Scott A. Goorland
Principal Attorney
Florida Power & Light Company
700 Universe Boulevard
Juno Beach, FL 33408-0420
(561) 304-5633
(561) 691-7135 (Facsimile)
scott.goorland@fpl.com

October 13, 2014

-VIA ELECTRONIC FILING -

Ms. Carlotta Stauffer
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 140001-EI
FPL's Petition for Prudence Determination Regarding Acquisition of Gas Reserves

Dear Ms. Stauffer:

Enclosed for electronic filing in the above docket the prepared rebuttal testimony of Florida Power & Light Company witnesses Sam Forrest, Dr. Tim Taylor, Kim Ousdahl, and J. Terry Deason.

If there are any questions regarding this transmittal, please contact me at 561-304-5633.

Sincerely,

s/ Scott A. Goorland
Scott A. Goorland
Fla. Bar No. 0066834

Enclosures

1525056

CERTIFICATE OF SERVICE
Docket No. 140001-EI

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by electronic service this 13th day of October, 2014 to the following:

Martha F. Barrera, Esq.
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850
mbarrera@psc.state.fl.us

Jon C. Moyle, Esq.
Moyle Law Firm, P.A.
Attorneys for FIPUG
118 N. Gadsden St.
Tallahassee, Florida 32301
jmoyle@moylelaw.com

Beth Keating, Esq.
Gunster Law Firm
Attorneys for FPUC
215 South Monroe St., Suite 601
Tallahassee, Florida 32301-1804
bkeating@gunster.com

John T. Burnett, Esq.
Dianne M. Triplett, Esq.
Attorneys for DEF
299 First Avenue North
St. Petersburg, Florida 33701
john.burnett@duke-energy.com
dianne.triplett@duke-energy.com

James D. Beasley, Esq.
J. Jeffrey Wahlen, Esq.
Ashley M. Daniels, Esq.
Ausley & McMullen
Attorneys for Tampa Electric
P.O. Box 391
Tallahassee, Florida 32302
jbeasley@ausley.com
jwahlen@ausley.com
adaniels@ausley.com

Jeffrey A. Stone, Esq.
Russell A. Badders, Esq.
Steven R. Griffin, Esq.
Beggs & Lane
Attorneys for Gulf Power
P.O. Box 12950
Pensacola, Florida 32591-2950
jas@beggslane.com
rab@beggslane.com
srg@beggslane.com

Robert Scheffel Wright, Esq.
John T. LaVia, III, Esq.
Gardner, Bist, Wiener, et al
Attorneys for Florida Retail Federation
1300 Thomaswood Drive
Tallahassee, Florida 32308
schef@gbwlegal.com
jlavia@gbwlegal.com

James W. Brew, Esq.
F. Alvin Taylor, Esq.
Attorney for White Springs
Brickfield, Burchette, Ritts & Stone, P.C
1025 Thomas Jefferson Street, NW
Eighth Floor, West Tower
Washington, DC 20007-5201
jbrew@bbrslaw.com
ataylor@bbrslaw.com

J. R. Kelly, Esq.
Patricia Christensen, Esq.
Charles Rehwinkel, Esq.
Erik L. Sayler, Esq.
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, Florida 32399
kelly.jr@leg.state.fl.us
christensen.patty@leg.state.fl.us
rehwinkel.charles@leg.state.fl.us
sayler.erik@leg.state.fl.us

Michael Barrett
Division of Economic Regulation
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850
mbarrett@psc.state.fl.us

Scott A. Goorland. Esq.
Principal Attorney
Florida Power & Light Company
700 Universe Boulevard
Juno Beach, FL 33408
Telephone: (561) 304-5795
Facsimile: (561) 691-7135

By: *s/ Scott A. Goorland*
Scott A. Goorland
Fla. Bar No. 0066834

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY'S

PETITION FOR PRUDENCE DETERMINATION

REGARDING ACQUISITION OF GAS RESERVES

REBUTTAL TESTIMONY OF SAM FORREST

DOCKET NO. 140001-EI

OCTOBER 13, 2014

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Sam Forrest. My business address is Florida Power & Light Company, 700 Universe Boulevard, Juno Beach, Florida 33408.

Q. Have you previously submitted direct testimony in this proceeding?

A. Yes. My direct testimony was submitted on June 25, 2014.

Q. Have your position, duties, or responsibilities changed since you last filed testimony in this docket?

A. No.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibits SF-10 and SF-11, which are the Customer Savings under FPL and Intervenor Gas Price Forecasts and Total Volume Traded on NYMEX in 2014, respectively.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address three major themes in the testimony of OPC witnesses Ramas and Lawton and FIPUG witness Pollock. Specifically, I will show that: 1) the projected savings for FPL's customers resulting from the Woodford Project are substantial; 2) rather than constituting a "handsome profit" on the Woodford Project as the intervenor witnesses assert, the return on investment for FPL's shareholders is appropriate, by definition, because it is established at the midpoint of what the Florida Public Service Commission ("FPSC" or "Commission") has determined to be a fair

range; and 3) the Woodford Project actually reduces risk for FPL's customers, rather than increasing it as claimed by the intervenors. FPL's other rebuttal witnesses will address additional issues, errors, and misstatements in the testimony of the intervenor witnesses.

My rebuttal testimony commences with a discussion of why FPL is seeking approval of the Woodford Project. This project benefits FPL customers through the significant customer savings that are projected under a number of scenarios, as well as through the project's value as a hedge for FPL's natural gas procurement portfolio. The overriding theme running through the testimony of all the intervenor witnesses that the Woodford Project is being pursued just for the benefit of shareholders and offers only risk to FPL's customers is highly inaccurate. To the contrary, the Woodford Project will be extremely beneficial to customers, providing them with a high probability of achieving lower gas costs starting in Year 1 (2015) and continuing thereafter, as well as mitigating price volatility.

My rebuttal testimony will then address another overriding, but completely inaccurate, theme of the intervenor witnesses (primarily OPC witness Lawton and FIPUG witness Pollock): that there will only be customer savings for the Woodford Project under FPL projections of future gas prices, which may turn out to be too high. I will show that the intervenor witnesses are again completely off base and that, in fact, customer savings can be expected under

a wide range of forecasted gas prices, including the forecasts suggested by the intervenor witnesses.

I conclude my rebuttal testimony by addressing what both OPC witness Lawton and FIPUG witness Pollock assert are "significant risks" with the Woodford Project and show that, in fact, the Woodford Project reduces risk for our customers. The market price risk for natural gas to customers is lower with this transaction than it is without it. I then address the issues raised by the intervenors around the proposed gas reserves guidelines and show that their opposition appears to be fixated on the "benefits" to FPL's shareholders, rather than the benefits for customers that arise from gas reserves transactions. This transaction, and subsequent gas reserves transactions pursued under the proposed guidelines, reduce gas price risk for customers and provide an opportunity for lower overall gas costs.

II. CUSTOMER BENEFITS FROM THE WOODFORD PROJECT

Q. Why did FPL propose the Woodford Project?

A. Despite the misguided claims of the intervenor witnesses, FPL proposed the Woodford Project to benefit FPL's customers. The Woodford Project is the result of FPL creatively looking for ways to capitalize on the low price environment for natural gas that has arisen out of the prolific production from unconventional gas discoveries like the Woodford shale formation. FPL's

customers will benefit from the Woodford Project in two significant ways. First, there is a very strong probability that the Woodford Project will lower the fuel costs that FPL customers pay through the Fuel Clause. In eight out of nine sensitivity scenarios that FPL analyzed, the Woodford Project is projected to achieve natural gas price savings for FPL's customers, with the most likely scenario resulting in net present value savings of $107 million. As shown in FPL's response to Staff discovery on this topic, there is an 85% chance that customers will see savings from the Woodford Project. And even in the one sensitivity scenario under which customers would not see savings from the project, the additional cost would be small (about $14 million) while FPL customers' overall fuel costs would be dramatically lower because that scenario envisions market gas prices far below FPL's current projections.

Second, and regardless of where gas prices actually end up, customers will benefit from the Woodford Project because it is a long-term physical hedge against highly volatile gas prices. It is curious, if not completely inconsistent, that the intervenor witnesses seek to downplay this valuable role of the Woodford Project as a long-term hedge, because if they are right that there is a high degree of uncertainty about future gas prices, then that environment is exactly where a long-term hedge would be most valuable.

Q. FIPUG witness Pollock asserts on page 8, lines 10-12 of his testimony, that potential savings of $107 million for the Woodford Project are not significant. What is your reaction to this assertion?

A. Mr. Pollock's dismissive statement is astoundingly wrong. FPL proposes to invest up to $191 million in 2015 to achieve enormous customer fuel savings. For this investment of $191 million, customers are projected to receive fuel cost savings of $395 million on a nominal basis over the life of the Woodford Project -- more than doubling the investment in the project. These fuel savings equate to the net reduction in cost to customers of $107 million (net present value) that I refer to in my direct testimony. This is an exceptional value creation for customers. While the Woodford Project is relatively modest in size compared to FPL's overall natural gas requirements, it clearly represents the sort of first step that FPL's customers should be very happy to see FPL take.

Mr. Pollock also attempts to detract from the significance of customer savings with his misleading calculation of the benefit to shareholders (what he characterizes as "FPL's Benefits"). His FPL Benefit figure of $155 million incorrectly contains a return *of* capital component, which can hardly be construed as a benefit to shareholders, because it simply represents getting their initial investment back over time. No rational investor who puts money into a multi-decade project would consider getting only that original investment back, at a later date, a benefit. Likewise, no rational investment

analyst would consider a return *of* investment as a benefit. FPL's proposal for the Woodford Project is that, like all FPL investments, it will earn FPL's authorized weighted average cost of capital, as calculated under the Commission-approved formula for Fuel Clause recovery (to which OPC had stipulated), as a return *on* capital. This return includes both debt and equity capital. It is only that return allocated to equity capital that can properly be seen as a benefit to shareholders. That "benefit", however, is merely the ability to earn what the Commission has determined to be the actual *cost* of equity capital. By definition, a return that is equal to the cost of capital produces $0 NPV to shareholders. It should be noted that all $107 million savings to customers from this project otherwise would have been profit to third party, out of state, gas companies.

Finally, Mr. Pollock attempts to mislead the Commission by calculating the savings resulting from the Woodford Project on a typical residential customer bill. His convoluted math erroneously depicts the total savings to FPL's customers of $0.013 per month over the life of the Woodford Project. In fact, this is fairly substantial given the relatively small investment in the Woodford Project and the amount of gas to be recovered. However, the actual savings presented in the Base Case are immediate and reflect approximately $0.07 in savings per month on a typical residential customer bill in 2015 and $0.09 in 2016. Again, given the relatively small volume of gas to be received from the

Woodford Project, these savings underscore the real benefit of the proposed gas reserves transaction for our customers.

Q. Are there any previous decisions by the Commission that would indicate a net present value of $107 million of customer savings is significant?

A. Yes. For instance, in 1995, the Commission approved FPL's recovery of the cost of rail cars to deliver coal to Plant Scherer, where FPL showed that an investment in the rail cars would save customers more than $24 million. Order No. PSC-95-1089-FOF-EI. In 1996, the Commission approved FPL's recovery of the cost of thermal uprates at the Turkey Point nuclear units that were projected to result in fuel savings of $97 million on a net present value basis. Order No. PSC-96-1172-FOF-EI. And, in a series of decisions, the Commission approved recovery by Duke Energy Florida's predecessor of the costs of fuel-conversion projects at oil-fired plants that were projected to produce fuel savings varying between $2.1 million and $22 million over a five-year period, on a nominal basis. Order Nos. PSC-96-0353-FOF-EI, PSC-97-1045-FOF-EU, and 97-0359-FOF-EI.

Q. Looking now to the second customer benefit that you attribute to the Woodford Project – that it serves as a long-term physical hedge mitigating natural gas price volatility to customers – please address the intervenor witnesses' treatment of this benefit.

A. Remarkably, despite their ready acknowledgement of natural gas price volatility, the intervenor witnesses either ignore or disagree that there is a hedging benefit associated with the Woodford project. Witnesses Ramas and

Pollock completely ignore the hedging value of the Woodford project. The only customer benefit that they address is potential natural gas price savings. OPC witness Lawton at least acknowledges that FPL takes the position that the Woodford project will serve as a hedge, but he tries to deflect attention from that benefit by asserting a narrow conception of what constitutes hedging:

> Hedging, like FPL's financial hedging program, involves locking in a future price to avoid the adverse effects of price fluctuations. Hedging does not lower costs or create savings but rather stabilizes prices over time. FPL's portrayal of the Petition as a hedging mechanism is at odds with its representation that customers will likely see a lower cost of gas if its Petition is granted.

While I agree with his assessment of hedging as a tool to reduce price fluctuations, I totally disagree that a project cannot be intended to provide fuel at a cost that is both lower *and* more stable. To assert that hedging stabilizes prices but cannot also be beneficial in lowering prices is completely illogical. Indeed, that is one of the real advantages of the Woodford Project. Because the inputs to the cost of gas from the Woodford Project are largely fixed and well understood, the cost to FPL for that gas should remain within a narrow range. This stable relationship is hedging, pure and simple. At the same time,

there is a very high probability - approximately 85% - that this stable cost of gas produced from the Woodford Project will be below the volatile market price of gas over the life of the Woodford Project.

As described in the rebuttal testimony of FPL witness Taylor, the drilling of shale formations is well understood and fairly predictable in the aggregate. Because of this fact, the effective cost of gas in the Woodford Project will be stable over the long run, which makes it an excellent hedge to the larger procurement portfolio managed by FPL and a nice complement to FPL's current Commission-approved hedging program.

The intervenor witnesses' failure to even acknowledge the Woodford Project's hedging value to FPL's customers is, at best, disappointing. Fortunately, as I will explain, the Commission understands the value of hedging natural gas and has allowed the recovery of hedging activities, both financial and physical, through the Fuel Clause, even when they do not have a high assurance of it resulting in customer savings.

Q. What is your reaction to OPC witness Lawton's assertion that "FPL … cannot predict future market prices for natural gas"?

A. FPL has never suggested it can "predict" future gas prices. He is absolutely correct in that assertion. Although I explain in the next section of my testimony that FPL's *forecast* is reasonable and the Commission has much experience reviewing proceedings that utilize FPL's longstanding

methodology to forecast prices, there is no question regarding the uncertainty of gas prices going forward.

On page 28, lines 12 – 14, OPC witness Lawton states: "The unknowable nature of future prices of natural gas and oil is one of the reasons natural gas and oil exploration and drilling is a risky business." The uncertainty of future natural gas prices is one of the very reasons that FPL has proposed the Woodford Project. No one can precisely say what the future price of gas will be, and that is why this hedging transaction is so valuable for customers.

As discussed previously, the underlying costs of this project are fairly predictable, as is the expected production, making the effective cost of gas received from the Woodford Project largely known. While it does not eliminate all the risks inherent in the market, the project clearly will reduce the volatility of future fuel costs for FPL's customers.

Reducing or mitigating the volatility of future fuel costs is one of the key tenets of FPL's current hedging program, a tenet recognized by the Commission in their original 2002 order on hedging, as is further described in the rebuttal testimony of FPL witness Deason. The Commission reiterated its views on hedging and its purpose regarding the reduction of the impacts of volatility on the fuel charges paid by customers in their order (PSC-08-0667-PAA-EI) that established the Hedging Guidelines that currently control FPL's

hedging activities. Each of the statements made by the Commission reinforces one of the primary benefits of the Woodford Project, and that is to reduce volatility in the customer's fuel bill, something the Woodford Project clearly will do.

III. FPL'S NATURAL GAS PRICE FORECAST

Q. The intervenors question FPL's projection of natural gas prices. Would this be a valid reason to reject the Woodford Project?

A. No it would not. There are certainly many views of the forward price for any commodity, and natural gas is no exception. In fact, as mentioned previously in my testimony, the high degree of uncertainty and volatility in the natural gas market is the driving force behind hedging, whether those hedges are financial or physical. As discussed above, the role of the Woodford Project as a long-term physical hedge is one of the principal benefits of the project.

