 311, which is the public utility depreciation practices, NARUC, August 1996, Pages 188 and 189?

A. I don't have that here.

MR. REHWINKEL: If I may approach, Madam Chairman, the witness and hand him Exhibit 311.

BY MR. REHWINKEL:

Q. Is this something that you consulted in evaluating -- well, have you ever heard of this document?

A. Yes, I have.

Q. Is this something you consulted in preparing your testimony?

A. Not in preparing this, my rebuttal testimony, no. It was something that was certainly consulted in the preparation of our current depreciation study.

Q. Okay.

A. I think our Witness Earl Robinson covered that ground.

Q. Okay. On Page 189, if you will?

A. Yes.

Q. Are you familiar with this first paragraph at the top of this page?

A. Yes, I am.

Q. Okay. Do you have any disagreement with what is stated in actually the two paragraphs at the top of Page 189?

A. Could you ask the question, again, please?

Q. I asked if you have any disagreement with what is stated at the top of Page 189, and by the top, I meant these two paragraphs.

A. Well, I would take some exception to the notion that it refers to if there is a -- an analysis confirms a material imbalance, one should make immediate depreciation accrual adjustments to the use of an annual amortization over a short period of time or the setting of depreciation rates using the remaining life technique are two of the most common options for eliminating imbalance. As my testimony was geared towards addressing GAAP, depending upon how one implements those two options that seem to be pretty wide, that is, the use of a remaining life approach or a shorter period of time. And that is where I would take some exception to whether in all circumstances that would comply with GAAP.

Q. Okay. So, other than your concern about GAAP, do you have any concerns about these two? Do you have any disagreement with what is stated in these two paragraphs?

A. No, I think it supports what I have been saying about the need to understand fully or have a clear understanding of what is causing a reserve variance and then depending upon that, taking appropriate action. It is just the response to that that I would question whether or not in all circumstances it would comply with GAAP.

Q. Okay. Do you know if any members of the Florida Public Service Commission staff participated in the preparation of this document?

A. No, I do not.

Q. Okay. I just have a little bit more for you, but I want to kind of go back to GAAP since we just discussed it in this document here. But just so I understand, is it your testimony that SFAS 154 supersedes the Public Service Commission's authority to adjust theoretical reserve variances in the manner that it feels is best in the interest of the ratepayers of PEF?

A. No, that is not my testimony. As I said earlier, the Commission has considerable latitude, obviously, I think to establish the cost of service that they think is appropriate. 154, I think, just lays out the clearest principles associated with how enterprises should account for changes in estimates, and in particular depreciation.

Q. And, is it your testimony that SFAS 154 would come into play anytime the Public Service Commission corrected a theoretical reserve variance in a time period faster than the remaining life would call for?

A. Yes. Again, I think if any period short of the average remaining life is -- would warrant some review of whether or not that fit in the GAAP framework.

MR. REHWINKEL: Okay. Mr. Chairman, I would like to ask if I could have an exhibit identified for -- Madam Chairman, I'm sorry, I need to look up more often.

COMMISSIONER McMURRIAN: All right.

MR. REHWINKEL: For cross examination purposes.

COMMISSIONER McMURRIAN: Well, I think we are at 316.

MR. REHWINKEL: 316.

MS. KLANCKE: That is correct.

COMMISSIONER McMURRIAN: Thank you.

MR. REHWINKEL: This is -- we will just call it List of PSC Orders. Ms. Bradley has agreed to pass them out for me.

(Exhibit Number 316 marked for identification.)

BY MR. REHWINKEL:

Q. Mr. Garrett, what I have -- well, let me ask you this: In the research that you did -- if I could get you to turn to the first page of this exhibit, and up at the top it says FPSC orders requiring elimination of a depreciation reserve imbalance (surplus/deficiency through other than remaining life recovery.) And I would represent to you that this was provided to the Public Service Commission staff in discovery and as a late-filed deposition exhibit of Mr. Pous. But be that as it may, did you review these orders that are shown on this page in preparing your testimony?

A. I haven't gone through -- no, I haven't reviewed all of these. I would have to take some time to determine whether or not any of those are cited in my exhibit that I provided as WG-3. But I have not -- like I say, I have not reviewed all of these orders. It is possible that I reviewed some in WG-3.

Q. Do you see some on here that you did review?

A. For example, the General Telephone one, 14929, is one I looked at. Do you want me to continue and go through all of these? Again, I can do that if you would like.

Q. So would we find all the orders that you reviewed in your testimony? Were there some in your testimony -- I mean, there were some that you reviewed that you didn't include in your testimony?

A. Well, I was looking for, as an example, one that we just discussed of West Florida Natural Gas Corporation with the $13,481 imbalance. I don't see that on here.

Q. Well, that was -- if I could interrupt you. I am not trying to cut you off, but that was an order where the reserve imbalance was eliminated through remaining life, correct?

A. Well, I think, what I thought was -- yes, the conclusion there was that the imbalance was not the result of technological changes. So it reinforced what we have been referring to. As I notice here there is a pretty long laundry list of telephone orders here. Again, I have not reviewed them, but I would surmise from what I have seen in the ones that I did refer to that a lot of that may have been attributed to technological changes or obsolescence. And this particular West Florida case concluded that since it was not, they did not propose an accelerated disposition of that deficiency.

Q. Okay. Let me ask you to turn to the third page of this exhibit, and I will represent to you that the text that you see under elimination of imbalance, quote, as soon as possible is something that was prepared by our offices, not the Public Service Commission's language. But I would like to ask you is if you looked at these orders, there is a much smaller list of orders, and I would like to ask you if you looked at these orders, Peoples Gas, FPUC, Chesapeake Utilities, FPL, FPUC, Gulf Power, Gulf Telephone, Quincy Telephone, United Telephone, Gulf Telephone. Did you review any of those orders?

A. Again, without going down through my exhibit and cross-referencing them off the top of my head, I can't say that I have. There is no subject matter here, it's just a docket number and an order number, and I would have to go back. Again, I haven't looked at every order. I think we established that quite early on. But I put orders in that I thought were relevant and appropriate. I can't tell, again, from these what the subject matters were, and so I am not sure that I looked at these.

Q. Okay. My question from these is whether you encountered any orders where you read language in there that said imbalances were being eliminated as soon as possible. Did you ever encounter that language in any of the orders you looked at?

A. No, not associated with surpluses.

Q. What about with deficiencies?

A. I do believe that there was cases where that was the conclusion.

Q. And was the only time where you saw orders with deficiencies and the as soon as possible language because it was some kind of a technological change?

A. Principally, yes.

Q. When you say principally, does that mean every time, or --

A. That is the dominant -- my dominant recollection is that it was largely due to an analysis or determination around technological changes.

Q. Okay. Did you see any language in there talking about the materiality of the reserve imbalance that was being corrected?

A. No, I don't recall that.

Q. Have you ever seen a Public Service Commission order addressing a depreciation reserve correction that used some sort of materiality threshold? I say as part of the -- I should add as part of the review you did for this docket?

A. No, not that I can recall.

Q. Okay. Did you look at any orders where there was any -- look at the last page of this exhibit, if you would. Did you look at any orders that discussed intergenerational inequities and the Commission's proposed treatment of reserve imbalances?

A. Specifically these five?

Q. Well, I would represent to you that these five orders address or discuss that issue, but I was really asking you if you came across any Commission discussion about intergenerational inequity?

A. Yes, I have. I have looked at orders that talk or speak to intergenerational inequities, but it may not have been in the context that you are referring to here, that is a reserve imbalance. I think that in some Commission actions that it has been appropriate to consider those impacts not just related to reserve imbalances or setting depreciation expense.

Q. Well, does SFAS 154 have anything in it that takes into account intergenerational inequity?

A. No, it does not.

MR. REHWINKEL: Okay. I know you are going to be sad to hear this, but that was my last question. Thank you.

COMMISSIONER EDGAR: Thank you.

Ms. Bradley, any questions on cross?

MS. BRADLEY: I don't think I can touch that. No questions.

COMMISSIONER EDGAR: Mr. Moyle.

MR. MOYLE: Thank you, Madam Chair.

CROSS EXAMINATION

BY MR. MOYLE:

Q. Good afternoon. I am going to ask you some questions about your testimony. I don't know that I will go into the level of detail that you just went through with Public Counsel, but, nevertheless I want to have a conversation with you.

The first thing I want to ask you about is what did you do to -- tell me about your research that you did to try to figure out what the Commission's policy or practice was.

A. Related?

Q. Related to dealing with this depreciation variance that we are talking about.

A. Well, the first thing I did was look at the direct testimony that was filed by the intervenors, and made sure I had a full and complete understanding as best I could of any regulatory dockets or opinions that they had referred to. And so my purpose, again, of my testimony was really to rebut the presumption that to reserve accumulative depreciation reserves was in conformity with GAAP. So I started with that. And, in addition, I have done quite a considerable amount of research related to the topic of what those generally accepted accounting principles are.

Q. Did you -- did you make any effort to try to locate Commission orders addressing depreciation variances?

A. Yes. As I said --

Q. You looked at the intervenor testimony, right?

A. Yes. And based on discussions with counsel and our internal regulatory people with their assistance, looked at orders that, again, I provided as an exhibit that I thought were relevant to the topic.

Q. Okay. So you didn't -- you know, lawyers sometimes they have got these computer programs, West Law and Nexus and you can go, you know, type in and see what you can find. You didn't do any kind of independent computer research to try to locate Commission orders dealing with this depreciation variance issue, did you?

A. No. My focus was principally on what transpired here and was in the state of Florida.

Q. And how about with respect -- that same question with respect to the state of Florida, did you do any independent research with respect to Commission orders related to this issue in the state of Florida, other than look at the orders that might have been provided or cited by witnesses for the intervenors?

A. Again, the ones that I thought were relevant I provided as my exhibit.

Q. Okay. But those were provided to you, right, you didn't independently come up with those?

A. When you say provided to me, some of those I did have some previous knowledge of, some of them, yes, were provided to me.

Q. I guess why I'm asking the question, because if I read your testimony, you state on Page 3, Line 21, quote, the Commission's long-standing policy is, in fact, to apply the average remaining life methodology to resolve reserve variances, correct?

A. Yes.

Q. And then if I look at this Exhibit 316 that Public Counsel handed out to you, that seems to suggest that the Commission has done things other than applying the average remaining life methodology to resolve reserve variances, correct?

A. Yes. And I would contend that many of those -- again, I haven't reviewed all of these that were on this exhibit, but --

Q. I'm sorry?

A. I haven't reviewed all the ones on this exhibit, but the ones that I reviewed it appeared to me that the policy or at least the intent to address the reserve imbalance was one really associated with minimizing future revenue requirement impacts. And what I mean by that is that to the extent that there were deficiencies like in the telecom examples where there was technological change and perhaps the assets had not been yet fully recovered, that some accelerated amortization of that or, for that matter, if there were assets that were no longer providing service, and, therefore, appropriate capital recovery was necessary. But it seemed to me that the principal motivation was to minimize future revenue requirements as opposed to the proposals that we are looking at here.

Q. Let me refer you to the second page of OPC's exhibit that has been marked as 316.

A. Yes.

Q. Do you see at the bottom there appears to eight orders dealing with electric companies?

A. Yes.

Q. Okay. How many of those did you review?

A. Again, I haven't cross-referenced which ones of those, sir, are contained in my exhibit, but I would be glad to do that if you think that is necessary.

Q. If we can look at them in the record, I won't take the time to do it. You would recall if you reviewed all of these, would you not?

A. Probably more so if there was some topical information there besides -- I haven't memorized the order numbers and dates and docket numbers.

Q. If you stay around here long enough that is what you start doing.

A. That's what happens.

Q. I'm kidding. Have you ever heard of the saying as a general proposition that you try to accelerate depreciation and defer taxes as an accounting rule of thumb, have you ever heard that?

A. No, I can't say that I have. In the context of --

Q. Of running a business. I have always been under the impression that accelerating depreciation is a positive thing for a business because it allows the business to recover its capital sooner rather than later.

A. No, I'm not familiar with that.

Q. Are you aware that sometimes, you know, policies are enacted where depreciation is accelerated as a stimulus mechanism?

A. For tax purposes?

Q. Yes, sir.

A. Yes, but that doesn't mean for book purposes we then follow the same accelerated method.

Q. Okay. We spent a lot of time, and I think we got into retroactive ratemaking, and I just wanted to make sure that I am looking at this clearly. I mean, this is really about how best to address an imbalance that happens to be on the positive side, correct, a depreciation imbalance?

A. No, I think it is broader than that. I think it is really a question of the appropriate way to recover the company's investments in its plant, and, in fact, doing it in a way that satisfies GAAP on the one hand, but also provides for the matching of recovery of those assets over the period those assets are used to provide service to our customers.

Q. So, that is at a little bit of a higher level?

A. Yes.

Q. And then because the company -- the actual lives of certain units are longer than originally projected, you have this surplus, right, in essence?

A. On a theoretical basis.

Q. Okay. And it is not a pile of money in a bank account, but it is a theoretical surplus, correct?

A. Yes. It is, again, theoretical.

Q. Okay. So now the question becomes, okay, how do you address it. How do you try to address the imbalance, isn't that right? That is sort of what this Commission is being asked to do?

A. I think they are being asked to do that. I think they -- as I said in my opening comments, that I think it is important to understand what is driving that, and a significant portion of our reserve surplus associated with the theoretical calculation is attributed to plant, production plant.

Q. Yes. It's something like 73 percent.

A. Right. Which clearly there have been significant investments placed in those assets that have allowed us to increase, or certainly that and the operating experience we have had with those plants to increase those useful lives; and, therefore, we are doing nothing more than matching the expense associated with the use of those assets over their remaining lives.

Q. I think we are on the same page, but I just want to make sure that we are clear. The plants have longer lives; therefore, we have a theoretical imbalance. Now the question is what do we do about it in effect. And the Commission, doesn't it have a couple of options before it? One, it can follow the approach that you are recommending, which is let that be amortized over the remaining life of the asset, correct?

A. Yes.

Q. Okay. It can follow an approach that my clients and others are recommending, which is, no, that is too long, amortize it over a shorter period of time, correct?

A. Yes, that is your proposal.

Q. Okay. Or I guess another option is, you know, maybe they could -- they could punt, but I don't think that is on the table today, correct?

A. Actually they really could do nothing in the sense that there is really -- absent the alternative proposals there is no need to do anything. The recovery of these investments over the remaining useful lives seems to me an appropriate matching recognition of that expense over the period that consumers will benefit, customers will benefit.

Q. Haven't we agreed that as a matter of good public policy that you should take some action to correct an imbalance? It is not a good public policy to kind of look the other way?

A. No, I don't think we have agreed on that. I went through considerable cross about the fact that this is unprecedented, I think, in terms of the size, the degree of it, and I trust that the Commission will take the implications of that quite seriously.

Q. Would you recommend that they leave the decision to adjust the reserve for the future, punt?

A. It's not punting. It treats current customers and future customers equitably. It allows the company to recover no more, no less than the net book value of our plant over its remaining useful life.

Q. Do you believe this is a material imbalance?

A. No, I do not.

Q. You do not?

A. Not in the context of adjusting what is being recommended in terms of corrective action.

Q. What is your definition of materiality?

A. I think it all -- it depends on understanding what the drivers are of what is creating the surplus or deficit, depending upon what the theoretical calculation yields. So I can't give you a magical threshold number. I think it depends on what is creating it.

Q. So it is your testimony, just so I am clear, that, you know, an accountant, you had used the term bean counter and different things, but you are saying that you can't give me a definition of materiality as it relates to the quantification or magnitude of a number in the financial outlook that you have to then go behind that and figure out, well, what is the cause of that number, is that your testimony?

A. No, I thought what you were asking me -- maybe I misunderstood your question. I thought you were asking about a materiality threshold that would require some response, some need to disposition the theoretical variance. I can say that my testimony here today is that the proposals that are before us are clearly material, 648 or $46 million accumulated depreciation reserve adjustment is material.

Q. Wouldn't you also consider a variance with respect to your depreciation look that is 15 percent or greater to be a material variance?

A. No. Again, I don't have a magic threshold. I really think perhaps a different way to think about it is to look at the effects that these proposals would have, one, on rate base, but also the effects on our depreciation expense levels. I can clearly state that the proposals before us are material to depreciation levels. We have today with no changes in depreciation rates, our depreciation levels are around $346 million. We have proposed that that would go up as a result principally of investments, some $2-1/2 billion of investments since 2007.

It seems to me that I can draw a conclusion that taking depreciation levels below the current levels would suggest there is no provision being made for recovery of incremental investment. That I think I can draw the conclusion if I have invested $2-1/2 billion and what is before us is to reduce depreciation expense below current levels dramatically, that seems material to me. So from that perspective I would -- I would start to be concerned.

Q. Anything else?

A. No.

Q. You have been here a little while. You are aware that the Commission has a practice of trying to get a yes or no answer followed by an explanation?

A. Yes, I am.

Q. Okay. And would you try to adhere to that practice, please?

A. Yes, I will.

Q. Let me -- let me go back to this exhibit. Do you still have that exhibit that was referred to as Exhibit Number 311? It is the excerpt from the public utility depreciation practices?

A. Yes, I have it here.

Q. Okay. And the last paragraph, I am just going to read it into the record. I think it will be easier to reference. If says, "Whereas, the judgment of materiality is subjective, if further analysis confirms a material imbalance, one, it should make immediate depreciation accrual adjustments. The use of an annual amortization over a short period of time or the setting of depreciation rates using the remaining life technique are two of the most common options for eliminating the imbalance. The size of the plant account, the reserve ratio, the account remaining life, the technology of the plant, and the account -- and the account reserve imbalance in relationship to the account annual accrual all have a bearing on the chosen course of action." Do you know that these NARUC guidelines are provided to utility regulators around the country?

A. Yes, I would assume they are.

Q. Okay. Have you ever been to a NARUC meeting?

A. Yes, I have.

Q. And you would agree that it is where utility regulators, such as these Commissioners and others, come and gather and have seminars and discussions about best practices and have breakout sessions on things like depreciation, correct?

A. Yes.

Q. Okay. And you don't -- you don't believe that what is set forth in the paragraph that I just read is not NARUC's words, they are not part of this study, do you?

A. No, I don't doubt that this is part of that study.

Q. Okay. And the way I am reading this is it says a couple of things. Number one, that the judgment on materiality is subjective, would you agree with that?

A. Yes, I would.

Q. Okay. And then it says if you do have a material imbalance, then there is a couple of things you can do. One is to use the annual amortization over a short period of time, correct?

A. Yes.

Q. And that is what my clients are proposing, correct?

A. Yes.

Q. Or, two, is setting the depreciation rates using the remaining life technique. That is what you are proposing, correct?

A. Yes.

Q. Okay. So you would agree that the judgment about materiality ultimately has to be made by this Commission, correct?

A. Yes, I do.

Q. Okay. And they can take into consideration a lot of things. They have a lot of information and evidence before them in making their judgment, correct?

A. Yes.

Q. Your testimony, the testimony of other expert witnesses, correct?

A. Yes, that is correct.

Q. Okay. You also are aware that our state is in the middle of what some people are calling the great recession, correct?

A. Yes.

Q. Okay. And if the action urged by my clients is adopted by this Commission, there is not going to be a refund. I mean, we are talking about this account, this theoretical reserve account. You have said -- I think we have established there is not a pot of money in an account, correct?

MR. WALLS: I am going to object to the form of the question.

THE WITNESS: No, I don't think that is correct.

BY MR. MOYLE:

Q. I thought -- I thought we had just established a little while ago that the theoretical reserve imbalance, you know, my clients are saying it is a surplus, that it is not -- it is not an account with a pot of money in it, correct?

A. That I would agree.

Q. Okay. And I just want to make sure we are clear. When we talk about a flowback, we are not talking about refunds being issued to people, you know, we are not asking that checks be written and say here is some money that relates to depreciation that is being provided back to you, correct?

A. No. I think we are proposing, or the intervenors are proposing, excuse me, that revenue requirements clearly are being reduced; and, therefore, I assume that would impact what prices are ultimately paid by customers.

Q. I think we are on the same page. I just want to make clear that the impact of my clients' proposal is simply to reduce the revenue requirements. You are in asking for half a billion dollars, correct?

A. Yes, I believe that is the correct number.

Q. Okay. So if the depreciation position urged by my clients was adopted, the number would be less as compared to the number if your position was adopted, correct?

A. It would be -- yes, it would be lower in the near term.

Q. Okay.

A. But not in the long-term.

Q. But there is not a process where you would have to go and issue refund checks, correct, it would just be a rate adjustment?

A. It would be part of revenue requirements and ultimately embedded in rates.

Q. Okay. Were you here when Mr. Dolan testified on rebuttal?

A. Not for all of it.

Q. Did you hear him talk about how he viewed the depreciation issue as a pay me now or pay me later proposition?

A. Yes, I did.

Q. Okay. And do you agree with that -- with that characterization of it in broad general terms?

A. Yes, I do.

Q. Okay. And given that -- my recollection of the pay me now, pay me later was the old Midas commercial where there was a car, and a guy coming in, and it was about hurrying up and getting your muffler changed or something. But isn't really the pay me now or pay me later proposition, isn't that an offer as to when you want to make a payment, again, in general terms?

MR. WALLS: I'm going to object.

THE WITNESS: I'm sorry, I don't follow.

COMMISSIONER EDGAR: You were going to object on what? I didn't catch --

MR. WALLS: I was going to object that it was vague and ambiguous, but the witness said he didn't follow, so --

COMMISSIONER EDGAR: Mr. Moyle, would you like to try again?

MR. MOYLE: I will try again.

BY MR. MOYLE:

Q. Couldn't we agree -- you have heard the term pay me now or pay me later?

A. Yes, I have.

Q. Okay. And doesn't that mean that ultimately somebody -- you know, if you said to me, Mr. Moyle, you have to pay me now or pay me later. You know, essentially that would mean, okay, well, my choices are, you know, pay you now or pay you down the road in essence, correct?

A. Yes.

Q. Okay.

A. That's what I think pay me now or pay me later would mean.

Q. And if that was a choice and an option provided to me, you know, in theory I should have the ability to choose which I would like to do, either pay you now or pay you later, correct?

A. Yes. I just don't see the relevance in terms of establishing depreciation policy where it seems to me the axiom is that we are trying to match depreciation expense over future lives, not change them arbitrarily to accommodate some pay me now or pay me later proposition.

Q. Well, let me see if I can help you on that. If that is an option that I have and my clients have, I think they have clearly said they would rather pay you later rather than pay you now. You would agree with that, correct?

A. I think that is what they have said.

Q. Okay. And the relevancy of it, the question I asked you about the great recession, is you are aware of things like disposable income being down, businesses laying off -- laying off people, unemployment in the state being at very high levels, correct?

A. Yes, I am generally aware of the state of the Florida economy.

Q. And so given the current state, which we know, and the state that may occur in four years, isn't that when the pay me later would come due, four years from now?

A. That would be the most -- yes, the most, the earliest period under your proposal.

Q. So the earliest that the pay me later would come due would be four years. You know, there is a decent chance that the economy may be improved four years from now as compared to today, correct?

A. It may. And, again, I don't see how the economy affects how one views determining depreciation recovery when -- I don't know of any principle there, if you will, that points to the state of the economy as a guiding light for determining depreciation levels.

Q. And it may not be in a GAAP principle, but you would agree, would you not, that this Commission when making judgments about setting rates is able to consider things like the state of the economy?

A. Clearly in terms of setting cost of service, absolutely. I am referring more to as I provided rebuttal testimony, I didn't find any example where the state of the economy was an element of consideration relative to establishing depreciation recovery level.

Q. You are not aware of anything that prohibits the consideration of the state of the economy, are you?

A. As negative assurance, no, I'm not aware of anything.

Q. Okay. And you had talked about, you know, different circumstances. The Florida Power and Light case that you cite, I think the circumstances there were maybe there was merchant plants that are on the horizon, so we are going to make an adjustment on depreciation related to the possibility of merchant plants coming into the picture, correct?

