BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION FOR INCREASE IN RATES BY FLORIDA POWER & LIGHT COMPANY.	DOCKET NO. 080677-EI
2009 DEPRECIATION AND DISMANTLEMENT STUDY BY FLORIDA POWER & LIGHT COMPANY. /	DOCKET NO. 090130-EI

VOLUME 49

Pages 6551 through 6831

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PROCEEDINGS:	HEARING
COMMISSIONERS PARTICIPATING:	CHAIRMAN MATTHEW M. CARTER, II COMMISSIONER LISA POLAK EDGAR COMMISSIONER NANCY ARGENZIANO COMMISSIONER NATHAN A. SKOP
DATE:	Friday, October 23, 2009
TIME:	Commenced at 9:30 a.m. Concluded at 9:45 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	JANE FAUROT, RPR (850) 413-6732
PARTICIPATING:	(As heretofore noted.)

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WITNESSES

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 48.)

CHAIRMAN CARTER: Call your next witness.

MR. BUTLER: That would be Mr. Reed.

CHAIRMAN CARTER: Mr. Reed. Okay.

MR. MOYLE: Mr. Chair, could we have a couple of minutes?

CHAIRMAN CARTER: Yes. Let's do this -- also, too, guys, is that you all know, about how the doors, they do the automatic lock. We should have air conditioning, but the doors are going to could do their normal things, stretch break and a necessary room break. We will come back at 15 after.

(Recess.)

CHAIRMAN CARTER: We are back on the record, and when we last left, you were calling your next witness.

Mr. Anderson, you're recognized.

MR. ANDERSON: Thank you, Chairman Carter. FPL calls as its witness Mr. John Reed.

JOHN REED

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

DIRECT EXAMINATION

BY MR. ANDERSON:

Q. Mr. Reed, have you been sworn?

A. Yes, I have.

Q. Would you tell us your name and your business address?

A. John Reed. My business address is 293 Boston Post Road, Marlboro, Massachusetts.

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

A. I am the Chairman and Chief Executive Officer of Concentric Energy Advisors.

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

A. Yes, I have.

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

A. No, I do not.

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

A. Yes, they would.

MR. ANDERSON: Chairman Carter, FPL asks that the prefiled direct testimony of the witness be inserted into the record as though read.

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

BY MR. ANDERSON:

Q. You are sponsoring exhibits to your direct testimony?

A. Yes, I am.

Q. These are JJR-1 through 12?

A. That's correct.

MR. ANDERSON: Mr. Chairman, I would note that these exhibits have been premarked in the staff composite exhibit list as Exhibits 168 through 179.

CHAIRMAN CARTER: 168. Hang on one second, Mr. Anderson.

MR. ANDERSON: Thank you.

CHAIRMAN CARTER: 168 through 179. Commissioners, that is on Page 27.

Mr. Anderson, you may proceed.

BY MR. ANDERSON:

Q. Have you prepared and caused to be filed 20 pages of prefiled rebuttal testimony in this proceeding?

A. Yes, I have.

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

A. No.

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

A. Yes, they would be.

MR. ANDERSON: FPL asks that the prefiled rebuttal testimony be inserted into the record as though read.

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

BY MR. ANDERSON:

Q. You have one exhibit to your rebuttal testimony?

A. I do.

Q. That is JJR-13?

A. Correct.

MR. ANDERSON: Chairman Carter, that has been premarked as Exhibit 381 on staff's composite exhibit list.

CHAIRMAN CARTER: Commissioners, that is Page 43, Exhibit Number 381.

You may proceed, Mr. Anderson.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

DIRECT TESTIMONY OF JOHN J. REED

DOCKET NO. 080677-EI

Q. Please state your name and business address.

A. My name is John J. Reed. My business address is 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. By whom are you employed and what is your position?

A. I am the Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric").

Q. Please describe your duties and responsibilities in that position.

A. Concentric is an economic advisory and management consulting firm, headquartered in Marlborough, Massachusetts, which provides economic and financial services related to the energy industry.

Q. Please describe your background and professional experience.

A. I have more than 30 years of experience in the energy industry, having served as an executive in energy consulting firms, including the position of Co-Chief Executive Officer of the largest publicly-traded management consulting firm in the U.S., and as Chief Economist for the largest gas utility in the U.S. I have provided expert testimony on a wide variety of economic and financial issues related to the energy and utility industry on numerous occasions before administrative agencies, utility commissions, courts, arbitration panels, and elected bodies across North America. A copy of my Curriculum Vitae is included as Exhibit JJR-1. A list of prior proceedings in which I have provided testimony is included as Exhibit JJR-2.

Q. Are you sponsoring any exhibits in this case?

A. Yes. I am sponsoring the following exhibits:

- JJR-1: Curriculum Vitae
- JJR-2: Testimony List
- JJR-3: Situational Assessment Rankings
- JJR-4: Productive Efficiency Rankings
- JJR-5: Operational Metrics Rankings
- JJR-6: Benchmarking Workpapers
- JJR-7: FPL 2007 Assessment and Efficiency Tables
- JJR-8: FPL 2007 Combined Rankings
- JJR-9: 2007 Greenhouse Gas Emissions Comparison
- JJR-10: Consumer Price Index and Producer Price Index
- JJR-11: Average Weekly Earnings – Electric Utility Employees
- JJR-12: Utility Construction Costs

Q. Are you sponsoring or co-sponsoring any Minimum Filing Requirements in this case?

A. No, I am not.

I. TESTIMONY OVERVIEW AND SUMMARY

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

A. I have been asked by Florida Power & Light Company ("FPL" or the "Company") to conduct an analysis of FPL's operational and financial performance over the past few years through the use of a benchmarking study, and to comment on how the results of that benchmarking study may be incorporated into this rate case. I have also been asked to review the macroeconomic and service area economic drivers that have contributed to FPL's requested rate increase. In addition, I have been asked to review the benchmarking efforts conducted by FPL witnesses and comment on the accuracy and fairness of their analyses.

Finally, I have been asked to opine on the appropriate use of the Test Year upon which FPL should set base rates.

Q. How is your testimony organized?

A. After this overview and summary, my testimony is presented in the following sections:

II. Benchmarking Approach

III. Benchmarking Results

IV. Regulatory Construct and Policy Overview

V. Economic Drivers of FPL's Requested Rate Increase

VI. Appropriate Test Year For New Rates

VII. Conclusion

Q. Please summarize your testimony.

A. My review of FPL's performance has demonstrated that the Company has out-performed similarly sized companies across an array of financial and operational metrics. The Company has achieved this result in spite of the fact that it is somewhat disadvantaged by the exogenous factors that are known to have an impact on efficiency, as shown in the situational assessment metrics contained in Exhibit JJR-3. FPL's customer base consists of a high percentage of residential customers with low usage, its sales volume has been decreasing in the past year and is expected to continue this trend due to Florida's economic downturn, and its infrastructure is aging. In addition, the state's emerging energy policies will likely place future cost pressures on FPL to continue to reduce harmful air emissions and improve the efficiency of its generation fleet.

In terms of productive efficiency, FPL is one of the top performers among comparable companies, as shown in metrics contained in Exhibit JJR-4. FPL has ranked in the top quartile of the 28 companies in the Straight Electric Group for nine out of the past 10 years. In terms of operation and maintenance expenses specifically, FPL has ranked in the top quartile among comparable companies and first among regional utilities over the past 10 years. On individual metrics where FPL has not been a top performer, the characteristics of FPL's service area and recent economic factors explain much or all of the underperformance. It is important to note that FPL's cost trends have improved over the past 10 years relative to its industry peers, even while undertaking significant expenditures to decrease the impact of its operations on the environment, in support of the state's emerging clean energy policy.

It is important to note that FPL's high level of productive efficiency has not been achieved at the expense of customer service or system reliability, as shown in metrics contained in Exhibit JJR-5. FPL is, and has been, a top decile performer in controlling the duration of its transmission and distribution system outages, and has consistently achieved above-average performance on the frequency of interruptions. Furthermore, FPL has been and remains a very strong performer on customer service quality and customer satisfaction measures.

FPL's commitment to reducing the environmental impact of its operations begins with a clean and efficient generation fleet. Due to its low-carbon fuel mix, FPL is recognized as a clean-energy company, with one of the lowest carbon emissions profiles among major U.S. utilities. The company's fossil generation fleet performance continues to be in the top decile among comparable companies in every year in terms of availability and forced outages. Its nuclear generation fleet, despite operational challenges in recent years, has continued to be a critical factor in FPL's ability to achieve its favorable air emissions profile and its capacity to support its commitment to environmental stewardship.

The benefits of FPL's strong performance in terms of financial and operational metrics are substantial. For 2007 alone, if FPL had been merely an average performer among the 28 straight electric companies, its non-fuel operation and maintenance costs charged to customers would have been between $700 million and $1.3 billion higher than its actual costs.

Q. How should these results be incorporated into the ratemaking process?

A. It is appropriate to consider the Company's productive efficiency, service quality, and responsiveness to state policies in setting the allowed return on equity in this proceeding. The customer benefits from FPL's superior performance are clear and substantial. The cost differential at issue within the reasonable range of cost of equity estimates is relatively small compared to the value of the customer benefits produced by FPL's superior performance. It is consistent with both cost-based regulation and the long-standing latitude of regulators to recognize low-cost efficient service in setting an appropriate return. Based on my benchmarking results and the economic requirements necessary to maintain FPL's outstanding quality of service, I urge the Florida Public Service Commission ("FPSC" or "Commission") to authorize an ROE of 12.5 percent as supported by the testimony of FPL witness Pimentel.

II. BENCHMARKING APPROACH

Q. Please describe your approach to benchmarking the Company's performance.

A. Providing reliable and reasonably-priced electric service involves a complex array of infrastructure, general corporate services, customer services and financial resources. Assessing whether a particular company has successfully achieved both its service and cost obligations involves an evaluation of its productive efficiency and its service quality. Productive efficiency is best measured on a relative basis. I have measured FPL's productive efficiency against three different peer groups of companies to evaluate its relative performance in specific years, and across time to capture the trend in its performance. In addition, one must ascertain whether any cost improvements that may have been achieved were done at the expense of reducing customer service or reliability. These measures are considered separately from productive efficiency. One final element to consider is a company's responsiveness to regulatory and environmental policy objectives in the states in which it operates. I have considered all of these aspects of FPL's performance and, where possible, measured and quantified the associated customer benefit.

Q. In general, what steps did you take in constructing your benchmarking analysis?

A. The first two steps of the benchmarking analysis were to define the timeframe over which the analysis was to be performed, and develop the composition of the peer groups used to compare to FPL. The third step was to define the operational, financial and reliability/service quality metrics that were to be used in the benchmarking. Finally, in recognition of the significantly different service area characteristics that the different peer group members face, and the consequently different performance challenges created by these service area characteristics, I developed a situational assessment ranking which reflects the "degree of difficulty" that each peer group member faces in seeking to maximize its productive efficiency.

Q. What time frame did you use for your benchmarking analysis?

A. In general, I used the most recent 10 years of data for both the situational assessment and the performance metrics. These are the years 1998 through 2007. In some cases, such as for generating unit performance and reliability measures, data was only available for the most recent five years.

Q. Please describe the process you used to develop these benchmarks.

A. I developed merit order benchmarking results for both the operational and economic performance of the companies in the comparables groups. These generally measure the level of cost input per unit of "output," such as customer service expense per customer, or operations and maintenance (O&M) expense per megawatt-hour (MWh) sold. These cost diagnostics are presented individually by rank or merit order, with the lowest cost per unit of output being ranked number one. In order to develop an "overall" assessment based on rank order, I took an average of all the rank order values and developed a merit order based on those averages. This approach shows FPL's relative overall merit order. In addition, I conducted a "situational assessment" which used the same method to rank the level of challenges to performance that different companies face in order to put the benchmarking results in context.

Q. How did you select the companies to include in your benchmarking peer groups?

A. My objective in determining the sample set of electric utility companies was to achieve the largest group for which consistent data were available and which was, broadly speaking, operationally similar to FPL. Since FPL is a large electric-only utility with ownership in generating resources, I established a group of companies with electric-only utility operations who have at least 500,000 customers and own generating resources. I refer to this group of 27 comparable companies as the "Straight Electric Group." I also wanted to perform a comparison to other investor-owned electric utilities subject to the same jurisdictional authority. This "Regional Group" includes Progress Energy Florida, Gulf Power Company and Tampa Electric Company. Finally, I also looked at other large utility companies. These include companies with electric operations and at least two million electric customers, yielding a group of six companies I refer to as the "Large Utility Group." American Electric Power Company, Incorporated met the screening criteria. However, due to its substantial operations in the Texas ERCOT market, and ERCOT's competitive retail/customer choice market structure, reported data did not permit meaningful comparisons to companies outside of ERCOT. The composition of each of my comparable groups is shown in Exhibit JJR-6, page 2 of 47.

Q. Why did you focus on number of customers as a key measure for refining your comparable groups?

A. The purpose of this benchmarking analysis is to develop a meaningful comparison of FPL's costs and economic metrics that are indicative of utility performance. Many of the challenges and opportunities for a company are a function of its size. Since my focus is on controllable economic efficiencies, size is an important attribute and a utility's size tends to vary most directly as a function of the number of customers it serves.

Q. How did you conduct your situational assessment, and what is the purpose of this analysis?

A. Drawing comparisons through the use of benchmarking is inherently difficult because no two utility companies face the same set of circumstances in terms of service area economic factors, and because utilities have an obligation to serve all customers within their service area. The purpose of a situational assessment is to recognize that the cost advantages or disadvantages that many utilities face are the product of circumstances beyond their control. For example, utilities with faster growing service territories, with a more dispersed service territory, with no indigenous fuel supplies, that have a higher proportion of low load factor, smaller residential customers, and that are more transmission dependent all face greater cost challenges than do utilities without these characteristics.

My situational assessment examines these factors, which are then used to place a utility's cost performance in the context of the market it serves. Often, a utility's above-average or below-average performance on a single performance metric can be explained by the results of the situational assessment.

Q. **What data sources did you rely on for the benchmarks you are presenting?**

A. For the benchmarking analysis, I compiled data from various sources to provide sufficient metrics to assess FPL's overall performance relative to the comparable groups. For most data, I relied upon FERC Form 1 reports (as reported by SNL Financial). For supplemental metrics related to FPL's operational performance, I was able to review data from the North American Electric Reliability Corporation (NERC), Edison Electric Institute (EEI), and Institute of Nuclear Power Operations (INPO).

III. BENCHMARKING RESULTS

Q. Please begin by describing the results of your situational assessment.

A. The results of this assessment are provided in Exhibit JJR-3, pages one through 10. This exhibit shows the rank order of each of the companies, in each of the comparison groups, for each metric, as well as an overall score in the far right column based on the average rank. These metrics generally provide insight regarding the operational challenges that the various companies face that could be expected to adversely affect cost. In this situational assessment, a ranking of one indicates the company with the highest level of challenge related to economic efficiency for a particular measure. The situational assessment helps to explain the challenges a utility company faces in keeping costs low.

Q. Would you please identify the exogenous factors you assessed and describe how FPL was challenged by each one?

A. I looked at eight different factors from publicly reported statistical sources that indicate challenges to operational performance. The results are presented in Exhibit JJR-3, pages one through 10 and the following is a summary of each metric:

- Percent Sales Residential: More than half of FPL's sales by volume are sales to residential customers. FPL has a greater proportion of residential sales than any other company in any of the comparable groups in any year. Residential customers are more expensive to serve than commercial and industrial customers, and utilities with a higher proportion of residential customers tend to have higher costs and higher rates.

- Percent Sales Other: Other sales represent all sales other than sales to residential, commercial, and industrial customers. This category includes Sales for Resale. Sales for Resale present the lowest cost per unit for a utility company. FPL, with a very low volume of other sales, is the most challenged in the Regional Group and the Large Utility Group each year, and the most or second-most challenged in the Straight Electric Group each year.
- Use per Customer: Use per customer measures the average volume of sales for each customer. Since many of the costs of serving an individual customer do not vary with the level of consumption, utilities with lower use per customer levels tend to be higher cost operations. FPL is consistently the most challenged in the Regional Group, having the lowest use per customer each year. In the Large Utility Group, FPL is either the most or second-most challenged each year. In the Straight Electric Group, FPL has the second or third lowest use per customer each year.
- Change in Customers (%): Increases or decreases (in percentage terms) in the number of customers create challenges in terms of managing capital expenditures, plant utilization and fixed cost

amortization. FPL's customer growth rate has always placed it in the top half of the Straight Electric Group, and it is often in the top quartile in terms of the challenge represented by this metric.

- Change in Sales Volume (Rolling Five Year Growth): Like changes in customer base, dramatic shifts in sales volume pose challenges to any company. FPL has been challenged by more dramatic changes in sales volume as compared to both the Regional Group and Large Utility Group. When measured on a rolling five year basis, FPL's change in sales volume has placed it as most challenged in the Regional Group in six out of the last seven years and most challenged in the Large Utility Group in five out of the last seven years.
- Percent Generation Nuclear: The costs for nuclear generation are comparatively higher than coal-fired, oil-fired, gas-fired and hydroelectric generating resources. FPL has a higher percentage of its generation produced by nuclear resources than its peers in any of the comparison groups. FPL is ranked first in every year in terms of percentage nuclear generation in the Regional Group and in the top half in the Straight Electric and Large Utility Groups. This places significant pressure on FPL's cost structure and its ability to maintain competitive rates relative to its peers in the region.
- Energy Losses: Energy losses are a product of the transmission and distribution infrastructure through which the energy is transmitted.

Electric utilities which are more transmission dependent experience higher losses than utilities which are able to site generation closer to load centers. This metric represents a significant challenge for FPL. FPL is consistently the most challenged in the Regional Group, and either the most, or second most challenged each year in the Large Utility Group. In the Straight Electric Group, FPL is in the most challenged quartile each year.

- Accumulated Provision for Depreciation as a Percent of Gross Plant: This metric is a reasonable proxy for the age of a utility's asset base. Utilities with a higher proportion of accumulated depreciation to gross plant are systems which tend to be older. The higher this proportion is the more challenged a utility will be in terms of the need for maintenance and capital expenditures. FPL is consistently in the most challenged quartile on this metric, and consequently faces greater capital expenditure requirements.

The detailed results of the situational assessment are presented in Exhibit JJR-6, pages five through 13.

Q. **How would you summarize the situational assessment?**

A. It is important to keep the situational assessment in context. I offer these metrics as a means of "getting the lay of the land" in understanding the productive efficiency metrics. This is not a perfect means of capturing all of the challenges or advantages of the companies in the comparables groups, but represents a reasonable cross-section of publicly available measures of a utility's operating environment. While only a high-level snapshot, these data indicate that FPL is consistently one of the three most "challenged" companies within the comparison groups, as the results for 2007 show in Exhibit JJR-7.

Q. In general, what are the results of your productive efficiency benchmarking analysis?

A. I have utilized 21 productive efficiency metrics which I combined to create 11 benchmark metrics against which to compare FPL's performance to the three different peer groups, across the 10-year study period. Exhibit JJR-4, pages one through 10, present the merit order rankings for each company, on each metric, for each year. The underlying values for the productive efficiency metrics are provided on pages 14 through 35 of Exhibit JJR-6.

The "high-level" conclusions that I have drawn from this analysis are:

- FPL has ranked in the top quartile of the 28 companies in the Straight Electric Group in every year for the past 10 years and in the top decile for the past six years.
- FPL has ranked as the top (out of four) regional utility in every one of the past 10 years.
- FPL has ranked as the top large utility (out of seven) in every one of the past 10 years.

- On the individual metrics where FPL has not been a top performer, the characteristics of FPL's service area and recent economic drivers explain much or all of the underperformance.
- FPL's cost trends have improved over the past 10 years relative to its industry peers, with the exception of system-average fuel costs. The addition of new nuclear capacity as described by FPL witness Stall and new renewable capacity as described by FPL witness Bennett will help to lower system-average fuel costs.

Q. What metrics did you use to assess FPL's performance?

A. FPL's performance was measured across a variety of expense categories. I included high-level measures, such as total non-fuel O&M expenses, as well as various subcategories. These subcategories include:

- Non-Fuel Production O&M expenses
- Transmission O&M expenses
- Distribution O&M expenses
- Administrative and General (A&G) expenses
- Customer expenses
- Uncollectible expenses

In addition, I looked at performance metrics outside of O&M expenses to measure corporate performance. These metrics include:

- Days sales outstanding

- Labor Efficiency
- Gross asset base
- Additions to plant relative to customer growth

To ensure that FPL's performance on cost metrics did not occur at the cost of lower reliability or safety, I also compiled a variety of metrics to measure FPL's operational performance, which are discussed in detail later in my testimony. These metrics include:

- Nuclear capacity factor
- Nuclear forced loss rate
- Nuclear industrial safety accident rate
- Fossil plant equivalent availability factor (EAF)
- Fossil plant equivalent forced outage rate (EFOR)
- Distribution system average interruption frequency index (SAIFI)
- Customer average interruption duration index (CAIDI)
- Distribution system average interruption duration index (SAIDI)
- Customer service efficiency and quality

The detailed definitions of each of the productive efficiency and operational metrics I used are presented on pages three and four of Exhibit JJR-6.

Q. How did you adjust the metrics to account for companies of different sizes?

A. Most metrics are calculated on an expense per-customer or an expense per-MWh sold basis. The productive efficiency metrics presented in my analysis are an average of the per-customer values and the per-MWh values for each cost element. For example, the A&G expenses productive efficiency metric reflects each utility's A&G expenses per MWh sold and A&G expenses per customer, and presents the average performance rank on these two metrics as the measure of A&G productive efficiency.

Q. Which metrics provide the best indication of FPL's overall performance efficiency relative to the comparables group?

A. While each metric is significant and may help identify particular areas of strength and explain FPL's results, the best indication of FPL's overall level of performance in controlling costs is total non-fuel O&M expenses. This category covers all four primary operating functions (generation, transmission, distribution and customer service), and includes all administrative and general functions. This metric also has the advantage of removing the effects of environmental policy decisions (e.g., reduction in coal use) from the costs being studied.

FPL's performance is particularly strong in controlling non-fuel O&M expenses each year. It is the top performer in Regional Group, and the Large Utility Group each year. In the Straight Electric Group, FPL is in the top quartile every year in controlling its non-fuel O&M expenses. Most recently, in 2007, FPL was the second highest ranked utility out of the 28 companies in the Straight Electric Group in controlling non-fuel O&M expenses on combined per-customer and per-MWh basis.

FPL's performance has translated into real cost savings to its customers. In 2007 alone, this performance has saved customers between $700 million and $1.3 billion as compared to costs that customers would have incurred if FPL's non-fuel O&M expenses had been merely average (consistent with the average of the 28 companies in the Straight Electric Group).

Q. Would you please summarize the results of the other productive efficiency metrics?

A. Yes. I looked at a number of productive efficiency metrics in analyzing FPL's overall performance, as summarized in the following:

- Production, Transmission, and Distribution O&M Expenses: Production O&M (less fuel and purchased power expenses) has consistently been one of FPL's greatest strengths. FPL is consistently in the top quartile of the Straight Electric Group, and the top performer in the Regional Group and Large Utility Group. In 2007, FPL ranked fourth out of the 28 companies in the Straight Electric Group in Production O&M expenses. FPL has also performed well in controlling Transmission O&M Expenses (in addition to the "per-customer" and "per-MWh" measurement used in other metrics, the overall merit-order ranking for Transmission O&M also takes into account Transmission O&M expenses per mile of transmission line). FPL has consistently been in the top two quartiles, and most recently, the top performer in the Regional Group. Finally, looking at Distribution O&M expenses, FPL's improvement is most notable. FPL has improved from the fourth quartile of the Straight Electric Group in 1998 to the second quartile in 2007. It has also become the top performer in the Regional Group over that time.

- A&G, Customer, and Uncollectible Expenses: FPL is consistently a top performer in controlling A&G Expenses. FPL has been in the top quartile in the Straight Electric Group each year, and is one of the top two performers in the Regional Group and Large Utility Group each year. FPL has typically been in the top half of the Straight Electric Group and Large Utility Group in terms of controlling customer expenses; however, when compared to the Regional Group, FPL is consistently the top performer on this metric. In controlling Uncollectible Expenses, FPL typically performs in the top quartile of the Straight Electric Group, and is one of the top two companies in the Regional Group and Large Utility Group.
- Days Sales Outstanding: In analyzing Days Sales Outstanding, which is a measure of the average level of accounts receivable in relation to

total electricity sales over a year, FPL exhibited mid-level performance in each group, every year.

- Labor Efficiency: FPL has consistently been a strong performer in terms of Labor Efficiency. In analyzing Labor Efficiency, which is a combined metric that includes Salaries, Wages, Pension and Benefits per Employee and Employees per Customer, the results show that FPL has ranked in the top quartile in nine out of the last 10 years in the Straight Electric Group, and has been a top performer in the Regional Group in eight out of the last 10 years.
- Gross Asset Base and Additions to Plant: FPL's level of Gross Asset Base per Customer is generally comparable to its peers in each of the comparable groups. FPL's Gross Asset Base expressed on a per kWh basis is noticeably above its peers, which is linked to FPL's high proportion of residential customers, and the Company's low use per customer. FPL's Additions to Plant per New Customer demonstrate superior performance. FPL is the lowest cost performer each year in the Large Utility Group and in the top quartile in eight out of the last 10 years in the Straight Electric Group. In the Regional Group, FPL is either the second or third ranked, indicating that its costs on this metric are at or near average.

Q. How does FPL compare in the overall merit order rankings?

A. As shown in Exhibit JJR-7, FPL is currently the overall top performer in the Regional Group, the Large Utility Group and in the Straight Electric Group in terms of productive efficiency in 2007. It should be noted that these results are based entirely on the ranking of the performance metrics, without any adjustment made for the challenges demonstrated in the Situational Assessment.

Q. Is there a means of considering both the challenges identified in the situational assessment and the productive efficiency ranks from your benchmarking analysis?

A. Yes. Exhibit JJR-8 combines the productive efficiency merit order rankings and the situational assessment rankings. When viewed on these axes, a bandwidth around the diagonal line running from the upper left corner to the lower right corner (shown in yellow on the chart) reflects the utilities whose productivity is consistent with the challenges identified in the situational assessment. The further away (either above or below) that a utility's performance is from this line, the more exceptional is its performance (either exceptionally good or exceptionally poor). As shown in Exhibit JJR-8, FPL's performance in 2007 was exceptionally good, and FPL most outperformed its straight electric peers on a basis which considers both absolute productivity measures and the relative challenges it faced.

Q. Are there any sensitivities associated with the benchmarking analysis you wish to point out?

A. Yes. There are some points of which the Commission should be aware in judging these results. In looking at economic efficiencies, it is easy to assume that the companies represented in the data set are all equivalent in terms of safety, customer satisfaction and other important operational standards, but that is not always the case. If a utility's management decides to launch major service quality initiatives, these initiatives may well have appropriate attendant costs but the data illustrate only the cost impact and not the off-setting service improvement. To examine these issues, I have separately analyzed FPL's trends and performance on a set of operational metrics.

Q. Did your analysis indicate that FPL's level of operational performance was diminished in any way as a result of FPL's cost control activities?

A. No. I analyzed a number of operational performance metrics to examine FPL's level of performance over time and relative to the industry. These results are presented in Exhibit JJR-5. Page one of this exhibit presents FPL's values for each of these metrics for each year that data were available. Page two presents FPL's merit order rank on each item, as compared to its industry peers. On the whole, I found FPL's operational performance to be improving, and above industry norms, on all performance metrics. FPL's investment in its nuclear units has resulted in recent performance improvements, as further explained in the direct testimony of FPL witness Stall. However, while FPL's cost control activities have not affected its level of performance to date, the rising cost of labor and materials, as discussed later in my testimony, make it virtually impossible to avoid cost increases without an impact on performance.

Q. Please describe the operational metrics you examined, and the results of this analysis.

A. I examined fossil generating plant performance, nuclear generation plant performance, distribution system reliability, and customer service efficiency and quality. The results of this analysis are summarized below:

- Fossil Plant Equivalent Availability Factor: FPL's fossil generation fleet has consistently performed well above industry average in terms of its availability. From 2002 through 2007, FPL has been in the top quartile when compared to the industry average, and was in the top 20 percent of fossil units in 2007.
- Fossil Plant Equivalent Forced Outage Rate: FPL's fossil units have performed exceptionally well compared to the industry on this metric. From 2002 through 2007, FPL ranked in the top quartile compared to the industry average, and was in the top 20 percent of fossil units in 2007.
- Nuclear Plant Capacity Factor: FPL's nuclear generation performance in terms of capacity factor has been near industry average from 2002 to 2007. As discussed in FPL witness Stall's testimony, this performance is largely due to industry events which resulted in

significant regulatory impacts affecting the entire nuclear industry. FPL has made significant investments in these units based on these industry events, and these investments have already resulted in performance improvements.

- Nuclear Plant Forced Loss Rate: FPL's Nuclear Plant Forced Loss Rate, a measure of how well an owner is maintaining and operating plant equipment has been close to industry average from 2002 to 2007. As previously noted, FPL has made significant investments in its nuclear operating equipment since 2005, and has shown an improvement in this metric in each subsequent year.
- Nuclear Industrial Safety Accident Rate: FPL's Nuclear Industrial Safety Accident Rate, a measure of accidents per 200,000 man-hours worked, has been at or near industry average in each year since 2003.
- Distribution System Average Interruption Frequency Index, Customer Average Interruption Duration Index, and Distribution System Average Interruption Duration Index: In analyzing FPL's Distribution System Average Interruption Frequency Index, FPL has consistently performed in the top half of the industry in each year since 2003. FPL's Customer Average Interruption Duration Index has been outstanding, with FPL being in the top decile among industry peers in each year over the last five years. Similarly, FPL's Distribution System Average Interruption Duration Index, has been in the top

quartile in each year over the last five years, and was in the top decile in 2006. These metrics indicate that FPL is providing above average service to its customers in terms of reliability.

- Care Center Cost, Abandonment Rate, and Average Speed of Answer: In terms of FPL's level of customer service as measured by Care Center Cost per customer, Abandonment Rate, and Average Speed of Answer, FPL has significantly outperformed its peers. Based on industry data, from 2003 to 2007, FPL has ranked in the first or second quartile in four out of the last five years. In 2007, FPL ranked in the first quartile as compared to industry average in all three metrics.

Q. **What conclusions have you reached regarding your operational benchmarking results?**

A. FPL's superior performance on the productive efficiency benchmarks has not occurred at the expense of operational performance or customer satisfaction. On all of these metrics, FPL has achieved above average performance, often far above average, and there is no evidence of a trend towards declining performance or customer satisfaction.

Notably, the operational metrics demonstrate that FPL has achieved the following performance levels:

- Top decile performance in every year for fossil plant performance;

- Top decile performance for customer average interruption duration and distribution system average interruption duration, and consistently above average performance for distribution system average interruption frequency; and
- Top quartile performance for customer service efficiency, and above average performance on customer service quality/satisfaction.

As stated earlier, FPL is above average on all items except nuclear plant availability metrics (specifically, capacity factor and forced loss rate), and is frequently in the top quartile or decile. FPL witness Stall's testimony discusses the recent operational challenges that FPL's nuclear fleet has experienced, and explains the causes of those challenges and FPL's excellence program for these assets. FPL has achieved its top quality productive efficiency rankings even while increasing nuclear plant O&M and capital improvement expenditures as described in the testimony of FPL witness Stall.

Q. Is there any other operational area in which you examined FPL's relative performance?

A. Yes, there is. Given Florida's very ambitious goals for greenhouse gas emissions reductions, I also calculated FPL's approximate level of CO_2 emissions relative to a peer group.

Q. Please describe how you compared FPL to other utilities in terms of greenhouse gas emissions.

A. I created a dataset of comparable companies whose energy generation was within 50 percent (above or below) of FPL's 2007 generation level. Exhibit JJR-9 shows that FPL produced 97,169,891 MWh of net generation in 2007. There were eight utility companies within ±50 percent of FPL's figure. For this comparison, I also considered Progress Energy Florida, Gulf Power Company, and Tampa Electric Company (the regional comparables group).

As shown in Exhibit JJR-9, FPL is the cleanest utility among both the eight-utility and regional comparables groups, with an average of 0.41 tons of carbon dioxide emitted per MWh. FPL's exceptional performance in the area of greenhouse gas emissions is a direct result of FPL's commitment to addressing global climate change consistent with the state's evolving energy policies.