OPC witness Lawton dedicates several pages of his testimony to questioning FPL's ability to forecast natural gas prices. As I acknowledged in my direct testimony, FPL is not in the natural gas forecasting business. However, that does not mean that FPL does not and will not routinely assess the forecasted market price of natural gas over a wide range of time horizons, using inputs from a variety of third party experts.

A reliable fuel forecast, including a reliable natural gas forecast, is essential to the conduct of FPL's business. There are very few major decisions that FPL makes that are not affected by FPL's fuel forecast. For instance, fuel forecasts play an important role in the selection of resources employed by FPL to meet customer needs. The fuel forecast affects the choice of whether to employ supply side or demand side resources to meet customer needs and what type of supply side resource should be selected. Mr. Lawton's suggestion that FPL cannot be counted on to reasonably forecast future market prices for natural gas ignores the fact that FPL has been providing such forecasts for decades as an essential part of its business and of the Commission's review process.

Q. Is FPL's natural gas forecast in this proceeding reliable?

A. Yes. FPL's natural gas forecast relies on reputable and recognized independent third party experts. As the Commission well knows from review of FPL's natural gas forecasts in the Fuel Clause, Ten Year Site Plan and resource planning proceedings, FPL utilizes NYMEX market prices for the first two years of its forecast, to reflect the more liquid part of the curve and to be consistent with the prices used for FPL's Commission-approved hedging program. FPL then transitions to a more fundamental market forecast provided by PIRA Energy Group ("PIRA"), which takes into consideration such things as future LNG exports, increasing industrial demand, and carbon regulation.

The fuel forecasting methodology employed to estimate the pure economic customer benefit of the Woodford Project is the exact same methodology FPL has utilized for years to evaluate every project presented to this Commission. It has been reviewed with great regularity. It is relied upon every day by FPL in running its business. It has been relied upon by the Commission in making important resource decisions and should be relied upon once again in this proceeding.

Q. Has FPL considered price sensitivities other than the Base Case in evaluating the Woodford Project?

A. Yes. As discussed in my direct testimony, FPL ran "Low Fuel" price and "High Fuel" price sensitivities which were part of the 9-box customer savings estimates. These sensitivity cases represented a full standard deviation above and below the Base Case fuel forecast. FPL's sensitivity analysis also considered changes in the volume of gas produced from the Woodford Project, above and below the Base Case. In only one unlikely scenario where fuel prices were low and production was low at the same time, was there a net cost increase to customers of only about $14 million (net present value). As shown in FPL's response to Staff discovery, there is an 88% chance that the actual results will be better for customers than that small additional cost in this one scenario (and an 85% chance the results will be positive for customers). For perspective, the Commission should keep in mind that at the other end of the spectrum, there is a 9% chance that savings to customers will exceed $246 million on a net present value basis.

Furthermore, if the market price for natural gas turns out to be very low, this would be a wonderful outcome for all of FPL's customers. The impact of lower market prices on the rest of FPL's procurement portfolio would be enormous and highly beneficial to FPL's customers. For instance, in 2017, the Low Fuel price sensitivity projects an absolute cost for natural gas of $3.67/MMBtu (versus the Base Fuel price in 2017 of $4.70/MMBtu). Based on this lower price, the fuel bill for FPL customers would drop by nearly $600 million, dwarfing the $3 million in higher costs for gas from the Woodford Project that would result from that scenario. To put this in context, in 2017 a typical 1000 kWh monthly residential customer bill would be lowered by more than $5.00 due to the lower market price for gas, while the cost of production from the Woodford Project would increase the bill by only $0.03.

Q. Do you agree with OPC witness Lawton's statement on page 36, lines 17-18, that the Energy Information Agency ("EIA") is an objective source for data on projected fuel prices?

A. Yes. In fact, FPL utilizes EIA data in its own forecasts for the period after the PIRA forecast ends.

Q. Do you agree with how Mr. Lawton has used EIA data in critiquing FPL's fuel forecast and re-calculating the fuel savings from the Woodford Project?

A. No. He has completely misapplied the EIA data. He uses the EIA's data on the escalation of "real price" forecasts, which is a complete mismatch for FPL's forecast in nominal dollars. FPL's use of a nominal-dollar price

forecast is consistent with the approach FPL uses in all economic analyses presented to this Commission. In this instance, the use of a nominal-dollar gas price forecast is dictated by the fact that the projections of revenue requirements for the Woodford Project are in nominal dollars, and that both the revenue requirements and the projected fuel costs for the Woodford Project are discounted back to a present value using FPL's weighted average cost of capital ("WACC"), which is an appropriate nominal discount rate. Mr. Lawton should know that using a real price forecast in that setting would result in "deflating" the fuel prices twice and would create a complete mismatch with the corresponding projection of revenue requirements.

Q. If Mr. Lawton would like to rely upon EIA, is there a more appropriate data set that EIA provides that he could have used in his calculation?

A. Yes. Mr. Lawton should have used EIA's forecast of nominal prices provided in its 2014 Annual Energy Outlook, instead of just applying the EIA real-price rates of escalation to current gas prices. If EIA's forecast of actual nominal prices was utilized, rather than a general rate of escalation, then the projected fuel savings from the Woodford Project would be approximately $91 million, which is more than double the figure that Mr. Lawton miscalculated and very similar in magnitude to FPL's forecast of $107 million in customer savings. My Exhibit SF-10 shows each of these forecasts, the associated methodologies, and the resulting customer savings by year.

There is one more important point to be made about Mr. Lawton's re-calculation of the Woodford Project fuel savings. Regardless of whether one uses the relevant EIA data or makes an erroneous comparison as Mr. Lawton has done, the result would still be substantial projected fuel savings. Whether the figure is $107 million, $91 million or even $43.8 million, these are all substantial, net present value benefits to customers, above and beyond paying the Woodford Project's revenue requirements. None of the intervenor witnesses provides any compelling reason why the Commission should reject such a beneficial proposal.

Q. Mr. Lawton devotes a part of his testimony to the projected increase in FPL's natural gas price forecast between 2017 and 2018. Is that increase significant to evaluating the Woodford Project?

A. No. The projected increase is the consequence of the shift in that time period from FPL relying entirely on the NYMEX forward curve to beginning to incorporate the better-developed view on medium-term prices reflected in PIRA's gas price forecast. It is true, as Mr. Lawton points out, that this shift in forecasting method creates a 22% projected increase for the period 2017 to 2018. FPL believes that this increase more likely indicates that the NYMEX forward curve does not reflect fundamental factors that the PIRA forecast does, such as LNG export and industrial demand. Support for this view is provided by the EIA forecast that Mr. Lawton utilizes. It shows a 10.7% increase from 2017 to 2018, the same period he calls into question. Additionally, the EIA forecast shows a 12% increase between 2016 and 2017,

whereas FPL's forecast for the same period only grows at a 6.9% rate. In any event, to attack individual years of a 50 year forecast is certainly missing the forest for the trees. As pointed out in the response to the previous question, the FPL and EIA forecasts are very similar on an overall basis, and as noted above, FPL's forecasting methodology has been presented time and again to and utilized by this Commission.

Q. Do you agree with FIPUG witness Pollock's assessment of natural gas prices?

A. In the short term, yes; but in the long run, absolutely not. In fact, FPL utilizes the same market prices in the early years of its forecast to reflect the liquidity of the market, as well as the supply and demand fundamentals that trade in the short-term. From Mr. Pollock's Exhibit JP-3, you can see the majority of the value of the Woodford Project, even using his updated projections, is in the first 3 years where customers will enjoy the benefits of purchasing gas below market prices. However, using the Henry Hub Natural Gas Futures contract (based on delivery at the Henry Hub located in Southwest Louisiana) ("Henry Hub") to develop a long-term forward curve misses the mark. For the reasons I explain below, these futures contracts are not well suited to capturing market fundamentals for more than a few years into the future.

The NYMEX forward curve used by Mr. Pollock is based upon actual market transactions, or offers to transact. The exchanges where Henry Hub is traded, such as the Chicago Mercantile Exchange and New York Mercantile

Exchange, are very liquid in the short-term. In fact, Henry Hub is one of the largest physical commodity futures in the world by volume and is widely used as a benchmark for natural gas prices. However, beyond just the first few years, the exchanges lack any kind of liquidity as demonstrated by exhibit SF-11, which shows a sharp decline during the period from 2015 to 2019 in the volume of gas contracts traded. With such light liquidity at the later years of the curve, there are not enough transactions to truly reflect what buyers and sellers collectively believe. This is evidenced by sudden jumps in prices in the back from single trades and no movement when significant events occur that should shift prices.

As an example, in June 2014 the Environmental Protection Agency ("EPA"), pursuant to Section 111(d) of the Clean Air Act, proposed a plan to cut carbon pollution from power plants. As a result of this proposal, it is forecasted that tens of thousands of MWs of coal plants will need to be retired. Despite this forecasted impact, there was no flurry of trading on the exchanges and no run up in prices to reflect what will no doubt be a significant increase in the demand for gas. In fact, in the weeks leading up to EPA's announcement and the weeks following the announcement, gas prices fell an average of more than $0.50 per MMBtu over the last 5 years of the curve. This demonstrates that futures are not a forecast. Instead, they are an expression of where transactions moved prices on any given day. This type of market "forecast" as

implied by Mr. Pollock simply isn't in the best interest of FPL and its customers for determining potential forward prices for natural gas.

This is why PIRA and EIA are utilized for forecasting beyond the early years of liquidity of the Henry Hub futures contracts to capture the underlying fundamental impacts to market prices. Organizations like PIRA, IHS Cambridge Energy Research Associates ("IHS CERA"), and EIA utilize bottoms-up approaches to develop curves that are based on many different factors such as growth in the economy, natural gas production levels, LNG exports, use of natural gas as a transportation fuel, etc. For example, the EIA, in its 2014 Annual Energy Outlook, forecasts "the United States becomes a net exporter of natural gas in 2018, with net exports growing to 5.8 Tcf in 2040. Most of the projected growth in exports consists of LNG exported to overseas markets." This type of information is utilized by professional forecasters to build a curve that takes into consideration all factors from a supply and demand perspective.

Q. On page 35, line 10 through page 36, line 11, OPC witness Lawton points to data in an interrogatory you sponsored indicating that the cost of production in the Woodford has previously exceeded market prices and argues that this is a reason to deny FPL's petition. Do you agree?

A. No. Witness Lawton is referring to a table in my response to Staff Interrogatory No. 75, which shows a semi-annual comparison of Henry Hub prices over the past four years to a Wood Mackenzie (global energy research

and consulting firm) analysis of break-even prices experienced by producers in the Woodford during the same periods. While it is correct that the breakeven cost of production was above the average market price for the 2010-2013 time period shown on that table, there are three important points to consider about the table that all help illustrate the value of the Woodford Project.

First, the period chosen for the comparison is not very representative because it coincides with a gas price environment that was exceptionally low. There are very few gas production plays that could have been considered "economic" when compared to the historically low pricing that occurred on the NYMEX for natural gas over the 2011 – 2013 period. However, by any measure of forecasts, including those provided by the intervenors, this level of pricing is not expected to continue into the future.

Second, the table illustrates a consistent downward trend in the Woodford breakeven pricing, going from $4.75 in 2010 to $3.89 in 2013. This trend is expected to continue, as reflected in FPL's estimates that the Woodford Project will produce gas at an effective cost of approximately $3.50 in 2015. Pairing this trend of decreasing effective costs for Woodford production with the general consensus that future natural gas prices will be above the historical lows in the 2011-2013 period provides a high degree of confidence that there

will be strong opportunities to save customers money on their fuel bills with the Woodford Project.

Finally, it is instructive to compare the relative volatilities of the two price strips. Over the 2010-2013 period, the 6-month average Henry Hub price varied over a bandwidth of $1.91, while the effective cost of Woodford gas stayed within a band of $0.89, less than half as wide. This illustrates quite effectively the hedging value that gas priced at the cost of Woodford production would have provided and clearly demonstrates one of the key benefits that customers will experience: a reduction in price volatility.

Q. What if gas prices go higher than forecasted?

A. If gas prices go higher than currently forecasted, the Woodford Project will provide an even greater level of customer savings and will provide a small hedge against higher prices. As was shown in my direct testimony, the High Fuel price sensitivity coupled with the Base Case level of gas production results in an estimated $203.5 million in customer savings over the life of the project, and they would save almost $16 million in 2017 alone as a result of the Woodford Project.

Q. What is your conclusion about the different forecasts of natural gas prices and their impact on the Woodford Project?

A. In every natural gas price forecast presented in this case, the Woodford Project is estimated to yield significant customer savings. The robust sensitivity analysis that is discussed in my direct testimony provides

confidence that the Woodford Project will be good for customers. That assessment of savings is actually reinforced by the alternative gas forecasts suggested by intervenor witnesses Pollock and Lawton. Even using their lower gas forecasts, the Woodford Project generates tens of millions of savings to FPL's customers. And in every forecast looked at, including those provided by the intervenors, the customer savings benefits began to accrue immediately in 2015.

IV. RISK ASSOCIATED WITH GAS RESERVES PROJECTS

Q. Are FPL's customers exposed to additional market price risk as a result of the potential investment in the Woodford Project?

A. No. The opposite is true – as a form of hedging the Woodford Project will insulate a portion of the gas purchases that FPL must make each year to run its power plants from market price risk.

OPC witness Lawton devotes a considerable portion of his testimony (pages 47 - 56) to a series of quotations from disclosure statements that PetroQuest makes as a publically traded company in order to create the misimpression that participating with PetroQuest in the Woodford Project will entail a high degree of risk. He cites an excerpt from PetroQuest's 2013 10-K cautioning investors about variances in business results due to the impact of the market price for natural gas, and potential volatility in that price as a result of an

extensive list of contributing factors. This sort of risk disclosure should be quite familiar to anyone who reads the disclosure statements of publically traded companies, regardless of the industry. For example, FPL acknowledges the same general market price risk in its own 2013 10-K and agrees there is potential volatility and uncertainty inherent in projecting how the expected market price of natural gas will impact the utility and its customers. In fact, it is common for many public companies that produce, transport, or consume natural gas as part of their business to include an exhaustive list of these very same risks in their filings with the Securities and Exchange Commission. This practice is meant to warn potential investors of all known risks, regardless of how large or remote, that may impact normal business operations as part of the requirement to comply with SEC risk disclosure regulations. This depiction of risk is in no way unique to PetroQuest or the gas production industry.

FPL has proposed the Woodford Project to insulate customers from what both FPL and the intervenors agree is potential volatility in natural gas pricing. Only with the addition of a long-term physical hedge, as provided by the Woodford Project, will FPL be able to provide its customers a decoupling of fuel costs from volatile market prices for natural gas – volatility which is often caused by the very factors Mr. Lawton points out in his testimony. And unlike many forms of hedging, the Woodford Project will provide this stability while also having a high probability of yielding fuel savings for

customers (85% chance that there will be savings at some level, and nearly a 50% chance that those savings will exceed $107 MM over the life of the project).

Q. Is FPL attempting to shift risk onto its customers that its shareholders and PetroQuest would not otherwise take?

A. No. The notion that FPL's parent company NextEra Energy Inc. ("NextEra") and its shareholders would not be willing to participate in the Woodford Project is completely belied by the actual structure of the transaction. FPL's affiliate, USG Properties Woodford I, LLC ("USG"), is currently named as the counterparty in the Woodford Project and, given the large benefits expected from the investment, intends to fully participate in the development of these natural gas wells should FPL not be granted approval from the Commission. This project was independently vetted and approved by USG as a strong addition to its existing upstream portfolio. USG is providing a free option to FPL's customers, so that upon FPSC approval customers may receive the benefits that USG has already concluded make the Woodford Project an attractive investment. It is disappointing that the intervenor witnesses assiduously avoid mentioning the fact that this valuable option is being provided solely to benefit FPL's customers.

Q. Does the fact that USG (and FPL) will be paying a "carry" for the Woodford Project suggest that PetroQuest considers the project to be especially risky?