A. Yes, I believe it was an issue around stranded cost-recovery, and I don't think that in the circumstances that we are dealing with here we are dealing with stranded cost-recovery. I think we are dealing with the reduction of existing accumulated depreciation reserves or a surplus.

Q. Yes, sir. And the point I am simply trying to draw is there are no rules with respect to merchant plants and the advent of competition in the electric industry that would drive a decision on depreciation, correct?

A. Again, I'm not sure I follow your --

Q. The Commission -- you reference an order, the FPL order, and part of it was, well, there was merchant plants on the horizon, we are going to allow the depreciation to be accelerated, correct?

A. Yes, that is my understanding.

Q. Okay. And there is no GAAP provision or any kind of rule or regulation that talks to the factual circumstance of merchant plants being on the horizon as a reason for accelerating depreciation, correct?

A. No, there is no -- there is no GAAP basis that deals with deregulation in the context that you are talking about, but I think we were straying a little off of the principles around how to deal with changes in estimates in the context of setting depreciation levels.

Q. And I want to -- I'm going to get to the nuts and bolts of the depreciation, but I am just trying to get you to agree -- I am suggesting that the state of the economy today is the equivalent of the prospect of merchant plants on the horizon many years ago when the FPL decision was rendered. Do you understand and can you agree with that?

MR. WALLS: Objection, asked and answered. This is cumulative.

MR. MOYLE: I think it was asked. I'm not sure that I got an answer.

MR. WALLS: I believe the witness has answered several questions about what the Commission can take into account with respect to the economy.

COMMISSIONER EDGAR: To the witness, do you have anything else to expand upon the subject that you were discussing with Mr. Moyle?

THE WITNESS: No, I don't. Again, just real quickly on -- I will say, again, I think --

MR. MOYLE: So that would be a yes, but go ahead.

THE WITNESS: Well, I'm sorry. I rethought that because I do think -- because just with due respect to the Commission, the notion of recovering stranded costs, and I am just struggling with the connection between recognition that there may be investment that is stranded in a competitive market and the analogizing that to an economic climate that looks to essentially the reverse and says, oh, I want to increase the rate base, or increase rate base or investment in the near term at the expense of future customers just strikes me as not consistent with standard practices around depreciation.

MR. MOYLE: Okay.

COMMISSIONER EDGAR: Mr. Moyle.

MR. MOYLE: If I can follow up on that?

COMMISSIONER EDGAR: You may.

BY MR. MOYLE:

Q. We are the customers, correct?

A. Yes.

Q. And we are saying we would rather take the accelerated amortization, correct?

A. Yes, that is your proposal.

Q. And the merchant plant example that I am using, I am trying to just simply draw a relationship between merchant plants and the economy, and that both of them at a particular point in time presented factors that are worthy of consideration. Can we agree with that?

A. Yes.

Q. Okay. And, indeed, with respect to the economy, we know as a factual matter that the economy is in bad shape currently in Florida, correct?

A. Yes, the state of the economy is poor.

Q. Okay. And with respect to the information that prompted the Commission to make a decision back in the FPL case, the stranded assets, that never came to be, did it, because competition and merchant plants never really got a foothold in Florida, correct?

A. That is correct.

Q. Just a couple more questions. I mean, with respect to -- I think we have covered this, but just to make sure. The other expert witnesses, you don't -- you don't question their expert qualifications, you just question their judgments, isn't that right?

A. No, I don't question -- maybe you should rephrase that.

Q. Sure. Like Mr. Pous, Mr. Pollock, you know, any of the other experts that have provided testimony, you are not -- you are not questioning their -- their expert qualifications to provide an opinion to this Commission, are you?

A. No, I'm not questioning their qualifications.

Q. Okay. All right. And, indeed, this is the first time you have rendered testimony on depreciation before -- before a Commission, correct?

A. Yes, we have established that other than in the context of setting overall revenue requirements for the utility.

Q. And you are also aware that this Commission is being asked to set fair, just, and reasonable rates, correct?

A. Yes.

Q. And judgments with respect to fair, just, and reasonable, those may not be easy decisions, correct?

A. No doubt.

Q. And you have to weigh a lot of factors, correct?

A. Yes.

Q. Would you agree that if it is a close call that the benefit of the doubt ought to go in favor of the consumer in these economic times?

A. I don't have an opinion on that.

Q. Page 14, Line 10.

A. Yes, I am there.

Q. I understand the point that you are trying to make here is that it is difficult to, you know, to hit it right on the mark with respect to estimating depreciation variances, is that correct?

A. Yes, they are inherently dependent on significant estimates.

Q. And you had indicated, well, Mr. Pous, he says take $161 million per year, isn't that right, that is his recommendation?

A. Yes, it is.

Q. Okay. And Mr. Pollock is at 100 million a year, right?

A. Yes.

Q. Okay. So you would presumably prefer Mr. Pollock over Mr. Pous, is that right, in terms of the relative positions?

A. No, I --

Q. You prefer -- your position is Position A. Mr. Pollock is Position B?

A. I didn't rank them.

Q. Okay. Would that generally be fair?

A. Again, in terms of the order of magnitude, the impact, yes, your proposal is not as significant as the proposal by OPC.

Q. And to the point about -- that I thought you were making in criticizing Mr. Pous by saying, well, you know, the 161, you know, may not be the right number, that there is no variability in there. One way -- if that were a concern of the Commission, one way they could deal with that would be to say, okay, well, let's do 150 million, that gives you a little more variability. That would be a possible approach, would it not?

A. I don't want to speculate how the Commission would view that.

Q. You also have a little bit in your testimony about the depreciation study. You are the main person from Progress Energy Florida that was responsible for getting this depreciation study done, is that right?

A. Yes, in that I engaged Earl Robinson to perform that study, yes.

Q. Okay. And then just so I am clear, Mr. Crisp yesterday testified, and he is running the plants and on the ground. You took some information that he provided and gave to it Mr. Robinson, is that right? I say you, I'm talking about the company.

A. No, I did not provide that information to Mr. Robinson. Mr. Robinson sought that out through his, if you will, field work, his interviewing of our company management to solicit that information.

Q. Okay. You were here when Mr. Crisp testified yesterday?

A. Yes, I was.

Q. Okay. He said he wasn't a depreciation expert, correct?

A. Yes, I believe he did say that.

Q. Okay. So to the extent that there is a question about a service life, you would tend to rely, would you not, on the information in the study that was put together by Mr. Robinson, your expert depreciation witness?

MR. WALLS: Let me object to this line of questioning. This is way beyond the scope of rebuttal. He is now asking him about Mr. Crisp's testimony.

COMMISSIONER EDGAR: Mr. Moyle, how does this tie to this witness' rebuttal prefiled testimony?

MR. MOYLE: I hope to be able to show you in a minute as a foundation question.

COMMISSIONER EDGAR: Now would probably be better.

MR. MOYLE: He has an exhibit attached that has the lives of the units. It's WG-2, I believe, and deals with comparison of the plant dates. He made that correction on it earlier and talks about prior study, current study.

COMMISSIONER EDGAR: I recall. And that ties to your question in his rebuttal how?

MR. MOYLE: I'm trying to understand his chart, the information on his chart relative to information that may have been provided in other context.

MR. WALLS: Well, maybe we can ask about the chart instead of Mr. Crisp's testimony.

COMMISSIONER EDGAR: Mr. Moyle, can you phrase it in that context related directly to the chart before us?

MR. MOYLE: Sure.

BY MR. MOYLE:

Q. Is the information contained on this chart true and accurate?

A. Yes.

Q. So, if I had a question about, well, what is the best information to get to average service life, I would look at your chart, is that right?

A. No. Again, I corrected this --

Q. I'm sorry, the service life?

A. -- average service life.

Q. Okay. Is the service life on this chart the same as the estimated service life, do you know?

A. It is the estimated service life, yes.

Q. Okay. So where did this information come from that is on WG-2?

A. It is basically -- oh, I gave that back. I'm sorry. The exhibit that Mr. Crisp provided, I think we talked about this exhibit earlier that had the possible retirement dates that were determined by system planning. I'm sorry, I don't have the exhibit number, and I gave that copy back. It merely takes the estimated retirement date and compares it to the original in-service date to arrive at a service life.

Q. So, if Mr. Crisp said in his rebuttal testimony on Page 4, Line 12, that the estimated service life for the Anclote oil steam units is an average of 46 years, I would be better off relying on the information contained in your exhibit, would I not, that references the current study, which says it is 48 years, isn't that correct?

A. No. This is -- the in-service year could very well be the first unit that went into service and the information you have perhaps averages the service dates. So this in-service period, I just merely went back to the first date that Anclote appeared as an operating plant. So, for example, Crystal River 1 and 2, that is not the in-service date for Unit 2, it is the in-service date for Unit 1.

Q. It struck me as a little unusual, because I think one of our experts had said 50 years was the average service life for Anclote, and if I am reading your chart correctly, it suggests 48 years, whereas, Mr.

Crisp in his rebuttal testimony said 46 years.

MR. WALLS: Objection, mischaracterization of his testimony.

MR. MOYLE: Of whose testimony?

MR. WALLS: Mr. Garrett just explained that he went back to the first year of the unit and didn't do an average and Mr. Crisp did an average.

COMMISSIONER EDGAR: Mr. Moyle?

MR. MOYLE: Well, I guess I am confused, because I thought we were doing apples-to-apples with the average service lives, but I guess you're saying, well, that was struck, so that's now --

COMMISSIONER EDGAR: I thought that it was not average.

MR. WALLS: The witness just told you he didn't average them. He went back to the first unit in-service date when he prepared his chart. That is my point.

MR. MOYLE: Okay. Well, I don't --

COMMISSIONER EDGAR: What I would say, Mr. Moyle, is we want you to get the answers to the questions, and maybe you are not the only one that is confused about what is on the chart. But, if you could, you know, repose the question, and let's try to see if he can give the answers.

MR. MOYLE: Okay.

BY MR. MOYLE:

Q. And I will ask it in an open-ended way, which they tell you in law school not to do, but your chart lists for these units, and it references a study. For Anclote it lists the number 48, which I found in Mr. Crisp's testimony at 46. For Crystal River Units 1 and 2, it lists 53, and in your chart you have 54. And for Crystal-- for your reference, that is on Page 4 of Mr. Crisp. And then 4 and 5, your chart list 53 years, whereas Mr. Crisp said 52 years. Can you help me reconcile the difference in those numbers?

A. Yes. Again, I think Mr. Crisp's information is averaging the in-service date for the units to arrive at this service life. I think what I am using it for here is as support for why in the theoretical reserve calculation it is not surprising to see that 73 percent of that is attributed to production plants when I go over and look at Exhibit WG-2 and see that there have been on balance extensions of lives. What is relevant to Mr. Robinson's study is the terminal date, which I think you will find there is consistency there between what Mr. Crisp provided and what I have here on the schedule.

Q. Thank you. The schedule that you have, because we had talked earlier about, well, it is important to find out what caused the depreciation imbalance, right?

A. Yes.

Q. Doesn't this schedule reflect that the major cause of this has been the underestimate of the average service life of the generating units?

A. Underestimated?

Q. From the original point in time when they made an estimate, and the estimate turned out to be shorter than in actuality the plants are able to provide as a general rule of thumb, correct?

A. Yes, it does show that those service lives have increased since the previous study, but as I have mentioned previously in my opening comments and as we have talked through this, that is not surprising given the level of investment that has been made in those assets, as well. That impact was considered, as I understand Mr. Crisp's testimony, in his integrated resource planning.

Q. I did a quick calculation on this chart, and it looked to me like there was an additional 98 years over on the last column, increase/decrease in average service life. Should we strike average off that, too? That is what I think we did, right?

A. Yes, we did.

Q. So increase/decrease in service life, and there is a lot more years, positive years than negative years, correct?

A. Yes, there are.

Q. And if you were going to look at this and try to draw a conclusion about a trend, I mean, my numbers were 98 positive years and ten negative years, so that the net effect was an additional 88 years in the life of plant. Would it be a fair conclusion or inference to draw that looking at it historically that the judgment that was initially made with respect to depreciation as a whole came up on the light side, came up short?

A. No, I wouldn't draw that conclusion from that.

Q. And that was because some of them -- some of them went the other way? Why would you not draw that conclusion?

A. Well, because these were done at different points in time. The current terminal dates are based on, as I think we have gone over with Mr. Crisp, his integrated resource planning process that takes into consideration the most current assumptions that we know. Clearly, those assumptions could have changed from the previous date the study was done. That is all that that tells me.

Q. Okay. And you would agree with me that depreciation is, in effect, a theoretical concept, correct?

A. No, I don't think it is a theoretical concept. I think it is a well-founded principle of matching the utilization of assets over their useful -- or recognition of expense over the useful life of the given property.

Q. Okay. That is a concept, is that right?

A. I don't know if that is concept, but maybe we are just talking past each other.

Q. Maybe we are.

MR. MOYLE: I appreciate your patience. I am learning depreciation, and thank you for spending some time with me. That's all.

COMMISSIONER EDGAR: Thank you.

Mr. LaVia?

MR. LaVIA: No questions, Madam Chair.

COMMISSIONER EDGAR: No questions. Are there questions from staff?

MS. KLANCKE: There are.

COMMISSIONER EDGAR: Okay.

CROSS EXAMINATION

BY MS. KLANCKE:

Q. Good evening. Mr. Garrett, I'm Caroline

Klancke for Commission staff.

If you would turn back to Page 13 of your rebuttal testimony.

A. Yes, I'm there.

Q. And in particular, on Lines 3 through 10, you had previously discussed with Mr. Rehwinkel your statement on this page with respect to the company's 2002 rate case that ended in a settlement, do you recall that?

A. Yes, I do.

Q. And on Lines 6 through 7, in particular, you discuss your statement that, quote, 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.

Q. And you had also discussed with Mr. Rehwinkel that that 2002 settlement allowed PEF to reduce depreciation expense by $62.5 million each year of the stipulation with the ability to reverse all or part of that amount. Do you recall that?

A. Yes, I do.

Q. Are you aware that as part of that 2002 settlement the depreciation rates prescribed in Docket Number 971570, or what are here referred to as the 1997 depreciation study, did not change?

A. No, I was not aware of that.

Q. Well, are you aware that the Commission did not, in fact, approve the company's depreciation rates in the 2002 settlement, but, rather, it merely continued the depreciation rates prescribed in the 1997 study?

A. Could you rephrase that or ask that again, please?

Q. Certainly. You reference the 2002 settlement in your rebuttal testimony. I'm asking if you are aware that this Commission did not, in fact, approve the company's depreciation rates in that 2002 settlement, but, rather, in that settlement it merely continued the depreciation rates that were prescribed in the 1997 study?

A. Yes, it does say that on Page 18 of the settlement document.

Q. Switching gears, would you agree, basically, that the remaining life depreciation rate formula measures the amount remaining to be recovered divided by the number of years left in which to recover, is that correct?

A. Yes, I would agree with that.

Q. And the measurement of the amount remaining to be recovered involves the reserve, is that correct?

A. Yes.

Q. The relative adequacy of the reserve causes the remaining life depreciation rate formula to self-adjust, is that correct?

A. Yes, I would agree with that.

Q. So, if there is a reserve surplus, the depreciation rate would naturally be lower than it would be otherwise -- than it would otherwise be because a lesser amount is needed to be recovered in the future, is that correct?

A. Yes, I would agree with that. In fact, we have quantified what we think that benefit is and provided it as an exhibit in my rebuttal testimony.

Q. Certainly, and we will discuss that in a little more depth later. If the remaining life rates essentially correct the reserve over the average remaining life, do you consider this to be retroactive ratemaking?

A. No, I do not.

Q. Why do you not?

A. Because the adoption of the depreciation parameters in this case where you talk about the average remaining life is recognizing those changes in estimates over a prospective period, over a future period.

Q. I would like you to refer now to Page 30 of your testimony.

A. Page 30?

Q. Page 30.

A. I am there.

Q. In particular, in your rebuttal testimony on Page 30 in Lines 3 through 5. Here you state that it is not unusual for the Commission to establish accelerated amortization schedules to address equipment or facilities specific reserve issues. Is that a fair encapsulation of what you discussed in those lines?

A. Yes, it is.

Q. If the amortization period matches the remaining service period of the related assets, would you characterize this as an accelerated amortization?

A. I want to make sure -- I want to try to repeat that, if I could. If we -- if we depreciate the assets over their remaining useful life, is that accelerated. Maybe you should reask or rephrase that.

Q. I can rephrase.

A. Yes.

Q. In this portion of your testimony you discuss how it is not unusual for this Commission to establish accelerated amortization schedules to address equipment or facilities specific reserve issues. Do you see that at the top of the page?

A. Yes, I do.

Q. Thus, if the amortization period matches the remaining service period of the related assets, would this constitute or would you characterize this as accelerated amortization?

A. No, I don't think I would.

Q. Why is that?

A. Well, if I understand what you are asking, if I am taking the net plant balance -- we talked earlier about that under the average remaining life it takes into consideration the initial investment in plant, the accumulated recoveries of that plant and recovers it over the remaining useful life, or the remaining service life. Then it seems to follow, then, that that is not an accelerated amortization. We are merely matching that expense over the period in which those assets will provide service.

Q. I would like you to look a little further down on this page on Lines 17 through 18.

A. Yes, I'm there.

Q. In these lines you quote -- well, a little bit before that, in Lines 15 through 18, you quote from Order Number PSC-93-1839-FOF-EI, and in particular you assert that the quoted statement is the Commission staff's position, not the Commission's itself. Do you see that?

A. Yes, I do.

Q. Are you aware that on Page 4 of this order, the Commission ordered the corrective reserve transfers?

A. Yes.

Q. Now, Mr. Garrett, I know that you have previously stated that you are not a lawyer, and I'm not asking you for a legal conclusion, but since the Commission ordered the corrective reserve transfers in this order that you quote, the same transfers that you characterize as merely, quote, the opinion of the Commission staff at the time, end quote, wouldn't this order imply that the Commission held the same position?

A. Yes, as it relates to the practice of reserve transfers, I would agree with that.

Q. On the same page you go on to say, in Lines 18 through 23, that the Commission did not order a change in customer rates as a means to correct reserve variance. Do you see that?

A. Yes, I do.

Q. Are you aware that the following year, 1994, this Commission reset customer rates in Docket Number 930400, which considered the effects of the depreciation study concluded in 1993?

A. No, I did not look at that.

Q. Would you please refer to your Exhibit WG-2 attached to your rebuttal testimony?

A. Yes, I am there.

Q. As you had discussed previously, this is a comparison of the terminal dates -- this exhibit contains a comparison of the terminal dates for PEF's 2005 depreciation study and those contained in the current depreciation study, is that correct?

A. Yes.

Q. Did you perform a similar comparison of the terminal dates from the company's 1997 depreciation study and those contained in the current study?

A. No, I did not.

Q. Just a few more questions. Mr. Garrett, is a negative depreciation rate, in your opinion, a reversal of depreciation expense?

A. I am not sure what a negative depreciation rate is other than perhaps, the -- I'm not sure I understand what a negative depreciation rate would be.

Q. You had previously conversed with Mr. Rehwinkel with respect to the possibility, the theoretical possibility of a negative depreciation rate. Do you recall that line of question?

A. I'm not sure I talked about a negative rate. I think we talked about a negative level of depreciation expense. That is my recollection.

Q. That is what I'm referring to.

A. Yes.

Q. Would you consider a negative rate of depreciation expense -- would that be tantamount to a reversal of depreciation expense?

A. Yes, it seems mechanically -- if I follow what you are asking, is a negative rate would be the opposite of depreciating an asset. Where you would have depreciation expense, you would be increasing the asset value.

Q. Yes. Then is it your opinion that a negative depreciation rate, as you just stated, would that theoretically constitute retroactive ratemaking?

A. I think without getting into ratemaking concepts, I would say it is clear to me that if it is the effect of a change in the estimate where you are reducing current period depreciation expense to a negative level, that that is a restatement or a restatement of a prior period. The determination of whether that is retroactive ratemaking it seems to me depends if you consider that bringing into question the level of revenues that were provided by or afforded by a previous Commission action. So, clearly, it seems to me that it qualifies as a restatement.

MS. KLANCKE: Fair enough. Madam Chairman, I have no further questions for this witness.

COMMISSIONER EDGAR: Thank you.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Madam Chair. Good evening, Mr. Garrett.

THE WITNESS: Good evening.

COMMISSIONER SKOP: I just have a few follow-up questions for you on what has been a lengthy rebuttal testimony. Mr. Garrett, as controller you have direct oversight of the regulatory accounting function, correct?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: Okay. So you would be familiar with the concept of a true-up as it would pertain to regulatory accounts?

THE WITNESS: Yes, I am.

COMMISSIONER SKOP: Okay. Based on your response to my prior question, do you believe that a fully litigated rate case should essentially function as the ultimate true-up for all regulatory accounts?

THE WITNESS: I'm not sure I understand completely the concept of an overall regulatory true-up. I think earlier you had asked about the true-up for change in plant lives, is that what you are asking?

COMMISSIONER SKOP: Well, if I could -- actually that is a good segue into explaining what I mean. If I could call your attention to what was previously marked as Exhibit Number 316, which I believe on the second page of that document -- on the second page of that document -- if you don't have it, I can wait a moment.

THE WITNESS: Yes. I don't think -- I'm not sure what Exhibit 316 was.

COMMISSIONER EDGAR: Yes, of course. Thank you.

THE WITNESS: Yes, I have it here.

COMMISSIONER SKOP: Okay. Are you on the second page, which is entitled Elimination of Reserve Imbalances Through Other Than Remaining Life Recovery?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now, as part of that exhibit, and you may agree or disagree with what is on that page. But just looking at the first sentence under the heading reserve transfers, do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And that sentence reads: As part of the review and approval of new depreciation rates, it is the practice of Florida PSC to restate or rebalance the existing reserves in order to eliminate differences between the book reserve and the theoretical reserve based on the new rates on an account by account basis. Is that correct? Is that what it reads?

THE WITNESS: That is what it reads.

COMMISSIONER SKOP: So, going back to my prior question, again, do you believe that a fully litigated rate case should essentially function as the ultimate true-up for all regulatory accounts?

THE WITNESS: No, I don't know that I fully agree with that. In the context of depreciation expense, clearly it provides an opportunity to reset rates based on the best available estimates that we currently have. I think as I discussed earlier, I don't think there is a need necessarily to -- based on a theoretical determination of what book reserves should be, that is what should -- what the accumulated depreciation should be based on those updated estimates, that there is any need to true-up to that amount because the average remaining life approach essentially accomplishes that.

COMMISSIONER SKOP: Okay. Fair enough. Again, I'm trying to just get a yes or no followed by an explanation. I understand that you may disagree with a subcategory under a central premise, but if you could just state yes or no and then provide the explanation, I would be appreciative.

Moving on. With respect to the subject of depreciation in itself, if a depreciation study resulted in a depreciation deficit, then Progress would seek to true-up the depreciation account by recovering the depreciation deficit amount from its ratepayers, correct?

THE WITNESS: Yes, I think that is correct.

COMMISSIONER SKOP: Okay. So, conversely, if the depreciation study resulted in a theoretical depreciation surplus, then why would Progress not seek to true-up the depreciation reserve imbalance by crediting the depreciation reserve, thereby reducing the near term rates of Progress customers as suggested by intervenor Witnesses Pous and Pollock?

THE WITNESS: Well, although I said that a deficit, it would make sense that we would seek recovery of that, I would add that it would be appropriate, unless there was some unusual circumstances, I will put it that way, to recover that over the remaining life of that group's assets. So, conversely, it is my position that it would be appropriate to recognize the theoretical surplus over the average remaining life of those assets.

COMMISSIONER SKOP: Okay. But with respect to the average remaining life of the assets, would you agree that taking action to reduce rates by the approach suggested by the intervenor witnesses would remedy the intergenerational inequity imbalance associated with the theoretical depreciation surplus?

THE WITNESS: No, I don't know that I would agree with that. I think it actually will create a prospective intergenerational inequity in that customers that received service over the period in which those reductions have been reflected, that is there has been a recognition of lower depreciation expense. Once that expires, it will cause future customers after that period to pay or be required to be exposed to higher depreciation levels.