Q. Are there benefits associated with FPL's commitment to a clean energy portfolio that are not reflected in base rates?

A. The costs that FPL has incurred in ensuring that the generating units that make up FPL's portfolio are as clean and efficient as possible are significant. While FPL's investment in its generating portfolio has resulted in fossil units that are significantly more efficient, the costs associated with these improvements are reflected in FPL's total rates. However, the savings associated with this improved efficiency are not reflected in base rates, but instead are ultimately reflected in lower fuel and environmental compliance costs, which are recovered through separate adjustment clauses.

IV. REGULATORY CONSTRUCT AND POLICY REVIEW

Q. Does the Florida Public Service Commission have the authority to recognize corporate performance in setting rates for public utilities?

A. Yes. Florida Statute 366.041(1) provides the Commission with the authorization to "give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered; the cost of providing such service and the value of such service to the public; the ability of the utility to improve such service and facilities; and energy conservation and the efficient use of alternative energy resources" in determining the just, reasonable, and compensatory rates for services provided within the state by any and all public utilities under its jurisdiction.

Q. Are you aware of whether regulatory commissions in practice consider a utility's performance as a factor in setting the appropriate return on equity for utilities that they regulate?

A. Yes. Regulators at both the state and federal levels reward utilities for superior performance by either explicitly, or implicitly, reflecting performance in setting the allowed rate of return. The underpinnings of such an approach extend back at least to 1923 in the Supreme Court's decision in Bluefield Water Works (262 U.S.

679). For example, many public utility commissions have referred to that case in the context of setting rates of return giving due consideration to a company's efficiency, a key element of performance.

Q. **Would it be appropriate for the Commission to consider FPL's superior performance in its return on equity determination in this case?**

A. Yes. Consideration of FPL's superior performance would be consistent with this and other Commissions' authority and precedent, as well as in the public interest. In terms of this case, it would be appropriate to consider and recognize the high performance of FPL and the benefits and value such service provides to customers in selecting a return on equity within the cost of equity range identified by FPL witness Avera, and at a level equal to or greater than the amount requested in FPL witness Pimentel's testimony.

V. ECONOMIC DRIVERS OF FPL'S REQUESTED RATE INCREASE

Q. **Please discuss the macroeconomic and service-area economic trends that are principal drivers of FPL's requested rate increase.**

A. As discussed in Section III of my testimony, FPL has done an exceptional job of controlling costs and achieving a very high level of productive efficiency, even though it faces circumstances that make it one of the most operationally challenged utilities in the nation. Notwithstanding FPL's performance in controlling costs, it is facing a set of macroeconomic and service-area economic drivers that compel it to seek a rate increase for 2010.

Q. What is the relevant period for considering the economic drivers of FPL's requested rate increase?

A. FPL's last general base rate increase was in 1985. Base rates were subsequently reduced in 1990, and were lowered by $350 million on an annual basis in 1999 and another $250 million on an annual basis in 2002 as a result of stipulated reductions. Rates were increased in May 2007, in accordance with the terms of the Generation Base Rate Adjustment (GBRA) mechanism that recognized the cost of placing new generating units into service. Given this rate history, I have focused my review of economic drivers on data since 2001.

Q. Please describe the macroeconomic trends that have affected FPL's costs.

A. Two common measures of the macro-economy's general price level are the Consumer Price Index for urban consumers (CPI-U) and the Producer Price Index for finished goods (PPI). Exhibit JJR-10 shows the performance of the CPI-U and PPI for finished goods since 2001. The CPI-U and PPI have increased nearly 20 percent and 23 percent, respectively, between 2001 and 2008. Since 2005, when FPL's last rate case was settled, these two indices have increased by approximately seven percent and nearly nine percent, respectively.

Since 2003, industrial commodities have accelerated their rate of growth over general inflation as measured by the CPI-U. Exhibit JJR-10 presents the PPI for cement, concrete products, copper and brass mill shapes, copper ores, fabricated iron and steel pipe, tube, and fittings, iron ore, and steel mill products versus the CPI-U. While each of these industrial commodities has outpaced general inflation, copper ores, copper and brass mill shapes and steel mill products experienced the greatest increases. There is also a clear divergence between these commodities and the CPI-U in 2003. A similar divergence occurs for cement, concrete products, and iron ore in 2004. These commodities are essential to FPL's capital expenditure program, and thus, their prices are putting significant upward pressure on costs even beyond the general inflationary pressure measured by the CPI.

An additional area that has had a significant impact on FPL's costs is the cost of utility labor. Like the overall price level and the price of specific fuels and commodities, the cost of labor has continued to climb since 2001. Exhibit JJR-11 shows electric utility employee average weekly earnings as reported by the Bureau of Labor Statistics. Since 2001, average weekly earnings have increased from approximately $996 to approximately $1,289, or 29.6 percent in nominal growth. As noted previously, FPL's last rate case was settled in 2005, and since then, electric utility employee compensation has regained its upward momentum.

Lastly, overall utility construction costs have increased significantly in recent years. The Handy-Whitman Index of Public Utility Construction Costs provides a good indication of the rising cost of construction incurred by FPL. This index is calculated on a regional basis and incorporates all construction costs including materials and labor. Exhibit JJR-12 presents the Handy-Whitman Index for the South Atlantic region between 2001 and 2008. There are separate data series for steam production plant, hydraulic production plant, nuclear production plant, transmission plant and distribution plant. All five series show a general upward trend with transmission and distribution plant outpacing the others after 2005. As noted earlier, since FPL's last rate case was settled in 2005, these costs have increased significantly.

Q. Please describe the current economic environment faced by FPL and its impact on revenues.

A. Florida is in the midst of a severe economic downturn. FPL's customer growth has fallen since 2007. Likewise, economic activity has slowed over the past two years. Employment has been declining and personal bankruptcies are increasing while real household income has been contracting. All of these factors have plunged Florida into a severe economic downturn. As a result, FPL's sales growth and revenue growth are declining. The recession is expected to continue through 2009, which will result in continued lower sales growth and decreased use per customer.

As described in the testimony of FPL witness Morley, from 1985 to 2005, FPL's customer base grew at an average annual rate of about 85,500 customers, or 2.8

percent per year. During the same time, energy use per customer grew at about 0.6 percent per year. As a result, FPL's electric sales almost doubled in the 20-year period ending in 2005. From 2006 through 2010, as discussed above, both customer growth and sales are expected to slow dramatically due to the economic slowdown. However, the growth in new service accounts is expected to slow only moderately despite the absence of sales growth. This is due to requests for new service installations with potentially little or no new revenues associated with many of them in the short term due to high vacancy rates, as well as high vacancy rates for premises associated with existing service accounts. It is this addition of new service accounts that, in part, requires FPL to continue to invest in its infrastructure today in order to be ready to serve its customers in the future. The combination of the costs associated with continued growth in new service accounts and the declining revenue as a result of decreased customer growth and sales have put greater pressure on FPL's financial performance.

At the same time that revenues are declining, costs are increasing sharply. FPL's commitment to the maintenance and improvement of its generation fleet and transmission infrastructure requires a significant investment in these assets. The increasing cost of material and labor, as previously discussed, has resulted in sharply increased O&M and capital expenditures. Transmission and substation capital expenditures to maintain reliability of delivery service are forecasted to increase 2.9 percent over 2006 levels while operation and maintenance expenses are forecasted to increase approximately 46 percent from 2006 to 2010. In order to maintain its fossil-fired generation fleet, FPL forecasts an increase of approximately 77 percent in capital expenditures, from approximately $231 million in 2006 to $410 million in 2010.

In addition, the costs of compliance with both state and federal mandates have put significant pressure on FPL's cost structure and its ability to manage costs.

VI. APPROPRIATE TEST YEAR FOR NEW RATES

Q. Which year is FPL proposing to use as the basis for its overall jurisdictional revenue requirement calculation?

A. FPL is proposing to use 2010 as the Test Year upon which to base its revenue requirement calculation.

Q. Would you please explain the basis of selection of a 2010 Test Year?

A. Certainly. Based on the stipulation to the Company's 2005 rate settlement agreement, FPL's base rates were to remain unchanged from January 1, 2006 through December 31, 2009, and would remain effective until new base rates were set. As a result, FPL's base rates could not change until January 1, 2010, at the earliest. Therefore, it is reasonable to set the Test Year at 2010 since this would be the year in which the new rates would go in effect.

Q. What are the regulatory principles that apply to the selection of a Test Year?

A. The entire purpose of establishing a Test Year is to measure the expenses, investment, costs of capital, taxes, and billing determinants as they are projected to exist during the period for which the rates will be in effect, so as to allow the Commission to "test" whether the rates approved by the Commission will result in the utility significantly under-earning or over-earning its authorized rate of return. The establishment of a proper Test Year begins with the use of a 12-month base period, which is then adjusted for known or measurable changes, or which is used as the basis for a partially or fully forecasted Test Year. Whichever approach is selected, the Test Year must be representative of future conditions (which reflect the effective date of the new rates) or the "test" is not valid. FPL's proposed use of a 2010 Test Year meets these regulatory principles and the use of 2009 or an earlier test year does not.

VII. CONCLUSION

Q. What are your conclusions?

A. FPL has demonstrably superior performance in many areas of financial and operational efficiency, which provides customers significant savings as compared with average performance. These benefits are the result of focused efforts by the Company and are enhanced by FPL's strong customer service record.

FPL has done an exceptional job of controlling costs and achieving high levels of service to its customers, even in the face of many economic drivers over which it has little or no control. Macro-economic trends in the CPI and PPI, as well as labor and material costs, have put enormous cost pressures on FPL. In addition, the global economic crises, as well as Florida's economic downturn, have negatively affected FPL's revenue growth.

It is well within the purview of this Commission, on the basis of the quantifiable benefits the Company has already achieved and provided to customers, to support an ROE that represents strong performance and demonstrated commitment to superior quality of service. It is consistent with both cost-based regulation and the long-standing latitude of regulators to recognize efficient, high quality service in setting a compensatory return.

Q. Does this conclude your direct testimony?

A. Yes.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF JOHN J. REED

DOCKET NO. 080677-EI

AUGUST 6, 2009

Q. Please state your name and business address.

A. My name is John J. Reed. My business address is 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

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

A. Yes.

Q. Are you sponsoring any rebuttal exhibits in this case?

A. Yes. I am sponsoring the following exhibit:

- Exhibit JJR-13, Average Customer Savings

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to comment on the testimony of the following witnesses:

- South Florida Hospital & Healthcare Association (SFHHA) witnesses Kollen and Baudino; and
- Florida Industrial Power Users Group (FIPUG) witness Pollock.

Specifically, I will address issues raised by these witnesses related to Subsequent Year Adjustment, management of Operation and Maintenance (O&M) Expenses, recognition of superior performance in setting the Return on Equity (ROE), and the recognition of Power Purchase Agreements (PPAs) in setting the common equity ratio.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. My rebuttal testimony provides the Commission with additional information on the topics listed above, including examples demonstrating how other regulators have addressed these issues. As discussed in my rebuttal testimony, the FPL proposals that I address are consistent with how these issues have been addressed in other states and should be approved by the Commission. Specifically:

- FPL's proposal that its superior performance in keeping costs under control should be recognized in establishing the authorized return on equity in this case is consistent with the Commission's prior treatment of management performance and is consistent with how several other states have addressed the issue. Contrary to SFHHA witness Baudino's testimony that this would result in excessive rates, FPL's superior performance has produced approximately $1 billion per year of savings for its customers, while a 50 basis point increase in the authorized ROE would represent only $60 million in additional revenue requirements.

- A rate adjustment for expected post-test-year cost changes, which is what is reflected in FPL's proposed subsequent year adjustment, is commonly used in ratemaking and reasonably balances the need for administrative efficiency in the ratemaking process with the requirement that a utility be afforded a reasonable opportunity to earn its authorized return.
- SFHHA witness Kollen's claims that FPL's projected O&M costs are "wildly excessive" are both untrue and unsupported. FPL's non-fuel O&M costs, which are what are covered in base rates, are among the lowest in the nation and FPL has historically kept the increases in these unit costs to far less than the rate of inflation. The projected cost increases for the test year are the product of inflationary pressure and the need to maintain service adequacy and reliability. My analysis indicates that FPL should be recognized as having achieved superior performance in controlling costs, rather than being penalized through the exclusion of reasonable costs from its revenue requirement.
- The financial pressure on a utility's credit metrics from significant fixed cost obligations in Purchase Power Agreements (PPAs) is real and requires recognition in the ratemaking process. The appropriate vehicle for this recognition is to consider the effects of imputed debt when setting the common equity ratio to be used for ratemaking purposes. This

approach is often used by regulators in other states, and is what FPL has proposed in this case.

REBUTTAL OF ISSUES RELATED TO THE RECOGNITION OF MANAGEMENT PERFORMANCE IN SETTING AN AUTHORIZED RETURN ON EQUITY

Q. SFHHA's witness Baudino recommends that the Florida Commission reject the recognition of superior performance in the setting of an allowed Return on Equity. Do you agree with this recommendation?

A. No, I do not. SFHHA witness Baudino states that "increasing the investor required return to recognize factors such as 'exemplary management' would over compensate investors and result in excessive rates to ratepayers" (See Direct Testimony and Exhibits of Richard A. Baudino, at page 34 lines 17 – 19). In fact, there is historic precedent and numerous cases of public utility commissions recognizing management performance in setting an appropriate ROE.

Q. What precedent exists for this type of recognition?

A. The judicial underpinnings of such recognition extend back at least to 1923 in the Supreme Court's decision in *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, (1923)*. Many public utility commission orders reference that case in the context of setting rates of return giving due consideration to a company's efficiency. In a number of cases from the late 1970's to the mid–1990's, commissions reviewed utility efficiency and either explicitly or implicitly reflected that in setting an allowed rate of return.

Q. Are you aware of similar cases in other jurisdictions?

A. Yes, I am. In addition to Florida, these include Iowa, New Mexico, Rhode Island and Utah.

Q. Please describe the regulatory contexts of these precedents.

A. In a 1992 order deciding a MidWest Gas rate case, the Iowa Utilities Board (the "Board") explicitly awarded the company 50 basis points in its allowed ROE in recognition of superior management efficiency and benefit to ratepayers. The Board noted in its order the Iowa statutory provision (Iowa Code §476.52 (1991)), allowing such recognition:

> If it "determines in the course of a proceeding ... that a utility is operating in such an extraordinarily efficient manner that tangible financial benefits result to the ratepayer, the Board may increase the level of profit or adjust the revenue requirement for the utility."

The order goes on to note some of the factors the Board considers when making adjustments to a utility's return of equity. In its final determination, the Board stated:

> [The] Board adjusts the cost of common equity upward by 50 basis points, finding that consistently superior service, beneficial corporate restructuring, and investment in a pipeline

> interconnection stemmed from extraordinary management efficiency and resulted in tangible financial benefit to ratepayers (Iowa Utilities Board, May 15, 1992. Re Midwest Gas, a Division of Iowa Public Service Company, Docket No. RPU-91-5).

In the context of a general rate case, the New Mexico Public Service Commission, in 1978, awarded Southwestern Public Service Company "an extra" 50 basis points in setting its ROE in part as a means of recognizing "the efficiency and prudence" of company actions while keeping its costs competitive. The order stated:

> The Commission believes that regulatory incentives should be provided for efficient management. Such incentives need not always be punitive. In an instance where a utility management's activities have resulted in the development of farsighted utility planning at minimal costs to the ratepayers, positive incentives are warranted and will ultimately accrue to the benefit of the ratepayer (New Mexico Public Service Commission, December 5, 1978. Re Southwestern Public Service Company, Case No. 1435).

In addition, in Rhode Island, the Rhode Island Public Utilities Commission ("RIPUC"), as part of a general rate case for Narragansett Electric Company, took note of corporate performance in setting ROE. The RIPUC noted:

> In establishing a reasonable return from within a range, the commission has in the past given consideration to the service record of the company and the general attitude of management in meeting its public service obligations. In recognition of the company's performance the Commission finds the fair rate of return to be 13.75 which is the upper end of the range proposed .....(Rhode Island Public Utilities Commission, November 8, 1980. Re Narragansett Electric Company, Docket No. 1499)

In two cases the Utah Commission noted that various elements of utility performance warranted recognition in setting the ROE for a company. Specifically, in a 1990 order in a Utah Power and Light general rate case, the Utah Commission noted:

> We recognize that management performance is an appropriate factor for the Commission to consider in setting the ROE within a reasonable range (Public Service Commission of Utah, February 9, 1990, Re Utah Power and Light Company, Docket No. 89-035-10).

Later, in a 1995 case for Mountain Fuel Supply Company, the Commission echoed that perspective:

> The Commission agrees that the Company's gas procurement performance merits recognition and is a factor contributing to the stipulated return-on-rate base (Public Service Commission of Utah, October 17, 1995 Re Mountain Fuel Supply Company, Docket No. 95-057-02).

Q. Are there more recent examples of regulators incentivizing management performance through the use of ROE adders?

A. Yes. In Virginia pursuant to H.B. 3068 (now Chapter 888) and S.B. 1416 (now Chapter 933), commonly referred to as electricity "re-regulation" legislation, which became law on July 1, 2007, recognition of performance is authorized. The legislation provides Virginia utilities with an opportunity to earn returns competitive with those of their peers in the Southeastern U.S. and also authorizes the State Corporation Commission to adjust a utility's authorized return to reward it for good performance, including superior customer service, or penalize it for poor performance.

In addition, the Texas Public Utility Regulatory Act, as amended in September of 2007, requires that the Texas Commission consider certain factors in determining an electric utility's rate of return, including: (1) the efforts and achievements of the utility in conserving resources; (2) the quality of the utility's services; (3) the efficiency of the utility's operations; and (4) the quality of the utility's management (Texas Public Utility Regulatory Act, Subchapter B, Sec. 36.052, September 2007).

Furthermore, the Florida Commission plainly has the discretion to reward a utility's superior management and efficiency by approving an upward adjustment to the utility's authorized rate of return and has done so as recently as 2002. In the petition of Gulf Power Company for a rate increase in 2002, the Florida Commission explained the factors leading to approval of a reward adjustment as follows:

> The testimony of Gulf witnesses Labrato and Fisher demonstrates that Gulf's service is excellent. In addition, testimony of customers at the customer service hearings was very favorable. We find that Gulf's past performance has been superior and we expect that level of performance to continue into the future. In recognition of this, we find that Gulf deserves to have 25 basis points added to the mid-point ROE of 11.75%. Thus, a 12% ROE shall be used for all regulatory purposes, including, for example, implementing the cost recovery clauses and allowances for funds used during construction (Docket No. 010949-EI; Order No. PSC-02-0787, FPSC June 10, 2002).

REBUTTAL OF ISSUES RELATED TO THE SUBSEQUENT YEAR ADJUSTMENT FOR SIGNIFICANT INCREASES IN O&M EXPENSES

Q. **SFHHA witness Kollen and FIPUG witness Pollock both argue that the Subsequent Year Adjustment is unnecessary and simply avoids a necessary regulatory process to review FPL's expenses. Do you agree with this position?**

A. No, I do not. SFHHA witness Pollock claims that the Subsequent Year Adjustment is nothing more than a back-to-back rate increase. Specifically, Witness Pollock states that "such back-to-back rate increases fail to properly balance the utility's needs with the needs of its customers. Assuming its 2011 assumptions are accurate (which FIPUG disputes), FPL is really asking the Commission to guarantee that it will achieve the authorized return. Providing such a guarantee is contrary to accepted regulatory practice, which is to provide an opportunity to earn the authorized return" (See Testimony and Exhibits of Jeffrey Pollock, at page 32, lines 20 through 23, page 33, lines 1 through 2). In fact, the use of a Subsequent Year Adjustment is a common regulatory practice utilized in Florida and other jurisdictions to efficiently address expected increases in expenses.

Q. **Please describe the Florida Commission's past use of the Subsequent Year Adjustment.**

A. As stated in FPL witness Deason's rebuttal testimony, the Florida Commission has statutory and rule authority to approve subsequent year adjustments to rates, and has exercised that authority when a utility proves or projects with reasonable certainty that there will be future changes in factors considered in setting rates that will affect the utility's ability to earn a fair and reasonable return on its investments. As illustrated by the cases in which subsequent year adjustments have been granted, the Florida Commission has used the adjustment to meet the requirement of providing a utility a reasonable opportunity to earn its authorized rate of return.

Q. Are you aware of other Commissions that utilize this mechanism?

A. Yes, I am. In March 2009, the California Public Utilities Commission ("California PUC") authorized Edison International subsidiary Southern California Edison ("SCE") a $308.1 million rate increase for 2009. The California PUC also authorized an additional $205.3 million increase for 2010 and a $219 million increase for 2011. SCE indicated that the rate increases were necessitated by system load growth, the need to replace aging distribution infrastructure and business systems, increased expenses to meet regulatory requirements for electricity generation and procurement, higher operations and maintenance expenses, and increased employee costs (Docket No: Ap-07-11-011. Decision 09-03-025. 3/12/2009).

In 1993, Potomac Electric Power Company requested, and the Maryland Public Service Commission approved, a two step rate increase. The increase in base rates included a $23.2 million increase effective March 13, 1994 and a $2.2 million increase effective June 5, 1994 (Docket FC-929; Approved by Commission 3/4/1994).

In August of 2000, the Public Service Commission of Wisconsin issued an order approving Wisconsin Electric Power Company's ("WEPCO's") request for an increase in base rates. In this case, the Public Service Commission of Wisconsin found that it was reasonable to implement an increase in WEPCO's retail electric rates by $36,538,000 for the 2000 test year and to further increase WEPCO's Wisconsin retail electric rates by $27,521,000 effective January 1, 2001, to allow the company to recover incremental costs associated with its electric reliability and safety construction expenditures (Final Decision in Application of Wisconsin Electric Power Company for Approval of Plan to Improve Reliability Through Infrastructure and Incentives and Request for Rate Increase for Test Year 2000, Docket No. 6630-UR-111, at page 7).

Clearly, subsequent year adjustments are simply a means by which a Commission sets rates that allow a fair and reasonable return to utilities, when the factors considered in establishing rates change between the first test year and the subsequent year such that fair rates set for the first year may no longer be adequate to allow a fair and reasonable return in the subsequent year.

REBUTTAL OF ISSUES RELATED TO THE MANAGEMENT OF OPERATION AND MAINTENANCE EXPENSES

Q. **SFHHA witness Kollen claims that the requested level of increased O&M expenses is excessive and can't be justified. Do you agree with this assertion?**

A. No, I do not. SFHHA witness Kollen claims that the requested level of increase in O&M expenses for the test year is "wildly excessive and cannot reasonably be justified given the present economic circumstances, particularly in South Florida, the Company's proven ability to implement cost reductions, including the effects of productivity improvements through capital investment and continued efficiency improvements through the adoption of best practices" (See Direct Testimony and Exhibits of Lane Kollen, at page 17, lines 5 through 9). Witness Kollen's claims would be more appropriately applied to an organization, unlike FPL, that has not been successful in managing its costs.

FPL's superior achievement in managing its O&M expenses is indicative of an ability to produce a given level of service quality and reliability at relatively low cost. The superiority of this performance is demonstrated by the fact that FPL has achieved a rank of 1, 2 or 3 for each of the years studied (out of the 28 companies studied), as shown in Exhibit JJR-6 in my Direct Testimony. A high rank indicates that FPL's financial controls and operational performance have combined to produce very significant savings for FPL's customers. Specifically, in the area of non-fuel O&M expenses, FPL has managed to hold these expenses to an increase of 11.4% from 1998 through 2007, while the Consumer Price Index increased approximately 27.2% from 1998 to 2007 and the Handy-Whitman index, commonly used to measure increases in construction costs for electric utilities, increased by 40% to 60% for different cost categories.

Q. Is it reasonable to expect FPL to continue to manage its non-fuel O&M expenses to the same levels to which it has previously managed them?

A. No, it is not. FPL's corporate commitment to superior operating efficiency has put the Company in the enviable position of being a low cost provider. This is evidenced by the fact that in 2007, FPL was the second highest ranked utility out of the 28 companies in the Straight Electric Group in controlling non-fuel O&M expenses on combined per-customer and per-MWh basis, while decreasing retail rates in 1990, 1999, and 2002.

FPL's performance has translated into real cost savings to its customers. In 2007 alone, this performance has saved customers between $700 million and $1.3 billion as compared to costs that customers would have incurred if FPL's non-fuel O&M expenses had been merely average (consistent with the average of the 28 companies in the Straight Electric Group). While Florida is in the midst of a severe economic downturn, FPL cannot achieve additional operating cost savings beyond that which it has already achieved through its demonstrated commitment to managing costs. In order to ensure that customers continue to receive the level of service that FPL has historically provided, O&M expenses must be allowed to reflect a level commensurate with the operational improvements necessary to continue to provide exemplary service to customers.

Q. If the Commission ultimately determines that it is appropriate to recognize FPL's superior performance through an ROE adder, how would the effect of this adder compare to the savings that FPL customers have enjoyed over the past several years?

A. As I stated above, FPL customers saved approximately $1 billion in 2007 alone as a result of FPL's superior ability to manage costs, while being more operationally challenged than its peers. FPL's exceptional performance in this area is demonstrated in Exhibit JJR-13, which shows that FPL's customers have realized significant cost savings over the past 10 years when compared to the costs they would have faced if FPL had only achieved "average" performance on its cost controls, rather than being a top performer.

An ROE adder in recognition of FPL's performance of 50 basis points would represent approximately $60 million in revenue requirements. Clearly, the effect of recognizing FPL's performance through an ROE adder is diminutive compared to the benefits that FPL's customers have realized and will continue to realize.

REBUTTAL OF ISSUES RELATED TO THE TREATMENT OF POWER PURCHASE AGREEMENTS IN SETTING FPL'S COMMON EQUITY RATIO

Q. FIPUG witness Pollock argues that the Florida Commission should exclude imputed debt for purchase power obligations in setting the common equity ratio since these costs are allowed to be recovered through the Fuel and Capacity Cost Recovery Clauses and ratings agencies do not necessarily recognize power purchase obligations as imputed debt in evaluating a utility's financial strength. Do you agree with witness Pollock's position?

A. No, I do not. SFHHA witness Pollock claims that since the cost of purchasing power under PPAs can be passed through to customers, ratings agencies such as Moody's regard these PPAs as operating costs with no long-term debt-like attributes and therefore imputes no debt for such contracts where recovery is guaranteed (See Direct Testimony and Exhibits of Jeffry Pollock, at page 24 lines 2 through 17). In fact, rating agencies recognize the financial effects that stem from the debt-like features of the PPAs. The debt rating agencies have increasingly considered those effects when evaluating the creditworthiness of the utility purchaser under a PPA. The rating agencies treat the PPA's fixed cost obligations as "imputed debt", which is seen as increasing the financial leverage of the utility, decreasing the interest coverage levels of the utility, and reducing its credit quality.

Q. What is "imputed debt" and how does it affect a utility's cost of and access to capital?

A. Imputed debt represents the inherent financial risk of fixed payment obligations associated with long term PPAs. Imputed debt is a rating agency construct whereby the agency develops a risk-adjusted value of the fixed payments under the PPA and "imputes" that value as debt when developing the metrics used to determine a company's credit rating. Standard & Poor's ("S&P") states that it views electric utility purchased-power agreements as debt-like in nature, and has historically capitalized these obligations on a sliding scale. S&P applies a 0% to 100% "risk factor" to the net present value of the PPA's capacity payments, and designates this amount as the debt equivalent ("Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements," May 7, 2007).

Through this process, rating agencies attempt to capture the risks that a PPA may impose on a utility-purchaser and reflect those in the credit rating, even if Generally Accepted Accounting Principles ("GAAP") do not require a PPA to be recorded on the balance sheet as a long-term obligation. The risk apportionment of the PPA, the size of the utility's financial obligation, and the term of the PPA will all likely be considered in the debt imputation to the utility, and can most certainly have a significant negative impact on credit rating. This will, in turn, put upward pressure on the utility's cost of debt, and the utility's access to capital in a tight market may be limited.

Q. Have other Commissions recognized the imputed debt associated with Power Purchase Agreements?

A. Yes, they have. State Commissions have given explicit consideration to the effects of imputed debt when considering whether a proposed PPA is "least cost" or in the public interest. These considerations have included an adjustment to the direct cost of power under the PPA when evaluating the PPA against power supply alternatives, and increasing the utility's target equity ratio to offset the debt imputation effects.

For example, in 2001, Nevada adopted what was at the time one of the country's more aggressive renewable portfolio standards ("RPS"), which ultimately required the state's utilities to sign a substantial number of new, long-term contracts for renewable power. In June 2005, the Nevada legislature passed Assembly Bill 3 which became Chapter 2 (22^{nd} Special Session) that modified Nevada's RPS and increased the target percentages for energy from renewable resources. At the same time, the legislature recognized that the goal of significantly increasing the number of renewable energy contracts signed would be difficult without proactively addressing the issue of imputed debt. The legislation addressed imputed debt directly by requiring the Commission to adopt regulations that established "methods to classify the financial impact of each long-term renewable energy contract and energy efficiency contract as an additional imputed debt of a utility provider. The regulations must allow the utility provider to propose an amount to be added to the cost of the contract, at the time the contract is approved by the Commission, equal to a compensating component in the capital structure of the utility provider. In evaluating any proposal made by a utility provider pursuant to this paragraph, the Commission shall consider the effect that the proposal will have on the rate" (See State of Nevada, Assembly Bill No. 3, Section 29.7 (b), pg. 21).

The Wisconsin Public Service Commission ("Wisconsin PSC") expressly recognizes the debt associated with PPAs. The Wisconsin PSC sets a common equity ratio target based on what they call a "Financial Capital Structure" that includes imputed debt on PPAs that supports a given credit rating. This determines the amount of equity that will be included in the "Regulatory Capital Structure" in setting rates. The effect is to allow the company to carry a higher equity ratio and have it considered within the ratemaking process (Edison Electric Institute, Understanding Imputed Debt Issues, June 2008 citing Wisconsin Public Service Commission, Final Decision, Docket No.6690-UR-118, January 15, 2008).

In addition, the Delmarva Public Service Commission has recognized the financial risk associated with long term PPAs. On August 1, 2006, in response to Commission directives, Delmarva Power and Light filed a draft Request for Proposals (RFP) for long term contracts to supply its standard offer service customers. Throughout the process, there was a substantial amount of discussion about the terms and conditions of the RFP, including the imputed debt cost factors in bid evaluation. On November 21, 2006, the Delaware Public Service Commission issued Order No. 7081, which found that Delmarva's (DP&L) imputed debt adjustment should be used in their RFP. The Order stated:

> We believe that the RFP should provide that DP&L will be permitted to assess the incremental equity amount to be equal to 30% of the net present value of the bid's capacity payment, and that a portion of the energy price may also be included if DP&L concludes that a portion of the bid's energy component would be imputed as debt by rating agencies in their assessment of DP&L's creditworthiness.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BY MR. ANDERSON:

Q. Mr. Reed, have you prepared a summary of your direct and of your rebuttal testimony?

A. Yes, I have.

Q. Would you please provide your summary to the Commission?

A. Yes. Good afternoon. My direct testimony presents the results of an analysis of FPL's operational and financial performance from 1998 to 2007 through the use of a benchmarking study and comments on how the results of that benchmarking study should be incorporated into this rate case. My study involved measuring FPL's productive efficiency against three different peer groups to evaluate its performance over ten years.

In addition, I reviewed customer service and reliability measures to ascertain whether any cost improvements that may have been achieved were done at the expense of service quality. I have where possible measured and quantified the associated customer benefits from FPL's performance.

My review of FPL's performance has demonstrated that the company has consistently and significantly outperformed similarly sized companies across a broad array of financial and operational metrics. For example, FPL is a top performer in managing A&G expense, labor costs, and the cost of adding new customers to its system. In addition, FPL's generation fleet is highly efficient and produces far less CO2 per megawatt hour than its peers.

The company has achieved these outstanding results in spite of the fact that it is somewhat disadvantaged by the exogenous factors that are known to have an impact on a utility's costs. For example, FPL's customer base consists of a high percentage of residential customers with low usage, its sales volume has been decreasing, and it is more transmission dependent than its peers.

The combined situational assessment and the productive efficiency metrics are shown on Exhibit JJR-8, which is on the easel next to me. And as shown there in the upper right-hand corner, FPL is truly a top performer among the 28 utilities.

In terms of overall productive efficiency, FPL has ranked in the top three of the 28 companies in the straight electric group in every one of the past ten years. It is also important to note that FPL's cost trends have improved over the past ten years, even while undertaking significant expenditures in support of the state's emerging clean energy policy.