A. No. It is correct that FPL will pay a larger percentage of the capital invested in the Woodford Project than the percentage it will receive of gas produced by the project. This differential is referred to as a "carry" and is common practice in the industry. It compensates PetroQuest as initial developer for the ownership interest in the leasehold and associated mineral rights that are currently owned by PetroQuest and will be transferred to USG or FPL. Without acquiring the leasehold interest, FPL would not be entitled to drill any wells or the associated production of gas on this acreage. It is unrealistic to believe that PetroQuest would transfer that valuable interest without compensation. Additionally, the carry serves to compensate PetroQuest for acting as the operator and to reimburse it for previous expenses incurred and risks taken in purchasing the mineral rights, developing the acreage and enhancing the drilling and completion techniques that increase the productivity of future wells in that acreage.

In actuality - and contrary to Mr. Lawton's suggestion - as discussed in the rebuttal testimony of FPL witness Taylor, the acreage in the Area of Mutual Interest ("AMI") for the Woodford Project has already been significantly "de-risked" by PetroQuest because there are 19 currently producing wells. These producing wells not only show the productive nature of the acreage, but also

"prove up" surrounding well locations in the AMI. PetroQuest has offered USG and FPL an attractive joint venture relationship because the relationship will allow PetroQuest to continue its focus (as stated in its 2013 Annual Report) on "finding and developing oil or natural gas liquids-rich projects."

The fact that USG and FPL are being offered a high percentage of the Woodford Project does not show that it is especially risky, but rather that it is a near-perfect fit for FPL's particular needs. The Woodford Project is expected to produce 100% dry-gas, which is precisely the fuel FPL needs to help meet the gas requirements of its generation fleet. While the production of natural gas liquids ("NGLs") and/or oil can be economically beneficial, the purpose of these gas reserves transactions is to procure natural gas at cost. At the same time, PetroQuest is more interested in targeting its limited capital on the development of areas that are rich in NGLs and oil and hence is offering FPL a large stake in the Woodford Project. This preference for NGLs and oil extends to a majority of producers beyond PetroQuest. This current preference of most market participants for NGLs and oil has created an exceptional "win-win" opportunity for FPL at the Woodford Project.

Q. FIPUG witness Pollock asserts on page 11, lines 12-13 of his testimony that it is unreasonable to assume that the gas pipeline transportation rate included in FPL's estimated costs for the Woodford Project will remain unchanged during the life of the project. He goes on to suggest, on page 11, lines 21-24, that an increase of 2% per year should be assumed. Do you agree with that assessment?

A. No. As noted by Mr. Pollock, FPL has assumed that all gas from the Woodford Project would be transported on the Enable Pipeline to Perryville, where it would then be transported to FPL's power plants in Florida using the same transportation network that FPL uses for gas that it buys on the market. This is only one of several alternatives that FPL is currently exploring for transporting the natural gas from the Woodford Project to Florida. It is the most direct and obvious alternative, but it is not the cheapest. FPL chose to reflect the transportation costs for the Enable Pipeline in its economic evaluation of the Woodford Project in order to be conservative, recognizing the likelihood that actual transportation costs will be lower.

Furthermore, even if FPL were to use the Enable Pipeline exclusively to transport the Woodford Project gas to Florida as assumed in the economic evaluation, there is no reason to expect significant increases in Enable's transportation charges over time. The capacity would be purchased at the pipeline's current recourse rate as posted in the pipeline's Federal Energy Regulatory Commission ("FERC") tariff. This rate includes a fixed demand

charge that cannot change absent a rate case filed under Section 4 or a complaint under Section 5 of the Natural Gas Act. Due to the time-consuming nature of a rate case filing, pipelines will avoid filing a rate case unless required under a settlement agreement in a previous rate case, a significant decrease in throughput, or a serious degradation in the return on equity. In FPL's experience, rate cases usually settle through negotiations between the shippers and the pipeline and usually result in only minor rate increases or in some cases, rate decreases. For example, over the past 20+ years, one of the two FGT transportation demand charges that FPL pays has increased modestly (a little more than 1% per year) while the other has actually gone down over that period. Please keep in mind that, after 20 years, FPL expects to have received more than 80% of the total gas production from the Woodford Project, so any escalation in transportation charges applicable to the small remaining volume of gas to be delivered thereafter would have a minimal impact on the nominal cost of the project and, of course, even less on the NPV.

Because of the minimal impact that one could reasonably expect from escalation of the Enable Pipeline demand charge and the potential for FPL to find less expensive transportation alternatives in any event, FPL does not believe it would be necessary or appropriate to escalate the tariff demand charge in the evaluation of the Woodford Project.

V. BENEFITS OF GAS RESERVES GUIDELINES

Q. The intervenor witnesses assert that FPL's proposed guidelines are unnecessary. Do you agree?

A. No. To the contrary, if the Commission agrees that gas reserves projects that offer fuel stability and savings are good for customers, then approval of guidelines is essential to FPL's ability to deliver those projects. The proposed guidelines will enable FPL to act in real time to secure gas reserves projects that will benefit customers, which, based on our experience, likely will be impossible if FPL must defer closing on such projects until after a lengthy regulatory-approval process is completed. As I explained in my direct testimony, the gas exploration and development industry is not accustomed to waiting months for a potential counterparty to decide whether to close on a transaction, and FPL has been given no indication that is about to change. Both witnesses Pollock and Lawton assert that FPL could continue to bring such projects to fruition without guidelines, but neither proposes any meaningful solution to the timing problem that seeking regulatory review would pose. And certainly their clients' vociferous opposition to the Woodford Project does not give FPL any comfort that it could or should move forward on a new project without the type of guidelines proposed by FPL, which would provide the needed level of certainty for FPL to expand into these transactions and their accompanying customer benefits.

Q. OPC witness Lawton asserts that FPL's proposed guidelines would create the opportunity for excessive shareholder "profits." Do you agree?

A. No. Mr. Lawton's claim illustrates a puzzling, misguided perspective that pervades OPC's opposition to FPL's gas reserves petition and appears to be contrary to the best interests of the customers OPC represents. FPL proposes only to earn its allowed return on equity for the Woodford Project and any other gas reserves project that might be pursued under the guidelines. By definition, earning a return on equity within the authorized range of return on equity is appropriate. These projects, recovered through the Fuel Clause, will earn at the midpoint of the authorized range which cannot be considered "excessive." FPL will pursue projects only where fuel savings are expected to exceed the projects' revenue requirements. Simple math dictates that any such projects therefore would be expected to reduce electric rates, and the more projects FPL is able to find that meet the criteria, then the greater the rate reduction will be. OPC appears to be determined to focus on reducing earnings (which do not directly affect customers) rather than on reducing rates (which provide a direct benefit to customers).

Q. On page 68, line 19 through page 69, line 8 of his testimony, OPC Witness Lawton portrays an extreme example whereby FPL would invest in a gas reserves project that was only estimated to save customers one dollar on an NPV basis and asserts that such an investment would not be beneficial for customers. Do you agree with his assertion?

A. No. First, I will observe that his example is unrepresentative of the sort of gas reserves investments that FPL would expect to identify and pursue. However, assuming for the sake of discussion that FPL identified such a transaction, it would absolutely be in the best interests of customers for FPL to pursue it. Mr. Lawton fails to recognize in his extreme example the value of having a long-term supply of gas that is not subject to market volatility, even in a circumstance where customers would effectively break even on the investment. FPL agrees that it is important to show customer benefit in terms of fuel cost savings and has proposed that as part of the guidelines, but the benefit of stable pricing, while difficult to quantify, is also very advantageous to customers and one of the defining characteristics of an effective physical hedge.

Currently, the natural gas forecast that FPL utilizes shows prices increasing from approximately $4.00 to $11.00 over the next 20 years, compared to the effective cost of production from the Woodford Project increasing from $3.50 to $6.00 over the same period. The magnitude of this differential creates a great opportunity for FPL to lock in the lower cost of production associated

with a gas reserves deal, as well as provide customer savings. However, let's look at a scenario in which projected future gas prices are much lower, such that the Woodford Project only projects a limited amount of fuel savings. Consider a hypothetical scenario where the market curve is much flatter, perhaps increasing from $4.00 to only $7.00 over the same period of time, while using the same effective cost of gas from the Woodford Project. Clearly, the absolute dollar value of potential customer savings in the hypothetical case would be considerably less when stacked against the current case, but this does not make this incredible opportunity to secure a long-term physical hedge any less valuable to customers. In the hypothetical case, customers are still receiving that same benefit of stable and predictable gas pricing in addition to fuel savings. Following witness Lawton's logic that FPL should only invest in gas reserves projects that have large projected fuel savings, FPL would not pursue the Woodford Project under this scenario and would therefore forego an incredible opportunity for customers to reduce volatility for a portion of FPL's fuel-supply requirements over an extended period of time. This result would fly in the face of Commission's consistent recognition and support for the value of a properly run hedging program and its acknowledgement that these hedges are not expected to save customers money. Rather the Commission has consistently valued hedges for the reduction in market volatility they provide. The gas reserves projects that FPL is evaluating are indeed intended to provide customer savings, but their long-term hedge value cannot, and should not, be ignored.

Q. Mr. Lawton also criticizes the opportunity under the guidelines for FPL to pursue gas reserves transactions that contain NGLs and oil. Is this a realistic criticism?

A. No. While FPL is pleased to have identified a dry gas opportunity with the Woodford Project, there may not be many other such projects available given the industry's focus on NGLs and oil. Rather than forego the opportunity to continue benefiting customers with future gas reserves projects in the absence of attractive dry gas projects, FPL believes that it would be in the best interest of customers to allow FPL to pursue projects that have a limited amount of NGLs and oil so long as dry gas is at least 50% of the projected volume of production.

Q. Do FPL's guidelines contain a loophole, as asserted by FIPUG witness Pollock, which would allow FPL to deviate from the proposed guidelines without Commission oversight?

A. Absolutely not. Witness Pollock apparently misunderstands the purpose of the following provision from the guidelines:

> Flexibility to respond to market opportunities is in the best interest of FPL and its customers. Therefore, it is understood that FPL may ... seek Fuel Clause recovery for a project that deviates from one or more of the guidelines upon a showing that the project nonetheless is executed to benefit FPL customers.

This provision would not allow FPL to circumvent the guidelines, which are intended to establish criteria within which FPL may act without seeking advance Commission approval. Rather, it is intended to recognize that FPL may seek advance approval for a project that does not meet the guidelines but FPL nonetheless feels would be beneficial to customers. Any such project would be brought to the Commission by petition and would be subject to the same sort of scrutiny as the Woodford Project is receiving here.

Q. Does this conclude your rebuttal testimony?

A. Yes.

Customer Savings under FPL and Intervenor Gas Price Forecasts

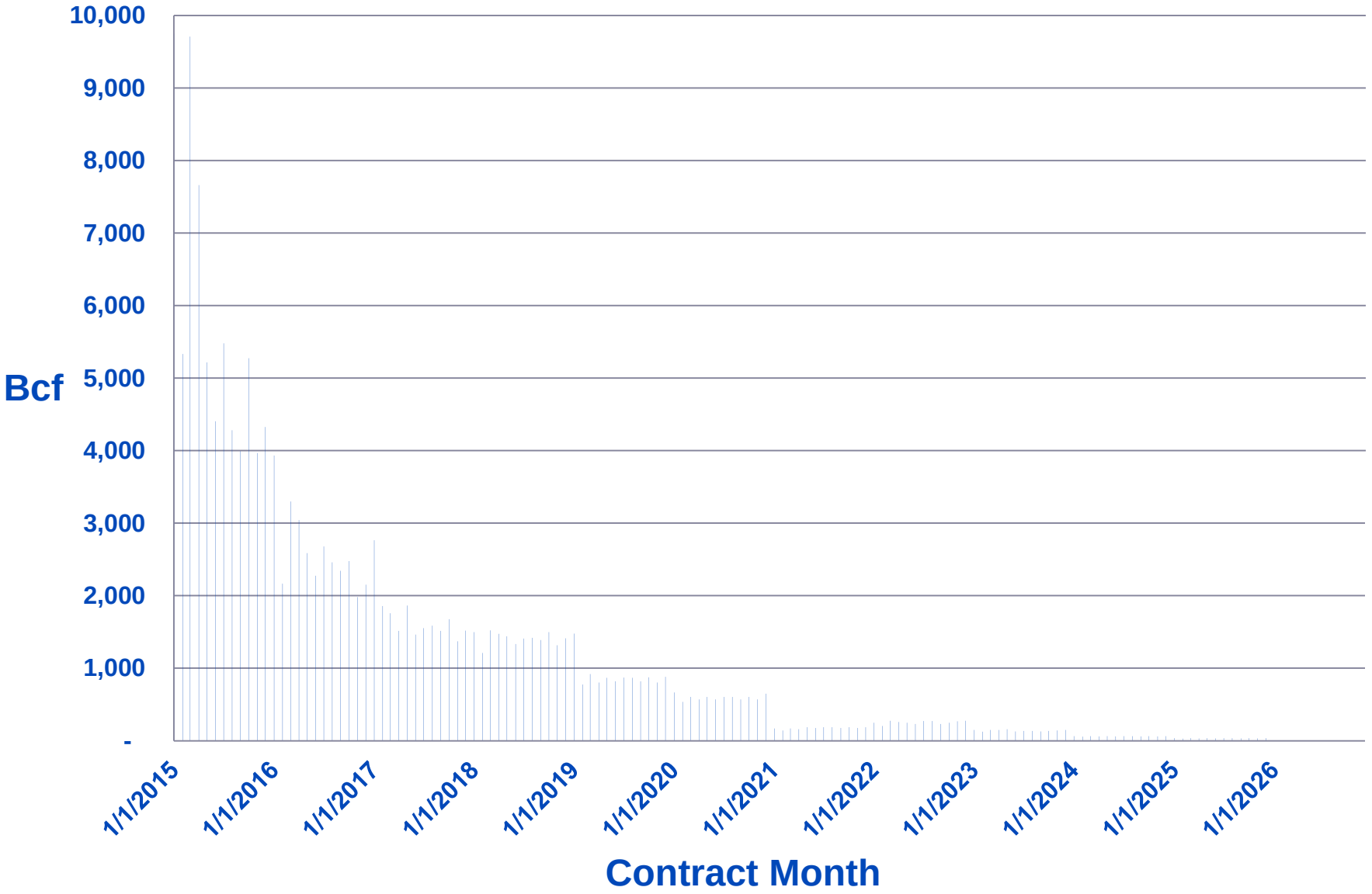
Year	NYMEX Price Curve[1] $/MMBtu	Customer Savings $MM	EIA 3.7% Escalation[2] $/MMBtu	Customer Savings $MM	EIA Forecast[3] $/MMBtu	Customer Savings $MM	FPL Base Forecast $/MMBtu	Customer Savings $MM
2015	$3.86	$5.9	$4.02	$8.4	$3.93	$7.0	**$4.02**	**$8.4**
2016	$4.01	$7.5	$4.17	$10.2	$4.41	$14.3	**$4.30**	**$12.4**
2017	$4.15	$1.7	$4.32	$3.7	$4.76	$8.6	**$4.70**	**$8.0**
2018	$4.25	-$1.3	$4.48	$0.8	$5.27	$7.6	**$5.74**	**$11.6**
2019	$4.35	-$4.3	$4.65	-$2.2	$5.19	$1.7	**$5.89**	**$6.6**
2020	$4.49	-$1.8	$4.82	$0.2	$4.96	$1.0	**$6.03**	**$7.6**
2021	$4.62	-$1.7	$5.00	$0.3	$5.37	$2.3	**$6.13**	**$6.3**
2022	$4.74	-$1.6	$5.18	$0.5	$5.64	$2.7	**$6.33**	**$5.9**
2023	$4.82	-$1.7	$5.38	$0.7	$5.90	$3.0	**$6.63**	**$6.1**
2024	$4.90	-$1.7	$5.57	$0.9	$6.20	$3.4	**$7.03**	**$6.6**
2025	$4.97	-$1.0	$5.78	$1.9	$6.45	$4.3	**$7.33**	**$7.5**
2026	$5.08	-$0.8	$6.00	$2.2	$6.72	$4.7	**$7.63**	**$7.7**
2027	$5.51	$0.4	$6.22	$2.6	$7.00	$5.0	**$7.93**	**$7.9**
2028	$5.73	$0.8	$6.45	$2.9	$7.26	$5.3	**$8.33**	**$8.4**
2029	$6.00	$1.3	$6.69	$3.2	$7.63	$5.8	**$8.63**	**$8.6**
2030	$6.35	$2.0	$6.93	$3.5	$8.12	$6.6	**$8.83**	**$8.4**
2031	$6.69	$2.5	$7.19	$3.8	$8.47	$6.9	**$9.17**	**$8.6**
2032	$7.01	$3.0	$7.46	$4.0	$8.91	$7.3	**$9.52**	**$8.7**
2033	$7.39	$3.4	$7.73	$4.2	$9.41	$7.8	**$9.88**	**$8.8**
2034	$7.77	$3.8	$8.02	$4.3	$9.83	$8.0	**$10.26**	**$8.8**
2035	$8.13	$4.1	$8.31	$4.5	$10.31	$8.3	**$10.65**	**$8.9**
2036	$8.59	$4.5	$8.62	$4.6	$10.93	$8.7	**$11.06**	**$9.0**
2037-65	$15.82	$183.0	$13.49	$129.2	$21.62	$316.8	**$17.16**	**$213.8**
Totals Savings (Undiscounted)		**$208.2**		**$194.4**		**$446.9**		**$394.7**
Totals Savings (Discounted)		**$26.8**		**$43.8**		**$90.8**		**$106.9**