COMMISSIONER SKOP: All right. Absent impact to cash flow and financing requirements, is there any other reason not to lower rates for your current customers by crediting the theoretical depreciation reserve as suggested by OPC Witness Pous and FIPUG Witness Pollock?

THE WITNESS: I think -- yes, I think there are reasons beyond the investment perspective which I don't want to discount, I think that is a significant consideration. As we just discussed a little bit about the intergenerational inequity potential that exists, I challenge that that approach really effectively accomplishes a matching principle of recovering those assets, the remaining net book value of the assets that we have over the appropriate service life, and that we are matching that level of recovery that is fair and equitable to customers, both in the near term, but also in the long-term.

COMMISSIONER SKOP: Okay. But adopting the approach suggested by OPC Witness Pous and FIPUG Witness Pollock, wouldn't that -- if that approach were adopted, wouldn't that be effectively analogous to a true-up in favor of the ratepayers?

THE WITNESS: I think it would be a significant windfall in terms of impact to customers in the near term but at the expense of future customers. And as I mentioned, I think some of the impacts of what a decrease of that magnitude would have on cash flow and other investment parameters, I would leave that to other witnesses to address. But, clearly, it seems to me that as we use the term pay me now or pay me later concept, clearly, I think it would create that.

COMMISSIONER SKOP: Okay. Are you familiar with the rebuttal testimony given by Progress Witness Crisp in this rate case?

THE WITNESS: Yes, I am.

COMMISSIONER SKOP: Okay. And Mr. Crisp's rebuttal testimony took exception to the useful life and retirement dates used my Witnesses Pous and Pollock in their depreciation studies, correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Would you agree, would you not, that no harm would result from using the useful life and retirement dates utilized by Witnesses Pous and Pollock in their depreciation studies to the extent that any difference or any -- excuse me, to the extent that any differences in projected versus actual values would be picked up as a true-up within the next depreciation study?

THE WITNESS: Yes. I think I would agree that because we conduct depreciation studies on a four-year cycle, that it would afford an opportunity to certainly update those underlying estimates. I would point out, as Mr. Crisp provided in rather lengthy cross, that management believes that certainly through their planning process they are in the best position to know those assets and what those useful lives are.

COMMISSIONER SKOP: Okay. If I could next turn your attention to Page 13 of your rebuttal testimony and focusing on Lines 3 through 10.

THE WITNESS: Yes, I am there.

COMMISSIONER SKOP: Okay. Now, your rebuttal -- excuse me, your rebuttal testimony on these lines discusses the depreciation rates approved by the Commission within the 2002 settlement agreement, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now, under the 2002 settlement agreement, Progress credited depreciation expense totaling $250 million over four years, is that correct?

THE WITNESS: Yes, that is correct.

COMMISSIONER SKOP: Okay. Is there any reason why you omitted that relevant -- I mean, is there any reason why you omitted that relevant fact from your testimony?

THE WITNESS: No, there was no particular reason I didn't point that out. I think I assumed people would have access to the stipulation and settlement agreement.

COMMISSIONER SKOP: Okay. If I could next turn your attention back to Page 12 of your rebuttal testimony, please.

THE WITNESS: Yes, I am there.

COMMISSIONER SKOP: Okay. Now, you became controller for Progress on November 7, 2005, correct?

THE WITNESS: Yes, that's correct.

COMMISSIONER SKOP: Okay. Now, that was obviously before the 2002 settlement, right -- I mean, after. It was obviously after.

THE WITNESS: It was after.

COMMISSIONER SKOP: I'm sorry. It's getting late in the day.

THE WITNESS: It was after.

COMMISSIONER SKOP: Okay. Now, that was likely also after the 2005 settlement agreement, is that correct?

THE WITNESS: Yes, it was.

COMMISSIONER SKOP: Okay. Now, in your testimony on that page, generally Lines 3 through 12, you were critical of the approach taken by the intervenor witnesses and would conclude that it was improper to credit back the theoretical reserve back to the customers, is that correct?

THE WITNESS: Yes. As it was characterized, yes.

COMMISSIONER SKOP: Okay. The reason I ask is I want to make sure that I understand your testimony on this particular point. And in light of the 2002 settlement agreement, is it your testimony that it is okay to record a credit to depreciation expense within the context of a settlement agreement, but it is not appropriate to do the same to lower consumer rates in times of economic hardship within the context of deciding a rate case?

THE WITNESS: No, that is not my testimony. My testimony went to really two points. One, whether or not in the context of a settlement there is some precedent that is set, and that is why there is some lengthy discussion about other Commission orders that would help frame the Commission's approach to establishing depreciation levels. And, secondly, to the question of whether or not under the proposals which are significantly higher in terms of value, the impacts to the company, whether or not those proposals represent an appropriate application of GAAP, Generally Accepted Accounting Principles.

COMMISSIONER SKOP: Okay. But I want to discuss the testimony that you omitted from your rebuttal testimony, namely that under the 2002 settlement agreement, Progress credited depreciation expense totaling $250 million over four year. So what I want to understand and have you reconcile for me is why it is appropriate to credit depreciation expense in the context of a settlement agreement, but Progress is not willing to do so now in the context of a rate case. Again, you are looking at the remaining life depreciation as the basis for why doing something that was done previously is not appropriate, where it would demonstratively benefit ratepayers by mitigating the impact of the proposed rate increase.

THE WITNESS: Again, I can't really speak to what the overall balancing of interests were in the settlement for 2002. I can speak to the fact that, as I pointed out in the cross, that there have been changes, at least from my perspective, of certainly sensitivity around the accounting issue of whether or not reserve transfers, and that is what I think we are speaking of here, that is a reduction in accumulated depreciation expense is, in fact, acknowledged as generally accepted accounting principle. And I think we talked through the cross process that between the issuance of Accounting Standard 154, and also my conversations with our auditors, and my general knowledge of issues that have been raised by the SEC staff on this matter, that it is my opinion that it does not qualify for GAAP based on the, you know, the reasons I stated earlier, which are largely again due to fundamental principles of applying a change in an estimate over a prospective period, and that being the useful life of the assets in this situation.

COMMISSIONER SKOP: All right. Well, let's further get into that, since you raised the accounting standards. I guess some people have called me a rocket scientist, and I am many things, but I am definitely not an accountant, so I will seek your knowledge and expertise in that regard. But when was Accounting Standard 154 promulgated by FASB?

THE WITNESS: It was issued in May of 2005.

COMMISSIONER SKOP: Okay. So that would be subsequent to the 2002 settlement agreement, is that correct?

THE WITNESS: That is correct.

COMMISSIONER SKOP: Okay. Would that have significantly changed GAAP accounting for taking the depreciation credit that may have been done in the 2002 settlement?

THE WITNESS: No, I don't -- I think it clearly lays out what the principles are that are to be applied in change of estimates. I think, furthermore, I would refer to guidance that has been issued by D&T, and that we provided in discovery to staff, and also in that concerns that the SEC staff have expressed about transfers of depreciation reserves. And, again, I think I can summarize that quite simply that there are very rare circumstances under GAAP where the write-up of assets is appropriate. And that is essentially what we have before us, that is the reduction of accumulated depreciation reserves, which will have the effect of increasing asset values by up to $646 million. And it is my testimony that that creates a problem from a GAAP perspective.

COMMISSIONER SKOP: But isn't GAAP based on a matching principle, where you want to match expenses and revenues, and just matching in general?

THE WITNESS: Yes, I would agree with that. And 154, I think, speaks to that when it -- as it lays out the recognition of a change in estimate for depreciation over those asset lives, which would accomplish, as you just mentioned, the matching principle.

COMMISSIONER SKOP: Okay. Well, it is late, and I am not going to venture a guess into what accounting standard it might be numbered, but are you familiar with mark to market accounting?

THE WITNESS: In some circumstances, yes.

COMMISSIONER SKOP: So, basically, adjustments need to be made based on market value and other things. That is, in essence, a matching principal in itself, is that correct?

THE WITNESS: I don't know that I quite follow the analogy there, because we are not -- in the context of these fixed assets, our property, we are not marking them to a market value, they are the historical costs, the acquisition costs to those assets. The concept of mark to market seems to certainly have applicability if you are looking at fuel positions, derivative positions in terms of marking those based on current market values, but I'm not aware of any circumstance where that would apply to fixed assets.

COMMISSIONER SKOP: I know it wouldn't apply to fixed assets, but I guess in relation to my prior question, you mentioned that the effect of making an adjustment or crediting depreciation expense by $640-something-million would effectively be writing up the assets, is that correct?

THE WITNESS: That is correct.

COMMISSIONER SKOP: All right. So that is basically on the books increasing the value of that property, right?

THE WITNESS: It is increasing the net book value as the carrying value of those assets.

COMMISSIONER SKOP: Okay. All right. I think that is all my questions. I would just ask staff with respect to Mr. Garrett's testimony in terms of the documentation provided by their independent auditor and the pronouncements that they may have provided in evidence, if they could please provide a copy of that to my office. I would appreciate that. Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioners, anything further from the bench?

Redirect.

MR. WALLS: Yes, briefly.

REDIRECT EXAMINATION

BY MR. WALLS:

Q. Mr. Garrett, you were asked a number of questions about the 2002 order approving the settlement agreement by intervenors and Commissioner Skop. Do you recall that?

A. Yes.

Q. Was that paragraph dealing with depreciation, was that one element of many elements in that settlement agreement?

A. Yes. Yes, it is.

Q. And was there also revenue sharing in that settlement agreement?

A. Yes, there was.

Q. And as a result of that settlement agreement, Progress Energy also had no set ROE, correct?

A. Yes, that is correct.

Q. Okay. And how would you characterize the result of the settlement agreement, does that involve give and take between the parties?

A. Absolutely, and I think it is an attempt for all the parties to balance and mutually arrive at a solution that best meets everyone's needs.

Q. I think you were also asked a number of questions about Exhibit Number 311, the excerpt from the public utility depreciation practices, NARUC document from August 1996 regarding the statement on 189 regarding the option of use of amortization over a short period of time or remaining life technique as the two most common options for eliminating a reserve imbalance. Do you recall that?

A. Yes, I do recall that.

Q. I don't believe anyone asked you which one was the most appropriate to do in this case. Which one is?

A. Well, again, my position is that if depreciation -- if the intent of depreciation is to fulfill the matching principle, that is to match the cost, recognition of expense over the period that those assets are used, that the most appropriate approach would be to use an average remaining service life approach.

Q. I think this goes way back to Mr. Rehwinkel's questions early in the afternoon where he asked you with respect to Page 11, Lines 10 to 13.

A. Yes, I'm there.

Q. And he asked you whether any of the intervenor witnesses had used those terms, excess or surplus, to mean that PEF has overcharged and customers have overpaid depreciation expense. Do you recall that?

A. Yes, I do recall that.

Q. Were you here when, or did you hear Mr. Pous give his summary in this docket?

A. Yes, I was.

Q. Okay. Do you recall him saying, quote, at Page 2146, Lines 17 to 19 of the transcripts, the existence of a reserve imbalance, either positive or negative, indicates that past customers have paid either too much or too little?

A. Yes.

Q. And he also said at Page 2147, Lines 9 through 14, under either calculation of excess reserve, the surplus level is massive and imposes an unreasonable and unacceptable level of intergenerational inequity on current customers who have paid far more for their use of the plant today than was either appropriate or equitable. Do you recall him saying that?

A. Yes.

Q. Do you agree with those statements?

A. No, I do not. I think customers have paid exactly what the Commission has established is the cost of service for depreciation, and that has been reflected in our accumulated depreciation reserves and serves to reduce the recovery of investments on a prospective basis.

MR. WALLS: I have no further questions.

CHAIRMAN CARTER: Exhibits.

MR. WALLS: Yes. We would move Exhibits 225 to 228 -- I'm sorry, 225 to 230.

CHAIRMAN CARTER: Are there any objections?

MR. REHWINKEL: No.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit Numbers 225 through 230 admitted into the record.)

CHAIRMAN CARTER: Hang on a second before we go to the back pages.

Mr. Rehwinkel, you have Exhibit 315 and 316. You are recognized.

MR. REHWINKEL: I would move those.

CHAIRMAN CARTER: Any objections?

MR. WALLS: I have no objection to 315, but I do have an objection to 316.

CHAIRMAN CARTER: Okay. Let's hear your objection.

MR. WALLS: The first page I believe is already an exhibit because it was sponsored by Witness Pous, if I am recalling correctly.

MS. KLANCKE: That is correct.

MR. WALLS: So obviously that is already in evidence. The other pages are not sponsored by any witness at all, and I don't know who prepared the headings for these documents. Certainly no witness did in this case, and I would object to those headings going in. I believe if OPC wants to brief these orders in their brief, they will have the opportunity to do so.

MR. REHWINKEL: Mr. Chairman, I know when I am beat, and I withdraw Exhibit 316.

CHAIRMAN CARTER: Okay. Thank you, Mr. Rehwinkel. We will just modify it. Just take the first page --

MR. REHWINKEL: Actually, I think that I could just withdraw the exhibit. I don't know that it really --

CHAIRMAN CARTER: Okay. Withdrawn. Show it done.

MR. REHWINKEL: I want Mr. Walls to be happy at the end of this day.

CHAIRMAN CARTER: You're such a nice guy, Mr. Rehwinkel.

MR. WALLS: You can do other things to make me happy.

CHAIRMAN CARTER: Let me do something to make the court reporter happy. I promised to give her a break because she is going to be with us for the duration. We will come back at seven after.

(Recess.)

CHAIRMAN CARTER: We are back on the record. And when we last left we had completed Witness Garrett.

Call your next witness.

MR. WALLS: Progress Energy calls Dr. Michael Vilbert.

MICHAEL J. VILBERT

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

DIRECT EXAMINATION

BY MR. WALLS:

Q. Mr. Vilbert, will you please introduce your yourself to the Commission and provide your business address?

A. My name is Michael J. Vilbert. My business address is 353 Sacramento Street, Suite 1140, San Francisco, California, 94111.

Q. And who do you work for and what is your position?

A. I am a principal of the Brattle Group, which is an economic consulting firm with offices in Cambridge, Massachusetts, Washington, D.C., San Francisco, California, London, Brussels, and Madrid.

Q. And have you filed rebuttal testimony and an exhibit in this proceeding?

A. Yes, I have.

Q. And do you have your prefiled rebuttal testimony and exhibit with you?

A. Yes.

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

A. No.

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

A. Yes.

MR. WALLS: We request that Dr. Vilbert'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.

I. INTRODUCTION AND SUMMARY

Q1. Please state your name and address for the record.

A1. My name is Michael J. Vilbert. My business address is The Brattle Group, 353 Sacramento Street, Suite 1140, San Francisco, CA 94111, USA.

Q2. Please describe your job and your educational experience.

A2. I am a Principal of The Brattle Group, ("Brattle"), an economic, environmental and management consulting firm with offices in Cambridge, Washington, London, San Francisco and Brussels. My work concentrates on financial and regulatory economics. I hold a B.S. from the U.S. Air Force Academy and a Ph.D. in finance from the Wharton School of Business at the University of Pennsylvania.

Q3. What is the purpose of your testimony in this proceeding?

A3. I have been asked by Progress Energy Florida, Inc. ("PEF" or "the Company") to respond to the testimonies of Mr. Daniel J. Lawton ("Lawton Testimony") on behalf of the Florida Office of Public Counsel ("OPC"), Mr. Jacob Pous ("Pous Testimony") on behalf of OPC and Mr. Jeffry Pollock ("Pollock Testimony") on behalf of The Florida Industrial Power Users Group ("FIPUG") regarding the appropriate regulatory treatment of the Company's estimated depreciation reserve variance. As a group, I refer to the testimonies of these individuals as the intervenors.

My focus is on whether there is any precedent either by other regulators or by the accounting profession to support the intevenors' proposal and whether the proposal represents good regulatory policy. In addition, I discuss the effect of the proposal on the Company's financial integrity and cost of capital. I am not reviewing or critiquing the depreciation studies of either the Company or the intervenors, and I accept as given the estimate from the Company's depreciation study of an amount of depreciation reserve variance. In particular, I am not disputing or estimating the useful lives of the

Company's assets. I am not evaluating the return on equity ("ROE") estimates by either the Company or any other intervenors in this proceeding, but I do have some comments on the likely effect on the cost of capital of adoption of the intervenors' proposal to reverse the depreciation reserve.

Q4. Please summarize the parts of your background and experience that are particularly relevant to your testimony on these matters.

A4. Brattle's specialties include financial and regulatory economics as well as the gas and electric industries. I have worked in the areas of cost of capital, investment risk and related matters for many industries, regulated and unregulated alike, in many forums. I have testified or filed testimony on regulatory issues and on the cost of capital before the Federal Energy Regulatory Commission, the Arizona Corporation Commission, the Pennsylvania Public Utility Commission, the Public Service Commission of West Virginia, the Tennessee Regulatory Authority, the Public Utilities Commission of Ohio, the Montana Public Service Commission, the South Dakota Utilities Board, the California Public Utilities Commission, the Public Utilities Commission of the State of Colorado, the Public Service Commission of Wisconsin, the New Jersey Board of Public Utilities, the Canadian National Energy Board, Alberta Energy and Utilities Board, the Ontario Energy Board, the Régie de l'Énergie and the Labrador & Newfoundland Board of Commissioners of Public Utilities. I have not previously testified before the Florida Public Service Commission. Appendix A contains more information on my professional qualifications.

Q5. What have the intervenors proposed in this proceeding with regard to the estimated depreciation reserve variance?

A5. The Company's depreciation study estimates the depreciation reserve variance to be $645,805,342, and the intervenors' estimates are even higher. The intervenors' proposal is designed to eliminate the $645,805,342 estimated depreciation reserve variance over a four year period. The intervenors propose to reverse an amount of depreciation equal to the amount of estimated depreciation imbalance that has already been recovered from customers in Commission approved rates and add it back to the rate base. Specifically, they propose to reduce the amount of depreciation currently in the Company's revenue requirement by $161,451,336 per year offset by $12,147,032 of additional return on rate base over each of the next four years. This latter amount includes return on equity, interest expense and income taxes. The ROE inherent in the recommended return is that of Dr. Randall Woolridge.[1]

Q6. What is the Company's proposal with regard to the depreciation reserve variance?

A6. The Company's depreciation study shows that the depreciation reserve variance is caused by changes in depreciation estimates (e.g., service lives, average remaining life, net salvage) such as the increase in the estimated economic life of several coal generating plants and the Crystal River nuclear generating plant. As is standard in regulatory jurisdictions, the Company proposes to adjust the depreciation rate going forward to correspond to the increased estimated lives of the assets and other changes in depreciation estimates. The remaining amount of investment to be recovered from customers would be spread over the remaining estimated life of the assets. As a result, the depreciation charge in the revenue requirement would be reduced, but the reduction would be spread over a longer period than four years.

Q7. What is your conclusion on the appropriateness of the intervenors' proposal to reverse the level of depreciation recorded by the Company?

A7. The intervenors' proposal to reverse the depreciation reserve is counter to Generally Accepted Accounting Principles ("GAAP") and is poor regulatory policy. When there are changes in depreciation estimates, for example, a change in an asset's expected useful life, GAAP recommends adjusting the depreciation rate going forward to correspond to the new life and recommends against any adjustment in the current balances of depreciation. I have found no regulatory precedent in other jurisdictions to reverse accrued depreciation, in part, probably because such a procedure is poor regulatory policy.

[1] On page 4 of his direct testimony, Dr. Woolridge recommends an allowed ROE of 9.75 percent for the Company. On page 6 of Dr. Vander Weide's testimony, he recommends an ROE of 12.54 percent.

It is poor regulatory policy because it increases regulatory uncertainty in that past decisions can be altered based upon information not available at the time of the decision. Such a policy opens the door to endless debates about whether cash flows in previous periods should be adjusted because actual costs or revenues varied from forecasts. Increased regulatory uncertainty is likely to increase investors' required return. It is also poor regulatory policy because it will increase the level and variability of rates to customers over the long term at the expense of a temporary reduction in the revenue requirement thereby creating a class of "winners" versus a much larger class of "losers" among customers. It is also a particularly bad time to increase regulatory uncertainty, because the capital markets are only now beginning to emerge from a period of turmoil and increased investor risk aversion. Although the economy is showing signs of stabilizing, investors' risk aversion remains higher than it was prior to the current economic crisis. If adopted, the intervenors' proposal would weaken the Company's credit metrics at a time when it must access the capital markets to acquire the funds necessary to finance its forecasted capital investment program.

Q8. How does the current turmoil in the financial markets affect the cost of capital for a regulated utility?

A8. I discuss the effect of the credit crisis on the cost of capital in detail in *Section III* below, but in general, the cost of capital is higher for all companies today than it was before the crisis. The intervenors' proposal will substantially affect the Company's cash flow and its perceived risk. Because of the unusual conditions still prevailing today, it is a particularly poor time to increase investor uncertainty regarding recovery of their investment in the Company's assets.

Q9. How is your testimony organized?

A9. *Section II* on the theory and application of the concept of depreciation is divided into five subsections. The first describes the role of depreciation in the revenue requirement. Depreciation increases the revenue requirement but reduces the rate base so that under fair regulation both investors and customers are protected if depreciation rates turn out to be higher or lower than necessary to recover the investment over the expected useful life of the asset. I next discuss the lack of regulatory precedent for the intervenors' proposal. The third subsection describes why the Company would be inadequately compensated under the intervenors' proposal and shows how much the return would have to increase to provide adequate compensation. The fourth subsection shows that adoption of the intervenors' proposal is likely to increase the cost of capital for the Company because of increased regulatory uncertainty as well as due to the weakening of the Company's credit ratios. The final subsection explains why the intervenors' proposal is poor regulatory policy, in part, because it relies upon imposing 20-20 hindsight on previous regulatory decisions. *Section III* discusses current market conditions and the likely effect on the cost of capital. In particular, the recent turmoil in the financial markets has increased the cost of capital for all companies including utilities so this is a particularly inopportune time to adopt a proposal that increases regulatory uncertainty. *Section IV* provides my conclusions. *Appendix A* contains my resume.

II. DEPRECIATION THEORY AND APPLICATION

A. DEPRECIATION IN THE REVENUE REQUIREMENT

Q10. Please briefly review the role of depreciation in setting the revenue requirement for a regulated utility?

A10. In a regulated setting, depreciation is designed to recover the cost of an asset over its expected useful life as opposed to adding the full cost of the asset to the revenue requirement in the year of investment. The concept is to match the cost of the asset to the period of service.

Q11. How is the amount of depreciation for an asset determined?

A11. For regulatory purposes, assets are generally depreciated on a straight-line basis over their expected life. An estimate of salvage value, either positive or negative, is added to the total cost of the asset to be depreciated. There are a few points to note about depreciation. First, no matter what method is chosen or how long the estimated life, depreciation will never be greater than the amount of investment minus the estimated salvage value. If the estimated life is longer, the annual rate of depreciation is lower, but the total still adds to 100 percent. Second, it is not unusual for the useful life of assets to vary from expectations. For example, some assets will not last as long as expected and some will last much longer. Nor is it unusual for assets to be fully depreciated and remain used and useful. As a result, when companies perform depreciation studies, it is common that the expected lives of some assets will be modified. Third, depreciation reduces the rate base upon which a rate of return is earned.

Q12. How is a change in the expected life of an asset usually handled in regulatory settings?

A12. Usually, the rate of depreciation is adjusted so that the percentage of the asset remaining to be recovered is spread over the remaining estimated life of the asset. For example, an asset with an initial expected life of 10 years would have a straight-line depreciation rate of 10 percent per year. If its expected life were extended at the end of 5 years to a revised expected life of 15 years, a new, lower rate of depreciation would be appropriate. Specifically, at the 5 year point, half of the depreciation would have been recovered leaving half to be recovered in the remaining 10 years, or 5 percent per year. Alternatively if the revised life were shortened to 7 years, the depreciation rate would have to be increased to 25 percent to recover the full remaining amount of the investment.

Q13. Are customers harmed if the life of the asset is revised, particularly if the expected life of the asset is increased?