Importantly, these savings have not been achieved at the expense of customer service or system reliability. FPL has been a top decile performer in controlling the duration of its transmission and distribution system outages and has consistently achieved above average performance on the frequency of interruptions. Furthermore, FPL has been and remains a very strong performer on customer service quality and customer satisfaction measures.

Turning to my rebuttal testimony, which responds to the testimony filed by the SFHHA and FIPUG witnesses, and addresses FPL's management of its own O&M expense, the basis for its requested subsequent year adjustment, the appropriateness of recognizing superior performance in setting the return on equity, and why power purchase agreements should be considered in setting the common equity ratio. On each issue I have provided examples demonstrating how other regulators have addressed these issues.

Regarding FPL's proposed request for a subsequent year adjustment to reflect post-test year cost changes, the Florida Commission has the statutory and rule authority to approve subsequent year adjustments to rates. This type of mechanism is commonly used in ratemaking in other jurisdictions when significant and predictable increases in costs are expected after the test year on which base rates are predicated. This approach appropriately balances the need for administrative efficiency in the ratemaking process with the requirement that a utility be afforded a reasonable opportunity to earn its authorized return.

I was also asked to opine on the financial and regulatory treatment of the imputed debt associated with power purchase agreements. Imputed debt is a rating agency mechanism developed to recognize the impact that payments under a power purchase agreement have on a company's credit rating. The appropriate vehicle for recognizing these effects is to consider imputed debt when setting the common equity ratio. This is the approach often used by regulators in other states and is what FPL has proposed in this case.

The Commission can be confident that FPL is effectively managing its costs and maintaining its high quality of service. Under Florida's and many other states' regulatory frameworks, it is appropriate to consider the company's efficiency and service quality in setting a utility's allowed return on equity. Contrary to claims that this would result in excessive rates, FPL's superior performance has produced approximately $1 billion per year of savings for its customers as shown on the chart to my right, while the comparison -- while by comparison, a 50 basis point increase in the authorized return on equity would represent only about 60 million in additional annual revenue requirements. Both of those figures are shown on the chart.

In situations such as these, where a utility is delivering extraordinarily favorable results for its customers, regulators can and should constructively align and balance the interests of customers and investors by recognizing this performance in the ratemaking process.

That concludes my summary.

MR. ANDERSON: Mr. Reed is available for cross-examination.

CHAIRMAN CARTER: Thank you.

Mr. Beck, you're recognized.

MR. BECK: No questions, Mr. Chairman.

Ms. Bradley, you're recognized.

MS. BRADLEY: No questions.

CHAIRMAN CARTER: Mr. Moyle, you're recognized.

MR. MOYLE: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. MOYLE:

Q. Good evening, Mr. Reed.

A. Good evening, Mr. Moyle.

Q. I want to just follow up on a couple of points that you raised in your testimony and you hit on them during your summary. And the first relates to this subsequent year adjustment issue.

A. Yes.

Q. And in your summary, you said that there should be -- it is recognized of a post-test year adjustment. You used that term in your summary, correct?

A. Yes, I did.

Q. Okay. And with respect to what is in front of this Commission, what would be the test year?

A. 2010.

Q. And isn't it true that in the vast majority of jurisdictions in this country that revenue requirements and rates are set using historical data or a portion of historical data as compared to making rate decisions based on projections of what may happen in the future?

A. I think in all jurisdictions, including Florida, the base period, which is the first term I have used, is based upon historical data. Then the question becomes as you are projecting to establish rates for a forward-looking period, how do you adjust the base period data for the test year? The test year is the period, the first full year in which the rates will be in effect. In many states, for example, those rate increases go into effect subject to refund while the hearings are going on. So, yes, every jurisdiction uses historical data. That is not in any way inconsistent with also a forward-looking test year.

Q. Okay. And that question probably was not that clear. You made the point, yes, you have to have a baseline, a historical year, correct?

A. Correct.

Q. And isn't it true that the majority of the states when they have a baseline, a baseline year, but then with respect to setting rates, that they also do a retroactive look, look at historical information as compared to projected information?

A. I think most states look at historic information, but then adjust that historic information for what are called known and measurable changes. So a base year adjusted for known and measurable changes or a forward-looking test year, it really becomes a distinction without much of a difference.

Q. And with respect to subsequent year adjustments, aren't those typically done, for example, as it relates to maybe a particular asset or a particular issue as compared to, in effect, having a two-year test year?

A. No. It is actually quite common to have it be a fully projected cost of service for two or even three years. If you look at California's current mechanism, for example, they set rates in a rate case for three years based upon fully projected test year revenue requirements for each of the three years.

MR. MOYLE: I want to pass out a document, if I could, Mr. Chair.

CHAIRMAN CARTER: Do you need a number?

MR. MOYLE: Yes, please.

CHAIRMAN CARTER: Okay. For the record, Commissioners, that next number will be 537.

A short title, Mr. Moyle?

MR. MOYLE: Historic Test Year Versus Forecast Test Year.

CHAIRMAN CARTER: Historic Test Year Versus --

MR. MOYLE: Versus Forecast Test Year.

(Exhibit Number 537 marked for identification.)

BY MR. MOYLE:

Q. Sir, are you familiar that NARUC tracks jurisdictions which use historic test years as compared to forecast test years?

A. I am aware that it did do that.

Q. And the information set forth on the exhibit that I have provided you, 437 (sic), based on your knowledge does this look to be an accurate depiction of states that use historic test years as compared to forecast test years?

A. I really can't vouch for the accuracy of what is here. I see that the sources are a study from 13 or 14 years ago by NARUC updated by apparently some telephone interviews. I don't know the source of this document. I really can't vouch for its authenticity.

Q. Do you know -- are you familiar with the Brattle Group?

A. Yes.

Q. Who are they?

A. It's a consulting firm.

Q. And FPL used them in this case, did they not? Do you know?

A. I believe they used them for a demand forecasting verification.

Q. You talk a little bit about the imputed debt, and you indicate that the rating agencies impute debt. Isn't it true that Fitch does not impute any debt related to purchase power agreements?

A. Fitch takes a qualitative approach to the issue rather than a quantitative approach. They don't attempt to measure the net present value and make a numerical adjustment, although they do consider it in credit quality issues.

Q. But they have not detailed in any significant way how it is considered, correct?

A. Other than qualitatively, that is correct.

Q. Okay. And the same goes with Moody's, they have not -- they have not quantified in any kind of detail how they evaluate purchased power agreements, correct?

A. In general, Moody's has detail that they do consider it, and they have described what they consider in terms of the magnitude of the nature of the fixed costs, the present value of the fixed obligations, but they don't have a formulaic approach to it the way Standard and Poor's does.

Q. Right. And you would agree that consistency in a regulatory environment is a positive aspect or characteristic of a regulatory environment, correct?

A. In general. I think commissions always are hoping to reconsider issues, but consistency is generally a positive.

Q. And you are aware in the Tampa Electric decision that this Commission recently issued that it declined to recognize or make a requested adjustment related to purchased power agreements that Tampa Electric Company was seeking, correct?

A. In general terms, although this issue is very fact specific by utility because the magnitude of the purchased power contracts is very different by utility.

Q. I understand, but when you said in general, you would agree with me, correct, with respect to the decision in TECO?

A. I agree that that is what happened in the Tampa case, yes.

Q. Now, I was a little unclear yesterday in questioning one of FPL's witnesses about FPL's position with respect to return on equity and a return on equity adder. You spent a considerable amount of testimony in your rebuttal talking about jurisdictions that have provided additional return on equity because of good management or things of that nature, correct?

A. More generally, I provide examples of where other commissions have considered management performance in establishing the return on equity, whether it is done through an adder or, again, just qualitatively.

Q. What is your understanding as to what FPL is asking with respect to qualitative performance in the return on equity in this case?

A. It is not seeking a specific increase or adder for management performance, but has suggested that the management performance should be considered by this Commission in establishing the appropriate return on equity.

Q. And do you agree with that? Do you agree that management performance should be considered in establishing the return on equity?

A. Yes, I do. I think it is important to align the interests of investors and ratepayers.

Q. Okay. And the testimony you have provided is situations which commissions have provided additional return on equity based on positive operations and behavior, correct?

A. Yes. As I said, that is part of what I cover in that part of my testimony.

Q. Sure. And the converse is also true, is it not, that to the extent that a utility may have provided poor service or acted inappropriately, that it would be appropriate for an ROE reduction to be considered, correct?

A. I think it is a symmetrical process, and I think both sides of the equation can be considered.

Q. Okay. And I don't know, have you been here for the days and days and days of our hearing?

A. I have listened to or been here for almost all of them.

Q. Okay. There was a little bit of an exchange previously about an aviation issue. And I don't know how closely you followed the aviation issue, but you would agree, would you not, that a $16 million issue is not a distraction?

A. I think to put it in context, I think it is 7 million in the first -- in the test year and then 9 million in the subsequent year. It is certainly not a distraction, and I think it is important for the Commission to look at every dollar of expense and make itself comfortable that the costs are appropriate. I would point out that my testimony goes to the management performance of the company overall. And we are talking about a $5 billion revenue requirement of which 7 million in one year is 0.12 percent, one-tenth of one percent. It is certainly not indicative of anything with regard to the overall management performance of the company.

Q. So, you said it is not indicative of the overall performance. I guess you would disagree -- you have heard the saying that sometimes if you -- you know, if you look at the small things, that may indicate how big things are being done?

A. Well, Mr. Moyle, I look at it from this perspective: If I or any other witness came before this Commission and said I want you to determine that the company has done a fantastic job, and I am presenting to you information on one-tenth of one percent of its costs, and I want you to infer from that that they have done a great job because they did a great job on this one-tenth of one percent, I would suggest to you it would be appropriate to give that testimony no weight whatsoever.

If there is evidence as to the inappropriateness of any of the 7 million, and I don't think that there necessarily is, but we don't need to argue that point, I think the same weight should be given that 7 million if it has negative connotations as if I was to put it forward for positive connotations.

Q. And you make that statement just based on the dollar figures, is that right?

A. Based on the fact that you need to look at the overall management performance. And we are talking about a company where the base rate revenue requirement is $5 billion. And on any quantitative measure that I have been able to come up, which actually looks at the entirety of the costs as well as subsets of the costs, the company has performed exceptionally.

Q. And you don't have -- I know you have a business background. Are you familiar with audits typically or generally?

A. Yes. In fact, we have done audits and presented them to this Commission.

Q. And sometimes in an audit they do, I guess, a random sampling or they pick something and go look at it, isn't that right?

A. Certainly.

Q. Okay. And in this case are you aware that aviation expense was not identified as a contested issue by the parties initially?

A. I'm not aware of that.

Q. Okay. Are you aware that Commissioner Skop kind of looked into that issue and asked a whole lot of questions about the aviation costs?

A. I am.

Q. Would you agree that looking into that aspect is roughly analogous to sort of a random audit?

A. Not at all. An audit needs to look at a representative cross-section of the accounting information and the cost information to determine whether, in fact, costs are appropriate. I don't think anybody would purport that the aviation logs that have been looked at here are in any way meant to even be a representative sample of the overall $5 billion of expense of this company.

Q. You would agree with the proposition that leadership -- that the leadership should lead by example, correct?

A. Yes, I do.

Q. Okay. And I don't know if you have familiarity with the mechanisms and the ways in which allocation of costs for airline use, corporate air line use are supposed to be allocated with respect to FPL?

A. No.

Q. Do you have a general understanding about how aircraft use is supposed to be allocated between regulated entities and nonregulated affiliates or parent companies?

A. I have heard the testimony on that issue at this hearing, that is the limit of my understanding.

Q. Okay. And to the extent that there are clear guidelines about how you account for costs and the evidence indicated that the top management of the company did not follow the proper guidelines or the proper procedures for allocating those costs between the regulated entity and the nonregulated entity, you would agree that that would be a factor that could be considered by this Commission in determining the attitude of the company?

MR. ANDERSON: FPL would object because counsel's question is obviously argumentative, but it assumes facts that are not in evidence. There has been absolutely no showing of anything like a violation of practice or procedure, and I would object to the characterization of that question. We suggest a different question be asked.

CHAIRMAN CARTER: To the objection, Mr. Moyle.

MR. BECK: I would respectfully disagree with my colleague. The document came into evidence yesterday that was the results of the audit that Commissioner Skop had asked for. It showed disallowances, partial disallowances for flight costs that had been inappropriately booked to the regulated utility and adjustments were made to back those costs out. And I think that is in the record, it is evidence, and it is a fair question. With respect to the attitude portion, he uses a quote about the general attitude of management in his testimony, so I think it's a fair question.

CHAIRMAN CARTER: Mr. Teitzman.

MR. TEITZMAN: If I could have just one second.

CHAIRMAN CARTER: Yes, sir.

MR. TEITZMAN: Mr. Chairman, I would recommend letting Mr. Moyle continue that line of questioning.

CHAIRMAN CARTER: Okay. Mr. Moyle, tread lightly.

BY MR. MOYLE:

Q. Sir, Page 7.

A. Of my direct?

Q. I'm sorry, of your rebuttal.

A. My rebuttal.

Q. Line 6. Here you are quoting a decision of the Rhode Island Public Utilities Commission, and I believe you are talking about ROE, and you state, "In establishing a reasonable return from within a range, the Commission has in the past given consideration to the service record of the company and the general attitude of management in meeting its public service obligations." I take it from that that you would agree that consideration of the general attitude of management is an appropriate thing that can be considered by this Commission, correct?

A. I can. All I would ask is that the Commission take under advisement and recognition of all of the evidence on all $5 billion of the costs.

Q. Yes, sir. And I think we all have every confidence that that will be done. Were you here yesterday when there was testimony about FPL's activities related to the service hearings and activities where they met with customers and did follow-up activity to make sure that customers who had positive things to say about the company showed up at the service hearings?

A. I was here and heard that evidence.

Q. It's getting late. I have some other areas that we might be able to discuss, but I think we will have to save that to another day. Thank you for your time and attention.

A. My pleasure.

CHAIRMAN CARTER: Thank you, Mr. Moyle.

Mr. Wright.

MR. WRIGHT: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. WRIGHT:

Q. Good afternoon, Mr. Reed.

A. Good afternoon, sir.

Q. My name is Schef Wright. I represent the Florida Retail Federation in this proceeding, and like my colleague, Mr. Moyle, I have some brief cross-examination for you.

With regard to your direct testimony, you talk about -- at various points about customer benefits, and then at Page 37 you talk about FPL's strong customer service record, and that is at the very bottom of Page

37 of your direct testimony. I just have a few questions for you along that line. Are you an FPL customer, perhaps of FPL New England?

A. I am an FPL customer here in Florida.

Q. Do you live here?

A. I have a home here, too.

Q. Okay. Good for you.

Did you interview any other FPL customers in connection with your conclusion that FPL has a strong customer service record?

A. No, I did not interview customers.

Q. Did you conduct an independent assessment of FPL's customer service?

A. No, I would say not an independent assessment. I conducted a review of the available statistics with regard to the customer service function, which are compiled in my exhibits.

Q. I'm sure you are familiar with J.D. Power and Associates and their rankings of customer satisfaction?

A. Very, very familiar with that.

Q. Okay. Will you agree -- and I can show you the exhibit, it's already in evidence, will you agree that Florida Power and Light is ranked below average for the South Florida segment in the most recent J.D. Power electric utility residential customer satisfaction study?

A. I will accept that, but it was very, very slightly below average for this region, above average for the nation, and I would be glad to talk to you at length about that study if you would like. It is a study that I helped to create. I was the CEO of Navigant, and Navigant created that study with J.D. Power. My staff created it. It is what we largely refer to as a popularity contest, but we can go into it as much length as you would like to.

Q. That was really about all I wanted to touch on with respect to that. With respect to your rebuttal testimony, you talk in several places about the public utility commissions recognizing management performance in setting an appropriate ROE, and then you also go on to cite one of the landmark cases in utility regulation, Bluefield Waterworks. Are you trying to suggest that the Florida Public Service Commission should give FPL a higher rate of return on equity because of its efficiency or its superior performance?

A. Certainly it has the ability to do that and it has done exactly that in other cases before it. That action is also consistent with what many other commissions do when they consider management performance. I'm not making a specific recommendation here in terms of an adder, nor is the company seeking an adder to the return on equity, but I do think it is fair to consider management performance and especially when it is as superior as what FPL has posted consistently. I think it should be taken into consideration.

Q. I want to talk to you briefly about Bluefield. Will you agree that the relevant principle of Bluefield relative to the concept of efficient management is that the rate of return must be set to provide the company with the opportunity to provide its service, to fulfill its public duties, to maintain its credit, and to earn a reasonable return assuming that the utility has efficient and economical management?

A. Yes. I think that sounds familiar within the context of the Bluefield decision.

Q. Can you point me to anyplace in the Bluefield decision where it says that a regulatory body should reward efficient management different than what I just talked to you about?

A. Obviously, I didn't quote Bluefield for that purpose. My testimony points specifically to a number of states, including Florida, where that has occurred, and where the commissions have very explicitly adopted adjustments to return on equity for management performance. I think it is consistent with Bluefield.

I don't think it is mandated by Bluefield.

Q. Do you agree with the following statement: A utility is under an obligation to serve its customers and to do so at the lowest possible cost?

A. No, I don't agree that lowest possible cost is the appropriate standard.

Q. Would it surprise you that I just quoted from Mr. Davis' rebuttal testimony in this case?

A. No. Again, I'm not sure that he was testifying on that issue. But if the standard is lowest possible cost, you can obviously sacrifice reliability, you could sacrifice service quality, customer satisfaction by reducing cost. So I don't think lowest possible cost is the appropriate standard.

Q. Modifying the statement slightly, would you agree that it is the utility's duty to provide safe, adequate, reliable service to its customers at the lowest possible cost?

A. No. Once again, I think reasonable cost is the standard that most commissions and most courts have adopted. That is the one I would endorse. Lowest possible carries with it a lot of baggage that I think actually works to the customers' detriment.

Q. Would you agree that it is the utility's duty in fulfilling its public service responsibilities to be as efficient as possible?

A. Yes. I think it is certainly the objective of every utility that I have worked with to be as efficient as possible. I think that is discharging their duty to their customers.

Q. I'm sure you are very familiar with the concept of regulatory lag?

A. I am.

Q. And regulatory lag refers to the time period between rate cases, and if a utility saves money during that time, it makes more net income; and if it is not successful at controlling costs during that time, then it make less net operating income. Is that about right?

A. Not really. Regulatory lag is much broader than that. It incorporates the time period between the incurrence of cost and the recovery of a cost, as well as the space between utility -- between utility rate cases or the time frame between utility rate cases.

Q. Wouldn't you agree that to the extent the utility saves money by reducing costs between rate cases, its net operating income will be higher, other things equal?

A. All other things being equal, meaning as established in the underlying original rate case, yes, if it reduces cost it will increase operating income.

That's a pretty unusual circumstance, obviously.

Q. By that you mean the other things equal assumption?

A. Yes. You never have all other things being equal to what is in the actual rate case.

Q. Right. In your analyses of FPL's performance, to what extent, if at all, did you consider violations of Nuclear Regulatory Commission rules?

A. We considered all of the metrics that we had with regard to nuclear cost, reliability, safety, and operating performance in terms of capacity factor. There is no quantitative metric with regard to, as you described it, violations of NRC rules that we considered. But to the extent there are violations of NRC rules, you would expect that to show up in the factors that we did quantify.

MR. WRIGHT: I am going to ask my law partner, Mr. LaVia, to please pass out an exhibit, Mr. Chairman.

CHAIRMAN CARTER: Do you need a number?

MR. WRIGHT: I do, please.

CHAIRMAN CARTER: It would be 538.

MR. WRIGHT: 538.

CHAIRMAN CARTER: A short title?

MR. WRIGHT: Miami Herald Article, re: 2-26-2008 Blackout.

(Exhibit Number 538 marked for identification.)

CHAIRMAN CARTER: You may proceed.

MR. WRIGHT: Thank you, Mr. Chairman.

BY MR. WRIGHT:

Q. Are you familiar with the event that is discussed in this article as an outage resulting from a transmission glitch in February of 2008?

A. I am familiar in general terms with the incident.

Q. Were you in Florida when that occurred and were you impacted by it?

A. No, I was not in Florida at the time.

Q. To what extent, if at all, does your evaluation of FPL's customer service take account of this?

A. It is captured -- hang on just a second. This occurred on February 26th, 2008. My data as presented in the testimony ended in 2007, so this is just beyond the interval that we examined, the ten-year interval that we examined.

Q. I will submit to you that it is already in evidence that FPL's projected fuel costs for 2009 as of the fall of 2008 were approximately $7 billion, and that their currently projected fuel costs for 2010 are approximately $3.8 billion. I don't know to what extent you track those things in your work, but does that sound familiar to you?

A. I was aware there was a substantial projected reduction in fuel cost. I can't vouch for the individual numbers.

Q. Would you agree that that is largely due to declines in the price of natural gas?

A. As I recall, it is due to many things. Declines in the price of all fossil fuels, as well as decline in load, as well as the substitution of more efficient forms of fossil generation. So I think it is many factors that contributed to it.

MR. WRIGHT: I need a minute to refer to an exhibit that is already --

CHAIRMAN CARTER: Take a moment.

MR. WRIGHT: Thank you.

CHAIRMAN CARTER: Commissioner Skop, you're recognized.

COMMISSIONER SKOP: Thank you, Mr. Chair. I just want to ask a brief intervening question. I guess I heard the witness just state that he looked at a ten-year interval which did not include 2008, is that correct?

THE WITNESS: That's correct in terms of what is presented in the testimony. I actually have looked at 2008 to see if it would have changed any of my conclusions, but the testimony only presents the ten years ending 2007.

COMMISSIONER SKOP: Okay. Why would you not have considered the historical test year which would have, I believe, been 2008?

THE WITNESS: The data were not all available at the time the testimony was submitted, especially the operational data were not available as of that date. As I said, I have gone back and looked at all of the '08 statistics and at least for internal purposes continued the benchmarking. I can tell you that in 2007, FPL was the number one performer of the 28 straight electric utilities. In prior years it had been number two or number three. In 2008 it was number two out of 28, so it has continued to be in the top three positions, but in 2008 it did achieve a number two ranking.

COMMISSIONER SKOP: So if you took the most recent year, which is 2008, that you say that you did also benchmark on, and dropped the oldest year, how would that might have changed the results, if any?

THE WITNESS: Not at all. The conclusion would be even more compelling that it has continued to achieve a ranking of either first, second, or third in every year that we have examined, and that is consistent in 2008.

COMMISSIONER SKOP: Thank you.

CHAIRMAN CARTER: Mr. Wright.

MR. WRIGHT: Thank you, Mr. Chairman.

BY MR. WRIGHT:

Q. Mr. Reed, in your response to my previous question you talked briefly about declining load. The only information I have handy is FPL's Ten-Year Site Plan, which shows total sales to customers projected for 2009 at 101,078 gigawatt hours, and for 2010, 101,029 gigawatt hours. Do you have any particular information about what you referred to as declining load?

A. No. Again, just what has been submitted in the evidence in this case.

Q. Do you believe that regulatory lag offers the utility an appropriate incentive to be efficient and save costs between rate cases?

A. No, not necessarily. Regulatory lag, you know, as I said covers many sins. It covers many changes of events, both in terms of the addition of new rate base, additional costs, changes in load, changes in load profile. In my view, the most appropriate vehicle for both reviewing and measuring corporate efficiency or utility efficiency is by the kind of analysis, the benchmarking analysis I have performed. I don't think you can count on that sort of interstitial or intertemporal period between rate cases as necessarily being representative of an incentive to achieve efficiency or indicating whether the company has or hasn't achieved sufficient efficiency.

Q. Would you agree that FPL has been, generally speaking, highly profitable for the 25 years between fully litigated rate cases?

A. I would say it has been a strong financial performer. Again, it has managed its costs well, it has managed its capital expenditures well, and it has had a supportive regulatory environment. I think all of those things have contributed to being -- it has been a financially strong utility, which is a good thing.

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

CHAIRMAN CARTER: Thank you, Mr. Wright.

Mr. Wiseman.

MR. WISEMAN: No questions, Your Honor.

CHAIRMAN CARTER: Staff.

MS. BROWN: Commissioner, we just have one exhibit to enter into the record. The parties have agreed to it. It is FPL's Response to Staff's Ninth Set of Interrogatories Number 130, and it is found on Page 5, Item 7 of staff's comprehensive exhibit list.

CHAIRMAN CARTER: Now, that is in lieu of any cross-examination?

MS. BROWN: Yes.

CHAIRMAN CARTER: Okay. When we finish and go to exhibits we will deal with that.

MS. BROWN: All right. That's fine.

CHAIRMAN CARTER: Okay.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chair. Just one quick follow-up question, Mr. Reed. I guess your rebuttal testimony discusses how overall management excellence should be, I guess, rewarded for lack of a better term. Does your analysis take into account in any way existing mechanisms that this Commission already uses to address operational excellence?

THE WITNESS: I am certainly very familiar with the regulatory framework, the ratemaking framework within Florida. I'm not aware of any way in which operational excellence finds its way into the ratemaking process other than through consideration of this type of analysis in a rate case.

COMMISSIONER SKOP: Are you familiar with our fuel docket, annual fuel docket?

THE WITNESS: Yes, I am.

COMMISSIONER SKOP: Okay. Are you familiar with in the context of that docket that there is GPIF, or generating performance incentive factor that rewards operational excellence for meeting certain generational criteria?

THE WITNESS: Yes, I am aware that there is that mechanism within the fuel docket.

COMMISSIONER SKOP: Okay. So that would be one mechanism of rewarding a company for having its generating units operate at high performance levels, is that correct?

THE WITNESS: I think in terms of high availability and low forced outage rate, I think that is correct.

COMMISSIONER SKOP: Okay. But if the primary function of the utility is to generate electricity, certainly that is one of the big parts absent transmission and distribution of actual delivery, but generation is a big part of what a typical electric utility company does, is that correct?

THE WITNESS: It is. Of course, it is not the part -- at least the fuel component that we have talked about in the fuel case is not the component that we are here today to talk about in base rates, which is why my mechanism really focused on base rates.

COMMISSIONER SKOP: Okay. Are you also familiar with other revenue sharing mechanisms and various clauses that the Commission uses?

THE WITNESS: I am familiar with revenue sharing in terms of the most recent rate case settlements, if that is what you are speaking of.

COMMISSIONER SKOP: Okay. I guess how would you distinguish -- again, certainly FPL is a large electric utility, and they do have certain functional areas. Again, you have the generating group and distribution, transmission, customer service, and I know that your -- the context of your rebuttal was to look at overall performance. How would you, you know, characterize an overall rating, if you will? Do you have you to look at the individual aspects of each of those functional areas, or could you provide some sort of, I guess, guidance on how you would arrive at what you concluded in your testimony?

THE WITNESS: Yes. And if I could, I would refer you to Exhibit JJR-6 in my direct. Beginning at Page 15 of 47 in those workpapers, you can actually look at these charts and see the performance by functional area of the company, production, both fossil and nuclear. And within the O&M and A&G categories you can look at, for example, customer collection, accounting, and sales expense, you can look at labor, you can look at A&G, you can look at the transmission function and you can look at the distribution function.

What is so striking to me is that the company really -- while it was not necessarily the top performer in every category, it is consistently a top performer in all of these categories, meaning one of the top three or four. So it achieves its number one overall ranking in the data that we have not by being first in every category, but by being a top performer in every category. And, again, that is even with the challenge that it has of serving a very residential intensive service territory, of relatively small customers, virtually no heavy industrial load, and being a very transmission dependent company.

We set these charts out individually so that you could, in fact, look by function and see if there was, you know, for example, a strong performance in one area and a weak performance in the other area. There really is no area in which there is a weak performance.

COMMISSIONER SKOP: Okay. And just one final question. On the exhibit entitled JJR-13, which is the large graph to your left, I guess you are comparing the savings that FPL has incurred on nonfuel O&M expenses in relation to benchmarking against other companies in similarly situated groups.

Do those savings -- I'm trying to figure out how to say this in a concise manner. You are showing a correlation between, I think, over a billion dollars in savings in O&M costs versus the impact of, you know, giving them 50 additional basis points in ROE kind of as an ROE adder or moving them up into the upper range. With respect to the savings that have been incurred, aren't those, you know, as a result of proposals that the company has brought forth to this Commission that the Commission has approved with sound regulatory policy that has enabled those savings to be achieved?

THE WITNESS: Certainly it has been supported by a favorable regulatory environment, but I would say that there are lots of companies in the group, especially of 28 utilities, that are in favorable regulatory environments. And as you will recall, one of the groups that we have measured the performance against is the regional group, which is all Florida. So, certainly all of those companies have also benefited from the strong regulatory environment, the favorable regulatory environment historically here in Florida.

Again, just to make sure we are talking about the same thing in terms of the measured savings there. What is shown on the chart is how much higher FPL's nonfuel O&M costs would have been if it had been an average performer, meaning performing at the mean of each of those other study groups, the 28 straight electrics, the large utilities, and the regional utilities. So the billion to 1.5 billion represents the savings each year relative to where it had been if it had been an average performer.

Certainly, with regard to the Florida utilities, that is actually the biggest differential, that is the 1.5 billion. And the other Florida utilities have also, you know, been operating here under a relatively constructive and favorable regulatory environment. So I think whether you look at the Florida group, the large group, or the straight electric group, it is a very consistent message, very, very, substantial savings versus what they would have achieved if they were performing at the mean level.

COMMISSIONER SKOP: I guess just one follow-up, you know, in terms of, you know, doing the job and delivering electricity to its customers in the most cost-effective manner as possible. Wouldn't you expect some of these savings to occur by virtue of prudently running or managing your company as would happen in the normal course of business, and why would there be an additional need to further incentivize as an adder over and above what has been previously testified to the appropriate ROE range?

THE WITNESS: I have two comments on that. The first is that I view prudence as being independent of management performance. I mean, typically a regulatory commission will only allow the recovery of prudently incurred costs. So if the costs aren't prudently incurred, they get disallowed, period. What we are talking about here is allowing costs that are prudently occurred and then recognizing management performance and return on equity.

So, let's accept that what we see in the costs here of all of these utilities are prudently incurred or they would have been written off, they would have been disallowed in the ratemaking process. Then, how do we recognize performance above and beyond the mean, not just slightly, but actually far above and beyond the mean. And in that regard, my answer is to why you should recognize that for a regulated utility is because we are largely with regulation trying to replicate the result that would have occurred in a competitive environment. We are acting as a surrogate or a substitute for competition and for a competitive marketplace. I can assure you in a competitive marketplace management excellence counts. Management excellence absolutely determines whether you are able to achieve an above average return.

Having at least some measure of that, not the full capture of the billion dollars of savings, but at least some recognition of that in return on equity I think does what this Commission should do, which is to align the interests of ratepayers and investors. Both benefit. Certainly, ratepayers right now benefit dramatically, the billion dollars from FPL's excellent performance. Having some small share of that, in this case potentially 60 million out of the billion, accrue to management, accrue to I should say the investors, I think is consistent with aligning the interests of customers and investors.

COMMISSIONER SKOP: Okay. Just one final question. In light of rewarding management performance, aren't the individual managers, as well as the executive managers, properly rewarded with their total compensation package that the cost of which FPL has sought to recover in its base rates?

THE WITNESS: Yes. And I want to be clear, we are not talking about rewarding management here; we are talking about providing, if anything, recognition of performance in establishing the return on equity that goes to investors, that goes specifically to equity investors. We are not talking about paying bigger bonuses to management. We are not talking about having higher compensation levels. It is all about demonstrating to the investor that the investor will also see some benefit from a truly exceptional performance by the management team.

COMMISSIONER SKOP: Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioners, anything further from the bench?

Redirect.

REDIRECT EXAMINATION

BY MR. ANDERSON:

Q. A couple of quick questions. One of them is staff offered into evidence Interrogatory 130, which you responded to, is that right?

A. Yes.

Q. And that interrogatory asked if you performed an analysis that demonstrates a cause and effect relationship between a higher authorized ROE and higher productive efficiency ranking, is that right?

A. Yes.

Q. Your response to the question, which staff just put in the record or will offer, was Mr. Reed has not performed an analysis, is that right?

A. That is correct.

Q. Why is that?

A. The question asked about a cause and effect relationship between a higher ROE and productive efficiency, and I certainly don't think that higher ROEs create higher productive efficiency, so we didn't try to capture that. There is actually no causal link between those two.