1) Utilizes NYMEX forecast as suggested by FIPUG witness Pollock

2) Applies EIA 2012-2040 real price annual escalation rate of 3.7% to FPL 2015 nominal forecast price as suggested by OPC witness Lawton

3) Utilizes EIA nominal price forecast from their 2014 Annual Energy Outlook

Total Volume[(1)] Traded on NYMEX[(2)] in 2014



[(1)] Henry Hub Natural Gas Futures (NG) contract symbol NN (trades in 2500 mmBtu per day)

[(2)] The New York Mercantile Exchange (NYMEX) is a commodity futures exchange owned and operated by CME Group

Docket No. 140001-EI
Total Volume Traded on NYMEX in 2014
Exhibit SF-11, Page 1 of 1

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY'S

PETITION FOR PRUDENCE DETERMINATION

REGARDING ACQUISITION OF GAS RESERVES

REBUTTAL TESTIMONY OF DR. TIM TAYLOR

DOCKET NO. 140001-EI

OCTOBER 13, 2014

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Q. Please state your name and business address.

A. My name is Dr. Tim Taylor. My business address is 601 Travis, Suite 1900, Houston, Texas, 77002.

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

A. Yes. My direct testimony was submitted on June 25, 2014.

Q. Have your position, duties, or responsibilities changed since you last filed testimony in this docket?

A. No.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibits TT-11 and TT-12, which are Type Curve 1 (Western): 5.3 Bcf Estimated Ultimate Recovery ("EUR") and Type Curve 2 (Eastern): 7.4 Bcf EUR, respectively.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address claims made in the direct testimony of the Office of Public Counsel witness Lawton and the Florida Industrial Power Users Group witness Pollock. Specifically, my rebuttal testimony addresses and refutes witness Pollock's and witness Lawton's erroneous assertions regarding production risks of the Woodford Project. I will discuss the production risk for the Woodford Project's Area of Mutual Interest ("AMI"), which I conclude is very low. I also explain why it is possible to forecast production and operation expenses for the Woodford Project with a high degree of accuracy. Finally, I review investment in gas

reserves throughout the Arkoma-Woodford region generally, and refute assertions about the quality of PetroQuest.

I. WOODFORD PROJECT PRODUCTION RISKS ARE LOW

Q. Mr. Lawton asserts that FPL's customers will be incurring risks of future output and reserve levels being different than forecasted by FPL. How would you characterize the level of that risk?

A. While it is certainly possible that the output and reserve levels will vary to some degree from the forecasted levels, I do not expect any such variances to be significant. In order to assist us in forecasting production for the wells in the Woodford Project, we analyzed the production performance of the 19 existing wells in the AMI and built type curves that represent the average performance of wells to be drilled in close proximity to the existing wells. These type curves, based on the 19 wells drilled in the AMI by PetroQuest, are shown in Exhibits TT-11 and TT-12. The red line on each graph is the type curve. It represents the average performance of all the wells in the western (Exhibit TT-11) and eastern (Exhibit TT-12) portions of the AMI. The grey lines represent the individual existing PetroQuest wells in the AMI that were averaged in order to create the type curves. The grey lines include all actual data to date together with updated forecasts of future production based on the actual data. As explained in my direct testimony, two type curves were necessary because of the difference in well performance in the

eastern and western areas of the AMI. Since the actual start date of production for the wells in the AMI varies by well, I normalized the curves by showing all wells as starting at Year 0. There is little deviation in the pattern of production among individual wells and the type curves (the red lines) closely follow the pattern for the individual wells

The production risk of the Woodford Project with PetroQuest is very low. Exhibits TT-11 and TT-12 show that production from all 19 wells in the AMI has been robust and consistent, as well as highly predictable. There is little deviation in the pattern of production among individual wells, and the average for the wells (the red line) closely follows the pattern for the individual wells. This provides a high degree of confidence that the type curves we have used to forecast production from the Woodford Project accurately model the performance of wells in the AMI and provide a realistic and reasonable prediction of actual production from the Woodford Project wells.

The use of type curves is an industry standard method of forecasting production with a proven high level of confidence. In my career, I have built a large number of type curves in this manner. After new wells were drilled, their actual production performance was routinely compared to the forecasted production from the type curves. In my experience, when sufficient, consistent data was available to build type curves, as is the case in the Woodford Project, this method has proved to be very accurate. Furthermore,

my production estimates were confirmed by an independent third party consulting firm, Forrest A. Garb & Associates, Inc., a trusted engineering firm with experience in the Woodford Shale.

This is not an exploration project where FPL will be "wildcatting" (i.e. drilling exploration wells). It is a development project in an area that has been thoroughly defined by the existing wells. Thus, it has been "de-risked" to a substantial degree by the time the Woodford Project begins.

Q. Mr. Pollock states that the benefits to customers are uncertain in part because of uncertainty about the operating costs incurred to produce the gas. Do you agree with this assertion?

A. No. Mr. Pollock's assertions evidence his lack of experience and expertise in the area of natural gas production. Natural gas production is a well understood technology, and the operating costs associated with gas production are highly predictable. Furthermore, PetroQuest has a long history of production in the Arkoma-Woodford region, and it is very familiar with operations in the region. That is one of the great benefits of selecting PetroQuest as a partner in this Joint Venture.

Q. Mr. Pollock expresses concern that FPL assumed no escalation of production costs in calculating projected total costs, arguing that it is not reasonable to assume that production costs will not change during the projected life of the Woodford Project. Similarly, Mr. Lawton asserts that FPL customers will be incurring risks of future operating and

maintenance costs being different than estimated by FPL. Do you agree with these assertions?

A. No. As discussed above, natural gas production costs are well understood. For the Woodford Project we examined the actual operating cost for each of 12 prior months from PetroQuest's records. We used the average of that operating cost in our PHDWin database to represent the future operating cost for all Proved Developed Producing (PDP), Proved Undeveloped (PUD) and Probable (PRB) wells. We did not escalate this operating cost because the continuing evolution of the production technologies is likely to cause those costs to decline, not increase, over time.

As discussed in the rebuttal testimony of FPL witness Forrest, the effective costs for production in the Woodford Shale region have been declining over the past few years as a result of technological advances. The following are just a few examples of such advances since 2008:

- Efficiencies in horizontal drilling from pads has made it possible to better operate multiple wells from a common surface location meaning several wells can share production equipment, which lowers the per-well operating costs.
- Operating multiple wells from a common surface location has also allowed those wells to share the same water disposal facilities and thus decrease salt water disposal costs.

- Additional experience in the dry gas portion of the Arkoma Woodford has allowed operators to refine the types of surface equipment, well treatments and choke sizes that regulate the surface pressure of the wells, all of which reduce down-time and the amount of man-time necessary for operating the wells.

These and future technological advances will impact the productions costs for the Woodford Project. For example, though not forecast in FPL's models, drilling in well-established areas such as the AMI is entering into a "manufacturing" mode where multiple wells can be drilled from one surface location. In view of this well-established and continuing pattern of technological progress, FPL's assumption that the production costs will remain the same over the life of the Woodford Project is, if anything, conservative.

II. ARKOMA-WOODFORD AREA MEETS FPL'S NEEDS

Q. Do you agree with Mr. Lawton's assertion that the market suggests that drilling in the Arkoma-Woodford area is decreasing to a "basic drilling standstill" at this time?

A. No. His assertion is simply not true. While it is true that drilling activity is less than it was four years ago, that activity is far from coming to a "basic drilling standstill" and, in fact, is increasing between 2013 and 2014. In 2013, there were 25 drilling rigs active in the Woodford in the Arkoma Basin. In

2014 that number grew to 37 rigs. Further, in 2013 there were 66 Woodford drilling permits issued by the State of Oklahoma. So far in 2014, 97 such drilling permits have been issued.

Moreover, Mr. Lawton's inaccurate assertion is not relevant to determining the value of the investment for FPL in the region. Rather, the specific economics of the project for FPL are what dictate whether the project is a good investment. As I indicated in my direct testimony, the Woodford Project is an economically viable and commercially attractive natural gas recovery project, operated by an industry leader in this region.

Q. Mr. Lawton suggests that FPL is ignoring competitive market price signals by investing in the Arkoma-Woodford region. Do you agree with his suggestion?

A. No. First of all, as I discuss above, it is simply not the case that drilling activity has dried up in the Arkoma-Woodford region. Second of all, to the extent that other investors are currently putting more emphasis on drilling in areas with substantial NGLs and oil rather than dry gas, then this creates an excellent opportunity for FPL to obtain dry gas on favorable terms from the Arkoma-Woodford and similar regions. Now is an excellent time for FPL to invest in dry-gas regions, while the competition for dry gas is lower than it will be in periods of higher gas prices. So there is no reason for FPL to delay its investment in the Arkoma-Woodford region; delay could end up costing

FPL's customers a substantial premium when general market interest returns to dry-gas drilling.

III. PETROQUEST IS AN APPROPRIATE PARTNER FOR FPL

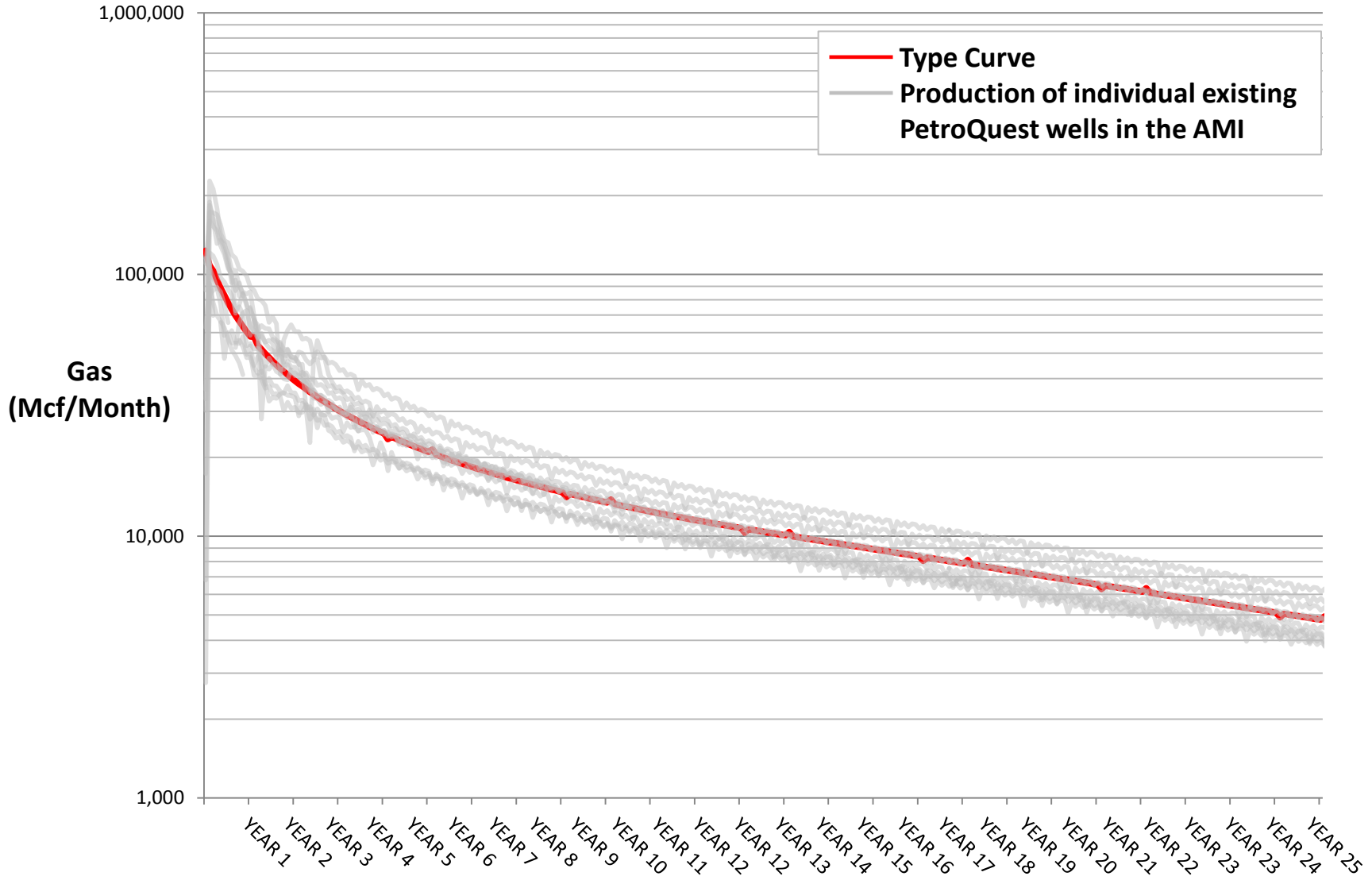
Q. What is your opinion of Mr. Lawton's suggestion that PetroQuest's relatively small size and scale make it riskier than its peers in the gas and oil exploration and drilling industry?

A. Mr. Lawton does not understand the oil and gas industry. PetroQuest's size has nothing to do with its ability to drill and produce wells in an efficient and profitable manner. There are many more small independent companies in this industry than there are major companies. Because the smaller companies have fewer employees does not mean they are lacking in technical expertise. Rather, smaller companies are often substantially better at managing expenses such as overhead, and can focus their expertise. Because PetroQuest concentrates in only a few areas, it has become expert in drilling, completing and operating wells in those areas. PetroQuest has a long history of very successful operations in the oil and gas industry generally and the Arkoma-Woodford region in particular, which has made it highly respected within the industry.