A13. No. Recovery of depreciation automatically has an offset for customers. The regulated company not only recovers its investment in assets that provide service to customers, it also earns a rate of return on the investment not yet recovered. Depreciation is the return *of* the investment. The rate of return *on* the investment is the weighted-average cost of debt and equity in the capital structure plus an allowance for income tax. Under fair regulation, the present value of the depreciation and return on the investment will equal the amount of investment. If the initial rate of depreciation turns out to be higher than required because the expected life is increased, customers save the return *on* the depreciation recovered. However, the present value of recovery is unchanged.[2] Only the timing of the cash flows is different.

Q14. How do regulators ensure that differences in the timing of the recovery of an investment do not raise the issue of intergenerational fairness?

A14. To begin with, there is no existing level of complete intergenerational fairness within the process of setting rates because the composition of the customers' group always changes over time. However, the primary reason offered by the intervenors for their proposal in this proceeding to reverse the depreciation already recovered is an appeal to intergenerational fairness, but their proposal actually creates a set of intergenerational winners and losers. Specifically, reversing the depreciation allowance over the next four years creates a group of customers that unfairly receive a rate reduction at the expense of customers who paid rates earlier or who will pay rates after the four year period. There is no reason that the depreciation reserve should be reversed over a four year period. That period is completely arbitrary. In fact, the only logical and completely fair way to deal with the issue is to adopt the Company's proposal to reset the depreciation rate based upon the remaining useful life of the assets whose expected useful lives and other depreciation parameters have changed. This again matches the remaining investment to be recovered to the expected life of the asset. This is, in fact, the way that changes in expected lives of depreciable assets are usually handled.

Q15. Do you agree that the existence of a depreciation reserve imbalance means that intergenerational unfairness has already occurred?

A15. No. The depreciation rates that were in place for the Company's assets were approved by the Commission based upon the best information available at the time. In other words, the depreciation rates were appropriately set and recovered in rates. The Company is not

[2] This assumes that the allowed rate of return is set equal to the cost of capital.

accused of making an error in the calculation of the amount of depreciation, nor did the Company change its method of calculating depreciation. The primary reason for the depreciation reserve imbalance is that the depreciation estimates have changed over time, for example, estimated lives of some assets have been increased. It is only in retrospect that we forecast today that the depreciation rate was higher than necessary in the past, but that is fundamentally different than purposely creating a set of "winners" by reducing depreciation over the next four years at the expense of all future and past customers as would result from adoption of the intervenors' proposal.

Q16. Please summarize this section of your rebuttal.

A16. It is effectively impossible to forecast exactly the depreciation parameters, such as the useful life of depreciable assets, so revisions to the expected lives of some assets and net salvage parameters will be necessary each time a depreciation study is performed. Fortunately, depreciation automatically provides a benefit to customers in the form of a reduction in the return *on* the investment because depreciation reduces the rate base. This means that the fact that the depreciation rates were not perfectly matched to the actual useful life of the assets does not result in harm to rate payers because the present value of the amounts paid by customers will equal the amount of investment.

B. There is No Accounting or Regulatory Precedent for the Intervenors' Proposal

Q17. Have you found any precedent for the depreciation recapture or reversal proposed by the intervenors in this proceeding?

A17. No. I have searched for decisions by other regulators in the U.S. that address the issue of how to treat depreciation on an asset whose estimated life changes at some point in its regulatory life. I am not aware of any jurisdiction that has implemented a policy of refunding a portion of the depreciation already collected in rates from customers. To my knowledge, all jurisdictions revise the depreciation rate to match the new estimated life of the assets. I also reviewed the accounting profession's treatment of changes to the useful life of assets and found that under Generally Accepted Accounting Principles ("GAAP") it is clear that such a change needs to be handled prospectively not retroactively.

Q18. What evidence do you have that there is no regulatory precedent for the proposal?

A18. While I have been unable to find any precedence for the proposal, both the Federal Energy Regulatory Commission ("FERC") and regulators in several states clearly rely on the methodology proposed by the Company and depreciate the remaining assets over the remaining useful life.[3]

Q19. Please summarize FERC's methodology.

A19. Broadly speaking, the FERC requires that

> Utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of depreciable property over the service life of the property.[4]

Like most regulatory entities, the FERC requires entities to file periodical depreciation studies, and while the determination of depreciation rates frequently is subject to dispute, the FERC consistently has relied on prospective changes to rates when accounting estimates of service lives change. Indeed, the FERC in a recent decision stated that

> Because of estimates inherent in depreciation accounting, Commission policy generally requires that over-or under-accrued provisions for depreciation be corrected prospectively by an upward or downward adjustment in the depreciation rate.[5]

Another FERC decision goes on to state that the FERC will consider adjusting the balance if the entity can establish that, in addition to there being a variance in the accrued and theoretical depreciation reserve, the variance was caused by an accounting error

[3] Regulatory accounting usually refers to "service life" which is the useful life to a specific entity.

[4] FERC, "*Uniform Systems of Accounts*," Section 22, paragraph A.

[5] FERC, "Order Authorizing the Acquisition of Jurisdictional Facilities," Docket Nos. EC08-33-000 and EC08-33-001, Issued March 31, 2008, p. 21-22, paragraph 62.

rather than the use of estimates. This is consistent with financial accounting principles and with prior FERC decisions. For example, the FERC has rejected an agreement between parties to restate a utility's depreciation reserve stating:

> 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.[6]

Thus, FERC's position is clear and I have not found instances in which FERC reversed the depreciation or depreciation reserve because the service life of an asset was extended or any other depreciation estimate changed.

Q20. Please summarize the evidence you have that other state commissions do not reverse past depreciation.

A20. It is common for utilities to file depreciation studies and consequently depreciation rates for approval with regulatory commissions. As a result of such studies, the useful life or service life of major assets (or classes of assets) is updated to reflect up-to-date information. Therefore, depreciation rates are modified, so that the time horizon over which the remaining asset (or asset minus salvage value) is depreciated reflects the remaining service life. While such updates change the depreciation rates going forward, no attempt is made to reverse past depreciation. For example, in connection with Kansas City Power & Light's ("KCPL") expected expansion of the Wolf Creek nuclear power plant's useful life from 40 to 60 years, the Missouri Public Service Commission allowed KCPL to modify its depreciation rate going forward.[7] Similarly, the Minnesota Public Service Commission recently approved Xcel Energy to recover the remaining net asset

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[6] FERC, "Order Affirming Initial Decision", Carnegie Natural Gas Company, Docket No. FA89-16-000, Issued August 7, 1992, p. 6-7.

[7] Public Service Commission of the State of Missouri, Report and Order, Case No. EO-2005-0329, Issue date, July 28, 2005, p. 30.

value of its Prairie Island and Monticello nuclear plants over the extended service life of these assets.[8]

Q21. Do you have any comments on the Commission decisions cited by the intervenors as relevant?

A21. Yes. While I leave the detailed comments to those more familiar with Florida regulatory precedent, I observe that the decisions cited by intervenors tend to involve either a transfer between accounts rather than a reversal of the accumulated depreciation reserve and/or they involve unique circumstances that are not present in the current situation. Looking at the decisions cited by the Pous Testimony, I have the following observations. The Gulf Power Company, Marianna Electric Division and Tampa Electric Company decisions cited on p. 32 all pertain to a "reserve transfer" between accounts rather than a reversal of account balances. In addition, the Gulf Power decision, Order No. 19901, involves a change in methodology rather than estimates, and it is noteworthy that the decision ensured that the "Restated Reserve" equals the "Book Reserve" for plant sites, so no change was made to the total accumulated depreciation reserve. The General Telephone Co. decision specifically discusses the fast paced development in technology for telecommunications and the risk of stranded cost in its decision to shorten the time over which General Telephone's assets' are amortized.[9] To summarize, these decisions from the Pous Testimony pertain to unique or different circumstances than what is being proposed by interveners.

[8] Minnesota Public Utilities Commission, "Order Amending Remaining Life of the Prairie Island Nuclear Plant," Docket No. E,G-002/D-03-230, January 5, 2004. See also Xcel Energy's Q2, 2009 10-Q and Minnesota Public Utilities Commission, Staff Briefing Papers, June 25, 2009.

[9] The decisions cited by the Pous Testimony are discussed in more detail in the Rebuttal Testimony of Mr. Will Garrett ("Garrett Rebuttal").

Q22. Do you have comments on the Pollock Testimony's reliance on a settlement?

A22. Yes. On page 50, the Pollock Testimony references a settlement that grants FPL "the option to amortize" an amount annually over the settlement period.[10] First, a settlement is inherently different from a Commission order, and second, an option to amortize is different from requiring a company to reverse its accumulated depreciation. Without knowing the full details of the settlement, it is difficult to determine the comparability to the current matter.

Q23. How is a change in expected useful life or service life of a depreciable asset treated by the accounting profession?

A23. The accounting profession also alters the depreciation rates to reflect the revised estimate of the remaining useful life. Generally Accepted Accounting Principles ("GAAP") are clear on this issue. As noted in the *Miller GAAP Guide*, "Estimates are necessary in determining depreciation and amortization of long-lived assets, ..." and "[a] change in an accounting estimate is not accounted for by restating prior year's financial statements ..."[11] To quote one of the most commonly used intermediate accounting textbooks in the U.S.:

> [The company] should report this change in [useful life] estimate in the current and prospective periods. It should not make any changes in previously reported results. And it does not adjust opening balances nor attempt to "catch up" for prior periods.[12]

Thus, the Financial Accounting Standard Board ("FASB") has made clear that GAAP distinguishes between a change in accounting estimates such as a depreciation rate *and* a change in accounting principles or accounting errors. In the case of a change in accounting estimates (e.g., depreciation rates), the change is reflected prospectively

[10] Florida Public Service Commission, "Order Approving Stipulation and Settlement," Order No. PSC-05-0902-S-EI, Issued September 14, 2005, p. 3.

[11] Quoted from Jan R. Williams and Joseph V. Carcello, "*Miller GAAP Guide*," Aspen 2004, Chapter 1.

[12] Donald E. Kieso, Jerry J. Weygandt, and Terry D. Warfield, *Intermediate Accounting*, 12th Edition, Wiley 2008, p. 533.

whereas a change in accounting principles or accounting errors are reflected retrospectively.[13] To my knowledge, the accounting profession never suggests that accumulated depreciation should be reversed (other than in cases of restatements or a change of accounting principle).

Q24. Do you have other comments on the regulatory precedent of adopting the intervenors' proposal?

A24. Yes. Effectively, the intervenors' proposal amounts to a request to the Commission to reverse the previous decisions of the Commission. The depreciation expense recovered by the Company leading to the current depreciation reserve variance was approved by previous Commission decisions, and those decisions were based upon the best information available at the time. To reverse those decisions based upon information not available at the time of the previous decisions is a form of ex-post rate making. Worse, it sets a precedent that says no past regulatory decision is final even for the period of the decision. For example, a commission could decide that the allowance for O&M expense was too high (or too low) in a previous period because the actual expenses were less than (greater than) forecast and require a refund or surcharge. Such a policy would increase regulatory uncertainty from the investors' and the customers' points of view. Investors dislike uncertainty, and increased uncertainty would likely lead to an increase in the required cost of capital for the company. Customers seem to dislike uncertainty and volatility in rates as well.

C. The Intervenors' Proposal Does Not Provide Adequate Compensation to the Company

Q25. Please review the intervenors' proposal to reverse the depreciation "surplus."

A25. The intervenors propose to reduce the amount of depreciation in the Company's revenue requirement by $161,451,336 per year and to add that amount to the rate base, and the reduction is to be offset by $12,147,032 for an increase in return on rate base over each of

[13] See Jan R. Williams and Joseph V. Carcello, Miller GAAP Guide, Chapter 1.

the next four years.[14] This latter amount includes return on equity, interest expense and income taxes which is sometimes called the before-tax weighted-average cost of capital, the BTWACC. The proposal is designed to reverse the $645,805,342 of depreciation reserve variance estimated in the Company's depreciation study.

Q26. If adopted, does this proposal adequately compensate the Company?

A26. No. Under the intervenors' proposal, the Company's rate base will increase by the $646 million amount of the estimated depreciation reserve, but the proposed allowed return of $12 million is based upon ½ of the first year's depreciation offset alone. At the end of the first year of the proposal, the Company's gross rate base will be $161 million larger than at the start of the process which would require an increase in the return for interest, ROE and income taxes of more than $24 million plus the additional $12 million for the $161 million of depreciation returned in the second year. At the end of the second year, the Company's rate base will be $322 million larger requiring a return of $48 million plus $12 million for the $161 million of deprecation return in the 3rd year and so forth. The result is that the company should be awarded an annual return of four times the initial proposal of $12,147,032 or $48,588,128 in each of the next four years to be adequately compensated for the increase in rate base. In other words, the return should be based upon approximately ½ of the estimated depreciation reserve. The actual situation is slightly more complicated than this because of deferred income taxes ("DIT").[15] Table 1 below demonstrates how rates should be reflected considering the change in the rate base and DIT resulting from adding back book depreciation already taken.

[14] The ROE in the calculations is the 9.75 percent as recommended by Dr. Woolridge not the Company's requested ROE of 12.54 percent as recommended by Dr. Vander Weide. I do not endorse Dr. Woolridge's recommendation.

[15] DIT is calculated as (tax depreciation minus book depreciation) times the marginal income tax rate. In Florida, accumulated DIT is used to adjust the weighted-average cost of capital as a source of capital that has no cost. The intevenors' proposal would increase DIT which would also reduce the weighted-average cost of capital instead of the rate base as illustrated in the example.

Table 1

	Depreciation [1]	Beginning Rate Base [2]	Unadjusted End of Year Rate Base [3]	Deferred Income Tax ("DIT") [4]	Average Rate Base [5]	Return on Rate Base [6]	Net Cashflow [7]	End of Year Rate Base with DIT [8]
Year 1	161.5	0.0	161.5	62.3	80.7	12.1	(149.3)	99.2
Year 2	161.5	99.2	260.6	62.3	179.9	27.1	(134.4)	198.3
Year 3	161.5	198.3	359.8	62.3	279.1	42.0	(119.5)	297.5
Year 4	161.5	297.5	459.0	62.3	378.2	56.9	(104.5)	396.7
Total	**645.8**			**249.1**				
Average						**34.5**	**(126.9)**	

Sources and Notes:
Values are in millions.
[1]: Direct Testimony of Daniel J. Lawton.
[2]: [8] from previous year, except Year 1 which is 0.
[3]: [1] + [2].
[4]: [1] x 38.575%; where 38.575% is the tax rate.
[5]: Average of [2] and [3].
[6]: [5] x 15.05%. Where 15.05% is implied BTWACC.
[7]: [1] - [6].
[8]: [3] - [4].

Q27. Please describe the calculations in Table 1.

A27. Column [1] shows the proposed reversal of depreciation of about $161 million over each of the next four years, which generates an increase in DIT because book depreciation is effectively less than it was in the past. The reduction in the Company's revenue requirement is shown in column [7]. It is equal to the reduction in depreciation expense ($161 million) minus the increase in return on rate base from column [6]. For ease of demonstration, I have used DIT to reduce rate base rather to adjust the weighted-average cost of capital as is the procedure in Florida, but effectively the result is the same. Note that the reduction in rates (i.e., the reduction in net cash flow in column [7]) declines over time as the amount of annual reversed depreciation accumulates in the rate base. However, this is not the end of the story because the gross rate base is now about $646 million greater than it would have been, and this increase must now be recovered over the remaining life of the assets. The Pous Testimony notes that the remaining life is about 21 years[16] which leaves about 17 years following the four years of the intervenors' proposal. Table 2 below demonstrates the recovery.

[16] Pous Testimony, p. 34.

Table 2

	Depreciation [1]	Beginning Rate Base [2]	Unadjusted End of Year Rate Base [3]	Deferred Income Tax ("DIT") [4]	Average Rate Base [5]	Return on Rate Base [6]	Net Cashflow [7]	End of Year Rate Base with DIT [8]
Year 5	38.0	396.7	358.7	14.7	377.7	56.8	94.8	373.4
Year 6	38.0	373.4	335.4	14.7	354.4	53.3	91.3	350.0
Year 7	38.0	350.0	312.0	14.7	331.0	49.8	87.8	326.7
Year 8	38.0	326.7	288.7	14.7	307.7	46.3	84.3	303.3
Year 9	38.0	303.3	265.4	14.7	284.4	42.8	80.8	280.0
Year 10	38.0	280.0	242.0	14.7	261.0	39.3	77.3	256.7
Year 11	38.0	256.7	218.7	14.7	237.7	35.8	73.8	233.3
Year 12	38.0	233.3	195.4	14.7	214.4	32.3	70.2	210.0
Year 13	38.0	210.0	172.0	14.7	191.0	28.7	66.7	186.7
Year 14	38.0	186.7	148.7	14.7	167.7	25.2	63.2	163.3
Year 15	38.0	163.3	125.4	14.7	144.3	21.7	59.7	140.0
Year 16	38.0	140.0	102.0	14.7	121.0	18.2	56.2	116.7
Year 17	38.0	116.7	78.7	14.7	97.7	14.7	52.7	93.3
Year 18	38.0	93.3	55.3	14.7	74.3	11.2	49.2	70.0
Year 19	38.0	70.0	32.0	14.7	51.0	7.7	45.7	46.7
Year 20	38.0	46.7	8.7	14.7	27.7	4.2	42.2	23.3
Year 21	38.0	23.3	(14.7)	14.7	4.3	0.7	38.6	0.0
Total	**645.8**			**249.1**				
Average						**28.7**	**66.7**	

Sources and Notes:
Values are in millions.
[1]: 645.81 / 17 years.
[2]: [8] from previous year. Year 5 from Table 1 Year 4.
[3]: [2] - [1].
[4]: [1] x 38.575%; where 38.575% is the tax rate.
[5]: Average of [2] and [3].
[6]: [5] x 15.05%. Where 15.05% is implied BTWACC.
[7]: [6] + [1].
[8]: [2] - [1] + [4].

Q28. Please describe the calculations in Table 2.

A28. The recaptured depreciation must once again be charged to customers, but it is done over a 17 year period which is an estimate of the average remaining life of the assets.[17] The depreciation expense in column [1] recovers the $646 million of depreciation and column [6] displays the return on rate base. Column [7] shows the net cash flow in each of the next 17 years required to amortize the recaptured depreciation from the intervenors' proposal. In exchange for saving an average of about $127 million for four years (average of column [7] in Table 1), the trade off is rates that are about $67 million higher for 17 years (average of column [7] in Table 2). A graph of the change in rates due to the

[17] The 17 year period is for illustration purposes and is not intended to be an independent estimate of the average remaining life.

intervenors' proposal is displayed in Figure 1 below, which shows how much more variable rates would be if the intervenors' proposal is adopted. Note that between year 4 and year 5, the revenue requirement would jump by about $200 million.

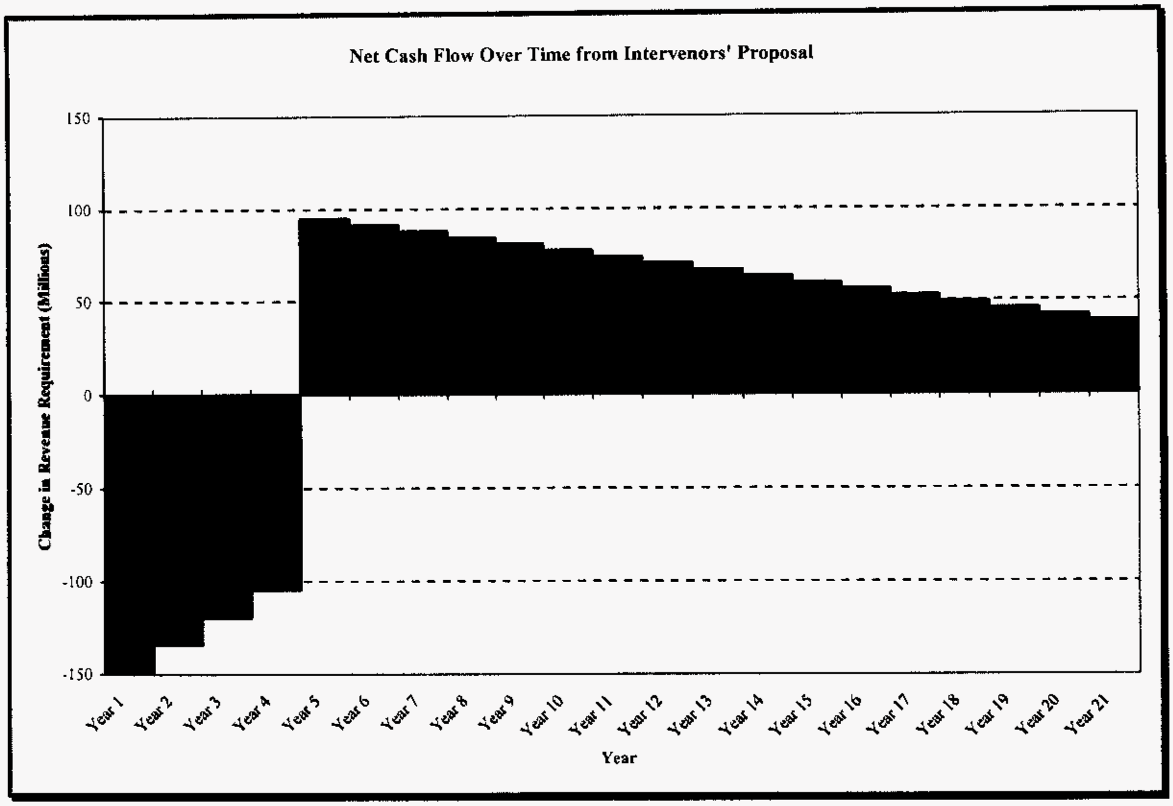

Figure 1

Q29. Is there an alternative to the additional rate of return you have estimated?

A29. There are two alternatives: 1) the Commission could deny the intervenors' proposal to reverse the depreciation reserve, or 2) the Company would be forced to file a rate case in each of the next four years to be adequately compensated. Clearly, denying the proposal is preferable.

Q30. If the Company must be fairly compensated for the reversal of the depreciation reserve in the form of a higher return and increase in rates, how will customers be treated?

A30. If the Company is fairly compensated through higher future rates, the customers will also be treated fairly because the present value of the return on investment and the future depreciation allowance will equal the $646 million reversal of the depreciation reserve. However, it is worth noting that in exchange for a temporary reduction in the average revenue requirement of about $127 million over the next four years, future customers will pay a higher cost of service including the return of the $646 million in depreciation that is the source of the temporary reduction in the revenue requirement. In addition, customers will have to pay a rate of return on that $646 million so that rates will average about $67 million higher at the beginning of the fifth year. Moreover, the cost of capital requested by the Company is higher than recommended by the intervenors. If the Company's requested cost of capital had been used in the analysis, the benefit to customers will be even lower, because customers receive a return on the depreciation already recovered equal to the cost of capital. The higher the allowed return, the greater the benefit in terms of cash flow from depreciation. *If the Company is fairly compensated, the intervenors'* proposal does not seem as beneficial to customers.

D. The Cost of Capital is Likely to Increase if the Intervenors' Proposal is Adopted

Q31. Please explain briefly why you believe that the Company's cost of capital would increase if the intervenors' proposal were adopted.

A31. There are two reasons why the cost of capital is likely to increase. First, investor uncertainty will increase because this proposal opens the door to reversing or revising previous Commission decisions for periods already past. No Commission decision will be seen as final. Second, the Company has plans for substantial capital investment going forward, in particular its planned new nuclear generation. The reduction of cash flow over the next four years means that the Company will have to go to the capital markets to acquire the funds necessary for its capital investment program to replace the lost cash flow from the intervenors' proposal as well as the additional funds necessary. This will result in higher transactions costs to acquire capital, because it will be necessary to acquire $646 million more capital in the short term if the intervenors' proposal is adopted. Even more costly is likely to be the increase in the cost of capital for these new funds because the Company's credit metrics will be weakened compared to what they would have been without the depreciation reversal.

Q32. If the Company's debt rating were not downgraded, will its cost of debt still increase?