I suppose if the question was meant to be the other way around, is there a causal link between higher productive efficiency and higher authorized returns, I would say that at best that is a very, very loose relationship because so many other factors come into the equation. The degree of leverage the company has, the regulatory environment in which the company operates, the mix of generation that the company has, for example, how much of it is nuclear. Those kinds of things really overwhelm the effect of management performance frequently when you try and examine differences in allowed returns on equity. But I answered the question the way it was posed, which is is there any cause and effect relationship between higher ROEs and productive efficiency. And I think the answer to that is clearly that there is not.

Q. I think it was Mr. Moyle asked you some questions concerning TECO and the adjustments to equity and purchased power agreements, do you recall that?

A. I do.

Q. Okay. Specifically, I think in the TECO case, and I have the decision pages here if you need to refer to them, I think what the Commission did is they rejected a pro forma adjustment to equity requested by TECO, is that right?

A. That is my recollection, yes.

Q. Okay. Can you tell us, if you know, how FPL's request is different from TECO and why it is reasonable?

A. FPL is not requesting that the Commission add, basically add on something to its equity ratio or its return on equity to allow for the imputation of debt costs associated with PPAs. All it is saying is you should understand when you examine the actual equity ratio of the company that the effects of PPAs are reflected in how the company establishes its actual equity ratio. It is not seeking something above and beyond the actual level. So it is different from Tampa. It is different, in fact, from Progress in how it is handling this issue. It is simply saying we are seeking recovery of the actual equity ratio which has been influenced by that factor or should be considered in light of that factor.

MR. ANDERSON: We have no further questions for the witness. Thank you.

CHAIRMAN CARTER: Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chair. I missed one, and I will give Mr. Anderson the ability to redirect if necessary.

Mr. Reed, on the exhibit that you asked me to refer to in your direct testimony, JJR-7.

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Which I believe shows some benchmarking by functional area, is that correct?

THE WITNESS: Actually, it is Exhibit JJR-6. I hope I didn't misspeak. It is 6, beginning on page -- I think it is 17. Give me just a moment. Beginning on Page 15 of 47 is where the productive efficiency by function is measured.

COMMISSIONER SKOP: Okay. I guess if I could just turn your attention to JJR-7, it would probably be quicker this way.

THE WITNESS: Okay.

COMMISSIONER SKOP: I guess that was a productive efficiency and situational assessment for the year 2007 for FPL alone?

THE WITNESS: Yes, showing its position -- ranked position relative to the different peer groups.

COMMISSIONER SKOP: Okay. For the bottom table, which is FPL 2007 productive efficiency, do you see the row entitled Labor Efficiency?

THE WITNESS: I do.

COMMISSIONER SKOP: Okay. And do you see rank and large utility group of three of seven?

THE WITNESS: I do.

COMMISSIONER SKOP: Okay. Can you briefly explain what labor efficiency is a measure of in relation to that large utility peer group?

THE WITNESS: The measure is the same across all of the peer groups, and it is actually explained -- the definition of that term is on Exhibit JJR-6, Page 3 of 47. And it is a measure -- it is a combination of two different labor efficiency measures. One is employees per 1,000 customers. And, obviously, the fewer employees you have per 1,000 customers, the more efficient you are. And the second is salaries, wages, pensions, and benefits per employee. And that is, again, the more efficient is the lower total compensation per employee. So it is a combination of those two measures.

COMMISSIONER SKOP: Okay. So, in relation to the rank in the large utility group being three out of seven, could that be some indication to the extent that either, one, they are not as lean as they might otherwise be, or, two, that their salaries, wages, pensions, and benefits per employees were higher than necessary?

THE WITNESS: Three means they are above average, of course. One would be the top. Three is slightly above average out of the group of seven.

COMMISSIONER SKOP: Okay.

THE WITNESS: When you take that in the combination of the regional market, which is the Florida utilities, they achieve the top score out of the four utilities, investor-owed utilities in the state. And they are right on the verge of the top quartile in the straight electric group. So I think taking all three measures together indicates that they are doing a very good job in that category.

COMMISSIONER SKOP: Okay. And just one question with respect to the regional group, and I don't want to rehash your direct testimony. I thought I heard previously that regional was in the southeastern states. Am I misunderstanding that? Is it strictly limited to Florida utilities?

THE WITNESS: It is all four are in Florida.

COMMISSIONER SKOP: All right. Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioners, anything further?

Exhibits. Let's go to Page 27.

Mr. Anderson.

MR. ANDERSON: Thank you, Chairman Carter. FPL offers Exhibits 168 to 179 into evidence.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit Numbers 168 through 179 admitted into the record.)

CHAIRMAN CARTER: Hang on one second, Mr. Anderson, before you go to the next.

Commissioners, let's go to Page 43.

Mr. Anderson, you're recognized.

MR. ANDERSON: FPL offers Exhibit 381 into evidence.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit Number 381 admitted into the record.)

CHAIRMAN CARTER: Let's go to the back pages.

Mr. Moyle, Exhibit 537.

MR. MOYLE: I move it into the record, please.

CHAIRMAN CARTER: Are there any objections?

MR. ANDERSON: No.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit Number 537 admitted into evidence.)

CHAIRMAN CARTER: Mr. Wright.

MR. WRIGHT: I move 538, Mr. Chairman.

CHAIRMAN CARTER: Are there any objections?

MR. ANDERSON: No.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit Number 538 admitted into evidence.)

CHAIRMAN CARTER: Staff and parties, is there anything further for this witness?

MS. BROWN: Yes, Commissioner.

CHAIRMAN CARTER: There you go. I knew that.

MS. BROWN: Page 5. Staff would move FPL's Response to Staff's Ninth Set of Interrogatories Number 130. It has been stipulated. It is Item 7 of the comprehensive exhibit list.

CHAIRMAN CARTER: Are there any objections?

MR. ANDERSON: None.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit admitted into the record.)

CHAIRMAN CARTER: Anything further, Ms. Brown?

MS. BROWN: No, sir.

CHAIRMAN CARTER: Okay. Anything further for this from any of the parties or staff?

Thank you, sir, you may be excused.

THE WITNESS: Thank you.

CHAIRMAN CARTER: Call your next witness.

MR. BUTLER: We call our next and final witness, Mr. Deason, testifying on rebuttal.

CHAIRMAN CARTER: Okay. And I know he has already been sworn. I saw him this morning when I swore in the witnesses as a group. I see you got the blue shirt and the yellow tie memo.

THE WITNESS: I hope I am in uniform, Mr. Chairman.

CHAIRMAN CARTER: Yes, you are.

MR. MOYLE: Mr. Chairman, before Mr. Deason takes the stand --

CHAIRMAN CARTER: Okay. Mr. Moyle, you're recognized.

MR. MOYLE: I have consulted with the intervenors and would like to make a joint motion on behalf of the Retail Federation, the Attorney General's Office, and the South Florida Hospital Association that -- and with all due respect to Mr. Deason, you know, largely everything that he testifies about has already been testified about by other witnesses. And a review of the issues listed by witnesses will reflect that there has been numerous, numerous witnesses that talk about every issue that Mr. Deason is talking about.

In no case is there only one witness who has talked about issues Mr. Deason has talked about. It is either two or three other witnesses have already talked about the issues. And in his summary, he talks about the subsequent year adjustment. We have heard about that. The appropriate regulatory treatment for theoretical depreciation reserve surplus, we had the witness on the stand for hours today talking about that. Equity ratio, you have had financial witnesses talking about that. GBRA, we have had tons of witnesses talking about that. And incentive compensation, Ms. Slattery spent about -- you know, many hours talking about that, and FPL has removed some of that.

So, you know, again, with all due respect, I think this is repetitive, redundant, and ought to not move forward. There is a rule of civil procedure that permits parties or the court to move to strike redundant material, so we would make that motion. And I don't know if any of my colleagues have anything to add, but I was, for the purposes saving time, trying to make it on behalf of everyone. I haven't talked to Mr. McGlothlin, but --

CHAIRMAN CARTER: Mr. McGlothlin.

MR. McGLOTHLIN: It is not my motion.

CHAIRMAN CARTER: Okay. And you have talked to the other intervenors, right, Mr. Moyle?

MR. MOYLE: Yes.

CHAIRMAN CARTER: Okay.

Mr. Butler, to the motion.

MR. BUTLER: Thank you, Mr. Chairman. First of all, I think it is phenomenally late to be made at this point in the proceeding. You know, Mr. Deason's testimony was filed on August 6th. We had our prehearing conference eons ago. There is a provision in the order establishing procedure to make motions to strike, you know, before the prehearing conference. You know, nothing has been brought up until this point, so I think it is very inappropriate to be raising it at this time.

Mr. Deason's testimony touches on topics that other witnesses certainly have also testified to, but it does so both different substance and from a different perspective, that of somebody who has had a great deal of experience and expertise with the specifics of this Commission's regulation of these subjects, so I don't think that it is cumulative to other testimony. I certainly think that all parties have had an adequate opportunity to prepare for and respond to it, and do not think that the motion is either timely or substantively warranted.

Having said that, I was prepared to and do continue to intend to withdraw specifically the section of Mr. Deason's testimony that relates to the subject of incentive compensation, you know, that being the subject of FPL's adjustment that it agreed to make with respect to executive incentive compensation. It doesn't seem that that portion of his testimony needs to be included in the record or otherwise the subject of the proceeding. And that appears specifically on Page 29, Line 10, through Page 31, Line 3 of his rebuttal testimony.

CHAIRMAN CARTER: Okay.

Mr. Teitzman.

MR. TEITZMAN: Mr. Chairman, in the order establishing procedure, Section 60, it specifically states that motions to strike any portion of the prefiled testimony and related portions of exhibits of any witness shall be made in writing no later than the prehearing conference. Motions to strike any portion of prefiled testimony and related portions of exhibits at hearing shall be considered untimely absent good cause shown. I don't believe Mr. Moyle has made any argument regarding cause or good cause.

I would also note that as far as what the APA states regarding repetitious evidence, it says it has to be unduly repetitious. And I don't believe that they have made the case for unduly either.

CHAIRMAN CARTER: Okay. Overruled.

MS. BRADLEY: Mr. Chairman.

CHAIRMAN CARTER: Ms. Bradley.

MS. BRADLEY: Just for the record, we were asked this afternoon to try to come up with anything we could do to shorten these proceedings because people were ready to be through with it. And I know you said you will give it whatever time is necessary, but in response to that request we started looking at it. And since this was a witness that other people, multiple other people have testified to the same thing, we thought it would be cumulative and redundant and that was the purpose behind this motion. As Mr. Moyle has repeatedly said, it is no offense to Mr. Deason or anything concerning him, but an effort to shorten the proceedings. I think it was at this point that Progress withdrew their last witness for this very reason.

And as to the timeliness, well, that order also talks about no late-filed exhibits and all exhibits have to be identified by the pretrial, and that has been repeatedly broken. So it is -- you know, it seems like we are upholding some of the parts of the order, but not others, so -- but I will abide by your ruling.

CHAIRMAN CARTER: Okay. My ruling stands, but maybe this will be a short cross-examination. You know, maybe it can be a real short examination since you guys don't see a whole lot of information other that redundancy. Let's see where we go with this.

My motion -- my ruling stands.

Mr. Butler, you may proceed.

MR. BUTLER: Thank you, Mr. Chairman.

TERRY DEASON

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

DIRECT EXAMINATION

BY MR. BUTLER:

Q. Would you please state your name and business address for the record, Mr. Deason?

A. Yes. My name is Terry Deason. My business address is 301 South Bronough Street, Suite 200, Tallahassee, Florida.

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

A. I am employed by the firm Radey, Thomas, Yon and Clark as a consultant specializing in utility matters.

Q. Thank you. Have you prepared and caused to be filed in this proceeding 33 pages of rebuttal testimony?

A. Yes, I have.

Q. Do you have any changes or corrections to make to it?

A. I have no corrections to the testimony.

Q. If I asked you the same questions that appear in that testimony today, would your answers be the same?

A. Yes, they would.

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

CHAIRMAN CARTER: Mr. Butler, before I do that, the information on incentive compensation, did you want to withdraw that?

MR. BUTLER: I'm sorry. Yes, I mentioned it, but I should have said formally at this point, yes.

CHAIRMAN CARTER: Okay.

MR. BUTLER: We would be inserting into the record Mr. Deason's prefiled rebuttal testimony, except for the portions from Page 29, Line 10, through Page 31, Line 3, which is the portion that relates to incentive compensation.

CHAIRMAN CARTER: Okay.

THE WITNESS: And, Mr. Butler, in relation to that, on Page 3, Line 1, the term incentive compensation should be deleted there, as well.

MR. BUTLER: Good catch. Thank you.

CHAIRMAN CARTER: Okay. Let's do that. With the revision as presented, the prefiled testimony of the witness will be inserted into the record as though read.

MR. BUTLER: Thank you, Mr. Chairman.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF TERRY DEASON

DOCKET NO. 080677-EI

AUGUST 6, 2009

Q. Please state your name and business address.

A. My name is Terry Deason. My business address is 301 S. Bronough Street, Suite 200, Tallahassee, Florida 32301.

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

A. I am employed by the law firm Radey Thomas Yon and Clark as a Special Consultant specializing in the fields of energy, telecommunications, water and wastewater, and public utilities generally.

Q. Please describe your educational background and professional experience.

A. I have over thirty-two years of experience in the field of public utility regulation spanning a wide range of responsibilities and roles. I served a total of seven years as a consumer advocate in the Florida Office of Public Counsel on two separate occasions. In that role, I testified as an expert witness in numerous rate proceedings before the Florida Public Service Commission. My tenure of service at the Florida Office of Public Counsel was interrupted by six years as Chief Advisor to Florida Public Service Commissioner Gerald L. Gunter. I left the Florida Office of Public Counsel as its Chief Regulatory Analyst when I was first appointed to the Florida Public Service Commission in 1991. I served as

Commissioner on the Florida Public Service Commission for sixteen years, serving as its chairman on two separate occasions. Since retiring from the Florida Public Service Commission at the end of 2006, I have been providing consulting services and expert testimony on behalf of various clients, including public service commission advocacy staff and regulated utility companies, before commissions in Arkansas, Montana, New York and North Dakota. My testimony has addressed various regulatory policy matters, including: regulated income tax policy; storm cost recovery procedures; austerity adjustments and prudence determinations for proposed new generating plants and associated transmission facilities. I have also testified before various legislative committees on regulatory policy matters. I hold a Bachelor of Science Degree in Accounting, summa cum laude, and a Master of Accounting, both from Florida State University.

Q. Are you sponsoring an exhibit?

A. Yes. I am sponsoring the following rebuttal exhibit:

- TD-1, Biographical Information for Terry Deason

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to offer my opinion and recommendation as to certain assertions made by Office of Public Counsel witnesses Brown, Pous and Woolridge, Florida Industrial Power Users Group witness Pollock and South Florida Hospital and Healthcare Association witnesses Baudino and Kollen. My rebuttal testimony addresses the appropriate regulatory treatment of a theoretical depreciation reserve surplus, the critical role of subsequent year rate adjustments, the proper equity ratio for Florida Power & Light (FPL or the Company), the

Generation Base Rate Adjustment (GBRA), incentive compensation and the benefits of a regulatory approach which recognizes and rewards superior performance.

THEORETICAL RESERVE SURPLUS

Q. What is a theoretical reserve surplus?

A. As the name implies, it represents the difference between the amount of accumulated depreciation that theoretically should exist, based upon current estimates of asset lives and salvage values, and the amount of accumulated depreciation that has actually been booked. When the theoretical amount is less than the booked amount, there is a theoretical surplus. When the opposite is true, there is a theoretical deficit.

Q. Why is the amount of the reserve surplus or deficit referred to as theoretical?

A. It is theoretical because it is not based upon actual booked amounts of accumulated depreciation and the corresponding actual depreciation rates that have been ordered by the Commission. It is an estimate, based upon what is believed to be the current parameters of asset lives and salvage values, compared to actual booked amounts.

Q. Is it uncommon for there to be theoretical reserve surpluses or deficits?

A. No, reserve surpluses or deficits are routine and to be expected.

Q. Why are they not uncommon?

A. Estimating asset lives and salvage values is not an exact science. The assumptions and forecasts used to establish these parameters change with the passage of time and are impacted by factors beyond the control of utility management and utility regulators. This is why the Commission requires periodic depreciation studies for electric utilities to be filed every four years.

Q. What are some of the factors which can impact depreciation parameters?

A. There are many such factors. They include "wear and tear," obsolescence, environmental impacts, governmental requirements, changes in technology and economic changes. All of these factors can have significant impacts on the need for early retirements of some assets and the potential for extensions of the useful lives of other assets.

Q. What does a theoretical reserve surplus represent in a regulatory sense?

A. It is best to answer this question by clarifying what a theoretical reserve surplus does <u>not</u> represent. It does not represent a "pool of cash" sitting in an account which can be tapped to fund refunds or to fund the provision of utility service below the cost to provide that service on a going forward basis. Neither does a theoretical reserve surplus represent over-billings to customers for past service.

Q. Witness Pous states that a utility has an incentive to favor higher depreciation expense and higher depreciation reserves. Do you agree?

A. No, I do not agree. A utility's incentive is to deploy capital when needed, to earn a fair return on that capital and to recoup that capital in the form of ratable depreciation allowances. Because the source of profit for a regulated utility is an authorized rate of return on shareholder supplied capital in rate base (invested capital), it would be counter to its own interest to prematurely erode its earnings base by excessive depreciation rates. Only if a utility were earning a non-compensatory return would there be an incentive to prematurely recover capital from one investment and redeploy it where a compensatory return could be earned. I do not believe that witness Pous is suggesting that FPL's past earned return or its requested authorized return is non-compensatory.

Q. What method does the Commission employ to set depreciation rates?

A. The Commission has generally relied on the remaining life approach.

Q. What is the remaining life approach?

A. As the name implies, it is an approach that uses the remaining life of an asset over which to depreciate the remaining (undepreciated) cost of an asset, net of any salvage.

Q. Why does the Commission rely on the remaining life approach?

A. It is a generally accepted method and has the advantage of being self correcting. By this I mean that the method acknowledges that there can be either theoretical reserve surpluses or deficits and that these can be corrected over the remaining lives of the assets in question. By this method, there are not large single-year swings in depreciation expense. This is also consistent with the Commission's policy to require comprehensive depreciation studies every four years.

Q. Are there other principles by which the Commission has historically set depreciation rates?

A. Yes, there are three broad principles that the Commission has relied upon when setting depreciation rates. The Commission has historically used these principles to reach reasonable results. First, the Commission has used the principle of matching costs and benefits. This principle is consistent with the purpose of depreciation, to recognize the utilization of an asset (cost) ratably with the service it provides over its useful life (benefit). Adherence to the remaining life method is consistent with this principle.

Second, the Commission has historically made decisions to protect customers for the long term. This is particularly true in the case of theoretical reserve deficits, where the Commission has attempted to eliminate them in recognition of the fact that theoretical reserve deficits can have long term cost impacts by increasing rate base.

Third, the Commission has maintained a separation between the setting of depreciation rates and their immediate impacts on rates. Stated differently, the Commission has not allowed impacts on rates to be the primary driver in setting depreciation rates. Rather, depreciation rates have been set based upon depreciation studies and objective estimates of lives and salvage values, not as part of a base rate proceeding. This has the advantage of promoting greater objectivity in setting depreciation rates.

Q. Is it inappropriate to set depreciation rates concurrently with the setting of base rates in a rate proceeding?

A. It is not inappropriate to do so. The establishment of depreciation rates and their impact on base rates can be reflected simultaneously. However, the temptation to have depreciation rates set according to their impacts on base rates, and not the consistent application of generally accepted depreciation practices, should be avoided.

Q. What is being recommended by witnesses Kollen, Pollock and Pous in this proceeding?

A. These witnesses take slightly different approaches, but all three recommend a rapid flow through of the theoretical reserve surplus in order to achieve a large short term but unsustainable reduction in FPL's revenue requirements.

Q. Do you agree with their recommendations?

A. I do not. Their recommendations violate the three principles I earlier identified. Their recommendations constitute a significant deviation from the generally accepted and long established use of the remaining life method to set depreciation rates. Their recommendations also have the effect of rapidly flowing through theoretical benefits to the long term detriment of the general body of ratepayers. Their recommendations also appear to be driven by the temptation to have depreciation policy driven by immediate base rate impacts, which is fundamentally the wrong approach.

Q. Why do their recommendations appear to be driven by immediate base rate impacts?

A. Their recommendations to rapidly flow back the difference between the theoretical reserve and the booked reserve is conveniently aided by two facts.

The theoretical reserve is currently in a surplus position, and FPL is seeking a base rate increase. If either of these two factual situations were changed, I am not sure we would see the same recommendations from these witnesses, i.e., to eliminate the deficit over a short period of time by significantly raising depreciation expense, with a commensurate increase in base rates.

Q. Why do you believe the recommendations would differ?

A. If the theoretical reserve were in a deficit position, their recommendations to set aside the self-correcting function of the remaining life method would have the effect of <u>increasing</u> base rates above what they otherwise would be. If FPL were not in a base rate proceeding, their recommendations would result in a rapid amortization of the theoretical reserve with no beneficial impact on base rates. If FPL were to file for a base rate increase after the rapid amortization of the theoretical reserve surplus were completed, there would be no surplus available for recognition at that time. I do not believe that the intervenors would find either of these scenarios acceptable. The impacts of these scenarios illustrate the better policy of setting depreciation rates on the consistent application of a generally acceptable methodology (remaining life in this case) and avoiding setting depreciation rates on their immediate and potentially volatile impacts on base rates.

Q. Witness Pous asserts that the Commission has a long and identifiable policy of correcting material reserve imbalances by amortizing the reserve differences over periods much shorter than the remaining life of the investment. Do you agree?

A. I agree that the Commission on occasion has amortized theoretical reserve deficiencies. However, I disagree with the characterization that this is a long and identifiable policy which should dictate how FPL's theoretical reserve surplus should be treated in the present case.

Q. Does witness Pous cite Florida cases to support his assertions?

A. Yes, he cites three specific cases, one involving a telephone company, one involving a gas utility and one involving FPL. However, a closer reading of these cases and the facts surrounding the decisions do not support witness Pous' claim of an identifiable policy which should control in the present case. I note that all of these cases involved the consideration of theoretical reserve deficits outside the scope of a base rate proceeding, thus with no corresponding increase in customer rates to accommodate the rapid elimination of the deficit. These are significantly different factual situations from the present case.

The General Telephone Company case (Docket No. 840048-TL) took place during the 1984-85 time period. At that time, the Commission had just transitioned away from the whole life to the remaining life depreciation methodology. There was a controversy over whether the Federal Communications Commission could or would preempt Florida in the setting of intrastate depreciation rates. In addition, the Commission was concerned about substantial developments in the areas of technology and competition that had the potential to result in significant amounts of stranded investment. Within this context, the Commission decided to amortize a theoretical reserve <u>deficit</u> of $32 million over five years. I believe the Commission's decision was influenced by two considerations. First, given all of the uncertainty at the time, it was inconclusive that the self-correcting function of the remaining life approach would be sufficient to correct the theoretical reserve deficit. Second, consistent with a principle I earlier identified, the Commission took steps to mitigate the long term rate base impacts of a reserve deficit, outside of a rate proceeding and, therefore, without increasing customer rates to reflect these changes.

The City Gas Company case (Docket No. 890203-GU) took place in 1989. Again, this case involved a theoretical reserve deficit outside of a rate proceeding. The Commission decided to retain the benefit of an already existing annual expense of $48,000 to be applied to the theoretical reserve deficit. By taking this action, the Commission observed that it would "correct that overstatement of rate base in seven years, rather than the 19 years remaining under the present amortization pattern." Again, the motivation was to more quickly eliminate the rate base impacts of a reserve deficit, outside of a base rate proceeding and, again, without a corresponding increase in base rates.

The cited electric case (Docket No. 970410-EI) involved FPL in a relatively unique factual situation in 1997. The Commission had two years earlier approved a plan, outside of a base rate proceeding, to eliminate perceived deficits in nuclear production accounts. The subject of the 1997 case was whether the existing plan should continue, but in a modified manner. The backdrop at that time involved two major considerations. First, there was much debate in Florida, and actual movement in other jurisdictions, to transform the electric industry to a competitive market. With this trend, there was a justified concern that significant amounts of investment would become stranded. Second, FPL was experiencing strong growth in customers and sales (materially different from the current situation). This enabled the Commission to direct revenues received above certain thresholds to be applied toward eliminating the potential stranded investment. The Commission was fully cognizant of the material impacts stranded investment was having in other jurisdictions and saw an opportunity to address this looming problem, outside of a base rate proceeding. The Commission approved the plan and issued it as proposed agency action (PAA). Within the PAA order, language was added essentially stating that the terms of the plan could be altered or terminated in the event the retail electric market in Florida was deregulated. The Commission's decision to approve the plan had the effect of reducing FPL's rate base in the long term, the benefits of which are reflected in the current case.

Obviously, the unique factual situation I just described distinguishes this case from the present case. This 1997 case does not support the action recommended by witness Pous to flow through a theoretical reserve surplus. In the present case, there is the opportunity for the self-correcting function of the remaining life method to address the theoretical reserve surplus, particularly given the large amounts of investment that I understand the Company is making over the next few years. In the 1997 case, the Commission had a sense of urgency that moves toward retail electric competition would preclude the opportunity to allow the self-correcting function of the remaining life approach to address stranded investment.

Q. What is your recommendation in this case?

A. I recommend the consistent application of the remaining life approach.

Q. If the Commission were to follow your recommendation, would the benefits of the theoretical reserve surplus be lost?

A. No, not at all. Consistent application of the remaining life approach recognizes an immediate and significant reduction of rate base and an immediate and significant reduction in annual depreciation expense. This reduces customer rates, both now and in the long term. Therefore, the beneficial effects are recognized without the significant rate fluctuations inherent in the intervenors' approach.

SUBSEQUENT YEAR ADJUSTMENT

Q. Witnesses Kollen and Pollock recommend that the Commission reject the requested subsequent year adjustment. Do you agree?

A. No. I do not agree for a number of policy and factual reasons.

Q. Why do you disagree as a matter of policy?

A. The Commission has statutory and rule authority to consider subsequent year adjustments and to set rates accordingly. A company seeking a subsequent year increase, or an affected party seeking a subsequent year decrease, must show with reasonable certainty that there will be future changes sufficient to justify the subsequent year rate change. As such, the use of subsequent year adjustments is a valuable and useful regulatory tool that is necessary for the Commission to meet its statutory obligations to all parties. To reject out-of-hand the use of a subsequent year adjustment, as witnesses Kollen and Pollock suggest, would eliminate this tool and be inconsistent with established regulatory policy in Florida.

Q. Why is the use of a subsequent year adjustment a valuable regulatory tool?

A. The use of a subsequent year adjustment can minimize or eliminate regulatory lag for a longer period of time, without the need for back-to-back rate cases.

Q. What is regulatory lag?

A. Regulatory lag is the period of time from when a change in rates (up or down) is needed and when the rate change can be legally implemented. It can have a significant impact on a utility's ability to earn its authorized return when capital expenditures and inflation are high. Regulatory lag is inherent in the regulatory process, and ways to minimize its impacts should be part of good regulatory policy. Subsequent year adjustments are an accepted and recognized method of addressing forecasted financial and operating conditions that affect a utility's opportunity to earn the approved rate of return.

Q. Has the Commission previously used subsequent year adjustments to set rates?

A. Yes, the Commission has done so and the use of subsequent year adjustments has become standard practice in Florida.

Q. Has the use of subsequent year adjustments been a recent development in Florida?

A. No, subsequent year adjustments have been used as far back as 1984. In a case involving FPL (Docket No. 830465-EI, Order No. 13537), the Commission not only determined that it had the legal authority to consider a subsequent year adjustment, the Commission determined that a 1985 "subsequent year" was appropriate to use to set rates.

This determination was appealed to the Florida Supreme Court in Floridians United for Safe Energy, Inc. v. Public Service Commission, 475 So.2d 241 (Fla. 1985). In its decision approving the use of the subsequent year, the Court explained:

> At the heart of this dispute is the authority of the PSC to combat "regulatory lag" by granting prospective rate increases which enable the utilities to earn a fair and reasonable return on their investments. We long ago recognized that rates are fixed for the future and that it is appropriate for PSC to recognize factors which affect future rates and to grant prospective rate increases based on these factors.

Q. Should the Commission simply reject the subsequent year adjustment being requested by FPL in this proceeding?

A. No. The Commission must give the proposed subsequent year adjustment due consideration as a matter of precedent and policy and not reject it out-of-hand.

The Commission has an obligation to scrutinize the subsequent year request and approve a subsequent year rate change, if it is justified based on the information provided by the Company.

Q. In response to a previous question, you responded that there are also factual reasons for why you disagree with the recommendation to reject the use of a subsequent year adjustment. What are your factual reasons?

A. In his testimony, witness Pollock makes a number of factual assertions, interposed with some policy implications. I disagree with these assertions and discuss their policy implications.

Q. Would you please elaborate?

A. Yes, I will. On page 33 of his testimony, witness Pollock states, "Rates should not be set on speculation about the future." First, it is a given that rates are set prospectively and to best establish future rates you must consider future costs and future revenues. If by use of the term "speculation" witness Pollock is stating that rates should not be set on unsubstantiated and unscrutinized future data, I agree. However, FPL is not proposing such in its subsequent year adjustment. FPL is fully aware that its data must be substantiated and will be thoroughly scrutinized. To that end, FPL has filed a complete set of Minimum Filing Requirements and supporting testimony consistent with Commission requirements. Only if the merits of the filing are considered by the Commission, can a proper assessment of the proposed subsequent year adjustment be done. Witness Pollock's recommendation is to simply reject the analysis of the case FPL has filed. This is not an appropriate regulatory response.

On page 32, witness Pollock states that FPL is really asking the Commission to guarantee that it will achieve the authorized return and that such a guarantee is contrary to accepted regulatory practice. I agree that regulatory policy does not include a "guarantee" of a specific authorized return, but it does include a reasonable opportunity to earn the authorized return. I strongly disagree that FPL's requested subsequent year adjustment constitutes a guarantee. FPL is merely asking the Commission to review its operations and costs in the subsequent year and to set rates appropriately. FPL must then manage its business with the rates granted and hopefully earn a reasonable return. This is certainly not a guarantee.

On page 34, witness Pollock asserts that the rates from the subsequent year adjustment "may be in effect for a long time and ratepayers may be paying more than necessary." Even in the unlikely event that rates were to be set too high, I disagree with witness Pollock's assertion that rates could be too high <u>and</u> that the rates would continue for a long time. This assertion totally ignores the Commission's comprehensive earnings surveillance program and its historical propensity and alacrity to initiate rate decreases when earnings are excessive. What is missing from witness Pollock's statement is an understanding that the purpose of the subsequent year adjustment is to have fair rates that are in existence for a long time. If that is the result, regulation will have done its job. A necessary and valuable tool to do its job should not be discarded as witness Pollock suggests.

On page 38, witness Pollock states that Florida utilities may file for a limited proceeding. I agree that this is available to Florida utilities and that limited proceedings can serve a useful purpose in Florida's regulatory scheme. However, I disagree with the assertion that a limited proceeding is a satisfactory substitute for a comprehensive review of operations and earnings contemplated within the subsequent year adjustment. It is ironic that a limited proceeding, which has been so vehemently criticized by a number of intervenors historically for its lack of comprehensiveness and earnings review, is now being suggested to be a satisfactory substitute for a comprehensive subsequent year adjustment.

And lastly, on pages 33 and 39, witness Pollock asserts that the use of cost recovery clauses substantially limits the need for the subsequent year adjustment. This assertion is incorrect. The existence or nonexistence of a cost recovery clause is not relevant to the need for a subsequent year adjustment to set base rates. Recovery clauses are designed to permit recovery, where justified, of specific costs which are not considered in base rates and not part of a base rate proceeding. Witness Pollock incorrectly asserts that the recovery of a non-base rate cost in a non-base rate proceeding is grounds for ignoring an otherwise legitimate base rate cost in a legitimate base rate proceeding. This assertion is mixing apples and oranges.

EQUITY RATIO

Q. In a regulatory context, what is meant by the term equity ratio?

A. Equity ratio is the ratio of equity capital to all investor supplied capital (which includes equity capital, preferred stock and debt). The equity ratio can be stated on an "actual" basis, which does not reflect the very real considerations of off-balance sheet obligations, or on an "adjusted" basis, which does reflect the off-balance sheet obligations.