Q. Does this conclude your rebuttal testimony?

A. Yes.

Exhibit TT-11: Type Curve 1 (Western): 5.3 Bcf Estimated Ultimate Recovery (EUR)



Type Curve 1 (Western): 5.3 Bcf Estimated Ultimate Recovery (EUR)
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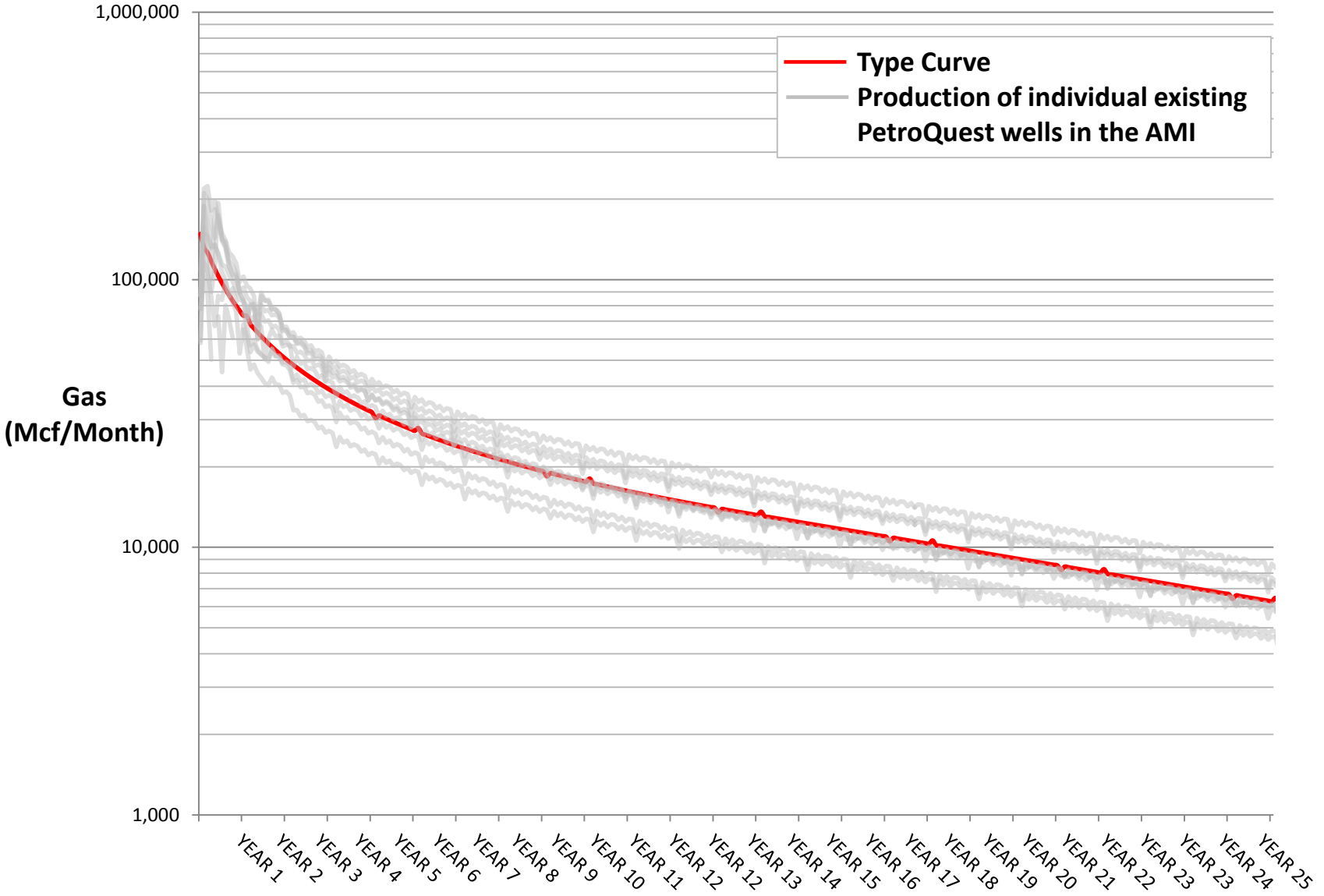
Exhibit TT-12: Type Curve 2 (Eastern): 7.4 Bcf Estimated Ultimate Recovery (EUR)



Docket No. 140001-EI
Type Curve 2 (Eastern): 7.4 Bcf Estimated Ultimate Recovery (EUR)
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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY'S

PETITION FOR PRUDENCE DETERMINATION

REGARDING ACQUISITION OF GAS RESERVES

REBUTTAL TESTIMONY OF KIM OUSDAHL

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kim Ousdahl and my business address is Florida Power & Light Company ("FPL" or the "Company"), 700 Universe Boulevard, Juno Beach, Florida 33408.

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

A. Yes. My direct testimony was submitted on June 25, 2014.

Q. Have your position, duties, or responsibilities changed since you last filed testimony in this docket?

A. No.

Q. Are you sponsoring any exhibits to your rebuttal testimony?

A. Yes. I am sponsoring Exhibit KO-8 – Environmental Clause Sample Form 42-4P.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address accounting and auditing issues, errors and misstatements presented by Office of Public Counsel ("OPC") witness Donna Ramas. Specifically I will:

1. Clarify the use of the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA") for the accounting and ratemaking associated with investment in the Woodford Project and

potential future gas reserves projects, including the related depletion accounting;

2. Demonstrate the adequacy of the FPL internal controls and audit capabilities relied on for FPL's current joint venture activities and the reliance the Florida Public Service Commission ("Commission" or "FPSC") has placed on those controls and audits along with the applicability of that approach to gas reserves projects; and

3. Clarify the purpose and benefits of outsourcing the transactional accounting for the gas reserves activity.

Q. Please summarize your rebuttal testimony.

A. The Company's proposed investment in gas reserves for the benefit of customers can be readily and appropriately accounted for consistent with the USOA, and the proper accounting for those investments is the responsibility of FPL management. FPL's books and records form the basis for proper ratemaking, and I will explain how the Company's internal controls and active annual audits are relied on by this Commission for ratemaking as it relates to FPL's current joint venture activities. The Company's decision to outsource the accounting for these activities was premised upon considerations of both efficiency and effectiveness. The design and operating effectiveness of the outsourcer's internal controls, coupled with the complementary controls provided by FPL, will provide assurance such that the financial information provided by the outsourcer can be relied on for ratemaking.

II. APPLICATION OF THE UNIFORM SYSTEM OF ACCOUNTS

Q. OPC witness Ramas asserts that "capital investments in gas exploration, drilling, and production joint ventures are so foreign to an electric utility's regulated monopoly business that such items are incompatible with the system of accounts that the Commission prescribes for electric utilities." Do you agree with her assertion?

A. No. As explained in my direct testimony on page 27, lines 9 through 12, and illustrated in Exhibit KO-7, FPL is proposing to use the FERC USOA natural gas chart of accounts in FPL's consolidated financial statements as shown in the aforementioned exhibit. Witness Ramas is evidently unfamiliar with the use of account mapping. The transactional information that we will receive electronically from the gas reserves project's operator will be coded using the standard financial accounting classifications for this industry in the subsidiary ledger which will be maintained using the industry standard chart of accounts. For FPL consolidation and financial reporting and ratemaking, the activity will be mapped to the USOA natural gas chart of accounts. In this fashion, we can lever the robust industry-standard controls at the transactional level in the subsidiary ledger, while remaining compliant with the FERC natural gas chart of accounts.

Q. OPC witness Ramas' testimony on Page 9, Lines 18-20 states in part, that "FPL and its subsidiary *are not* proposing to record the investments in gas exploration, drilling and development ventures in Plant in Service accounts that fall under the FERC USOA." Is she correct?

A. No. Exhibits KO-5 and KO-6 were prepared to illustrate the financial results for the first year of the FPL's subsidiary operations and a sample schedule which will be provided to the Commission as part of the Fuel Clause filing, respectively. Exhibit KO-7 bridges the gap between the industry standard accounts and the FERC natural gas chart of accounts.

Witness Ramas concludes on lines 1 through 4 of page 10 that because Exhibit KO-6 identifies the projects as "investments" instead of "plant in service," they do not qualify as utility rate base. This underscores her complete misunderstanding of FPL's proposed accounting and of this Commission's established practice for presentation of clause-recoverable capital projects. Exhibit KO-6 is patterned after Form 42-4P that is used to present the calculation of revenue requirements for capital environmental projects through the Environmental Clause. The format of Form 42-4P is specified by the Commission Staff. I have attached as Exhibit KO-8 a copy of the Form 42-4P for FPL's Commission-approved Clean Air Interstate Rule ("CAIR") Compliance Project that was filed in Docket No. 140007-EI on August 22, 2014. That project relates to emission-control equipment that is

installed on power plants that FPL owns or co-owns. As you can see, Form 42-4P refers to the cost of those emission-control assets as "Investments" in exactly the same way that Exhibit KO-6 refers to the gas reserves project assets as "Investments." There obviously would be no merit in the assertion that the emission-control equipment is not Plant in Service simply because Form 42-4P uses the term "Investments," yet that is exactly what witness Ramas is asserting with respect to the gas reserves assets that appear on Exhibit KO-6. Please note that Exhibit KO-7 reflects Account 101 Gas Plant in Service, which is where the "Investments" on Exhibit KO-6 will be recorded in FPL's books.

Q. Do you agree with OPC witness Ramas' assertion on Pages 17 and 18 that the USOA and Generally Accepted Accounting Principles ("GAAP") accounting are mutually exclusive?

A. No. GAAP contemplates the effects of regulation, as codified in Accounting Standards Codification ("ASC") 980 Regulated Operations. As explained previously, FPL will utilize the USOA to reflect the costs incurred in gas reserves development and production while concurrently reporting its results in accordance with GAAP and the Securities and Exchange Commission ("SEC") requirements. The successful efforts method of accounting preferred by the SEC will not change the economic or ratemaking results of the transaction in any material way. Regulatory ratemaking is strengthened where GAAP and FERC are consistent. This is evident as the few changes to the

USOA that FERC has made over the years are generally in recognition and adoption of changes in GAAP such as accounting for leases, derivatives, and asset retirement obligations.

Q. Is the use of depletion accounting as contemplated by FPL appropriate and consistent with FERC and FPSC rules?

A. Yes. Subchapter F of the USOA Natural Gas, Part 201, 12A reads:

> "12. A. *Depletion,* as applied to natural gas producing land and land rights, means the loss in service value incurred in connection with the exhaustion of the natural resource in the course of service."

FERC account 404.1 - Amortization and Depletion of Producing Natural Gas Land and Land Rights, reads in part:

> "A. This account shall include charges for amortization and depletion of producing natural gas land and land rights. (See account 111, Accumulated Provision for Amortization and Depletion of Gas Utility Plant).
>
> B. The charges to this account shall be made in such manner as to distribute the cost of producing natural gas land and land rights over the period of their benefit to the utility, based upon the exhaustion of the natural gas deposits recoverable from such land and land rights."

Witness Ramas evidently does not recognize that depletion accounting, which by definition results in application of a new rate in each reporting period, is integrally woven into the FERC USOA.

III. ACCOUNTING CONTROLS AND AUDITING JOINT VENTURE ARRANGEMENTS

Q. Please describe the purpose of the Commission audits of financial results in the context of ratemaking.

A. The objective of the FPSC clause audits is to ensure that the costs included in rates are reasonable. This is done by examining the books and records of the utility to validate that the costs which make up the revenue requirement are properly recorded in compliance with the USOA such that the resulting revenue requirement is reasonable. This examination ensures that the costs reflected in the clause are recoverable from customers under the applicable orders, rules and statutes.

Q. In the conduct of audits of FPL by the Commission, what records are sampled for the purpose of confirming the reasonableness of the financial results provided by the Company?

A. Generally in audits of clause financial records, the auditors will agree amounts reflected in the clause schedules to the general ledger thereby ensuring that the customer bill reflects the actual costs incurred by the Company in providing

that service. In addition, other procedures are performed including sampling of invoices and agreeing those invoices to the general ledger. Likewise, they will review contracts and purchase orders as evidence of the reasonableness of the costs invoiced and recorded to the general ledger.

Q. Are there any costs in an adjustment clause today that are incurred through a joint venture agreement between FPL and a third-party owner/operator?

A. Yes. FPL contracted in 1982 with JEA for a 20% ownership interest in its St. Johns River Power Park ("SJRPP") and for a 37½% interest in JEA's 80% remaining interest through a purchased power agreement ("PPA"). Additionally, in 1991 FPL purchased a 76.4% interest in the Georgia Power Company's Plant Scherer Unit 4. JEA remains the owner/operator of SJRPP and the same is the case for Georgia Power Company with Scherer Unit 4. FPL recovers the fuel costs for both plants through the Fuel Clause, the capacity charges under the SJRPP PPA through the Capacity Clause, and FPL's share of environmental costs for both plants through the Environmental Clause.

Q. Does the Commission staff utilize a different procedure for the audit of FPL's current joint venture activities?

A. Not to my knowledge. The audit procedures utilized by Staff that we are able to observe in its report are no different for those costs than for any other invoiced costs.

Q. Does FPL have any additional controls related to its participation in joint venture agreements?

A. Yes. FPL's joint venture agreements all provide FPL access to the owner/operator's books and records for periodic on site audit of its billings to FPL to ensure all charges are appropriately incurred by FPL's customers. In addition, all of these entities are subject to external audits which provide assurance that the financial statements are free of material misstatement and that the entity is maintaining effective internal controls. These are the same rights that FPL will have under the Drilling and Development Agreement ("DDA") for the Woodford Project.

Q. Does the Commission Staff audit the books and records of any of FPL's vendors or joint venture partners?

A. Not to my knowledge. Rule 25-6.0151 F.A.C., Audit Access to Records requires access to books and records of FPL (including its subsidiaries) in order to perform a staff audit and does not contemplate the audit of transactions of its vendors or partners or the access to records thereof.

Q. How does FPL's external audit address costs that FPL incurs with its vendors or joint venture partners in order to express an opinion on FPL's financial statements?

A. FPL's external audit would include sampling and agreeing invoices from vendors and joint venture partners to amounts recorded on FPL's general ledger and to the contractual agreements themselves. FPL would expect its

external auditors to take the same approach to the extent the Woodford Project and any future gas reserves projects are subject to their audit procedures.

Q. Do you agree with OPC witness Ramas' conclusion on Page 20, lines 12 through 15 of her testimony that because the Commission would have no ability to audit PetroQuest, it does not have jurisdiction over the FPL gas reserves activities?

A. No. As explained above, an audit of FPL's books and records involves testing *FPL's* books and records, not those of its vendors or partners. FPL's rates are derived from its financial statements and the Commission can be confident of the reasonableness of those financial results based on the Company's external audit, the Company's documented internal controls and the audit of those controls in compliance with Sarbanes Oxley ("SOX") Section 404 and the Commission's audit of the financial statements as performed today.

Q. Does FPL intend to design and implement new controls and revisions to its existing controls in order to provide appropriate assurance of the reliability of financial reporting for its investment in gas reserves projects?

A. Yes. Upon approval of the Woodford Project by the Commission, FPL will develop and implement SOX processes designed to ensure gas reserves transactions are in compliance with GAAP and any unique regulatory requirements, if any. These processes will likely include controls around:

* Review and approval of Authorizations for Expenditure ("AFE")

* Verification of ownership interests

* Estimating and recording accruals

* Calculating depletion including reserve validation

It is also important to note that the controls of any service provider that FPL ultimately chooses for performing the gas reserves accounting will be examined by an independent auditor in compliance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements 16. This provides further assurance of the adequacy of the design and operation of their internal controls around the transactional accounting for this activity.

IV. PURPOSE AND BENEFITS OF OUTSOURCING THE GAS RESERVES SUBSIDIARY LEVEL ACCOUNTING

Q. Why has FPL decided to contract with a third-party provider to perform the accounting, recordkeeping and reporting for the gas reserves transaction accounting?

A. We have carefully evaluated the path forward for gas reserves accounting and business management to ensure that it is prudently operated and accurately reported so that customers' rates based on those costs are reasonable. In making the evaluation as to how to manage this effort, we began by gathering information that would help us to assess the risks and benefits of managing all

the processes including the transactional accounting and reporting. That due diligence is nearly concluded and we have learned that not only can an experienced third-party service provider ramp up faster due to its existing systems and processes, but it can provide an immediate robust internal control environment which helps ensure the accuracy all parties desire. Additionally, as we finalize our negotations with a short list of firms, it is clear that the cost, at least at the outset, will be lower with the use of a third-party than what FPL would incur initially; thereby saving customers money.

FPL's management is responsible to ensure that it maintains adequate internal control over financial reporting and that its books and records fairly present its financial results in accordance with GAAP, FERC and FPSC requirements. In addition as Chief Accounting Officer, I am committed to ensuring that FPL's regulators continue to feel confident in our ability to provide accurate information derived from those financial statements for ratemaking. In this instance, I have concluded that FPL's and my responsibilities will be most efficiently and effectively met by engaging a third-party to perform the accounting, recordkeeping and reporting for the gas reserves transaction accounting, at least initially.