A32. Yes. Even if the Company's debt rating were not downgraded, its cost of debt is highly likely to increase because the reduction in cash flow will affect its credit ratios as Mr. Lawton acknowledges. All debt with a similar rating does not have the same yield. There are variances in the cost of debt based upon the underlying strength of the company even for companies with identical credit ratings. All else equal, a reduction in the strength of the Company's credit ratios will result in an increase in the cost of debt.

Q33. Do you have other comments on the effect on the Company's financial integrity?

A33. Yes. As acknowledged by Mr. Lawton,[18] Progress Energy's financial ratios will decline if the proposal were implemented. According to Mr. Lawton's calculations, which I have not verified, the cash flow from operations to debt ratio drops substantially and is near the bottom of the range for a BBB-rated entity even if none of the other suggested changes to PEF's requested revenue requirement were made. If any other of the intervenors' suggested reductions were implemented, the effect could easily be a ratio outside the BBB-range. Using Mr. Lawton's figures, the cash flow from operations-to-debt (before and after tax) as well as the cash flow from operations-to-interest ratio will be below the BBB-range if the Company's request with the OPC's rate of return adjustments is implemented. It is important to note that the ratios that are below the BBB-range, by Mr.

[18] Lawton Exhibit DJL-5 p. 1 of 2.

Lawton's calculations, are the cash flow ratios which are the most important ratios for rating purposes. As Standard & Poor's ("S&P") has said "Cash is King."[19] Solid cash flows are more important today than just a few years ago.

Q34. Why is an impact on cash flow ratios especially important in today's environment?

A34. There are at least two reasons why cash flows have become extremely important. First, the current economic environment increases the uncertainty of utilities' cash flows because the revenue stream may be more uncertain than usual and access to capital markets is more challenging. Second, Progress Energy, like many other utilities, has committed to investing in its infrastructure and will therefore need solid financial metrics to attract capital on reasonable terms.

Q35. What is the importance of PEF's credit metric?

A35. PEF needs to maintain its access to capital market under reasonable terms, and as S&P points out, cash flow is vital to ensure access. For example, many of the key ratios used by S&P in its evaluation of utilities are linked to cash flow,[20] and S&P recently opined that in times of financial turmoil,

> … a financial position, featuring strong debt service coverage and liquidity, can temporarily insulate utilities from each of these financial challenges.[21]

Debt costs have increased more for lower rated utilities than for higher rated utilities, so the costs associated with a weaker credit metric could be substantial. For example, recent yield data indicate that the cost of BBB- rated utility debt has increased substantially more than the cost of BBB+ utility debt. However, the most important reason to maintain solid debt coverage and cash flow is to ensure PEF's ability to maintain its access to

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[19] Standard & Poor's, "*Corporate Ratings Criteria,*" 2008 p. 46.

[20] See, for example, Standard & Poor's, "*Corporate Ratings Criteria,*" 2008 p. 52.

[21] Standard & Poor's RatingsDirect, "*U.S. Public Power Outlook: 2009 Could Provide Some Shocks,*" January 20, 2009, p. 5.

capital markets in times when liquidity and market access remain fragile.[22] In Moody's view, "the biggest near-term challenge [for utilities] is the need to maintain adequate sources of liquidity."[23]

The Lawton Testimony acknowledges the importance of credit ratios. He calculates and provides four cash-based ratios in his exhibit DJL-5 but fails to acknowledge that the intervenors' proposal regarding the depreciation reserve variance in combination with any of a number of other intervenor proposals would result in PEF's credit metrics being below those required for an investment grade credit rating.

Q36. Please elaborate on the impact of the challenging economic environment.

A36. During times of financial crisis access to capital markets becomes more restrictive because investors require a higher return for any given level of risk. This happened in the U.S. in the summer and early fall of 2007 and also in the fall of 2008 as the amount of funds available to companies was reduced. Investors expect a return that is equal to the return on comparable risk investments. As the financial metrics of a company weaken, the required return increases because the company is perceived to be riskier. Cash flow is of utmost importance for bond holders, so stable and adequate cash flows are crucial for a company that seeks to raise debt capital on reasonable terms. In the current environment, the difference between the cost of debt for A-rated and BBB-rated utilities has increased. As the BBB-range is broad and lower rated utilities face a higher cost of debt, a decline in cash flow credit ratios could easily impact the cost of debt for the Company. An equally important consideration is the access to capital. In times of crisis, financial markets are more volatile, and access to credit is more limited. When the access to credit becomes limited, companies with weaker credit metrics are more affected than those with stronger credit metrics. It is therefore imperative that the Company maintains sufficiently strong credit ratios such that the Company can attract debt capital on reasonable terms. If

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[22] See, for example, FitchRatings, "*U.S. Utilities, Power and Gas 2009 Outlook,*" December 22, 2008, p. 2.

[23] EUCI, "*Utility Credit Risk,*" presented by Moody's, February 25, 2009. Quote from brochure.

adopted, the intervenors' proposals would dangerously weaken the Company's credit metrics.

Q37. Please summarize this section.

A37. The Company's cost of debt and equity will both likely increase if the intervenors' proposal is adopted. The cost of debt will increase somewhat because the Company's credit ratios will be weakened, and the cost of equity will increase because of the heightened uncertainty regarding the possibility that previous Commission decisions could be reversed for historical periods. Finally, the Company will experience additional transaction costs to acquire additional capital to replace the cash flow lost if the proposal is adopted.

E. THE INTERVENORS' PROPOSAL IS NOT SOUND REGULATORY POLICY

Q38. Please explain why you believe that the adoption of the intervenors' proposal is not sound regulatory policy.

A38. There are at least four reasons why the intervenors' proposal is not sound regulatory policy. First, there is no other regulatory precedent supporting the proposal to reverse depreciation expense already recovered from customers. Second, the proposal is counter to GAAP. Third, the policy creates a small set of winners (i.e., customers over the next four years) at the expense of all past and future customers, and fourth, the intervenors' proposal is an application of 20-20 hindsight which will create unnecessary regulatory uncertainty.

Q39. Please discuss the fourth objection, the application of 20-20 hindsight.

A39. All regulatory decisions are made in the context of the information available at the time of the decision. The estimated lives and net salvage parameters and depreciation rates that have subsequently resulted in the estimated depreciation reserve variance were approved by the Commission based upon the best information available at the time. In the Company's current depreciation study, the estimated lives of some generating assets have been increased and other depreciation estimates (e.g., average remaining life, net salvage) have changed with additional experience and information over the four years since the last depreciation study, but that information was not available to the Commission when it made its previous decisions. Obviously, forecasts almost never exactly match actual outcomes, so a policy that recommends reviewing the outcome of past decisions and modifying them to match actual outcomes will result in endless debate about past decisions.

Moreover, there is no guarantee that the increase in the estimated lives of the assets that, in part, generated the depreciation reserve variance, will actually come to pass. It is not hard to imagine new regulations on the emission of carbon dioxide that could limit the useful lives of coal plants. Likewise, a similar reduction in life of older nuclear plants could occur.[24] If the lives were shortened, the excess depreciation reserve would quickly be reduced or disappear. Of course, regulators today have no way to know whether shortened lives will occur just as past regulators had no way to know that the current estimates of the useful lives of the assets would be increased. Any proposal that relies upon 20-20 hindsight is ill advised.

Q40. Do you agree with Mr. Pous' claim that the risk that the estimated lives of the generating plants will be shorter than current forecast is small?

A40. As I noted at the outset, I am not critiquing the depreciation studies of either the Company or the intervenors; however, as a matter of logic, the fact that there may be a low probability of a shorter life does not mean that there is a zero probability. Moreover, it is precisely because the future is unknown today that the depreciation reserve variance arose in the first place. Events unexpected today could result in the estimated lives of the generating plants being further revised, either longer or shorter, in future depreciation studies.

[24] In fact the testimony of Mr. Jacob Pous, on p. 37, cites an example from the testimony of Mr. Earl Robinson of AUS Consultants who performed the depreciation study for the Company. If approval for the life extension for the Crystal River nuclear generating plant is not received from the Nuclear Regulatory Commission, the reserve variance will largely disappear overnight.

III. IMPACT OF CURRENT ECONOMIC TURMOIL ON THE COST OF CAPITAL

Q41. What is the topic of this section of your testimony?

A41. This section addresses the effect of the current economic situation on the cost of capital. Any proposal that weakens the Company's credit metrics during a time of market uncertainty and an increase in investor risk aversion should be carefully considered for its likely effect on the Company's cost of capital.

Q42. Please summarize the effect of current economic conditions on the cost of capital.

A42. The current economic situation in the U.S., as well as most of the rest of the world, is very uncertain for investors. Economic growth has slowed, and it is now negative in many countries. Stock markets worldwide have lost substantial value. In the U.S., for example, the S&P 500 fell more than 50 percent from its peak at the end of 2007, and the volatility of the index increased dramatically. (See Figures 2 and 3 below.) The likely result of the increased uncertainty is that investors' risk aversion has increased, which, in turn, means that the cost of capital is higher today than in the recent past.

Q43. What do you mean by the term investor "risk aversion"?

A43. Risk aversion is simply the recognition that investors dislike risk. A fundamental tenet of investing is that investors face a risk-return tradeoff in selecting from among the various investment options. Risk-averse investors can only be induced to accept more risk if the expected return is higher. When investors' risk aversion increases, the expected return (sometimes called the required return) increases for any level of risk.[25] In other words, the market risk premium ("MRP"), the premium required for an average risk stock, is higher today than it was in the recent past.

[25] Academic articles frequently use the term "coefficient of risk aversion" in conjunction with an assumption regarding investors' utility functions. In this testimony, I am using the term in a more generic sense.

Q44. What evidence do you have that investors' risk aversion has increased?

A44. A number of readily observable factors indicate an increase in investors' risk aversion. Unprecedented defaults in debt instruments that had previously been highly rated (AA or A), such as collateralized debt obligations and mortgage-backed securities, and the fall in value of most securities caused investors to seek investments that would preserve the value of their investments. As a result, there has been a "flight to safety" by investors seeking to maintain the value of their investments. In general, investors perceive bonds as less risky (safer) than equity and government bonds as safer than corporate bonds. As a result, the demand for bonds, particularly government debt, has increased substantially. In fact, at what *may* have been the height of the crisis, the yield on U.S. Treasury bills actually fell below zero![26] The flight to safety had two other results. First, the yield spread between corporate bonds and government bonds has increased dramatically. Although the yield spreads have declined somewhat from their highest levels, they remain high by historical standards as can be seen in Table 3 below.

Table 3

Spreads between US Utility Bonds (20 year maturity) and US Government Bonds (20 year maturity)
(in percentage)

Periods	A-Rated Utility and Government Bonds	BBB-Rated Utility and Government Bonds	Notes
Period 1 - Average Mar-2002 - Dec-2007	1.05	1.43	[1]
Period 2 - Average Aug-2008 - Aug-2009	2.38	3.26	[2]
Period 3 - Average Aug-2009	1.37	1.88	[3]
Period 4 - Average 15-Day (Jul. 31, 2009 to Aug. 24, 2009)	1.33	2.05	[4]
Spread Increase between Period 2 and Period 1	1.33	1.83	[5] = [2] - [1].
Spread Increase between Period 3 and Period 1	0.32	0.45	[6] = [3] - [1].
Spread Increase between Period 4 and Period 1	0.28	0.62	[7] = [4] - [1].

Source:
Spreads for the periods are calculated from Bloomberg's yield data.
Average monthly yields for the indices were retrieved from Bloomberg as of August 25, 2009.

Second, the stock market plummeted in value as investors attempted to move out of investments considered risky and into those of lower risk. Increased risk aversion

[26] "Treasury Bills Trade at Negative Rates as Haven Demand Surges", by Daniel Kruger and Cordell Eddings, *Bloomberg*, December 9, 2008.

translates into a requirement for an investment to provide a higher expected return for a given level of risk. Under such circumstances, prices of investments fall until investors can again expect to earn their (now higher) required rate of return. Of course, part of the fall in prices is the result of a fall in expected cash flows, but it is also the result of increased risk aversion as indicated by the differential decrease in investments of different risk. It is only recently that the market has begun to recover some of its lost value.

Q45. How different is the overall economic environment now compared to other time periods in which you have testified?

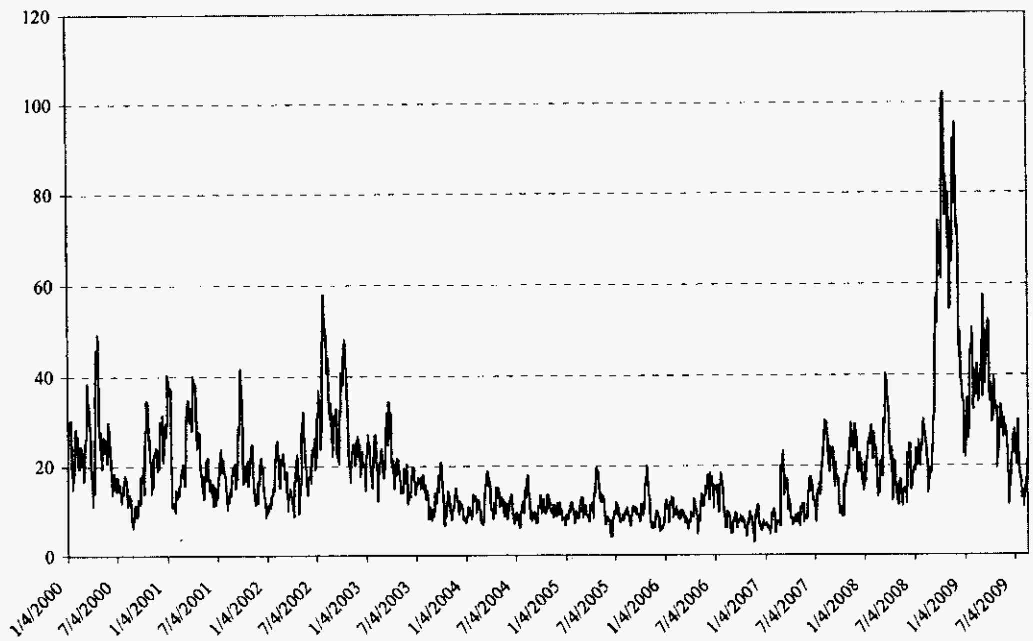
A45. We now live in a very different economic environment compared to one or two years ago. The U.S. and world economies are in a state of recession triggered by the deep financial crisis that emerged from the housing bubble and from financial institutions' use of sophisticated structures that concealed the true risk faced by the investors. Stock markets are down, market volatility and the spread on corporate debt is high, and for most firms it has become extremely hard to gain access to external financing on reasonable terms.

More specifically, as Figure 2 below indicates, the S&P 500 index is down by approximately 27 percent compared to mid-2008 which is a recovery from its lowest point.

Notes: Prices are pulled from Bloomberg as of August 25, 2009.

Figure 2 Daily S&P 500 Index Prices from January 2000 to August 2009.

Figure 3 below displays the market volatility, measured by the 10-day rolling volatility on the S&P 500 index, over the period beginning in 2000 through August, 2009.



Source: Data pulled from Bloomberg as of August 25, 2009.

Figure 3 S&P 500 Index's Annualized 10-Day Rolling Volatility from January 2000 to August 2009

Until relatively recently, average volatility was in the 20 percent range, but it spiked to over 100 percent in late 2008. Although volatility has decreased somewhat over the last several months, it is still somewhat higher than the average value for the 2003 to 2007 period.

The Federal Reserve's efforts to stimulate spending via interest rate cuts have resulted in the drop of the federal funds rate as indicated in Figure 4 below. The yield on Treasury bills is also at extraordinarily low levels with yields close to zero.

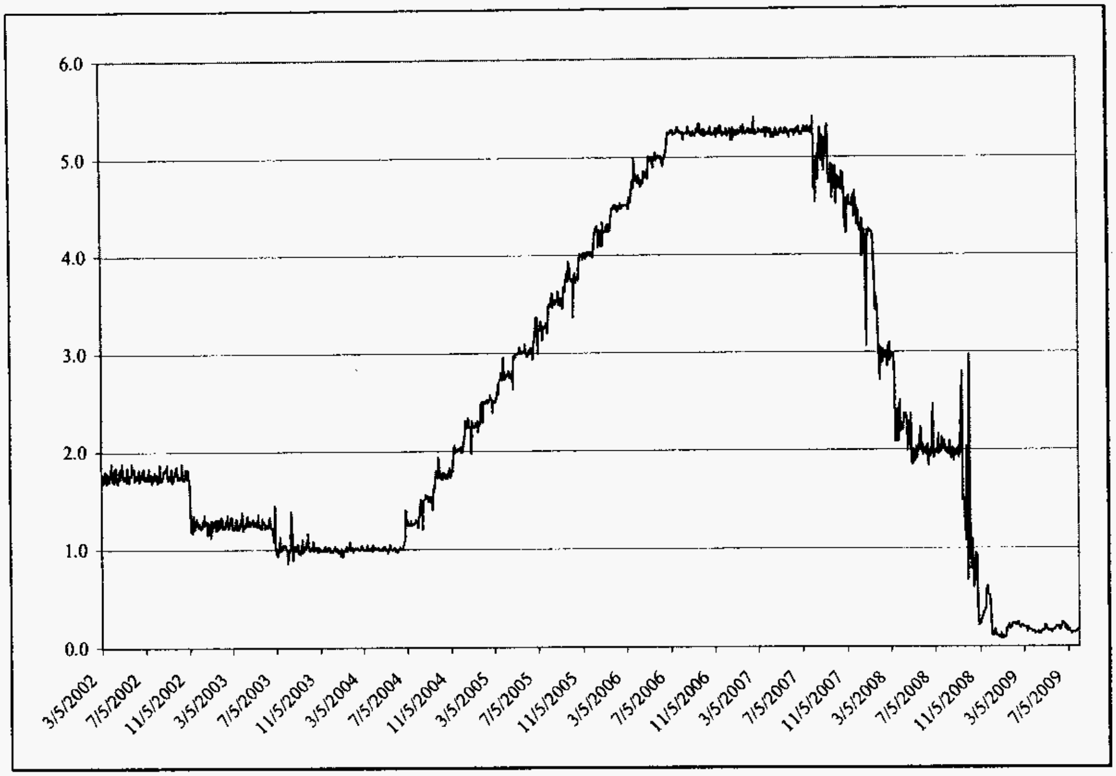


Figure 4 Federal Funds Effective Rate – January 2000 to August 2009

The lower yields on government debt, however, have not translated into lower yields on corporate debt (including the yields on investment grade utility bonds). As Figure 5 shows, the spreads over Treasury bonds for long-term A and BBB utility debt have declined but remain somewhat higher than before the credit crisis. Figure 6 displays the yields on A and BBB-rated utility debt relative to government bond yields.

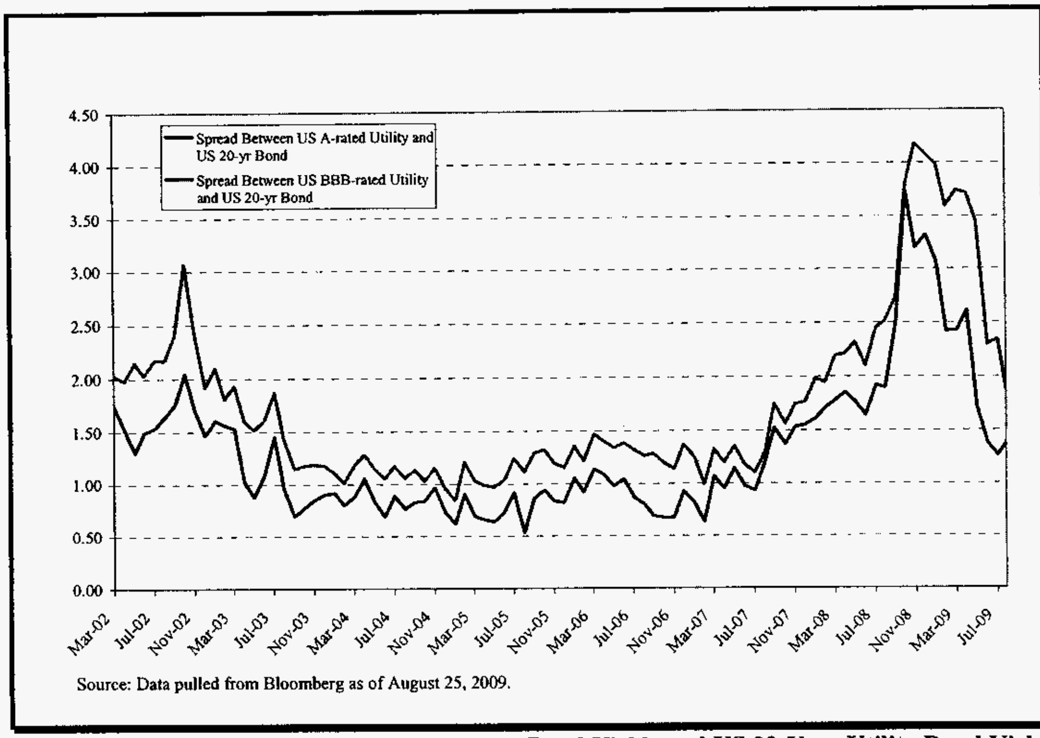


Figure 5 Spread between US 20-Year Treasury Bond Yields and US 20-Year Utility Bond Yields

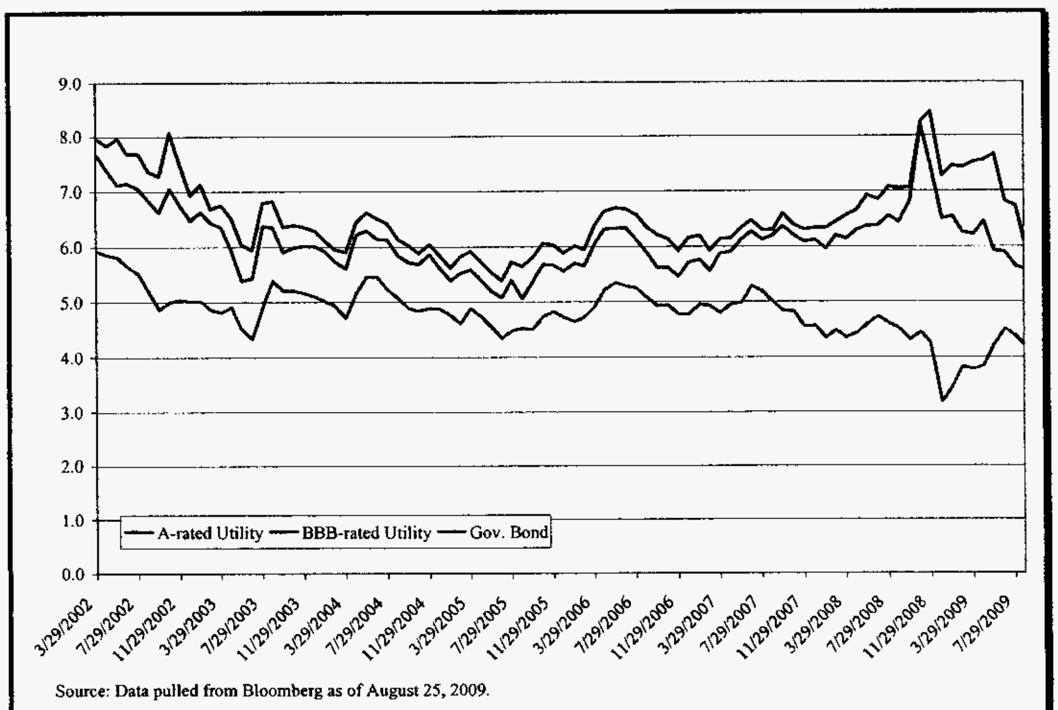


Figure 6 US Bond Yields from January 2002 to August 2009

Q46. Is the increase in investors' risk aversion from current economic conditions likely to be a temporary or permanent change?

A46. It is likely that some of the increase in risk aversion stems from the chaotic market conditions and will, I hope, be transitory in nature. There is, however, a strong possibility that there will also be a longer-term and perhaps permanent effect as market participants draw conclusions from the crisis on the fundamental risk-return characteristics of investment alternatives.