Q. How is the equity ratio used in the rate making context?

A. The equity ratio is part of a regulated utility's capital structure and is assigned a cost factor commensurate with the cost to obtain and compensate equity investors for the use of their capital. When combined with all other sources of capital in the capital structure and their respective cost rates, an overall weighted cost of capital is derived. It is this overall weighted cost of capital which is multiplied by a company's rate base to yield its required net operating income.

Q. Is it the "actual" equity ratio or the "adjusted" equity ratio that is used in the capital structure to determine the overall weighted cost of capital?

A. Normally it is the actual equity ratio as reported on the utility's books. Of course, the Commission has the ability to adjust the actual equity ratio, up or down, for ratemaking purposes and to make reconciling adjustments to remove non-rate base components such that rate base and the capital structure can be equalized.

Q. What then is the relevance of an equity ratio that is adjusted for off-balance sheet obligations?

A. As I indicated earlier, off-balance sheet obligations are very real and should be considered as the debt equivalents they are. The adjusted equity ratio reflects these debt equivalents and can be used to compare equivalent equity ratios across companies with varying levels of off-balance sheet obligations. Thus, an adjusted equity ratio can be used to judge the relative reasonableness of a company's actual equity ratio.

Q. Should an adjusted or hypothetical equity ratio be used in a regulated utility's capital structure to determine its overall weighted cost of capital?

A. As a general rule, an adjusted or hypothetical equity ratio should not be used in the capital structure. Absent a showing of imprudence regarding its actual equity ratio, the actual equity ratio should be used to determine the overall weighted cost of capital. In fact, the Commission has stated a preference for using the actual capital structure and equity ratio and has recognized the need for a regulated utility to manage its capital ratios. In Docket No. 71342-EU, the Commission confirmed the use of Gulf Power's actual capital structure and actual equity ratio and stated:

> Nevertheless, capital structures basically fall within the prerogatives of management because of the impact that capital ratios exert on the ability of a utility to maintain its credit and attract capital. Management lives from day-to-day with the intricate and complex problems of corporate finance, and has the responsibility of seeing that the utility has the financial ability to meet its service obligations. The invasion of this field of

management is justified only when the public interest requires the exercise of extreme measures for its protection (sic) and benefit.

Q. What equity ratios do witnesses Baudino, Pollock and Woolridge recommend?

A. The specific equity ratios vary by witness, but they all recommend that FPL's actual equity ratio be adjusted downward, in some cases quite significantly.

Q. What impacts do their recommendations have?

A. As they describe in their respective testimonies, the impact is to reduce FPL's revenue requirement, all other things being equal. Witness Pollock quantifies the impact of his recommended equity ratio to be about $192.9 million. This is an extremely large adjustment for just one component of the capital structure.

Q. In your previous answer, you used the phrase "all other things being equal." Do you think it is realistic to hold all other things equal when making such large adjustments to FPL's actual equity ratio?

A. No, I do not. When making such large adjustments to something so integral to the ratemaking process, it would be unreasonable to expect all other things to remain equal.

Q. What would change if the Commission were to adopt such large adjustments to FPL's actual equity ratio?

A. To adequately answer this question, it is necessary to review the history of FPL's actual equity ratio and the Commission's decisions affecting it.

In Docket No. 990067-EI the Commission set an upward limit on FPL's adjusted equity ratio of 55.83%. The Commission acknowledged the very real debt equivalent of the off-balance sheet obligations by stating the upward limit in terms of an adjusted equity ratio. The Commission also acknowledged that the off-balance sheet obligations could change over time and that the equity ratio limit stated in terms of an adjusted equity ratio was more dynamic and meaningful. It also gave FPL better guidance from its regulators in managing its actual equity ratio. The resulting actual equity ratio from this upward limit was then used to monitor FPL's earnings. The Commission subsequently reaffirmed its use in FPL's 2002 Stipulation and Settlement, Docket No. 001148-EI and its 2005 Stipulation and Settlement, Docket No. 050045-EI.

By these actions, the regulatory process in Florida, which includes FPL, the Commission and all of the signatories to the Stipulation and Settlements, sent a strong and clear message to the investment community that FPL's financial integrity would be maintained by the use of a strong, but reasonable, equity ratio. These actions also sent a strong and clear message to FPL's customers that FPL would remain a financially strong utility with the capability to meet its obligation to provide safe and reliable service, even in the face of uncertain challenges that it may face.

A significant departure from this long standing policy on equity ratio, as recommended by witnesses Baudino, Pollock and Woolridge, would send a negative message to the investment community with potential negative consequences for customers. Instead of being a win-win situation, it could quickly become a lose-lose situation.

Q. What challenges did FPL and its ratepayers face during the intervening years since the Commission adopted the use of FPL's adjusted equity ratio?

A. The challenges have been many and in some cases quite extreme. These challenges have been identified and discussed in greater detail by other witnesses. However, I will list some of the substantial challenges: an increase in the number and severity of hurricanes impacting FPL's service territory; an increase in the level and volatility of fuel prices; the need to provide increased reliability through additional base load generation while maintaining FPL's significant progress in limiting CO_2 emissions; and the most severe economic downturn since the great depression. Throughout these challenging times, FPL maintained access to capital on reasonable terms enabling FPL to deploy capital to meet the needs of its customers and provide savings through increased efficiencies. All of this was done while FPL's base rates remained unchanged.

Q. Can the successes of meeting these challenges be solely attributable to FPL's equity ratio?

A. Of course not. However, I am convinced that the Commission's guidance on the appropriate equity ratio and FPL's management of its equity ratio consistent with that guidance was and continues to be a significant and integral component of the successes that were and continue to be achieved.

Q. You referred to FPL's consistent management of its equity ratio. Why is this significant?

A. It is significant for a number of reasons. First, it signifies the importance FPL places on regulatory compliance. Second, it shows that FPL is committed to and understands the importance of maintaining its financial integrity for its own benefit as well as its customers. FPL could have taken steps to temporarily enhance its earnings by allowing its equity ratio to decline between rate reviews. However, FPL chose not to sacrifice its long term financial integrity for temporary earnings enhancements. In essence, FPL's actions clearly denote the importance of maintaining financial integrity through a strong but reasonable equity ratio.

Q. Now that FPL has found it necessary to seek a base rate increase, can customers afford to continue FPL's equity ratio?

A. Now is the time that customers can least afford a reduction in the equity ratio as suggested by witnesses Baudino, Pollock and Woolridge. As I indicated earlier, such significant declines in the equity ratio will have adverse consequences for customers which could be long term in nature. I believe that any temporary benefits in lower rates will be short lived by comparison.

Q. The intervenor witnesses state that the equity component of the capital structure is the highest cost component. Is this correct?

A. It is true that equity has a higher cost than debt. However, the assertion that the equity component should be minimized to lower the overall cost is misplaced. Significant reductions in the equity ratio will increase FPL's financial risk and its cost of capital, both debt and equity. This could have the unintended consequence of raising FPL's overall weighted cost of capital, not lowering it.

The goal of a proper equity ratio and capital structure is to minimize the overall weighted cost of capital and maintain consistent access to capital on reasonable terms, even in the face of severe capital needs such as storm restorations. By this standard, FPL's equity ratio and capital structure have performed well and met the goal.

Q. Witness Pollock recommends that FPL's equity ratio be reduced to an average of A-rated electric utilities. Witness Baudino recommends that FPL's equity ratio be adjusted downward to the low end of a range suggested by a Standard & Poor's ratio analysis matrix. Are these approaches appropriate?

A. No, they are not. The goal should not be to set the standard at an average or at the low end of a range to achieve average or low end results. The goal should be to set it at a level that helps a utility achieve superior results at average rates. This has been the result of the Commission's current equity ratio standard for FPL.

Q. How then should the Commission approach the setting of FPL's equity ratio?

A. The Commission should determine whether its current policy of setting FPL's equity ratio should be changed. In taking this initial step I would urge extreme caution. The Commission should avoid the temptation to unnecessarily change a proven and consistent approach for the allure of temporary and perhaps illusory base rate impacts. To put it in the vernacular, "If it ain't broke, don't fix it."

Extreme caution is warranted for two reasons. First, the Commission's policy for setting FPL's equity ratio is long standing and has been clearly communicated to all affected parties, including the intervenors, the company's customers and its stockholders. Changing such an entrenched regulatory policy upon which affected persons have grown to rely causes uncertainty and all of the negative consequences accompanying uncertainty. Second, the existing policy has yielded significant positive benefits for both investors and customers. It should not be discarded in a cavalier manner.

FPL's equity ratio should be evaluated on FPL specific risk factors, including FPL specific off-balance sheet obligations. This risk evaluation should be done to yield an equity ratio that truly minimizes FPL's overall rate of return and not just the weighting of the equity component. To reduce the equity ratio and have the cost of debt and equity increase is not necessarily a good result. And lastly, I would urge the Commission to not simply rely on utility averages or low-end ranges as witnesses Baudino and Pollock suggest.

GENERATION BASE RATE ADJUSTMENT (GBRA)

Q. What is GBRA?

A. GBRA is a regulatory tool developed in conjunction with the 2005 Stipulation and Settlement. It provides a reasonable means, within established parameters, to facilitate cost recovery of prudent and cost efficient generating assets outside the scope of a base rate proceeding.

Q. What are those parameters?

A. The parameters to which I refer can also be thought of as safeguards. The safeguards within GBRA include:

- GBRA's applicability is limited to power plants approved pursuant to the Florida Power Plant Siting Act (PPSA).
- Rate adjustments pursuant to GBRA cannot become effective until after the commercial in-service date of any applicable power plant.
- The amount of the GBRA must be confirmed by the Commission using the Capacity Clause projection filing process.
- Any capital costs below projections must be flowed back via a true-up to the Capacity Clause.

Q. Why is it a significant safeguard that GBRA projects must be approved pursuant to the PPSA?

A. It is significant because of the rigorous process and the high standards that must be met under the PPSA, which include determinations that the power plant is needed and that it is the most cost effective alternative. I have personally participated in twenty-five "Need Determinations" in Florida under the PPSA and know this to be the case.

Q. Witness Kollen criticizes the GBRA as being "without the normal regulatory scrutiny and resulting cost-control discipline." Do you agree?

A. I do not. As I just stated, any project eligible for GBRA must have been determined, by this Commission, to be needed and to be the most cost effective alternative. In addition, there are provisions within GBRA that limit costs above those approved pursuant to the PPSA. GBRA does not limit regulatory scrutiny. GBRA is a tool to facilitate cost recovery outside of a base rate proceeding which includes necessary regulatory scrutiny.

Q. Why is it important that this regulatory tool be available to the Commission?

A. There are at least five significant policy reasons. First, generating plants are large investments which can have an immediate and material impact on a utility's rate base once the plant reaches commercial operation. In regulatory jargon, they are "lumpy" investments, meaning they do not occur every year but have significant impact when they do occur. GBRA can provide fair, efficient and timely cost recovery without the potential of a base rate proceeding (that is not otherwise needed) every time a new power plant reaches commercial operation.

Second, GBRA places initial cost recovery of a new generating unit on a more consistent basis as that afforded purchased power agreements. Thus, GBRA can act as a means to "level the playing field" when considering which different types of capacity additions to pursue.

Third, GBRA allows the planning, construction and operation of a new generating unit, and the reliability benefits and fuel savings it brings, to be done without having to coordinate it with the planning, filing and litigation of a base rate proceeding. Management should be free to optimize the deployment of new generating units to maximize customer benefits. GBRA provides a means to provide reasonable cost recovery so that this can be facilitated.

Fourth, GBRA provides a more efficient and consistent method to match the benefits and the costs of new generating capacity. This is particularly true for the potentially large savings from reduced fuel costs that will be immediately reflected in the fuel adjustment clause.

Fifth, GBRA facilitates the sending of timely and accurate price signals to customers. New generation, even though efficient with significant fuel savings, is capital intensive with upward pressure on rates. The impact of new generation needs to be communicated to customers through correct and timely price signals. This enables customers to make better decisions about cost effective conservation and demand side management programs and alternatives.

Q. Witness Brown states that the GBRA would transfer risks from FPL to its ratepayers. Do you agree with this characterization?

A. No, I do not. The real issue is not one of risk transfer. A regulated utility, by law and policy, has the obligation to serve and to deploy capital as needed. Ratepayers have an obligation to pay for the cost of the services they consume, including the cost of new power plants. Thus the real issue is how regulation can best facilitate each party to meet its respective obligations. The GBRA does this. If one were to inappropriately put the issue in terms of risk, I believe GBRA minimizes risk for both parties. Without GBRA, the only reasonable means to accomplish timely and accurate cost recovery is through the filing of numerous base rate proceedings. In my judgment, this could place ratepayers at greater risk.

Q. **How could this place ratepayers at greater risk?**

A. With GBRA, there is the distinct likelihood that rate increases that otherwise could be justified would be deferred or foregone. Without GBRA, they are more likely to be filed along with their associated rate case expense. In addition, ratepayers would lose the cost protections in GBRA which limit costs to those approved in a PPSA proceeding.

INCENTIVE COMPENSATION

Q. **Witness Brown recommends disallowances of 50% of FPL's incentive compensation costs because they benefit shareholders. Do you agree?**

A. I do not agree. Compensation to employees is a necessary cost of providing safe, efficient and reliable service to customers. As such, 100% of reasonable compensation costs should be included for ratemaking purposes. The fact that a portion of the compensation is based upon attaining performance criteria is not relevant.

Q. **Is this true even if some of the performance criteria are tied to metrics which may increase shareholder value?**

A. Yes, the regulatory principle is the same. Reasonable and necessary compensation costs should be included in rates. What is missing from Ms.

Brown's argument is recognition of the fundamental regulatory principle that shareholder interests and customer interests should be aligned. Incentive compensation does this. Ms. Brown attempts to pit shareholders' interest and customers' interests against each other, which is inappropriate and counterproductive.

Q. How is Ms. Brown's recommendation inappropriate?

A. The recovery of any reasonable and necessary cost benefits both shareholders and customers. Shareholders are reasonably compensated and customers get an essential service at a reasonable cost. The fact that the level of the compensation is based upon earnings criteria does not violate this relationship. In fact, it enhances the relationship because it can have the long term benefit of reducing costs.

Q. How is Ms. Brown's recommendation counterproductive?

A. Incentive compensation is a generally accepted and proven means of increasing employee productivity and retaining the most qualified and goals-oriented employees. This provides significant benefits to customers. Not recognizing 50% of the incentive compensation would be a strong and clear message to utility management that these benefits are not valued and that incentive compensation plans should be discontinued.

Q. If incentive compensation plans were discontinued would utility customers' rates be lower?

A. No, they would not be. Employees would still need to be compensated at a reasonable level, through a higher level of fixed compensation. In fact, discontinuing incentive compensation plans could have the unintended result of increasing rates because of lost productivity, lost efficiencies and higher employee turnover.

SUPERIOR PERFORMANCE

Q. Has the Commission ever used its discretion to reward a utility for superior performance?

A. Yes, the Commission has done so in the past. However, the Commission has set a relatively high bar before doing so.

Q. Witness Baudino recommends that no consideration be given to FPL's superior performance in setting its allowed return on equity. Do you agree?

A. No, I do not agree. Using the possibility of a reward is a useful regulatory tool that can be used to obtain significant benefits for customers. Even though Florida has set a high standard, the fact that Florida has a policy of rewarding superior performance has resulted in benefits to Florida customers. The use of such a valuable regulatory tool should not be dismissed as witness Baudino suggests.

Q. Why does witness Baudino recommend against consideration of a reward for superior performance?

A. Witness Baudino provides several reasons in his testimony. I disagree with all of them.

First, witness Baudino states that ratepayers should expect exemplary management. Given that FPL's management has performed in an exemplary manner over a sustained period of time, I can understand that this can be perceived as normal and could become an expectation. However, sustained past performance should not be taken as an expectation. I do agree that ratepayers have a reasonable expectation of competent management and a level of satisfactory service. The real issue is whether the correct use of an accepted regulatory tool can result in performance significantly above competent and satisfactory.

Witness Baudino also states that a reward would over-compensate investors. I do not believe this has been the case in Florida. Florida sets the allowed return on equity within a range. Any return within the allowed range is deemed reasonable. Therefore, any return within the range that recognizes superior performance would not over compensate investors.

Witness Baudino asserts that a reward would result in excessive rates to ratepayers. This is where I have the most disagreement with witness Baudino's reasoning. A properly structured reward for truly superior performance would not result in excessive rates. To the contrary, such a reward would result in rates lower than they otherwise would be. What is lost in witness Baudino's assertion is that a properly structured reward can have a multiplier effect.

Q. What do you mean by the term multiplier effect?

A. I use this term to describe the potentially large benefits that can inure to customers in the form of better service and improved efficiencies from a relatively small investment in a properly structured reward. In essence, the value of the benefits becomes a multiple of the investment. Witness Reed's testimony addresses the specifics of the benefits to which I generally refer.

Q. Does this conclude your testimony?

A. Yes, it does.

BY MR. BUTLER:

Q. And, Mr. Deason, did you also prepare an exhibit to your testimony?

A. Yes, I did.

Q. And do you have any changes or corrections to make to it?

A. No, I do not.

MR. BUTLER: Mr. Chairman, I would note that is Exhibit TD-1, and it has been pre-identified or premarked for identification as 382.

CHAIRMAN CARTER: That is on Page 43, Commissioners, on Page 43.

You made proceed, Mr. Butler.

MR. BUTLER: Thank you.

BY MR. BUTLER:

Q. Please summarize your rebuttal testimony, Mr. Deason.

CHAIRMAN CARTER: Mr. Deason, are you familiar with our light system here?

THE WITNESS: Yes, Mr. Chairman.

CHAIRMAN CARTER: It's really high-tech.

You may proceed.

THE WITNESS: Thank you, sir.

The purpose of my rebuttal testimony is to offer my recommendations in response to certain assertions and positions taken by intervenor witnesses. My rebuttal testimony addresses the appropriate regulatory treatment of a theoretical depreciation reserve surplus, the critical role of subsequent year adjustments, the proper equity ratio for FPL, the generation base rate adjustment, or GBRA, and the benefits of a regulatory approach which recognizes and rewards superior performance. I will briefly summarize my testimony on each of these beginning with the theoretical depreciation reserve surplus.

The Commission uses the remaining life approach to set depreciation rates. This approach is broadly accepted because it establishes stable rates that are self-correcting. FPL has used the remaining life approach in this case, but the intervenor witnesses recommend setting it aside and aggressively amortizing the theoretical reserve surplus. This is fundamentally the wrong approach and will be harmful to customers.

My rebuttal testimony identifies the principles that the Commission has consistently followed in setting depreciation rates and shows that the intervenor recommendations are inconsistent with these principles. The intervenor recommendations are focused on immediate impacts, which are unsustainable and counterproductive to protecting customers' best interests. The best approach is to consistently follow the remaining life approach, which has already provided significant benefits to customers and will continue to do so on a consistent and sustainable basis.

A subsequent year adjustment is a valuable regulatory tool that is consistent with the Commission's regulatory policies. It has its foundation in both statute and rule, and has been identified as a means to address regulatory lag by the Florida Supreme Court.

My rebuttal testimony addresses a number of assertions made by FIPUG Witness Pollock regarding the subsequent year adjustment. I show that his assertions are either incorrect or have inappropriate regulatory implications.

The generating base rate adjustment, or GBRA, is also a beneficial regulatory tool needed to facilitate cost recovery of prudent and cost efficient generating assets outside of a base rate proceeding. I identify and explain the consumer safeguards that are contained in the GBRA, and continue by explaining the significant policy reasons which call for the continued use of the GBRA mechanism in this proceeding.

I also address the Commission's longstanding and successful regulatory approach to setting FPL's equity ratio, and how the Commission has appropriately considered the debt equivalency of off-balance sheet obligations associated with purchased power. The resulting equity ratio has benefited customers by allowing FPL to weather financial, as well as real storms along with other challenges. The Commission should not discard its proven approach for the allure of temporary base rate impacts.

Finally, my rebuttal testimony addresses the need to recognize superior performance. Good regulatory policy should have a mechanism for recognizing superior performance for a regulated company. Such an approach would result in better service at lower rates in the long-term.

That concludes my summary.

MR. BUTLER: I tender the witness for cross-examination.

CHAIRMAN CARTER: Thank you.

Mr. McGlothlin.

MR. MOYLE: Mr. Chairman, could we just have two minutes real quick?

CHAIRMAN CARTER: Sure. Let's do this, Commissioners, let's give the parties -- how about we come back at a quarter of.

Mr. Moyle, will that give you appropriate time?

MR. MOYLE: I don't need much.

CHAIRMAN CARTER: A quarter of. We are on recess.

(Off the record.)

CHAIRMAN CARTER: We are back on the record.

Mr. Moyle, you're recognized.

MR. MOYLE: First of all, I wanted to thank you for a brief accommodation for us to have a conversation amongst our colleagues. I think Mr. McGlothlin is up, but I think Mr. Wiseman, while he has enjoyed his time in Tallahassee, is desirous of getting back to Washington tonight, so I think if he could go first, Mr. McGlothlin.

MR. McGLOTHLIN: I had indicated to Mr. Wiseman earlier that I would defer to him so he could possibly make his travel arrangements.

CHAIRMAN CARTER: Okay. Mr. Wiseman, you're recognized.

MR. WISEMAN: Thank you very much. Thank you, Mr. McGlothlin. And let me say as much as I enjoy it here in Florida, honoring the rule that was established earlier that you must obey your wife's instructions, I need to get out of here. Thank you.

CROSS EXAMINATION

BY MR. WISEMAN:

Q. Good evening, Mr. Deason.

A. Good evening.

Q. Congratulations on finally getting up here.

A. It has been a long time coming, Mr. Wiseman.

Q. It really has. Well, I am going to try to make this quick, and I will tell you in advance, I am just going to go over some things we discussed with in your deposition, if that helps.

Could we start at Page 6 of your testimony, specifically Lines 1 to 2. Do you have that?

A. Yes, I do.

Q. Okay. Now, there you state that there are three broad principles that the Commission has relied upon in setting depreciation rates, do you see that?

A. Yes, I do.

Q. And the first principle that you refer to is down on Lines 3 and 4. It is the principle of matching costs and benefits, is that correct?

A. Yes.

Q. All right. Now, I want to talk about that principle a little bit. You are familiar with the term intergenerational inequity, correct?

A. Yes, I am familiar with the term.

Q. And would you agree that the term intergenerational inequity applies where there is a disconnect between the time that benefits are provided and the utility's recovery of the costs associated with providing those benefits?

A. Yes. I believe that is the definition I gave during my deposition. It may not be the best artfully worded definition, but I think it is accurate enough for our discussion.

Q. Great. I thought it was accurate and articulately stated by you.

A. Thank you, sir.

Q. Would you agree that an intergenerational inequity could occur where ratepayers pay through rates for a facility that does not provide them any benefits, but that facility provides benefits to a subsequent set of ratepayers?

A. Let me see if I understand your question. There is the facility that is providing -- that is not providing benefits currently, but will be providing benefits in the future, and as to whether that creates a generational inequity?

Q. If the current ratepayers pay for the cost of that facility, that is correct.

A. Based upon that limited information, I cannot conclude that there would be a generational inequity. Under that limited scenario that you just provided, it would be difficult for a regulated utility to be able to add new efficient generation to its rate base and to be able to recover part of the construction work in progress associated with that, which is Commission policy when it can be shown that it is in the financial -- it's needed from a financial integrity standpoint. See, there are other matters beyond just intergenerational inequity which guide good regulatory policy.

Q. Well, let's try it this way. Let me give you -- I actually didn't refer to a generation facility in my question, but let's try something more specific. Would you agree that if the remaining life of a facility were set for depreciation purposes at less than the facility's actual remaining life, that that could lead to an intergenerational inequity?

A. First of all, I am going to make some further assumptions so that I can answer your question. If you are stating that the regulatory body set a depreciation rate consciously, that they set that rate on a remaining life less than what they knew was the best information available to them at the time, well, then I think that would be -- that would result in an intergenerational inequity.

On the other hand, if the Commission uses the best information available to it at the time to set that parameter and sets depreciation rates accordingly, and then subsequent to that for some reason that is beyond the control of regulation or beyond the control of management, that life is somehow changed, I would not say that that is an intergenerational inequity.

Q. Fair enough, but I want to make clear that my question was based upon the first scenario that you referred to where the depreciation rate was set based upon the best information available at the time which assumed that there would be a longer remaining life. So, I believe your answer in the context of that scenario was, yes, there would be an intergenerational inequity, correct?

A. If their depreciation rate is deliberately set based upon an inappropriate life, well, then, yes, I think that there would be -- the result would be an intergenerational inequity.

Q. Right. And the intergenerational inequity would occur because current ratepayers would -- or an earlier set of ratepayers, let's say, would be subsidizing the costs of a subsequent set of ratepayers, right?

A. Yes, because you set rates on a prospective basis, that sets the cost of the service that customers are consuming. If you intentionally set that cost or set that rate to recover a cost above that level, well, then, yes, I would agree.

Q. All right. Now, I believe you told me during the deposition that you agreed that when a utility commission is setting rates among the other policies that it should take into account is the policy concerning intergenerational inequity, correct?

A. I think intergenerational inequity is a consideration which should be made by a regulatory body. There are other considerations as well that need to be considered in establishing good regulatory policy. But, yes, it is one.

Q. All right. Now, can you refer to Page 5 of your testimony, please, specifically Lines 14 through 19.

A. Yes.

Q. Now, there you are referring to the remaining life approach to depreciation, correct?

A. Yes, I am.

Q. And you state that one advantage of the remaining life approach is that there are not large single year swings in depreciation expense, correct?

A. That is correct.

Q. Now, would you agree that it is important to prevent swings in rates, significant swings in rates from one year to the next?

A. Given Florida's approach to setting depreciation rates, I agree with that. Florida has a process wherein depreciation studies are required to be filed and reviewed by the Commission every four years. So following that procedure, one would not expect there would be large swings in depreciation rates from one year to the next.

Q. Well, my question was not necessarily related specifically to PSC regulation. I was asking you a question of general ratemaking -- a general ratemaking policy is that utility commissions try to prevent rate shock, right?

A. I think it is -- no, not necessarily. I think rate shock, like intergenerational inequity, is a consideration, but I'm not so sure it is the primary consideration. The primary consideration is to set rates on a going-forward basis to recover costs, to give a utility a reasonable opportunity to earn a return, and so that is the primary consideration. One would hope that that process of setting rates can be done in a way that you do not have large rate increases in any one year, but sometimes that is an impossibility.

Q. But you would agree that if there is going to be rate shock, that is at least a consideration that the Commission should take in account -- into account in determining what the appropriate rate level is, is that fair?

A. Only if there is a means wherein the going-forward costs that are anticipated to be in effect when the rates are in effect. Should that consideration ever be made, the first priority is to make sure that the cost of service is being recovered in rates.

Q. All right. Could you turn to Page 27 of your testimony, please?

A. Yes.

Q. Do you have that? Then take a look at Lines 7 through 10. First of all, you are talking about the GBRA in that testimony, right?

A. Yes, I am.

Q. And then at 7 to 10 you are discussing a number of policy reasons that you say are significant policy reasons why this is an important regulatory tool for the Commission, right?

A. Yes, that is correct.

Q. And the first one that you refer to there, starting on Line 8, is that generating plants are large investments which can have an immediate and material impact on a utility's rate base. Do you see that?

A. Yes, I do.

Q. All right. Now, would you agree that if the capital costs associated with an asset were about $800 million or more, that you would consider that level of investment at a magnitude that would have an immediate material impact on rate base?

A. Yes, I would.

Q. Okay. So would you agree, then, that an impact of approximately $800 million is of a sufficient magnitude that the Commission should take that value into account in setting rates?

A. Well, first of all, let me say -- answer your question by saying yes, but there is a responsibility for customers -- first of all, for a utility to be able to go and obtain capital deployment and put in facilities to serve customers. And then there is a responsibility for customers to pay for those facilities in their rates. So, it doesn't have to reach a threshold of 800 million to trigger that requirement. In fact, any dollar so expended there is a responsibility, if it is properly incurred, for those costs to be recovered on a prospective basis through rates.

Q. All right. Now, could you turn to Page 13 of your testimony, please? Specifically, if you could take a look at Lines 11 through 13.

A. I'm sorry, Page 13?

Q. Page 13, Lines 11 through 13.

A. Yes.

Q. Okay. Now, you are discussing the concept of regulatory lag there, right?

A. Yes.

Q. And I believe you say that regulatory lag is a period when a change in rates up or down is needed, is that correct?

A. Well, it is the time period from when there is a need to change rates and the time that elapses before that change can be implemented.

Q. So would you agree that regulatory lag concerns a period when a utility is underrecovering its costs or it could involve a period where a utility is overrecovering its costs, right?

A. Yes, it could include either situation.

Q. Okay. And you would agree that good regulation should attempt to eliminate regulatory lag, right?

A. Yes, I agree.

Q. Okay. Now, can you turn to Page 12 of your testimony. At Lines 17 to 19, that is where you discuss your disagreement with Witnesses Kollen and Pollock concerning the subsequent year adjustment, right?

A. Yes.

Q. Okay. Now, am I correct that you haven't reviewed the information and data that FPL submitted in support of its request for a subsequent year adjustment in this particular case, is that true?

A. I have reviewed it in the sense of being a consultant in this case. I have not reviewed it in the sense of whether I am recommending a specific rate request that it is appropriate. I have not reviewed it to that level of detail.

Within my review I am consistent that the -- that the amount of information, the type of information that has been filed in this case has been consistent with the type of information that has been filed in previous cases wherein the Commission has deemed that information sufficient upon which to consider granting a subsequent year adjustment. So, I want to make that distinction. But, no, it is not the purpose of my testimony to vouch for or somehow indicate that it is my opinion that the amount of the requested increase in the subsequent year adjustment is the correct amount.

Q. All right. And then if we could move to one last area, Page 19 of your testimony. At Lines 1 to 2, you refer -- you refer there to off-balance sheet obligations. Do you see that?

A. Yes, I do.

Q. And those off-balance sheet obligations are FPL's power purchase agreements, right?

A. Yes.

Q. Okay. And you haven't conducted a contract-by-contract review of FPL's power purchase agreements to determine whether the capacity payments in those agreements are above or below market, isn't that right?

A. That is correct, and I don't think it is necessary to make a determination such as that to make a determination of the credit quality impacts of a high level of purchased power agreements.

MR. WISEMAN: Thank you very much, Mr. Deason. And thank you, Mr. McGlothlin, for allowing me to precede you.

CHAIRMAN CARTER: Thank you, Mr. Wiseman. Have a safe trip.

Mr. McGlothlin.

CROSS EXAMINATION

BY MR. McGLOTHLIN:

Q. Good evening, Mr. Deason.

A. Good evening.

Q. There is some advantage to being the last witness, because like the other lawyers, I have been trying to cull questions, and eliminate questions, and some questions that seemed very important earlier in the process don't seem quite as important now. So I am going to attempt to be brief, but I do have a few things to ask you.

To begin with, please turn to Page 3 of your testimony.

A. Yes.

Q. The first two questions that appear under the topic of theoretical reserve surplus are: What is a theoretical reserve surplus; and why is the amount of the reserve surplus deficit referred to as theoretical. Do you see those questions and answers?

A. Yes, I do.

Q. You are familiar with the Commission's rules governing depreciation practices of the regulated electrics, are you not?

A. I am generally familiar with them.

Q. I am going to ask Mr. Poucher to distribute a handout that consists of the depreciation rules.

CHAIRMAN CARTER: You don't need a number, then, do you?

MR. McGLOTHLIN: No.

CHAIRMAN CARTER: Okay. That's fine.

BY MR. McGLOTHLIN:

Q. Do you have that, Mr. Deason?

A. Yes, I do.

Q. Please turn to Rule 25-6.0436, depreciation, the definition section.

A. Yes.

Q. And would you agree with me that under Sub (h) and Sub (i) the rules define terms reserve deficiency and reserve surplus?

A. Yes, I see that.

Q. And would you agree with me that the definitions in the Commission rules do not incorporate the word theoretical when referring to the reserve deficiency or reserve surplus?

A. I agree that the term theoretical does not appear where the term reserve deficiency and the term reserve surplus, where those terms are defined.

Q. Now, at Page 4, Line 13, if you will turn to that. The question posed to you is what does the theoretical reserve surplus represent in a regulatory sense? And in your answer you say it is best to answer this question by clarifying what a theoretical reserve surplus does not represent. And you proceed to identify two things that the reserve surplus does not constitute or incorporate, do you not?

A. That is correct.

Q. But in your answer you don't say what it does represent, do you, in terms of the affirmative expression or identification of the reserve surplus?