Q. Could FPL perform this accounting without the use of the third-party service provider?

A. Yes. Contrary to Witness Ramas' assertion on page 22, lines 5 through 7, FPL could have managed this effort internally; however, doing so initially would not have been efficient given the alternative available. The third-party firms are experienced and efficient, and have working knowledge of the operators, accounting and industry regulatory requirements. In addition, they are able to ramp up so quickly that contracting for this support in advance of the Commission approval was preferred due to the lead times that would have been required for us to develop and put into place the systems, process and people necessary to handle the accounting by the end of the year. FPL will continue to evaluate the relative merits of performing those functions in-house versus outsourcing them as our experience and portfolio of gas reserves projects evolve.

Q. Does this conclude your rebuttal testimony?

A. Yes.

FLORIDA POWER & LIGHT COMPANY
ENVIRONMENTAL COST RECOVERY CLAUSE
RETURN ON CAPITAL INVESTMENTS, DEPRECIATION AND TAXES

FORM: 42-4P

JANUARY 2015 THROUGH DECEMBER 2015

	Beginning of Period Amount	January Estimated	February Estimated	March Estimated	April Estimated	May Estimated	June Estimated	July Estimated	August Estimated	September Estimated	October Estimated	November Estimated	December Estimated	Twelve Month Amount
31 - Clean Air Interstate Rule (CAIR) Compliance														
1. Investments														
a. Expenditures/Additions		$0	$298,877	$363,065	$280,118	$197,150	$168,897	$38,764	$11,445	$7,612	$8,429	$104,174	$57,993	$1,536,524
b. Clearings to Plant		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$2,469,769	$2,469,769
c. Retirements		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
d. Other		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
2. Plant-In-Service/Depreciation Base [a]	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$523,657,056	$526,126,825	N/A
3. Less: Accumulated Depreciation	$43,384,566	$44,519,623	$45,654,680	$46,789,737	$47,924,793	$49,059,850	$50,194,907	$51,329,964	$52,465,021	$53,600,078	$54,735,135	$55,870,191	$57,007,924	N/A
4. CWIP - Non Interest Bearing	$933,245	$933,245	$1,232,122	$1,595,187	$1,875,305	$2,072,455	$2,241,352	$2,280,116	$2,291,561	$2,299,173	$2,307,602	$2,411,776	$0	N/A
5. Net Investment (Lines 2 - 3 + 4)	$481,205,734	$480,070,678	$479,234,498	$478,462,506	$477,607,567	$476,669,660	$475,703,500	$474,607,207	$473,483,596	$472,356,151	$471,229,523	$470,198,640	$469,118,901	N/A
6. Average Net Investment		$480,638,206	$479,652,588	$478,848,502	$478,035,036	$477,138,614	$476,186,580	$475,155,354	$474,045,402	$472,919,873	$471,792,837	$470,714,081	$469,658,770	N/A
7. Return on Average Net Investment														
a. Equity Component grossed up for taxes [b][g]		$3,191,109	$3,184,565	$3,179,227	$3,173,826	$3,167,874	$3,161,553	$3,154,707	$3,147,337	$3,139,865	$3,132,382	$3,125,220	$3,118,213	$37,875,877
b. Debt Component (Line 6 x debt rate x 1/12) [c][g]		$590,849	$589,637	$588,648	$587,648	$586,546	$585,376	$584,108	$582,744	$581,360	$579,975	$578,649	$577,352	$7,012,893
8. Investment Expenses														
a. Depreciation [d]		$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,135,057	$1,137,732	$13,623,358
b. Amortization [e]		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
c. Dismantlement [f]		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
d. Property Expenses		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
e. Other		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
9. Total System Recoverable Expenses (Lines 7 & 8)		$4,917,014	$4,909,259	$4,902,932	$4,896,531	$4,889,478	$4,881,986	$4,873,872	$4,865,138	$4,856,282	$4,847,414	$4,838,925	$4,833,297	$58,512,128

(a) Applicable beginning of period and end of period depreciable base by production plant name(s), unit(s), or plant account(s). See Form 42-4P, pages 33-36.

[b] The Gross-up factor for taxes uses 0.61425, which reflects the Federal Income Tax Rate of 35%; the monthly Equity Component of 4.8938% is based on May 2014 ROR Surveillance Report and reflects a 10.5% return on equity per FPSC Order No PSC-12-0425-PAA-EU.

[c] The Debt Component is 1.4751% based on May 2014 ROR Surveillance Report and reflects a 10.5% ROE per FPSC Order No. PSC-12-0425-PAA-EU.

(d) Applicable depreciation rate or rates. See Form 42-4P, pages 33-36

(e) Applicable amortization period(s). See Form 42-4P, pages 33-36.

[f] Dismantlement only applies to Solar projects - DeSoto (37), NASA (38) & Martin (39)

[g] For solar projects the return on investment calculation is comprised of two parts:

Average Net Investment: See footnotes (b) and (c).

Average Unamortized ITC Balance:

Equity Component: Gross-up factor for taxes uses 0.61425, which reflects the Federal Income Tax Rate of 35%; the monthly Equity Component of 6.4207% based on the May 2014 ROR Surveillance Report and reflects a 10.5% return on equity.

Debt Component: Return of 1.8538% based on the May 2014 ROR Surveillance Report and reflects a 10.5% ROE. Per FPSC Order PSC 12-0425-PAA-EU.

Note: Totals may not add due to rounding.

Docket No. 140001-EI
Environmental Clause Sample Form 42-4P
Exhibit KO-8, Page 1 of 1

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

PETITION FOR PRUDENCE DETERMINATION

REGARDING ACQUISITION OF GAS RESERVES

REBUTTAL TESTIMONY OF J. TERRY DEASON

DOCKET NO. 140001-EI

OCTOBER 13, 2014

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, FL 32301.

Q. By whom are you employed and what position do you hold?

A. I am a Special Consultant for the Radey Law Firm, specializing in the fields of energy, telecommunications, water and wastewater, and public utilities generally.

Q. Have you previously submitted direct testimony in this proceeding?

A. No.

Q. Please describe your educational background and professional experience.

A. I have thirty-seven years of experience in the field of public utility regulation spanning a wide range of responsibilities and roles. I served as a consumer advocate in the Florida Office of Public Counsel ("OPC") on two separate occasions, for a total of seven years. In that role, I testified as an expert witness in numerous rate proceedings before the Florida Public Service Commission ("Commission" or "PSC"). My tenure of service at OPC was interrupted by six

years as Chief Advisor to Florida Public Service Commissioner Gerald L. Gunter. I left OPC as its Chief Regulatory Analyst when I was first appointed to the Commission in 1991. I served as Commissioner on the Commission for sixteen years, serving as its chairman on two separate occasions. Since retiring from the Commission at the end of 2006, I have been providing consulting services and expert testimony on behalf of various clients. These clients have included public service commission advocacy staff and regulated utility companies, before commissions in Arkansas, Florida, 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; depreciation policy; subsequent year rate adjustments; appropriate capital structure ratios; 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. For whom are you appearing as a witness?

A. I am appearing as a witness for Florida Power & Light Company ("FPL" or the "Company").

Q. What is the purpose of your testimony?

A. The purpose of my rebuttal testimony is to respond to many of the positions and recommendations contained in the testimony of witnesses Donna Ramas and Daniel J. Lawton on behalf of OPC and witness Jeffrey Pollock on behalf of the Florida

Industrial Power Users Group ("FIPUG"). Collectively, I refer to these witnesses as "the intervenor witnesses."

Q. What do the intervenor witnesses recommend?

A. They all recommend that FPL's gas reserves project costs not be recovered through the Fuel Clause. In making their recommendation, they rely on misguided opinions on the risks of the project and incorrect interpretations of regulatory principles on how to manage risk for the benefit of customers. In some situations, they contort regulatory principles to fit their conclusion which, in the end, would be counterproductive to the Commission's goal and responsibility to regulate in the public interest.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibit JTD-1, which is my curriculum vitae.

Q. How is your rebuttal testimony organized?

A. I first discuss the appropriate use of the Fuel Clause mechanism to recover eligible costs, including costs associated with FPL's gas reserves project, and address the intervenor witnesses' overly restrictive and myopic view of previous Commission decisions. Second, I discuss the regulatory policy basis by which the Commission should consider FPL's proposal, and I identify incorrect interpretations of policy that are expressed by the intervenor witnesses. Lastly, I discuss how the Commission appropriately regulates in the public interest and the intervenor witnesses' ill-founded concerns over the Commission's ability to do so here.

I. Fuel Clause Mechanism

Q. What is the Commission's policy on the recovery of costs through the Fuel Clause?

A. The Commission has a long and consistent policy of allowing timely and complete recovery through the Fuel Clause of fossil fuel-related expenses which are subject to volatile changes. This policy has served the Commission, utilities and their customers well over the years, by allowing rates to reflect the current cost of fuel and thereby provide prompt and accurate price signals to customers, without the need for expensive and time-consuming rate cases.

At the same time, however, the Commission recognized that allowing timely and complete recovery of fuel costs could reduce incentives for utilities to keep those costs low. The Commission has addressed that concern in two ways. First, when the Fuel Clause was initially amended to provide for recovery of projected costs and true-up to actual costs, the Commission included the Generation Performance Incentive Factor to provide an incentive to utilities to operate their generating units efficiently and at a high availability. Second, the Commission's policy was refined in an investigation docket in 1985 (Docket No. 850001-EI-B). At the conclusion of its investigation, the Commission, in its Order No. 14546, reiterated its desire to have utilities pursue opportunities to achieve fuel savings. The tenth item of a list of items eligible for recovery through the Fuel Clause reads:

> Fossil fuel-related costs normally recovered through base rates but which were not recognized or anticipated in the cost levels used to determine current base rates and which, if expended, will result in fuel savings to customers. Recovery of such costs should be made on a case by cases basis after Commission approval.

Thus, Item 10 encouraged utilities to pursue innovative ways to lower fuel costs, by giving them an opportunity to seek prompt, Fuel Clause recovery of costs incurred to achieve fuel savings.

Q. Doesn't witness Ramas reference this same language from Order No. 14546 to support her conclusion?

A. Yes, but this is a prime example of how she is contorting Florida regulatory policy to support her misguided conclusion.

Q. Please explain.

A. Witness Ramas interprets two specific phrases from Item 10 in an incorrect and overly restrictive manner.

First, she concludes that the phrase "normally recovered through base rates" automatically excludes FPL's investment in the gas reserves project from consideration for recovery through the Fuel Clause, apparently because Florida electric utilities have not heretofore recovered that specific form of investment in base rates. That is the wrong standard and is not consistent with the intent of Item 10. The intent was and continues to be a policy statement to encourage prudent

investments which benefit customers by saving fuel costs, regardless of the nature of the investment. It was the intent of the Commission to emphasize that any prudent investment (regardless of whether or not it otherwise might have been a rate base type item) should be pursued to save customers money. In a sense, it was a declaration to utilities to "think outside the box" by looking for innovative ways to save fuel costs without being worried that an overly restrictive application of the "rate base versus clause" distinction would place recovery in jeopardy. Ironically, witness Ramas is urging exactly the sort of restrictive application of the Fuel Clause that Item 10 is intended to avoid.

Q. What is the second phrase from Item 10 that witness Ramas incorrectly interprets?

A. It is the phrase "will result in fuel savings to customers." She mistakenly interprets this phrase to require that fuel savings must somehow be guaranteed for recovery to be allowed. This interpretation should be rejected for at least two reasons.

First, it would amount to the use of hindsight in evaluating forward-looking utility decisions. That approach would be fundamentally inconsistent with the accepted and appropriate standard of prudence for either rate base inclusion of an investment or the recovery of costs through the Fuel Clause. A good example is the inclusion in rate base of a new generating plant that has gone through a need determination pursuant to the Power Plant Siting Act. In order to be built, the plant must be shown to be the most cost-effective alternative available. The standard is one of prudence, not that it must always show savings throughout its operating life in

comparison to other alternatives that were considered and rejected. Given that technologies will change and prices of inputs will also change, it would be inconsistent with both fundamental fairness and sound regulatory policy to require a utility to show consistent and always net positive savings over an investment's 40 or 50 year life.

Second, her interpretation again flies in the face of the purpose of Item 10, which is to encourage innovative ways to save fuel costs. In fact, following her interpretation would have just the opposite effect, i.e., it would be a tremendous disincentive for a utility to pursue innovative approaches to fuel savings. In effect, it would be a "heads I win, tails you lose" proposition that no rational investor would be willing to pursue.

Q. So Item 10 does not prevent the Commission from considering the recovery of FPL's gas reserves project through the Fuel Clause?

A. That is correct. Not only does it not prevent it, FPL's gas reserves project is exactly the type of innovative investment that Item 10 is designed to encourage.

Q. Is there a subsequent Commission decision that provides insight as to the proper interpretation of the language you and witness Ramas quote from Order No. 14546?

A. Yes. In Order No. PSC-11-0080-PAA-EI, the Commission explicitly addressed the proper interpretation of the language both I and witness Ramas quote from Order No. 14546. Four passages are of particular importance.

- First, immediately after quoting the passage from Order No. 14546, the

Commission made the following statement: "We find that the appropriate interpretation of this section of Order 14546 is that capital projects eligible for cost recovery through the Fuel Clause should produce fuel savings based on lowering the delivered price of fossil fuel, or otherwise result in burning lower price fuel at the plant." The Commission went on to note in that same paragraph that the fuel savings in that comparison would be "estimated."

- In the very next paragraph the Commission also noted, "As Order 14546 states, projects that request recovery of costs through the Fuel Clause should be 'fossil fuel related."'
- In Attachment A to Order PSC-11-0080-PAA-EI, which the Commission characterized as "a complete review of the capital costs that have been recovered through the fuel clause pursuant to Order No. 14546," the Commission made the following summary statement regarding a number of the Commission orders allowing capital recovery pursuant to Order No. 14546: "Order 14546 allows a utility to recover fossil-fuel related costs which results in fuel savings when those costs were not previously addressed in determining base rates."
- Finally, the Commission summarized its going forward interpretation of this provision in Order No. 14546: "…we believe that the appropriate policy going forward is to restrict capital project cost recovery through the Fuel Clause to projects that are 'fossil fuel-related' and that lower the delivered price, or input price, of fossil fuel. At the same time, we reaffirm our

practice of reviewing the eligibility of projects for recovery on a case-by-case basis."

Q. So this order shows that witness Ramas' interpretation of the Commission's policy is incorrect?

A. Yes. Order No. PSC-11-0080-PAA-EI gives further clarification of Order No. 14546 and clearly shows that both of witness Ramas' interpretations of Order No. 14546 are erroneous. First, her interpretation of the "normally recovered through base rates" language in Order No. 14546 as requiring gas production costs to have previously been in rate base completely misses the point – which is whether the costs of a Fuel Clause capital project are already reflected in base rates. This is seen best in Order PSC-11-0080-PAA-EI where the Commission repeatedly states in Attachment A of the Order: "Order 14546 allows a utility to recover fossil-fuel related costs which results in fuel savings *when those costs were not previously addressed in determining base rates*." (Emphasis added) This clearly does not mean that a project must have previously been in base rates at some point in time before it is eligible for recovery through the Fuel Clause. Second, witness Ramas' interpretation of the following language from Order No. 14546, "will result in fuel savings to customers" as requiring certainty of fuel savings is entirely at odds with the Commission's explicit acknowledgement that the savings to customers were "estimated." There is nothing certain about an estimate or projection, yet the Commission acknowledged in Order No. PSC-11-0080-PAA-EI that it relies upon fuel savings estimates in determining eligibility for Item 10 recovery.

Q. In two decisions since Order No. PSC-11-0080-PAA-EI, Fuel Clause recovery under Item 10 has been limited in each year to the actual fuel savings resulting from the projects in question, with any portion of that year's revenue requirement that is not recovered being deferred for recovery in future years when the level of fuel savings permit. Would that approach be appropriate for FPL's gas reserves project?