Q47. If some of the increase in the cost of capital is likely to be temporary, why should the Commission still take the increased cost of capital into consideration when judging the appropriateness of the intervenors' proposal?

A47. Although I believe that some of the increase in the MRP is likely to be temporary, it is very difficult to predict when the capital markets will return to more normal conditions, so it is difficult to predict when the market cost of risk will return to more normal levels. Even when market conditions are more normal, investors' risk aversion may remain higher well into the recovery period until their confidence fully returns. The federal government seems to recognize investors' fears, and it has signaled that it intends to overhaul the financial regulatory environment in order to restrict the behavior by financial institutions that led to the current crisis. While the success or failure of those actions are unlikely to be observed in the short- to medium-term, in the long run these measures may help alleviate investors concerns. However, it could easily be years before investors regain the confidence prevailing prior to the current crisis. In fact, there may be a "permanent" adjustment in risk tolerance now that investors realize that severe economic conditions are still possible even with the increased tools to manage the economy available to government. Therefore, I recommend that the Commission recognize the increased cost of capital stemming from the current market conditions makes adoption of the intervenors' proposal particularly risky at the current time.

Q48. Aren't the recent low realized returns on the market index a clear indication that market participants are willing to accept a lower expected return on their investments?

A48. Absolutely not. To the contrary – market values have been falling in order to allow an increase in the expected returns on investment. As risk aversion increases, *expected returns* must increase in order to induce investors to buy, so prices must fall. In other words, realized returns over the last few months are not indicative of investors' required rate of return. Investors have undoubtedly been disappointed recently. Bond investors are familiar with this process. As the general level of interest rates in the economy increases, the market price of a bond will decrease so that the yield-to-maturity will increase to the level required by the market. The same phenomenon occurs with equities as well. When the required return on investment increases, market prices must fall.

Q49. What do you conclude from the evidence on current economic conditions?

A49. The cost of capital is much higher today than in the relatively recent past. Although some of the increase in the MRP will, I hope, reverse when stable economic conditions return, it may be many years before investors' regain the level of confidence that will result in an MRP as low as immediately before the crisis. The intervenors' recommendation on depreciation will increase investor uncertainty and will increase the Company's cost of capital. The current conditions in the capital markets potentially make such a policy particularly costly.

IV. CONCLUSIONS

Q50. Please summarize your conclusions with regard to the intervenors' proposal to reverse the estimated amount of the Company's depreciation reserve variance.

A50. The intervenors' proposal to reverse the depreciation expense already recovered from customers should be rejected by the Commission. Under fair regulation, the present value of the cash flows from a faster or slower rate of depreciation is offset by a lower or higher return on rate base so that customers are automatically protected against changes in the estimation of the useful life of assets purchased to provide them service and other depreciation parameters. There is a timing difference in the cash flows from depreciation rates that turn out to be higher or lower than required. So some customers may turn out to have paid more or less than required during some period of time, but customers as a group are fully protected.

In this case, rate payers are likely to be worse off if the Commission were to adopt the intervenors' proposal because at a minimum transaction costs associated with acquiring new capital to finance planned capital investments will be higher. In addition, the proposal increases investor uncertainty and weakens the Company's credit metrics both of which are likely to increase its cost of capital. Debt costs will increase due to weaker credit ratios, and equity costs will increase due to heightened investor uncertainty regarding the permanence of previous regulatory decisions. If adopted, customers would also trade a temporarily lower rate for a higher long term rate and more variability in rates. In addition, although the proposal is justified on the basis of intergenerational fairness, the proposal itself creates intergenerational unfairness in that customers over the next four years receive a benefit at the expense of future customers and those historical customers no longer on the system.

Q51. Does this conclude your testimony?

A51. Yes.

BY MR. WALLS:

Q. Dr. Vilbert, do you have a summary of your testimony?

A. Yes, I do.

Q. Will you please provide that summary to the Commission?

A. Yes.

The intervenors propose to eliminate the depreciation reserve imbalance by reversing an amount of depreciation expense in the company's revenue requirement over a four-year period. Now, I believe the proposal by the intervenors is poor regulatory policy. It creates intergenerational inequity in the name of intergenerational fairness. Specifically, it creates a set of winners over the next four years at the expense of all past and future customers. It also creates regulatory uncertainty by setting a precedent that past regulatory decisions are never final because results of the decisions may be compared to actual outcomes.

Regulatory decisions made on the best information available at the time should not be reversed or adjusted after the fact just because expectations differ from forecasts. Moreover, there is no regulatory precedent that I have found that is similar to the intervenors' proposal, and it is contrary to GAAP.

The proposal by the intervenors does not adequately compensate the company. The intervenors' proposal to compensate the company only considers the first year's depreciation, i.e., about $161 million, but the proposal envisions reversing $645 million over four years. To compensate the company completely, the amount of compensation in rates for depreciation would have to be increased each year over the next four years, or the initial amount of the compensation should be based on $322 million, one-half of the total to be returned.

If adequately compensated, the proposal results in more volatile rates and higher average payments by customers than would be the case under the company's proposal. The proposal by the intervenors would also likely increase the cost to customers separately from the need to adequately compensate the customers for the reversal of depreciation. This is because the company's forecast of capital expenditures is an excess of its cash flows. If you reduce their depreciation cash flow, they will have to go to the market to raise more debt and equity than they would have to otherwise, and that has a transaction cost.

In addition, the loss of cash flow would weaken the company's credit metrics, which will have the effect of -- likely an effect of increasing the cost of debt for the company. In addition, there is an element of uncertainty stemming from the intervenors' proposal which may also increase the company's cost of capital, because decisions that were rendered in the past can be undone or reversed going forward.

Finally, in that sense, the financial markets as we discussed earlier is just now starting to recover from the economic turmoil that we experienced, and it is a particularly bad time to increase uncertainty for a company that has to go to the capital markets to acquire capital to meet the investment needs of the company going forward.

Finally, this is a point that has not been to me addressed adequately or discussed enough, at least in the time I have been sitting here. The proposal by the intervenors is unnecessary in the sense that depreciation automatically protects customers. Depreciation reduces rate base. It is as if the customers are investing in these assets, and they get a rate of return equal to what you would allow on the rate base, including taxes, return, interest, and that automatically compensates the investors for a depreciation rate that is higher or lower than it ultimately turns out to be needed. And that concludes my summary.

MR. WALLS: We tender Dr. Vilbert for cross.

CHAIRMAN CARTER: Thank you.

Mr. Rehwinkel, you're recognized.

MR. REHWINKEL: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q. Dr. Vilbert.

A. Yes.

Q. Good evening. My name is Charles Rehwinkel with the Public Counsel's Office.

A. Good evening.

Q. Who chose the timing of the filing of this rate case?

A. The company, as I understand it.

Q. Can I ask you to turn, please, to Exhibit A-1 of your testimony, please?

A. Yes.

Q. And in Exhibit A-1 you list on Page A-6 all of the testimonies -- well, let me ask it this way. You list testimonies that you provide, is that correct?

A. Yes.

Q. Okay. From there through the end of that exhibit, correct?

A. Yes.

Q. Is this all of the times that you have provided testimony?

A. Yes.

Q. I have looked at each one of these testimonies. I don't see any that say that you have testified on depreciation specifically, is that correct?

A. Yes.

Q. Have you ever testified on -- so I would take it from that that you have never been accepted as an expert in depreciation matters in any regulatory jurisdiction in this country?

A. Are you -- I don't know the answer in the sense that are you asking me whether I have ever done a depreciation study or whether I have ever used depreciation analysis?

Q. No. I'm asking have you ever been accepted as an expert in depreciation before a regulatory body in this country?

A. Not on a depreciation study, no.

Q. Okay. On Page 2 of your testimony, at the bottom, on Lines 27 and 28, you state there the intervenors propose to reverse an amount of depreciation equal to the amount of estimated depreciation imbalance that has already been recovered from customers in Commission approved rates and added back to the rate base. Did I read that correctly?

A. Yes.

Q. How does one recover a depreciation imbalance?

A. The company's proposed method is to recover -- to change the depreciation rates over the remaining life of the assets.

Q. And that is a prospective approach, correct?

A. Yes.

Q. I am focusing more on the grammar here of that has already been recovered. How has a depreciation imbalance already been recovered?

A. Perhaps I didn't say this as clearly as I should have. What I meant was the proposal envisions reversing the amount of depreciation expense that has already been recovered from customers and adding it back to the rate base. That is the proposal, as I understand it.

Q. Page 3, if I could ask you to look there. You state on Line 11 and 12, you start that sentence as is standard in regulatory jurisdictions, the company proposes to adjust the depreciation rate going forward to correspond to the increased estimated lives of assets and other changes in depreciation estimates. Is that correct?

A. Yes.

Q. What is your basis for saying, as is standard in regulatory jurisdictions?

A. As part of the process of trying to determine whether this is good regulatory policy, I looked at other jurisdictions in the United States starting with FERC. The FERC's policy is consistent with the company's proposal. I have looked at other states, not every single state, but other decisions in other states with similar sorts of circumstances where a nuclear plant was extended in life and looked at how they proposed to change depreciation rates. And in every single instance in which I was able to find a decision, they were consistent with the proposal of the company.

Q. Okay. So, I think you alluded to it in your answer, you did not look at each and every regulatory jurisdiction in this country, correct?

A. That is correct.

Q. And that would include the District of Columbia, and however many there are in the state of Louisiana, correct?

A. Yes, that is correct.

Q. You state on Page 3, Line 20, beginning on Line 20, that this proposal, the intervenors' proposal to reverse depreciation reserve is counter to Generally Accepted Accounting Principles, is that correct?

A. Yes.

Q. And what is your basis for saying it is counter to GAAP?

A. Again, as part of the process of understanding this proposal, I investigated what GAAP says about it, and the way I read GAAP it says that if there is a change in estimate as opposed to a change in accounting principles, you recover it not looking backwards, but you recover the change by looking forward.

Q. Okay. And is that the same GAAP principle that Mr. Garrett testified to earlier today?

A. Yes. I think he was referencing SFAS 154 and that is the same one, yes.

Q. Okay. Well, let's turn to Page 9 of your rebuttal testimony. Well, let's see, actually I wrote that down wrong. Let's turn to Page 12 of your rebuttal testimony.

A. I'm there.

Q. Is this your discussion about how GAAP interacts with this issue in this case, starting on Line 8 forward onto the next page?

A. Yes.

Q. Now, you don't cite SFAS 154 anywhere on this page, do you?

A. No, I don't. I cite the Miller GAAP guide and then just last night I looked at the 2009 version of this, and it cites SFAS 154.

Q. All right. What I want to ask about is what is in your testimony here, and if I could ask you to look at the Footnote 11 on Page 12. I think -- well, you were in the room, were you not, when Mr. Garrett testified about the effective date of SFAS 154, were you not?

A. I was.

Q. And I think he stated, if I recall correctly, that it was in May of 2005?

A. Yes, that's correct.

Q. Now, you cited in Footnote 11 a 2004 GAAP guide, have you not?

A. Yes. And hearing the discussion of 154, I went and looked yesterday at GAAP 2009, and its language is almost identical to this in this testimony.

Q. Okay. But there was no 154 in 2004, was there?

A. No.

Q. Page 4, if you will, please.

A. I'm sorry, what page?

Q. Page 4.

A. I'm there.

Q. Actually, let's go back to Page 3, I apologize. If I could get you to turn to 3.

A. Yes.

Q. On Line 23, with respect to GAAP, you use the word recommends, is that correct?

A. Yes.

Q. Okay. So you are saying that somehow you can -- does GAAP opine on this specific issue as far as you can tell?

A. Can you be specific about the specific issue you have in mind?

Q. Well, the one you are here to testify on, which would be that issue.

A. Yes, they are specific. However, there are some caveats associated with the language in the GAAP that has to do with whether or not there was a change of accounting principle, or whether there was an error in accounting, or some other factor that would then lead you to go backwards in time and adjust the books looking backwards versus a simple change in estimate, which is forward-looking.

Q. Okay. Now, you are not an accountant, correct?

A. That is correct.

Q. And you are not a CPA, of course, then, right?

A. No.

Q. And on Line 25 of Page 3 where you state you have found no regulatory precedent in other jurisdictions to reverse accrued depreciation. With regard to that statement, that would be with respect to the number of jurisdictions that you did look at, correct?

A. Yes, that is correct. My staff and I tried to do a thorough investigation to look for circumstances in which depreciation was effectively reversed as opposed to changing depreciation rates going forward, and we found no similar procedures.

Q. Okay. So, is it your testimony that you found no instance where accrued depreciation was reversed?

A. Under the circumstances of a change in estimate, that is correct.

Q. That is insofar as you looked at a particular state, correct?

A. Yes. As I fully agree there is a lot of states and a lot of decisions, and I'm sure I didn't look at every one or even get close, but I tried to do a thorough test.

Q. Now, with respect to the state of Florida, did you look at all of the depreciation decisions in the state of Florida?

A. No, that role fell to Mr. Garrett that you had a fairly extensive conversation with. I looked at the ones that Mr. Pous cited thinking that that would be the primary place to find something that would support the procedure that he was recommending, and to my read of those decisions, I don't see the similar situation.

Q. Okay. On Page 4 of your rebuttal testimony on Line 9 --

A. Yes.

Q. -- you state there that it is also a particularly bad time to increase regulatory uncertainty because the capital markets are only now beginning to emerge from a period of turmoil and increased investor risk aversion, is that correct?

A. Yes.

Q. Now, you don't have -- you didn't do a similar analysis of the timing of this case with respect to the impact that a $500 million rate increase would have on customers, did you?

A. I made no analysis of the impact of increased rates on customers, no.

Q. Okay. And on Page 4, Lines 21 through 23, you offer the opinion to the Commission that because of unusual conditions still prevailing today, it is a particularly poor time to increase investor uncertainty regarding recovery of their investment in the company's assets, is that correct?

A. Yes.

Q. Okay.

A. It is more or less redundant, isn't it?

Q. But you --

A. Sorry about that.

Q. That's okay. And you may not have written it with the same emphasis that I used on certain words, but this only refers to the company's perspective, not the customers' perspective, does it not?

A. I think -- I think that is not correct. The reason is that if the company's cost of capital increases, then ratepayers will ultimately have to pay that cost of capital. So it is not in their interest, the ratepayers interest, to have the cost of capital be higher than it would otherwise be.

Q. Okay. You didn't do any analysis, sensitivity analysis to determine how much customers need to pay in order to get that opportunity to have the benefit of a lower cost of money, did you?

A. I did not do an empirical analysis to estimate it. I am simply opining that increasing uncertainty will increase the cost of capital, even if it is only by a little bit.

Q. Okay. I am interested, I guess, in your opinion about the role of depreciation on Page 4, Lines

26 through the end of that page and onto the next page. You start off talking about the role of depreciation, if I could characterize it that way, on Line 26. You say the first describes the role of depreciation and the revenue requirement. Depreciation increases the revenue requirement, but reduces rate base, so that under fair regulation both investors and customers are protected if depreciation rates turn out to be higher or lower than necessary to recover the investment over the expected useful life of the asset. Do you see that?

A. Yes.

Q. Is it your testimony here that the primary role of depreciation is to get the rate base down?

A. No.

Q. Okay. Is that a goal of depreciation to reduce the rate base?

A. It is a result of depreciation. It reduces the rate base. The purpose of depreciation is to recognize that an asset used to provide service deteriorates over time and has some limited expected life, useful life, and you recover the cost of the asset over its useful life.

Q. Is it your testimony that customers always benefit from higher depreciation rates, because higher depreciation rates generate credits in the rate base?

A. No.

Q. So on Page 7 of your rebuttal testimony, if I could get you to look at the top, on Lines 1 through 4.

A. Yes.

Q. You say if the initial rate of depreciation turns out to be higher than required because the expected life is increased, customers save the return on the depreciation recovered.

A. Yes, that's correct.

Q. Aren't you suggesting there that customers benefit by higher depreciation rates?

A. No. If I may explain, the goal of depreciation -- of the depreciation rate is to recover the cost of the asset over its expected life. But, we don't have crystal balls, so we don't know how long all the assets are going to last, and so effectively what ends up happening every time we do a depreciation study the estimated lives of some assets turn out to be different than we thought when we did it.

What I am saying is when you base depreciation rates and a fair rate of return, the present value of the sum of depreciation that you get for an asset and the expected return -- or the return you receive on that asset is equal to the cost of the asset that you start with. And, so, in present value terms, the ratepayers have paid present value of the assets and the company has received in rates the present value of the assets. If you change the depreciation schedule, what you have done is changed the time period over which these payments occur, but you have not changed the present value under fair regulation.

Q. Do you think it is preferable, all things being equal, for depreciation rates to be higher than lower?

A. No. The goal of setting depreciation rate is to spread the cost over the expected life of the asset. Higher or lower doesn't come into that. You set rates to recover the costs, and normally in regulation we set it on a straight line basis, so we spread the cost evenly over the life of the asset.

Q. I could have sworn you said in your opening summary that depreciation protects customers because it decreases rate base.

A. It does. I did say that, but it seems to be ignored in what I am listening to sitting in the audience, the idea that depreciation was somehow too high over the recent past and somehow ratepayers have been harshly disadvantaged by that. I don't believe that to be the case because, as I said, the sum of depreciation and return on the asset is equal to the amount of money you spend to start with. And it is only a matter of timing, then, about how those cash flows are spread out through the life of the asset.

Q. Is it your testimony here that it doesn't matter how large the theoretical depreciation reserve is relative to the accumulated depreciation reserve?

A. No. I'm not sure I have an opinion on how large or how out of sync the depreciation reserve could be before it becomes some kind of problem that would need to be addressed in terms of the intergenerational equity issue that has been raised here. However, the proposal, as I understand it to the company from the intervenors is quite different than changing the depreciation rates going forward. They are actually going to reverse depreciation and build the rate base back up to a higher level and you haven't added any new plant to the system.

Q. You haven't performed any analysis, have you, to determine -- well, let me ask it this way. You didn't consider whether the depreciation reserve that is at issue in this case is, to use your words, materially out of sync, did you?

A. No. And keep in mind, as I understand the depreciation reserve imbalance that is at issue here, the way it came about was based upon a study done today or during this proceeding, and it wasn't -- it's new information. It is saying the lives of these assets will be longer than we originally forecast; and, therefore, we have collected more depreciation on those assets based upon their older shorter life than is necessary going forward. So that reserve imbalance is a new phenomenon in that sense. So, what the proposal by the intervenors effectively does is say, well, the Commission got it wrong when it set rates before. We need to go back and fix that, because the life turned out to be different than we thought four years ago.

Q. What would your recommendation be if the depreciation reserve theoretical -- if the theoretical depreciation reserve imbalance was twice what it is here? Would you say that there still should be nothing other than a remaining life treatment of that reserve imbalance?

A. No. I don't know the answer. The inherent in your question is that there is some cut off above which the imbalance is too great to be recovered over the remaining expected life of the assets. The principle under which the company is operating is that these kinds of changes in reserve depreciation should be amortized over the remaining life of the assets. That is the principle. How big an imbalance needs to be before some other principle needs to be invoked, I don't have an objective way to determine that.

Q. You just know that in this case it hasn't reached that threshold, whatever it is?

A. I'm sorry, what?

Q. You just know that in this case, this imbalance has not reached that threshold, whatever it may be, is that right?

A. Effectively that is my judgment, yes.

Q. Okay. And how many depreciation reserve imbalances have you evaluated as part of the testimony that you have provided in the past?

A. This is the first one.

Q. Okay. On Page 7, Lines 14 through 21, you state there is no reason that the depreciation reserve should be reversed over a four-year period. That period is completely arbitrary. In fact, the only logical and completely fair way to deal with the issue is to adopt the company's proposal to reset the depreciation rate based upon the remaining useful life of the assets whose expected useful lives and other depreciation parameters have changed. Did I read that correctly?

A. Yes.

Q. Now, is it your testimony that PEF has always followed this principle in addressing depreciation reserve imbalances?

A. No. I was here when the discussion of the previous settlement -- where they did something different than this procedure that they are now recommending in this case.

Q. Okay. And I think -- did you hear testimony about 1997 treatment and maybe that there were some amortizations?

A. There was -- I understand that sometimes depreciation reserves are shifted among accounts, and --

Q. So those would not have been logical or completely fair when those were done?

A. Those methods, the changing reserves among accounts, does not change the depreciation principle going forward. It just reallocates the depreciation you have calculated already among different accounts.

Q. Okay.

A. It is fundamentally different than the proposal in this proceeding.

Q. Now, as part of your testimony in the preparation and the research you did for this case, you did not come across any accounting guidance that said that reserve transfers were violative of GAAP, did you?

A. No, I don't believe I did.

Q. Okay. On Page 7 on Lines 20 and 21, you state, and, again, I think you are referring to the portion of your testimony I just read, that this is, in fact, the way that changes in expected lives of depreciable assets are usually handled, is that correct?

A. You read it correctly.

Q. And were you referring to that sentence that I read earlier, those couple of sentences I read in Lines 14 through 19?

A. In most of the jurisdictions or in the jurisdictions that I found decisions addressing this issue, the change in estimated life was -- in depreciation was changed to recover the remaining depreciation over the life of the asset.

Q. Okay. And I think you just answered this question, but when you say usually handled, that is insofar as you researched it in the jurisdictions that you looked at, correct?

A. Yes.

Q. And if I asked you the same question on Page 8, Lines 25 through 27, where you state to my knowledge, all jurisdictions revise the depreciation rate to match the new estimated life of the assets. That all jurisdictions, again, should be qualified by to the extent you looked at those jurisdictions?

A. Yes. Had I found a jurisdiction that did it differently, I would have reported that fact. But I didn't find such a jurisdiction.

Q. Okay. And, again, on Page 8, Lines 27 through Page 9, Lines 1 and 2, when you testify about Generally Accepted Accounting Principles making it clear that such a change needs to be handled prospectively, not retroactively, you are referring to what you found in the Miller GAAP guide?

A. Yes, and also the 2009 GAAP guide. I mean, I read English. I'm not an accountant, but I read English, and the English says if it is a change in estimate, do it forward.

Q. Okay. Now, you didn't make any judgment about how materiality might enter into the application of the GAAP, that you -- the principles that you read about in Miller GAAP guide, did you?

A. No.

Q. Okay. Dr. Vilbert, if depreciation rates had been set in the past such that there was no theoretical depreciation reserve, or there -- let me start again and ask it this way. If depreciation rates had been set in the past such that by the end of the next four-year period the theoretical depreciation reserve essentially equaled zero, wouldn't customers of PEF be facing a rate base that will be the same as the rate base that would result if Mr. Pous' recommendation is adopted?

A. I think so, if I followed your question. Can I restate what I think you said to be sure we are on the same page?

Q. Yes, sir.

A. I think you said that if the $645 million had not already been collected in depreciation, the rate base would be $645 million higher.

Q. That is correct, yes.

A. And the answer to that one is, yes, I believe so.

MR. REHWINKEL: Dr. Vilbert, thank you. Those are all the questions I have. Thank you, Mr. Chairman.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Ms. Bradley, you're recognized.

CROSS EXAMINATION

BY MS. BRADLEY:

Q. Just a question, a couple of questions, sir. Would you agree that a higher return on equity is not a guarantee of a higher credit rating?

A. As a single stand-alone item --

Q. Yes.

A. -- I would agree with that, yes.

Q. Okay. Were you aware that the Legislature granted some preconstruction costs for Progress for them to build their nuclear plant?

A. I learned this, I believe, a couple of days ago where, if I understand the proposal, they have CWIP in rate base where they get the actual costs of -- or some of the costs recovered as opposed to capitalizing them.

Q. And are you aware that the PSC granted some interim rates for their Bartow plant?

A. I was not aware.

Q. Okay. Is there any indication in the credit market that they feel that the PSC does not provide the money that the company needs?

A. No. My testimony isn't that the Public Service Commission is treating the company unfairly. My testimony is that if the intervenors' proposal were adopted, the cash flow to the company would be reduced, that cash flow reduction would affect their credit metrics, their credit ratios that the investors look at when determining whether to invest in the company. And that then in turn reconfigured ratios would likely lead to increased cost of debt, as well as the possibility of an increased cost of equity stemming from uncertainty about whether or not decisions can be reversed by looking backwards as opposed to going forward.