A. No, I do not include that.

Q. Now, let's look at the same rule and read what the Commission's definition indicates the reserve surplus represents in a regulatory sense. Would you read Subsection (i), the definition of reserve surplus?

MR. BUTLER: I'm sorry. I'm going to object. Madam Chairman, the rule has, as Subsection (k) a discussion of theoretical reserve. And to the extent that Mr. McGlothlin is wanting to refer to the rule's conversation on the subject of theoretical reserve, it seems like he ought to refer to the right subsection.

COMMISSIONER EDGAR: Mr. McGlothlin.

MR. McGLOTHLIN: My question relates to the discussion in the witness' testimony where he was asked the questions that are specific to reserve surplus. And I am pointing to the rule that defines surplus and distinguish his discussion versus what the Commission has promulgated by rule.

COMMISSIONER EDGAR: I'll ask the witness to try to respond.

THE WITNESS: Okay. Can you repeat your question?

MR. McGLOTHLIN: Yes.

BY MR. McGLOTHLIN:

Q. Would you read the definition of reserve surplus under Sub (i)?

A. Reserve surplus in excess in the reserve of a category as evidenced by a comparison of that reserve indicated as necessary under current projections of life and salvage with that reserve historically accrued. The latter figure may be available from the utility's records or may require retrospective calculation.

Q. At Page 3, Line 21, you say that reserve surpluses or deficits are routine and to be expected. You would agree, would you not, that the objective of depreciation practice is to have no difference between the theoretical reserve and book reserve?

A. That would be an ideal situation. It rarely occurs. But, yes, if when an asset is closed to plant-in-service and we could determine its useful life with 100 percent certainty, well, then, that would be the result. But obviously we know that that is a difficult proposition and rarely does it occur in reality.

Q. Would you expect that a reserve surplus in the amount ranging from $1.25 billion to $2.7 billion would be routine and to be expected?

A. Yes.

Q. Would you agree that the purpose of the periodic review of depreciation studies and the setting of depreciation rates is to have a series of midcourse corrections that would either eliminate or, at least, reduce the difference between the book reserve and the theoretical reserve?

A. Well, I need to clarify. It is not the purpose of the periodic depreciation reviews to correct a reserve one way or the other. The purpose of the review is to determine on a going-forward basis what the depreciation rate should be, with the purpose, primary purpose in mind being that the cost, the remaining undepreciated cost of the asset is to be recovered over its then estimated remaining life.

By that exercise, it has the effect, particularly in the remaining life approach of eliminating any surpluses or deficits. But it is a mechanism of the process of setting the rates on a going-forward basis. The goal being that at the time that that asset -- its useful life is expired, that its net plant value has been 100 percent depreciated.

Q. You refer in your testimony to the remaining life methodology as self-correcting, do you not?

A. Yes, I do.

Q. Your recommendation and the recommendation of others who have appeared for the company is that the existing reserve surplus be addressed via application of the remaining life methodology, is that right?

A. Yes.

Q. Would you agree that where circumstances have warranted in the past, the Commission has used approaches other than remaining life to address the status of the reserve of a particular utility?

A. I would agree that it has happened under unique factual situations, and it has primarily been in the case of deficits where the Commission has looked at those deficits, made a determination as to how they originated, what was the cause, and whether those deficits needed to be corrected outside of the confines of a base rate proceeding and within the earnings of the company at the given time with the idea that that would protect customers by eliminating the deficit, reducing rate base on a going-forward basis without any increase in rates.

Q. You were a Commissioner when the Commission approved the settlement agreement that concluded the 2002 rate case, were you not?

A. Yes.

MR. McGLOTHLIN: I am going to ask Mr. Poucher to distribute a document now.

CHAIRMAN CARTER: Just for cross-examination, Mr. McGlothlin?

MR. McGLOTHLIN: I couldn't hear you, sir.

CHAIRMAN CARTER: The document that Mr. Poucher is distributing, it's just for cross-examination purposes.

MR. McGLOTHLIN: We will need -- yes, for cross-examination. We will need an exhibit number for this one.

CHAIRMAN CARTER: Okay. If you need a number, that number will be 539. Commissioners, for the record, 539. A short title?

MR. McGLOTHLIN: Transcript, Special Agenda Conference.

(Exhibit Number 539 marked for identification.)

CHAIRMAN CARTER: You may proceed, Mr. McGlothlin.

BY MR. McGLOTHLIN:

Q. Mr. Deason, we provided you what has been marked as 539, the transcript of the special agenda in Docket Number 001148. Do you have that available to you?

A. Yes, I have that.

Q. Now, you will recall that at the time the Commission took up its consideration of the proposed settlement agreement, or what was at that point a proposed settlement agreement, the parties presented the settlement agreement at a meeting with the Commissioners, and this a transcript of that meeting. Do you recognize it as such?

A. Yes, I do.

Q. And among other things, the parties presented as part of that package the provision of a settlement agreement relating to the ability of Florida Power and Light Company to credit depreciation expense by $125 million per year during the four years of the agreement. Do you recall that?

A Yes.

Q. Please turn to Page 30 of the document.

A. Yes.

Q. And you will see at the top of the page the transcript of one of the questions that you posed. Would you read that first paragraph?

A. Okay. The other question I have, I guess this is probably more appropriately addressed to the company, and it has to do with the ability of the company to -- to book credit amounts to the depreciation expense up to

$125 million per year. And we got -- just got clarification as to how that would work during the -- during the duration of this agreement.

Q. Now --

A. I guess when you read a transcript you see that you don't speak as well as you would like to write something. But I read it word for word, Mr. McGlothlin.

Q. Yes, sir. And I'm not going to spend the Commissioner's time going through all of this word for word. I have tried to select those parts of the exchange that fairly depict the conversation you had with the parties, including FPL, in the course of your inquiry. And so please turn to Page 31. First of all --

A. Well, if you are leaving Page 30, I would like to point something out, please, Mr. McGlothlin.

Q. Uh-huh.

A. If you will see the third paragraph there, I was actually posing a question to the company expressing some concern with this provision that was within the settlement agreement. And I am indicating there that I was looking for some assurance from the company that this provision, the provision being the $125 million per year depreciation credit, that it would not be utilized unnecessary. And I was looking for a commitment from the company, looking for some assurances. Unfortunately, I did not get that assurance. But this indicates that I did have a problem with this concept of booking the negative depreciation. And so I'm sure we are going to review other aspects of this transcript, but I did want to point out that the overall context of this particular section of the transcript in my exchange with Mr. Evanson, I believe at the time, and my concerns about this provision.

Q. Yes, sir. And as I say, we are going to introduce the entire document, and you are certainly free to point to anything that you think is necessary to fairly represent what you were thinking and asking at the time. But in an effort to do that in something of a short form or manner, you will see that Mr. Evanson, who was then president of FPL, was he not, answered your question. And at Page 31, would you read the first full paragraph beginning with number two?

A. Now, this is Mr. Evanson speaking, but you want me to read it?

Q. Yes.

A. Okay. Number two, on the depreciation side, I think it is likely that we would avail ourselves of that provision probably to the fullest extent probably in every year. And I say that for not -- not primarily because of the earnings impact, but also because when we actually compare ourselves, our depreciation rates to all of our various peers in the industry, it is very clear that our rates are far higher than most. In fact, they may be the highest in the industry in terms of the depreciation rate that we are taking.

Q. And Mr. Evanson elaborates on that on that page. And I will just observe that your transcript reads at least as well as his does in terms of how articulate the two of you were. And having said that, I refuse to read my own transcript in the future.

And if you will turn to Page 32.

A. 32?

Q. Page 32, the paragraph beginning -- Mr. Evanson is speaking, and he says, so, frankly. Would you pick up with that?

A. So, frankly, we think it is appropriate to look at that depreciation in that -- in that this reduction is probably bringing depreciation to an appropriate level. And since we will not be having, I believe, not having a full review of depreciation by the staff during that period, we think the review probably would have shown that we were overdepreciating.

Q. And continue on the next paragraph, please?

A. And the next paragraph?

Q. Yes.

A. So it serves a few purposes, but I think it certainly would serve the purpose of bringing our depreciation more in line. And I think after we have taken that, to the extent that we take the full 125 million, we actually will be in line with peer groups.

Q. Now, Mr. Deason, please turn to Page 33.

A. Before we do that, let me expand a little bit upon that in the discussion that I was having with Mr. Evanson and his discussion and little bit of the historical perspective that we were dealing with, or maybe some of the history that preceded this exchange.

In the 1990s, the Commission was approached by FPL with a concern of some of the items on its balance sheet concerning regulatory assets, some concerns that they were in a position of perhaps having to prepare for competition, perhaps looking at the possibility of having to divest generation units, the possibility of stranded investments as a result. And, in fact, this similar situation was actually happening in other jurisdictions.

They came with that concern to the Commission. They came with a plan to address that within the current earnings of the company to try to remove those regulatory assets which were a burden for customers, and to try to get their depreciation accounts and the depreciation methodologies more in line with a competitive company in the event that they were deregulated, and to perhaps relieve customers of the burden of potential stranded investments that customers in other jurisdictions were facing.

So, the Commission took that action for the right reasons. And at that time, that was a deviation from pure remaining life depreciation. That was a situation where I think that it was an extraordinary circumstance in which the Commission saw the merits of the proposal and how it actually would benefit customers. So there was a deviation from that.

Now, I think there was some discussion earlier today with Mr. Davis. I think he verified that, I think history of the record verifies it, that Florida did not deregulate its generation. FPL and the other investor-owned utilities in this state were not subject to competition. So I think the Commission at that time took the right measures for the right reasons, but as it turned out it was not a necessary function. So I think what Mr. -- I'm not speaking for him, but reading what is in this transcript and recalling by my own memory of the exchange with Mr. Evanson, he was saying we saw a problem in the '90s, we have corrected it, the problem didn't materialize and as a result we are overdepreciated now. I think that is the overall context.

Q. I think that sets the stage. Now, if you will turn to Page 33, and at the bottom of that page, you begin a comment at Line 23. Would you read that and the remainder of the paragraph on the following page?

A. Well, I am glad we are having this discussion, because it is clarifying to me the purpose of this latitude which is given to the company that is really not a cushion to be able to absorb earnings or unforeseen circumstances. This is really an effort to get depreciation, at least in the view of the company, to a level to where it needs to be. That is what I understand the explanation. Am I oversimplifying it, Mr. Evanson?

Q. And after his answer, you comment again. Mr. Deason, would you read beginning at Line 11?

A. Yes. I guess what I'm -- I'm hopeful that we can avoid, and it gives me some comfort in your representation that this is really an effort to get depreciation reserves, not the rates, the rates stay the same, get the depreciation reserves in the long-term where they -- they need to be.

If you will let me expand upon that.

Q. If you will read the rest of that comment first, then you can expand.

A. Okay. Very well. You want me to read the next paragraph?

Q. To where it ends on Page 35, and I promise you we are almost through.

A. Okay. 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 try -- I want the depreciation reserves to be as accurate as possible. I want to hopefully avoid through erratic changes in depreciation rates. And I know that this agreement keeps rates frozen, depreciation rates frozen during the entire period. 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 be -- theoretically should be. And you have given me the indication that you think this is a step in the right direction to get those -- actually to get those as a positive thing to get the reserves where they should be.

Q. Now, did you want to elaborate?

A. Yes, I do want to elaborate. First of all, I want to make a general comment, but before I do that, I want to emphasize some of the language that I used in this. And I am emphasizing that when I'm -- I'm speaking about depreciation reserves, I am talking about the reserves and not the rates themselves. We were not in a rate proceeding, and I was speaking in terms in the long-term. And I also indicated that -- I had language in here where I wanted to avoid erratic changes in depreciation rates.

And, Commissioners, what I want to point out to you at this point is what the intervenors are proposing that you approve will generate erratic changes in depreciation rates. They want you to approve the amortization of 125 -- I'm sorry, $1.25 billion to be amortized over four years. And I think Mr. Davis previously testified today that what that means is that you are going to have a period of time where you are actually going to have negative depreciation in that amount, you are going to be adding plant to rate base, and then after that four-year period you are going to be faced -- I think his calculations, depending exactly of what he included or excluded was anywhere from 400 million up to -- I heard a figure of $478 million. Those are his numbers, not mine, that is what I heard.

But what I'm saying is that there is going to be a very substantial change, both in the rates customers pay, which we were not changing in this proceeding or this transcript that is being -- being read. You are going to have a large change in rates to customers and you are going to have a large swing in the depreciation rates themselves. So I want to distinguish what was going on in this proceeding from that.

Another thing I want to emphasize, and it was the reason that I was having this discussion with Mr. Evanson, and why I gave the historical perspective of what happened in the '90s to bring us to this point. The Commission for the right reasons at that time deviated from remaining life depreciation. We felt that the remaining life approach was not going to be sufficient to address the concerns of stranded investment. We were wrong. But I think we were cautious; we did the right thing. We deviated from that. We deviated from remaining life depreciation here as well to get things back to where they should be.

Now, that we have -- we went down that road concerned about depreciation and stranded investment, took action to address it, took action to reverse it, we are back now to a situation where we do not have to deviate from remaining life depreciation. And if we do deviate from remaining life depreciation, we are going have the very thing that I cautioned against, and that is erratic changes in depreciation rates, and not only depreciation rates, but rates to customers, as well.

Q. Now, that was a long answer. Let me make a couple of points through questions to you. You have indicated two occasions in which the Commission saw circumstances that warranted an approach other than remaining life, correct? One is with the request of FPL to get its costs down to be competitive?

A. Yes, that is one situation, correct.

Q. And in this situation when the settlement package in 2002 was presented to you, you saw in the provision allowing FPL to credit depreciation expense by $125 million per year for four years an approach other than remaining life to address what the company called overdepreciation, correct?

A. That is correct.

Q. And is it fair to say --

A. Overdepreciation was a result of the actions the Commission took in the 1990s wherein we --

Q. Excuse me. I think you have said that twice now. I would like to pose my questions to you after giving you considerable latitude.

Can we -- is it safe to assume that when FPL says we are overdepreciated, that meant they had a reserve surplus?

A. Yes. I think that those terms in this context would be synonymous, but the surplus originated from a deviation from remaining life, as opposed to the surplus that exists now, which is within the confines of the normal deviation of depreciation with the remaining life approach.

Q. Now, you said in your answer that you are concerned about the possibility of erratic changes in depreciation rates. Isn't it true -- let me back up. You have identified two situations in which the Commission departed from the remaining life methodology to address circumstances that in its view warranted the departure. So, would you agree that this Commission has the same ability to assess the circumstances in this case and determine whether in its judgment a departure from remaining life is warranted by the circumstances?

A. The Commission always has that latitude and discretion. But to say that this stands for the proposition that they should do that in this case is absolutely not the case, Mr. McGlothlin. It is not the case at all.

What we have here is a situation where this overdepreciation, as Mr. Evanson described it, resulted from a deviation from remaining life. Then we deviated from remaining life to correct it. The concern was that remaining life would not enable -- and remember my number one goal of depreciation, Mr. McGlothlin, the number one goal is to be able to set rates such that when we reach end of life of an asset it is 100 percent depreciated.

When we were concerned about stranded investment, we could not depend on remaining life to achieve that goal, so we had to deviate from it. What we have in this case currently before the Commissioners is you have a case where you can remain -- you can rely upon the remaining life approach. And at the end of the useful life of the assets in question, they will be 100 percent depreciated. So, to say that this stands for the proposition that this Commission should take the specific action to deviate from remaining life, no, I disagree with that.

Q. When you say this, are you talking about --

CHAIRMAN CARTER: Excuse me, Mr. McGlothlin, would you yield for a moment, please, sir?

MR. McGLOTHLIN: Yes, sir.

CHAIRMAN CARTER: Thank you.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chair.

Just so I'm following along, Mr. Deason, in relation to the comments that stem from the proposal that was brought forth by the company to allow it to be more competitive in anticipation of deregulation in this state that never happened, I think that, subject to check, there was a departure made, but that departure clearly inured to the benefit of the company. In a similar situation that we are faced with today, where there may be a theoretical surplus, and you want to have some sort of matching principle, and in the case where a rate case would function as true-up regulatory accounts, why would it not be appropriate to do the exact same opposite to something that would near term benefit the customers, perhaps address some intergenerational inequity arguments, but fully recognizing that you can pay me now or pay me later or refund me now and pay me later. There is ultimately going to be a true-up. You know, it is just a timing issue and a cash flow issue. But explain to me how I am inaccurate in that assessment.

THE WITNESS: Commissioner, that was a lot of information thrown at me at one time. I want to be responsive. I do not accept the premise of your question that what was done in the 1990s was beneficial to the company. It was beneficial in the sense that it was making efforts to prepare them for -- to perhaps face competition and deregulation. But, remember, we were -- when we were doing -- taking those measures, we were reducing the company's rate base. Now, that was fine when they were facing the prospects of deregulation, but generally a company does not want to have its rate base reduced unless that reduction is accompanied by an increase in its revenues through higher depreciation rates.

Remember, what was done in the 1990s is we took this action within the existing rates of the company. And some of the actions that were taken were based upon a sharing of revenues above certain levels. So, to say it was done for the benefit of the company, I think that it was their initiative and they saw that there was a reason for it, but it was not done for the benefit of the company to the exclusion of customers. Customers benefited as well by a reduction in the rate base as a result of those actions.

COMMISSIONER SKOP: Okay. And just as a follow-up, and I will yield back to Mr. McGlothlin. In the 2002 settlement agreement, again, I believe it is 125 million per year, subject to check, and totaling, I guess subject to check, or we can either use the 2005 settlement agreement, whichever. But assuming that there was a depreciation adjustment of $125 million per year over a four-year period, I think subject to check that would be, you know, $625 million or whatever the math works out to be.

I guess currently the intervenors have alleged that the surplus is approximately 1.2 -- actually the company has alleged, I think, it may be 1.2 billion and the intervenors are saying it is much higher. But in relation to either the 2002 or the 2005 settlement, what percentage has the rate base itself grown since that time?

Again, in 2002 or 2005, again, there was $625 million all in somewhere around there. Now, OPC and the other intervenors are alleging that, you know, perhaps 1.2 million should be recaptured over four years. So that would be effectively a doubling of depreciation surplus during that time. But how big has the rate base grown since that, since the addition of new generating plants and all of that. Do you have a perspective on that?

THE WITNESS: Commissioner, I cannot answer your question specifically as to the dollar increase in rate base that took place during that time. I would suspect that FPL, being in a growing territory and being a company which does not hesitate in obtaining and deploying capital to meet its customers' needs and to do that cost efficiently, I would anticipate that there had been a great deal of investment in terms of plant that was added during that time, but I cannot quantify that.

COMMISSIONER SKOP: Okay. And you mentioned that from a company's perspective that they don't want to see their rate base decline. They want their rate base to grow, is that correct?

THE WITNESS: I think as a general proposition, a company wants to see their rate base grow. That means they are serving a growing territory. That is generally a healthy thing. That is one of the things that enabled Florida and particularly this company to keep rates low or even have rate reductions was healthy cost-effective growth. It is a good thing, but just -- but neither does a company want assets to remain on their books and in their rate base if the assets are not going to be recovered over the useful life. A company wants that balance. It wants to deploy the capital, earn a return on it, and depreciate it over its useful life, thereby providing a cash flow to the company to go out and reinvest in new assets.

COMMISSIONER SKOP: Okay. Just three quick follow-up questions, and I will yield back. The larger the rate base, the more a company would earn generally speaking, is that correct?

THE WITNESS: I think generally -- yes, all other things being equal that would be correct.

COMMISSIONER SKOP: Okay. And I guess as I listen to the rest of the question, I guess the central principle I'm trying to understand is often from a company's perspective. The Commission hears arguments related to asymmetric risk and why that is not appropriate, and why, you know, we should adopt their position on certain instances.

In this situation, I have seen it done one way. I have seen it done in settlements. And now in, you know, what are arguably, you know, bleak economic conditions where ratepayers are, you know, struggling to make their bills and rates may go up somewhat offset by fuel savings and what have you. It is my understanding in the rate case, not only are they asking to not do any depreciation adjustments, they are seeking to increase depreciation rates also. So I guess I'm trying to struggle to understand why if there is a theoretical surplus something cannot be done, although there is a trade-off in doing anything, because you are going to have to, you know, add additions to the rate base later. But in the near term, why would it not be appropriate on the flip side of this argument to benefit consumers in the near term by reducing their rates by crediting or doing similar credits that were done in the settlement?

THE WITNESS: First of all, let me be clear that customers do benefit by the surplus. The rate base is lowered by that amount and so customers have received that benefit in the past. They will continue to receive that benefit. I think your question goes to the fact as to whether there should be a reversal of the depreciation to reduce near term revenue requirements and whether that is symmetrical.

Commissioner, that is certainly within your discretion to do, and I know you have had concerns about GAAP. You have had a discussion with Mr. Davis about that, and I think he has described it is his position that even with his general concerns about GAAP, that it is probably within your discretion to do that.

I don't -- I don't deny that that is within your discretion, as well. The question is should you do it. And I still think that even in these bleak economic times that it is not the correct approach to deviate from remaining life. For the very reasons Mr. Davis identified, you are going to be looking at a very substantial rate increase four years from now.

It is true that customers are suffering. I did not personally go to the customer hearings, but believe me in a former life I attended many. And customers find it difficult -- some customers find it difficult to pay their bills even in robust economic times. And there are some customers through no fault of their own who are having difficulties, and I do not want to sound callous. And there are certain measures available to address those concerns of the customers.

In fact, this company participates in some of those measures by some of its contributions and some of its budget billing plans and things of that nature. But the truth of the matter is that for a regulated utility -- when times are robust, this company was not earning excessive amounts. In fact, this company was reducing its rates because it had healthy growth in the number of customers.

Now, that's a deviation from the normal competitive model where companies during robust economic times doing extremely well. That is not the case for a regulated utility. They still earn within the confines set by this Commission. And intervenors and consumer advocates did -- and neither would I expect them to, during those robust economic times did not come to the Commission and say we are in a very good economic time here, and if it is ever a time that our customers can afford a rate increase, it is now. They didn't do that.

I wouldn't expect them to do that. They are advocates for their positions and they do an extremely good job for that. But what I am saying is the dynamic of the regulatory scheme in Florida, and generally in the nation, is that a company, regardless -- a regulated utility regardless of the general economic conditions, its earnings are regulated. They are not allowed to earn outside of that range when times are good; neither should they be allowed or required to earn below that when times are bad.

Now, Commissioner Skop, I know your proposal is to not have this company earn lower than its return, but what is being proposed is a procedure that is not in the customers' long-term best interest, the general body of customers. Sure, it is in the customers' best interest who are going to be on this system the next four years, but what about the four years after that and the four years after that? Those customers are going be paying higher rates because of the action that is going to take place, possibly take place if you take the intervenors' recommendations to provide some relief for customers during this four-year period of time.

Commissioners, that is a judgment you have to make. It is not an easy one, and I think I probably could speak as well as anybody in this room the difficulties of the decisions that you all have to make, and you have to weigh that. I am just saying you need to weigh that in terms of the longer term picture, as well. And what is being proposed, $1.25 billion to be amortized over four years is a large number, and the impact as a result will be tremendous benefits for four years, but tremendous increases four years later.

COMMISSIONER SKOP: Mr. Deason, two follow-up questions. Again, I don't have the numbers before me, and it is hard to quantify what the respective rate bases were in 2002 and 2005 respectively. We do know what the depreciation amount that was agreed to, the settlement agreements there. And we know what the intervenors are asking for now. But on a percentage basis, noting the growth in rate base, would it be theoretically possible that it would be the same percentage of rate base over the two instances?

THE WITNESS: Commissioner, I'm having difficulty understanding your question. You do have a tendency to ask difficult questions, and I mean that as a compliment, Commissioner.

COMMISSIONER SKOP: No, I need to be more concise. Let me try and be more concise.

Say for the hypothetical example rate base was $5 billion.

THE WITNESS: Okay. A 5 billion rate base at what time?

COMMISSIONER SKOP: Let's say 2005. Again, those numbers are not accurate. I'm just trying to make a hypothetical example.

THE WITNESS: Okay.

COMMISSIONER SKOP: Okay. So five billion -- actually, let's make it even simple. Let's make it simple math so I can do it in my head. Let's say rate base was $500?

THE WITNESS: Okay.

COMMISSIONER SKOP: And let's say the depreciation that they were going to credit in that case was $5.

THE WITNESS: Okay.

COMMISSIONER SKOP: Now, let's jump forward to current period, whereas the rate base may have grown to $1,000, and the depreciation reserve amount would now be $10, because, again, it is roughly 1.25 is twice 625 million.

On a percentage-wise basis, if rate base has grown and the depreciation that they are looking to recapture over four years has doubled, on a percentage basis in those two situations it might be the same, is that correct?

THE WITNESS: That possibly could be, but I think you need to look at it in terms of the incremental effect. And we know that if you adopt the intervenors' position, that rate base, after the amortization period the rate base is going to be $1.25 billion more than it otherwise would be. And at the end of that four-year period you are going to have the higher rate base, you are going to have to then start depreciating that higher rate base, which means there is going to be an erratic increase in depreciation rates at that time.

And then the credit itself goes away, which had been keeping rates low. So it is like a triple whammy on customers at the end of that four-year period. So on an incremental -- I mean, you are going to have growth. We are hopeful there is going to be growth, but within that growth you are still going to have these impacts.

Now, if the company grows enough and the billing determinants are higher, perhaps that will mitigate to some extent the impact on specific customers' rates. But 1.25 billion in four years, I don't think it is reasonable to expect that customer growth is going to mitigate -- maybe some, but certainly not all of that.

COMMISSIONER SKOP: Okay. Just, again, one follow-up question to that. You served on the Commission for 16 years, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: And you have an accounting background, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. In both the 2002 and 2005 settlements respectively, by virtue of the adoption of those settlements by the Commission, didn't you effectively do the same thing that the intervenors are asking for now?

THE WITNESS: We effectively did it for different reasons, okay? But, yes, I am not trying to dodge that vote. I can tell you this, and if you have not had a settlement presented to you before, I'm sure that you will at some point, what you find is that it is an up or down vote, take all or take none. I can honestly tell you sitting here today that in my mind I did not vote for that 125 million credit. I voted for an overall package, that that just happened to be something that -- to get the overall benefits is something I had to swallow.

COMMISSIONER SKOP: But as detailed in the transcript that Mr. McGlothlin reviewed with you, certainly, you exchange in some specific discussion or expressed discussion on that very point, and you seemed to have some comfort that you were doing the right thing in the context of the settlement.

THE WITNESS: Yes, and for reasons that we deviated from remaining life, we needed to take action to correct our earlier mistake, which we did for the right reasons, but it turned out to be unnecessary. So we took that action. The numbers work out very close. The additional depreciation and amortizations that the Commission authorized during the 1990s roughly equated to one billion dollars. The 1.25 -- I mean, the 125 million over two four-year periods equals one billion dollars. So in rough terms we took actions to correct when we deviated from remaining life. It is not necessary to deviate from remaining life now, even though it is within your discretion to do so.

COMMISSIONER SKOP: And just as you struggled with during your long tenure on the Commission, I am looking at ways and discretion as I listen to the testimony to, you know, ensure fair, just, and reasonable rates, to allow the utility to recover reasonable incurred costs and prudently incurred costs, and to keep them financially healthy. But I am also looking at ways where opportunity exists.

And this is why my questioning is very

specific. I'm trying to vet a very contentious issue. I am looking to leverage every possible opportunity where I have discretion to exercise that discretion to keep rates low.

So, again, it is a tough decision, but, again, I'm trying to vet this very thoroughly. And I don't mean to take the Commission's time, but it is a very critical important issue with a rate case that has a substantial dollar amount in play.

THE WITNESS: And, Commissioner, you need to weigh that. And I guess if there is one message I would leave with you is that I would hope you would weigh that both in terms of immediate benefits and long-term impacts.

CHAIRMAN CARTER: Thank you, Commissioner.

Anything further at this time from the bench?

Mr. McGlothlin, you may proceed.

BY MR. McGLOTHLIN:

Q. Mr. Deason, there were two responses, one to Mr. Wiseman and one to me that I want to follow up on in terms of your most recent answers to Commissioners. At one point you said, and I'm paraphrasing, but I think I have this right, that the paramount objective is to ensure that 100 percent of the utility's investment is collected by the end of the service life. Did I hear that correctly?

A. Yes, that the asset that is deployed by the end of its service life that that asset is 100 percent depreciated. That is the goal of depreciation, yes.

Q. And I also heard you say in response to a question from Mr. Wiseman that you disagree with the proposition that if an earlier generation of customers are on line when a reserve surplus is created you don't regard that as an example of intergenerational inequity. Did I hear that correctly?

A. It depends on how that surplus was generated. If the Commission made a conscious decision that it was going to intentionally either overdepreciate or underdepreciate, well, then, yes, it could be an intergenerational inequity. But when the Commission gets the very best information it has, the very best parameters in terms of lives and salvage values, and makes a determination of what the depreciation rate should be, and those rates are then incorporated into the utility's rates such that customers support that depreciation expense through rates, that does not in and of itself create an intergenerational inequity.

What is happening then is the Commission is setting -- the Commission is setting the cost of providing service to those customers, and that is what rates are based upon. And so the deal is struck. The customers subscribe to the service based upon those rates, based upon those parameters, and they pay for that.

The customers are not overcharged or undercharged when that happens. The existence of a theoretical depreciation surplus or reserve does not in and of itself mean that customers have been overcharged or undercharged.

MR. McGLOTHLIN: I want Mr. Poucher to hand out another document.

CHAIRMAN CARTER: Okay. Do you need a number?

MR. McGLOTHLIN: No, sir.

CHAIRMAN CARTER: Okay. Mr. Poucher, you may proceed.

(Pause.)

CHAIRMAN CARTER: Do we have enough copies? I don't think that Ms. Bradley and Mr. Moyle and Mr. Wright got a copy.

Ms. Bradley, you can have mine.

MS. BRADLEY: That's okay. I think you need it more.

CHAIRMAN CARTER: Mr. McGlothlin.

BY MR. McGLOTHLIN:

Q. Mr. Deason, you have been provided a copy of

Order Number 980027 in Docket 970410. Do you have that before you now?

A. Yes, I do.

Q. And do you see your name is on the panel of Commissioners that voted to make this decision?

A. Yes.

Q. And do you recall the docket as the Commission's consideration of a proposal to extend certain provisions for Florida Power and Light Company in terms of increasing the collection of nuclear dismantlement expense?

A. Yes. I see proposal to extend plan for recording of certain expenses for years 1998 and 1999 for Florida Power and Light Company.

Q. Yes. And do you recall that in this case FPL presented the testimony of Mr. Gower, whom those of us who have been at this for awhile will remember as a frequent witness for the company?

A. Yes, that is correct.

Q. Please turn to Page 6 of the order.

A. Yes.

Q. And at this point the order is reciting the presentation of Witness Gower. Would you read the first portion of the last -- or the next to the last paragraph on that page?

A. Is this the paragraph that begins Witness Gower further testified?

Q. No. Because of reserve deficiencies, below that.

A. The paragraph that begins because the reserve deficiencies?

Q. Yes.

A. Okay. Do you want me to read that entire paragraph?

Q. Yes, please.

A. Because the reserve deficiencies represent costs that should have been recovered in prior years, intergenerational equity suggests that these deficiencies be recovered quickly so that future ratepayers are not burdened with an unfair share. The primary purpose of the proposed plan is to correct past deficiencies. This correction is not an acceleration of expenses appropriately attributable to future periods, but, in fact, is remedial, because it addresses expenses appropriately attributable to prior years; and, therefore, corrects intergenerational inequities. The intergenerational inequity has already occurred, and if not corrected by the proposed plan will only be exacerbated.

Q. Now, if you will turn to Page 11.

A. If we are going to leave this page, there are a few things I need to point out, Mr. McGlothlin.

Q. Well, let's do this. I would like to pose my questions and then after --

A. Mr. McGlothlin, my memory is not that good, and while I've got something on my mind, I believe that while we're on a page of an order you ought to at least allow me the latitude to answer what you just had me read.

Q. Well, we're in the middle of a question, that's the problem, Mr. Deason, and I would like to pose my question and have you answer that first and then, as the Commission has frequently allowed you, you will have a chance to explain.

A. As long as Mr. Chairman allows me sufficient time to go back and review this order sufficiently, I'll make the case clear to the Commission.

CHAIRMAN CARTER: You can answer the question, and then if you feel like you need to explain it later, you can do that.

Mr. McGlothlin.