A. No. The orders in question approved Fuel Clause recovery for fuel conversion projects at two Tampa Electric Company ("TECO") power plants (Polk Unit 1 -- Order No. PSC-12-0498-PAA-EI and Big Bend Units 1-4 – Order No. PSC-14-0309-PAA-EI). The approach taken in those orders would not be appropriate here for several reasons:

- In its petitions for both of the fuel conversion projects, TECO proposed to limit its annual recovery of project costs to that year's fuel savings, and the orders accepted the proposed limitation. Thus, it would not be accurate to characterize that limitation as arising out of an interpretation of Order No. 14546; rather, it appears that the Commission merely approved TECO's proposal to impose the condition. Two of the Commissioners commented on this feature of TECO's petition at the agenda conference where the Big Bend fuel conversion project was approved, characterizing it as specific to the unique factors of TECO's particular project, without an expectation that other utilities would follow suit.
- The relationship over time between fuel savings and costs to be recovered for the TECO fuel conversion projects appears to be quite different from

what one expects with gas reserves projects. TECO is depreciating the investment in its fuel conversion projects over a short, fixed period of five years. TECO expects that the generating units at which the projects have been implemented will remain in service -- and the projects will continue to generate fuel savings -- for many years thereafter. Thus, deferral of cost recovery as a result of the fuel-savings cap would impose little risk of ultimate non-recovery. In contrast, recovery of the gas reserves project investment occurs via depletion that is proportional to the volume of produced gas each year as a fraction of the total expected production volume. At the point when only a small portion of the gas reserves investment remains to be recovered, the volume of gas remaining to be produced will be small as well. Thus, if the market price of fuel were to be lower than forecasted for the first several years of the project, when most of the gas is produced, there never would be a period when FPL could reasonably expect to recoup deferred costs out of "surplus" fuel savings. This would impose an asymmetric risk of recovery. I discuss this point elsewhere in connection with witness Ramas' testimony.

- Imposing a fuel-savings cap would also be logically inconsistent with one of the important benefits of a gas reserves project: providing a form of long-term hedging against volatility in natural gas market prices. When a hedge is used to mitigate market volatility, it is expected that the hedge price will remain relatively constant while market prices go up *and* down. This means that the hedge price can reasonably be expected to exceed market price at

times, just as it is expected to fall below market price at other times. Because of this reasonable expectation that prices under a well-designed hedge will occasionally exceed volatile market prices, a fuel-savings cap on recovery for hedging costs could result in an under-recovery. This would be an illogical and punitive outcome. It also would be inconsistent with the Commission's established practice concerning the recovery of hedging costs through the Fuel Clause, whereby costs incurred consistent with a utility's approved hedging plan are recoverable without regard to whether they lead to savings or costs in a particular period. I discuss the Commission's policy on hedging later in my testimony.

Q. Does witness Ramas misuse another Commission order in arguing against FPL's gas reserves petition?

A. Yes, she refers to Order No. 20604 and argues that gas reserves project costs should not be recovered through the Fuel Clause because those costs would not reflect market prices for natural gas. In doing so, she completely misses the point of FPL's proposal and the benefits it offers customers.

Witness Ramas is correct that in 1989 the Commission decided to change to a market-based pricing for coal that was purchased from an affiliated company. The first ordering paragraph of Order No. 20604 reads: "ORDERED by the Florida Public Service Commission that as a matter of general policy, market-based pricing for affiliate fuel and fuel transportation services shall be used for the purposes of fuel cost recovery where a market for the product or service is reasonably

available." In reaching its decision, the Commission concluded that the then-current system had been "generally successful in allowing only reasonable and prudent costs to be passed through" but cited concerns over administrative costs and lingering suspicion over contract negotiations. However, witness Ramas' interpretation of that order with relation to FPL's gas reserves project is misguided and myopic.

Q. Please explain.

A. Ms. Ramas' reference to Order No. 20604 suggests that the situations there and here are analogous. They are not, for several reasons:

- First, FPL is not proposing to buy any gas from an unregulated affiliate. FPL is proposing to make an investment through a wholly-owned subsidiary, which merely preserves certain accounting benefits for customers that FPL witness Ousdahl has explained. For purposes of ratemaking and cost-recovery policy, however, it is a distinction without meaning. Nor will FPL be negotiating the terms of the gas reserves investment with an affiliate. Instead, FPL affiliate USG Properties Woodford I, LLC ("USG") will be making an upfront investment in a gas reserves, which will entitle USG to a stated percentage of the natural gas output from that reserve, regardless of what the market price of natural gas may be at any given time. USG will then transfer its investment and concomitant gas entitlement to FPL's wholly-owned subsidiary at USG's cost, upon Commission approval of FPL's proposal to recover its investment through the Fuel Clause. Review of USG's investment (and

FPL's assumption of it) is more akin to an upfront prudence determination, much like a need determination for new generating plants subject to the Power Plant Siting Act. Furthermore, the gas output will be for the purpose of lowering the cost of generating electricity for FPL customers and will not be sold as a profit making enterprise as was the case for much of the coal output from the affiliated coal companies addressed in Order No. 20604.

- Second, contrary to intimations from witness Ramas, the Commission did not find that the cost-plus standard previously used for coal (even as an affiliate purchase of fuel) resulted in any unreasonable or imprudent costs. Rather, the Commission cited concerns over administrative costs and lingering suspicions arising from the nature of affiliated contract negotiations. Addressing these affiliate-contract negotiations, the Commission stated:

> In contrast to this, the typical affiliate contract is let without the benefit of competitive bidding. Instead, confident that the contract will be given to the affiliate, representatives of the two companies negotiate the rate at which the product or service will be purchased. They must do so recognizing that a favorable contract concession to the utility (and its ratepayers) comes at the expense of the affiliate and, ultimately, the parent holding company. Conversely, terms favorable to the affiliate come at the expense of the utility and, because of the pass-through nature of the fuel adjustment clauses, its customers.

As I stated earlier, FPL will be making an upfront investment and there will be no negotiations with an unregulated affiliate over the prices to be paid for the fuel that could pit the interest of the utility against the interest of its affiliate. So a major reason for relying on market prices for coal in 1989 does not apply to FPL's gas reserves project.

- Finally, it is undisputed that natural gas has now become the dominant source of fuel for utilities in Florida. The market for natural gas is inherently volatile and fundamentally different than the market that existed for coal in 1989. In fact, in 2002 as part of its investigation into risk management for fuel procurement (Docket No. 011605-EI), the Commission approved a framework for fuel hedging initiatives that in great part was precipitated by the increasing reliance on natural gas as a fuel source to generate electricity and the high level of volatility in those prices. In accepting a proposed resolution of the issues, the Commission acknowledged the importance of managing fuel risk when the reliance on one type of fuel grows. Order No. PSC-02-1484-FOF-EI states: "…the greater the proportion of a particular fuel or purchased power it relies upon to provide electric service to its customers, the greater the importance of managing price volatility associated with that energy source." FPL is proposing a project that is a long-term physical hedge fully consistent with the Commission's policy on hedging; and the fact that it is made through a subsidiary is entirely understandable and, in my view, appropriate to the circumstances.

Witness Ramas' heavy reliance upon Order No. 20604 shows that she has a blind faith in the natural gas market and the prices that it charges. But the FPL gas reserves project challenges that blind faith with a fundamental and important question: "Is there a better way to protect customers than simply assuming that 100% reliance on natural gas market prices is best?" As shown in the direct and rebuttal testimony of FPL's witnesses, the answer is a clear "yes." Neither Order No. 14546 nor Order No. 20604 should be interpreted in a way that interferes with the Commission's and FPL's ability to use this better way for the benefit of customers.

II. Regulatory Policy Considerations

Q. What are the regulatory policy considerations relevant to the Commission's consideration of FPL's gas reserves project?

A. Unsurprisingly, they are the same considerations as those that are applied to any investment made by a regulated utility to provide service to its customers. Among these are:

- A regulated utility has the obligation to provide reliable and cost-effective service to its customers and to deploy capital to meet this obligation. Inherent in this obligation is a responsibility to manage costs and mitigate risks where reasonably possible.
- All investments are subject to a determination of prudence, based on the

reasonably anticipated costs, risks, and benefits of said investment that are known or reasonably known at the time that the investment is made. Concomitant with this principle is that future changed circumstances that can be known and applied only in hindsight are not a valid basis to reverse a previous determination of prudence.

- All prudently incurred investments that are used and useful in providing service are to be afforded rate recovery treatment, both in the form of a reasonable return on the investment and a reasonable return of the investment, generally over the useful life of said investment.
- The reasonable rate of return is a necessary cost to provide service and should be set at a level to adequately compensate investors for the risk of their investment and to be fair to customers on whose behalf the capital is deployed. Inherent in this principle is the expectation that customer and investor interests are balanced in a fair and symmetrical manner.
- While the reasonable return on investment is not guaranteed, there is an expectation that rates will be set to afford a utility a reasonable opportunity to actually earn its authorized rate of return. Without that reasonable opportunity, the allowed return would have to be substantially higher, and over time this would result in higher electric rates for customers.
- The reasonable rate of return is set and monitored to fall within an established band, so that the return is neither excessive nor deficient.

Q. Do the intervenor witnesses adhere to these principles?

A. No, not consistently. There are at least three significant instances in which the intervenor witnesses stray from these principles or at least do not appreciate the need to evaluate FPL's gas reserves project consistent with them.

Q. What is the first such instance?

A. The first instance concerns the concept of risk mitigation and witness Ramas' apparent misunderstanding of the purpose of the gas reserves project. This is aptly illustrated by the following quote from page 27 of her testimony: "Under FPL's approach, 100% of the risk associated with FPL entering into gas exploration, drilling and production projects – whether from unconventional or conventional sources – would be pushed onto ratepayers." Obviously, witness Ramas does not understand or simply chooses to ignore the fact that one of the central purposes of the gas reserves project is to mitigate risks through hedging for the benefit of customers. There is no risk shifting from investors to customers, merely a proposal to better manage and mitigate a risk that is currently being borne by customers.

Q. Please explain what risk the customers are currently bearing.

A. Customers are already bearing the price risk associated with the high volatility of the natural gas market. This volatility is felt directly by customers through the functioning of the Fuel Clause, in which fuel costs are passed directly through to customers. The drillers and producers of natural gas are not concerned about the prices paid by customers. In fact, it is in their best economic interest to have prices as high as possible. It is only natural and expected that drillers and producers will seek to maximize their returns when they are not constrained by regulation. In

contrast, FPL is proposing to make an investment to mitigate this risk by making the output of the gas reserves available exclusively to benefit its customers and to have its return on investment limited to a reasonable level (its authorized level) consistent with its role as a regulated utility. In short, FPL's gas reserves project mitigates and manages risks that customers already bear. The project represents a natural extension of FPL's obligation as a regulated utility to provide service reliably and cost-effectively and to mitigate risks where reasonably possible.

Q. What is the second instance in which the intervenor witnesses stray from regulatory principles?

A. Witness Ramas appears to suggest that it would be inappropriate for FPL to be allowed a return on its prudently incurred investment. This is illustrated by the following passage from pages 27 and 28 of her testimony:

> If the Commission approves FPL's request without modification, the result would be that FPL's investors, who are ultimately the shareholders of NextEra Energy, Inc., would earn additional returns through the operation of FPL's fuel cost recovery clause and such returns would be guaranteed. This would result as FPL would be applying a rate of return to the associated capital costs in the fuel clause calculations. That return includes a return on equity component at the Commission's authorized rate of return on equity for FPL, which is essentially the earnings or profit that is applied on behalf of investors.

Q. What is incorrect in her statement?

A. First and foremost is her inference that it would be inappropriate for FPL to earn a return on an investment, even though it is being made as a regulated utility exclusively for the benefit of its customers. Consistent with the regulatory principles I previously identified, all such investments that have been determined to be prudent and incurred to produce benefits for customers are an appropriate cost and should be allowed for recovery, including a reasonable return. Second is her misleading characterization that FPL would "earn additional returns" on future gas reserves projects. It is true that, if additional investments are made, those investments should be allowed to earn a rate of return. However, this would be the same allowed return that is earned on all other regulated investments and simply illustrates the unremarkable mathematical outcome that if the level of investment goes up then the dollars (but not the rate) of return will increase proportionately.

While witness Ramas' apparent concern is that customers would be paying for an additional return in their rates, the more meaningful question is how much customers are already paying in their rates to provide unregulated returns to the drillers and producers of natural gas. While this would be an interesting exercise to try and ascertain, it is really not germane to the issue at hand. The real issue is whether the gas reserves project is prudent and produces benefits for customers. The regulated return earned by FPL is but one cost component in making that overall determination. Contrary to witness Ramas' apparent concern, there is nothing inappropriate or untoward for a regulated utility to earn a reasonable return

on additional investments prudently made to serve customers. In fact, it is essential and is a healthy thing, both for customers and investors.

Q. Does OPC witness Lawton address the return component of FPL's gas reserves project?

A. Yes. He refers to a 2011 Commission order that, in turn, refers back to Order No. 6357 that was issued in a 1974 investigation docket (Docket No. 74680-CI). In Order No. 6357 the Commission stated that "a utility does not make a profit on its fuel costs." Mr. Lawton opines that the return component of FPL's gas reserves project would result in FPL earning a profit in excess of the cost of fuel and that doing so would be inconsistent with the order. However, witness Lawton is completely wrong in his assertion.

Q. Please explain.

A. Witness Lawton apparently does not understand or simply fails to appreciate the fact that the Commission's policy and practice is to allow the recovery of all prudent fuel costs incurred by a utility in generating electricity for its customers. And this recovery is generally restricted to the actual cost, except perhaps for rewards or penalties pursuant to the Commission's Generation Performance Incentive Factor. The phrase cited by witness Lawton simply means that no recovery is allowed beyond those prudent costs, like a mark-up on the commodity price of fuel purchased. The Commission's policy appropriately recognizes that the determination of "fuel cost" properly includes a cost of capital component for any investments prudently incurred to obtain fuel reliably and cost-effectively. Order No. 6357 recognizes this: "The charge reflected on a customer's bill each month is

designed only to provide for a recovery of fuel costs experienced by the utility in generating the customer's power…." Order No. 6357 also states: "Certainly, all reasonable costs incurred up to the time the fuel is burned represent a part of a utility's fossil fuel expense" and in addressing the trade-off between capital and fuel, the Order states: "In our judgment, the proper design criterion is to minimize both capital and fuel costs combined."

It should also be emphasized that since 1974, the Commission has supplemented its policy by encouraging utilities to look for innovative ways to reduce fuel costs and to engage in hedging activities to mitigate the impacts on customers of fuel price volatility. As previously noted, one of those changes in policy was made in 1984 in Order No. 14546, Item 10. Order PSC-11-0080-PAA-EI explains this change in policy in great detail and explicitly notes that the new policy is an extension of the policy established in Order No. 6357.

> In Order No. 14546 we approved the stipulation of the parties and adopted them as our own. We found that the stipulated provisions (including the fuel clause exception to base rate recovery) [Item 10], were an appropriate extension of the policy established by Order No. 6357.

Order PSC-11-0080-PAA-EI goes on to give an extensive discussion of "capital projects eligible for cost recovery through the Fuel Clause." Such recovery necessarily includes a return on the capital investment in the project.

Contrary to witness Lawton's assertion, there is nothing in Order 6357 that would suggest that the return component of FPL's investment in gas reserves would result in a recovery that exceeds the amount of fuel costs "experienced by the utility in generating the customer's power." Moreover, subsequent Commission decisions extending Order No. 6357 make it explicitly clear that certain capital projects can be recovered through the Fuel Clause, and that a necessary cost for such projects is a return on investment. See, Order No. 14546, Order No. PSC-11-0080-PAA-EI and the orders cited in Attachment A to Order No. PSC-11-0080-PAA-EI.

Q. Has the Commission addressed how the return on investment is to be calculated for capital investments eligible for recovery through the Fuel Clause?