Q. Would it be fair to say that if the PSC has routinely granted the money it felt the company needed to do its buildings and other projects, that the investors would have some assurance that the PSC will grant the money they need for current projects and ongoing projects even if it is not everything they have asked for?

A. It's not a yes/no question. That is a fairly involved set of hypotheses, so let me try to answer it this way. Regulatory certainty is certainly a factor in investors' minds when they go to buy the securities of regulated companies. In this case, the proposal to reverse depreciation, as I mentioned earlier, if it is done properly, the present value to the company and the customers will be unaffected by changing the time period. However, in the short-term, over the next four years, your reducing -- this proposal, if adopted, would reduce the cash flows to the company. That will weaken the credit metrics. That is a real effect even if investors believe ultimately they will recover the money at some future point.

Q. Would it be fair to say, though, that the credit rating and the risk involved is based more on the PSC granting them the money they feel like they need to go forward with their projects versus just giving them whatever they want?

A. There is more -- I don't know whether that is a yes/no question. There is more involved in credit ratings than simply regulatory support. There is allowed rates of return, there is processes of recovery, there is a certainty of recovery. All of those things -- and allowed cash flows. All of those things go into the credit rating. And so the simple support by the regulator, while beneficial, is not sufficient, particularly if you reduce the cash flows sufficiently to weaken the credit ratings.

Q. Isn't a credit rating tied more to needs versus wants?

A. Yes, I forgot to address that. I'm not advocating that the company should be able to come before the Commission and as much as they may like to, get everything they ask for. There is always going to be a give and take in this process. But the process, the Commission is going to adjust or evaluate the information to provide a fair rate of return, a fair cost-recovery and all of those things. It is not necessarily what the company exactly wants nor is it likely to be the case that intervenors will get what they want. It is somewhere in the middle generally.

Q. Were you aware of the testimony by some of the people that testified at the service hearings that they were investors and that they usually look at utilities, especially those that are monopolies and that are regulated utilities as being a fairly safe investment?

A. Oh, yes, I agree with that completely.

MS. BRADLEY: All right. Thank you. No further questions.

CHAIRMAN CARTER: Thank you, Ms. Bradley.

Ms. Kaufman.

MS. KAUFMAN: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MS. KAUFMAN:

Q. I guess it is good evening, Dr. Vilbert. How are you?

A. Good evening. So far so good.

Q. Okay. I am Vicki Kaufman, and I am here on behalf of the Florida Industrial Power Users Group, and I have a couple of follow-up questions to what Mr. Rehwinkel asked you, and then I've got just a few questions of my own.

I thought I heard you say in response to one of his questions that it is not in the ratepayers' interest to have a higher cost of capital. Is that what you told him?

A. I don't think so. I think he asked me, or at least I thought he asked me, that it is in the interest of the ratepayers to have a higher depreciation rate, which would then reduce the rate base. He interpreted what I said to mean that, and I disagreed with that conclusion.

Q. Okay. Thanks for clarifying that. I think you also had a discussion with him about the fact that you did not do an analysis or try to gauge the materiality of the depreciation surplus, do you remember that?

A. Yes.

Q. Okay. And I just want to be clear about that discussion that you had. Is it your testimony that there is some point at which the reserve might require some treatment other than what the company has suggested here, but we are just not at that point yet?

A. It is a very tough question to answer, I think, because as I said, inherent in that is a belief that there is some sort of a bright line that you can say if the reserve as a percentage of total plant or some other measure is less than a certain amount we are okay, and if it is greater than a certain amount, we are not okay, and we have got to do something different. I don't know how you would draw that line, and so I don't want to rule out the possibility that there is some chance that you could be in such a world. But, in general, I think you are better off adhering to principles every time you make one of these kind of decisions. If you adhere to the same principles each and every time, that will pay off in the long run.

Q. So is it your testimony that one should adhere to the principles espoused by the company regardless of the amount of the depreciation excess?

A. With all due respect, these are principles not that the company is following, but these are principles that are not just espoused by them, but it's by GAAP, it's by FERC, it's by most other regulatory jurisdictions. I fully admit that I didn't check every single one of them, but other regulatory jurisdictions.

And, again, you are asking me to give you a magic number. I don't have that magic number. I'm not even sure how I would get there. To me to get to an imbalance that is of the type you are talking about, you would need to have an error, a clear error somehow as opposed to a change in estimate of ongoing life.

In this case, most of this results from a change in the future life of the assets. You could not have known that in the past or should not or did not know that in the past. And, by the way, those estimates could be faulty in themselves. They could be longer or shorter than the current estimate. The nuke could not get extended in its life or some other aspect could change that would cause it to close early. So we only assume that it will make that length of life, as is the same for the coal plants.

Q. Okay. Now, I think I heard you now say that the only time you consider a treatment other than the principles espoused in your testimony is if there had been an error made by the company. Is that your testimony?

A. Well, let me be clear.

Q. I think that's a yes or no, and then you can explain.

A. No. Let me be clear.

Q. Okay.

A. What I said was you are hypothesizing a -- I don't know how to characterize it, a massive imbalance in reserve. And the hypothesis -- my response to you is I don't know how to set that magic number. And under the due course of events, I would think you would not arrive at such a point unless you made an error. The only way I think you could get there is if somehow you made an error in the past. You made a false calculation or something, added things wrong. You know, these things happen. That is hypothesizing how you would get there. Otherwise, the very careful depreciation studies that are done every four years you would not expect to reach the threshold level of massive, if you will, whatever the characterization you want to make of it.

Q. So whatever this magic number is, I'm just trying to understand your position on this. There is some point, and would you agree that that point requires an exercise of judgment on the part of the regulators to determine when that magic number has been reached or that line has been crossed?

MR. WALLS: Objection, mischaracterizes his testimony.

CHAIRMAN CARTER: To the objection, Ms. Kaufman.

MS. KAUFMAN: I thought that that is what the witness talked about, a magic point at which the imbalance might become great enough to have him veer from his principles, and I was just trying to understand how we might arrive at that.

CHAIRMAN CARTER: Mr. Walls.

MR. WALLS: His testimony was there was no magic number.

CHAIRMAN CARTER: That is what I heard. You want to rephrase?

MS. KAUFMAN: I will try.

CHAIRMAN CARTER: Good.

MS. KAUFMAN: Thank you, Mr. Chairman.

BY MS. KAUFMAN:

Q. Dr. Vilbert, would you agree with me that regardless of the reason for the -- for a reserve excess, there may well be a point at which a treatment other than that that you recommended would be appropriate?

A. As a theoretical matter, unlikely to occur under the system that you have in place, there probably is some number beyond which you would say we need to do something different going forward, and perhaps you would want to fire your depreciation expert that you got in the situation in the first place. But, I mean, theoretically I guess there is some number out there beyond which you would say things are just too out of control. But I don't think there is a magic number, and I don't think you are there. I don't think you are likely to get there if you do depreciation studies every four years.

Q. And would you agree with me that at the end of the day it is the Commission that will make the judgment about whether or not we are there?

A. Ultimately, the Commission has to make all of these judgments.

Q. If you turn to Page 2 of your rebuttal testimony at the bottom, the question begins on Line 22, and I guess I should ask you this question first. Have you reviewed Mr. Pollock's testimony on the depreciation reserve issue?

A. Yes.

Q. Okay. If you would look at your testimony beginning on Line 22, and it actually goes over to the next page. But at any rate, beginning on Line 25, you say the intervenors' proposal is designed to eliminate the $645 million depreciation reserve variance over a four-year period. Is that your testimony there?

A. Yes, that is the proposal I understand is the primary proposal.

Q. That is not Mr. Pollock's proposal, is it?

A. I understand now that he is talking about $100 million a year over four years.

Q. Did you not understand that when you drafted your testimony?

A. No, I didn't. I thought it was -- I thought they were all supporting the same sort of reduction. Although the effect of his proposal is the same.

Q. Do you have a copy of Mr. Pollock's testimony?

A. Not with me, no.

MS. KAUFMAN: Mr. Walls, does somebody have a copy?

CHAIRMAN CARTER: You may approach.

BY MS. KAUFMAN:

Q. Dr. Vilbert, you now have Mr. Pollock's testimony?

A. Yes, I do.

Q. If you take a look at Page 49 at the top, the question actually begins on Line 1, and the answer continues through Line 10. If you would just take a moment to review that.

A. Yes.

Q. So you would agree with me that Mr. Pollock's recommendation is not as you stated it on Page 2 of your rebuttal testimony, correct?

A. No, that is correct. And I understand that he said it is now four years for the period. I understand that was a correction he made while he was testifying. So instead of 300 million, it's 400, is my understanding.

Q. It would be until the next depreciation study is filed, is that what you understand?

A. Yes.

Q. Okay. And so that would not eliminate the $645 million reserve surplus, would it? It would reduce it, but it would not eliminate it?

A. Well, that is correct. The principle inherent in that proposal is smaller in magnitude but identical in approach to the one that I addressed.

Q. If you turn to your rebuttal, Page 7, please, and take a look at Line 16. I think Mr. Rehwinkel talked to you a little bit about this section. Do you see the sentence that begins in the middle of Line 16, "In fact, the only logical and completely fair way to deal with the issue is to adopt the company's proposal." Do you see that?

A. I do.

Q. Is it your testimony that if the Commission adopts either Mr. Pollock's or Mr. Pous' recommendation that they will be acting illogically and unfairly?

A. I think they would treat some -- yes, I think they would treat some ratepayers unfairly, because you are creating by this proposal a set of winners over the next four years at the expense of ratepayers from years five and on, because rates will go up based upon a temporary reduction in rates over the next four years. I think it is illogical. Whether the Commission thinks it is illogical, I guess I don't want to say that.

Q. I think that was a highly diplomatic answer.

Dr. Vilbert, are you familiar with the NARUC public utility depreciation practices manual? I know that it was discussed with Mr. Garrett.

A. I know of its existence. I wouldn't say I am an expert on it.

Q. I'm sorry, I didn't hear the last part.

A. I'm not an expert on what is in it.

Q. Have you reviewed it?

A. Not completely, no. I have read parts of it.

Q. Have you reviewed the portion that deals with the treatment of theoretical reserve, or with --

A. No.

Q. Excuse me.

A. No.

Q. You have not.

MS. KAUFMAN: Mr. Chairman, I know this is already in evidence, and I apologize, I don't know what the exhibit number is.

CHAIRMAN CARTER: Ms. Kaufman, it is 311.

MS. KAUFMAN: Thank you, Mr. Chairman.

BY MS. KAUFMAN:

Q. Mr. Wright is going to hand you a copy, an excerpt from this manual, and if you would flip over to Page 188 at the bottom, it talks about treatment of reserve imbalances.

A. Yes.

Q. Okay. If you would just take a moment and read just that last paragraph under the heading treatment of reserve imbalances to yourself.

A. Yes.

Q. And would you agree with me that the NARUC depreciation practices manual sets out several ways to deal with a reserve imbalance, one being the way the company has suggested, and the other being that the imbalance be amortized to the current depreciation expense over a short period of time?

A. If I understand what it is saying, I think that is correct. I would note one thing, if I look -- if I am understanding correctly, this document is a 1996 document, which was prior to the change in FASB 154, so this proposal would now be, as I understand it, counter to GAAP. So I guess I will stop there.

Q. Are you aware that this is the current, even though it is from 1996, the current NARUC manual on depreciation, or would you accept that, subject to check?

A. I would accept that subject to check.

Q. If you turn to your testimony on Page 9 and beginning at Line 3, they are talking about the lack of regulatory precedent for the proposal that Mr. Pous or Mr. Pollock have suggested, correct?

A. I'm sorry --

Q. I'm sorry, Page 9, Line 3.

A. May I amend my last answer?

Q. Of course you may.

A. The only other thing I would note, when I was reading this quickly, it said should the imbalance be amortized, debited, or credited to the current depreciation expense over a short period of time. The way I read that, unless I am misunderstanding what this is saying, that is different from the intervenors' proposal to reverse the depreciation and rebuild the rate base. But I may be reading it wrong, but that is the way I read this.

Q. Were you here for Mr. Garrett's cross-examination?

A. I was.

Q. Okay. And correct me if I'm wrong, but did he not agree that these were two different ways to treat a reserve imbalance?

A. Yes. If I understand correctly what he said, he agreed there were two different ways. One was the remaining life, the other was a shorter period of time. The distinction I'm drawing is whether or not you actually reverse depreciation, because that to me is quite different.

Q. Well, this quote that we have just been looking at here says that the imbalance would be amortized, debited, or credited. Is that not what Mr. Pollock and Mr. Pous are suggesting?

A. To the current depreciation and expense, but not to increase rate base. That is the way I am reading it. I could be wrong.

Q. Well, I guess it will speak for itself.

We were about to look at Page 9, starting at Line 3.

A. Yes.

Q. Okay. Are you there? And you talk about not being able to find any precedent, and then you go on to say, "Regulators in several states clearly rely on the methodology proposed by the company." How many states are you intending to refer to by several?

A. I think I list two or three in the process of this, but it seemed -- we looked at lots of states and found no ones that were counter to what I am saying here. We only reported the ones that had decisions that were of similar nature, which is to say a nuclear unit got an extension of life, or a coal plant got an extension of life as opposed to reporting every time we could find something. So I don't know the number of states, sorry.

Q. That's okay. You filed this on October 31st, so about a month ago. And when you wrote this sentence several states, you were intending to refer to two or three states, or --

A. In the process of doing this, we had already come across several, which, you know, three or four or five. And we continued the ongoing investigation to see if we found any until I filed it, and I just didn't go back and change and put the exact number here.

Q. And I am just trying to get a handle on what you meant when you wrote that. First you said two to three, then you said three, four, five. Do you have a ballpark of what you meant when you said several states?

A. What I thought I said was I referenced two or three state decisions, plus the FERC, plus GAAP, plus we looked to find if I could find anything counter to the procedures that I have discussed here, and was not able to, and so did not list the number of states or the number of negatives, I guess, if you will.

Q. If you will flip over to Page 12 at the top. And you're commenting on Mr. Pollock's discussion of the settlement, and I guess we have already had some discussion about that earlier. And I think Commissioner Skop discussed it with Mr. Garrett, if I recall correctly. And I am correct, am I not, that as a result of that settlement, the company took a charge to its depreciation expense of $250 million, correct? Is that your understanding?

A. Yes, it is in the context of a settlement in which there was give and take on a number of issues. But, yes, that is my understanding.

Q. Absolutely. I totally agree with you. Are you aware that the Public Service Commission reviewed and approved that settlement?

A. Yes.

Q. Okay. So would you agree with me that the Commission found that depreciation treatment appropriate at that time?

A. In the context of the settlement as a whole, I would agree with that, yes.

Q. And on the Commission, you would agree with me that the Commission did not find any regulatory or other impediments to approving those provisions in the settlement?

A. I think the answer must be they did not, because they would not have approved it had they found any impediments, or would have stated so, but I don't know what they said other than the settlement itself.

Q. On that same page beginning at Line 8, you say, "To quote one of the most commonly used intermediate accounting textbooks," and then you have a quote there on Page 17 to 20. I'm just curious, is that quote specifically related to electric plants, or regulated utilities, or is that a general statement from this textbook?

A. It is a general statement from the textbook.

Q. And then if you would flip over to Page 13, Line 25. And I just want the record to be clear. And also take a look at Page 14, Lines 6 through 7. And, again, we now understand that your reference there to the proposal of intervenors is not Mr. Pollock's proposal, correct?

A. That is correct in terms of magnitude. In terms of all the other aspects of it, it is the same.

Q. Flip over to Page 18, please.

A. I'm there.

Q. And down at the bottom, beginning under the heading the cost of capital is likely to increase, take a look at Line 27. And you are talking -- actually, 26 and 27. You are talking about the company's plans for substantial capital investment going forward and in particular its planned new nuclear generation. Do you see that?

A. Yes.

Q. Are you aware that the company has pushed out the date of its two Levy units by almost two years?

A. No, I wasn't aware of the date, although that does not surprise me. However, they are still in, as I understand it, a negative cash flow situation, which is to say that to meet all of their investment needs, they are -- have negative cash flow.

Q. Well, when you made this reference to planned new nuclear generation on Line 27, I assume, and correct me if I'm wrong, that you were referring to the two proposed Levy nuclear plants?

A. I understand that the capital plan is $2-1/2 billion going forward, or something like that over the next few years.

Q. That is related to the nuclear plants?

A. I don't know if it is -- I don't think it is all nuclear plant. It is the sum of everything they are doing.

Q. Would you agree that a substantial portion may be related to the nuclear plants?

A. Yes.

Q. And so if that project didn't go forward, the nuclear project, would that change some of the recommendations you have in this paragraph?

A. To the extent that -- to the extent that their capital expenditures are lower, they would have to access the capital markets with less volume and less frequency.

Q. If you would look at Page 21, Line 9 is actually the question. And if you could keep your finger there, and also flip over to Page 24, Line 7. And in both of those questions -- well, on the question on Page 21 and in your answer you are discussing the challenging economic environment. And then on Page 24 you are talking about current economic conditions, correct?

A. Yes.

Q. Would you agree with me that Florida ratepayers are certainly facing challenging -- a challenging economic environment?

A. I'm not sure what you mean by challenging. Things are not as economically healthy for the state of Florida or the rest of the United States as they were a few years ago, two years ago. So in that sense, it's less beneficial to the economy than it was before, if that is what you mean by challenging, higher unemployment, so forth.

Q. Right. And I was just going to ask you if you would accept, subject to check, that we have heard a lot of testimony about the high unemployment and high foreclosure rates that we have here in Florida. Are you familiar with that?

A. In general terms, yes, not the specifics.

Q. Well, you don't -- I guess you would agree that Florida is facing -- Florida's consumers are facing some difficult economical challenges due to the state of the economy?

A. I would say you could say that generally about most states in the country right now, yes.

Q. Do you think that given some of the economic challenges that consumers face, and taking that into account as we look at the depreciation surplus, that it might be a reasonable approach to temper the company's half a billion dollar rate increase by utilizing the suggestion of Mr. Pollock and Mr. Pous in regard to this $645 million reserve surplus?

A. I don't know how to answer, whether it is a yes or no, so I will say I don't know to start with. First of all, this section that you just were referencing deals with the cost of capital. And the cost of capital is estimated in the capital markets, and whether the economy is booming or not doing well, the theory of the Hope case and Bluefield is that you award the cost of capital and you don't consider whether ratepayers are unemployed currently or not. The cost of capital is the cost of capital.

With respect to depreciation and other rates, I think the issue is less clear. Certainly, I think considering whether the ratepayers can afford to pay the rates that you set is an important consideration in determining what to do. However, in this case, you are talking about simply moving money around in time for a short-term benefit. And in my experience there is almost always the case in every proceeding I think I have ever been in that the two sides are saying similar things to what is being said here.

In one case the ratepayers are saying we can't possibly pay these higher rates even when the stock market was over 10,000 or whatever. And on the other hand, the company is saying we need these costs to cover our costs. So I think it is a slippery slope to go down to say that you are going to make a judgment on how to recover depreciation simply because you currently have an economic situation that you believe will get better in the future.

You have already recovered this money from customers. They are going to amortize the imbalance over the remaining life of the assets. This is new information. To me, policy-wise, you are better off treating it as you've treated it in the past.

Q. And I guess one final question. I assume that you would agree that in the context of the half a billion dollars that is being requested by the company here that the Commission should look to do whatever it can to mitigate the impact of such a large increase on ratepayers?

A. Yes, I think such considerations is things that the Commission should always consider, but they also have to balance, as I'm sure they well know, that the company needs to recover its costs. There are principles about how you recover depreciation and all of those sorts of things that I am simply suggesting you don't want to disrupt for short-term goals.

Q. And so I guess if I can paraphrase what you are saying, at the end of the day it is up to the Commissioners, and thank goodness not to you or I, to balance what essentially are competing interests here?

MR. WALLS: Objection, asked and answered.

MS. KAUFMAN: I don't believe that I asked that and I don't believe that he answered it.

MR. WALLS: What you wanted to do was rephrase what he just said.

CHAIRMAN CARTER: All right. All right. Ask your question.

BY MS. KAUFMAN:

Q. My question was, Dr. Vilbert, I am assuming that you would agree that at the end of the day and at the end of this case, it is up to the Commissioners to balance the competing interests of the company versus the impact on the ratepayers, to take all those factors into account?

A. Yes. And I don't want to be too flippant, but that is why they pay them the big bucks to make these kinds of decisions.

CHAIRMAN CARTER: They are not that big.

MS. KAUFMAN: I don't know if they would agree with that, but --

CHAIRMAN CARTER: Strike that.

MS. KAUFMAN: Thank you very much, Dr. Vilbert. Thank you, Mr. Chairman.

CHAIRMAN CARTER: Thank you, Ms. Kaufman.

Mr. Wright, you're recognized.

MR. WRIGHT: Thank you, Mr. Chairman. Thank you for your patience. I just wanted to borrow Ms. Kaufman's copy of an exhibit before I proceeded and made a lot of noise.

CHAIRMAN CARTER: Hang on a second. Mr. Brew, did you want -- okay.

Mr. Wright.

MR. WRIGHT: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. WRIGHT:

Q. Good evening, Dr. Vilbert.

A. Good evening.

Q. We met earlier. I'm Schef Wright, and I represent the Florida Retail Federation in this case. I have a few questions for you.

First, as a general proposition, would you agree that the ideal state of the world would be where the depreciation rates always matched the actual asset lives?

A. Yes.

Q. I would like to ask you a couple of questions about the little exhibit that I handed you, which has been numbered Exhibit 311.

A. Yes.

Q. And Ms. Kaufman directed your attention there to the suggestion on Page 189, I think, where it says, "The use of an annual amortization over a short period of time, or the setting of depreciation rates using the remaining life technique are two of the most common options for eliminating the imbalance." Do you remember that?

A. Yes.

Q. Would you agree that this statement in a publication of the National Association of Regulatory Utility Commissioners evidences regulatory acceptance of amortization over a short period of time?

A. I don't know. They certainly list it as an option. I don't know whether that means they are taking a position on that or not.

Q. Well, they are not saying it is a no-no, are they?

A. Not in the three pages that you have handed me, but --

Q. Okay. You and Ms. Kaufman also discussed briefly a couple of settlements involving Progress Energy Florida and also involving Florida Power and Light Company, I think, in which the utilities involved agreed as part of the settlement, or we agreed that they would, and they agreed to amortize certain amounts of depreciation surplus over short periods of time, correct?

A. Yes, within the context of the settlement.

Q. And they did that by effecting a credit against depreciation expense and a debit to the bottom line depreciation reserve, correct?

A. If I have my debits and credits right, it is my understanding that they increased the depreciation -- decreased depreciation reserve and decreased depreciation expense. Reserve went up.

Q. Expense went down?

A. Yes.

Q. Thank you. Surely you would agree that that evidences the fact that the Florida Public Service Commission has accepted this as a valid regulatory accounting practice?

A. I'm not sure you can get to that conclusion from a settlement, because in my experience, most times settlements have language, and I understand this particular one did not, that it does not set a regulatory precedent in any way. Because the way that these settlements work out is there is a lot of horse trading going on back and forth. Various things are done. And so normally you don't rely on these things as regulatory precedent. And whether that means that it would also be acceptable regulatory accounting-wise, I think is a similar sort of situation.

Q. Well, understanding that you are not an accountant nor a certified public accountant, I do want to ask you do you think the Florida Public Service Commission would have approved such a practice, albeit as part of a settlement, if they believed that it were contrary to Generally Accepted Accounting Principles?

A. My expectation, without knowledge, would be that they would not, and I would also note that I think Mr. Garrett said the accounting principles have changed since the time of the settlement such that today it would likely not be consistent with GAAP.

Q. Well, are they still -- as far as you know, aren't the utilities involved still operating under settlements approved by this Commission -- that the Commission approved in 2005?

A. I believe that is correct.

Q. I know you have talked more than you wanted to about materiality, but I want to just touch on it briefly. The NARUC manual states the following: "Whereas, the judgment of materiality is subjective, if further analysis confirms a material imbalance one should make immediate depreciation accrual adjustments." That is right on Page 189, and it is right before what we talked about a minute ago.