BY MR. McGLOTHLIN:

Q. At Page 11 you will see that after reciting the presentation and submissions by the company, the Commission in this order characterized the issue before it. Do you see the paragraph that begins this issue is one of timing. Would you read the first sentence of that paragraph?

A. The first sentence?

Q. Yes.

A. This issue is one of timing, whether reserve deficiencies associated with nuclear decommissioning and fossil dismantlement should be recovered over the remaining life of the respective units, as is currently being done, or whether these deficiencies should be written off over a shorter period of time.

Q. And the final portion of this is on Page 14. The paragraph beginning with the remaining threshold. Would you read that paragraph -- that short paragraph?

MR. BUTLER: Excuse me, Mr. Chairman, but I would suggest something. I don't want to interfere with Mr. McGlothlin's approach to cross-examination, but we would certainly stipulate, if it were even needed, to his ability to quote any portion of these orders that he wishes in briefing. And so to the extent it is a matter of getting paragraphs into the record, we certainly would stipulate anything that would help move it along.

CHAIRMAN CARTER: Let's do this. Staff, I need you to take a minute and get with the parties and the lawyers, because I thought I was clear earlier, but

I guess I'm not.

MR. McGLOTHLIN: If it would help matters, this is the last portion of the quotation that is --

CHAIRMAN CARTER: That's okay. That's all right. We're going to need to -- let's do this. I'm going to give staff a break to talk with you guys and kind of remind you about what we discussed this morning. I don't want to be redundant or repetitive. And let's take -- Commissioners, we will take five, and we will come back at five after.

(Off the record.)

CHAIRMAN CARTER: We are back on the record.

When we left, Mr. McGlothlin, you were on cross-examination. You're recognized, sir.

MR. McGLOTHLIN: Thank you. And I am about to reach an end point with respect to my reference to this order, and I will try to conclude this exchange as expeditiously as I can. But in order to tie what was pending at the time of the break with my last question, I would like to do this.

BY MR. McGLOTHLIN:

Q. Mr. Deason, earlier I referred you to Page 6 of this order, and to the language that said intergenerational equity suggests that these deficiencies be recovered quickly so that future ratepayers are not burdened with an unfair share. Do you remember that question and answer?

A. Yes.

Q. And my last reference is on Page 14, which contains the articulation of the Commission's decision, and I will take a turn at reading. At Page 14, the last -- next to the last paragraph, the order says the remaining threshold is whether the record demonstrates that correcting a reserve deficiency over a shorter period of time is more reasonable or fair than correcting the reserve deficiency over the remaining life. The record evidence demonstrates that the tenet of intergenerational equity dictates that in this docket correcting reserve deficiencies over a shorter period of time is more reasonable or fair than correcting the reserve deficiency over the remaining life. Did I read that correctly, sir?

A. Yes, you did.

Q. And, again, you were on the panel that adopted this order, were you not?

A. Yes, I was.

Q. That concludes my questioning on that subject. And I believe you said you wanted to explain your answer.

A. Yes. I want to just make sure that the

Commission understands the factual situation of what was happening at this time with this order, and I will be brief.

First of all, it is clear that we are talking about deficiencies and not surpluses. Also, if you will refer to Page 6, the first full paragraph there, I think you get a flavor of the degree to which this was an extreme circumstance. There are examples of plants that were 50 percent of their estimated useful lives that only had 12 percent depreciation reserve. There was an example of plants that originated 20 years prior to 1987, but for whatever reason the Commission did not even initiate fossil dismantlement until 1987. So these were examples far beyond the norm that we were faced with at that time.

Also, I would just like to point out that there are numerous references in this order talking about the benefits of the action in terms of reducing investor capital, lowering costs in the long run and allowing rates to remain low. What the intervenors are proposing that the Commission do in the present case is just the opposite. It would require there to be more investor capital obtained. There would be higher costs in the long run and the rates would not remain low. They would actually substantially increase.

And, Commissioners, here again, I'm trying to be succinct, but I want to point out something to you that I think is going to be very critical to your deliberation on this. If you have a chance to review this order in more detail, you will see that this Commission had the benefit of numerous experts on the subject. There was Mr. DeWard, who was testifying on behalf of Ameristeel, but he is the same Mr. DeWard who has provided testimony on behalf of the Office of Public Counsel in numerous proceedings in the past.

Because this was a deficiency, he was actually recommending the exact same methodology, that it should be amortized over the remaining life. The same methodology that the Public -- I mean, that FPL is recommending to be done for the surplus.

Mr. Cicchetti also testifying on behalf of consumers, not for Public Counsel, but it is the same Mr. Cicchetti that has testified in the past for Public Counsel. He was recommending that it should be amortized over the remaining life. The reason I point this out to you is that depending upon whether it is going to be a reserve or deficit you are going to see the various arguments come out as to which direction this is going in. And if you adopt the intervenors' position in this case, I am concerned you are setting a very bad precedent that when we have a situation that comes up again with deficiencies like was the subject of this order, if you have a policy in the confines of a rate proceeding to rapidly amortize a deficiency, you are looking at increasing rates to customers immediately.

So just be advised that when you are looking at the direction of things, you are going to hear arguments from different sides depending upon who is going to be impacted the most the soonest, so just be prepared for that. That concludes my answer.

CHAIRMAN CARTER: Mr. McGlothlin.

MR. McGLOTHLIN: Let me consult my notes. I think I'm close.

CHAIRMAN CARTER: Take a moment.

MR. McGLOTHLIN: That's all I have.

CHAIRMAN CARTER: Thank you, Mr. McGlothlin.

Ms. Bradley, you're recognized.

MS. BRADLEY: I just have some real quick ones.

CROSS EXAMINATION

BY MS. BRADLEY:

Q. Mr. Deason, did I understand them to say that you are billing at an hourly rate for the time you are spending on this case?

A. The firm for which I am -- at which I am employed is billing my time on an hourly basis, yes.

Q. Okay. And do you know what that hourly rate is?

A. It is a composite rate depending upon the function that I am fulfilling at the time. If it is general consulting, there is a rate, and then for testifying there is another rate.

Q. And what is the difference in those two rates?

A. The testifying rate is higher, and I think it should be.

Q. Let me rephrase that. What is the testifying rate?

A. The testifying rate is $400 an hour.

Q. And what is the consulting rate?

A. $295 an hour.

Q. Okay. Now, is there any maximum number of hours that you can bill?

A. If there -- I have not been advised that we have reached the maximum number. I don't know if there is a maximum number. Ms. Clark actually takes care of the business end of those matters more than I do. I just don't know the answer to that question.

Q. I noticed you sitting out and it looked like listening to a lot of the testimony. Have you been here the whole time?

A. I have been here the majority of the time, yes.

Q. Now, I am assuming the hourly rate that you were talking about and the time you spent testifying and consulting has been billed to the case?

A. I hope so.

Q. To your knowledge, has it been?

A. To my knowledge, it has through the month of September.

Q. Okay. What I am wondering, though, is the time you spent watching the case, has that been billed to the case?

A. Yes, it has. But what you characterize as watching, I consider working. My consulting duties would be -- I did not sit out here for the pleasure of it. It has been reminiscent of my days sitting through these proceedings, but I do have a role in this case other than providing testimony, and it is one of general consulting. So the time that I have spent at the hearing has been in assistance to this case.

When we leave the hearing, we have further meetings, and these are matters in which it is important that there be participation, and I hope that my participation has been beneficial to the effort.

Q. Let me ask you this, then, are you a registered lobbyist for the IOUs, including Florida Power and Light?

A. I believe that I gave a presentation to a Senate committee on the basics of ratemaking. I am not sure. I may have registered in an abundance of caution to go over and make that presentation. I believe that maybe I am, but that has been pretty much -- making presentations in front of committees has been the extent of my participation in that particular endeavor.

Q. Let me ask you this, then. Is it fair to assume that at some point in the future the information that you gleaned watching these proceedings will be used in your lobbying capacity?

A. I certainly hope not. The level of detail that goes on in this hearing, I think, is far more than what a typical committee at the Legislature is interested in terms of policy. But I do think that the experience of understanding the current issues from a broad perspective, that may be beneficial if I ever get an opportunity again to make a presentation in front of one of the committees. But the efforts that I am engaged in at this point is strictly not -- is in no way lobbying. It is regulatory.

Q. Well, let me ask you this. At this time have any of the companies approached you about going over and representing them before the Legislature?

MR. BUTLER: I am going to object to this line of questioning. I've let it go on a while, but it just really seems entirely irrelevant to Mr. Deason's rebuttal testimony.

CHAIRMAN CARTER: Tread lightly.

MS. BRADLEY: Thank you.

THE WITNESS: Should I answer the question?

CHAIRMAN CARTER: Yes, sir.

THE WITNESS: No, I have not been approached about doing any presentations at the Legislature.

BY MS. BRADLEY:

Q. Have any of the companies, though, asked you to represent them in the upcoming session?

A. No.

CHAIRMAN CARTER: They probably heard his presentation. Sorry, that was uncalled for.

THE WITNESS: Well, Mr. Chairman, when you are given the subject to explain regulation, it is hard to make it interesting.

CHAIRMAN CARTER: Sorry, Ms. Bradley.

MS. BRADLEY: That's all right. On that note, I think I'm finished.

CHAIRMAN CARTER: Mr. Moyle, you're

recognized.

MR. MOYLE: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. MOYLE:

Q. Good evening, Mr. Deason.

A. Good evening, Mr. Moyle.

Q. I want to follow up on some conversations you had with Commissioner Skop and Mr. McGlothlin on behalf of Public Counsel, and focus a little bit on this issue of depreciation. You served -- you served as a Commissioner for 16 years, correct?

A. Yes.

Q. And you would agree that this Commission, it has to -- it has to make a judgment about the way in which it wishes to view depreciation and handle the surplus depreciation, correct?

A. Sure, the Commission has to exercise that discretion.

Q. And you would not -- I mean, you would agree that there is evidence in the record that gives them the ability to make a decision either in the way that you are suggesting it be decided or in the way that the intervenors are suggesting it be decided, correct?

A. I just want to suggest to Ms. Bradley the fact that I have been in this hearing makes me able to answer this question. So see the benefit of me being here in this hearing?

Yes, I think there is -- there is a full and complete record in front of this Commission.

Q. All right. And the effect of adopting the position of the intervenors would be that the consumers, the customers, people I represent, business interests, the residents, FPL serves over half the population give or take, correct?

A. I think that is a fair approximation.

Q. That they would -- they would receive or they would not pay as much in rates if the intervenors' position was adopted as compared to the position espoused by you and Florida Power and Light over the next four years, correct?

A. That is a fact, yes.

Q. And in terms of order of magnitude, do you have any idea what that -- what that cumulative order of magnitude is over four years that they would not have to pay?

A. Well, I think generally depreciation is an extremely large part of this case. In fact, it may be up to somewhere in the neighborhood of $500 million, but that includes all the depreciation issues, including surpluses, capital recovery schedules, and the issues about what is the appropriate lives and salvage values of the various accounts. So depreciation as a whole is an extremely large issue, yes.

Q. And if we were to isolate this issue related to how the surplus should be treated, do you know what that number might be over a cumulative basis?

A. Well, I know that it was Mr. Davis' testimony that this proceeding, the request in this case is $300 million, give or take a little bit, because of the actions that the Commission had taken in prior years concerning the $125 million per year, which accumulates to about a billion dollars. So, I guess in rough terms a billion dollars of depreciation reserve has an impact of about $300 million in this case.

Q. Is that an annual revenue requirement?

A. That is my understanding, yes.

Q. So 300 million times four over the four-year period in question, we are talking about 1.2 billion, correct?

A. In extremely rough numbers, I think that is probably an order of magnitude. But, here again, I cannot testify to those numbers. I am just reciting to you numbers that Mr. Davis calculated and he presented to this Commission earlier today.

Q. And I understand. I am not looking to hold you to exacting precision. I am just trying to establish an order of magnitude.

Now, you were shown copies of orders, and I know you sat on this Commission for a long time and took a lot of, you know, a lot of votes. You would agree that the order that Mr. McGlothlin spent time showing you and walking you through, I don't know if you still have a copy, but it was Order 980027 in the case 970410-EI, that at the end of the day the Commission in which you were a member voted to go with a depreciation that was a shorter period of time as compared to a longer period of time, correct?

MR. BUTLER: I am going to object to the form of the question. I think it is incorrectly referring to a decision on depreciation, whereas I think this had to do with decommissioning expenses.

CHAIRMAN CARTER: Just rephrase, Mr. Moyle.

MR. MOYLE: Okay.

BY MR. MOYLE:

Q. The order that Mr. McGlothlin shared with you --

A. Yes.

Q. -- in the paragraph that he read, that indicated that with respect to the amount of time over which action was going to be taken, it was going to be over a shorter period of type as compared to a longer period of time, correct?

A. Yes. That was the nature of the question, and that is one of the issues that this order addresses.

Q. And that was done in part to address intergenerational inequities, correct?

A. Yes, intergenerational inequities which was caused by the extreme circumstances which were delineated in the order.

Q. Okay. And you used that form -- that term extreme circumstances. There were a couple of other situations that I think you talked about, one being the prospect of deregulation and merchant plants that prompted this Commission or the Commission to deviate from the average life approach, correct?

A. To deviate from the remaining life approach.

Q. I'm sorry, the remaining life approach.

A. Yes.

Q. And were those extreme circumstances?

A. Yes, I believe they were. The Commission took action based upon those circumstances, and I believe the Commission would not have taken those actions unless it deemed that the circumstances justified the action taken.

Q. And the other one that you spent some time talking about was a settlement agreement that was reached, and Mr. McGlothlin spent some time walking through that, and at the end of the day that was a matter in which the depreciation was taken over a shorter period of time, correct?

A. Well, that was actually a depreciation credit that was part of a settlement, the $125 million per year that we have been talking about.

Q. All right. Did that settlement situation present extreme circumstances in your judgment?

A. Yes. It was to correct the extreme circumstances that took place before where, according Mr. Evanson's words, the company found itself in an overdepreciated position.

Q. Okay. In your testimony on Page 22 at Line 12, I don't know if you need to refer to it, but you, I think, acknowledge that we are in the most severe economic downturn since the Great Depression, correct?

A. No, I don't remember me saying that. So maybe you do need to refer me to that. I'm not saying I didn't, I just don't recall, Mr. Moyle.

Q. Well, take a look, then, on Page 22.

A. Okay.

Q. Line 12.

A. Yes. It's right there. You are correct, yes.

Q. So, you would agree that, to use your words, we are in the most severe economic downturn since the Great Depression, correct?

A. Well, we are coming out of that, and this was -- this reference was made to the -- in terms of an appropriate equity ratio, how the equity ratio and the means by which the Commission had set that over the last ten years has provided the financial wherewithal for the company to address a number of challenges. And one of those was the economic downturn, which we hope we are seeing the end of, but that equity ratio existed during that time, and I think it was beneficial to the company.

Q. I understand, and whether you are talking about equity ratio or some other issue, I guess the point I wanted to focus on is that, you know, your testimony is that this is the most severe economic downturn since the Great Depression. While you said you hope we are coming out it, you are also aware that the unemployment rate in the state is over 11 percent as we sit here today, correct?

A. I am aware that it is over 10. It may be 11. I've just heard statistics that has put it at 10 or higher.

Q. Okay. And you have been here through a lot of testimony. You are also aware that the amount of disposable household income has declined during this economic time period, correct?

A. I believe I have heard testimony to that effect.

Q. Okay. And wouldn't you have a concern -- well, let me put it this way: Don't you think the citizens of Florida, and the businesses of Florida, and the consumers of Florida would have a concern if this Commission -- and you talked about precedent, and you told this Commission they would be setting a bad precedent if they adopted the position of the intervenors.

But if you look at the precedent where with the prospect, no concrete evidence, no bill had passed, but just the mere prospect of merchant plants coming into the state, the Commission determined that was an extreme circumstance that warranted action with respect to not depreciating something over the average life. That a settlement agreement likewise represented an extreme circumstance, that the most severe economic time since the Great Depression would, likewise, represent an extreme circumstance in which this Commission would be free to exercise its discretion and make a judgment in a way that saves ratepayers $1.2 billion over four years. Would you agree with that?

A. I agree the Commission has that discretion, but the actions that the Commission has taken before should not be used as a precedent to reach that conclusion. The reason that the Commission took the actions it did to deviate from the remaining life was a concern that the remaining life was not going to be adequate to address the circumstances. That situation does not exist here in this present case. The remaining life approach is consistent with policy, and it is adequate to set rates which will achieve the goal of providing recovery of the assets over their useful life.

Mr. Moyle, you referred me, and, Mr. McGlothlin -- you referred to orders that Mr. McGlothlin referred to me, as well. So I think it is incumbent upon me to let you know that there is an order that is the most relevant to this issue than any of the orders that have been referred to me before now which addresses specifically the question of a reserve surplus. And it was presented to the Commission in terms of a storm cost-recovery surcharge where the proposal was made to utilize that depreciation -- theoretical depreciation surplus to use it to, basically, pay for or to use it in terms of a -- as a credit to obviate the need to increase rates to -- or to obviate the need for a storm cost-recovery surcharge.

That is the most relevant order. In all the ones that I have reviewed, that is the most relevant one. And the Commission's decision was not to take that action for various reasons which are in that order, and it is Order Number PSC-05-0937-FOF-EI.

Q. That is what I get for pausing in between my questions. Your Counsel I know will have a chance to point that out in terms of relevancy. I mean, really, all the Commission orders speak for themselves, do they not?

A. Yes, they do.

Q. Okay. And lawyers can argue about which one is more relevant, which facts are more pertinent, and, you know, we can debate whether the prospect of merchant plants is more of an extreme circumstance than the dire economic situation confronting Floridians. But at the end of the day, it's this Commission's judgment that is going to make the difference, is it not?

A. At the end of the day the people with the votes, that's what matters.

Q. Yes. And wouldn't you also agree that it wouldn't be the right message to send to the Floridians, the consumers in this state if this Commission were to adopt a prospect or a proposal that you touch on in your testimony, and Mr. Reed spent some time talking about, which is to provide a return on equity adder. You were here when Mr. Reed indicated that that adder would benefit investors, not necessarily the management of FPL, were you not?

A. Yes, I heard that testimony.

Q. Okay. Did you disagree with that?

A. No, I do not disagree with his characterization.

Q. Okay. What I heard him say is he said this ROE adder benefits, you know, equity investors which are, you know, some individuals, but a lot of pension funds, insurance companies, big institutions that invest in FPL stock, correct?

A. Well, whomever the stockholders are, if there were some benefit that inured to stockholders generally, well, then, it would include all classes of stockholders, yes.

Q. Do you have any information about who the stockholders of FPL are in terms of individuals as compared to pension funds, or hedge funds, or any large entities like that?

A. I do not know that breakdown. But let me be clear, I don't think it is the position of FPL that there be a specific ROE adder. I know that my testimony addresses the concept of a regulatory mechanism for the

Commission to consider that evidence, and that it should just not -- it should not be dismissed out of hand, that it should be part of the regulatory process.

Q. So, given the economic circumstances, and the dire economy and to use your words the worst economy since the Great Depression, would you suggest that maybe now is not the time for the Commission to adopt any kind of an ROE adder that would benefit equity investors on Wall Street to the detriment of consumers in the state of Florida?

A. I don't address that in my testimony. It certainly is a consideration of the Commission, but there is a requirement that the cost of service be included in rates and that would include a fair ROE. And I believe that Mr. Reed indicated that the purpose of regulation is to act as a surrogate for competition. That in the competitive field that companies which provide superior service at a reduced cost, that there are economic benefits of that often expressed in terms of a higher ROE. But it is up to the Commission to consider that and to weigh all of the evidence and determine if that is appropriate or not.

Q. Well, when you say you didn't address it in your testimony, you do address the ROE adder, do you not?

A. I talk about that -- I do not use the term ROE adder. I do say that it is part of a good regulatory structure to consider the performance of a company, and if there is superior performance it should be considered. I also allude to the fact that the Commission has had a policy of looking at customer -- I mean, at companies whose performance was not as good as it should have been and that there was regulatory action in that direction, as well. And I also indicated that if there is to be recognition that usually Florida has set it at a high threshold. It is not something that is done on a whim.

Q. Wouldn't the argument in your judgment be better for an ROE rider if the benefit went to the people responsible for the management of the company as compared to equity investors?

A. No, I think it should go to the individuals that are taking the risk in the company who are responsible for making sure that the management performs correctly, and that is the stockholders.

Q. You have been here through a lot of this testimony. You are aware that -- were you here when Mr. Woolridge testified, the Penn State economist?

A. I may have been here for part of that.

Q. Okay. You know that he has recommended a return on equity of 9.5 percent, correct?

A. I would accept that as his recommendation. I cannot sitting here say with certainty that is his recommendation. But if you represent that is the recommendation, fine.

Q. And there has also been a document that has been -- that we spent a lot of time on that shows an average return on equity of 10.5 percent for decisions rendered in 2009. Are you familiar with that document?

A. I am familiar with that, and I am familiar with the testimony that described that there were a lot of considerations beyond just looking at averages that, here again, the Commission should consider and particularly the risk profile of FPL.

Q. And each point, each 100 basis points or one percentage point of return on equity is translated into approximately $130 million in rates, correct?

A. Revenue requirements, yes.

Q. I'm sorry, revenue requirements.

A. Yes.

Q. So that if the Commission said, you know what, we are going to go with a 9.5 as compared to a 12.5, that would save ratepayers close to $400 million, correct?

MR. BUTLER: I'm going to object to this. I believe it is outside the scope of Mr. Deason's rebuttal testimony. If Mr. Moyle can point to --

CHAIRMAN CARTER: He's basically asking his opinion.

MR. MOYLE: Sorry?

CHAIRMAN CARTER: I will allow. You may proceed.

THE WITNESS: Yes. If you took the $130 million per basis points, and whatever the basis point differential is, you can make that calculation and the math is what the math is. I would just say that that would be a short-term benefit.

To the extent that if the 9.5 percent, and I'm not rebutting Dr. Woolridge, but I'm saying if the 9.5 percent is actually lower than the true cost of equity to the company, that there may be short-term benefits, but there would be long-term harm to the customers because there would be financial implications of setting rates lower than the cost of equity capital.

Q. And you reference some of that in your rebuttal testimony, but we don't want to get into the analysis of the cost of debt and the relative cost of debt as compared to the additional equity or the additional revenue requirements that the ratepayers would have to pay, do we?

A. I hope we don't have to discuss that.

Q. Okay. You are not offering detailed testimony on that, are you?

A. No. I am offering testimony in terms of an appropriate equity ratio within the capital structure, but I don't address specific cost of debt other than to say that a healthy equity ratio is an indication of financial strength, and then that has benefits in terms of a company being able to go to capital markets and acquire capital on favorable terms.

Q. And to the extent, sir, that this Commission was inclined to take action that recognized the very difficult economic circumstances facing Floridians, and consumers, and Florida businesses now, and they had areas of discretion in which to make judgments that would benefit consumers, you would agree that the return on equity is an area that provides a considerable amount of discretion, given the 9.5 range, which you've accepted, to the 12.5 range, which FPL is seeking, correct?

A. The Commission has an abundance of evidence on that subject matter with a wide range, I would agree.

Q. And you would agree it is a discretionary call own their part as to where to come down on that point, correct?

A. It is discretionary, but the Commission has an obligation, which I'm sure they take seriously, to make an informed objective decision as to what the true cost of equity is, and that it should not be artificially deflated because we are in hard economic times, only to the extent if hard economic times somehow effect capital markets, so that is the cost of equity.

Q. The recommended capital structure, and I don't want to spend a lot of time on this, but do you know what the capital structure that FPL is seeking this Commission to approve is?

A. I know what the equity ratio is, which I testify about specifically.

Q. Yes, I'm sorry. What is the equity ratio?

A. It is 55 point -- I want to say 83 percent, but if you will hold on for just a moment I will get that number.

Q. I think Page 21, Line 2.

A. Thank you, Mr. Moyle. Yes, I was correct, 55.83 percent. That was the -- let me clarify that. That was the limit that the Commission determined was appropriate for FPL back in a docket in 1999, and it is my understanding that, and my review indicates that FPL has adhered closely to an equity ratio with close to that cap. So, I am not testifying that their specific equity ratio in this rate proceeding is 55.83, but my understanding is it is close.

MR. BUTLER: Okay. And, Mr. Chairman, Exhibit 462 is already in the record. If I could just approach briefly.

CHAIRMAN CARTER: I knew it would come before the end of the day that we would have to go back to 462. And believe it or not, in the either case it was 264 on Page 3.

Mr. Moyle.

MR. MOYLE: Thank you, Mr. Chairman.

BY MR. MOYLE:

Q. This document has an average ROE of 10.51 percent, that's the one I asked you about earlier, but it also has a column for the common equity that has been authorized by commissions throughout the country in 2009, correct?

A. Yes, I see the column.

Q. Okay. And we haven't done an average of it, but if we did, wouldn't you think that number would be a lot closer to, you know, in the upper 40s as compared to a 55 percent number, given the fact that no number is higher than the number we reference, 55.83?

A. I mean, the average would be whatever the average is. I would just caution against setting policy based upon averages. I think there needs to be an assessment of the company's operations and its risk profile. And the results speak well for FPL in that its overall rate of return is quite low when you consider the cost of debt and equity ratio that goes into that calculation. But in terms of an average, whatever the calculation is it is.

Q. And I'm not going to ask you to do it. It is late in the day. But you would agree, would you not, that if this Commission awarded a common equity rate, equity at 55.83, that given the information found on Exhibit 462 that it would allow the highest percentage of common equity of any commission in the country in the year 2009, correct?

A. I agree that 55.83 appears to be at the high end or may be the highest number that I see in that column.

Q. Thank you. And with respect to some suggestions that others are making about ways in which consumers might pay less --

A. Mr. Moyle, there is -- Duke Energy of Ohio has 58.28. But, anyway, it is what it is. I didn't mean to interrupt. Unless I am reading the wrong column, Mr. Moyle.

Q. Yes. I think you might be, Mr. Deason, because I thought I had looked at it. You are reading the column that says common equity percent total cap?

A. Yes. And if you will see for Ohio, Duke Energy Ohio, Incorporated, there is a number there represented.

Q. Doesn't it say 51.59?

A. Mine says 58.28.

Q. And I think our point of confusion is you are looking at a set of documents that are for the increase requested. Do you see that at the top?

A. Oh, okay. I see that.

Q. And I am looking at the increase authorized. Do you see that?

A. Okay. You are correct. Then that number is 51.59.

Q. Okay.

A. So I was looking at the wrong column, I apologize.

Q. No worse. Just a couple more points. Again, Mr. Pollock is a FIPUG witness, correct?

A. Yes.

Q. And he is making a recommendation with respect to the equity that would save consumers approximately $200 million, correct?

A. Yes. I believe it is slightly less than

200 million, as I recall, but it is like 192 million or so.

Q. Yes, sir. And while we spent a lot of time about -- you know, talking about other topics, really things like equity ratio, ROE, and depreciation, those matters constitute the lion's share of the ask by Florida Power and Light, do they not?

A. Depreciation, ROE, equity ratio, I think those are all significant issues in terms of policy and revenue requirements, I would agree. But let me clarify. In answer to your question about the quantification of Mr. Pollock's adjustment and about it reducing revenue requirements, I think that is the calculation, but one needs to consider that in terms of its impacts in the longer term, and as to whether a lower equity ratio would actually result in lower rates in the long-term. And that is, here again, a judgment decision the Commission will have to make.

Q. Right. And we have spent time about that. I mean, you understand that the consumers are unified in their view that they would rather have more money in their pocket now as compared to later, correct?

A. I have heard you say that many times, Mr. Moyle.

Q. Okay. And with respect to Mr. Pollock's recommendation with respect to the capital structure, you don't question Mr. Pollock's bona fides in terms of his expertise, do you?

A. I have a great deal of respect for Mr. Pollock. I hope he can say the same for me.

Q. He is probably right. And I think that the Commission has evidence and can make a judgment. They have discretion as to where to set the capital structure based on the evidence in the record, correct?

A. Absolutely, yes.

Q. Okay. One final line, I do believe. Let me just check my notes, but you also comment on the GBRA, the generation base rate adjustment?

A. Yes.

Q. And you have a lot of experience, you have been on the Commission 16 years. How many rate cases did you sit through in the 16 years?

A. Mr. Moyle, I really don't know. I'm sure it was probably more than I realize, especially when you consider the number of water and wastewater cases.

Q. Okay. I should have refined it to talk about electric cases.

A. Oh, electric rate cases over that 16 years, you know, a number somewhere maybe -- at least ten I would say, maybe as a good walking around number to use.

Q. You would agree that the rate case is an opportunity for a whole variety of issues to be considered. It has been referred to as the ultimate regulatory true-up, is that appropriate?

A. Mr. Moyle, I have heard that, and I have heard Commissioner Skop ask that question, and I tend to disagree that a rate proceeding is a true-up. And maybe I am reading more into the term true-up than is there. When I hear the word true-up, I usually associate that term with what is normally done in the fuel adjustment proceedings where there is an estimate of costs, there are rates set, revenues are collected, and those revenues are compared to actual costs, and then at some point there is a true-up.

That is not the process for a base rate proceeding. The purpose of a base rate proceeding is to ascertain costs on a going-forward level, and to set rates to hopefully cover those costs and give the utility an opportunity to earn a fair rate of return. And there is no true-up in the sense that if the company underearns that there is somehow that is made up, or if they overearn that there is an automatic refund. It takes another action by the Commission to change that level of rates.

So, with that understanding -- now, I do agree with Commissioner Skop and what I have understood his questions that, sure, a base rate proceeding is a good opportunity to look at a company's cost structure and to make decisions as to what going-forward costs are. And if certain adjustments need to be made to a company's costs, if there were some imprudent actions, some adjustments that need to be made, certainly that is the time to kind of come to a decision as to how to best address those. So if that is the purpose of the true-up, well, then I agree with it in those terms.

Q. And I understand the distinction I think you are making, but in broad general terms the rate case presents an opportunity for the Commission to consider a wide variety of issues, correct?

A. Yes.

Q. And from a regulatory standpoint and a regulator, that is a good opportunity, a good thing to do, is it not, when you are in the business of regulating entities like Florida Power and Light?

A. Once again, the purpose of rate setting is to set rates on a going-forward basis. A rate case is a means to accomplish that, but the Commission has other means, as well. I mean, the Commission has had a history of settlements. I think those have worked well. So there are -- you know, there are means. But sure, you know, in the classic sense or the normal sense a rate proceeding is the time to take a look at all of those costs, all of the operations of the company, and make a decision on a going-forward basis. And your hope, your hope is that you set those rates at a level such that those rates are going to be in effect for a long period of time.

My concern with the intervenors' recommendation on the depreciation surplus is that we know with certainty if we adopt that recommendation that we are going to be back in here in four years with another rate case. And that's fine. If that it's what we need to do, that's it, but that is going to definitely be the result.

Q. You were here when Mr. Barrett used that term certainty that if a subsequent test year wasn't provided that they would be back in for a rate case, and he corrected himself, and said, no, we would have to evaluate it. The same holds true with respect to the depreciation issue, does it not, sir?

A. Well, I probably should correct myself, yes. I mean -- but you are talking about a revenue requirement deficiency depending on the calculation of anywhere from 400 million to 478 million. Most likely there would be a rate proceeding, so I stand corrected.

I can't say that with certainty.

Q. Okay. And, again, I was asking these questions just in some broad context on the GBRA, because, you know, the GBRA acts as a one-way street, does it not, that the only issue in play is the cost of the plant that is going in at that particular point in time?

A. Yes, the cost of the plant that has gone through a Power Plant Siting Act process.

Q. And in a rate case you have what I will call a two-way street where you have somebody like Office of Public Counsel coming in and saying rates should be reduced by over a hundred million and the company is coming in and making an ask for 1.5 billion. It presents an opportunity for a broader airing of issues, correct?

A. That's true. But in terms of the GBRA, you need to realize that the GBRA does not affect that relationship whatsoever. The GBRA just recognizes a cost, the cost of which has already gone through a need determination process, and to set rates to recover the investment in that plant on a going-forward basis, and it does not have the effect of causing overearnings or causing underearnings.

Q. You would agree that one of the reasons that

FPL is suggesting a GBRA be adopted is because it would make it less likely that a rate case happen, correct?

A. I think that is a benefit of GBRA, yes.

MR. MOYLE: All right. Mr. Chairman, thank you. That's all I have.

CHAIRMAN CARTER: Thank you, Mr. Moyle.

Mr. Wright, you're recognized.