A. Yes. The practice of allowing utilities to earn a return on investments through the Fuel Clause and other clauses has become so well established that the Commission approved in 2012 a stipulation setting out the details of how the weighted average cost of capital for such investments is to be calculated. Order No. PSC-12-0425-PAA-EI. OPC and FIPUG were parties to that stipulation.

Q. What is the third instance in which the intervenor witnesses stray from regulatory principles?

A. The third instance can be succinctly stated as witness Ramas' "heads I win, tails you lose" philosophy. She recommends that the Commission tell FPL that if it goes forward with its gas reserves project then the benefits must be guaranteed or there will be no cost recovery. In essence, she wants FPL to take all the risks of the project and recover costs only to the extent that actual benefits result – and to do so

for only a reasonable regulatory rate of return. She takes the foundational concepts of fairness and symmetry embedded in the regulatory principles I earlier identified and turns them on their heads.

Q. Please explain.

A. Witness Ramas' unfair and asymmetrical position is stated on page 30 of her testimony: "the recovery of the cost of natural gas obtained by FPL from such joint ventures will be limited to the market price of gas." She continues by directing the Commission to: "ensure that any recoveries by FPL of its proposed investments each year are limited to the actual resulting fuel savings." What she does not address in a symmetrical fashion is the situation where market gas prices exceed the cost of the gas produced from the reserve project (which is the expected outcome from most of the scenarios analyzed). In that situation, she wants to deviate from her basic position that the market price of gas is the best and most fair price for customers to pay, such that customers would continue to pay FPL only the actual cost of production for the gas. In essence, she wants to have her cake and eat it too.

Q. Is there a way to make her position symmetrical?

A. Yes, but doing so would strip FPL's gas reserves project of all benefits for customers.

Q. Please explain.

A. For witness Ramas' proposal to be fair and symmetrical, FPL would have to be compensated for gas from the gas reserves project at the market price of natural gas regardless of whether the market price were above or below the cost of production. Should the market price of natural gas fall below the cost of gas from the reserves

project, the market price would be used in the Fuel Clause and FPL would incur a loss. Should the market price of natural gas exceed the cost of gas from the reserves project, the market price would still be used in the Fuel Clause and FPL would achieve a gain. While this would be symmetrical, it would not be consistent with other basic tenets of regulation and would not produce any customer benefits compared to the current status quo of buying all gas on the open market.

In contrast, FPL's proposal is entirely consistent with the concept of a regulatory rate of return and other fundamental tenets of rate regulation. FPL's proposal is designed to provide significant benefits for customers within the established principles of rate regulation that I earlier identified.

Q. Are these benefits limited to the potential for cost savings?

A. No. While the potential for significant cost savings are an integral part of FPL's proposal, there are also hedging benefits that must be considered.

Q. What is the Commission's policy on fuel hedging?

A. In Docket No. 011605-EI, opened to address public utility risk management policies and procedures, the Commission approved a settlement among the parties, which included OPC and FIPUG. The settlement endorsed the use of hedging, both financial and physical hedges, as a risk management tool to mitigate price volatility for the benefit of customers. In Order No. PSC-02-1484-FOF-EI, the Commission stated:

> We find that the Proposed Resolution of Issues, modified as set forth above, provides a reasonable resolution of all issues in the

docket. The Proposed Resolution of Issues establishes a framework and direction for the Commission and the parties to follow with respect to risk management for fuel procurement. It provides for the filing of information in the form of risk management plans and as part of each IOU's final true-up filing in the fuel and purchased power cost recovery docket, which will allow the Commission and the parties to monitor each IOU's practices and transactions in this area. In addition, it maintains flexibility for each IOU to create the type of risk management program for fuel procurement that it finds most appropriate while allowing the Commission to retain the discretion to evaluate, and the parties the opportunity to address, the prudence of such programs at the appropriate time. Further, the Proposed Resolution of Issues appears to remove disincentives that may currently exist for IOUs to engage in hedging transactions that may create customer benefits by providing a cost recovery mechanism for prudently incurred hedging transaction costs, gains and losses, and incremental operating and maintenance expenses associated with new and expanded hedging programs. For these reasons, we approve the attached Proposed Resolution of Issues, as modified above.

Q. Is FPL's proposed gas reserves project consistent with this policy?

A. Yes, it is. In particular, the policy recognizes that the Fuel Clause is an appropriate

mechanism to effectuate cost recovery for hedging initiatives, that there should be flexibility in structuring hedging proposals, that there should be a determination of prudence, that customer benefits should be the emphasis of a hedging initiative, that potential disincentives to hedging should be removed that otherwise could prevent achieving customer benefits, and that both gains and losses can result from prudent hedging initiatives. Consistent with this policy, FPL is seeking a determination of prudence for its gas reserves project that is anticipated to provide costs benefits along with its hedging benefits.

Q. Would the approach recommended by the intervenor witnesses be a disincentive to achieving the benefits of a gas reserves project as a prudent hedging initiative?

A. Yes. I cannot imagine any utility being willing to pursue a gas reserves project under the conditions that they recommend.

III. Public Interest Regulation

Q. Where does the Commission derive its authority and obligation to regulate utilities in the public interest?

A. The Commission's authority and obligation to regulate in the public interest is derived from Section 366.01, Florida Statutes, which says: "The regulation of public utilities as defined herein is declared to be in the public interest and this chapter shall be deemed to be an exercise of the police power of the state for the protection of the public welfare *and all the provisions hereof shall be liberally*

construed for the accomplishment of that purpose." (Emphasis added)

Q. How is this relevant to FPL's gas reserves project?

A. FPL's gas reserves project is a new innovative approach that provides benefits to customers by investing in gas reserves. Such an initiative has not been attempted before by an investor-owned utility in Florida. It has been attacked by the intervenor witnesses because it is new and different from traditional approaches. Witness Ramas even declares that the costs of the reserve project are ineligible for recovery because "capital investments in gas exploration, drilling, and production are so foreign to an electric utility's regulated monopoly business that such items are incompatible with the system of accounts that the Commission prescribes for electric utilities." She continues: "As such, these costs do not qualify for recovery through the fuel cost recovery clause under the order upon which FPL relies." Witness Ramas' positions are shortsighted and inconsistent with Chapter 366, Florida Statutes.

Q. Please explain.

A. Witness Ramas attempts to limit the Commission's discretion to determine what activities and investments are eligible for cost recovery to those that have traditionally been undertaken by "regulated monopolies." However, her standard is not the correct one. Section 366.01, Florida Statutes, makes it clear that the public interest is the ultimate test and not whether an investment incurred to provide electric service to customers at a lower and more stable fuel cost has been traditionally done or whether it fits neatly in a Uniform System of Accounts designation. If a project can be shown to be in the public interest, it should be

considered on the same basis that other investments are considered. The Commission certainly has the discretion to do so, and perhaps the obligation to do so as well.

Q. What does the statute say about the recovery of utility investments?

A. Section 366.06 requires the Commission to "investigate and determine the actual legitimate costs of the property of each utility company, actually used and useful in the public service" and that the net investment "shall be used for ratemaking purposes and shall be the money honestly and prudently invested by the public utility company in such property…." So, succinctly stated, the standard is one of prudently incurred costs in property which serves the public.

Q. Does FPL's proposed gas reserves project fall within this statutory provision?

A. Yes. FPL is seeking the Commission's determination that its investment in the gas reserves project is prudent and is used and useful in serving the public, such that it is in the public interest and eligible for cost recovery. What is being sought is squarely within the statutory framework and is eligible for cost recovery through the Fuel Clause.

Q. Does witness Ramas present other arguments in support of her position that FPL's gas reserves project should be ineligible for cost recovery?

A. Yes, she presents a variant of her primary argument that the gas reserves project is new and different. She opines that the Commission would be unable to audit the project and that the Commission is ill equipped to regulate the project stating: "While the Commission has some very qualified and experienced auditors and analysts on its staff, I suspect that the PSC audit and technical staff also lack the

specialized expertise in the unique and 'very specialized' accounting requirements associated with the competitive gas exploration, drilling and production industry."

Q. Are witness Ramas' concerns well-founded?

A. No. She is correct that the Commission does indeed have very qualified and experienced auditors and analysts. I can personally vouch for that based on my first-hand knowledge and experience with the Commission as a consumer advocate, PSC staffer, commissioner, and expert witness over the past 37 years. However, in those 37 years, this is the first time that I recall a witness concluding that a public interest determination be constrained by what they believe to be deficiencies in the ability of PSC staff to understand and effectively oversee a new proposal. Witness Ramas' concern is ill-founded and, frankly, fails to appreciate the talents of the PSC staff.

Q. Please explain.

A. The Commission's role is to regulate in the public interest and in so doing should not be constrained by witness Ramas' "business as usual" considerations. Stated differently, the scope of regulation should be determined by what is needed to serve the public interest and not have the determination of what is in the public interest constrained by the existing scope of regulation. This would be the proverbial "tail wagging the dog" situation. If a new proposal can be shown to be in the public interest, it is the responsibility of the regulator to adapt to the requirements to effectively regulate it in the public interest. This is something that I have seen the Commission do very well as technology, governmental policies, risk factors, and economic considerations have changed over the years. By necessity, regulating in

the public interest is a dynamic undertaking. It is my opinion that the Commission and its staff have the ability to effectively regulate FPL's gas reserves project. Even if this means that existing staff expertise needs to be refined and expanded, I have every confidence that staff will be able to do so.

Q. Is witness Ramas correct in her assessment that the Commission would be unable to audit the gas reserves project?

A. No. The Commission staff would be able to audit the gas reserves project in the same manner and to the same extent that it audits the whole range of utility transactions with third parties. FPL's investment in the project would be auditable. In addition, FPL would be able to audit transactions with its joint venture partner and the Commission auditors would have access to the results of those audits.

Witness Ramas asserts that this conventional approach to auditing utility transactions would be insufficient here and declares that this asserted deficiency is "germane to OPC's position that the transactions fall outside the limits of the Commission's regulatory domain." She apparently believes that the Commission must have the ability to directly audit the third party operators and suppliers as a prerequisite for the gas reserves project to be eligible for cost recovery. However, hers is the wrong standard and could result in unnecessary and ill-advised rejections of third party arrangements that would be beneficial for customers.

Q. Please explain.

A. The Commission has full audit capability over Florida regulated utilities and their affiliates which do business with the regulated utility. This enables the

Commission to ascertain the correctness and the reasonableness of costs which are sought for recovery through rates. The Commission does not have the authority to audit third party operators or suppliers. However, the Commission still retains its authority and ability to judge the reasonableness of costs incurred from third parties.

A good example is a regulated utility's purchase of power from a third party cogenerator. The Commission does not have the authority to directly audit the third party cogenerator, but still determines the reasonableness of the costs incurred by the regulated utility to obtain the power. The Commission can and does rely on the regulated utility's audits and other verifications that the power is being delivered consistent with the contracts that have been approved by the Commission. This is analogous to what is being proposed for the gas reserves project.

Witness Ramas' incorrect standard would call into question a whole array of third party arrangements that have produced benefits for customers, such as cogenerated power and joint venture arrangements like FPL's co-ownership of Plant Scherer in Georgia. Obviously, the Commission does not have the ability to audit Georgia Power Company ("Georgia Power"). However, the Commission did thoroughly review and ultimately approved FPL's co-ownership arrangement with Georgia Power and routinely relies on FPL audits and transactional verifications in judging contract compliance and the reasonableness of costs flowing from those transactions with Georgia Power. This too is analogous to what is being proposed

by FPL for the gas reserves project. Another analogous third party arrangement that has produced benefits for customers is FPL's ownership interest in JEA's St. Johns River Power Park, as discussed in the rebuttal testimony of FPL witness Ousdahl.

Q. Please summarize your testimony.

A. FPL's gas reserves project is an innovative approach to provide fuel savings and hedging benefits for customers. Like any other capital expenditure made by a regulated utility for the benefit of its customers, eligibility for cost recovery should be governed by a prudence determination that is based on an informed assessment of its costs, benefits, and risks. Cost recovery should also be treated consistent with the sound principles of ratemaking that I identified and not by the inconsistent and asymmetrical application of those principles as suggested by the intervenor witnesses.

FPL's gas reserves project is an innovative approach to reducing fuel costs of the type that is contemplated and encouraged by the Commission's policy on Fuel Clause eligibility as contained in Order No. 14546. Such a project is especially needed in today's environment of increasing reliance on natural gas to generate electricity and the volatile nature of the market price for natural gas. Indeed, the project is also consistent with the Commission's hedging policies.

The intervenor witnesses contort previous decisions of the Commission to support their incorrect conclusion that the gas reserves project should be ineligible for cost

recovery. They do not understand or simply choose to ignore the benefit of the project in mitigating risks that are currently borne by customers. Consistent with the Commission's responsibility to regulate in the public interest, the Commission should ask this question: "Does the gas reserves project offer a better way to protect customers from the vagaries of the natural gas market than simply continuing with a 100% reliance on natural gas market prices?" If the Commission answers this question in the affirmative, then the costs for the project should be recoverable through the Fuel Clause. Not only would this be the appropriate treatment for the project, but also it would reconfirm the Commission's commitment to encourage the development of innovative ways to reduce fuel costs and mitigate fuel risks for the benefit of customers.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

Terry Deason*

Special Consultant (Non-Lawyer)*
Phone: (850) 425-6654
Fax: (850) 425-6694
E-Mail: tdeason@radeylaw.com

Practice Areas:

- Energy, Telecommunications, Water and Wastewater and Public Utilities

Education:

- United States Military Academy at West Point, 1972
- Florida State University, B.S., 1975, Accounting, summa cum laude
- Florida State University, Master of Accounting, 1989

Professional Experiences:

- The Radey Law Firm, Special Consultant, 2007 - Present
- Florida Public Service Commission, Commissioner, 1991 – 2007
- Florida Public Service Commission, Chairman, 1993 – 1995, 2000 – 2001
- Office of the Public Counsel, Chief Regulatory Analyst, 1987 – 1991
- Florida Public Service Commission, Executive Assistant to the Commissioner, 1981 – 1987
- Office of the Public Counsel, Legislative Analyst II and III, 1979 - 1981
- Ben Johnson Associates, Inc., Research Analyst, 1978 – 1979
- Office of the Public Counsel, Legislative Analyst I, 1977 – 1978
- Quincy State Bank Trust Department, Staff Accountant and Trust Assistant, 1976 - 1977

Professional Associations and Memberships:

- National Association of Regulatory Utility Commissioners (NARUC), 1993 – 1998, *Member, Executive Committee*
- National Association of Regulatory Utility Commissioners (NARUC), 1999 – 2006, *Board of Directors*

RADEY
ATTORNEYS & COUNSELORS at LAW

Terry Deason*

- National Association of Regulatory Utility Commissioners (NARUC), 2005-2006, *Member, Committee on Electricity*
- National Association of Regulatory Utility Commissioners (NARUC), 2004 – 2005, *Member, Committee on Telecommunications*
- National Association of Regulatory Utility Commissioners (NARUC), 1991 – 2004, *Member, Committee on Finance and Technology*
- National Association of Regulatory Utility Commissioners (NARUC), 1995 – 1998, *Member, Committee on Utility Association Oversight*
- National Association of Regulatory Utility Commissioners (NARUC) 2002 *Member, Rights-of-Way Study*
- Nuclear Waste Strategy Coalition, 2000 – 2006, *Board Member*
- Federal Energy Regulatory Commission (FERC) South Joint Board on Security Constrained Economic Dispatch, 2005 – 2006, *Member*
- Southeastern Association of Regulatory Utility Commissioners, 1991 – 2006, *Member*
- Florida Energy 20/20 Study Commission, 2000 – 2001, *Member*
- FCC Federal/State Joint Conference on Accounting, 2003 – 2005, *Member*
- Joint NARUC/Department of Energy Study Commission on Tax and Rate Treatment of Renewable Energy Projects, 1993, *Member*
- Bonbright Utilities Center at the University of Georgia, 2001, *Bonbright Distinguished Service Award Recipient*
- Eastern NARUC Utility Rate School - Faculty Member