A. I found it.

Q. Okay. Does the name Lewis Powell mean anything to you?

A. I don't think so.

Q. Mr. Powell was formerly a justice of the United States Supreme Court, and I believe that he wrote the opinion -- I apologize, I don't remember the case. But I believe he wrote some oft quoted opinion in a case involving pornography. And he said, to the effect of, I can't define it, but I know it when I see it. Do you remember that?

A. Yes. And now that you bring my attention to who you are talking about, yes, I know who you are talking about.

Q. So my question for you here is do you think the Florida Public Service Commission would know an imbalance when it saw it, a material imbalance when it saw it?

A. In the context of their job, I would think so. However, I continue to bring you to the distinction that I think is important and that is the reversal of the rate base so that you increase the rate base. That to me is a big distinction, and I realize that you are going to show me the settlement, again, but --

Q. Well, the Commission approves settlements that involve debits to the bottom line depreciation reserve, correct?

A. Yes.

Q. And is that the practice that you are characterizing as a reversal of depreciation?

A. Yes.

Q. I want to talk about your testimony regarding increased regulatory uncertainty. The Public Service Commission in a different order -- the Florida Public Service Commission in a different order made the following statement: Reserve imbalances are primarily a matter of differences in current and past projections. Such deficiencies should be recovered as fast as possible, unless such recovery prohibits the company from earning a fair and reasonable return on its investments. Do you think that is sound regulatory policy, Dr. Vilbert?

MR. WALLS: I am going to object to the question since the context is not provided in which that was made.

CHAIRMAN CARTER: Rephrase.

MR. WRIGHT: Well, he has talked extensively about what he considers to be poor regulatory policy. I have read him a statement of regulatory policy, which, in fact, is a statement made by this Commission. And I'm asking him does he consider that policy statement to be poor regulatory policy. That is a fair question with or without context.

MR. WALLS: I believe it is an unfair question since the context is important to understand in which statement that policy was made.

CHAIRMAN CARTER: Ms. Brubaker.

MS. BRUBAKER: Could I ask that the statement be repeated? I'm sorry.

MR. WRIGHT: Sure. The quoted statement is this, and I could just as easily take the quotes off and ask him the question, but here it is. Reserve imbalances are primarily a matter of differences in current and past projections. Such deficiencies should be recovered as fast as possible, unless such recovery prohibits the company from earning a fair and reasonable return on its investment.

MS. BRUBAKER: It seems to me that Mr. Wright is asking -- is quoting this as essentially a generic statement of policy and is asking the witness his opinion of whether this is sound regulatory policy. If the witness is able to answer it, I think he may do so. If more context is needed, he can certainly request it.

CHAIRMAN CARTER: Overruled.

You may proceed.

BY MR. WRIGHT:

Q. Do you want me to read it one more time, Dr. Vilbert?

A. I think I have the gist. So, no, thank you. You are putting -- you are putting a statement in front of me and saying is this fair regulatory policy. I think in general you want to correct the imbalance. As quickly as possible sort of implies there is limits on how fast you can do it. In this case they said they want to make sure they earn their allowed rate of return. That seems to be a reasonable constraint to me.

However, to really respond fully to how good a policy this is or isn't, I think I need to understand better the context in which it was uttered. Because those words that you talk about, fast as possible and other aspects of it, I think are only meaningful in the context in which that statement was made.

Q. Okay. I am not going to belabor that, but I do want to loop back to regulatory uncertainty and certainty. I think that you and I would both agree that investors like certainty, yes?

A. Yes.

Q. Okay. Wouldn't investors be comfortable with a regulatory policy that assured that the utility would be able to recover deficiencies or negative imbalances in their depreciation reserve on a symmetric basis with the amortization of positive imbalances or surpluses in the regulatory deficiency -- in the regulatory -- I'm sorry, in the reserve account?

A. As a general principle, I would agree that investors would like such a principle.

Q. You talk on Page 4 about your suggestion that the intervenor witnesses' proposals would create a class of winners versus a much larger class of losers among customers. And that is at Lines 8 and 9 on Page 4 of your rebuttal testimony. Are you with me?

A. Yes.

Q. Thanks. How did you -- well, let me ask it this way. Did you evaluate or calculate the numbers of customers in the class of winners versus the class of losers?

A. No. But as a general view, if you look at my Figure 1, which is Page 12, I think. No, it is Page 17.

Q. I see it.

A. If you believe that these -- this imbalance should generally be recovered over 21 years, which is an estimate that I got, I believe, from the company or Mr. Pous, you see that for four years you have a group of people who get a rate decrease at the expense of 17 years worth of customers who get a rate increase. To me that means that the winners are far fewer in numbers than the losers from this policy.

Q. Did you make any consideration of the customers over previous time from today backwards who paid in the money that created the surplus?

A. In this calculation I did not. However, I would note that the intervenor proposal doesn't say we need to reduce rates for people who paid in such that the depreciation is higher today than it was. They want to give it to the people from years one through four, which may have very little to nothing to do with the people who actually made the payments in the past. Now, likely most of the ratepayers are similar, but it is not an exact match.

Q. Wouldn't you agree that there is likely to be a better match with the customers -- of the customers in years one through four going forward with the previous customer population than the batch of customers from year five through 21 with the batch of previous customers?

A. Yes. In general, you would expect the customer turnovers to accumulate over time so that the longer you are from the event the more different your customer base will be.

Q. Do you have any knowledge about what the attrition or turnover among Progress Energy Florida's customers is?

A. No direct knowledge. I read something in one of the pieces of testimony, I think an estimate of 30 percent or something like that, but that was just my memory from reading. As a cumulative, I believe, over several years.

Q. I think you are right. I think it was cumulative 33 percent over 20 years.

Are you aware of any consumer party in this case -- do you know who the consumer parties in this case are?

A. Not directly. I know the titles that you have given me.

Q. Okay. Would you agree, subject to check, that the Office of the Public Counsel, the Public Counsel of Florida represents all customers in all rate classes?

A. That would be my understanding.

Q. And the Attorney General, similarly in this case represents all customers, correct, would you agree with that?

A. Yes.

Q. Okay. And Ms. Kaufman's client, the Florida Industrial Power Users, represents industrial customers?

A. Yes.

Q. And my client, the Florida Retail Federation, not surprisingly represents retail customers, would you agree with that?

A. That would be my expectation.

Q. Now, no consumer party in this case supports Progress' proposal, do they?

A. Not to my knowledge.

Q. I just want to ask you a few more questions, Dr. Vilbert. Really, these go to your summary statements on Page 33 of your testimony. Beginning at Line 7 -- and I am going to break this down into component parts -- you make the statement, "In this case, ratepayers are likely to be worse off if the Commission were to adopt the intervenors' proposal because at a minimum transaction costs associated with acquiring new capital to finance planned capital investments will be higher."

A. Yes.

Q. That is your statement?

A. Yes.

Q. By the transaction costs, do you mean basically that the debt issuance or equity flotation type costs?

A. Yes, to replace the money that is reduced from your revenue requirement, and particularly depreciation, which is a non-cash expense, you would now have to go to the market to make your investments to either get debt or equity and that will cost you money.

Q. Okay. Have you done any analysis of what that transaction cost impact might be?

A. No. There are estimates that are available in the finance literature, and it depends on the size of the issuance, and so forth, but it is anywhere from, you know, 3 to 10 percent. Depending on the size, it could be a significant expense. For a company this size it is likely to be a lower range -- lower end of the range.

Q. Slightly further down you make the statement that the proposal increases investor uncertainty, and we talked about that, so I'm not going to ask about that now. But you go on to say that the proposal weakens the company's credit metrics. My question for you is did you do any analysis of the impact of the intervenors' proposals on the company's credit metrics?

A. I looked at the analysis done, I think, by Mr. Lawton on the credit ratios, and he shows they weakened. But his ratios are a single issue view. To the extent that there are other things that the company has requested that does not get approved, the ratios would be further weakened. And my point is that weakened credit ratios will inevitably lead to higher cost of debt than if you had stronger credit ratios. But I haven't tried to estimate how big the effect will be --

Q. It was --

A. -- in dollars, sorry.

Q. I apologize, I thought that you had finished your answer.

A. I thought I had, too, so we were both missing things.

Q. In the next line you make the statement that debt costs will increase. Have you done an analysis of the impact on debt costs?

A. This is a theoretical view that says that investors care about the strength of the credit ratios. Weaker credit ratios will cost you more in debt.

Q. I don't think I asked you this question, if I did, I ask your forgiveness in advance. This is the question. Do you know how many customers there are on Progress -- served by Progress Energy Florida?

A. Not the total number of customers. It's a large number.

MR. WRIGHT: Thank you. That is all the questions I have, Mr. Chairman.

Thank you, Dr. Vilbert.

CHAIRMAN CARTER: Thank you, Mr. Wright.

Staff, you're recognized.

MR. YOUNG: No questions.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman.

Good evening, Mr. or Dr. Vilbert.

THE WITNESS: Good evening.

COMMISSIONER SKOP: Just a few follow-up questions on your rebuttal testimony. On Page 3, Line 3, you discuss the company's revenue requirement and the impact of reducing the depreciation, and then you indicate that it is offset by approximately

$12.1 million. Can you explain that briefly?

THE WITNESS: Yes. The intervenors' proposal, as I understand it, recognizes that the rate base will increase by the amount of depreciation that is reversed. In the first year it is $161 million, approximately, of depreciation that is going to be added back to the rate base. And in recognition of that, they use a half a year convention and apply their recommended rate of return to approximately $80 million to end up -- and that return includes interest, return on equity, and taxes, and they end up with $12 million, approximately, in return.

COMMISSIONER SKOP: Okay. So that is basically adopting the proposal, I believe, of OPC Witness Pous, is that correct, combined with the ROE recommended by Dr. Woolridge?

THE WITNESS: Yes, that's right.

COMMISSIONER SKOP: Okay. All right. I guess in the interest of fairness, I have asked the questions to the other intervenor witnesses with respect to their testimony on depreciation, so I want to give you the opportunity to respond to the same question. Why should this Commission find your testimony more persuasive and adopt it over that offered by Witness Pous and also by Witness Pollock?

THE WITNESS: I think this question gets to the heart of what I am here for. To me, there is a number of things to keep in mind. One is that reversing depreciation that the Commission authorized based upon the best available information at the time they made the decision effectively reverses a decision that the Commission made in the past.

I think it is also true, as I mentioned earlier, that there will be a set of winners. The people over the next four years will have lower rates than they would have had had they amortized the surplus over the remaining life of the assets, at the expense of future ratepayers who will pay higher costs than they would have paid had they not done that procedure.

It also has the effect of making rates more variable, because as you saw on that Figure 1, we go from a negative to a positive in one year of about $200 million effectively in the rates. I think that GAAP is fairly clear if you read the FAS 154 that says that if you change the life you should recover it over the future new revised life. So all of those reasons are ones that I would put forward as a reason not to adopt the intervenor proposal.

COMMISSIONER SKOP: Very well. If I could turn your attention now to Page 4 of your rebuttal testimony, please.

THE WITNESS: Yes.

COMMISSIONER SKOP: And generally at Lines 16 through 23, and also Lines 9 through 11, you discuss I believe from the company's and investors' perspective why regulatory uncertainty would be bad given the current economic or prevailing economic conditions, is that correct?

THE WITNESS: Yes. This section of my testimony was focused primarily on the cost of capital, because I believe that not only do you have an effect on depreciation, you potentially could effect the cost of capital, both either through weakened credit ratios or because you have increased perceived uncertainty by investors.

COMMISSIONER SKOP: Okay. Now, also on Line 11 of that page, you indicate that although the economy is showing signs of stabilizing. So, essentially, although your testimony looks at it through the eyes of the company and prospective investors of the company and the impact that might incur, your testimony also inherently recognizes the poor economy, is that correct?

THE WITNESS: Oh, yes, sir, I do.

COMMISSIONER SKOP: And so given the poor economy, would you agree that considerations as to the ratepayer are important in terms of addressing the merits of the proposed rate increase, is that correct?

THE WITNESS: Yes. As I mentioned earlier, I think there is potentially a slippery slope here if you start trying to say, well, are these times much better or much worse than on average; and, therefore, should we make judgments that we wouldn't otherwise make based upon that, I fear that that doesn't lead you in a good direction. But, of course, you always have to consider whether the ratepayers can pay the rates that are being required.

COMMISSIONER SKOP: Okay. Moving to Page 7 of your rebuttal testimony, Lines, generally, 5 through 21.

THE WITNESS: Yes.

COMMISSIONER SKOP: You address generally the -- excuse me, the intergenerational fairness argument, is that correct?

THE WITNESS: Yes, at a high level.

COMMISSIONER SKOP: Okay. And on Lines 11 through 12, you discuss what you deem to be a set of intergenerational winners and losers, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Does the graph reflected on Page 17 illustrate that effect?

THE WITNESS: Yes.

COMMISSIONER SKOP: Which is Figure 1, as you have previously referenced, is that correct?

THE WITNESS: Yes, it does.

COMMISSIONER SKOP: Okay. And on Lines 14 and 15 of the same page, you state, "There is no reason that the depreciation reserve should be reversed over a four-year period," correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Would a potential reason be to mitigate the impact of the proposed rate increase on consumers?

THE WITNESS: You can select a period of time that you want to change depreciation rates, but four years seems arbitrary to me but for the fact that potentially you might have another depreciation study to look at in four years. But other than that, I see no reason for it to be four years, or ten years, or any other particular number.

COMMISSIONER SKOP: Okay. Moving to -- bear with me for one moment, please. Moving to Page 8, Line 27 and the following Page 9, Lines 1 and 2, you discuss the application of GAAP to the proposed change recommended by the intervenors, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Now, I guess as you have previously stated, you are not an accountant nor a CPA, is that correct?

THE WITNESS: Yes, that is correct.

COMMISSIONER SKOP: Okay. What did you rely upon in formulating your testimony as to the applicability or inapplicability of that financial accounting standard as it pertains to the adjustment recommended by the intervenors?

THE WITNESS: Well, fortunately, within my office we have two Ph.D finance and accounting people, one of whom was a professor and taught accounting for many years. And I told them about this problem, and asked them to help me reach a judgment on what GAAP would say about it. And after talking to them in general terms, general accounting principles lays out how a change in the estimated life should be handled according to GAAP.

COMMISSIONER SKOP: Okay. I guess that's at least for me, you know, an important consideration. It gives me some pause. Because, again, I'm not an accountant, but I'm trying to understand some of the testimony that has been provided as to that single issue. So I think the issue somewhat turns on how you interpret that standard to apply to what the intervenors propose. But I will accept, as you stated, that in your opinion GAAP does not provide for making the adjustment as requested by the intervenors, is that correct?

THE WITNESS: Yes, that is the determination that I arrived at.

COMMISSIONER SKOP: Okay. Next, turn your attention to, I believe, Page 14 -- actually, excuse me, let me move forward in the interest of time back to -- forward to Page 17, please.

THE WITNESS: Yes.

COMMISSIONER SKOP: And on Figure 1, do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: And I note that the colors reflected in the graph certainly aren't the school colors of Air Force Tuffs or Fort Warton (phonetic), correct?

THE WITNESS: No, I don't think quite so.

COMMISSIONER SKOP: Okay. All right. With respect to the graph as shown, which I believe illustrates from your perspective what would happen if the intervenors' proposal is adopted, does that -- I mean, is that an apples-to-apples comparison to the extent that the analysis provided does not recognize any further additions to plant during years five through 21?

THE WITNESS: That's a good question. This is a stand-alone analysis as you were focusing solely on the $645 million proposal.

COMMISSIONER SKOP: Okay. The orange and blue caught my eye. Let's be clear. All right. Now, in that analysis, does that also turn upon using OPC or Witness Woolridge's recommended ROE of 9.75 in any way?

THE WITNESS: Yes, it does. The magnitudes of the bars would be different. In particular, the magnitudes of the year one through four would be less, and the magnitudes of the years five through 21 would be greater if you were to award a rate of return on equity greater than 9.75.

COMMISSIONER SKOP: Okay. I'm sorry. I didn't hear the last part of that. Can you --

THE WITNESS: If you were to award an allowed return on equity greater than 9.75, then the bars would be of different magnitude, and in particular they would be higher in the positive years and lower, less negative in the early one through four years.

COMMISSIONER SKOP: Okay. So they would increase in the out years in terms of revenue requirement based on the higher ROE?

THE WITNESS: Yes, that is correct.

COMMISSIONER SKOP: Okay. Now, I guess subject to check, would you agree, and if you don't have knowledge, fine, but essentially with respect to ROE in this particular case, 100 basis points is approximately equal to $51.6 million?

THE WITNESS: I think I heard that number said earlier, and I think that is my memory of what was said, in that range.

COMMISSIONER SKOP: Okay. So there is some form of correlation between the awarded ROE and what would result from the figure shown on Figure 1, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now, one of the issues that you raised I believe on Page 20 is the impact on cash flow that would result from crediting the theoretical depreciation surplus back to the ratepayers, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now, certainly going back to the question, the difference between Dr. Woolridge's proposed ROE, which OPC has advocated for, and others that the company has requested, there is a significant spread there, but certainly ROE impacts cash flow, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And if I could -- I think I've got two more additional questions. Page 22, Lines 12 through 20.

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. You discuss why in your opinion the adoption of the intervenors' proposal is not sound regulatory policy. And I would like to briefly explore those four reasons that you cite there with you. On Line 15, for the first reason, you cite there is no other regulatory precedent supporting the proposal to reverse depreciation expense already recovered from customers. Would you agree that in the context of the 2002 settlement agreement, the company credited approximately $250 million of depreciation over four years?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. So there is some form of precedent, albeit via settlement agreement that was approved by the Commission, but perhaps not in a direct order, but there is some sort of precedent. Wouldn't you concede that point?

THE WITNESS: I concede that that happened within the context of the settlement, yes, sir.

COMMISSIONER SKOP: Okay. All right. So moving on to the second point, you state at Line 16, the proposal is counter to GAAP. I guess since you are just relying on your own opinion, you can't say that with certainty that it is counter to GAAP, is that correct?

THE WITNESS: It is my opinion based upon the documents that I reviewed, but I am not an accountant, and ultimately that decision would have to be rendered by the company and its accountants. It is my opinion, yes, sir.

COMMISSIONER SKOP: Okay. For your third reason starting at Line 17, the policy would create a small set of winners at the expense of past and future customers. I guess with respect to the winners shown on Figure 1 -- and, again, that figure is subject to change depending upon adopted -- or the ROE that is adopted by the Commission in some form, so there is some sensitivity there. But given the difficult economic times and all things being equal, would it not be appropriate to consider addressing the near term intergenerational argument that would effectively mitigate in some form part of the proposed rate increase for consumers now rather than not making the choice as you have proposed?

THE WITNESS: The short answer is yes. If I may expand just briefly. First of all, I don't believe the intervenors' proposal fully compensates the company the way it is set up right now, because the amount of return abstractly from whether you set it at Dr. Woolridge's estimate or Dr. Vander Weide's estimate, the proposal as it is set up now only recognizes depreciation in the first year. So if you were to do it correctly, so that the company -- the present value of the payments received is equal to $645 million, that would alleviate some of the concern. But there is still going to be this excess cost that you will get from transaction costs from issuing new debt and equity and potentially weakened credit metrics and these other costs, as well, and so in some sense in the long run, ratepayers actually pay a bit more than they would have to pay otherwise.

COMMISSIONER SKOP: Okay. In that analysis did you consider anything other than the intervenors' recommendation? Did you consider something perhaps less than that, the balancing, if you will, or was it more of an all or nothing analysis?

THE WITNESS: My analysis was based, as was brought up, on the $645 million. I think the principles of Mr. Pollock's recommendation are identical. The magnitude is different, and so the impact is less.

COMMISSIONER SKOP: Okay. For your fourth point, beginning at Line 18 on Page 22 of your rebuttal testimony, you state that the adoption of the intervenors' proposal would be an application of 20/20 hindsight, which would create unnecessary regulatory uncertainty. Can you defend that statement in light of what was actually approved by the Commission in terms of the 2002 settlement agreement?

THE WITNESS: Well, I can certainly try. The idea that I have in mind is that this Commission made a judgment about appropriate depreciation rates and set them into motion for recovery from ratepayers. As far as I understand, there has been no allegation that the rates that were set were not just and reasonable, that they were not based upon the best available information at the time, all of the things that you would think would go into setting rates that are just and reasonable.

At this point, effectively what the intervenors' proposal does, as far as I can see, is to say that those judgments were not correct. We are going to reverse them. We are going to add back to the rate base $645 million of depreciation that has already been recovered from ratepayers, because we believe that -- we have found out today or in this proceeding that the lives were longer than we had before.

This sets a precedent to me that you can now go back and question any decision that was made by this

Commission, and say, well, it didn't turn out like you thought. We need to go back and fix that. I think that gets you into endless fights about these sorts of issues.

COMMISSIONER SKOP: But --

CHAIRMAN CARTER: Commissioner, how much more do you have?

COMMISSIONER SKOP: Probably three brief questions.

CHAIRMAN CARTER: Okay. Well, we may stay a little longer than --

COMMISSIONER SKOP: Okay. I would appreciate it.

Dr. Vilbert, just quickly, on Page 33 of your rebuttal testimony, Lines 15 and 16. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. You indicate that the intervenors' proposal is justified on the basis of intergenerational fairness, yet the proposal itself creates, I guess, intergenerational fairness in the future, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. But certainly you seem to suggest that there would be some merit in -- or it is justified of looking at this intergenerational fairness argument that is raised by the intervenors, is that correct?

THE WITNESS: I'm not sure I would go there. I think intergenerational fairness is a tough thing because it is always going to be unfair. Some set of customers leave, some set of customers arrive. It is not possible to achieve perfect intergenerational fairness. So worrying too extremely about it does not make sense to me.

COMMISSIONER SKOP: Just one final question. I guess I saw from your bio that you are a former fighter pilot in the Air Force. So, I don't know if you have any experience with the defense industry, but have you ever heard of the expression there is no such thing as a free ham sandwich?

THE WITNESS: Yes. The way I say that is there is no such thing as a free lunch.

COMMISSIONER SKOP: Okay. Same difference. I guess as I heard you previously testify that the Commission is called upon to make very difficult judgment calls, is that correct?

THE WITNESS: Absolutely.

COMMISSIONER SKOP: Okay. So given what was done in the previous settlement agreements, and what has changed with the current situation we are facing and the consumers are facing, would it be fair to say that the prevailing economic conditions have declined significantly since 2002?

THE WITNESS: I don't know the definition of significantly, but as a general statement, yes, we are less well off economically today than then.

COMMISSIONER SKOP: Okay. And would you go so far as to say we are in a deep recession?

THE WITNESS: Well, as an economist, the latest forecast I saw is that we are actually coming out of the recession now, but we certainly have been in one.

COMMISSIONER SKOP: Okay. All right. So, again, just applying the discretion of the Commission, could you -- could you see that difficult judgment choices might need to be made in light of ensuring affordable rates, as you have previously alluded to?

THE WITNESS: Absolutely. I don't think I would want to have your job. Some tough decisions.

COMMISSIONER SKOP: All right. Thank you, sir. I appreciate your testimony, Dr. Vilbert. And, like I say, I wanted to give you the same opportunity as I gave the other intervenors to state your case. Thank you.

THE WITNESS: Thank you. I appreciate it.

CHAIRMAN CARTER: Thank you. Thank you, Commissioner.

Commissioners, anything further from the bench?

Redirect.

MR. WALLS: No redirect.

CHAIRMAN CARTER: Exhibits.

MR. WALLS: There is just one; 231 we would move in.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit Number 231 admitted into the record.)

CHAIRMAN CARTER: Anything further for this witness?

MR. WALLS: Can he be excused?

CHAIRMAN CARTER: You may be excused.

See you guys at 9:30 in the a.m.

(Hearing adjourned at 8:08 p.m.

Transcript continues in sequence with Volume 24.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

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

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

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.

JANE FAUROT, RPR
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