MR. WRIGHT: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. WRIGHT:

Q. Good evening, Mr. Deason.

A. Hello, Mr. Wright.

Q. We meet in a different circumstance than ever we have before. It is nice to see you.

A. Thank you.

Q. I don't have very much cross-examination for you. Just a couple -- follow on a couple of things that you discussed with other of my colleagues on the consumer side of things.

In response to a question from Mr. Moyle just now, you said you set the rates and you hope they will be in effect for a long period of time. Do you remember saying that?

A. Yes.

Q. Would you agree that you also hope that the utility during that long period of time would be able to provide safe, adequate, reliable service, cover its costs, and be able to attract capital during that period?

A. Yes.

Q. Mr. Moyle asked you if you accepted, or if you understand that it is the customer parties' unified position that they would prefer to have more money in their pockets now. My notes indicate that your response to that was I have heard you say that many times, Mr. Moyle. Do you remember that exchange?

A. Yes.

Q. I have a simple question for you. Do you acknowledge that this is the customer parties' position?

A. Yes, I acknowledge that is the position.

Q. We are not asking for free electricity, are we?

A. No, I think you -- I think you -- I think all of the intervenors are sophisticated enough to know that the cost of providing service has to be recovered. And I understand that in your positions you are making recommendations or asserting positions which have the effect of delaying costs.

Q. In terms of the outcome of this case, we are really talking about the difference in total all-in rates of something in the range of 85 to $90 a megawatt hour on our side versus 95 or $100 a megawatt hour on FPL's side. Isn't that about right?

A. I can't verify that calculation one way or the other.

Q. Okay. In some discussion that you had with Mr. McGlothlin regarding the 001148 docket, I believe that you touched on the fact that FPL reduced its rates as part of that settlement. I just want to ask you a couple of real quick questions about that.

A. I'm sorry, which settlement was that?

Q. It was the one for which Mr. McGlothlin has proffered the transcript.

MR. BUTLER: I think you are referring to the 2002 settlement, is that right, Schef?

MR. WRIGHT: I believe so. Sorry.

THE WITNESS: Okay. I think there was a rate decrease within the 2002 settlement.

BY MR. WRIGHT:

Q. In fact, I think there was a rate decrease both in the '99 settlement and the 2002 settlement, correct?

A. Yes. But there was -- they are starting to run together, but there was a 2005 settlement, as well, and I think that was basically a rate -- more of a rate stabilization docket as opposed to a rate decrease. Is that correct?

Q. That is consistent with my understanding, Mr. Deason. My recollection is that there was a $350 million base rate reduction in the settlement of this docket, the 001148 docket, and there was another $250 million reduction in the 2002 case, and then a freeze in 2005.

A. Well, I'm sure --

MR. BUTLER: I'm sorry, Mr. Moyle. You said this docket --

CHAIRMAN CARTER: Mr. Wright.

MR. BUTLER: I'm sorry, Mr. Wright. You referred to the 001148. I believe that is the 2002 settlement docket.

MR. WRIGHT: Mr. Butler is right, and I appreciate the correction.

BY MR. WRIGHT:

Q. The point is the same. The point I am going to is the same. I believe there was a $250 million rate reduction coming out of the 2002 settlement, correct?

A. Yes.

Q. Okay. If FPL had not reduced its rates through that settlement, wouldn't you agree that it would have been likely that FPL would have otherwise overearned?

A. One would assume that everything else being equal and that that stipulation was the result of all of the parties' positions, that no one would have -- everyone negotiated a fair resolution, and that if you were to take one aspect of that out of that resolution that it could have a material impact on earnings one way or the other. Now, whether it would cause overearnings or not, I'm not -- I can't really say.

Q. Well, I bet you would agree that FPL did not underearn during the period 2002 to 2005, wouldn't you?

A. I think that is correct, because I think there was some revenue sharing in that, and I think that customers shared in those revenues, so that would make me think that the company's earnings based upon that revenue stream were certainly -- certainly the company did not underearn.

Q. Thank you. In response to -- or in the course of some discussion with Mr. McGlothlin, I believe you made a statement to the following effect that the number one goal of depreciation is to set rates so that at the end of an asset's life the asset is fully depreciated. Is that a fair characterization of your prior testimony?

A. Yes, I think that's fair.

Q. Thank you. Will you agree that depreciating a reserve surplus over a period shorter than the remaining life of an asset is not the same as depreciating the whole asset value over the amortization period?

A. Well, actually in the context of a remaining life depreciation -- can you be more clear in your question?

Q. Well, an asset has a value.

A. Yes.

Q. And it has a remaining life?

A. Yes.

Q. If there is a surplus, then in the context of our conversation on this issue, we are talking about only amortizing the surplus over a shorter period than the remaining life, is that what you understand we are talking about?

A. Yes, not the full value. Yes, I would agree with that.

Q. So would you also agree that amortizing the surplus over a shorter period is not inherently inconsistent with your number one goal of having the final depreciation come out at about the time the asset actually uses up its useful life?

A. If you recognize there is going to be extremely -- I say extremely -- there is going to be higher depreciation rates and expenses after that amortization is complete. So, while I have confidence in the regulatory process and in this Commission to make sure that rates ultimately are set to where rates, depreciation rates cover the investment in the assets, any time you start adding -- basically adding to rate base or adding to investment by reverse depreciation, it certainly -- it certainly increases more risk associated with the ultimate outcome. It also creates more risk in terms of cash flows, which I think other witnesses have alluded to, as well.

Q. But the answer to my specific question is that it is not inconsistent with having depreciation come out at the end, isn't that correct?

A. With the understanding that rates would have to be higher in the latter years of an asset, that is true. And you also have the risk in the latter years of an asset as to whether that asset may be prematurely -- not prematurely, but retire for valid reasons, and then you have the prospects of capital recovery schedules. So there are tools to address it, and hopefully it will come about that the asset's value is recovered, but it makes it a little more difficult to get there.

Q. Would it be reasonable to assert that a number two goal of depreciation would be for the depreciation booked and recovered from customers in each year throughout an asset's life should track closely to the actual depreciation of the asset throughout its life?

A. Yes, that would be a goal, as well.

Q. Finally, I think you discussed, and Mr. Davis also discussed that -- I think it may be over the period 2000 through 2009, or 1999, maybe it was -- somewhere there is an eight-year period over which FPL amortized prior depreciation surpluses at the rate of $125 million a year, leading to a total amortization over the period of a billion dollars, correct?

A. Correct.

Q. And even after that amortization, as we sit here in 2009 looking ahead to 2010, the company by its own depreciation study still shows a depreciation surplus of roughly $1-1/4 billion, correct?

A. That is correct, and you need to put that in perspective. The company's overall reserve ratio with the surplus is slightly over 40 percent. And if you were to instantaneously remove that surplus, then the overall reserve is slightly under 40 percent. So while $1.25 billion is a huge number, you need to look at it in the context of the company's overall depreciation reserve position.

MR. WRIGHT: Thank you. And thank you, Mr. Chairman. Mr. Deason, that's all I have.

CHAIRMAN CARTER: Thank you.

Staff.

MS. BENNETT: No questions.

CHAIRMAN CARTER: Commissioner Skop, you're recognized.

COMMISSIONER SKOP: Thank you, Mr. Chair, and given the late hour and the need to finish, I am going to try to make this very quick.

Hello, again, Mr. Deason.

THE WITNESS: Hello, Commissioner.

COMMISSIONER SKOP: I just want to briefly -- again, it is kind of like a dead horse, but I want to touch upon depreciation just with four more questions.

With respect to the subject of depreciation, if a depreciation study resulted in a depreciation deficit, then certainly FPL would seek to true-up the depreciation reserve account by recovering the depreciation deficit amount from FPL ratepayers, correct?

THE WITNESS: Yes, and they would do that over the remaining life of the asset.

COMMISSIONER SKOP: Okay. So in a sense would that not function as a true-up to the depreciation reserve amount in the context of a rate case?

THE WITNESS: Yes, there is a true -- when I describe remaining life as a self-correcting mechanism, that is what I allude to. To the extent that there is any theoretical reserve imbalance, the remaining life approach by its very nature and structure, that is the calculation, that it basically trues up those imbalances over the remaining life.

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

THE WITNESS: Four years is too rapid of an amortization when the remaining life approach is adequate to address the nature and the magnitude of the imbalance. And the method, the remaining life method, would provide benefits to customers over that entire remaining life by reduced rate base and reduced depreciation expense on a going-forward basis, just not the magnitude that you would see if you did it over four years.

COMMISSIONER SKOP: You would agree, would you not, that no harm would result from using the useful life and the retirement dates utilized by the intervenor witnesses to the -- in their depreciation studies 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: Commissioner, I cannot agree to that. I think it is extremely important to set depreciation rates on a going-forward basis based upon the very best information that you have, that information concerning the parameters of remaining lives, the various asset classes, and the salvage values.

Now, I have not made a judgment. It may be that that intervenors' recommendations are best in that regard. That was not the scope of my review. It may be the company's position is best or maybe it is somewhere in between, but just to adopt the intervenors' positions with the comfort that at some point it is going to be trued up, I would strongly recommend against doing that.

COMMISSIONER SKOP: But depreciation studies are a snapshot in time, and they are conducted, I guess, typically every four years or every so often, correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: So if you get it wrong the first time, then certainly you are going to take action, as the companies have in the past, to correct any imbalance, whether it be a deficit or a surplus, is that correct?

THE WITNESS: Yes. The remaining life approach would correct that on a going-forward basis. But let me reiterate, there is still an obligation to set those rates based upon the best estimates of lives and salvages that you have at the time that you set those rates.

COMMISSIONER SKOP: Okay. 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: Commissioner, you have the discretion to do that. It is my position that if the nature of the imbalance, in this case the surplus, and the magnitude of that surplus is such that it can be adequately addressed over the remaining life, that is the preferred alternative.

COMMISSIONER SKOP: Okay. Would your answers to any of my prior questions change if the Commission departed from the remaining useful life approach, but adopted either a smaller number than the $1.2 billion advocated by the intervenors or a longer amortization period?

THE WITNESS: Commissioner, I thought you might ask me this question, and I have thought about it. I am glad to know that I am in tune enough to maybe anticipate that. Obviously, if I believe the best approach is the remaining life, which in this instance is 22 years, I would be more comforted by an amortization period longer than four, even if it is somewhere between 4 and 22. That just makes sense. But I would still use caution.

Commissioner, I would -- if you are looking for some middle ground, I would suggest that you look at the capital recovery schedules and to see if that might be an accommodation to provide some immediate relief to customers without violating -- I say violate, without departing from the remaining life approach. That is a possibility.

COMMISSIONER SKOP: Okay. And just one final question, Mr. Chair.

On Page 27 of your rebuttal testimony, Lines 16 through 19.

THE WITNESS: I'm sorry, what page number?

COMMISSIONER SKOP: Page 27 of your rebuttal testimony, Lines 16 through 19.

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. In that passage you discuss a second reason why GBRA is appropriate to the extent that it, quote, levels the playing field. Can you briefly elaborate on that, because I have never really considered it in that context?

THE WITNESS: Yes, Commissioner. As you understand, the concept of GBRA is to allow for cost-recovery of generating units that have gone through the need process. We know that a utility has the obligation to put in generation or else acquire generation to meet the load. If a company is not going to self-build, their other alternative is to engage in purchasing power.

Now, under the current regulatory scheme, purchased power does not have to wait for a base rate proceeding. Purchased power, if the Commission reviews the contract and determines that it is prudent, it gets recovered through a recovery clause mechanism. So, what I'm saying is that GBRA allows cost-recovery to be more consistent with the approach that is afforded purchase power agreements.

COMMISSIONER SKOP: Okay. And just to that point in terms of long-term purchased power agreements, which as you have correctly stated the Commission approves, with respect to base load generation that goes through either a need determination process, you know, how for smaller projects could that not be reasonably accomplished through a limited proceeding? I know that the third point you made is the whole necessity of a full-blown rate case. But in your 16 years of experience on the Commission, have there been limited proceedings to address instances which are very analogous to GBRA type treatment of adding an additional generating unit?

THE WITNESS: Commissioner, one does not come to mind. Certainly that doesn't mean that it did not take place. I know that Mr. Pollock in his testimony suggested that a limited proceeding is an avenue available to the Commission and could provide for cost-recovery outside the scope of a full proceeding without having to implement GBRA. I just know from experience that limited proceedings are difficult in and of their own. Usually when a limited proceeding is initiated, there are interested parties who feel like that perhaps that there are issues which need to be incorporated within that limited proceeding. And then at some point perhaps the efficiencies of the limited proceeding go away and you basically find yourself effectively in something that resembles a full-blown rate case.

COMMISSIONER SKOP: And, finally, it is your testimony, though, that GBRA is the appropriate mechanism for the Commission to adopt on a forward-going basis to address the addition of base load generating units to the extent that there is a prerequisite need determination followed by a review of costs that would be recovered, is that correct?

THE WITNESS: Yes, that is correct.

COMMISSIONER SKOP: Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioner Edgar, you are recognized.

COMMISSIONER EDGAR: Briefly, I would just say that Mr. Deason has almost made the subject of depreciation less dull.

THE WITNESS: Thank you, Commissioner. That's a tall task.

CHAIRMAN CARTER: You did say almost, right?

COMMISSIONER EDGAR: Yes.

CHAIRMAN CARTER: Okay, good.

THE WITNESS: And I take that as an extreme compliment, even the almost.

CHAIRMAN CARTER: Okay. Redirect. Oh, excuse me, anything further from the bench?

Redirect.

MR. BUTLER: Extremely briefly.

REDIRECT EXAMINATION

BY MR. BUTLER:

Q. Mr. Deason, the use of a depreciation expense credit such as we have been talking about here, does that have the effect of taking assets from the status of being paid to unpaid?

MR. McGLOTHLIN: Could I hear the question again?

MR. BUTLER: I'm sorry?

CHAIRMAN CARTER: Could you restate the question.

BY MR. BUTLER:

Q. The use of depreciation credits, such as we have been discussing here, does that have the effect of taking assets from the status of being paid to the status of being unpaid?

MR. McGLOTHLIN: I object to the leading nature of the question. He is putting words in the witness' mouth.

CHAIRMAN CARTER: Okay. Rephrase.

BY MR. BUTLER:

Q. Would you comment, Mr. Deason, on what effect the use of accelerated amortization through depreciation credits would have on the paid status of assets?

A. Well, it has the effect of taking assets which have already been depreciated and putting them back on the books as if they were not depreciation. In effect, you are adding investment to rate base with no increase in generating capacity, or no increase in transmission, or no enhancements of infrastructure. You are basically just adding rate base, adding investment which has a revenue requirement with no concomitant increase in benefits to customers in terms of infrastructure investment.

MR. BUTLER: Thank you. That's all the redirect that I have.

CHAIRMAN CARTER: Okay. Exhibits. We're on page -- Commissioner, we will go to Page 43.

Mr. Butler.

MR. BUTLER: I would move the admission of Exhibit 382.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit Number 382 admitted into the record.)

CHAIRMAN CARTER: Now, let's go to the back pages, Commissioners.

Mr. McGlothlin, 539.

MR. McGLOTHLIN: I move 539.

CHAIRMAN CARTER: Try Ms. Bradley's microphone.

MR. McGLOTHLIN: I move 539.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit Number 539 admitted into the record.)

CHAIRMAN CARTER: Staff, you're recognized.

MS. BENNETT: I don't have any questions or exhibits for Mr. Deason. I have some housecleaning matters after --

CHAIRMAN CARTER: Okay. Before we get into the housecleaning matters -- actually, I guess we should say housekeeping matters -- do any of the parties or staff have anything further for the witness?

Ms. Bradley.

MS. BRADLEY: Not for this witness.

CHAIRMAN CARTER: For the housekeeping matters?

MS. BRADLEY: Yes, sir.

CHAIRMAN CARTER: Okay.

MS. BRADLEY: Well, I just need to ask you to take judicial notice of something, because I'm not sure I did previously.

CHAIRMAN CARTER: Okay. We'll do that.

Mr. Deason, have a great one.

THE WITNESS: Thank you, Mr. Chairman. It has been a pleasure.

CHAIRMAN CARTER: Staff, I will come back to you in a minute. Let me go to Ms. Bradley.

Ms. Bradley, you're recognized.

MS. BRADLEY: I know we did in Progress, and I cannot remember whether we did here, so to be sure that I got it covered, can I ask that you take judicial notice of the fact that the Governor, Cabinet, and all PSC Commissioners make less than 165,000.

CHAIRMAN CARTER: Show it done.

MS. BRADLEY: Thank you.

CHAIRMAN CARTER: Anything further from the parties before I go to staff?

Okay. Staff, you're recognized.

MS. BENNETT: Staff has a few more exhibits that it would like to be entered into the record, and the parties have graciously agreed to allow that. So if I might, on our comprehensive exhibit list on Page 4, Item 4, we would like entered into the record.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Staff's Comprehensive Exhibit List, Page 4, Item 4, Interrogatory Number 46 admitted into evidence.)

MS. BENNETT: I'm sorry, I should have said Interrogatory Number 46.

CHAIRMAN CARTER: Number 46. It's late.

MS. BENNETT: Yes. On Page 10 of the

comprehensive exhibit list, Item 42, Interrogatory Responses 4, 25 without attachments, 29, 37, and 69.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Staff's Comprehensive Exhibit List, Page 10, Item 42, Interrogatory Responses 4, 25 without attachments, 29, 37, and 69 admitted into the record.)

MS. BENNETT: On Page 14 of the comprehensive exhibit list, Item 63, Document Numbers 10 through 13, 16, 18, 21, and 22.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Staff's Comprehensive Exhibit List, Page 14, Item 63, Document Number 10 through 13, 16, 18, 21, and 22 admitted into the record.)

MS. BENNETT: On Page 14, Item 66, Document Number 39.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Staff's Comprehensive Exhibit List, Page 14, Item 66, Document Number 39 admitted into the record.)

MS. BENNETT: I am going to have Mr. Prestwood now hand two exhibits out that we would like marked for the record and then entered in.

CHAIRMAN CARTER: Okay. Let's take them one at a time, okay?

MS. BENNETT: All righty.

CHAIRMAN CARTER: 540. Okay.

MS. BENNETT: 540, which is the compact disk, the CD.

CHAIRMAN CARTER: Okay. 540 is the compact disk.

MS. BENNETT: It's FPL's Response to OPC's Second POD, Number 4.

CHAIRMAN CARTER: Hang on a second.

MS. BENNETT: Was that too long a title?

CHAIRMAN CARTER: No, no. We will just go with it at this point in time.

MR. WRIGHT: Mr. Chairman.

CHAIRMAN CARTER: Mr. Wright.

MR. WRIGHT: Could I just ask very briefly what the subject matter content of that exhibit is?

CHAIRMAN CARTER: Ms. Bennett.

MS. BENNETT: Certainly. It's the workpapers on depreciation and dismantlement backing up Mr. Clark's --

MR. WRIGHT: That's all I needed. Thank you very much, Mr. Chairman.

CHAIRMAN CARTER: Okay. Are there any objections on Exhibit 540, which is the one with the CD?

Without objection, show it done.

(Exhibit Number 540 marked for identification and admitted into the record.)

CHAIRMAN CARTER: 541.

MS. BENNETT: FPL's Response to OPC's Number 69 Interrogatory.

CHAIRMAN CARTER: Okay. Let's see here. This is -- are there any objections? Hang on a second. Let's make sure everyone gets a copy first.

MS. BENNETT: They had copies earlier, unless they want another one.

CHAIRMAN CARTER: Do you guys want some more paper? Okay. Are there any objections? Without objection, show it done.

(Exhibit Number 541 marked for identification and admitted into the record.)

MS. BENNETT: The next three documents are Staff's Composite Exhibit 35, 36, and 37.

CHAIRMAN CARTER: Now, that should be listed on the comprehensive exhibit list, shouldn't it?

MS. BENNETT: This is a little different. Thirty-seven did not come in, 36 is revised, and 35 that is being handed out is a checklist. It is not the actual what is in your document, but it is an item-by-item checklist. There will be some blanks, and then are some that have the witnesses' names that they came in through. And in an overabundance of caution, I want to make sure that all of staff's documents that were introduced by those witnesses get moved into the record.

CHAIRMAN CARTER: Okay. Let's make sure everyone has it first. Did you provide them to the parties in advance?

MS. BENNETT: Yes, I did.

CHAIRMAN CARTER: Okay. Let's deal with the fat one first.

MS. BENNETT: That one would be Composite Exhibit List 35 Checklist.

CHAIRMAN CARTER: Okay. Now, we don't need a number for this, do we, or do we?

MS. BENNETT: Yes. This one does need a number.

CHAIRMAN CARTER: Okay. So this will be 542. 542 will be Staff's Composite Exhibit Number 35 Checklist.

MS. BENNETT: And the first thing I would like to do is to move that into the record.

CHAIRMAN CARTER: Okay. Give me one second here. Let me write this down. Are there any objections from the parties?

MR. WRIGHT: No objection, Mr. Chairman. If I may just inquire. Do I understand correctly that the items next to which a witness' name is listed are coming in and those which are blank are not?

CHAIRMAN CARTER: That is my understanding. Is that right, Ms. Bennett?

MS. BENNETT: That's my -- and that was going to be my next request was that those items that have witnesses names beside them be moved into the record.

MR. McGLOTHLIN: No objection. I just want to make sure. Thank you.

CHAIRMAN CARTER: Mr. Wright.

MR. MOYLE: I just want to make sure I know what is happening. It is late.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: And, you know, this is like a list of all of these documents, and we have spent a lot of time with individual documents going in. By virtue of the fact that we are putting this list in, does this mean that everything on the list is coming in, as well?

MS. BENNETT: No. No. Absolutely not. Anything that is a blank, I'm not asking that that be moved in.

MR. MOYLE: So anything with somebody's next to it, shouldn't that already be in the record?

MS. BENNETT: What happened early in the proceeding was that we marked them, but we did not move them in, and I'm not sure at which point we started moving them in. So I just want to make sure --

CHAIRMAN CARTER: We said that at the beginning, Mr. Moyle. It seemed like forever ago, but we said that at the very beginning that we would do this, because there were some issues that the intervenors wanted to see. And during the intervening time, no pun intended, staff presented that to you. So that is the nature of this, okay?

MS. BENNETT: So only for those --

MR. MOYLE: Thanks. It just reminded me of the saying there is no such thing as a good surprise. But I think -- I think we will be okay.

CHAIRMAN CARTER: That is the reason why we didn't do it before, Mr. Moyle.

MR. MOYLE: Okay. Thank you.

CHAIRMAN CARTER: Okay. Are there any objections? Okay. Without objection, show it done. That's the fat one, 542.

(Exhibit Number 542 marked for identification and admitted into the record.)

CHAIRMAN CARTER: Now the yellow one.

MS. BENNETT: The yellow one is Staff's

Composite -- Confidential Composite Exhibit 36, Revised.

CHAIRMAN CARTER: Do we need a number?

MS. BENNETT: No, it is 36.

CHAIRMAN CARTER: That's 36.

You didn't get it, Mr. --

MR. WRIGHT: It seems not, Mr. Chairman. I have 35 and 37.

CHAIRMAN CARTER: Okay. Staff.

Here, take mine. Please.

MS. BENNETT: This is the red folder. This is the yellow sheet of red folders.

MR. McGLOTHLIN: I don't think I got it.

CHAIRMAN CARTER: The yellow sheet for the red folders, just in case.

MS. BENNETT: I may have confused people. I gave it as a white sheet the first time around.

CHAIRMAN CARTER: Well, just hang on a second. Let's make sure everybody has a copy.

MR. BUTLER: We don't know that we do. Would it be possible to get one? That would be good.

CHAIRMAN CARTER: Okay. Does everyone have a copy of the yellow sheet? Bread crumbs to find our way home. This is Composite Exhibit Number 36, the yellow sheet for the red folders. Any questions? Any concerns? Are there any objections? Okay. Without objection, show it done.

(Staff Confidential Composite List 36, Yellow Sheet, marked for identification and admitted into the record.)

MS. BENNETT: And that is we are moving the list and the exhibits into the record at this time. And then the next item is Composite Exhibit List 37.

CHAIRMAN CARTER: This the plain white -- plain white -- well, it's not really white. It's kind of --

MS. BENNETT: Kind of speckly.

CHAIRMAN CARTER: Kind of a not great quality copy, but it will do for 9:00 o'clock or whatever time -- 9:30.

Staff, you're recognized.

MS. BENNETT: And we would move Composite Exhibit List, the list itself, 37, into the record, and only Items 10 through 47, 63 through 98, 105 through 121, and 126 through 133 into the record at this time.

CHAIRMAN CARTER: Are there any questions?

Mr. Wright.

MR. WRIGHT: I'm just trying to keep up.

CHAIRMAN CARTER: Okay.

MR. WRIGHT: It was 10 through 47?

CHAIRMAN CARTER: It should be marked on there. Do you have --

MR. WRIGHT: Unfortunately, my marking on whatever it is, the third --

CHAIRMAN CARTER: If there is a line through it, that means --

MR. WRIGHT: Mine goes down to 52, hence my confusion, Mr. Chairman.

CHAIRMAN CARTER: Okay. I would gladly give you mine.

Let's just take a moment. Staff, make sure everyone has a copy. We don't want to come this far and at the end, you know, make a mistake.

Okay, Mr. Wright?

MR. WRIGHT: I'm fine, Mr. Chairman, but the problem I'm having is, in part, that the line on mine goes all the way down to 52, which makes it appear that 48 through 52 are coming in, but I think Ms. Bennett said only through 47.

CHAIRMAN CARTER: Hang on a second.

Ms. Bennett, you've got to explain the legend here.

MS. BENNETT: I picked up the wrong number. It is actually -- Mr. Wright is correct. It is 10 through 52, not 10 through 47.

CHAIRMAN CARTER: Ten through --

MS. BENNETT: 52.

CHAIRMAN CARTER: Ten trough 52.

MS. BENNETT: Correct.

MR. WRIGHT: And then what, 63 through 98?

MS. BENNETT: 63 through 98.

MR. WRIGHT: Thank you.

CHAIRMAN CARTER: Okay. And then 126.

MS. BENNETT: 105 through 121.

CHAIRMAN CARTER: 105 through 121?

MS. BENNETT: Correct.

CHAIRMAN CARTER: Okay. Mr. Wright.

MR. WRIGHT: I'm good, Mr. Chairman. Thank you.

CHAIRMAN CARTER: Okay. Staff.

MS. BENNETT: And 126 through 133.

CHAIRMAN CARTER: 126 through 133.

MS. BENNETT: Correct.

CHAIRMAN CARTER: Any questions? Any concerns? Are there any objections?

MR. WRIGHT: No objection. Do I understand this is 544 now, or is this 30?

CHAIRMAN CARTER: Do we need a number?

MR. WRIGHT: This is 37.

MS. BENNETT: This is 37.

MR. WRIGHT: It is 37. Thank you.

CHAIRMAN CARTER: Without objection, show it done.

(Composite Exhibit List 37, Items 10 through 47, 63 through 98, 105 through 121, and 126 through 133 marked for identification and admitted into the record.)

MS. BENNETT: I have no more exhibits. I took the -- I cross-examined Mr. Meischeid earlier, and Susan Clark told me on the way out that the errata sheet that Mr. Meischeid said he had, he does not have. He didn't have any corrections. So he wanted to make sure that was clear.

CHAIRMAN CARTER: Mr. Butler.

MR. BUTLER: That is accurate. Apparently there was an erroneous reference to their being an errata sheet as part of the introduction of the witness, and he did not have errata to his testimony.

CHAIRMAN CARTER: Okay. It is what it is.

Okay. Staff, before I ask you for scheduling information, are there any other final comments before we get to that level?

MS. BENNETT: None from staff.

CHAIRMAN CARTER: Commissioners, I'm going to go to the parties first and then I will come back to the bench.

From any of the intervenors or the company,

any matters before we go to staff to ask for a schedule to go forward from here?

Mr. McGlothlin, you're recognized.

MR. McGLOTHLIN: I would like to thank staff for these additional steps that make it possible for the parties to see these documents in sufficient time to react and deal with it. I know there was probably more work involved, but I think it is worth the effort. It's certainly appreciated.

CHAIRMAN CARTER: Thank you.

Mr. Moyle.

MR. MOYLE: Ditto.

MR. WRIGHT: Mr. Chairman, I, too, would like to --

CHAIRMAN CARTER: Mr. Wright.

MR. WRIGHT: -- thank you, all the Commissioners, the staff, FPL, and all the parties.

CHAIRMAN CARTER: Thank you.

Commissioners, before we go back to staff --

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chair. I just wanted to follow up with a few brief comments. I guess first to the parties. It has been a lengthy, but fully vetted and litigated rate case, and somewhat contentious at times, but I believe that it is the role of the Commission to ask tough questions to ensure that all amounts that FPL seeks to recover from its ratepayers are necessary, reasonable, and prudently incurred costs.

Just to FPL, I hope that you have made great progress overnight in addressing the concerns expressed by Ms. Naegel and the other residents of Mirror Lake Neighborhood and Plantation. And I hope the next time we have to repeat a rate case that maybe they will show up at the service hearings with more positive comments.

And, finally, to Commissioner Klement, if you are listening out there, you certainly have a lot of reading to do over the weekend, but we look forward to you joining us on the Commission next Tuesday.

CHAIRMAN CARTER: Thank you, Commissioner Skop.

Commissioners, anything further before I go to staff for --

COMMISSIONER ARGENZIANO: Safe trip home, everybody.

CHAIRMAN CARTER: Okay. Great job. Great lawyering, by the way.

COMMISSIONER EDGAR: Mr. Chairman, thank you to you for running a good hearing.

CHAIRMAN CARTER: Thank you. Thank you. I only had to medicate myself once today.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chair. And one other comment in passing. I think that my often statement of just a few more questions is about as accurate as Mr. Wright's.

CHAIRMAN CARTER: Yes. We noticed that a long time ago.

COMMISSIONER SKOP: Although, I've heard -- I think I have heard his quite often more than mine. But, anyway, again, it's been a very lengthy, but I think constructive process, and I will sign off by saying, go Gators.

CHAIRMAN CARTER: Thank you. Thank you.

Staff, the schedule.

MS. BENNETT: The current schedule for this proceeding is that the transcripts will be filed on October 26th. Staff's recommendation is due December 9th for a December 21 Commission decision on revenue requirements and rate design. The staff recommendation is due January 4th for a January 11th, 2010 Commission decision on rates, and staff recommends that the parties include in their briefs what the effective date of the new rates should be.

CHAIRMAN CARTER: Thank you. Let me ask the parties, did you all get that, or do we need --

MS. BRADLEY: I somehow missed --

CHAIRMAN CARTER: Okay. All right. Ms. Bennett.

MS. BRADLEY: -- the party part.

CHAIRMAN CARTER: Yes, the party part. It's a different kind of party.

Okay. Let's take it one step at a time, Ms. Bennett. I know you are ready to go.

MS. BENNETT: I guess I forgot brief dates.

CHAIRMAN CARTER: You know, my granddad -- my granddad used to have a mule when I was growing up, and on the way to the field, she -- I know you all get tired of my stories, but on the way to the field she would just take her time. And, I mean, you would work all day long, and then at the end of the day on the way home, she would just break out into a trot. So, I'm not calling you a mule, Ms. Bennett, but --

MS. BENNETT: I was going to say --

CHAIRMAN CARTER: -- but you did break out into a trot. So let's break it down.

MS. BENNETT: Yeehaw.

CHAIRMAN CARTER: Pretend like we are starting all over.

MS. BENNETT: Okay.

COMMISSIONER ARGENZIANO: You are digging yourself deeper.

CHAIRMAN CARTER: I'm sorry. I'm not responsible.

MS. BENNETT: I just want to know what the mule's name was.

CHAIRMAN CARTER: Pet.

MS. BENNETT: Okay. The transcripts will be filed on October 26th. Briefs are due November the 9th staff's recommendation is due December 9th. December 21st is the Commission decision on revenue requirements and rate design, and January 4th is staff's recommendation for a January 11th rates decision. And staff recommends that the parties include in their briefs what the effective date of the new rates should be.

CHAIRMAN CARTER: Are there any questions from the parties? Okay. Everybody is clear?

MR. BUTLER: Clear.

CHAIRMAN CARTER: Okay. You guys go and have a great dinner.

Commissioners, thank you for the marathon.

We are adjourned.

MR. BUTLER: Thank you.

Hearing concluded at 9:45 p.m.)

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 28TH DAY OF OCTOBER, 2009.

JANE FAUROT, RPR
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FPSC Division of Commission Clerk
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